



## MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

First Quarter Interim Period Ended July 31, 2007  
Prepared September 28, 2007

*This Management Discussion and Analysis (MD&A) dated September 28, 2007, 2007 focuses on key statistics from the consolidated financial statements for Dalmac Energy Inc. for the first three month quarter of fiscal 2008, ("Q1'08"), ended July 31, 2007 and pertains to known risks and uncertainties relating to Dalmac's operations in the oilfield services industry. This MD&A should be read in conjunction with the Corporation's corresponding financial statements for the same period and should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. MD&As and financial statements for earlier periods should also be considered relevant and are available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at [www.sedar.com](http://www.sedar.com) or on the Corporation's web site at [www.dalmacenergy.com](http://www.dalmacenergy.com).*

### *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 Corporation to be materially different from any future results implied or contemplated by such forward looking statements. Some of the risks that may cause actual results to vary are described under the "Business Risks" section. References made in this MD&A, to "Dalmac", the "Corporation", "Company", "us", "we" and "our" mean Dalmac Energy Inc. and its subsidiary Dalmac Oilfield Services Inc.*

### **Corporate Overview**

Dalmac operations have been servicing the oil and gas industry in west central Alberta for over 50 years. The Corporation operates a fleet of oilfield services units consisting of "hot oiler", "hydro vac", "vacuum", "pressure" and "tanker" trucks. Other services include sales of "methanol", "glycol", and "KCL" products which are distributed from the Corporation's tank farms in Fox Creek and Hinton.

In fiscal 2007, the Corporation announced a \$5.0 million equipment purchase. As of Q1'08 there was approximately \$500,000 of this new equipment still on back order and it is expected to be delivered in Q2'08. With the acquisition of North End Oil Industries Ltd. ("North End") completed May 1, 2007, Dalmac's fleet expanded by an additional 15 service units. As of the date of this MD&A, Dalmac's fleet of operating equipment is around 105 service units.

With the majority of the Corporation's operations being in the foothills of west central Alberta, Q1'08 was impacted by wet weather, road bans and decreased drilling activity. The foothills are characterized by muskeg, environmentally protected areas, and hilly terrain. The roads are mostly gravel with many single lane traffic areas and laced with steep slopes. They are usually in very rough shape and scarred with deep ruts. Most roads are privately owned by forestry and oil companies. Rainy weather creates very slippery and dangerous driving conditions, which often result in job cancellations and work rescheduling. Due to higher elevations the foothills usually have a longer spring break-up than the rest of the province. Dalmac has traditionally operated under these geographical and environment conditions. Historically, the Corporation's revenue was in sync with the season. This meant 2 weak quarters (Q1 and Q2) followed by 2 strong and profitable quarters (Q3 and Q4). The weather and capital expenditure programs of exploration and production companies (E&P) play a big part in determining the activity levels of the quarters. Most drilling and service related operations, with the exception of production operations, are subject to road bans.

In Q1'08, drilling services contributed to about 15% of the Corporation's revenues compared to 80% in the previous year. Production activities are mainly confined to day light hours but are more regular and year round. Drilling, in comparison, while being a 24 hours per day activity, continues to be more volatile and seasonal. Dalmac's goal is to structure an optimal balance with regards to drilling and production operations and to be the best structured and prepared Corporation to service the needs of the energy sector.

Production contracts are reviewed at various intervals and in accordance with new production coming on stream. Some contracts are tendered and others are not. Dalmac has been apprised by its customers of further production contracts to be awarded pending the receipt of the new equipment ordered in the previous fiscal year. Allocation of production hauls is being phased in according to customer scheduling, planning and activity levels.

### **Results of Operations**

The following analysis of the Corporation's results of operations refers to quarters ended July 31, 2007 ("Q1'08") and July 31, 2006 ("Q1'07") along with financial information from the financial statements filed for the year ended April 30, 2007 ("YE'07").

#### **Revenue**

Revenue for Q1'08 increased by 16% to \$2.5 million from the \$2.2 million reported in Q1'07. In spite of the decrease in drilling activity and prolonged road bans, the increase in revenue can be attributed to more production activities and the acquisition of North End Oil Industries Ltd.

#### **Net Income**

The net loss in Q1'08 was adversely affected by tax changes associated with the amalgamation of 750761 Alberta Ltd. and McClelland Oil Services Inc., on August 1, 2006. As a result of this amalgamation, the Corporation was unable to apply tax credits against income losses subsequent to the date of the amalgamation. Therefore the treatment of tax losses was different for Q1'08 as compared to Q1'07. Had the same tax policy, used in Q1'07, been in effect for Q1'08 the net loss would have been \$34,794 instead of \$197,504. This would have represented an improvement of \$51,075 over the same period last year, but as a result of the tax change, the Q1'08, net loss increased by \$111,635 to \$197,504 from the \$85,869 reported in Q1'07. The Corporation will, however, be allowed to claim the tax losses against future streams of income. Other reasons for the net loss are due to:

- Amortization increased \$67,820 or 33% to \$271,054 from the \$203,234 reported in Q1'07. This is due to the additional equipment purchased and the acquisition of North End Oil Industries Ltd.
- Interest on long term debt increased by \$79,731 or 128% to \$141,473 from the \$61,742 in Q1'07. This is due to increased debt to fund the purchase of equipment as described in the MD&A for the year ended April 30, 2007.
- Wages and Benefits increased by \$14,928 or 8% to \$189,798 from \$174,985 as reported in Q1'07, due primarily to the North End Acquisition.
- Management salaries increased \$45,989 or 57% to \$126,883 from the \$80,894 .reported in Q1'07. This increase is the result of an increase in management staff as a result of the North End acquisition.
- The Corporation recorded \$26,713 in stock based compensation as a result of the stock options issued. This is a non cash transaction is disclosed in note #3 of the Q1'08 financial statements.

## Selected financial Quarter End Information

(000's Cdn Dollars, except per share)	Q1'08 2007	Q1'07 2006
Revenues	2,536	2,195
Gross Margin	738	518
Gross Margin %	29.08%	23.58%
EBITDA (loss)*	226	115
EBIDTA/share - basic	0.02	0.01
EBIDA / share - diluted	0.02	0.01
Net income (loss)	(198)	(86)
Net income (loss) per share - basic	(0.02)	(0.01)
Net income (loss) per share - diluted	(0.02)	(0.01)
Total Assets	19,991	18,309
Total long-term financial liabilities**	5,287	4,130
Shareholder Equity	9,272	9,392
Weighted average common shares -basic	12,384	12,395
Weighted average common shares - diluted	12,384	12,395

\* EBITDA (earnings before interest, taxes, depreciation and amortization) is a financial measure that does not have any standardized meaning prescribed by Canadian GAAP and may not be comparable to similar measures presented by other companies. EBITDA is used by the Corporation to provide an indication of the results generated by the Corporation's business activities prior to how these activities are financed, assets are amortized or how the results are taxed in various jurisdictions.

\*\* Long term liabilities includes callable debt, long term debt and capital lease obligations.

EBITDA increased by \$111,669, or 97%, to \$226,927 from the \$115,258 reported in Q1'07 due to increased revenues as result of more production operations as opposed to drilling.

### Gross Margin

The gross margin in Q1'08 increased by \$219,948 or 42% to \$737,547 from \$517,600 in Q1'07. The Gross profit margin as a percentage of revenue increased to 29% from the 24% reported in Q1'07. The increase in the gross profit margin is due to the control of direct operating costs and improved utilization of human resources in production activities.

### General and Administrative ("G&A") Expenses

In Q1'08 general and administrative ("G&A") expenses (excluding amortization, interest on long term debt, interest on callable debt, stock based compensation, wages & benefits and management fees), increased by \$62,226, or 31%, to \$262,117 from the \$199,891 reported in Q1'07. This increase stemmed from higher professional fees, interest and bank charges, telephone and utilities, business taxes, and insurance costs. Wages and benefits increased \$14,813, or 8.0%, to \$189,798 from the \$174,985 reported in Q1'07. Management salaries increased by \$45,989, or 57%, to \$126,883 from the \$80,894 as reported in the same period last year. The increase in wages and management salaries are mainly due to the acquisition of North End. Stock based compensation increased by \$26,713 as a result of the stock options issued by the Corporation on June 21, 2007.

## Amortization of Property and Equipment

Amortization of property and equipment, in Q1'08, increased \$67,820, or 33%, to \$271,054 from the \$203,034 reported in Q1'07. This is consistent with the acquisition of additional operating equipment. Amortization is dependent on the timing of additions to property and equipment. There have been no disposals of equipment during Q1'08. As of May 1, 2008 the Corporation implemented a change of estimate regarding the salvage value of service vehicles and equipment. This change increased the salvage values and will reflect a more realistic net book value at the end of the equipment's amortized life. No changes have been made to the equipment's estimated useful life.

## Interest Expense

In Q1'08 the interest on long term debt increased by \$79,731, or 128%, to \$141,473 from the \$61,742 reported in Q1'07. This was a direct result of the new equipment purchases described in earlier in this MD&A. The long term debt arises from debt incurred for equipment purchases and vendor take back financing which is associated with the acquisition of McClelland Oil Services Inc., S Young Oilfield Ltd. and North End Oil Industries Ltd. Interest on callable debt has decreased by \$3,277 to \$2,289 from the \$5,566 reported in Q1'07. Callable debt consists of bank financing classified as demand loans and is thereby categorized as such.

## Income Taxes

The Corporation was not in a taxable position in Q1'08 on a consolidated basis. The current income tax receivable is the refund of tax installments paid during the year.

## Summary of Quarterly Results

(000's Cdn Dollars, except per share)	Q1'08	Q4' 07	Q3' 07	Q2' 07
	Quarter Ended	Quarter Ended	Quarter Ended	Quarter Ended
	31-Aug-07	30-Apr-07	31-Jan-07	31-Oct-06
Revenue	2,536	5,025	3,186	2,226
Net income (loss)	(198)	(151)	402	(255)
Net income per share - basic	(0.02)	(0.01)	0.03	(0.02)
Net income per share - diluted	(0.02)	(0.01)	0.03	(0.02)

(000's Cdn Dollars, except per share)	Q1' 07	Q4' 06	Q3' 06	Q2' 06
	Quarter Ended	Quarter Ended	Quarter Ended	Quarter Ended
	31-Jul-06	30-Apr-06	31-Jan-06	30-Oct-05
Revenue	2,195	4,018	4,533	3,472
Net income (loss)	(86)	535	411	30
Net income per share - basic	(0.01)	0.08	0.06	0.01
Net income per share - diluted	(0.01)	0.07	0.05	0.01

## 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.

Dalmac has current banking facility of \$6.0 million. This extended facility consists of a \$3 million line of credit and a \$3.0 million demand Revolving Term Loan. The interest rate on the line of credit is a floating rate of 1% above the bank's current prime lending rate (presently at 6.25%) and the rate on the term loan is a floating rate equal to 1.25% above the bank's prime lending rate. Bank indebtedness, at July 31, 2007, increased by \$164,605, or 14%, to \$1.4 million from the \$1.2 million reported at YE'07. This is commensurate with the increased activity as a result of the North End purchase. The Corporation's cash and cash equivalents decreased by almost \$2.0 million to \$3.5 million from the \$5.5 million reported at YE'07 largely as a result of the North End acquisition and the land and building purchase in Fox Creek described below (see "Recent Events").

In Q1'08, long term debt increased by \$1.2 million, or 28%, to \$5.3 million from the \$4.1 million reported at YE'07. The current portion of long term debt increased by \$75,629, or 4% from the \$1.9 million reported at YE'07. This is mainly due to the financing of the new equipment referenced earlier in this MD&A.

### **Working Capital**

The working capital of the Corporation decreased in Q1'08 by \$2.2 million to \$2.0 million from the \$4.2 million reported as of YE'07. This decrease is also due to the acquisition of North End Oil Industries Ltd. and real estate purchased in Fox Creek. The working capital has been calculated exclusive of the callable debt portion. Dalmac believes it has sufficient working capital, cash flow from operations, and access to capital to fund its ongoing business requirements.

### **Shareholders' Equity**

Shareholders' equity decreased by \$129,430, or 1.3% to \$9.3 million from the \$9.4 million reported at YE'07. This decrease is mainly the result of Corporations net loss in Q1'08. Retained earnings decreased by the amount of the net loss of \$197,504 to \$682,151 from \$879,655 at YE'07.

### **Outstanding Share Data**

Capital	Authorized	July 31, 2007	April 30, 2007
Dalmac Common Shares	Unlimited	12,383,925	12,427,833
Preferred Shares	Unlimited	Nil	Nil

The following are the issued and outstanding shares options and warrants as of the date of this MD&A:

Common Shares	Options	Warrants
12,383,925	1,560,752	2,373,000

On May 1, 2007 the Corporation issued 92,592 common shares as part of the North End Oil Industries Ltd. acquisition. Also in May of 2007 the Corporation cancelled 136,500 common shares which had been purchased under our normal course issuer bid. On June 21, 2007 the

Corporation issued 700,000 stock options to directors (see note 3 to the Q1'08 financial statements).

### **Related Party Transactions**

During Q1'08 the Corporation leased premises from a company controlled by a director of the Corporation for a total consideration of \$20,400, which remains unchanged from Q1'07. At Q1'08, the Dalmac was indebted to a former director of the Corporation for the amount of \$129,954, compared to \$222,809 at Q1'07. Also as at Q1'08, Dalmac was indebted to a director of the Corporation for the amount of \$140,000. There was no interest due on this loan as of Q1'08.

The aforementioned transactions are in the normal course of operations and have been valued in the Q1'08 financial statements at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

### **Critical Accounting Policies**

The Corporation's financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP) and 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 Events**

Dalmac announced on November 27, 2006 that it would conduct a normal course issuer bid to purchase up to 621,391 of its common shares, which represents approximately 5% of its 12,427,833 common shares outstanding as of the announcement date. Purchases under this normal course issuer bid are carried out through open market transactions through the facilities of the TSX Venture Exchange over a period of 12 months ending November 30, 2007. Any shares purchased by the Corporation under this issuer bid will be cancelled. As of September 27, 2007, the Corporation had repurchased and cancelled 136,500 of its common shares.

On July 5, 2007, Dalmac announced the signing of an LOI to purchase another oilfield services company. This target company is situated in west central Alberta and is currently outside the Corporation's operating area. This acquisition's revenue for their fiscal year ended December 31, 2006 was reported at approximately \$4.4 million with an EBITDA (earnings before income tax, depreciation and amortization) of approximately \$1.0 million. The purchase price is to be \$3.5 million, payable by \$2.7 million in cash, \$600,000 in vendor take back financing and \$200,000 in shares. This acquisition is expected to close about September 30, 2007.

In July of 2007 the Corporation completed the purchase of land and buildings in Fox Creek that had previously been leased by the Corporation. The property was purchased for \$625,000, which was funded in part by long term debt.

### **Subsequent Events**

The Corporation has leased new office space in Edmonton as of June 2007 and is gradually moving administrative functions into the City of Edmonton from Fox Creek. This relocation of

administrative functions will aid in more streamlined accounting and information flows, along with providing administrative cost savings on subsequent expansions.

Further to the signing of the letter of intent to purchase the oilfield services company, which is scheduled to close September 30, 2007, the Corporation has agreed to take possession of a new acid pumping unit which was ordered by the vendor. The cost of this new service unit will be about \$600,000 and it is scheduled to arrive before the end of Q3'08.

### **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 Corporation 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.

As a result of lower exploration and drilling activity, the Corporation has refocused its efforts towards production services. By focusing on the production sector of the industry the Corporation's revenues will be more insulated from the effects of changes in commodity prices. Production and field work provides a steady baseline demand for the Corporation's products and services. However, those competitors that are affected initially by reduced exploration activity will have idle equipment which they may attempt to redeploy into production activities. This could increase competition and put pressure on margins for Dalmac's core operations. The Corporation still has capacity to take advantage of increases in exploration and drilling activities when market conditions are right.

The risks associated with external competition are minimized by concentrating on activities in areas where the Corporation 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 Corporation also mitigates business risks by establishing strategic alliances with qualified partners and developing new technologies and methodologies, as well as investigating new business opportunities.

Management believes the Corporation 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.

### **Outlook**

The activity levels for oil and gas service industry remains uncertain for the short term. Much will depend on price movements of natural gas and drilling activity levels. Increases in North American off shore drilling activity has displaced the natural gas drilling activity in the Western Canadian Sedimentary Basin (WCSB) and has contributed to higher inventory storage levels. Lower utilization levels are expected for much of the industry due to record levels of well servicing equipment along with continued competitive pricing. The demand for oilfield services is further impacted by the strengthening of the Canadian dollar compared to its US counterpart. This serves to create an additional level of uncertainty for Canadian producers which may persist

until natural gas inventories adjust towards more normal levels and near term natural gas prices strengthen.

While the above conditions are expected to continue over the near future, Dalmac anticipates that the decreased drilling activity will eventually help balance out the North American gas storage levels, which will then in turn stimulate the demand for drilling services in the WCSB. Additionally, during periods of reduced drilling activity, producers are also more likely to focus on stimulating and working over existing wells in order to maximize production and cash flows.

Dalmac is committed to balancing its exposure between drilling and production activities. This strategy is further encouraged by the fact that the number of wells drilled in the WCSB is still quite high by historical standards. The Canadian Association of Oilwell Drilling Contractors (“CAODC”) forecasts 16,339 well to be completed in 2007. It is only over the past few years that that we have seen record well completions surpassing these levels.

Dalmac’s continuing strategy is to reduce its exposure to the volatility of the drilling sector by diversifying into more production activities. Production operations apply to everything involved in bringing the oil and gas products to market, including production hauls, plant turnarounds, and maintenance.

The Corporation earns its revenue by providing specialized services required for the exploration, development and production of petroleum resources. These petroleum resources are escalating in value and are plentiful in the areas in which the Corporation operates. The demand for the Corporation’s services is linked to the economic conditions of the energy industry and general levels of drilling and production activities in Western Canada. While the general drilling activity levels are lower than in the previous year, the Corporation continues to maintain good relationships with its customer base and has balanced its exposure to drilling versus production work. The latter is less affected by reduced capital spending and drilling activity. Dalmac is encouraged by the indications of demand for its services.

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

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

Management and the Board are committed to the promotion of investor confidence by ensuring that trading in the Corporation’s securities takes place in an efficient, competitive and informed market. In accordance with the continuous disclosure requirements under the securities commission rules and TSX Venture Exchange policies, the Corporation has adopted a Corporate Disclosure Policy and has procedures in place to ensure that any sensitive information is identified, reviewed by management and disclosed in a timely manner to the regulatory authorities, shareholders and the public.

Management has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the Canadian Generally Accepted Accounting Principles. No material changes to the Corporation’s internal control over financial reporting occurred during the period ended Q1’08.