



Dalmac Energy Inc.
2006 Third Quarter Interim Report
For the Three and Nine Months Ended January 31, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

The following discussion and analysis (MD&A) of the financial results for the 3 and 9 months ended January 31, 2006 (Q3'06) should be read in conjunction with the Company's corresponding financial statements for the same period. The MD&A and financial statements for earlier periods should also be considered relevant and can be found on the SEDAR website at www.sedar.com. Differences in the previous year(s) quarter ending dates are due to changing the Company's year end from December 31 to April 30.

Forward-looking information

Statements in this MD&A relating to matters that are not historical facts are forward looking statements. Such forward-looking statements may involve known and unknown risks and uncertainties which may cause the actual results, performances or achievements of the Company to be materially different from any future results implied by such forward looking statements. Some of the risks that may cause actual results to vary are described under the "Business Risks" section)

Corporate Overview

Dalmac Energy Inc. ("Dalmac" or "the Company") is a provider of "hot oiler", "hydro vac", "vacuum", "pressure" and "tanker truck" services to the west central Alberta energy sector. Other products and services provided by the Company include "methanol/glycol", and "KCL" distribution and delivery. The Company presently has a total of 67 service units.

Revenue

The 3 month revenue for Q3'06 increased by \$2.4 to \$4.5 million or 118% over the \$2.1 million reported in the comparative period ended December 31, 2004. The year to date ("YTD") revenue increased by \$8.7 million to \$10.8 million, an increase of 415% over the \$2.1 million reported in the comparable period of the previous financial year. High oil and gas prices combined with increased activity in the energy sector translated into increased revenues for the Company. Revenues for the current quarter represent over a two fold increase from the previous year, this is largely due to increased activity levels and the addition of service units which were purchased over the course of the year.

Gross Margin

The 3 month gross margin in Q3'06 increased by \$0.8 million to \$1.4 million or 125% over the \$0.6 million in the comparative period in the previous year. The YTD gross margin increased by \$2.3 million to \$3.0 million, or 324%, over the \$0.7 million reported in the preceding year. The increased gross margin is a reflection of both higher activity levels and the operating results from the purchase of \$2.7 million of new service equipment which took place at varying intervals since the comparative period in the previous year.

General and Administrative ("G&A") Expenses

General and administrative ("G&A") costs, which primarily represent the costs associated with head office, and all other non-direct operational costs such as management, administration,

dispatching and sales, were up for the 3 month period by \$0.3 million to \$0.9 million or 48% over the comparative period in the previous year. The YTD G&A costs increased by \$1.9 million to \$2.7 million or 228% over the \$0.8 million reported in the comparative period of the previous year. This is significantly less than the growth in revenues, meaning that the Company has been able to grow its revenues without a corresponding growth in its G&A expenses. During Q3'06 management has reduced management and dispatch costs by approximately \$30,000 per month through attrition. These savings will become evident in the subsequent reporting periods.

Amortization of Property and Equipment

Amortization of property and equipment for the quarter ending January 31, 2006, increased by \$101,373 to \$216,752 or 88% over the \$115,380 in the comparative period for the previous year. The YTD amortization increased by \$537,610 to \$652,990, or 466%, over \$115,380 reported in the comparable period. Amortization is dependant on the timing of additions to property and equipment. The major components of additions for the current year include the purchase of the assets of S Young Oilfield Ltd. and the acquisition of \$2.7 million in new service units. Disposals of property and equipment during the 3 month period ended January 31, 2006 were consistent with the normal course of business activities and resulted in a loss of \$17,390 on the disposal of assets. The YTD loss on disposal of assets was \$67,591.

Interest Expense

Interest expense for long term debt for the 3 month period ended January 31, 2006 increased \$35,005 to \$90,270 or 64% over the \$55,265 reported in the comparative period in the previous year. The YTD interest expense increased by \$230,548 to \$283,147, or 439%, over the \$52,599 reported in the previous year. The long term debt is for equipment leases and vendor take back financing which is associated with the acquisition of McClelland Oil Services Inc. and S Young Oilfield Ltd. Following the \$1.0 million financing in September 2005 the Company's bank debt was reduced by \$898,957.

Income Taxes

The Company's current income tax obligation at the end of January 31, 2006 was \$69,208. There was no current income tax owing for the comparable period dated December 31, 2004.

Summary of Quarterly Results

For the periods ended (Cdn Dollars)	3 Month Period Ended January 31 2006	3 Month Period Ended October 31, 2005	16 Month Period Ended July 31, 2005	3 Month Period Ended April 30 2005
Revenue	4,532,521	3,472,109	2,807,275	7,309,943
Gross Margin	1,431,078	982,302	592,959	2,158,002
Gross Margin %	32%	28.29%	21.12%	29.52%
Operating income (loss)	544,156	97,053	(358,156)	938,190
Operating income per share - basic	0.08	0.015	(0.061)	0.226
Operating income per share - diluted	0.07	0.013	(0.057)	0.195
Net income (loss)	411,738	32,800	(237,816)	327,551
Net income per share - basic	0.06	0.005	(0.041)	0.079
Net income per share - diluted	0.05	0.004	(0.038)	0.068
Weighted average common shares -basic	7,466,768	6,338,989	5,870,977	4,154,757
Weighted average common shares - diluted	8,633,547	7,578,363	6,276,759	4,816,814

Selected Period Information

	3 Month Period Ended March 31 2005	3 Month Period Ended December 31, 2004	3 Month Period Ended Sept 30, 2004	3 Month Period Ended June 30 2004
For the periods ended (Cdn Dollars)				
Revenue	4,441,921	2,083,643	0	0
Gross Margin	1,227,783	466,149	0	0
Gross Margin %	27.64%	22.37%	0.00%	0.00%
Operating income (loss)	751,905	28,779	(76,169)	(13,006)
Operating income per share - basic	0.181	0.01	(0.03)	(0.01)
Operating income per share - diluted	0.156	0.01	(0.02)	(0.01)
Net income (loss)	627,905	(225,692)	(72,737)	(9,594)
Net income per share - basic	0.151	(0.04)	(0.02)	(0.01)
Net income per share - diluted	0.130	(0.04)	(0.02)	(0.01)
Weighted average common shares -basic	4,154,757	3,714,285	3,367,583	3,350,983
Weighted average common shares - diluted	4,816,814	4,281,336	4,281,336	3,947,846

The Company's business is seasonal to some extent with the quarters ending January 2006 (Q3) and April 2006 (Q4) traditionally being the two strongest quarters and the Q1 and Q2 normally being the two weaker quarters. The underlying causes of the seasonality are weather conditions. The weather restricts operations during road ban season and in designated wildlife areas at certain times of the year. Other factors that impact operational levels are capital expenditure programs by energy producers.

Liquidity and Capital Resources

Dalmac's capital requirements consist primarily of working capital necessary to fund operations, capital expenditures related to the purchase and manufacture of operating equipment, and capital to finance strategic acquisitions. Sources of funds to meet these capital requirements include cash flow from operations, external lines of credit, equipment financing, term loans and equity financings.

The Company has a banking facility of \$3.0 million which consists of a \$1.5 million line of credit and a \$1.5 million demand Revolving Term Loan. The interest rate on the line of credit is a floating rate of 1% above the bank's prime lending rate (which prime lending rate is presently 4.50%) and the rate on the term loan is a floating rate equal to 1.5% above the bank's prime lending rate. In addition the Company has a \$4.0 million leasing line of credit with GE Canada Equipment Financing. As of January 31, 2006 bank indebtedness decreased by \$219,659 to \$937,074 or 19% less than the \$1,156,733 outstanding at the end of April 30, 2006.

As of January 31, 2006, the long term debt consisted of conditional sales contracts for operational vehicles and equipment, bank loans payable and promissory notes. The conditional sales contracts and bank loans for equipment purchases decreased by \$781,231 to \$3,066,534 or 21% lower than the \$3,847,765 outstanding as at April 30, 2006. The promissory notes, totaling \$697,901, represent the vendor take back financing associated with the McClelland and S Young Oilfield Ltd. purchases. This vendor take back financing is subordinated debt and is treated as quasi equity by the Company's lenders. The total amount of long term debt at January 31, 2006 was \$3,764,435. The amount of long term debt to be repaid over the next 3 months amounts to \$309,741, and the long term debt balance, at the end of the fiscal year, will be \$3454,694.

On September 27, 2005 the Company completed a short form offering of 1,428,571 units at a price of \$0.70 per unit, for a total proceeds of \$1 million. Each unit consists of one common share and one half share purchase warrant; each whole share purchase warrant entitles the holder to purchase on additional common share at a price of \$0.85 per share if exercised by September 27, 2007. The Company also granted agents options to purchase a total of 142,857 units at a price of \$0.70 per unit as part of the agent's compensation in connection with this offering.

Working Capital

At January 31, 2006, the Company had a positive working capital of \$996,267, compared to a deficit of \$960,317 at April 30, 2005. A substantial part of the working capital was the increase in accounts receivable by \$992,803 to \$ 3,189,803, or 46%, over the \$2,197,000 reported at April 30, 2005.

The Company believes that it has adequate capital resources available to meet its working capital and capital expenditure requirements as they arise.

Property and Equipment

At the end of Q3'06, property, plant and equipment assets decreased \$680,706 to \$4,815,223, or 13% less than the \$5,495,939 at the end of April 30, 2006. The Q3'06 goodwill was \$1,504,313 and the YTD amortization of property and equipment amounted to \$652,990.

Contractual Obligations

The Company has long term leases with respect to its premises, the details of which are outlined in notes 11 and 12 of the Q3 financial statements. The following table summarizes the Company's contractual obligations:

	Payments due by period				
	Total ⁽²⁾	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Contractual obligations⁽¹⁾					
	\$	\$	\$	\$	\$
Conditional Sales Contracts ⁽³⁾	3,066,534	643,972	1,287,944	643,972	613,307
Vendor Financing	697,901	139,580	286,139	139,580	139,580
Operating leases	2,574,512	514,902	1,055,549	489,157	463,412
Purchase obligations ⁽⁴⁾	463,832	97,405	190,171	92,766	83,490
Leases, Buildings, etc.	776,132	195,228	528,199	52,705	-
Total contractual obligations	7,578,911	1,591,087	3,348,002	1,418,180	1,299,789

- (1) See note 7 to the financial statements for the period ended January 31, 2006 for details respecting the long term debt.
- (2) The total amounts for contractual obligations includes, where appropriate, the total principal and interest components of the payments and, as a result, will not reconcile with the current outstanding balances shown in the Company's financial statements.
- (3) Conditional sales contracts are all the equipment leases for service equipment. Vendor financing pertains to the vendor take back financing pursuant to the purchases of McClelland Oil Services Inc. and S Young Oilfield Ltd. Operating leases refer to the new equipment leases entered into in Q2. (See note 12 of financial statements). Leases, Buildings, etc. refers to long term leases with respect to premises (see note 11 of financial statements).
- (4) Purchase obligations represent commitments under lease arrangements for equipment being acquired which has not yet been delivered to the Company.

Shareholders' Equity

At the end of Q3'06, shareholders' equity increased by \$1,230,042 to \$3,342,109 or 59% over the April 30, 2006 figure of \$2,112,067. Retained earnings increased \$206,722 to \$517,117 or 67% over \$310,395 reported at April 30, 2005. The Short Form offering of \$1,000,000 which closed in September 27, 2005 contributed significantly to the increase in equity.

Summary of securities as at the end of the reporting period

- a) Unlimited Common Shares without nominal or par value
Unlimited Preferred shares without nominal or par value

Capital	Amount Authorized	Outstanding as at January 31, 2006	Outstanding as at April 30, 2005
Dalmac Common Shares	Unlimited	7,550,228	5,795,964
Preferred Shares	Unlimited	Nil	Nil
Long Term Debt	N/A	\$3,454,694	\$3,408,868

On the closing of the short form offering on September 27, 2005 the Company issued 1,429,571 units, consisting of one common share priced at \$0.70 and one half share purchase warrant. Each whole share purchase warrant entitles the holder to purchase one additional common share at a price of \$0.85 per share if exercised by September 27, 2007. Wolverton Securities Ltd. received an option to purchase 142,957 units at \$0.70 per Unit. In addition, the Company has outstanding options under its Stock Option Plan for a total of 405,782 common shares.

Related Party Transactions

During this reporting period Company leased premises from 1010417 Alberta Ltd., a company owned by John Babic, a director and principal shareholder of the Company, for a total consideration of \$13,600 (see note 13 of April 30, 2005 financial statements). As of January 31, 2006, the Company was indebted to a director of the Company for an amount of \$140,000 (see note 7 of April 30, 2006 financial statements). The interest on these loans during the period was \$6,698. The aforementioned transactions are in the normal course of operations and have been valued in the January 31, 2006 financial statements at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Critical Accounting Policies

The Company's financial statements have been prepared in accordance with Canadian generally accepted accounting Principles (GAAP) and sometimes may include estimates that reflect management's estimates and assumptions which affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements for the period reported. Estimates are based upon historical experience and various other assumptions that reflect management's best judgments. These estimates are evaluated periodically and form the basis for making judgments regarding the carrying values of assets and liabilities and the reported amount of revenue and expenses. Actual results may differ.

Recent Developments

On February 28, 2006, Dalmac completed a bought deal private placement with Research Capital Company for total proceeds of \$6,000,000 through the sale of 4,800,000 units at \$1.25 per unit. Each unit consists of one common share and one half of one common share purchase warrant of the Company. Each common share purchase warrant entitles the holder to purchase one common share at \$1.50 and is valid for 24 months from closing.

Business Risks

Dalmac's business varies directly with production, exploration and drilling activity in northwestern Alberta and is subject to the risks and variables inherent in the oilfield services industry. The demand for Dalmac's products and services is directly affected by factors such as oil and gas commodity prices, weather, changes in legislation, exchange rates, the general state of domestic and world economies, concerns regarding fuel surpluses or shortages, substitution through imports or alternative energy sources, changes to taxation or regulatory regimes and the broad sweep of international political risks such as war, civil unrest, nationalization and expropriation or confiscation, which are all beyond the control of the Company and cannot be predicted. The oil market is influenced by global supply and demand considerations and by the supply management practices of OPEC. The natural gas market is primarily influenced by North American supply and demand and by the price of competing fuels.

The Company focuses mainly on production services rather than exploratory work, so the demand for its products and services is slightly insulated from the affects of changes in commodity prices. Production and field work provides a steady baseline demand for the company's products and services. However, those competitors that are affected initially by reduced exploration activity will have idle equipment which they would hope to redeploy into production activities. This could increase competition and put pressure on margins for Dalmac's core operations.

The risks associated with external competition are minimized by concentrating on activities in areas where the company has demonstrated technical and operational advantages and by employing highly qualified professional staff. Environmental and safety standards and regulations are continually becoming more stringent in the industry and Dalmac is committed to maintaining its high standards. The Company also mitigates business risks by establishing strategic alliances with qualified partners, developing new technologies and methodologies as well as investigating new business opportunities.

Outlook

High commodity prices continue to bode well for the oil and gas industry. Exploration and production from the Western Canadian Sedimentary Basin is also continuing at record levels. This, in turn, creates a healthy environment Dalmac's products and services in the foreseeable future. The Company's ability to meet the demands for its products and services is limited by its current capacity. This invariably results in work turn downs because of lack of equipment. The aforementioned underscores excellent growth opportunities for Dalmac. The current quarter (Q3'06) is representative of the busier winter season. The Company traditionally has two strong winter quarters followed by two weaker spring and summer quarters.

Dalmac believes it has adequate working capital, cash flow from operations, and access to capital to fund ongoing business requirements. Management believes the Company has a cost structure that has sufficient variability to be able to adapt to the volatility of the industry. Dalmac has experienced management at all levels of operations who are committed to the success of the Company.

Dalmac is currently reviewing expansion opportunities, including acquisitions, which may involve the requirement for capital expenditures beyond the normal course for the Company. Dalmac may pursue any or all these opportunities that may present themselves. In doing so the Company may incur term debt, issue equity, or any combination of the foregoing.