



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

Second Quarter Interim Period  
For the Three and Six Months Ended October 31, 2007  
Prepared December 20, 2007

*This Management Discussion and Analysis (MD&A) focuses on key statistics from the consolidated financial statements for Dalmac Energy Inc. for the three and six month periods ("Q2'08" and "YTD'08") ended October 31, 2007, of fiscal 2008, 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 subsidiaries Dalmac Oilfield Services Inc. and 1353245 Alberta Ltd.*

### **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", "chemical", "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, Hinton Warburg and Pigeon Lake.

Dalmac has completed its \$5.0 million equipment purchase announced in fiscal 2007, with the final 2 pressure truck units scheduled for delivery in December of 2007. The Corporation has also completed two acquisitions as of YTD'08. On May 1, 2007 Dalmac purchased the assets and business of North End Oil Industries Ltd. ("North End") for \$1.9 million and on October 1, 2007 Dalmac purchased the assets and business of KD Trucking (1989) Ltd. ("KD") for \$3.6 million. North End's fleet consists of 15 service units and KD has about 31 service units. Dalmac's current fleet stands at about 135 service units.

With the acquisition of North End and KD, the Corporation's operations have extended from the foothills of west central Alberta to the flat lands of Warburg and Pigeon Lake in the central part of the province. This marks a departure from operating almost exclusively in a region mainly characterized by muskeg, environmentally protected areas, and hilly terrain where the majority of drilling and service activity takes place mainly during winter season. The flat lands of Warburg and Pigeon Lake are conducive to year round operations and are associated mainly with production operations. The acquisitions of North End and KD, along with the acquisition of the new equipment mentioned above will provide the Corporation greater flexibility to take advantage of the production and well servicing opportunities in the energy sector.

In Q2'08, production services continued to dominate the revenue stream. Approximately 80% of the revenues were derived from production services with the balance coming from drilling. Dalmac expects that drilling, which is currently in a slump in Western Canada will eventually rebound. When it does, Dalmac will be well positioned to "ride the wave". Dalmac is optimizing its asset base to be ready and able to best service the complete drilling and production needs of the energy sector.

### **Results of Operations**

The following analysis of the Corporation's results of operations refers to the three and six month periods ended October 31, 2007 and October 31, 2006 ("Q2'07" and "YTD'07") along with financial information from the financial statements filed for the year ended April 30, 2007 ("YE'07").

### **Revenue**

Revenue for Q2'08 increased by \$1.0 million or 45% to \$3.2 million from the \$2.2 million reported in Q2'07. The year to date revenue increased \$1.3 million or 31% to \$5.7 million from the \$4.4 million reported in YTD'07. In spite of the decrease in drilling activity the increase in revenue can be attributed to an increase in production operations associated with the new equipment purchased along with the acquisition of business and assets of North End Oil Industries Ltd. and KD Trucking (1989) Ltd.

### **Net Income**

Net income for Q2'08 increased by \$505,428 or 196% to \$247,920 from a loss of \$257,508 reported in Q2'07. The year to date income also increased by \$414,661 or 114% to \$50,417 from a loss of \$364,244 as reported at YTD'07. In Q2'08 the Corporation had a recovery of expenses of \$243,593 derived from a review of GST input credits not claimed in previous periods. This review is ongoing and further adjustments may be made.

The Q2'08 income from operations increased by \$351,773 or 112% to \$36,892 from a loss of \$314,881 as reported in Q2'07. The income from operation for the year to date increased by \$324,300 or 61% to a loss of \$207,935 compared to a loss of \$532,235 reported for YTD'07. The EBITDA (earnings before interest, taxes and depreciation) for Q2'08 increased by \$0.7 million or 7025% to \$0.8 million from a loss of \$10,079 reported at Q2'07.

The year to date EBITDA increased \$0.7 million to \$1.0 million from the \$0.1 million reported at YTD'07. Most of these increases occurred in Q2'08 and were commensurate with increased production activity generated by the new equipment purchases and the acquisition of North End. As the KD purchase concluded on October 1, 2007, only one month of its revenue is included in Q2'08.

In Q2'08, the Corporation recorded a \$53,425 stock based compensation expense associated with stock options which were issued in Q1'08. The year to date stock based compensation expense as of YTD'08 was \$80,138. The stock based compensation is a non cash expense that is recorded in accordance with GAAP each time stock options are issued. The stock option expense has been calculated in accordance with the Black Scholes option pricing model.

**Selected financial Quarter End Information**

(000's Cdn Dollars, except per share)	Q2'08	Q2'07
Revenues	3,234	2,226
Gross Margin	1,117	510
Gross Margin %	34.54%	22.92%
EBITDA* (loss)	759	(10)
EBIDTA* per share - basic	0.061	(0.001)
EBIDA* per share - diluted	0.04	(0.001)
Net income (loss)	248	(255)
Net income per share - basic	0.02	(0.02)
Net income per share - diluted	0.02	(0.02)
Total Assets	23,033	18,309
Total long-term liabilities**	6,958	4,130
Shareholder Equity	9,904	9,392
Weighted average common shares -basic	12,581	12,395
Weighted average common shares - diluted	16,301	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 but excludes the current portion of such liabilities..

**Gross Margin**

The gross margin in Q2'08 increased by \$0.6 million or 119% to \$1.1 million from the \$0.5 million reported in Q2'07. Gross margin as a percentage, for Q2'08 increased by 12% to 35% from the 23% reported in Q2'07. The year to date, gross margin, increased by \$0.8 million or 75% to \$1.9 million from the \$1.1 million reported at YTD'07. The increase in the gross profit margin resulted from improved controls over direct operating costs and by optimizing utilization of company assets. This is borne out by the fact that in Q2'08 revenue increased by 45% over the previous year while gross margin increased by 119%. The year to date revenue increased by 17% and gross margin increased by 75%.

**General and Administrative (“G&A”) Expenses**

In Q2'08 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), decreased by \$26,425, or 9%, to \$261,572 from the \$287,997 reported in Q2'07. This decrease is associated with improved administrative procedures and the implementation of a new computerized accounting program. Wages and benefits increased by \$96,333, or 35%, to \$370,566 from the \$274,233 reported in Q2'07 due to increased administration requirements stemming from the growth of the Corporation. Administrative costs excluding stock based compensation totaled \$317,141. Stock based compensation was \$53,425.

The year to date wages and benefits increased by \$151,054, or 27%, to \$0.7 million from the \$0.6 million reported at YTD'07. The YTD'08 wages and benefits include \$80,138 of stock based compensation.

### Amortization of Property and Equipment

Amortization of property and equipment, in Q2'08, increased \$101,671, or 50%, to \$0.3 million from the \$0.2 million reported in Q2'07. The year to date amortization increased \$0.2 million or 38% to \$0.6 million from the \$0.4 million reported at the same period last year. This is consistent with the acquisition of additional operating equipment. Amortization is dependent on the timing of additions to property and equipment. There were no disposals of equipment during Q2'08. 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 Q2'08 the interest on long term debt (including callable debt) increased by \$83,685, or 139%, to \$143,979 from the \$60,294 reported in Q2'07. The long term interest for the year to date increased by \$0.2 million or 117% to \$0.3 million from the reported \$0.1 million at the same period last year. This increase 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., North End Oil Industries Ltd. and KD Trucking (1989) Ltd. Callable debt consists of bank financing classified as demand loans and is thereby categorized as such.

### Income Taxes

At YTD'08 the Corporation's future tax payable increased to \$53,861 or 12% to \$0.5 million from the \$0.4 reported at YE'07. The Corporation had no current taxes owing at YTD'08 on a consolidated basis.

### Summary of Quarterly Results

	Q2'08 Quarter Ended 31-Oct-07	Q1'08 Quarter Ended 31-Aug-07	Q4' 07 Quarter Ended 30-Apr-07	Q3' 07 Quarter Ended 31-Jan-07
(000's Cdn Dollars, except per share)				
Revenue	3,234	2,537	5,025	3,186
Net income (loss)	248	(198)	(151)	402
Net income per share - basic	0.02	(0.02)	(0.01)	0.03
Net income per share - diluted	0.02	(0.01)	(0.01)	0.03

	Q2' 07 Quarter Ended 31-Oct-06	Q1' 07 Quarter Ended 31-Jul-06	Q4' 06 Quarter Ended 30-Apr-06	Q3' 06 Quarter Ended 31-Jan-06
(000's Cdn Dollars, except per share)				
Revenue	2,226	2,195	4,018	4,533
Net income (loss)	(255)	(86)	535	411
Net income per share - basic	(0.02)	(0.01)	0.08	0.06
Net income per share - diluted	(0.02)	(0.01)	0.07	0.05

### **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 a 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 6.0%) 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 YTD'08, increased by \$0.3 million, or 29%, to \$1.5 million from the \$1.2 million reported at YE'07. This is commensurate with the increased activity as a result of the acquisitions made. The Corporation's cash and cash equivalents decreased by almost \$3.7 million or 69% to \$1.9 million from the \$5.5 million reported at YE'07. This is directly related to the purchase of the assets and business of North End and KD along with the land and building purchase in Fox Creek. (see "Recent Events").

At YTD'08, long term debt increased by \$0.8 million, or 20%, to \$4.5 million from the \$3.8 million reported at YE'07. The current portion of long term debt increased by \$155,510, or 8% to 2.0 million from the \$1.9 million reported at YE'07. Callable debt increased by \$2.0 million to \$2.2 million from the \$94,656 reported at YE'07. This is mainly due to the financing of the new equipment and acquisitions referenced earlier in this MD&A.

### **Working Capital**

The working capital of the Corporation decreased at YTD'08 by \$2.0 million to \$2.2million from the \$4.2 million reported as of YE'07. This decrease is also due to the acquisitions mentioned previously in this MD&A. The callable debt is bank financed debt and been excluded from the calculation of working capital as it is considered long term for the purposes of this report. 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 at YTD'08 increased by \$0.5, or 5% to \$10.0 million from the \$9.4 million reported at YE'07. This increase is mainly the result of Corporations earnings in Q2'08. Retained earnings increased by \$50,416 to \$930,071 from \$879,655 reported at YE'07.

### **Outstanding Share Data**

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

Common Shares	Options	Warrants
12,976,124	1,687,629	2,400,000

On May 1, 2007 the Corporation issued 92,592 common shares as part of the North End Oil Industries Ltd. acquisition and a further 592,199 common shares were issued for the acquisition of KD Trucking (1989) Ltd.

### **Related Party Transactions**

As of YTD'08 the Corporation leased premises from a company controlled by a director of the Corporation for a total consideration of \$40,800, which remains unchanged from YTD'07. Also

at YTD'08, Dalmac was indebted to a director of the Corporation for the amount of \$140,000. There was no interest due on this loan for this reporting period.

The aforementioned transactions are in the normal course of operations and have been valued in the Q2'08 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 were 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 were cancelled. As of November 30, 2007, the Corporation had repurchased and cancelled 136,500 of its common shares.

On October 1, 2007 the Corporation completed the purchase of the business and assets of KD Trucking for \$3.6 million, payable by \$2.7 million in cash, \$500,000 in vendor take back financing and \$300,000 in shares. The number of common shares issued for this transaction was 592,199. The purchase of the business and assets of KD Trucking (1989) Ltd. necessitated the formation of a new subsidiary company called 1353245 Alberta Ltd, which is 100% controlled by the Corporation. The Corporation has no plans for caring on any further activity in 1353245 Alberta Ltd. and expects that it will be dissolved in due course.

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, of which \$437,500 was financed in part by long term debt. This debt is financed by the Corporation's bank and in accordance with the lending documentation it is classified as callable debt.

### **Subsequent Events**

In November 2007, the Corporation took possession of a new acid pumping unit which was purchased for \$0.6 million. The Corporation also has commissioned the rebuilding of two hydro vac units which is expected to cost an additional \$0.6 million. These two hydro vac units should be completed in 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 placed more of its focus on production services. Production services activities are more insulated from the fluctuations of commodity pricing. Production and oilfield services provide a steady baseline revenue stream as compared to the more cyclical volatility of the drilling sector. Because of reduced exploration and drilling activity, there may be competitors who have excess idle equipment which could be redeployed into production activities. This could increase competition and put pressure on margins for Dalmac's core operations. The Corporation is constantly monitoring the activity in the energy sector and believes that it has strengthened flexibility and resources to adjust its oilfield service operations to match any anticipated changes in production, exploration and drilling levels.

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 drilling & service industry continues to remain uncertain for the short term. Drilling activity levels are very much dependent on price movements of natural gas. Currently we are witnessing increased North American off shore drilling activity which has displaced the extraction of natural gas from the Western Canadian Sedimentary Basin (WCSB) has and this in turn contributed to higher inventory storage levels. Lower utilization levels continue to plague much of the industry which is laboring under record levels of well servicing equipment along with continued competitive pricing. The strengthening of the Canadian dollar has further hampered the demand for oilfield services by displacing the cost advantage previously enjoyed in comparison to the US dollar. All blended together, this creates additional uncertainty for Canadian producers which may persist until natural gas inventory levels normalize and the price strengthens.

While the above conditions are expected to continue over the near future, Dalmac anticipates that the decreased drilling activity will eventually help decrease 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 efforts on stimulating and working over existing wells in order to maximize production and cash flows, which in turn will serve to stimulate increased activity levels for the Corporation.

Dalmac is committed to expanding its baseline revenue stream by focusing on the production sector and maintaining constant vigil towards optimizing its exposure between drilling and production activities. Production operations apply to everything involved in bringing the oil and gas products to market, including production hauls, plant turnarounds, and maintenance.

Even though the numbers for wells drilled has decreased from the record highs witnessed in 2006, the Canadian Association of Oilwell Drilling Contractors (“CAODC”) is still forecasting about 14,000 to be drilled in the WCSB in the 2008 calendar year. Much of the drilling is scheduled to take place in west central Alberta which is the target area for Dalmac’s operations.

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 Q2’08.

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