



Year Ended April 30, 2010  
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

*This Management Discussion and Analysis ("MD&A") prepared August 16th, 2010 focuses on key statistics from the audited consolidated financial statements of Dalmac Energy Inc. for the year ended April 30, 2010 ("YE'10") 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. The Corporation's consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada ("GAAP"). The Corporation's 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).*

**Non-GAAP Measures:** *Dalmac uses certain non-GAAP measures as indicators of financial performance and believes that these non-GAAP measures provide useful information to shareholders. EBITDAS and gross margin are measures used by the Company and which have no standardized meaning under GAAP. The Company's method of calculating EBITDAS and gross margin may differ from other companies and may not be comparable. EBITDAS is defined as earnings before interest, taxes, depreciation and amortization, gain or loss on sale of property, plant and equipment, and stock based compensation. Management believes that in addition to net income, EBITDAS is a useful supplemental measure which provides an indication of the operating cash flow generated by the Company. EBITDAS is not intended to represent an alternative to net income as determined in accordance with GAAP as an indicator of the Company's performance. Gross margin is defined as revenue less cost of sales. Cost of sales includes direct labor and costs directly associated with the provision of goods and services.*

**Forward Looking Statements:** *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", the "Company", "us", "we" and "our" mean Dalmac Energy Inc. and its subsidiaries Dalmac Oilfield Services Inc., 1421771 Alberta Ltd. and 1353245 Alberta Ltd.*

## **Overview**

Dalmac Energy Inc. (TSX Venture "DAL") is a growing company which specializes in oilfield servicing, fluid hauling, chemical sales, tank rentals and rig moving. Headquartered out of Edmonton, Dalmac's operations have been servicing west central Alberta for over 53 years. The Company's equipment consists of 162 pieces of rolling stock service equipment which includes, tank, vacuum, hydro-vac, pressure, hot oiler, acid flush, steamer, picker and winch trucks in addition to 250 pieces of oilfield tanks and matting which is rented out to customers. Dalmac currently employs over 100 people in its operations in Fox Creek, Edson, Warburg and Pigeon Lake, Alberta.

## **Operating Results**

The following analysis of the Company's results of operations refers to the years ended April 30, 2010 and 2009 ("YE'10" and "YE'09") along with three month (fourth quarter) periods then ended referenced as "Q4'10" and "Q4'09". This MD&A uses abbreviations "M" for million(s) and "K" for thousand(s).

## Selected Financial Information

(000's Cdn Dollars, except per share)	Q4'10	Q4'09	YE'10	YE'09
Revenues	4,788	5,821	16,573	21,492
Gross Margin	1,938	1,322	4,174	5,757
Gross Margin %	40%	23%	25%	27%
General and administrative expenses*	324	373	1,350	1,353
EBITDAS (loss)	1,132	(1,140)	782	319
EBIDTAS per share - basic	0.08	(0.09)	0.05	0.02
Dividend expense	-	-	72	-
Stock based compensation	(2)	4	16	65
Interest	185	141	636	716
Amortization	505	460	1,995	1,790
Net income (loss)	424	(1,869)	(1,756)	(1,909)
Net income (loss) per share - basic	0.03	(0.14)	(0.12)	(0.15)
Net income (loss) per share - diluted	0.03	(0.14)	(0.12)	(0.15)
Total assets	20,731	23,542	20,731	23,547
Total long-term financial liabilities**	3,412	6,708	3,412	6,708
Shareholders' equity	6,824	8,075	6,824	8,075
Weighted average common shares -basic	14,275,892	12,974,522	14,275,892	12,974,522
Weighted average common shares - diluted	14,275,892	12,974,522	14,275,892	12,974,522

\* General and administrative expenses include travel and automotive, advertising & promotion, telephone and utilities, insurance, business taxes and training.

\*\* Includes callable debt and callable capital lease obligations due beyond one year.

Total revenue for Q4'10 decreased by 18%, to \$4.7M from the \$5.8M reported at Q4'09. Much of this decrease is attributable to the Company's decision to reduce its reliance on subcontractor operations. The reduction of subcontractors in select areas helped increase utilization levels and profit margins on company equipment. The gross margin for Q4'10 increased by 47% to \$1.9M from the \$1.3M reported in Q4'09. This improvement is the result of the reduced use of subcontractors, improved cost efficiencies and cost reductions implemented over the course of the quarter. Because of higher costs the profit margin on subcontractors' revenue is considerably less than for Company operators.

The total revenue for YE'10 decreased by 23% to \$16.6M from the \$21.5M reported at YE'09. The gross margin for YE'10 also decreased by 27% to \$4.2M from \$5.8M reported at YE'09. The first 9 months of fiscal 2010 were severely affected by the slowdown in the oilfield services industry due to the global recession, low commodity prices, provincial royalty rates and decreased capital expenditures by producers. Activity levels in the oilfield services sector, which usually begins to pick up in September, did not pick up until January 2010. Since January much of the increased drilling activity stemmed from revised interest in reserves of the Pembina - Cardium formation in west central Alberta. The Petroleum Services Association of Canada ("PSAC") is forecasting that 2010 will see more oil than gas wells drilled in Alberta for the first time in 40 years. According to the Energy Resources Conservation Board ("ERCB") the Alberta Cardium formation is said to contain about 10 billion barrels of oil of which about 70% is still in place. With improved developments in multi-stage fracturing technology, this oil is now economically accessible. These developments have sparked an increased demand for Dalmac's operations in the Cardium zone.

Dalmac has reduced its preferred shares liability by \$327K from the \$900K reported at YE'09. This liability relates to the acquisition of the assets of Tinky Rentals L.P. and Tinky Trucking L.P. ("Tinky") which was completed September 15, 2008. The Company has also issued a dividend payment of \$72K which represents the interest owing to the preferred share holder.

## Reconciliation of EBITDAS to Historical Results (GAAP)

(000's Cdn Dollars)	Q4'10	Q4' 09	YE' 10	YE' 09
Net income (loss)	424	(1,869)	(1,756)	(1,909)
Add:				
Income tax (recovery)	-	100	(224)	(272)
Interest on short and long term debt	185	141	636	716
Amortization - tangible and intangible assets	505	460	1,995	1,790
Gain (loss) on sale of assets	20	(1)	43	(71)
Dividends	-	-	72	-
Stock - based compensation	(2)	4	16	65
Sub-total	708	729	2,538	2,228
EBITDAS	1,132	(1,140)	782	319

As a result of the increased oilfield activity, and the implementation of various cost control initiatives, the Q4'10 EBITDAS increased by 29% to \$1.1M from the \$(1.1M) reported in the same period last year. The net income for the period increased 123% to \$424K as compared to the \$(1.9M) reported in Q4'09. The YE'10 EBITDAS also increased by \$463K to \$0.8M from \$319K at YE'09. The net loss for the year was \$1.8M, a decrease of 8% from the \$1.9M loss reported at YE'09.

Dalmac responded to the losses incurred over the course of the year by cutting expenses and controlling costs. The refinancing of \$2.0M of its assets in Q2'10 and by providing a equity injection of \$500,000 from a private placement in Q3'10 also helped contribute to improve working capital (see "Working Capital" in this MD&A).

### Expenses

Expenses, before goodwill impairment charges, increased slightly at YE'10 to \$6.1M, up 6% from the previous year. The largest part of this increase is due to a full year of recognizing the expenses related to the Tinky acquisition as compared to only 8 months in the previous year. Wages and benefits increased by \$300K as a result of additional personnel associated with the acquisition along with additional onetime costs associated with administration restructuring which was necessary for further savings. The majority of the restructuring and cost saving reductions were completed by May of 2010 and the net effect of the restructuring should see administration and overhead costs decrease by about \$70K per month from their previous levels.

The amortization of property and equipment at YE'10 increased by 11% to \$2.0M from the \$1.8M reported in the previous year. This was consistent with the increase in assets associated with acquisitions made in the normal course of business. The total interest expenses at YE'10 decreased by 11%, to \$636K from the \$716K reported in the previous year as a result of the lowering of interest rates over the past year.

Callable debt relates to all financing completed through the Corporation's bank which was used for purchases of equipment and property.

Stock based compensation expense is a non-cash expense which is recorded in accordance with GAAP each time stock options are issued. This expense decreased 75%, to \$16K at YE'10 as compared to the same period last year. The stock option expense has been calculated in accordance with the Black-Scholes option pricing model. Stock based compensation is not referenced independently in the financial statements but is included as part of wages and benefits. All the stock options relating to this stock based compensation expense are subject to a three year vesting period.

## Impairment of Goodwill

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets of acquired businesses. Goodwill is tested for impairment annually or more frequently when an event or circumstance occurs that indicates that goodwill might be impaired. When the carrying amount exceeds its fair value, an impairment loss is recognized in an amount equal to the excess. The determination of fair value is based on estimates of normalized earnings, price earnings multiples, cash flow, discount rates and terminal values. Such estimates require judgment.

In fiscal 2009, based on the economic conditions and the decrease in share value, the Company concluded that the carrying value of goodwill was impaired and as such took a charge of \$2.1M for YE'09. Economic conditions that mainly impacted the charge were:

- Low commodity prices which negatively impacted oil and gas producers
- Reduced levels of exploration and development activity by energy producers in Western Canada which negatively impacted oil and natural gas drilling
- Downward pricing pressure resulting from a more competitive environment

There were no goodwill charges for the current fiscal year.

## Income Taxes

At YE'10 the company was not in a taxable position.

## Summary of Quarterly Results

	Q4'10	Q3'10	Q2'10	Q1'10
	Quarter Ended	Quarter Ended	Quarter Ended	Quarter Ended
(000's Cdn Dollars, except per share data)	30-Apr-10	31-Jan-10	31-Oct-09	31-Jul-09
Revenue	4,788	4,661	3,557	3,567
Net income (loss)	424	(369)	(1,007)	(805)
Net income (loss) per share - basic	0.03	(0.03)	(0.08)	(0.06)
Net income (loss) per share - diluted	0.03	(0.03)	(0.08)	(0.06)

	Q4'09	Q3'09	Q2'09	Q1'09
	Quarter Ended	Quarter Ended	Quarter Ended	Quarter Ended
(000's Cdn Dollars, except per share data)	30-Apr-09	31-Jan-09	31-Oct-09	31-Jul-09
Revenue	5,821	6,535	5,167	3,970
Net income (loss)	(1,869)	236	148	(425)
Net income (loss) per share - basic	(0.19)	0.02	0.01	(0.03)
Net income (loss) per share - diluted	(0.19)	0.02	0.01	(0.03)

### *Q4'10 vs. Q4'09*

In general, quarter four is very much dependent on prevailing weather conditions and road bans which can commence at any time during the months of March and April. These conditions affect the access to work areas and the timing of customer budget spending plans. The closing down of the Hinton operations in Q4'10 was revenue neutral because the Company managed to redeploy its assets amongst other divisions. In Q4'10 the gross profit margin increased by 47% contributing to a net income of \$424K as compared to a loss of \$1.9M during the same period in the previous year. Other cost cutting initiatives included administrative restructuring and personnel reductions which will further reduced operating costs by about \$70K per month.

### *Q3'10 vs. Q3'09*

This is generally one of the busiest quarters for Dalmac because the oil and gas drilling activity is at its highest levels of the year. The ground and unpaved roads freeze and this allows for easier access to the hard to reach areas. In Q3'10, the oil and gas industries tried to recover from the recessionary impact but it was not enough to bring the drilling utilization levels up from their record lows. It wasn't until January of 2010 that the drilling activity begins to rebound to seasonal norms. Increased drilling activity corresponds to increased demand for our products and services.

### *Q2'10 vs. Q2'09*

Q2 covers the months from August to October. For Dalmac, this is traditionally a breakeven quarter at best. This quarter continues to be affected by weather conditions and the timing of customer capital budget expenditures. Lower commodity prices, royalty rate and low capital expenditures continued to plague the oilfield service sector during Q2'10 contributing to the low utilization levels for Company operations resulting in reduced revenues.

### *Q1'10 vs. Q1'09*

Q1 is traditionally the slowest quarter. This quarter is hugely impacted by the spring break up conditions and road bans. As the ground thaws regulators and landowners prohibit the accessing of most work areas until the ground dries out and becomes passable to heavy equipment that may cause damage to the land. Traditionally road bans are lifted in May. However restrictions to entering certain areas that protect various wildlife species during their migrations and calving seasons can be extended to the middle of June. Production related projects, which are often given a waiver with respect to road bans regulations, may continue operations subject to limiting hauls to half loads etc. The combination of breakup conditions and depressed drilling activity contributed to a cumulative worsening of working conditions in Q1'10. The Company takes advantage of the slow period to focus on repairs, maintenance and certifications which invariably drive up operating costs in relation to revenues for this quarter.

## **Liquidity and Capital Resources**

The Company's capital requirements consist primarily of working capital necessary to fund operations, capital expenditures related to the purchase of operation equipment and capital to finance strategic acquisitions. Sources of funds available to meet these capital requirements include cash flow from operations, external lines of credit, equipment financing, term loans and access to equity markets.

Liquidity and capital resources are dependent upon the results of operations, commodity prices, capital expenditures and debt service charges. Cash flow from operating activities increased in the Q4'10 to \$580K from the \$252K reported in Q4'09. For YE'10 cash flow from operating activities decreased to \$1.3M from the \$1.8M reported for the same period last year. This is commensurate with the general slowdown in the sector and the recovery which commenced in January of 2010. Cash and cash equivalents at Q4'10 decreased by \$467K from \$467K reported in the comparable quarter of the previous year. On a year to date basis the cash and equivalents decreased by \$200K from the amount reported in the previous year. The Company is required by its principal lender to test for covenant breaches on an annual basis. As a result of the losses incurred year to date, the Company has failed to comply with the externally imposed working capital and debt servicing covenants at YE'10. As a result of the aforementioned breaches the bank term debt was reclassified as current increasing working capital deficit to \$6.1M (2009-\$6.7M).

In conjunction with the above referenced covenant breaches, the current primary lender has agreed to the new financing facilities and has consented not to take any action towards enforcing their right to demand repayment until the new financing facilities noted below have closed on August 17, 2010.

On July 23, 2010, the Company completed a financing arrangement with a new term lender to refinance the callable debt. The new financing consists of a \$3,300,000, non-revolving term facility which bears interest at 24% per annum. Repayment terms are interest only commencing on August 31, 2010 and maturing on July 23, 2011. The Company plans on refinancing this debt on more favorable terms over the course of the next 12 months.

On August 6, 2010, the Company completed a financing arrangement with a new primary lender which consists of a \$4,000,000 revolving operating line of credit margined on acceptable accounts receivable. The interest rate on this facility is lender prime plus 3.75%, with interest payable monthly. This facility is for a 2 year term expiring on August 17<sup>th</sup> 2012. Both the term debt and line of credit facilities are scheduled to close on or about August 17<sup>th</sup> 2010.

The Company's ability to continue as a going concern is dependent on its ability to generate positive cash flow from operations going forward, and to obtain alternative financing. Management is of the opinion that the following developments will contribute to maintaining the Company's ability to continue as a going concern:

- Positive cash flow from operations
- Healthy debt equity ratio of 0.97:1
- \$2.0 million of additional financing from another lender – completed in Q2'10
- \$500 thousand raised in a private placement, completed in Q3'10
- Subsequent to the year end, the Company has entered into financing agreement for a \$4.0 million operating line of credit from another lender. This facility was closed on August 17, 2010.
- Subsequent to the year end, the Company has received a proposal for refinancing of the above referenced, \$3.3 million callable debt which was closed on August 17<sup>th</sup>, 2010.

### **Long-Term Debt**

At YE'10 the long term debt, increased by 20%, to \$3.4M from the \$2.8M reported at YE'09. This is due to the refinancing of \$2.0M of current debt and subsequently reclassifying it as long term. At YE'10 callable debt decreased by 24%, to \$3.2M from the \$4.2M reported at YE'09. Capital lease obligations also decreased by 27%, to \$171K from the \$235K reported at YE'09. Total bank indebtedness on the operating line decreased by 37% or \$1.0M to \$1.8M from the \$2.8M reported at YE'09. Given the accounts relievable margining requirements on the credit line, the reduction of operating line indebtedness helps improve working capital during traditional periods of lower revenues, such as spring and summer.

### **Working Capital**

The Company continues to generate funds from operations sufficient to meet its primary monthly obligations. The Company's primary capital needs have been the funding of accounts receivable, debt service payments and capital expenditures. However, as working capital levels may vary primarily due to seasonal fluctuations and timing of payments and receipts, the Company utilizes its operating credit facility which assists with the timing of cash flows as required. Issues such as the ongoing worldwide financial crisis may have an impact on the Company's ability to renew its credit facility on existing or similar terms. Management will continue to monitor the impact of potential changes in the credit markets making necessary adjustments and continue to work on minimizing its working capital requirements which include a primary focus on reducing operating costs.

The working capital deficit calculation includes a current portion of long term debt of \$2.8M and a banking credit line balance of \$1.8M. The Company improved its working capital by \$500K in January 25, 2010 through a private placement of 5,000,000 units at a price of \$0.10. Each Unit consisted of one common share and one share purchase warrant. Each warrant entitles the holder

to purchase one common share at a price of \$0.15 per share if exercised within two years. Approximately 75% of this placement was taken up by directors, management and employees of the Corporation. Additional efforts to improve working capital may include the further disposition of non essential assets and alternative financing arrangements.

### Capital Management

With the governing objective to ensure sufficient capital to fund its ongoing business requirements, the Company evaluates the risk associated with its underlying assets by constantly evaluating the economic conditions and relevant business risks. The Company's objectives in managing capital are:

- to protect the Company's ability to function as a going concern
- to continue to provide value to the shareholders and other stakeholders
- to provide adequate return to shareholders by pricing its services appropriately
- to finance its operations properly in accordance with its growth strategies

In order to maintain or adjust the necessary capital structure, the Company may issue new shares, or sell assets to reduce debt.

### Contractual Obligations

Dalmac 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:

#### Lease Commitments

	2011	2012	2013	2014	2015
Equipment	\$ 11,187	6,371	4,352	2,909	-
Premises	474,012	354,126	109,633	-	-
Management Contracts	263,365	233,365	143,365	143,365	77,656
	\$ 748,555	593,862	257,350	146,274	77,656

The Company pays consulting fees of \$10K per month, pursuant to a contract that expired on September 15, 2009 and was extended to continue on a month to month basis. In addition, the consultant is entitled to a bonus based upon EBITDA to a cumulative maximum bonus of \$200K. The Company also pays a related party a consulting fee of \$12K per month pursuant to an agreement expiring on November 14, 2014. In addition, if the Company's net earnings before tax reach \$500,000, the agreement requires a bonus payment of 5% on the first \$500,000 of the Company's earnings before tax, 6% on amounts between \$500,001 and \$800,000, 7% on amounts between \$800,001 and \$1,000,000 and 7.5% on amounts over \$1,000,001.

### Shareholders' Equity

Consistent with the losses reported on current operations, shareholders' equity decreased by \$1.4M to \$6.7M from the \$8.1M reported at YE'09.

### Related Party Transactions

During the year the Company had the following transaction with related parties:

- a) Leased premises from a company controlled by a director for \$164,450 (2009 - \$109,217).
- b) Paid or accrued management and consulting fees to a company controlled by a director in the amount of \$160,038 (2009 - \$155,659) (Note 18(b) of April 30<sup>th</sup>, 2010 financial statements).

- c) The Company is indebted to a director of the Company for an amount of \$40,705 (2009-\$87,561) (Note 11 of financial statements). Interest expense of \$2,874 (2009 - \$4,529) has been paid during the year. The promissory note was non-interest bearing until February, 2008.
- d) The Company is indebted to a member of senior management for the amount of \$295,303 (Note 11 of yearend financial statements) by way of a promissory note in addition to \$573,203 in mandatorily redeemable preferred shares (Note 14). Preferred share dividend expense of \$71,558 (2009 - \$nil) is payable at year-end.

The aforementioned transactions were entered into in the normal course of business and have been valued in the financial statements at the exchange amount, which is the amount of consideration established and agreed to by the related parties and, in the opinion of management, were based on standard commercial terms.

### **Outstanding Share Data**

As of the date of this MD&A, the following are the issued and outstanding shares, options and warrants of the Corporation.

Common Shares	Options	Warrants
17,974,522	650,000	5,000,000

### **Subsequent Events**

The Company is in the process of refinancing its callable debt and operating facilities with new lenders and as such will be paying out the existing credit obligations of the current primary lender. The new facility will increase the line of credit availability from \$2.0M to \$4.0M. The interest rate on this facility is lender prime plus 3.75%, with interest payable monthly. This facility is for a 2 year term expiring on August 17<sup>th</sup> 2012. This facility will allow for quicker access to working capital when accounts receivable increase. Also as referenced earlier in this MD&A, the Company has entered into a new term agreement to refinance \$3.2 million of the existing callable debt. This facility consists of a \$3,300,000, non-revolving term facility which bears interest at 24% per annum. Repayment terms are interest only commencing on August 31, 2010 and maturing on July 23, 2011. The Company plans on refinancing this debt on more favorable terms over the course of the next 12 months. Both these new facilities were in place by August 17, 2010.

### **Outlook**

The winter drilling season did not really kick off until January of 2010 after which drilling activity roared back to near record levels. Nickle's Daily Oil Bulletin reported that Alberta had drilling rig utilizations around 60-65% for the first month of 2010, which marks a 40% improvement compared to the same time in the previous year. February 2010 continued the trend with utilizations peaking over 70%. A significant driver for these developments is the rediscovery of an all but abandoned oilfield which is transforming into one of Canada's biggest light oil opportunities. This field is located in west central Alberta and is referred to as the Cardium zone. Its reserves are estimated at about 10 billion barrels and it is believed that 70% of the oil is still in place. With the application of newly developed multi-stage fracturing technologies, the extraction of oil from the tight rock formation of the Cardium is now economically attractive. These developments, coupled with the recently announced changes in the Alberta oil and gas royalty rates are creating conditions that are expected to spark more activity in the Alberta energy sector.

The Canadian Association of Oilwell Drilling Contractors ("CAODC") has already bumped up its drilling forecasts by 36% for the second half of 2010. The CAODC anticipates that 11,587 wells will be completed in 2010, some 3,000 higher than its October projection of 8,523. Petroleum

Services Association of Canada (“PSAC”) has predicted that 2010 will see more oil than gas wells drilled in Alberta for the first time in 40 years. Dalmac’s core operations are situated in the geographical area of the Cardium zone and we expect to benefit directly from the activities required in its development. Management estimates that Dalmac’s operations in this area only require about 20-30 good wells to keep our equipment utilizations operating at a fairly steady pace.

The long term fundamentals still point to an expanding demand for oil and gas. The production rates in the Western Canadian Sedimentary Basin (“WCSB”) are continuously declining. This implies that more drilling will be required to maintain production at the current levels.

The outlook for Dalmac’s products and services continues to be more positive year over year. Over the main part of the past year the majority of Dalmac’s revenue stream was derived from existing production services such as fluid hauling. Production services usually exclude drilling and well workovers. Continued increases in drilling activity will only serve to supplement the existing revenue base. Dalmac plans to expand its continued focus on increasing relationships with new customers in the Cardium zone while concurrently maintaining and strengthening our relationships with existing customers. Dalmac’s goal is to provide a select range of products and services that provide an optimum solution for all our customers’ needs.

### **Risk Management**

*Business Risks:* Activity in the oil and gas industry is subject to a range of external factors that are difficult to manage, including resource demand, commodity pricing and climate. These include risks associated with the current crises in the financial sector in the United States, which is having an impact on commodity prices, the availability of credit, and other factors that affect the business of the Company. The Company plans to mitigate these risks by focusing on strong balance sheet fundamentals and remaining responsive to changes in industry dynamics. The Company has a comprehensive insurance policy to help safeguard its assets, operations, and employees. This is reviewed annually and revised as changes in circumstances warrant.

*Credit Risks:* The Company currently transacts with oil and gas exploration companies and is exposed to the associated credit risk. Management continually assesses the credit worthiness of these customers and monitors all outstanding balances. Management views the credit risk of its account receivables as normal for its industry.

*Financing Risk:* The ability of the Company to complete its budgeted capital acquisition program and meet its payment obligations as they become due will continue to be dependent on its ability to secure sufficient funds through additional debt and equity financing and to generate positive cash flow from operations.

*Supplier Risk:* The Company has a large portion of its service equipment and associated equipment manufactured by a single provider. While this arrangement provides certain market advantages, it also exposes the Company to potential short-term vulnerability if this supplier experiences unusual production disruptions or labor disputes.

*Seasonal and Weather Risk:* Seasonal factors and unexpected weather patterns may lead to reduced oil and gas exploration activity and corresponding declines in the demand for the Company’s services during various times of the year.

*Competitive Conditions:* The operating climate within the Western Canadian Sedimentary Basin is very competitive resulting in fluctuations of price and utilization rates. Dalmac attempts to mitigate these risks by creating good working relationships with its customers while focusing more on production operations and on longer term contracts.

### *Government Regulation*

The oil and natural gas industry in Canada is subject to federal, provincial, and municipal legislation and regulation governing such matters as land tenure, prices, royalties, production rates, environmental protection controls, the exportation of crude oil, natural gas and other products, as well as other matters. The industry is also subject to regulation by governments in such matters, including laws and regulations relating to health and safety, the conduct of operations, the protection of the environment and the manufacture, management, transportation, storage and disposal of certain materials used in the Corporation's operations. Government regulations may change from time to time in response to economic or political conditions. The exercise of discretion by governmental authorities under existing regulations, the implementation of new regulations or the modification of existing regulations affecting the crude oil and natural gas industry could reduce demand for the Corporation's services or increase its costs, either of which could have a material adverse impact on the Corporation.

In October 2007, the Government of Alberta unveiled a new royalty regime. The new regime introduced new royalties for conventional oil, natural gas and bitumen effective January 1, 2009 that are linked to price and production levels and will apply to both new and existing oil sands projects and conventional oil and natural gas activities. In response to declining industry activity levels, in November 2008 the Government of Alberta also introduced a transitional royalty program for new wells drilled subsequent to January 1, 2009. This transitional royalty program will result in temporarily lower royalty rates for some new wells drilled subsequent to January 1, 2009. Further incentives were announced in February 2009 which were aimed to stimulate drilling activity in 2009. In March, 2010, the Government of Alberta announced that it will make further changes to the province's royalty framework with final changes anticipated to be released in May, 2010. These changes to the royalty regime in Alberta are subject to certain risks and uncertainties, and may result in a material adverse effect on the industries in which the Corporation operates.

On March 10, 2008, the Canadian Federal Government announced new regulations regarding carbon dioxide emissions and sequestration which will impact future oil sands projects and coal fired electrical generation plants. Any initiatives by governments in areas in which the Corporation operates to set legally binding targets to reduce nation-wide emissions of carbon dioxide, methane, nitrous oxide and other so-called "greenhouse gases" may require the reduction of emissions or emissions intensity from the oil and natural gas industry. This may result in increased operating costs and capital expenditures for oil and natural gas producers, thereby decreasing the demand for the Corporation's services. Management is unable to predict the impact of these initiatives on the Corporation and it is possible that they will adversely affect the Corporation's business, financial condition, results of operations and cash flows.

### **CRITICAL ACCOUNTING ESTIMATES**

The Corporation prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"). In preparing its financial statements, management is required to make various estimates and judgments in determining the reported amounts of assets and liabilities, revenues and expenses, as well as the disclosure of commitments and contingencies. Management bases its estimates and judgments on its own experience and various other assumptions believed to be reasonable at the time and under the circumstances in existence when the financial statements were prepared. Anticipating future events cannot be done with certainty; therefore, these estimates may change as new events occur, more experience is acquired or the Corporation's operating environment changes. The accounting estimates believed by management to require the most difficult, subjective or complex judgments and which are material to the Corporation's financial reporting results are set out below.

#### *Allowance for Doubtful Accounts Receivable*

The Corporation periodically evaluates its accounts receivable on an individual and overall customer basis. This process consists of a review of historical collection experience, current aging

status of the customer accounts and other factors. Based on its review of these factors, it establishes or adjusts allowances for specific customers. This process involves a high degree of judgment and estimation. Accordingly, the Corporation's results of operations can be affected by adjustments to the allowance due to actual write-offs that differ from estimated amounts.

#### *Impairment of Long-Lived Assets*

Long-lived assets are comprised of property, plant and equipment and the finite-life intangible asset. Long-lived assets are tested for impairment when certain events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The recoverability test is performed using undiscounted future net cash flows that are directly associated with the asset's use and eventual disposition. The amount of impairment, if any, is measured as the difference between the carrying value and the fair value of the impaired assets.

#### *Goodwill Impairment*

Goodwill represents the excess of purchase price for a company acquired over the fair market value of the acquired company's net assets. Goodwill is allocated as of the date of the business combination to the Corporation's reporting units that are expected to benefit from the synergies of the business combination. Goodwill is tested for impairment at least annually.

The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and performance of the second step of the impairment test is unnecessary. The second step compares the implied fair value of the reporting unit's goodwill with its carrying amount to measure the amount of the impairment loss, if any.

#### *Depreciation and Amortization of Property and Equipment and Intangible Assets*

Depreciation and amortization is calculated using either the straight-line or declining balance method over the estimated useful life of the asset. Management bases the estimate of the useful life and salvage value of equipment on expected utilization, technological change and effectiveness of maintenance programs. Although management believes the estimated useful lives and salvage values of the Corporation's equipment are reasonable, they cannot be certain that depreciation and amortization expense measures with precision the true reduction in value of assets over time.

#### *Inventory*

Chemical inventory is valued at the lower of cost and net realizable value with cost being determined on average cost basis. Parts inventory is valued at the lower of cost and net realizable value with cost being determined on a first-in first-out basis. Cost includes the direct purchase price of the goods and transportation costs from vendors. There were no write-downs of inventory or reversals of previously written down inventory during the year. Cost of inventory sold is included on the income statement as "direct cost – product".

#### *Income Taxes*

The Corporation follows the asset and liability method of accounting for income taxes. Under this method, the Corporation records future income taxes for the effect of any difference between the accounting and income tax basis of an asset or liability, using the substantively enacted tax rates. Valuation allowances are established to reduce future tax assets when it is more likely than not that some portion or all of the future tax asset will not be realized. Estimates of future taxable income and the continuation of ongoing prudent tax planning arrangements have been considered in assessing the utilization of available tax losses. Changes in circumstances and assumptions may require changes to the valuation allowances associated with the Corporation's future tax assets.

### **Changes in Accounting Policies**

Effective May 1, 2009, the Company adopted CICA Section 3064 “Goodwill and Intangibles Assets”. This standard supersedes Sections 3062 “Goodwill and Intangible Assets” and Section 3450 “Research and Development Costs”. The new section establishes standards for the recognition, measurement and disclosure of goodwill, intangible assets and research and development costs. It also includes requirements for recognizing internally generated intangibles. There were no adjustments to goodwill and intangible assets in the adoption of this section.

*Future accounting policies*

In January 2009, the CICA issued Section 1582 “Business Combinations”, Section 1601 “Consolidations”, and Section 1602 “Non-controlling Interests”. These new standards are harmonized with IFRS. Section 1582 specified a number of changes including: an expanded definition of a business, a requirement to measure all business acquisitions at fair value, a requirement to measure non-controlling interest at fair value or proportionate share of identifiable net assets, and requirement to recognize acquisition related costs as expenses. Section 1601 establishes the standards of preparing consolidated financial statements. Section 1602 specifies that non-controlling interest be treated as a separate component of equity, not as a liability or other item of equity. The new standards will become effective in 2011. Early adoption is permitted. This new Section will only have an impact on the Company’s consolidated financial statements for future acquisitions that may be made in periods subsequent to the date of adoption.

In February 2008, the ASB confirmed the Canadian generally accepted accounting principles (“GAAP”) for publicly accountable enterprises will be converged with IFRS effective in calendar year 2011 with early adoption allowed starting in calendar year 2009. The conversion to IFRS will be required for the Company for interim and annual consolidated financial statements beginning on May 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP but there are significant differences on recognition, measurement and disclosures. The Company is currently conducting and evaluating its scoping efforts in order to prepare for the adoption of IFRS with regards to the significant areas that IFRS will have an impact on its consolidated financial statements. Given the economic recession and the low activity levels in the oil and gas sector over the previous year, the Company has found it necessary to prioritize its focus on operational and business issues during this period. Management expects that the prioritized operational issues will abate over the new fiscal year and this will allow for more focused time and effort to be directed at the IFRS implementation. Management is currently structuring a plan to have the Company in IFRS compliance for 2011.

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