

Consolidated Financial Statements

Dalmac Energy Inc.

Second Quarter Ended October 31, 2010

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## Management's Responsibility for Consolidated Financial Statements

The accompanying unaudited consolidated financial statements, and the information in the Management's Discussion and Analysis are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and include some amounts based on management's best estimates and judgments. When alternative accounting methods exist, management has chosen those it considers most appropriate in the circumstances. Management has prepared the financial information presented elsewhere in the Management's Discussion and Analysis and ensured it is consistent with the financial statements.

Dalmac Energy Inc. maintains a system of internal controls to provide reasonable assurance that transactions are properly authorized, financial records are accurate and reliable and the Company's assets are properly accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and is ultimately responsible for reviewing and approving the consolidated financial statements. The Board of Directors carries out its responsibility for the consolidated financial statements through its Audit Committee. The Committee meets periodically with management and the external auditors to review the financial statements and the annual report and to discuss audit, financial and internal control matters. The Company's external auditors have full and unrestricted access to the Audit Committee.

*Signed "John I. Babic"*  
Chief Executive Officer

*Signed "John Beasley"*  
Chief Financial Officer

November 29, 2010

## Dalmac Energy Inc. Consolidated Balance Sheet

As at	Oct 31, 2010 (unaudited)	April 30, 2010 (audited)
<b>Assets</b>		
Current		
Cash and cash equivalents	\$ 170,795	\$ -
Accounts receivable	4,864,183	3,361,114
Inventories	572,753	396,864
Prepays	<u>584,003</u>	<u>104,659</u>
	<b>6,191,734</b>	<b>3,862,637</b>
Property, plant and equipment	16,143,469	16,848,679
Intangible asset	<u>15,000</u>	<u>20,000</u>
	<b><u>\$ 22,350,203</u></b>	<b><u>\$ 20,731,316</u></b>

### Liabilities

Current		
Bank indebtedness (Note 2)	\$ 3,326,674	\$ 1,760,338
Accounts payable and accrued liabilities	3,592,347	3,031,756
Callable debt (Note 1)	3,260,000	3,226,730
Current portion of capital lease obligations	-	171,207
Current portion of long term debt	1,378,423	1,732,371
Current portion of preferred shares	<u>152,878</u>	<u>152,878</u>
	<b>11,710,322</b>	<b>10,075,280</b>
Capital lease obligations	-	-
Long term debt	3,053,633	3,411,863
Future income taxes	-	-
Preferred shares (Note 4)	<u>343,976</u>	<u>420,415</u>
	<b><u>15,107,931</u></b>	<b><u>13,907,558</u></b>

### Shareholders' Equity

Share capital (Note 4)	8,766,698	8,766,698
Warrants	160,800	160,800
Contributed surplus	646,354	642,267
Deficit	<u>(2,331,580)</u>	<u>(2,746,007)</u>
	<b><u>7,242,272</u></b>	<b><u>6,823,758</u></b>
	<b><u>\$ 22,350,203</u></b>	<b><u>\$ 20,731,316</u></b>

Going concern (Note 1)

On behalf of the Board

Signed "John I. Babic"  
Director

Signed "Shawn Szydlowski"  
Director

See accompanying notes to the consolidated financial statements.

**Dalmac Energy Inc.**  
**Consolidated Statements of Income**  
**Comprehensive Income and Deficit**

	Three months October 31		Six months October 31	
	2010	2009	2010	2009
	(unaudited)		(unaudited)	
Revenue				
Service	\$ 5,505,657	\$ 3,372,732	\$ 9,083,367	\$ 6,788,479
Product	404,038	184,596	640,117	335,889
	<u>5,909,695</u>	<u>3,557,328</u>	<u>9,723,484</u>	<u>7,124,368</u>
Direct costs				
Service	3,381,472	2,793,441	5,885,869	5,755,934
Product	346,440	169,318	529,313	320,574
	<u>3,727,912</u>	<u>2,962,759</u>	<u>6,415,182</u>	<u>6,076,508</u>
Gross margin	<u>2,181,783</u>	<u>594,569</u>	<u>3,308,302</u>	<u>1,047,860</u>
Expenses				
Wages and benefits	408,403	575,546	849,225	1,082,748
Amortization of property, plant and equipment	489,037	494,426	974,131	985,448
General and administrative	319,744	351,432	560,689	674,263
Interest on long term debt	237,133	49,650	330,777	133,934
Interest on callable debt and other	63,378	86,725	132,644	160,206
Interest on obligations under capital lease	-	3,853	2,893	8,070
Amortization of intangible asset	2,500	2,500	5,000	5,000
(Gain) loss on disposal of property, plant and equipment	10,522	(23,774)	38,516	(22,046)
Preferred shares dividend expense	-	60,806	-	60,806
	<u>1,530,717</u>	<u>1,601,164</u>	<u>2,893,875</u>	<u>3,088,429</u>
Income/(loss) before income taxes	651,066	(1,006,595)	414,427	(2,040,569)
Income tax recovery	-	-	-	229,456
Net income/(loss) and comprehensive income/(loss)	<u>651,066</u>	<u>(1,006,595)</u>	<u>\$ 414,427</u>	<u>\$ (1,811,113)</u>
Deficit, beginning of period	\$(2,982,646)	\$ (1,794,857)	\$ (2,746,007)	\$ (990,339)
Net income/(loss)	<u>651,066</u>	<u>(1,006,595)</u>	<u>414,427</u>	<u>(1,811,113)</u>
Deficit, end of period	<u>\$ (2,331,580)</u>	<u>\$ (2,801,452)</u>	<u>\$ (2,331,580)</u>	<u>\$ (2,801,452)</u>
Income/(loss) per share basic and diluted. (Note 5)	<u>\$ 0.04</u>	<u>\$ (0.08)</u>	<u>\$ 0.02</u>	<u>\$ (0.14)</u>

See accompanying notes to the consolidated financial statements.

## Dalmac Energy Inc.

### Consolidated Statement of Cash Flows

	Three months October 31		Six months October 31	
	2010 (unaudited)	2009	2010 (unaudited)	2009
Increase (decrease) in cash and cash equivalents				
<b>Operating</b>				
Net gain/(loss) for period	651,066	(1,006,595)	\$ 414,427	\$ (1,811,113)
Items not affecting cash:				
Amortization of property, plant and equipment	489,037	494,426	974,131	985,448
(Gain) loss on disposal of property, plant and equipment	(10,522)	(23,774)	(38,516)	(22,046)
Amortization of intangible asset	2,500	2,500	5,000	5,000
Future income tax recovery	-	-	-	(229,456)
Stock based compensation expense	3,692	7,266	4,088	10,897
	<u>1,135,773</u>	<u>(526,177)</u>	<u>1,359,130</u>	<u>(1,061,270)</u>
Change in non-cash operating working capital:				
Accounts receivable	(1,817,515)	(161,343)	(1,503,069)	1,705,188
Inventories	(85,825)	(59,741)	(175,890)	(94,043)
Prepays	(399,032)	(54,857)	(479,344)	68,782
Accounts payable and accrued liabilities	264,226	473,576	560,591	(146,470)
	<u>(902,373)</u>	<u>(328,542)</u>	<u>(238,582)</u>	<u>472,187</u>
<b>Financing</b>				
Net proceeds from the issuance of shares	(38,219)	-	(76,439)	-
Proceeds from long term debt		2,000,000	-	2,000,000
Repayment of long term debt	(367,979)	(258,617)	(712,178)	(695,305)
Repayment of callable debt	331,866	(93,254)	33,270	(373,013)
Repayment of obligations under capital lease	(153,143)	(17,069)	(171,207)	(35,178)
(Repayments) advances on bank indebtedness	1,605,543	(1,236,160)	1,566,335	(1,318,750)
	<u>1,378,068</u>	<u>394,900</u>	<u>639,781</u>	<u>(422,246)</u>
<b>Investing</b>				
Purchase of property, plant and equipment	(279,169)	3,385	(191,888)	1,111
Proceeds on disposal of property, plant and equipment	(10,522)	23,774	(38,516)	24,142
Cash paid on acquisition	(289,691)	27,159	(230,404)	25,253
	<u>(579,382)</u>	<u>54,318</u>	<u>(460,808)</u>	<u>50,506</u>
Net increase in cash and cash equivalents	186,004	93,517	170,795	75,194
Cash and cash equivalents				
Beginning of period	(15,209)	181,383	-	199,706
End of period	<u>\$ 170,795</u>	<u>\$ 274,900</u>	<u>\$ 170,795</u>	<u>\$ 274,900</u>

See accompanying notes to the consolidated financial statements.

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# **Dalmac Energy Inc.**

## **Notes to the Consolidated Financial Statements**

### **October 31, 2010 (unaudited)**

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#### **1. Description of operations and going concern**

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

The consolidated financial statements have been prepared on a going concern basis, which contemplates that the Company will be able to continue operations for the foreseeable future, and to realize on its assets and settle its liabilities in the normal course of operations.

On August 17, 2010, the Company completed refinancing its callable debt with a new mezzanine lender. The facility matures in one year on August 17, 2011, and as a result the debt balance has been shown as a current liability in the financial statements.

Management is of the opinion that the following developments will have contributed to maintaining the Company's ability to continue as a going concern:

- Net Income for second quarter ending October 31, 2010, of \$651,066;
- August 17, 2010, received \$4,000,000 operating line of credit from a new lender;
- August 17, 2010, refinanced callable debt with mezzanine financing;
- \$500,000 raised in a private placement completed in January 2010;

As at October 31, 2010, the Company was in full compliance with all its financial covenants.

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#### **2. Bank indebtedness**

On October 16, 2009, the Company signed an additional revolving loan and security agreement with a secondary lender for \$2,000,000. This facility is a 366 day long term facility with interest only payments in the first year, with an option to term out over 36 months at the end of the first year, or opt for a second year of interest only after which term out will be negotiated at 24 to 30 months. Interest on this facility is Bankers Acceptance 90 Days plus 5.90%. Principal repayment can be made at any time in increments of \$100,000.

The secondary lender has taken a first security interest in select equipment, with a second security interest in all remaining equipment. The Company's primary lender subrogated their first security position on certain assets pursuant to the new revolving loan and security agreement. As of October 31, 2010, \$2,000,000 had been drawn on this facility and the Company was in compliance with required debt covenants for this facility. The Company has opted for a second year of interest only which will expire on October 16, 2011.

On August 17, 2010, the Company completed a financing arrangement with a new primary lender consisting of a \$4,000,000 revolving operating line of credit margined on acceptable accounts receivable. The new facility, which is fixed for 2 years (expiring on August 17, 2012) carries an interest rate based on the lender's prime plus 3.75%. Extending the facility for a further term(s) is negotiable.

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**Dalmac Energy Inc.**  
**Notes to the Consolidated Financial Statements**  
**October 31, 2010 (unaudited)**

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**2. Bank indebtedness (cont'd)**

Also on August 17, 2010, the Company refinanced its callable debt with a mezzanine lender. The new facility consists of a \$3,260,000, non-revolving term loan which bears interest at 24% per annum. For the first 3 months subsequent to August 17, 2010, the repayment is interest only followed by monthly payments consisting of both interest and principle. The facility matures in one year on August 17, 2011 but the payments are based on a 4 year amortization.

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**3. Capital management**

The Company's strategy is to a) maintain a level of capital for operations and to sustain future growth of the business and b) meet the debt covenants imposed by our banking institution. The Company strives to maintain a healthy balance between debt and equity to ensure the continued access to capital to fund growth and ensure long-term viability.

The Company is subject to the following externally imposed capital requirements, from its new primary lender:

- Fixed Charge Coverage Ratio of not less than 1:1 effective September 30, 2010, calculated on a cumulative 12 month rolling forward basis and tested monthly.
- Tangible Net Worth of not less than \$6,800,000, effective October 31, 2010 and tested monthly.

As at October 31, 2010, the Company was in full compliance with its covenants with its new primary lender.

The Company is satisfied that it has sufficient access to capital resources for its operations and to fund the future growth of the business.

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**Dalmac Energy Inc.**  
**Notes to the Consolidated Financial Statements**  
October 31, 2010 (unaudited)

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**4. Share capital**

**Authorized:**

Unlimited common voting shares  
Unlimited preferred non-voting shares, issuable in series

**Common shares issued:**

	<u>October 31, 2010</u>		<u>April 30, 2010</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>
Balance, beginning of period	17,974,522	\$ 8,766,698	12,974,522	\$ 8,439,453
Issued for cash:				
Private placement cash	-	-	5,000,000	500,000
Less financing costs paid in cash net of future tax	-	-	-	(11,955)
Less deemed allocation to warrants	-	-	-	(160,800)
Balance, end of period	<u>17,974,522</u>	<u>\$ 8,766,698</u>	<u>17,974,522</u>	<u>\$ 8,766,698</u>

**Preferred shares**

The preferred shares are outstanding in 142771 Alberta Ltd., a wholly owned subsidiary of Dalmac Energy Inc. During the first two quarters of the year 76,439 of the preferred shares were redeemed for \$76,439.

**Preferred shares issued:**

	<u>October 31, 2010</u>		<u>April 30, 2010</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>
Balance, beginning of year	573,293	\$ 573,293	900,000	\$ 900,000
Preferred shares issued	-	-	-	-
Preferred shares redeemed	<u>(76,439)</u>	<u>(76,439)</u>	<u>(326,707)</u>	<u>(326,707)</u>
Balance, end of period	<u>496,854</u>	<u>\$ 496,854</u>	<u>573,293</u>	<u>\$ 573,293</u>

The current portion of the preferred share liability is \$152,878, and the long-term portion is \$343,976.

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**Dalmac Energy Inc.**  
**Notes to the Consolidated Financial Statements**  
**October 31, 2010 (unaudited)**

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**4. Share capital (cont'd)**

**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 exchanges on which the Company's common shares are then listed.

On August 26, 2010 the Company granted 306,000 options to its employees under the stock option plan. These options are vested equally over three years starting August 26, 2010. The fair value of the options granted was calculated using the Black-Scholes option pricing model. The fair value of the options was calculated using a risk free interest rate of 1.18%, the expected life of the options was five years and the expected volatility was 125%.

The total cost of options vested in the current year resulted in stock-based compensation expense and an addition to contributed surplus of \$3,692 (2009 - \$16,269).

**5. Income/(loss) per share**

The effects of the 5,000,000 (2009 – nil) warrants, and 956,000 (2009 – 775,000) stock options outstanding at October 31, 2010, are not included in the diluted income/(loss) per share calculation as the impact would be anti-dilutive.