

## **Management's Discussion and Analysis**

### **Dalmac Energy Inc.**

*Three Month Period ended July 31, 2005 (Q1)*

*Prepared September 28, 2005*

*This Management's Discussion and Analysis (MD&A") of the financial position and operating results of Dalmac Energy Inc. for the 3 months ended July 31, 2005 should be read in conjunction with corresponding financial statements for the quarter ended July 31, 2005. The MD&A and financial statements for earlier periods should also be considered relevant. Additional information relative to Dalmac Energy Inc. can be found on the SEDAR website at [www.sedar.com](http://www.sedar.com). In January of 2005 Dalmac received consent from the Alberta Securities Commission and the British Columbia Securities Commission to change its year end date to April 30 in order to be commensurate with the operations of its wholly owned subsidiary company McClelland Oil Services Inc. This has had the effect of making the Q1 results of Dalmac Energy Inc. for the period ending July 31, 2005 out of alignment with the quarterly periods of the preceding year. As a result the three month period ended June 30, 2004 has been used for the comparative financial period for the three months ended July 31, 2005. (In its Notice of Change of Year end the Corporation indicated that it would use the comparative financial information for the 3 month period ended July 31, 2004, but it has since determined to use the 3 month period ended June 30, 2004 for comparative purposes in order provide a comparison with previously issued statements.) This MD&A represents the 3 month non-audited, Q1 quarterly reporting for the operations of the Corporation*

### **Overview**

Dalmac Energy Inc. is a provider of "hot oiler", "hydro vac", "vacuum", "pressure" and "tanker truck" services to the energy sector. Dalmac also provides "methanol/glycol", and "KCL" distribution and delivery services.

In the period ended July 31, 2005, the Corporation had 58 service units which primarily service the west central Alberta areas of Fox Creek, Hinton and Grande Cache. This number includes the "hydro vac" units acquired through the S Young Oilfield Ltd. transaction which was announced March 15, 2005. The Q1 quarter ended July 31, 2005 typically represents the slowest period of the year. This quarter was impacted by the spring break-up and the heavy rainfall in June which resulted in a decline of activity throughout Western Canada. This quarter is normally our slowest period because the weather conditions restrict operating heavy equipment in the oil and gas fields.

In spite of the weather issues, the Corporation is experiencing a strong steady demand for its products and services and industry activity levels continue to remain at all time highs. The demand for Dalmac's products and services continues to exceed the company's current capacity to supply and this resulted in high levels of work turndowns during Q1. The Corporation's operating regions of Fox Creek, Hinton and Grande Cache have experienced activity levels that would normally be seen during winter months and management expects that activity in these areas will continue to increase over the course of the year.

### **Results of operations**

The results of operations record the full 3 months of operations for the period ended July 31, 2005. In the quarter ended June 30, 2004 Dalmac was a Capital Pool Company with no assets other than

the capital raised as a result of its IPO. Therefore the comparison with similar periods in the previous year provides little benefit. After the completion of Qualifying Transaction, being the purchase of McClelland Oil Services Inc. (“McClelland”), Dalmac’s year-end was changed to April 30, 2005 in order to be coordinated with McClelland’s operations. This resulted in Dalmac’s first quarter of this year ending July 31, 2005 while the closest corresponding quarter in the previous year was the period ended June 30, 2004.

### Selected financial Information

	Quarter Ended July 31 2005	Year Ended April 30 2005	Quarter Ended June 30, 2004
<b>For the periods ended (Cdn Dollars)</b>			
Revenues	2,807,275	7,309,943	0
Gross Margin	592,959	2,158,002	0
Gross Margin %	22%	30%	0%
Operating income (loss)	(358,156)	938,190	0
Operating income /share - basic	(0.07)	0.23	0.00
Operating income / share - diluted	(0.06)	0.20	0.00
Net income (loss)	(237,816)	327,551	(9,594)
Net income per share - basic	(0.04)	0.08	(0.01)
Net income per share - diluted	(0.04)	0.07	(0.01)
Total Assets	9,410,095	9,727,208	699,176
Total long-term financial liabilities	3,452,831	3,408,868	0
Weighted average common shares -basic	5,870,977	4,154,757	3,350,983
Weighted average common shares - diluted	6,276,759	4,816,814	3,686,081

The revenues from equipment operations were \$2,807,275 for the quarter ended July 31, 2005. This represents an increase of 100% over from the previous year’s quarter ended June30, 2004

Gross profit for the quarter ended July 31, 2005 was \$592,959 or 22% as a percentage of revenue, compared to no activity in the quarter ended June 30, 2004. The net income (loss) for the Corporation for the quarter ended July 31, 2005 was \$(237,816) or \$(0.04) per basic and fully diluted share. The net income (loss) for the Corporation for the preceding financial year was \$(9,594) or \$(0.01) per share on a fully diluted basis. Total assets at July 31, 2005 increased by \$8,710,919 to \$9,410,095, an increase of 1346% from \$699,176 as at the period ending June 30, 2004.

The direct costs for the quarter ended July 31, 2005 consists of, trades and subcontracts (\$763,518), direct labour and benefits (\$495,215), services vehicle costs (\$449,916), COGS (\$270,353), equipment repairs (\$136,542), property rent & taxes (\$63,207), workers compensation (\$23,937), and travel & accommodations (\$11,628). Direct costs totaled \$2,214,316, or 78% as a percentage of revenue, for the quarter ended July 31, 2005. There are no direct comparables for the quarter ended June 30, 2004.

Selling, general and administration (“SG&A”) costs for the 3 months ended July 31, 2005 were \$951,115, up from \$13,004 in the 3 months ended June 30, 2004. As a percentage of revenues the SG&A costs were 34% for the current period.

The Corporation has incurred professional fee expenses of \$25,541 which mostly apply to the due diligence costs associated a short form equity offering. Travel and automotive costs have increased by \$86,444 to \$88,699 from \$2,255 in the quarter ended June 30, 2004. This is due to the

sales, management and administration, travel and vehicle costs, which were largely non-existent in the quarter ended June 30, 2004.

For year the 3 month period ended July 31, 2005, the Corporation has paid \$323,534 in wages and benefits for sales, administration and supervisory personnel. The Corporation also paid \$55,855 in management fees, salaries and benefits. There were no wages, salaries or employee benefits paid for the quarter ended June 30, 2004.

Selling, general and administration (“SG&A) costs for the quarter ended July 31, 2005 was limited to the expenses referred above below.

SG&A Expenses	Quarter Ended July 31 2005	Quarter Ended June 30 2004
Wages and benefits	323,534	-
Amortization	218,119	-
Travel and automotive	88,699	2,255-
Interest on long term debt	71,294	-
Management salaries & fees	55,855	
Repairs and maintenance	36,750	
Telephone and utilities	36,378	453
Office	30,246	3,875
Professional fees	25,541	6,168
Interest and bank charges	24,593	-
Advertising and promotion	21,441	253
Insurance	18,665	-
<b>Total</b>	<b>951,115</b>	<b>13,004</b>

### Selected Period Information

For the periods ended (Cdn Dollars)	3 Month Period Ended July 31 2005	16 Month Period Ended April 30, 2005	3 Month Period Ended Mar 31, 2005	3 Month Period Ended Dec 31 2004
Gross Margin	2,807,275	2,158,002	1,227,783	466,149
Gross Margin %	22%	30%	28%	23%
Operating income (loss)	(358,156)	938,190	751,905	28,779
Operating income per share - basic	(0.07)	0.23	0.13	0.01
Operating income per share - diluted	(0.06)	0.20	0.12	0.01
Net income (loss)	(237,816)	327,551	627,905	(225,692)
Net income per share - basic	(0.04)	0.08	0.11	(0.04)
Net income per share - diluted	(0.04)	0.07	0.10	(0.04)

For the periods ended (Cdn Dollars)	3 Month Period Ended Sept 30, 2004	3 Month Period Ended June 30, 2004	3 Month Period Ended Mar 31 2004	Incorporation to Period Ended Dec 31, 2003
Revenues	0	0	0	0
Gross Margin	0	0	0	0
Gross Margin %	0	0	0	0
Operating income (loss)	(76,169)	(13,006)	(66,388)	(17,271)
Operating income per share - basic	(0.03)	(0.01)	(0.02)	(0.01)
Operating income per share - diluted	(0.02)	(0.01)	(0.02)	(0.01)
Net income (loss)	(72,737)	(9,594)	(62,953)	(16,981)
Net income per share - basic	(0.02)	(0.01)	(0.02)	(0.01)
Net income per share - diluted	(0.02)	(0.01)	(0.02)	(0.01)

### Liquidity and Capital Resources

The long term debt consists of conditional sales contracts for operational vehicles and equipment, bank loans payable and promissory notes. The conditional sales contracts amounted to \$3,616,347. The bank loans payable consists of two separate loans for the purchase of S Young Oilfield Ltd. and other related equipment, totalled \$386,739 at July 31, 2005. The promissory notes, in the amount of \$353,434, \$311,760 and \$140,000, are for the vendor take backs associated with the S Young Oilfield Ltd. and the McClelland Oil Services Inc. purchases and are subordinated to all senior debt. The total amount of long term debt at July 31, 2005 was \$4,421,541. The amount of long term debt to be repaid over the next 9 months is \$968,710, and the residual long term debt at the end of the current year, based on current debt, will be \$3,452,831.

The cash flow from financing activities decreased to \$(231,077) from \$(8,000) in the quarter ended June 30, 2004. \$53,086 was raised from the exercise of brokers warrants, \$54,109 raised from proceeds of long term debt financing and \$338,272 went to pay off long term debt. Wolverton Securities Ltd. exercised 176,953 of its agent's options for common shares of the Corporation for proceeds of \$53,086 (mentioned above) pursuant to the Agent's' stock option agreement.

Cash outflows from investing activities increased to \$66,970. This increase in investing activities reflects the purchase of various operating equipment. The net capital assets at Q1 totalled \$5,344,791, and goodwill was \$1,504,313.

The current quarter's cash flow increased by \$174,150 to \$154,867 from \$(19,283) in the previous comparable quarter of last year.

At July 31, 2005, the Corporation had a current bank indebtedness of \$1,001,866, accounts payable and accrued liabilities of \$1,424,028 and accounts receivable of \$2,083,260. The working capital deficit of the Corporation at July 31, 2005 was \$949,936. The working capital position should continue to improve with positive earnings in each successive month. The Corporation is presently in breach of its debt to tangible net worth ratio required under its covenants with its principal lender, but that the lender has agreed to waive that covenant for fiscal 2005 provided that Dalmac is in full compliance by the fiscal quarter ending October 31, 2005. These loan facilities include an operating loan (line of credit) set at a maximum of \$1,500,000 and a \$750,000 non-revolving loan. At present Dalmac has drawn down approximately \$950,000 of the line of credit and has a balance of approximately \$395,000 on its non-revolving loan.

The Corporation announced on September 27, 2005 that it had completed a short form offering of 1,428,571 units at a price of \$0.70 per unit for a total proceeds of \$1 million. Each unit consists of one common share and one half share purchase warrant; each whole share purchase warrant

entitles the holder to purchase on additional common share at a price of \$0.85 per share if exercised by September 27, 2007. The Corporation also granted agents options to purchase a total of 142,857 units at a price of \$0.70 per unit as part of the agent's compensation in connection with this offering. The equity raised is expected to bring the Corporation's debt to tangible net worth back into compliance.

There is an element of cyclical in the Corporations activities. The Corporation generally has two very strong quarters and two weak quarters, though just how weak depends on weather patterns. The winter period is the most active for Dalmac and the demands on working capital are highest during this period.

## Share Capital

### Summary of securities as at the end of the reporting period

a) Unlimited Common Shares without nominal or par value  
Unlimited Preferred shares without nominal or par value

Capital	Amount Authorized	Outstanding as at July 31, 2005	Outstanding as at June 30, 2004
Dalmac Common Shares	Unlimited	5,972,917	3,350,983 shares
Preferred Shares	Unlimited	Nil	Nil
Long Term Debt	N/A	\$3,452,831	Nil

The following table sets forth options granted to Executive Officers and directors of the Corporation and which are outstanding as of April 30, 2005.

Group (Number of Persons in Group)	Number of Dalmac Shares Under Option	Date of Grant	Expiry Date	Exercise Price per Dalmac Share	Market Value of Securities Underlying Option on Date of Grant (\$/Security)
Executive Officers including directors who are Executive Officers (one)	158,076	December 22, 2003	December 22, 2008	\$0.30	\$0.30
Directors who are not also Executive Officers (three)	97,706	December 22, 2003	December 22, 2008	\$0.30	\$0.30
Executive Officers including directors who are Executive Officers (one)	25,000	March 30, 2005	March 21, 2010	\$0.45	\$0.45
Directors who are not also Executive Officers (four)	125,000	March 30, 2005	March 21, 2010	\$0.45	\$0.45
<b>TOTAL</b>	<b>405,782</b>				

**Note:**

- (1) As the Corporation was not listed on an exchange on the date of grant, the initial CPC prospectus offering price of \$0.30 has been used to determine the market value on the date of grant.

At the quarter ended July 31, 2005, the Corporation had 5,972,917 million common shares issued and outstanding. The Corporation has issued 255,782 options to the Directors of the Corporation. These options are exercisable at \$0.30 and were granted December 22, 2003. The expiry date on these options is December 22, 2008. The Corporation has issued a further 150,000 options, on March 21, 2005, to the Directors of the Corporation which are exercisable at \$0.45. These options expire March 21, 2010.

Effective the closing of the short form offering on September 27, 2005 the Corporation issued 1,429,571 units of Common Shares and half Warrants and has granted Wolverton Securities Ltd. 142,857 units to purchase common shares of Dalmac Energy Inc. at \$0.70 per common share. Each unit consists of one common share and one half share purchase warrant; each whole share purchase warrant entitles the holder to purchase on additional common share at a price of \$0.85 per share if exercised by September 27, 2007.

**Related Party Transactions**

During this reporting period Corporation leased premises from 1010417 Alberta Ltd., related by common shareholders, for a total consideration of \$40,800. The Corporation also acquired all of the outstanding shares of McClelland Oil Services Inc. of which the details can be found in note 1 of the July 31, 2005 financial statements, from a related company related by common shareholders. Also, as of July 31, 2005, the Corporation was indebted to two directors of the Corporation for an amount of \$451,760 (see note 7 of July 31, 2005 financial statements). The interest on these loans during the period was \$6,283. The aforementioned transactions are in the normal course of operations and have been valued in the July 31, 2005 financial statements at the exchange amount which is the amount of consideration established and agreed to by the related parties.

**Stock – based Compensation**

The Corporation has adopted the Canadian Institute of Chartered Accountants (“CICA”) amended standard for stock-based compensation. The company has adopted the fair value standard, which requires that compensation expense be calculated and recorded in the income statement for options issued on or after January 1, 2004.

**Critical Accounting Policies**

The Corporation’s financial statements have been prepared in accordance with Canadian generally accepted accounting Principles (GAAP) and sometimes may include estimates that reflect management’s estimates and assumptions which affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements for the period reported. Estimates are based upon historical experience and various other assumptions that reflect management’s best judgments. These estimates are evaluated periodically and form the basis for making judgments regarding the carrying values of assets and liabilities and the reported amount of revenue and expenses. Actual results may differ.

## **Recent Investment Activities**

On March 15, 2005, Dalmac announced completion of its purchase the business and assets of S Young Oilfield Ltd., a company engaged in “hydro vac” operations in the Fox Creek, Alberta region. Hydro vac operations involve excavation and trench of mainly non-contaminated materials where as McClelland vac operations mainly involve work with contaminated material. Dalmac paid a total of \$850,000, of which \$150,000 will be paid in cash on closing; \$124,000 was paid by the issuance of Dalmac shares at \$0.59. Dalmac paid out approximately \$180,000 in debt on the equipment, and the Vendor will finance the balance over 3 years.

## **Business Risks**

Dalmac’s business varies directly with exploration and production drilling activity in northwestern Alberta. The Corporation focuses on production services rather than exploratory work, so the demand for its products and services would be slightly insulated. Production and field work provides a steady baseline demand for the company’s products and services. However, those competitors that are affected initially by reduced exploration activity will have idle equipment which they would hope to redeploy into production activities. This could increase competition and put pressure on margins for Dalmac’s core operations.

The risks associated with external competition are minimized by concentrating on activities in areas where the company has demonstrated technical and operational advantages and by employing highly qualified professional staff. Environmental and safety standards and regulations are continually becoming more stringent in the industry and Dalmac is committed to maintaining its high standards. The Corporation also mitigates business risks by establishing strategic alliances with qualified partners, developing new technologies and methodologies as well as investigating new business opportunities.

## **Outlook**

Current world commodity prices continue to be at an all time high levels. Exploration and production from the Western Canadian Sedimentary Basin is also continuing at record levels. This bodes well for Dalmac in the foreseeable future. The current demands for the company’s products and services are exceeding the Corporations capacity to supply. This provides excellent growth opportunities for Dalmac.

The current quarter was impacted by late spring break up and heavy rainfall in the month of June which restricted the operation of heavy equipment in the oil and gas fields. In spite of this, the Corporation’s operating areas are experiencing activity levels that would normally be seen in the winter months. Given that the Corporation traditionally has two weak quarters followed by two very strong quarters, this bodes well for a very robust and active winter season.

Dalmac believes it has adequate working capital, cash flow from operations, and access to capital to fund ongoing business requirements. Management believes the Corporation has a cost structure that has sufficient variability to be able to adapt to the volatility of the industry. The Corporation has experienced management at all levels of operations and administration who are motivated to achieve success in both the short and long term.

Dalmac is currently reviewing expansion opportunities, which may involve the requirement for capital expenditures beyond the normal course for the Corporation. Dalmac may pursue any or all these opportunities that may present themselves. In doing so the Corporation may incur term debt, issue equity, and retain cash that might otherwise be paid as dividends or any combination of the foregoing.

The activity levels for Dalmac's operations are expected to remain very strong. According to CAODC forecasts, the industry will complete over 24,000 wells this year. With industry activity at these levels Dalmac is projecting a strong fiscal 2006.

*Statements throughout this report that are not historical facts may be considered "forward looking statements". Such statements are based on current expectations that involve risks and uncertainties, which could cause actual results to differ from those anticipated. Important factors that can cause anticipated outcomes to differ materially from actual outcomes include the impact of general economic conditions, industry conditions, competition from other industry participants, volatility of petroleum prices, the ability to attract and retain qualified personnel, changes in laws or regulations, currency fluctuations, continued ability to access capital from available facilities and environmental risks. References in this MD&A to "Dalmac", the "Corporation", "Company", "us", "we" and "our" mean Dalmac Energy Inc. and its subsidiaries 750761 Alberta Ltd. and McClelland Oil Services Inc.*