



## ProspEx Announces 2010 Second Quarter Results

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

CALGARY, July 28, 2010 / CNW / - ProspEx Resources Ltd. ("ProspEx" or the "Company") announces its financial and operating results for the three and six months ended June 30, 2010.

### HIGHLIGHTS

- Production for the second quarter increased to 3,086 barrels of oil equivalent ("boe") per day, compared to 2,994 boe per day in the first quarter of 2010.
- The traditional spring break up period and wet weather in the second quarter curtailed the Company's capital program. Total capital expenditures were \$3.1 million during the second quarter of 2010, slightly less than cash flow for that period.
- ProspEx resumed horizontal drilling activity in the Falher play at Kakwa in early July, with a three well program planned for the summer. Drilling at Pembina in West Central Alberta is expected to commence as soon as surface access conditions permit.
- Second quarter cash flow (before changes in non-cash working capital items) was \$3.5 million, compared to \$2.5 million in the prior year's quarter reflecting increases in overall commodity prices.

### OPERATIONAL REVIEW

#### Capital Program

Total capital expenditures were \$3.1 million during the second quarter of 2010. As the spring break up period restricted drilling activity, the majority of these expenditures were attributable to acquisitions at Crown land sales, new seismic data and expansion of compression facilities in Kakwa.

ProspEx's drilling activity continues to focus on horizontal drilling of liquids rich, Cretaceous age, natural gas targets. The Company's summer drilling program was delayed due to wet weather in the second quarter impairing access to drilling locations. At Kakwa in the Deep Basin, the Company has now commenced its summer drilling program, and is currently drilling the first horizontal well of a planned three (1.5 net) well program targeting the Falher formation, following up on a successful drilling program over the past winter.

At Pembina in West Central Alberta, ProspEx plans to spud its first horizontal well (100% working interest) in August, contingent on surface access conditions. This well is to also target the Falher formation, and be ProspEx's first well on a land position acquired in 2009.

ProspEx continues to plan a capital budget of \$30.0 million (net of Alberta Royalty Drilling Credits) for 2010, contingent on commodity prices. Capital spending for the period July 1 to December 31, 2010 is therefore expected to be approximately \$19.0 million. The drilling program planned for this period includes approximately six horizontal wells, including the summer drilling described above.

Please be advised that the forecasts above with respect to capital spending may constitute a "financial outlook" as contemplated by National Instrument 51-102 ("NI 51-102") of the Canadian Securities Administrators entitled

Disclosure Obligations. The purpose of such information is to forecast the anticipated capital spending of the Company for 2010.

## Production

Production (boe/d)	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009
West Central Alberta	925	1,030	1,280	1,289	1,635
Deep Basin	2,129	1,953	1,183	675	944
Southern Alberta	25	3	6	7	503
Other Areas	7	8	8	7	7
Total	3,086	2,994	2,477	1,978	3,089

Second quarter 2010 production averaged 3,086 boe per day, increasing from first quarter 2010 production of 2,994 boe per day, as the benefits of a full quarter of production from wells brought on stream in the first quarter were partially offset by natural production declines.

No new production was brought on stream during the second quarter due to spring break up and wet weather in June, however the Company has received all required approvals to tie in the horizontal well drilled in Brazeau during the first quarter, and will start this project as soon as surface access conditions permit.

ProspEx's three horizontal wells in Kakwa have been on production for 4 to 8 months, and continue to produce at high rates, with estimated gross raw gas production in June ranging from 2.7 to 5.5 mmcf per day per well, plus natural gas liquids. Further information on the production of these wells is available on the Company's website at [www.psx.ca](http://www.psx.ca).

Given the weather related delay in starting the summer drilling program, ProspEx is adjusting its forecast of annual average production for 2010 to a range of 3,100 to 3,300 boe per day, compared to the previous guidance of 3,300 to 3,500 boe per day.

Including expected additions from the summer drilling program, production in late 2010 is anticipated to be approximately 4,000 boe per day. As production at the start of 2010 was approximately 2,700 boe per day, the forecasted 4,000 boe per day exit rate equates to approximately 50% production growth over the year.

ProspEx continues to monitor natural gas prices and may elect to curtail production in the event of deterioration in summer prices. The guidance given above assumes that there are no voluntary production curtailments due to low gas prices.

Guidance regarding production may constitute a "financial outlook" as contemplated by NI 51-102. The purpose of such guidance is to forecast the anticipated production for the Company for 2010.

## Financial

Second quarter cash flow (before changes in non-cash working capital items) was \$3.5 million, compared to \$5.3 million in the first quarter, as declines in commodity prices more than offset increased production. Total capital spending, net of dispositions and other capital assets, of \$3.1 million was slightly less than cash flow.

Total net debt (excluding the fair value of commodity contracts, the current loss on office sublease and associated future taxes) at June 30, 2010 was \$23.8 million which is equivalent to 1.8 years net debt to annualized trailing cash flow. During the second quarter, ProspEx's credit facility was renewed with a limit of \$40.0 million, compared to the

previous limit of \$33.0 million. This renewed facility provides the Company with financial flexibility and certainty of credit financing over the next year. The next scheduled review date of this facility is May 31, 2011.

ProspEx has historically followed a policy of hedging up to 50% of the Company's forecasted production up to a year in advance, typically using costless collars, swaps or puts. ProspEx has hedges in place for the period July 1, 2010 to September 1, 2010 for 7,000 Gigajoules ("GJ") per day of gas production, with an average minimum price of approximately \$5.03/GJ for the hedged volumes. For the period September 1, 2010 to October 31, 2010 the Company has hedges in place for 9,000 GJ per day of gas production, with an average minimum price of approximately \$4.80/GJ for the hedged volumes. Details of the individual hedges are provided in the Company's second quarter Management Discussion and Analysis. As forward prices for natural gas over the summer of 2010 remain weak, these hedges are expected to offer a degree of protection from lower natural gas prices over the summer.

### 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; 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; inadequate 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 "*Description of the Business – Risk Factors Relating to Our Business*" and "*Industry Conditions*" in the Company's most recent Annual Information Form, under the heading "*Operational and Other Business Risks*" in the Company's Management's Discussion and Analysis for the year ended December 31, 2009, 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). 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, boe has 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.

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

"Total net debt" is calculated by adding long-term debt less working capital (or plus working capital deficiency), excluding fair value of commodity contracts, current loss on sublease and associated future tax assets (liabilities).

ProspEx Resources Ltd.  
Consolidated Highlights  
For the periods ended

(unaudited)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
<b>FINANCIAL (\$000's)</b>				
Oil and gas revenue	9,564	7,370	20,090	20,135
Net (loss) earnings	(1,900)	(3,899)	8	(6,124)
Cash flow <sup>(1)</sup>	3,487	2,475	8,739	8,196
Total assets	154,936	159,790	154,936	159,790
Total net debt <sup>(2)</sup>	23,772	23,032	23,772	23,032
Net (loss) earnings per share (\$ per share)				
Basic	(0.03)	(0.07)	0.00	(0.11)
Diluted	(0.03)	(0.07)	0.00	(0.11)
Cash flow per share (\$ per share) <sup>(1)</sup>				
Basic	0.06	0.04	0.15	0.14
Diluted	0.06	0.04	0.15	0.14
Weighted average common shares (000's)				
Basic	57,385	57,385	57,385	57,385
Diluted	57,385	57,385	57,995	57,385
<b>PRODUCTION VOLUMES</b>				
Natural gas (mcf/d)	14,996	14,382	14,644	15,963
Natural gas liquids (bbls/d)	562	645	572	728
Oil (bbls/d)	26	47	27	58
Total (boe/d)	3,086	3,089	3,040	3,446
<b>SALES PRICES</b>				
Natural gas (\$/mcf)	4.70	3.89	5.20	5.15
Natural gas liquids (\$/bbl)	57.98	34.15	57.03	35.21
Oil (\$/bbl)	82.75	64.40	83.00	57.82
Total (\$/boe)	34.05	26.22	36.51	32.28
<b>OPERATING NETBACKS (\$/boe)</b>				
Price	34.05	26.22	36.51	32.28
Royalties	(7.49)	(1.21)	(6.69)	(4.60)
Operating costs	(7.90)	(9.30)	(7.93)	(8.12)
Transportation	(1.50)	(0.93)	(1.52)	(0.99)
Total	17.16	14.78	20.37	18.57
<b>CAPITAL (\$000's)</b>				
Drilling and completions	172	104	5,391	3,690
Facilities	882	(914)	2,154	(27)
Land and lease	1,028	1,568	1,722	1,889
Seismic	516	98	559	148
Capitalized general and administrative	640	763	1,270	1,561
Total exploration & development	3,238	1,619	11,096	7,261
Net property dispositions	(208)	(25,383)	(196)	(27,461)
Other capital assets	21	4	21	7
Total	3,051	(23,760)	10,921	(20,193)

(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 less working capital (or plus working capital deficiency), excluding fair value of commodity contracts, current loss on sublease and associated future taxes.

Cash flow, cash flow per share (basic and diluted) 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 six months ended June 30, 2010, and was prepared as at July 28, 2010. The MD&A should be read in conjunction with the audited consolidated financial statements and MD&A for the year ended December 31, 2009 including the notes related thereto and the consolidated financial statements for the three and six months ended June 30, 2010 together with the notes related thereto. The reader should be aware that historical results are not necessarily indicative of future performance.

### RESULTS OF OPERATIONS

The second quarter saw reduced operational activity, with a wetter than normal spring break up period limiting access to the Company's operating areas. ProspEx did not participate in the drilling of any wells during the quarter, but did spend \$1.5 million on the acquisition of Crown land and seismic data along with \$0.9 million in facilities construction in Kakwa. Total capital expenditures net of dispositions and other capital assets in the quarter were \$3.1 million.

Overall production levels were flat compared to the second quarter of the prior year, as the production loss from the properties disposed of in 2009 was offset by the production added in Kakwa. Cash flow for the quarter rose to \$3.5 million, 41% higher than the prior year's quarter of \$2.5 million, due to a 16% increase in operating netbacks.

During the quarter the Company completed its annual credit review and increased its credit facility to \$40.0 million. Total net debt as at June 30, 2010 (excluding the fair value of commodity contracts, current loss on office sublease and associated future taxes) was \$23.8 million, which is equivalent to a 1.8 to 1.0 ratio of trailing cash flow annualized. The next scheduled review date of the facility is May 31, 2011.

### Business Environment

Overall business conditions continue to improve but confidence remains fragile as concerns of a double dip recession remain, leading to uncertainty in capital markets. Natural gas markets continue to reflect concern over supply and demand fundamentals of the North American natural gas markets resulting in the deterioration of natural gas prices over the second quarter.

ProspEx's 2010 capital spending objectives continue to target the capture and evaluation of new opportunities. This activity is oriented towards increasing the opportunity set available to the Company as business conditions improve, rather than short term production growth.

### Revenue

(\$000's)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Natural gas	\$ 5,533	\$ 5,092	\$ 12,990	\$ 13,578
Realized gain on financial instruments	875	-	780	1,316
Total natural gas	6,408	5,092	13,770	14,894
Oil	193	272	411	602
Natural gas liquids	2,963	2,006	5,909	4,639
Oil and gas revenue	9,564	7,370	20,090	20,135
Unrealized (loss) gain on financial instruments	(1,058)	310	1,138	(517)
Total revenue	\$ 8,506	\$ 7,680	\$ 21,228	\$ 19,618

Second quarter oil and gas revenue of \$9.6 million in 2010 increased by \$2.2 million or 30%, compared to \$7.4 million in the second quarter of 2009. The increase in revenues for the quarter was due to the combination of slightly higher production levels, stronger natural gas liquids pricing and realized gains from the 2010 hedging program.

### *Production*

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
<b><u>Area (boe/d)</u></b>				
Deep Basin	2,129	944	2,041	965
West Central Alberta	925	1,635	977	1,866
Southern Alberta	25	503	14	607
Other Areas	7	7	8	8
	<b>3,086</b>	<b>3,089</b>	<b>3,040</b>	<b>3,446</b>
<b><u>Product</u></b>				
Natural gas (mcf/d)	14,996	14,382	14,644	15,963
Natural gas liquids (bbls/d)	562	645	572	728
Oil (bbls/d)	26	47	27	58
Total (boe/d)	<b>3,086</b>	<b>3,089</b>	<b>3,040</b>	<b>3,446</b>

Overall production remained flat compared to the prior year as increases in production seen in the Deep Basin as a result of the successful horizontal drilling program in Kakwa were offset by the sale of production from non-core assets at Medallion and West Central Alberta in 2009.

Second quarter production increased 3% relative to the first quarter of 2010, reflecting a full quarter's production from new wells in Kakwa, offset by natural declines. No new wells were brought on production in the quarter.

ProspEx's summer drilling program has been delayed due to wet weather in the second quarter which impaired surface access to drilling locations. With the delays in the summer drilling program, the Company now forecasts its annual average production for 2010 to be 3,100 to 3,300 barrels of oil equivalent ("boe") per day, compared to the previous guidance of 3,300 to 3,500 boe per day.

Production in late 2010 is expected to be approximately 4,000 boe per day, as a result of the summer drilling program that has recently commenced with the return to drilling in the Kakwa area. Production at the start of 2010 was approximately 2,700 boe per day, the forecasted 4,000 boe per day exit rate equates to approximately 50% production growth over the year.

Guidance regarding production may constitute a "financial outlook" as contemplated by National Instrument 51-102 of the Canadian Securities Administrators entitled Disclosure Obligations ("NI 51-102"). The purpose of such guidance is to forecast the anticipated production for the Company for 2010.

### Commodity Pricing

ProspEx Average Prices	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Natural gas (\$/mcf)				
Sales price	\$ 4.06	\$ 3.89	\$ 4.91	\$ 4.69
Realized gain on financial instruments	0.64	-	0.29	0.46
	4.70	3.89	5.20	5.15
Oil (\$/bbl)	82.75	64.40	83.00	57.82
NGL (\$/bbl)	57.98	34.15	57.03	35.21
Average realized price (\$/boe)	34.05	26.22	36.51	32.28
Unrealized (loss) gain on financial instruments (\$/boe)	(3.77)	1.10	2.07	(0.83)
Total average price (\$/boe)	\$ 30.28	\$ 27.32	\$ 38.58	\$ 31.45
Benchmark pricing	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
AECO C Spot (\$/mcf)	\$ 3.89	\$ 3.62	\$ 4.42	\$ 4.27
Edmonton Par – light oil (\$/bbl)	\$ 75.14	\$ 62.90	\$ 77.63	\$ 56.28

Average natural gas sales prices (prior to the effects of realized financial instruments) increased 4% to \$4.06 per thousand cubic feet ("mcf") in the second quarter of 2010, compared to \$3.89 per mcf in the second quarter of 2009. This price reflects a slight improvement in natural gas markets, but remains significantly lower than historical averages and is 30% lower than prices received in the first quarter of 2010. Overall market sentiment still reflects concerns over the potential of an over supply of North American natural gas market in the near term.

Benchmark AECO C daily spot prices for natural gas increased 7% compared to the second quarter of 2009, compared to the increase of 4% in the Company's natural gas sales price, as production from the Company's most recent Kakwa well is sold through the Alliance pipeline system and received lower pricing in the second quarter.

Realized gains in the natural gas hedging program for 2010 increased the realized price for natural gas sales by \$0.64 per mcf for the quarter and \$0.29 per mcf on a year to date basis. The results of the hedging program reflect the Company's efforts to create a more predictable operating cash flow and thus ensure an orderly 2010 capital program.

Oil prices received for the second quarter of 2010 were \$82.75 per barrel ("bbl"). This is a 28% increase from the \$64.40 per bbl received in the second quarter of 2009, consistent with the increase in benchmark pricing. The price realized for natural gas liquids ("NGLs") in the second quarter of 2010 was \$57.98 per bbl, an increase of 70% from \$34.15 per bbl in the second quarter of 2009. Overall, oil and NGL prices have recovered substantially, as the world economy recovered over the past year.

### Financial Instruments

The impact of the changes in the fair values of open financial instruments during the quarter ended June 30, 2010 was an unrealized loss of \$1.1 million and a year to date unrealized gain of \$1.1 million. This compares to an unrealized gain of \$0.3 million for the second quarter of 2009 and an unrealized loss of \$0.5 million on a year to date basis.

On a realized basis, gains from financial instruments were \$0.9 million in the current quarter of 2010 and \$0.8 million year to date.

The financial instruments open as of June 30, 2010 are described below:

<u>Type</u>	<u>Amount (GJ/day)</u>	<u>Term</u>	<u>Price (\$/GJ at AEEO)</u>	<u>Type</u>
Fixed	1,000	Jul. 1 – Oct. 31, 2010	\$5.18	Financial
Fixed	1,000	Jul. 1 – Oct. 31, 2010	\$5.385	Financial
Collar	1,000	Jul. 1 – Oct. 31, 2010	\$5.00 - \$6.16	Financial
Collar	1,000	Jul. 1 – Oct. 31, 2010	\$5.00 - \$5.90	Financial
Collar	1,000	Jul. 1 – Oct. 31, 2010	\$4.90 – \$5.63	Financial
Collar	1,000	Jul. 1 – Oct. 31, 2010	\$5.00 – \$5.95	Financial
Collar	1,000	Jul. 1 – Oct. 31, 2010	\$4.75 – \$5.86	Financial
Fixed	1,000	Sept. 1 – Oct. 31, 2010	\$4.05	Financial
Fixed	1,000	Sept. 1 – Oct. 31, 2010	\$3.96	Financial

These open financial instruments represent a mark to market asset at June 30, 2010 of \$1.0 million, as current natural gas forward prices are below the minimum prices that these open financial instruments receive.

### Royalty Expenses

(\$000's)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Crown	\$ 1,707	\$ (42)	\$ 2,974	\$ 1,973
Freehold and gross overriding	396	383	706	894
Total Royalties	\$ 2,103	\$ 341	\$ 3,680	2,867
\$ per boe	\$ 7.49	\$ 1.21	\$ 6.69	\$ 4.60
As a percentage of oil and gas revenue	22%	5%	18%	14%

In the second quarter of 2010, royalties totaled \$2.1 million or 22% of revenue compared to the previous year's \$0.3 million or 5% of revenue. During the first six months of 2010 royalties totaled \$3.7 million or 18% of oil & gas revenue compared to \$2.9 million or 14% of oil & gas revenue for the same period of 2009.

Crown royalty payments increased in the quarter compared to the first quarter of 2010 and to the prior year. This was due to production from new wells at Kakwa reaching the volume limit for the reduced 5% initial Crown royalty rate and a \$0.5 million reduction in the annual capital cost allowance for 2009.

ProspEx is required to pay the Province of Alberta and other royalty owners for the right to produce minerals owned by them. Such royalty payments are subject to change and any changes may have an impact on the profitability of a project. On March 11, 2010, the Government of Alberta announced additional amendments to the new oil and gas royalty framework which are to come into effect on January 1, 2011. Under the most recent amendments, the maximum royalty rate for natural gas is to be reduced from 50% to 36% and the maximum royalty rate for conventional oil wells is to be reduced from 50% to 40%. In addition the New Well Incentive Program is to become a permanent feature to the new oil and gas royalty framework. Further refinements to the amendments were announced by the Government of Alberta on May 27, 2010 including finalization of the royalty curves that are to be utilized to determine the applicable royalty rates, and the indefinite extension and adjustments to the New Gas Deep Drilling Program.

## Operating Costs

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Operating costs (\$000's)	\$ 2,218	\$ 2,613	\$ 4,364	\$ 5,066
Operating costs (\$/boe)	\$ 7.90	\$ 9.30	\$ 7.93	\$ 8.12

Operating costs for the second quarter were \$2.2 million or \$7.90 per boe, compared to \$2.6 million or \$9.30 per boe in the second quarter of 2009.

Operating costs on a unit basis have decreased compared to 2009, reflecting the disposition of higher operating cost areas, and the addition of production from horizontal wells in Kakwa.

## Transportation Expense

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Transportation expenses (\$000's)	\$ 420	\$ 262	\$ 837	\$ 619
Transportation expenses (\$/boe)	\$ 1.50	\$ 0.93	\$ 1.52	\$ 0.99

Transportation expense per boe for the three and six months ended June 30, 2010 increased compared to the prior year, reflecting increases in production in operating areas that attract higher transportation rates and the disposition of production in areas with lower transportation costs.

## General and Administrative Expenses

(\$000's)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Gross general and administrative	\$ 1,642	\$ 1,769	\$ 3,243	\$ 3,718
Recoveries	(318)	(155)	(549)	(400)
Capitalized expenses	(640)	(763)	(1,270)	(1,561)
Net general and administrative expenses	\$ 684	\$ 851	\$ 1,424	\$ 1,757
Net general and administrative expenses (\$/boe)	\$ 2.43	\$ 3.03	\$ 2.59	\$ 2.82

Gross general and administrative costs for the second quarter of 2010 remained approximately the same compared to the first quarter of 2010 and were slightly lower than the same periods in 2009 due to lower staff levels in 2010.

## Interest and Bank Charges

Interest and bank charges of \$0.4 million in the second quarter and \$0.5 million year to date in 2010 were slightly lower compared to the prior year amount of \$0.4 million in the second quarter and \$0.8 million year to date. This is due to the Company operating at lower debt levels compared to the prior year.

## Depletion, Depreciation and Accretion

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Depletion, depreciation and accretion (\$000's)	\$ 5,141	\$ 8,247	\$ 9,977	\$ 16,988
Depletion, depreciation and accretion (\$/boe)	\$ 18.30	\$ 29.34	\$ 18.13	\$ 27.24

Depletion, depreciation and accretion expense per boe in the second quarter of 2010 was \$18.30 per boe. This is a 38% decrease from the second quarter 2009 rate of \$29.34 per boe. This decrease reflects the impact of reserve additions at year end and the first quarter of 2010 within the Kakwa operating area.

## Income Taxes

In the second quarter of 2010, the Company had a future income tax reduction of \$0.6 million compared to a reduction of \$1.8 million in the same period in 2009. For the six months ending June 30, 2010 future income tax expense totaled \$0.2 million, compared to a \$3.0 million reduction in June of 2009.

Estimated tax pools as at June 30:

(\$000's)	2010	2009
Canadian development expense	\$ 25,683	\$ 37,473
Canadian exploration expense	35,611	32,101
Canadian oil & gas property expense	20,757	18,649
Undepreciated capital cost	26,576	33,283
Non Capital Losses	14,847	-
Other	3,092	4,499
	<b>\$ 126,566</b>	<b>\$ 126,005</b>

## Net Earnings

The Company reported a net loss of \$1.9 million for the second quarter of 2010 (\$3.9 million loss in 2009) resulting in negligible net earnings year to date compared to prior year to date losses of \$6.1 million. Net losses in the quarter and year to date were lower than the prior year due to a lower depletion, depreciation and accretion rate.

## Capital Expenditures

(\$000's)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Drilling and completions	\$ 172	\$ 104	\$ 5,391	\$ 3,690
Facilities	882	(914)	2,154	(27)
Land and lease	1,028	1,568	1,722	1,889
Seismic	516	98	559	148
Capitalized G&A	640	763	1,270	1,561
Exploration & development capital expenditures	3,238	1,619	11,096	7,261
Net property dispositions	(208)	(25,383)	(196)	(27,461)
Other capital expenditures	21	4	21	7
Total net capital expenditures	<b>\$ 3,051</b>	<b>\$ (23,760)</b>	<b>\$ 10,921</b>	<b>\$ (20,193)</b>

For the second quarter of 2010, the Company did not participate in any drilling as spring break up restricted access to drilling locations. Of the \$3.2 million invested in exploration and development capital expenditures, \$1.5 million was spent on the acquisition of new undeveloped lands and seismic, and \$0.9 million spent on facilities work in the Kakwa area.

The Company's 2010 summer drilling program was delayed due to wet weather in the second quarter which impaired surface access to drilling locations. At Kakwa in the Deep Basin, the Company has now commenced its summer drilling program, and is currently drilling the first horizontal well of a planned three (1.5 net) well program targeting the Falher formation. At Pembina in West Central Alberta, ProspEx plans to spud its first horizontal well (100% working interest) in early August, contingent on surface access conditions, which is to also target the Falher formation.

ProspEx maintains a capital budget of \$30.0 million (net of Alberta Royalty Drilling Credits) for 2010, contingent on commodity prices. Capital spending for the period July 1 to December 31, 2010 is therefore expected to be approximately \$19.0 million. The capital program planned for this period includes approximately six horizontal wells, including fourth quarter drilling in West Central Alberta and the Deep Basin, in addition to the summer drilling described above.

Please be advised that the forecasts above with respect to capital spending may constitute a "financial outlook" as contemplated by NI 51-102. The purpose of such information is to forecast the anticipated capital spending of the Company for 2010.

### Liquidity & Capital Resources

At June 30, 2010, ProspEx had the following financial resources available to fund its capital expenditure program.

(\$000's)	
Working capital deficiency, excluding fair value of commodity contracts, current loss on sublease and associated future tax liabilities	\$ (2,080)
Long-term debt	(21,692)
Bank facilities available	40,000
<b>Total capital resources available</b>	<b>\$ 16,228</b>

ProspEx expects that it will be able to fund its 2010 capital program from operating cash flow and the capital resources noted above.

As at June 30, 2010, the Company's ratio of net debt to trailing quarterly operating cash flow was 1.8 to 1.0, which meets the Company's guidelines on capital management (which call for a maximum of 2.0 to 1.0). The Company continues to closely monitor its overall net debt levels and the resulting ratio to ensure proper debt levels are maintained.

#### *Bank Debt*

At June 30, 2010 the Company has a \$40.0 million credit facility with a major Canadian bank. 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 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 covenants under the terms of this facility. As at June 30, 2010, the Company is in compliance with all covenants in accordance with the terms of the credit facility. The next scheduled review date of the facility is May 31, 2011.

### Share Capital

As at June 30, 2010, ProspEx had 57,385,162 common shares (2009 – 57,385,162), no warrants (2009 – 2,016,269), and 5,051,167 options (2009 – 5,060,078) issued and outstanding. Each option, upon exercise, entitles the holder to one common share.

As at July 28, 2010 ProspEx had 57,385,162 common shares, no warrants, and 5,051,167 options issued and outstanding.

### Contractual Obligations

The Company has committed to certain payments as follows:

Payments due (\$000's)	2010	2011	2012	2013	2014	Thereafter	Total
Long-term debt	\$ -	\$ 21,692	\$ -	\$ -	\$ -	\$ -	\$ 21,692
Building lease	470	1,051	1,356	1,433	358	-	4,668
Processing fees	404	809	640	480	360	57	2,750
Transportation	520	596	140	-	-	-	1,256
Other	2	-	-	-	-	-	2
<b>Total</b>	<b>\$ 1,396</b>	<b>\$ 24,148</b>	<b>\$ 2,136</b>	<b>\$ 1,913</b>	<b>\$ 718</b>	<b>\$ 57</b>	<b>\$ 30,368</b>

### Off-Balance Sheet Arrangements

The Company has not entered into any off-balance sheet transactions other than previously discussed.

### Summary of Quarterly Results

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

	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008
<b>Average Daily Production</b>								
Natural Gas (mcf/d)	14,996	14,288	11,327	8,906	14,382	17,561	16,868	18,379
NGL (bbls/d)	562	583	557	456	645	811	719	722
Oil (bbls/d)	26	29	32	37	47	69	57	65
Total (boe/d)	3,086	2,994	2,477	1,978	3,089	3,807	3,587	3,850
<b>Operating Netbacks (\$/boe)</b>								
Price <sup>(1)</sup>	\$ 34.05	39.07	35.49	27.61	26.22	37.25	45.59	55.65
Royalties	(7.49)	(5.85)	(5.15)	(1.21)	(1.21)	(7.37)	(8.18)	(12.98)
Operating costs	(7.90)	(7.97)	(8.72)	(8.37)	(9.30)	(7.16)	(4.58)	(7.76)
Transportation	(1.50)	(1.55)	(1.21)	(1.12)	(0.93)	(1.04)	(1.00)	(0.91)
Total	\$ 17.16	23.70	20.41	16.91	14.78	21.68	31.83	34.00
<b>E&amp;D Capital Spending (\$000's)</b>	<b>\$ 3,238</b>	7,858	3,988	6,438	1,619	5,641	12,797	12,693

**Selected Financial Results**  
(\$000's, except per share amounts)

Oil and gas revenue	\$ 9,564	10,526	8,088	5,023	7,370	12,765	15,046	19,714
Unrealized financial instrument (loss) gain	(1,058)	2,196	(2)	(401)	310	(828)	(363)	8,277
Net (loss) earnings	(1,900)	1,908	(1,231)	(3,082)	(3,899)	(2,225)	487	6,923
Basic per share	\$ (0.03)	0.03	(0.02)	(0.05)	(0.07)	(0.04)	0.01	0.12
Diluted per share	\$ (0.03)	0.03	(0.02)	(0.05)	(0.07)	(0.04)	0.01	0.12

<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 subtractions as a result of 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. In 2009 this trend was further complicated by disposition activity and production curtailments due to low prices.

World-wide commodity price environments have a significant influence on the overall Company's quarterly results. The Company is a price-taker in the oil & gas industry and as a result, world prices drive 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 may not follow traditional quarterly cyclical trends in 2010.

#### **INTERNATIONAL REPORTING STANDARDS**

On January 1, 2011 International Financial Reporting Standards ("IFRS") will replace Canadian generally accepted accounting principles ("GAAP") for Canadian publicly accountable enterprises. Quarterly and annual results will be reported in accordance with IFRS beginning in 2011, with the restatement of 2010 amounts for comparative purposes. A project team was set up internally to lead the conversion project. The project team, as well as other key finance personnel, has attended industry specific IFRS educational programs. The Company has and will continue to involve the external auditors throughout the process and maintain regular progress reporting to the Audit Committee of the Board of Directors.

The Company's IFRS transition project includes four key phases:

- project planning and scoping
- draft policy and impact assessment
- implementation and parallel reporting
- ongoing monitoring and IFRS policy updates

## **Project Planning and Scoping**

The Company has completed the project planning and scoping phase of the project. Project planning entailed developing a project plan, appointing internal staff and allocating resources. Scoping consisted of identifying and performing a high level impact analysis to identify areas that may be affected by the transition. The following areas are expected to change significantly for the Company:

- property plant and equipment ("PP&E"), specifically treatment of exploration and evaluation costs, depreciation and depletion of property, plant and equipment and impairment of assets
- asset retirement obligations
- business combinations
- future income taxes
- more extensive presentation and disclosure

Future changes in IFRS prior to adoption may result in other accounting policy changes which could significantly impact the financial statements.

## **Draft Policy and Impact Assessment**

The Company is currently in this phase of the project which involves analyzing policy choices allowed under IFRS and assessing their impact on the financial statements. The conclusion of this phase will require the Audit Committee of the Board of Directors to review and approve all accounting policy choices.

IFRS 1 First Time Adoption of International Financial Reporting Standards provides a number of optional exemptions and mandatory exceptions to the general requirement for full retrospective application. This standard is only applicable to the opening balance sheet of the entity on transition to IFRS.

The following is a discussion of which IFRS 1 exemptions and exceptions the Company is considering using and the policy choices the Company has made or the progress of policy decisions for areas for which a significant change on conversion is anticipated:

### *Property, Plant and Equipment*

ProspEx currently follows the full cost accounting guideline under Canadian GAAP resulting in the accumulation of all costs directly associated with the acquisition of, exploration for and development of oil and gas assets in one cost center. Costs are depleted using the unit of production method based on proved reserves. Under IFRS, costs previously accumulated in the full cost pool are capitalized as exploration and evaluation ("E&E") assets or developing and producing ("D&P") assets or expensed as E&E expenditures.

At transition to IFRS, new accounting policies must be adopted for E&E assets and expenditures and for D&P assets.

- Costs incurred by the Company before acquiring the legal right to explore in an area, do not meet the definition of an asset under IFRS and therefore will likely be expensed as E&E expenditures by the Company as incurred. The Company does not expect these costs to be significant.
- The Company intends to capitalize as E&E assets, costs for projects for which technical feasibility and commercial viability has not been determined but for which the legal right to explore in the area has been obtained. When the technical feasibility and commercial viability of the project is determined the costs will be transferred to D&P assets. The standard does not define technical feasibility and commercial viability. The Company intends to classify a project as technically feasible and commercially viable when proved plus provable reserves are assigned to the project. Unrecoverable costs associated with a project will likely be expensed. The Company does not intend to deplete any E&E assets.
- D&P assets will likely be defined as expenditures on projects where technical feasibility and commercial viability have been determined. Under IFRS these costs should be capitalized and depleted on a unit of production basis using proved or proved plus probable reserves over a component level instead of by one

company wide cost center. The Company intends to use proved plus probable reserves as a basis for depletion.

Under IFRS, impairment of assets is performed at the cash generating unit ("CGU") level which is a lower level than the country wide test currently required under Canadian GAAP. At this time the Company anticipates between two and four CGUs. Impairment tests may be performed using proved or proved plus probable reserves. The Company intends to test impairment using proved plus probable reserves.

On adoption of IFRS the Company has the option to retroactively restate PP&E or elect under IFRS 1 to measure PP&E at the date of transition at fair value or at the amount determined under Canadian GAAP. The Company will likely measure PP&E at the amount determined under Canadian GAAP. On transition, the PP&E balance will then be reclassified as E&E and D&P assets. The Company will likely first re-classify all E&E assets that are currently included in the PP&E balance on the balance sheet. The remaining PP&E balance will be the opening D&P asset value. The standard allows the Company to allocate the D&P asset balance to CGUs based on reserve volumes or values. The allocation method ProspEx intends to use is the net present value of proved plus probable company interest reserve cash flow values. Once oil and gas assets are allocated to cash generating units they are required to be tested for impairment, at the CGU level. Based on preliminary analysis PP&E will not be impaired on transition.

#### *Decommissioning Liability*

The decommissioning liability is currently referred to as asset retirement obligation under Canadian GAAP. IFRS 1 has an election which the Company plans to adopt, whereby the liability is measured at transition in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets, and any difference between that amount and the Canadian GAAP carrying amount of those liabilities at the date of transition is recognized in retained earnings. Based on preliminary calculations the liability will be higher under IFRS as the discount rate used in calculating the liability will likely be a risk free rate as opposed to the credit adjusted risk free rate currently used under Canadian GAAP.

#### **Implementation and Parallel Reporting**

This step will involve implementing all changes identified in the impact assessment phase including changes to information systems, business processes, and training of all staff impacted by the conversion. The Company's current data gathering and accounting system is capable of obtaining and recording data at a level of detail required for IFRS with slight modifications. Modifications include increasing the level of detail of which costs are tracked and adding new accounts.

#### **Ongoing Monitoring and IFRS Policy Updates**

The final phase of the project involves continuing education and training and ensuring maintenance of internal controls over IFRS financial reporting and disclosure control procedures.

The Company must also monitor all changes or anticipated changes in IFRS on an ongoing basis.

#### **Business Activities**

ProspEx has reviewed the impact of IFRS on its commodity price risk management practices, debt covenants and compensation arrangements and does not expect IFRS to have any significant changes in these areas.

#### **Internal Control over Financial Reporting and Disclosure Controls and Procedures**

Changes may be required to internal controls over financial reporting and disclosure controls and procedures with the implementation of IFRS. The implications will be analyzed once accounting policy choices and implementation plans are finalized.

## 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 Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of June 30, 2010, that the Company's disclosure controls and procedures as at such date 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 Chief Executive Officer and Chief Financial Officer 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 Chief Executive Officer and Chief Financial Officer of the Company have caused under their supervision the design of internal controls over financial reporting ("ICFR"), and have evaluated the design and effectiveness of those controls. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer of the Company have concluded that the design and operating effectiveness of the Company's ICFR as of June 30, 2010 are effective and provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

ICFR has inherent limitations no matter how well designed such controls may be. Control systems can only provide reasonable, not absolute, assurance that the objectives of the control systems are met.

There were no significant changes to the Company's ICFR during the second quarter of 2010.

## ADVISORIES

### Non-GAAP Measures

Within the MD&A references are made to terms commonly used in the oil and gas industry. The following terms are not defined by GAAP in Canada and are referred to as non-GAAP measures.

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

(\$000s)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Cash flow from operating activities	\$ 4,078	\$ (5,251)	\$ 8,191	\$ 3,728
Change in non-cash working capital	(591)	7,726	548	4,468
Cash flow	\$ 3,487	\$ 2,475	\$ 8,739	\$ 8,196

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

(\$000's)	As at June 30, 2010	As at June 30, 2009
Accounts receivable	\$ (6,306)	\$ (6,666)
Prepaid expenses	(197)	(275)
Accounts payable and accrued liabilities	8,583	9,023
Long-term debt	21,692	20,950
Total net debt	\$ 23,772	\$ 23,032

Barrel of oil equivalent amounts have been calculated using a conversion rate of six thousand cubic feet 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.

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

"Total net debt" is calculated by adding long-term debt less working capital (or plus working capital deficiency), excluding fair value of commodity contracts, current loss on sublease and associated future tax assets (liabilities).

### **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 "Description of the Business - Risk Factors and Industry Conditions" in 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)

**June 30, 2010**      **December 31, 2009**

**Assets**

Current assets

Accounts receivable	\$	6,306	\$	7,800
Prepaid expenses		197		389
Future income tax asset (note 2)		-		27
Fair value of commodity contracts (note 4)		1,045		-
		<u>7,548</u>		<u>8,216</u>

Property, plant and equipment, net

147,388      145,939

Total assets

\$ 154,936      \$ 154,155

**Liabilities**

Current liabilities

Accounts payable and accrued liabilities	\$	8,583	\$	12,599
Current loss on sublease		234		226
Fair value of commodity contracts (note 4)		-		93
Future income tax liability (note 2)		227		-
		<u>9,044</u>		<u>12,918</u>

Long-term debt (note 1)

21,692      17,234

Asset retirement obligation

3,653      3,810

Other long-term liabilities

92      198

Future income tax liability (note 2)

5,139      5,160

Total liabilities

39,620      39,320

**Shareholders' Equity**

Common shares (note 3 a)

90,800      90,800

Contributed surplus (note 3 b)

9,460      8,987

Retained earnings

15,056      15,048

Total shareholders' equity

115,316      114,835

\$ 154,936      \$ 154,155

Commitments (note 6)

See accompanying notes to consolidated financial statements

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

(Stated in thousands of dollars, except per share amounts)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Revenue				
Oil and gas	\$ 9,564	\$ 7,370	\$ 20,090	\$ 20,135
Unrealized financial instrument (loss) gain (note 4)	(1,058)	310	1,138	(517)
Royalties	(2,103)	(341)	(3,680)	(2,867)
	<u>6,403</u>	<u>7,339</u>	<u>17,548</u>	<u>16,751</u>
Expenses				
Depletion, depreciation and accretion	5,141	8,247	9,977	16,988
Operating	2,218	2,613	4,364	5,066
Transportation	420	262	837	619
General and administrative	684	851	1,424	1,757
Interest and bank charges	351	439	547	755
Stock-based compensation	113	105	237	209
Sublease loss	-	524	-	524
	<u>8,927</u>	<u>13,041</u>	<u>17,386</u>	<u>25,918</u>
(Loss) earnings before income taxes	(2,524)	(5,702)	162	(9,167)
Income taxes (note 2)				
Future (reduction) expense	(624)	(1,803)	154	(3,043)
Net (loss) earnings and comprehensive (loss) earnings for the period	(1,900)	(3,899)	8	(6,124)
Retained earnings, beginning of period	16,956	23,260	15,048	25,485
Retained earnings, end of period	<u>\$ 15,056</u>	<u>\$ 19,361</u>	<u>\$ 15,056</u>	<u>\$ 19,361</u>
Net (loss) earnings per share				
Basic	\$ (0.03)	\$ (0.07)	\$ 0.00	\$ (0.11)
Diluted	<u>\$ (0.03)</u>	<u>\$ (0.07)</u>	<u>\$ 0.00</u>	<u>\$ (0.11)</u>

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 June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
<b>Operations</b>				
Net (loss) earnings for the period	\$ (1,900)	\$ (3,899)	\$ 8	\$ (6,124)
Items not involving cash				
Depletion, depreciation and accretion	5,141	8,247	9,977	16,988
Stock-based compensation	113	105	237	209
Future income tax (reduction) expense	(624)	(1,803)	154	(3,043)
Unrealized financial instrument loss (gain)	1,058	(310)	(1,138)	517
Amortization of rent inducements	(28)	-	(55)	-
Amortization of sublease loss	(56)	524	(111)	524
Asset retirement expenditures	(217)	(389)	(333)	(875)
	3,487	2,475	8,739	8,196
Changes in non-cash working capital	591	(7,726)	(548)	(4,468)
	4,078	(5,251)	8,191	3,728
<b>Financing</b>				
Increase (decrease) in long-term debt	336	(16,521)	4,458	(19,858)
	336	(16,521)	4,458	(19,858)
<b>Investments</b>				
Exploration and development expenditures	(3,238)	(1,619)	(11,096)	(7,261)
Proceeds on property disposal	208	26,886	196	28,964
Property acquisition	-	(1,503)	-	(1,503)
Other capital expenditures	(21)	(4)	(21)	(7)
	(3,051)	23,760	(10,921)	20,193
Changes in non-cash working capital	(1,363)	(1,988)	(1,728)	(4,063)
	(4,414)	21,772	(12,649)	16,130
Change in cash	-	-	-	-
Cash, beginning of period	-	-	-	-
Cash, end of period	\$ -	\$ -	\$ -	\$ -

Additional cash flow disclosure (note 5)

See accompanying notes to consolidated financial statements

## Notes to Consolidated Financial Statements

For the three and six months ended June 30, 2010  
(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, 2009. 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 June 30, 2010 and the results of its operations and cash flows for the three and six months ended June 30, 2010. The disclosures included below are incremental to those included with the annual consolidated financial statements. 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, 2009.

### 1. LONG TERM DEBT

At June 30, 2010 the Company has a \$40.0 million credit facility with a major Canadian bank. 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 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 covenants under the terms of this facility. As at June 30, 2010, the Company is in compliance with all covenants in accordance with the terms of the credit facility. The next scheduled review date of the facility is May 31, 2011.

### 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	Three months ended	Six months ended	Six months ended
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
(Loss) earnings before income taxes	\$ (2,524)	\$ (5,702)	\$ 162	\$ (9,167)
Combined statutory rate (%)	28.0%	29.0%	28.0%	29.0%
Computed expected future income tax (reduction) expense	(707)	(1,654)	45	(2,659)
Increase (decrease) in taxes resulting from:				
Stock-based compensation expensed	31	30	66	60
Effect of change in tax rate	45	(211)	36	(490)
Other	7	32	7	46
Income tax (reduction) expense	\$ (624)	\$ (1,803)	\$ 154	\$ (3,043)

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

(\$000's)	June 30, 2010	December 31, 2009
Property, plant and equipment	\$ (5,700)	\$ (5,900)
Fair value of commodity contracts	(293)	27
Asset retirement obligation	913	952
Loss due to leasing arrangements	129	146
Share issue costs	85	142
	(4,866)	(4,633)
Valuation allowance	(500)	(500)
Future income tax liability	\$ (5,366)	\$ (5,133)

At June 30, 2010, the Company had estimated tax pools available to reduce future taxable income of \$126.6 million (December 31, 2009 – \$124.5 million).

Capitalized stock based compensation resulted in an increase to future tax liabilities of \$0.1 million during the six months ended June 30, 2010 (2009 – \$0.1 million).

### 3. SHAREHOLDERS' EQUITY

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

	June 30, 2010		June 30, 2009	
	Number of Shares/Warrants (000's)	Amount (\$000's)	Number of Shares/Warrants (000's)	Amount (\$000's)
Common shares				
Balance at the beginning and end of the period	57,385	\$ 90,800	57,385	\$ 90,802
Common share performance warrants				
Balance at the beginning and end of the period	-	\$ -	2,016	\$ 1,233

(b) Contributed Surplus

(\$000's)	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Balance at the beginning of the period	\$ 9,235	\$ 6,965	\$ 8,987	\$ 6,758
Stock-based compensation	225	209	473	416
Balance at the end of the period	\$ 9,460	\$ 7,174	\$ 9,460	\$ 7,174

(c) Stock Options

Changes in outstanding stock options are summarized below:

	June 30, 2010		June 30, 2009	
	Options (000's)	Weighted Average Exercise Price	Options (000's)	Weighted Average Exercise Price
Outstanding at beginning of period	5,261	\$ 2.34	5,160	\$ 3.44
Granted	-	-	617	0.70
Forfeited	(125)	1.92	(717)	3.52
Expired	(85)	3.22	-	-
Outstanding at end of period	5,051	\$ 2.33	5,060	\$ 3.10

The following table summarizes stock options outstanding and exercisable at June 30, 2010:

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 – \$ 0.92	1,082	4.0	\$ 0.66	200	\$ 0.70
\$ 0.93 – \$ 1.40	1,407	4.2	\$ 1.01	83	\$ 1.25
\$ 2.13 – \$ 3.20	250	2.4	\$ 3.01	167	\$ 3.01
\$ 3.21 – \$ 4.46	2,312	1.7	\$ 3.85	2,083	\$ 3.89
	5,051	2.9	\$ 2.33	2,533	\$ 3.49

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 June 30, 2010, a total of \$0.1 million (2009 – \$0.1 million) of stock-based compensation was recorded against income and \$0.1 million (2009 – \$0.1 million) was capitalized. During the six months ended June 30, 2010, a total of \$0.2 million (2009 – \$0.2 million) of stock-based compensation was recorded against income and \$0.2 million (2009 – \$0.2 million) was capitalized.

(d) Per Share Amounts

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Weighted average common shares basic	57,385,162	57,385,162	57,385,162	57,385,162
Dilutive securities:				
Stock options	-	-	609,536	-
Diluted	57,385,162	57,385,162	57,994,698	57,385,162

For the three months ended June 30, 2010, 5,051,167 options and no warrants (2009 – 5,060,078 options and 2,106,269 warrants) were excluded from the diluted calculations as they were anti-dilutive. For the six months ended June 30, 2010, 2,585,001 options were excluded due to their anti-dilutive impact (2009 – 5,081,483 options and 2,016,269 warrants).

#### 4. 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.

##### *Fair Value of Financial Instruments*

The fair value of measurements recognized in the balance sheet are classified according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the market place.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

	June 30, 2010			
	Fair Value	Level 1	Level 2	Level 3
Commodity Contracts	1,045	-	1,045	-

The Company's use of financial instruments has been assessed on the fair value hierarchy described above and the natural gas contracts are classified as Level 2.

The carrying value of the Company's financial instruments, other than bank indebtedness approximates their fair value due to their short maturity.

### ***Credit Risk***

Credit risk relates to the Company's receivables from joint interest 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 therefore is subject to concentration risk. To date the Company has not experienced any collection issues with its petroleum and natural gas marketers. Joint interest receivables are typically collected within one to three months of the joint interest bill being issued to the partner. The Company attempts to mitigate the risk from joint interest receivables by obtaining joint interest partners approval of significant capital expenditures prior to expenditure. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint interest partners; however in certain circumstances, it may elect to cash call a joint interest partner in advance of the work.

As at June 30, 2010 the Company's receivables consisted of \$2.5 million (December 31, 2009 - \$2.7 million) from joint interest partners, \$2.7 million (December 31, 2009 - \$3.5 million) of receivables from petroleum and natural gas marketers and \$1.1 million (December 31, 2009 - \$1.6 million) of other receivables. Of the \$6.3 million in total accounts receivable, \$0.2 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 June 30, 2010 and did not provide for any doubtful accounts nor was it required to write-off any receivables during the quarter ended June 30, 2010.

### ***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 June 30, 2010:

Financial Liability (\$000's)	< 1 year	1 - 2 years	2 - 5 years	Thereafter
Accounts payable and accrued liabilities	\$ 8,583	-	-	-
Long-term debt	-	21,692	-	-
Total	\$ 8,583	21,692	-	-

### ***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 six months ended June 30, 2010 and 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 June 30, 2010:

<u>Type</u>	<u>Amount (GJ/day)</u>	<u>Term</u>	<u>Price (\$/GJ at AEFCO)</u>	<u>Type</u>
Fixed	1,000	Jul. 1 – Oct. 31, 2010	\$5.18	Financial
Fixed	1,000	Jul. 1 – Oct. 31, 2010	\$5.385	Financial
Collar	1,000	Jul. 1 – Oct. 31, 2010	\$5.00 - \$6.16	Financial
Collar	1,000	Jul. 1 – Oct. 31, 2010	\$5.00 - \$5.90	Financial
Collar	1,000	Jul. 1 – Oct. 31, 2010	\$4.90 – \$5.63	Financial
Collar	1,000	Jul. 1 – Oct. 31, 2010	\$5.00 – \$5.95	Financial
Collar	1,000	Jul. 1 – Oct. 31, 2010	\$4.75 – \$5.86	Financial
Fixed	1,000	Sept. 1 – Oct. 31, 2010	\$4.05	Financial
Fixed	1,000	Sept. 1 – Oct. 31, 2010	\$3.96	Financial

The contracts in place during the three months ended June 30, 2010 resulted in an unrealized loss of \$1.1 million (June 30, 2009 - \$0.3 million unrealized gain) and a realized gain of \$0.9 million (June 30, 2009 – no realized gain or loss). During the six months ended June 30, 2010 the contracts in place resulted an unrealized gain of \$1.1 million (2009 - \$0.5 million unrealized loss) and a realized gain of \$0.8 million (2009 - \$1.3 million realized gain)

With respect to commodity prices, during the three months ended June 30, 2010, 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 (2009 – no production dedicated). A one dollar decrease in the price per GJ of natural gas on the same production would have increased net earnings after taxes for the three months ended June 30, 2010 by \$0.1 million (2009 – no production dedicated). 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 six months ended June 30, 2010. For the three and six months ended June 30, 2010, a difference in the interest rate of 1% would change net earnings after tax by an estimated \$0.1 million (2009 - \$0.1 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)	June 30, 2010	December 31, 2009
Shareholders' equity	\$ 115,316	\$ 114,835
Long-term debt	21,692	17,234
Working capital deficiency excluding fair value of commodity contracts, current loss on sublease and associated future taxes	2,080	4,410

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), current loss on sublease and associated future taxes; 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 June 30, 2010 the Company's ratio of net debt to annualized operating cash flow was 1.7 to 1.0, and compares to the annual ratio of 1.7 to 1.0 for the year ended December 31, 2009.

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 June 30, 2010, the Company is in compliance with all bank facility requirements.

There have been no changes to the Company's capital management strategy during the quarter ended June 30, 2010.

## 5. ADDITIONAL DISCLOSURES

### Interest and Taxes Paid

Net cash interest paid during the quarter was \$0.2 million (2009 - \$0.1 million). Cash taxes paid during the period was \$nil (2009 - \$nil). On a year to date basis, net cash interest paid to June 30, 2010 was \$0.4 million (2009 - \$0.5 million). Year to date cash taxes paid to June 30, 2010 was \$nil (2009 - \$nil).

## 6. COMMITMENTS

The Company has committed to certain future payments as follows:

Payments due (\$000's)	2010	2011	2012	2013	2014	Thereafter	Total
Long-term debt	\$ -	\$ 21,692	\$ -	\$ -	\$ -	\$ -	\$ 21,692
Building lease	470	1,051	1,356	1,433	358	-	4,668
Processing fees	404	809	640	480	360	57	2,750
Transportation	520	596	140	-	-	-	1,256
Other	2	-	-	-	-	-	2
<b>Total</b>	<b>\$ 1,396</b>	<b>\$ 24,148</b>	<b>\$ 2,136</b>	<b>\$ 1,913</b>	<b>\$ 718</b>	<b>\$ 57</b>	<b>\$ 30,368</b>

### **Contact Information**

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