

**DALMAC ENERGY INC.**  
**Consolidated Financial Statements**  
**Three Month Period Ended July 31, 2006**  
*(Unaudited)*

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## MANAGEMENT REPORT

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To the Shareholders of **Dalmac Energy Inc.**

The accompanying unaudited consolidated balance sheet of **Dalmac Energy Inc.** as at July 31, 2006 and the consolidated statements of loss, retained earnings and cash flows for the three month period then ended, have been prepared by management and approved by the Board of Directors of the Company.

These consolidated financial statements have not been reviewed by the Company's external auditors.

Edmonton, Canada  
July 20, 2006

*Signed "John I. Babic"*  
PRESIDENT AND CHIEF EXECUTIVE OFFICER

**DALMAC ENERGY INC.**  
**Consolidated Balance Sheet**  
**July 31, 2006**  
*(Unaudited)*

|                                                    | <i>July 31</i><br><b>2006</b> | <i>April 30</i><br>2006 |
|----------------------------------------------------|-------------------------------|-------------------------|
| <b>ASSETS</b>                                      |                               |                         |
| <b>CURRENT ASSETS</b>                              |                               |                         |
| Cash and cash equivalents                          | \$ 5,573,054                  | \$ 5,670,965            |
| Accounts receivable                                | 1,936,431                     | 3,180,717               |
| Inventory                                          | 76,936                        | 73,359                  |
| Income taxes receivable                            | 38,067                        | -                       |
| Prepaid expenses and deposits                      | 538,233                       | 514,824                 |
| Current portion of loan receivable <i>(Note 3)</i> | 32,034                        | 32,034                  |
|                                                    | <b>8,194,755</b>              | 9,471,899               |
| LOAN RECEIVABLE <i>(Note 3)</i>                    | 102,974                       | 102,974                 |
| PROPERTY AND EQUIPMENT <i>(Note 5)</i>             | 5,284,057                     | 5,180,299               |
| GOODWILL <i>(Note 1)</i>                           | 1,504,313                     | 1,504,313               |
|                                                    | <b>\$ 15,086,099</b>          | \$ 16,259,485           |
| <b>LIABILITIES</b>                                 |                               |                         |
| <b>CURRENT LIABILITIES</b>                         |                               |                         |
| Bank indebtedness <i>(Note 6)</i>                  | \$ 387,000                    | \$ 597,000              |
| Accounts payable and accrued liabilities           | 1,118,210                     | 1,784,858               |
| Income taxes payable                               | -                             | 52,776                  |
| Callable debt due within the year <i>(Note 7)</i>  | 79,659                        | 106,212                 |
| Current portion of long term debt <i>(Note 8)</i>  | 949,096                       | 1,224,957               |
|                                                    | <b>2,533,965</b>              | 3,765,803               |
| Callable debt <i>(Note 7)</i>                      | 200,868                       | 200,868                 |
|                                                    | <b>2,734,833</b>              | 3,966,671               |
| LONG TERM DEBT <i>(Note 8)</i>                     | 2,552,910                     | 2,440,655               |
| FUTURE INCOME TAXES <i>(Note 9)</i>                | 333,060                       | 311,632                 |
|                                                    | <b>5,620,803</b>              | 6,718,958               |
| <b>SHAREHOLDERS' EQUITY</b>                        |                               |                         |
| SHARE CAPITAL <i>(Note 10)</i>                     | 8,266,331                     | 8,255,693               |
| CONTRIBUTED SURPLUS <i>(Note 11)</i>               | 292,568                       | 292,568                 |
| RETAINED EARNINGS                                  | 906,397                       | 992,266                 |
|                                                    | <b>9,465,296</b>              | 9,540,527               |
|                                                    | <b>\$ 15,086,099</b>          | \$ 16,259,485           |

**APPROVED ON BEHALF OF THE BOARD**

Signed "John I. Babic" Director

Signed "Shawn T. Szydlowski" Director

See accompanying notes

**DALMAC ENERGY INC.**  
**Consolidated Statement of Loss**  
**Three Month Period Ended July 31, 2006**  
*(Unaudited)*

|                                        | <i>July 31</i><br><b>2006</b><br><i>(3 months)</i> | <i>July 31</i><br><b>2005</b><br><i>(3 months)</i> |
|----------------------------------------|----------------------------------------------------|----------------------------------------------------|
| Revenue                                | \$ 2,194,776                                       | \$ 2,807,275                                       |
| Direct costs                           | <u>1,634,396</u>                                   | <u>2,214,316</u>                                   |
| Gross profit                           | <u>560,380</u>                                     | <u>592,959</u>                                     |
| Expenses                               |                                                    |                                                    |
| General and administrative expenses    | 280,011                                            | 363,051                                            |
| Wages and benefits                     | 218,540                                            | 298,652                                            |
| Amortization                           | 203,234                                            | 218,119                                            |
| Interest on long term debt             | <u>67,307</u>                                      | <u>71,294</u>                                      |
|                                        | <u>769,092</u>                                     | <u>951,116</u>                                     |
| LOSS FROM OPERATIONS                   | (208,712)                                          | (358,157)                                          |
| Other income (expenses)                |                                                    |                                                    |
| Interest income                        | <u>53,428</u>                                      | <u>-</u>                                           |
| Loss before income taxes               | <u>(155,284)</u>                                   | <u>(358,157)</u>                                   |
| Income taxes recovered (provision for) |                                                    |                                                    |
| Current                                | 90,843                                             | 120,340                                            |
| Future                                 | <u>(21,428)</u>                                    | <u>-</u>                                           |
|                                        | <u>69,415</u>                                      | <u>120,340</u>                                     |
| <b>NET LOSS FOR THE PERIOD</b>         | <b><u>\$ (85,869)</u></b>                          | <b><u>\$ (237,817)</u></b>                         |
| Net income per share                   |                                                    |                                                    |
| Basic                                  | \$ (0.01)                                          | \$ (0.04)                                          |
| Diluted                                | \$ (0.01)                                          | \$ (0.04)                                          |
| Weighted average number of shares      |                                                    |                                                    |
| Basic                                  | 12,395,263                                         | 5,870,977                                          |
| Diluted                                | 13,299,452                                         | 6,276,759                                          |

See accompanying notes

**DALMAC ENERGY INC.**  
**Consolidated Statement of Retained Earnings**  
**Three Month Period Ended July 31, 2006**  
*(Unaudited)*

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|                                                 | <i>July 31</i><br><b>2006</b><br><i>(3 months)</i> | <i>April 30</i><br><b>2006</b><br><i>(3 months)</i> |
|-------------------------------------------------|----------------------------------------------------|-----------------------------------------------------|
| <b>RETAINED EARNINGS AT BEGINNING OF PERIOD</b> |                                                    |                                                     |
| As previously reported                          | <u>\$ 992,266</u>                                  | <u>\$ 250,206</u>                                   |
| Net loss for the period                         | <u>(85,869)</u>                                    | <u>(237,817)</u>                                    |
| <b>RETAINED EARNINGS AT END OF PERIOD</b>       | <u>\$ 906,397</u>                                  | <u>\$ 12,389</u>                                    |

See accompanying notes

**DALMAC ENERGY INC.**  
**Consolidated Statement of Cash Flows**  
**Three Month Period Ended July 31, 2006**  
*(Unaudited)*

|                                                   | <i>July 31</i><br><b>2006</b><br><i>(3 months)</i> | <i>July 31</i><br><b>2005</b><br><i>(3 months)</i> |
|---------------------------------------------------|----------------------------------------------------|----------------------------------------------------|
| <b>OPERATING ACTIVITIES</b>                       |                                                    |                                                    |
| Net loss for the period                           | \$ (85,869)                                        | \$ (237,817)                                       |
| Items not affecting cash and cash equivalents:    |                                                    |                                                    |
| Amortization                                      | 203,234                                            | 218,119                                            |
| Future income taxes                               | 21,428                                             | -                                                  |
|                                                   | <b>138,793</b>                                     | <b>(19,698)</b>                                    |
| Changes in non-cash working capital:              |                                                    |                                                    |
| Accounts receivable                               | 1,244,286                                          | 113,740                                            |
| Inventory                                         | (3,577)                                            | 170,499                                            |
| Prepaid expenses and deposits                     | (23,409)                                           | 3,994                                              |
| Accounts payable and accrued liabilities          | (666,645)                                          | 395,393                                            |
| Income taxes payable                              | (90,843)                                           | (150,825)                                          |
|                                                   | <b>459,812</b>                                     | <b>532,801</b>                                     |
|                                                   | <b>598,605</b>                                     | <b>513,103</b>                                     |
| <b>INVESTING ACTIVITY</b>                         |                                                    |                                                    |
| Purchase of property and equipment                | (306,995)                                          | (66,970)                                           |
|                                                   | <b>(306,995)</b>                                   | <b>(66,970)</b>                                    |
| <b>FINANCING ACTIVITIES</b>                       |                                                    |                                                    |
| Proceeds from issuance of share capital           | 40,138                                             | 53,086                                             |
| Share issuance costs                              | (29,500)                                           | -                                                  |
| Proceeds from callable debt                       | -                                                  | 54,109                                             |
| Proceeds from long term debt                      | 152,738                                            | -                                                  |
| Repayment of callable debt                        | (26,553)                                           | (23,847)                                           |
| Repayment of long term debt                       | (316,344)                                          | (314,425)                                          |
| Prior year difference                             | -                                                  | (60,189)                                           |
|                                                   | <b>(179,521)</b>                                   | <b>(291,266)</b>                                   |
| Increase (decrease) in cash and cash equivalents  | <b>112,089</b>                                     | <b>154,867</b>                                     |
| Cash and cash equivalents at beginning of period  | <b>5,073,965</b>                                   | <b>(1,156,733)</b>                                 |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b> | <b>\$ 5,186,054</b>                                | <b>\$ (1,001,866)</b>                              |
| <b>CASH (DEFICIENCY) CONSISTS OF:</b>             |                                                    |                                                    |
| Cash and cash equivalents                         | \$ 5,573,054                                       | \$ -                                               |
| Bank indebtedness                                 | (387,000)                                          | (1,001,866)                                        |
|                                                   | <b>\$ 5,186,054</b>                                | <b>\$ (1,001,866)</b>                              |

See accompanying notes

## 1. DESCRIPTION OF OPERATIONS

Dalmac Energy Inc. (the "Company") was incorporated under the Canada Business Corporations Act and is listed on the TSX Venture Exchange. The company is a provider of hot oiler, hydro vac, vacuum, pressure and tanker truck services to the oil and gas industry in Alberta.

Effective November 8, 2004 the Company acquired for cash and common shares, all of the outstanding shares of McClelland Oil Services Inc. (McClelland). McClelland operates a fleet of service vehicles and equipment used in the oil and gas industry in Alberta.

## McClelland acquisition

The purchase price was \$2,280,000, comprised of \$911,000 cash, \$509,000 of promissory notes, and 2,150,000 common shares valued at \$0.40 per share totaling \$860,000. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition.

|                           |                     |
|---------------------------|---------------------|
| Current assets            | \$ 2,164,204        |
| Property and equipment    | 3,900,931           |
| Goodwill                  | <u>1,222,713</u>    |
| Total assets acquired     | <u>7,287,848</u>    |
| Current liabilities       | 3,047,722           |
| Long-term debt            | 1,741,728           |
| Other liabilities         | <u>218,398</u>      |
| Total liabilities assumed | <u>5,007,848</u>    |
| Net assets acquired       | <u>\$ 2,280,000</u> |

Effective March 14, 2005, the Company acquired for cash and common shares the assets and business of S Young Oilfield Ltd. (S Young). S Young is engaged in hydro vac operations servicing the oil and gas industry in Alberta.

## S Young acquisition

The purchase price was \$850,000, comprised of \$340,000 cash, \$386,000 of promissory notes, and 210,169 common shares valued at \$0.59 per share totaling \$124,000. The following table summarizes the estimated fair value of the assets acquired at the date of acquisition.

|                        |                   |
|------------------------|-------------------|
| Property and equipment | \$ 568,400        |
| Goodwill               | <u>281,600</u>    |
| Total assets acquired  | <u>\$ 850,000</u> |

The results of operations from these acquisitions are included in the accounts from the effective date of acquisition.

**DALMAC ENERGY INC.**  
**Notes to Consolidated Financial Statements**  
**Three Month Period Ended July 31, 2006**  
*(Unaudited)*

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries 750761 Alberta Ltd. and McClelland Oil Services Inc.

(b) Cash and cash equivalents

The Company considers cash and short term investments as cash and cash equivalents.

(c) Inventory

Inventory is valued at the lower of cost and net realizable value with the cost being determined on a first-in, first-out basis.

(d) Property and equipment

Property and equipment are recorded at cost and amortized using the straight-line method over their estimated useful lives as follows:

|                                |               |
|--------------------------------|---------------|
| Rental equipment               | 12 years      |
| Service equipment              | 12 years      |
| Plant equipment                | 10 years      |
| Service vehicles               | 8 years       |
| Trucks                         | 8 years       |
| Office equipment and furniture | 4 years       |
| Leasehold improvements         | Term of lease |

(e) Impairment of long-lived assets

In the event that facts and circumstances indicate that the carrying value of long-lived assets may be impaired, the Company performs a recoverability evaluation. If the evaluation indicates that the carrying value of the asset is not recoverable from undiscounted cash flows attributable to the asset, then an impairment loss is measured by comparing the carrying amount of the asset to its fair value.

(f) Goodwill

Goodwill comprises the excess of cost over fair values of the underlying net assets acquired arising from business combinations accounted for using the purchase method. Goodwill is not amortized.

The Company continually evaluates, on a two-step basis, whether an impairment of goodwill has occurred and whether an impairment loss should be recognized. The first test for impairment involves comparing the fair value of the Company with its carrying amount, including goodwill. The fair value of goodwill is determined by the excess of the fair value of the Company over the carrying amounts of its assets and liabilities. If the fair value of the Company exceeds its carrying amount, then goodwill is not considered to be impaired, and the second test is unnecessary. When the fair value of the Company does not exceed its carrying amount, the second test for impairment is performed, which involves comparing the fair value of goodwill with the carrying amount of goodwill. When the carrying amount of the goodwill exceeds the fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess.

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**DALMAC ENERGY INC.**  
**Notes to Consolidated Financial Statements**  
**Three Month Period Ended July 31, 2006**  
*(Unaudited)*

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(g) Income taxes

Income taxes are accounted for by the asset and liability method whereby future tax assets and liabilities are recognized for the future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases.

(h) Revenue recognition

Service revenue is recognized when services are performed.

Product sales revenue is recognized when the products are shipped, at which time title passes to the customer.

(i) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. The significant areas requiring the use of management estimates relate to the amortization of property and equipment, determining the impairment of goodwill and the assumptions used in determining stock based compensation. Actual results could differ from these estimates.

(j) Lease obligations

Leases are classified as capital or operating leases. A lease that transfers substantially all of the benefits and risks incidental to the ownership of property is classified as a capital lease. At the inception of a capital lease, an asset and an obligation are recorded at an amount equal to the lesser of the present value of the minimum lease payments and the property's fair value at the beginning of the lease. All other leases are accounted for as operating leases wherein payments are expensed as incurred.

(k) Asset retirement obligations

The fair value of a liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value is added to the carrying amount of the associated asset. The liability is accreted at the end of each period through charges to operating expenses.

(l) Stock-based compensation

Stock-based compensation of employees, directors, officers and consultants is recorded in accordance with the fair value based method.

(m) Net income per share

Basic net income per share is calculated based on the weighted average number of shares outstanding during the year. Diluted net income per share reflects the assumed conversion of all dilutive securities using the treasury stock method. Diluted net income per share figures are equal to those of basic net income per share if the effects of stock options and warrants have been excluded since they are anti-dilutive.

(n) Share issuance costs

Costs related to the issuance of shares (net of the related income effect) are charged against share capital.

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**DALMAC ENERGY INC.**  
**Notes to Consolidated Financial Statements**  
**Three Month Period Ended July 31, 2006**  
*(Unaudited)*

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3. LOAN RECEIVABLE

Loan, receivable at \$3,339 per month, principal and interest at prime plus 1%, due June, 2010. Automotive equipment of the borrower has been pledged as collateral. Approximate principal repayments to be received within the next five years are as follows:

|                                          |                   |
|------------------------------------------|-------------------|
| 2007                                     | \$ 32,034         |
| 2008                                     | 33,940            |
| 2009                                     | 36,393            |
| 2010                                     | 30,107            |
| 2011                                     | <u>2,534</u>      |
| Subtotal                                 | 135,008           |
| Less current portion due within the year | <u>(32,034)</u>   |
|                                          | <u>\$ 102,974</u> |

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4. RESTRICTED CASH

Included in the Cash and Cash Equivalents, the Company has a \$100,000 deposit held in trust by legal counsel for a promissory note holder as security for the promissory note in the amount of \$222,809 (see note 8).

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**DALMAC ENERGY INC.**

**Notes to Consolidated Financial Statements**

**Three Month Period Ended July 31, 2006**

*(Unaudited)*

5. PROPERTY AND EQUIPMENT

|                                | Cost                | Accumulated<br>amortization |           | July 31<br>2006<br>Net book<br>value |
|--------------------------------|---------------------|-----------------------------|-----------|--------------------------------------|
| Service equipment              | \$ 4,453,637        | \$ 1,580,600                | \$        | <b>2,873,037</b>                     |
| Service vehicles               | 3,663,509           | 1,706,869                   |           | <b>1,956,640</b>                     |
| Plant equipment                | 413,054             | 165,509                     |           | <b>247,545</b>                       |
| Office equipment and furniture | 191,494             | 141,057                     |           | <b>50,437</b>                        |
| Trucks                         | 89,599              | 48,011                      |           | <b>41,588</b>                        |
| Rental equipment               | 74,573              | 31,683                      |           | <b>42,890</b>                        |
| Leasehold improvements         | 108,941             | 69,678                      |           | <b>39,263</b>                        |
| Land                           | 32,657              | -                           |           | <b>32,657</b>                        |
|                                | <b>\$ 9,027,464</b> | <b>\$ 3,743,407</b>         | <b>\$</b> | <b>5,284,057</b>                     |

|                                | Cost                | Accumulated<br>amortization |           | April 30<br>2006<br>Net book<br>value |
|--------------------------------|---------------------|-----------------------------|-----------|---------------------------------------|
| Service equipment              | \$ 4,449,225        | \$ 1,497,012                | \$        | 2,952,213                             |
| Service vehicles               | 3,403,509           | 1,611,890                   |           | 1,791,619                             |
| Plant equipment                | 400,754             | 156,509                     |           | 244,245                               |
| Office equipment and furniture | 189,651             | 134,259                     |           | 55,392                                |
| Rental equipment               | 74,573              | 30,129                      |           | 44,444                                |
| Leasehold improvements         | 107,100             | 64,894                      |           | 42,206                                |
| Land                           | 32,657              | -                           |           | 32,657                                |
| Trucks                         | 63,002              | 45,479                      |           | 17,523                                |
|                                | <b>\$ 8,720,471</b> | <b>\$ 3,540,172</b>         | <b>\$</b> | <b>5,180,299</b>                      |

6. BANK INDEBTEDNESS

The Company's credit facility includes a demand revolving operating loan to a maximum of \$1,500,000 (marginated to accounts receivable), at an interest rate of prime plus 1%. At July 31, 2006, \$387,000 (April 30, 2006 - \$597,000) had been drawn on this facility. In addition, the Company has a demand revolving term loan (see note 7) to a maximum of \$1,500,000 at an interest rate of prime plus 1.25%. At July 31, 2006, \$280,527 (April 30, 2006 - \$307,080) has been drawn on this facility.

The following has been provided as collateral for bank indebtedness and callable debt (see note 7):

- i) general security agreement providing a first security interest in all present and after acquired property;
- ii) assignment and postponement of creditors claim from a director and former director; and
- iii) assignment of insurance coverage for full insurable values of all assets of the borrower.

**DALMAC ENERGY INC.**  
**Notes to Consolidated Financial Statements**  
**Three Month Period Ended July 31, 2006**  
*(Unaudited)*

7. CALLABLE DEBT

|                                                                                    | <i>July 31</i><br><b>2006</b> | <i>April 30</i><br><b>2006</b> |
|------------------------------------------------------------------------------------|-------------------------------|--------------------------------|
| Bank loan, payable \$657 per month principal, plus interest at prime plus 1.25%.   | <b>\$ 21,008</b>              | \$ 22,979                      |
| Bank loan, payable \$7,292 per month principal, plus interest at prime plus 1.25%. | <b>216,234</b>                | 238,110                        |
| Bank loan, payable \$902 per month principal, plus interest at prime plus 1.25%.   | <b>43,285</b>                 | 45,991                         |
|                                                                                    | <b>280,527</b>                | 307,080                        |
| Less current portion due within the next nine months                               | <b>(79,659)</b>               | (106,212)                      |
|                                                                                    | <b>\$ 200,868</b>             | \$ 200,868                     |

Unless the bank loans are demanded the approximate principal repayments due within each of the next five years are as follows:

|      |                   |
|------|-------------------|
| 2007 | \$ 79,659         |
| 2008 | 106,212           |
| 2009 | 81,137            |
| 2010 | 10,824            |
| 2011 | 2,695             |
|      | <b>\$ 280,527</b> |

Collateral has been provided for the callable debt (see note 6).

## 8. LONG TERM DEBT

|                                                                                                                                                                                                                                                                                                                                                                            | <i>July 31</i><br><b>2006</b> | <i>April 30</i><br><b>2006</b> |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------|--------------------------------|
| Conditional sales contracts, consisting of eleven separate contracts, with interest at rates ranging from 6.60% to 7.95% per annum, repayable in monthly principal and interest payments that vary over the term of each contract, maturing on various dates to April, 2011, secured by specific service vehicles and service equipment                                    | <b>\$ 2,052,114</b>           | \$ 2,204,445                   |
| Conditional sales contracts, consisting of seven separate contracts, bearing interest at rates ranging from 7.25% to 8.75% per annum, repayable in monthly blended payments that vary over the term of each contract, maturing on various dates to January, 2010, secured by specific vehicles and equipment                                                               | <b>646,725</b>                | 614,628                        |
| Conditional sales contract, bearing interest at 8.5% per annum, repayable in monthly blended payments of \$4,136, maturing in April, 2010, secured by specific vehicle and equipment                                                                                                                                                                                       | <b>159,747</b>                | 168,635                        |
| Conditional sales contracts, consisting of three separate contracts, bearing interest rates ranging from 8.76% to 8.95% per annum, repayable in monthly principal and interest payments that vary over the term of each contract, maturing on various dates to September, 2008, secured by specific trucks                                                                 | <b>55,075</b>                 | 34,491                         |
| Promissory note, repayable at \$11,701 per month, principal and interest at 4.25%, due March, 2008, secured by a charge against the assets of the company, subrogated to any existing charges                                                                                                                                                                              | <b>225,536</b>                | 258,011                        |
| Promissory note due to a former director of the Company, payable \$8,373 per month, principal and interest at 4.25%, due November, 2008, secured by a general security agreement, shares of 750761 Alberta Ltd. sold by the promissory note holder to the Company and \$100,000 of monies in trust (see note 4)                                                            | <b>222,809</b>                | 245,402                        |
| Promissory note due to a director of the Company, repayable in equal monthly principal and interest payments of \$4,148 over thirty-six months with the first such payment commencing one month after the promissory note in the amount of \$222,809 (April 30, 2006 - \$245,402) is paid in full, to bear interest commencing from that date at a rate of 4.25% per annum | <b>140,000</b>                | 140,000                        |
|                                                                                                                                                                                                                                                                                                                                                                            | <b>3,502,006</b>              | 3,665,612                      |
| Less current portion due within the next nine months                                                                                                                                                                                                                                                                                                                       | <b>(949,096)</b>              | (1,224,957)                    |
|                                                                                                                                                                                                                                                                                                                                                                            | <b>\$ 2,552,910</b>           | \$ 2,440,655                   |

(continues)

**DALMAC ENERGY INC.**  
**Notes to Consolidated Financial Statements**  
**Three Month Period Ended July 31, 2006**  
*(Unaudited)*

8. LONG TERM DEBT *(continued)*

Approximate principal repayments due within each of the next five years are as follows:

|  |                     |                     |
|--|---------------------|---------------------|
|  | 2007                | \$ 949,096          |
|  | 2008                | 1,153,798           |
|  | 2009                | 784,012             |
|  | 2010                | 437,514             |
|  | 2011 and subsequent | <u>177,586</u>      |
|  |                     | <u>\$ 3,502,006</u> |

9. INCOME TAXES

(a) Non-capital losses

The Company has accumulated non-capital losses carried forward for income tax purposes of approximately \$341,914, the benefit of which has been reflected in these financial statements. These losses may be applied against future taxable income within the limitations prescribed by the Income Tax Act (Canada) and expire as follows:

|  |      |                   |
|--|------|-------------------|
|  | 2015 | \$ 187,614        |
|  | 2016 | <u>154,300</u>    |
|  |      | <u>\$ 341,914</u> |

(b) Temporary differences

A future income tax liability reflects the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's future income tax liability are as follows:

|                                                                         | <i>July 31</i><br><b>2006</b> | <i>April 30</i><br>2006 |
|-------------------------------------------------------------------------|-------------------------------|-------------------------|
| Income tax effect of taxable temporary differences:                     |                               |                         |
| Net book value in excess of undepreciated capital cost for tax purposes | \$ 655,627                    | \$ 597,225              |
| Non capital losses carried forward                                      | (114,541)                     | (119,678)               |
| Share issuance costs deductible for tax purposes                        | (237,742)                     | (193,294)               |
| Book value of goodwill in excess of tax value                           | <u>29,716</u>                 | <u>27,379</u>           |
| Recognized future income tax liability                                  | <u>\$ 333,060</u>             | <u>\$ 311,632</u>       |

**DALMAC ENERGY INC.**  
**Notes to Consolidated Financial Statements**  
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*(Unaudited)*

10. SHARE CAPITAL

- (a) Authorized:  
 Unlimited common voting shares  
 Unlimited preferred shares, issuable in series
- (b) Common shares issued:

|                                   | <i>July 31</i>    |                     | <i>April 30</i> |              |
|-----------------------------------|-------------------|---------------------|-----------------|--------------|
|                                   | <b>2006</b>       |                     | <b>2005</b>     |              |
|                                   | <b>Shares</b>     | <b>Amount</b>       | Shares          | Amount       |
| Balance, beginning of period      | <b>12,378,978</b> | <b>\$ 8,255,693</b> | 5,795,964       | \$ 1,736,980 |
| Issued on exercise of options     | <b>9,260</b>      | <b>6,482</b>        | 292,143         | 133,719      |
| Private placements                | -                 | -                   | 6,228,571       | 7,000,000    |
| Issued on exercise of warrants    | <b>39,595</b>     | <b>33,656</b>       | 62,300          | 52,955       |
| Fair value of options on exercise | -                 | -                   | -               | 77,501       |
| Share issuance costs              | -                 | <b>(29,500)</b>     | -               | (745,462)    |
| Balance, end of period            | <b>12,427,833</b> | <b>\$ 8,266,331</b> | 12,378,978      | \$ 8,255,693 |

In September 2005, pursuant to a private placement, the Company issued 1,428,571 units at \$0.70 per unit for aggregate proceeds of \$1,000,000. Each unit consisted of one common share and one-half common share purchase warrant. Each full warrant entitles the holder to purchase one common share at \$0.85 per share until September 27, 2007. The Company also issued options to the agent to acquire 142,857 units at an exercise price of \$0.70 per unit. The options expire on September 27, 2007, and each unit is identical to those issued under the private placement.

In February 2006, pursuant to a private placement, the Company issued 4,800,000 units at \$1.25 per unit for aggregate proceeds of \$6,000,000. Each unit consisted of one common share and one-half common share purchase warrant. Each full warrant entitles the holder to purchase one common share at \$1.50 per share until February 28, 2008. The Company also issued options to the agent to acquire 480,000 units at an exercise price of \$1.25 per unit. The options expire on February 28, 2008, and each unit is identical to those issued under the private placement.

During the period the company issued shares pursuant to business combinations described in note 1.

*(continues)*

**DALMAC ENERGY INC.**  
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10. SHARE CAPITAL *(continued)*

(c) Stock options

The Company has a stock option plan under which directors, officers and employees of the Company and its affiliates are eligible to receive stock options. The maximum number of shares issuable pursuant to the exercise of outstanding options granted under the plan shall be 10% of the issued shares of the Company at the time of granting the options. The maximum number of common shares optioned to any one optionee shall not exceed 5% of outstanding common shares of the Company and options granted under the plan may not exceed five years. The exercise price of each option shall be determined by the directors at the time of grant but shall not be less than the price permitted by the policy or policies of the stock exchange(s) on which the Company's common shares are then listed.

The Company accounts for options granted under this plan in accordance with the fair value based method of accounting for stock-based compensation. The application of the fair value based method requires the use of certain assumptions regarding the risk-free market interest rate, expected volatility of the underlying stock and life of the options.

During the year ended April 30, 2006, the Company granted 142,857 options on September 27, 2005 and 480,000 options on February 28, 2006 to agents of the Company as commissions. The fair value of the options granted on September 27, 2005 was calculated assuming the risk free interest rate was 3.3%, the expected life of the options was two years and the expected volatility was 57%. The market price of the Company's shares at the grant date exceeded the option exercise price. The fair value of the options granted on February 28, 2006 was calculated assuming the risk free interest rate was 3.91%, the expected life of the options was two years and the expected volatility was 55%. The market price of the Company's shares at the grant date exceeded the option exercise price. The options granted resulted in stock based compensation, which was recorded as a share issuance cost, and contributed surplus of \$305,377 during the year.

During the period ended April 30, 2005, the Company granted 150,000 options on March 21, 2005 to directors and senior officials of the company. The fair value of the options granted was calculated assuming the risk free interest rate was 2.5%, the expected life of the options was five years and the expected volatility was 4.5%. The market price of the Company's shares at the grant date exceeded the option exercise price. The options granted resulted in stock based compensation expense and contributed surplus of \$64,692 during the period.

*(continues)*

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**DALMAC ENERGY INC.**  
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**Three Month Period Ended July 31, 2006**  
*(Unaudited)*

10. SHARE CAPITAL *(continued)*

The following table summarizes activity related to stock options:

|                              | <b>Number</b>  | <b>Weighted<br/>Average<br/>Exercise Price<br/>July 31, 2006</b> | <b>Number</b>    | <b>Weighted<br/>Average<br/>Exercise Price<br/>April 30, 2006</b> |
|------------------------------|----------------|------------------------------------------------------------------|------------------|-------------------------------------------------------------------|
| Balance, beginning of period | 913,449        | \$ 0.83                                                          | 662,051          | \$ 0.33                                                           |
| Granted                      | -              | -                                                                | 622,857          | 1.12                                                              |
| Expired                      | -              | -                                                                | (79,316)         | 0.30                                                              |
| Exercised                    | <b>(9,260)</b> | <b>0.70</b>                                                      | <b>(292,143)</b> | <b>0.46</b>                                                       |
| Outstanding, end of period   | <b>904,189</b> | <b>\$ 0.83</b>                                                   | 913,449          | \$ 0.83                                                           |
| Exercisable, end of period   | <b>904,189</b> | <b>\$ 0.83</b>                                                   | 913,449          | \$ 0.83                                                           |

The following table summarizes stock options outstanding at July 31, 2006:

| <u>Expiry Date</u> | <u>Number<br/>outstanding</u> | <u>Exercise Price</u> |
|--------------------|-------------------------------|-----------------------|
| September 27, 2007 | 18,407                        | 0.70                  |
| February 28, 2008  | 480,000                       | 1.25                  |
| December 22, 2008  | 255,782                       | 0.30                  |
| March 21, 2010     | <b>150,000</b>                | 0.45                  |
|                    | <b>904,189</b>                |                       |

(d) Warrants

The following table summarizes warrants outstanding at July 31, 2006:

|                                                         | <u>Expiry Date</u> | <u>Exercise Price</u> | <u>Warrants<br/>Outstanding<br/>July 31, 2006</u> | <u>Warrants<br/>Outstanding<br/>April 30, 2006</u> |
|---------------------------------------------------------|--------------------|-----------------------|---------------------------------------------------|----------------------------------------------------|
| Issued pursuant to private placement in September, 2005 | September 27, 2007 | \$ 0.85               | <b>669,986</b>                                    | 709,581                                            |
| Issued pursuant to private placement in February, 2006  | February 28, 2008  | \$ 1.50               | <b>2,400,000</b>                                  | 2,400,000                                          |
|                                                         |                    |                       | <b>3,069,986</b>                                  | 3,109,581                                          |

The weighted average exercise price of the outstanding warrants is \$1.36.

**DALMAC ENERGY INC.**  
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11. CONTRIBUTED SURPLUS

The following table summarizes the changes in contributed surplus:

|                                                                 | <b>July 31, 2006</b> | April 30, 2006 |
|-----------------------------------------------------------------|----------------------|----------------|
| Balance, beginning of period                                    | \$ 292,568           | \$ 64,692      |
| Stock based compensation issued to agents on private placements | -                    | 305,377        |
| Fair value of options on exercise                               | -                    | (77,501)       |
|                                                                 | <b>\$ 292,568</b>    | \$ 292,568     |

12. CASH FLOW SUPPLEMENTARY INFORMATION

|                                                                                                      | <i>July 31</i><br><b>2006</b> | <i>April 30</i><br>2006 |
|------------------------------------------------------------------------------------------------------|-------------------------------|-------------------------|
| Interest paid                                                                                        | \$ 67,307                     | \$ 318,402              |
| Income taxes paid                                                                                    | \$ -                          | \$ 244,384              |
| Stock based compensation relating to options (issued to agents)<br>reflected as share issuance costs | \$ -                          | \$ 305,377              |
| Future income tax effect of share issuance costs                                                     | \$ 29,500                     | \$ 208,242              |

13. LEASE COMMITMENTS

The Company leases equipment and premises under long term operating leases. The leases for premises are exclusive of operating costs. Future minimum annual lease payments are as follows:

|           | 2007              | 2008              | 2009              | 2010              | 2011             |
|-----------|-------------------|-------------------|-------------------|-------------------|------------------|
| Equipment | \$ 651,177        | \$ 597,913        | \$ 569,425        | \$ 380,475        | \$ 38,949        |
| Premises  | 215,494           | 215,494           | 66,505            | -                 | -                |
|           | <b>\$ 866,671</b> | <b>\$ 813,407</b> | <b>\$ 635,930</b> | <b>\$ 380,475</b> | <b>\$ 38,949</b> |

14. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with financial statement presentation adopted for the current year.