



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

**Year Ended April 30, 2006**

**Prepared August 25, 2006**

*This Management Discussion and Analysis (MD&A) dated August 25, 2006 focuses on key statistics from the audited consolidated financial statements for Dalmac Energy Inc. for the year ended April 30, 2006 and pertains to known risks and uncertainties relating to the oilfield services industry where Dalmac operates. This discussion and analysis should be read in conjunction with the Company'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 MD&A 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).*

### *Forward-looking information*

*Statements in this MD&A relating to matters that are not historical facts are forward looking statements. Such forward-looking statements may involve known and unknown risks and uncertainties which may cause the actual results, performances or achievements of the Company to be materially different from any future results implied by such forward looking statements. Some of the risks that may cause actual results to vary are described under the "Business Risks" section. 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.*

### **Corporate Overview**

Dalmac Energy Inc. ("Dalmac" or "the Company") is a provider of "hot oiler", "hydro vac", "vacuum", "pressure" and "tanker truck" services to the west central Alberta energy sector. Other products and services provided by the Company include "methanol/glycol", and "KCL" distribution and delivery. The Company presently has a total of 67 service units.

2006 was an excellent growth year for Dalmac. Revenue has more than doubled from the preceding year. The increase in revenue is due to organic growth. The demand for Dalmac's products and services is continuing to exceed the Company's current capacity to supply which further indicates strong growth opportunities. The Company has received new equipment, through purchases or leases, valued at \$2.7 as of April 30, 2006 and will supplement that with a further purchase of \$5.0 million of new equipment expected to be delivered by the third quarter of fiscal 2007 (Q3, 2007).

Effective April 30, 2005 the Company changed its year end date from December 31 to April 30 resulting in a 16 month year for the financial period ended April 30, 2005. All future financial reporting will be done on the April 30 year end basis. This change further impacted on the quarterly comparisons and as a result the quarters are referred to "Period Ended" (See Summary of Quarterly Results)

## Selected financial Year End Information

(000's Cdn Dollars, except per share)	YE Apr 30, 2006	16 mo's YE Apr 30, 2005	YE Dec 31 2003
Revenues	14,779	7,310	0
Gross Margin	4,365	2,711	0
Gross Margin %	29%	37%	0%
Net income (loss)	742	267	(17)
Net income per share - basic	0.10	0.08	(0.01)
Net income per share - diluted	0.09	0.07	(0.00)
Total Assets	16,259	9,637	756
Total long-term financial liabilities	2,441	3,148	0
Shareholder Equity	9,541	2,052	745
Weighted average common shares -basic	7,679	4,155	3,351
Weighted average common shares - diluted	8,106	4,817	4,210

### Revenue

The annual revenue for the year ended (YE) April 30, 2006 increased by \$7.5 million to \$14.8 million or 102% over the \$7.3 million reported in 2005. High oil and gas prices combined with increased activity in the energy sector translated into increased revenues for the Company.

The 102% increase in revenue can be attributed to:

- Purchase or leases of new equipment, valued at \$2.7 million consisting of- 2 hydro vac units, 1 combo vac unit, 1 hot oiler, 1-3 ton 4x4 mini pumper, 2 –tandum tankers, 3 steel tridem pup trailers, 1 – aluminum tridem pup trailer and the immediate productive utilization of the new equipment to generate additional revenues.
- Successful marketing and consistent high quality customer service, especially in the Hinton – Grande Cache areas, created an expanded customer base and increased demand for our services
- Successful bundling of services to customers generated more revenue opportunities which would have previously been provided to our customers by third party sources

Revenues for YE 2003 reflect the period Dalmac was a Capital Pool Company.

### Gross Margin

The gross margin for 2006, increased by \$1.6 million to \$4.3 million or 60% over \$2.7 million in 2005. The Gross profit margin declined to 29% from 37% in the previous year primarily due to the increased use of subcontract operators driven by the demand for our services. The profit margins on subcontractors about 10% compared to 30% for company owned equipment. The Company received delivery of the \$2.7 million of new purchased or leased equipment, which when delivered has reduced the utilization of subcontractors. The previous year is not indicative of 12 months of operations due to the fact that it covers a 16 month period which only records the 6 months of operations of the Company's subsidiary, McClelland Oil Services Inc.. These last 6 months coincide with the Company's busiest periods. This also effectively, minimizes the negative

impact of the months that are weaker due to spring break up conditions. The 6 months of operations recorded is due to the timing of the Qualifying Transaction which occurred in early November 2004. The change in gross margin is attributed primarily to:

- larger revenues in 2006 compared to 2005.
- Along with increased purchase of new equipment the company hired new personnel. This increased training costs which are not immediately offset by increased revenue, thereby increasing labour costs disproportionately to revenues. The Company has introduced an extensive and effective training and education program of operations and field personnel which has increased the overall knowledge base. This knowledge transfer allows the new trainees to become productive within a relatively short period of time. This will minimize the effect of the “learning curve” and translate to a positive impact on costs.
- The Company’s receipt of new equipment purchased and leased decreased the use of subcontractors. Utilizing sub contractors is more costly than utilizing Company equipment. The receipt of the new equipment, however, happened primarily in the last quarter of 2006 therefore its effect on the gross margin was limited.
- 2005 represented 16 months of operations and as such did not fully reflect the effect of losses in the earlier quarters caused by spring breakup conditions.

Net income increased \$474,698 to \$742,060, or 178% from \$267,362 reported in 2005. Net income per fully diluted share increased by \$0.02 to \$0.09, or 29% from the \$0.07 reported in the previous period.

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

General and administrative (“G&A”) costs, which represent all non-direct operational costs, were up by \$0.5 million to \$1.2 million or 65% over the \$0.6 reported in the previous period. Wages & Benefits increased \$0.6 million to \$1.1 million or 96% from the \$0.6 reported for the period ended April 30, 2005. G&A plus wages and benefits increased 78% while revenues increased 102%. This indicates that the Company has been able to increase revenues without a corresponding increase operating (G&A, Wages & Benefits) expenses.

### **Amortization of Property and Equipment**

Amortization of property and equipment, increased by \$349,113 to \$737,959, or 90%, over the \$388,846 in the previous period. Amortization is dependant on the timing of additions to property and equipment. Disposals of equipment during the year ended April 30, 2006 were consistent with the normal course of business activities and resulted in a loss of \$73,676 on the disposal of assets compared to a loss of \$17,980 in the previous period.

### **Interest Expense**

Interest expense for long term debt for the year ended 2006 increased \$132,245 to \$251,196 or 111% over the \$118,951 reported in the previous period. The long term debt is for equipment purchases and vendor take back financing which is associated with the acquisition of McClelland Oil Services Inc. and S Young Oilfield Ltd. In 2006 interest on callable debt and other was \$67,206.

### **Income Taxes**

The Company was in a taxable position in 2006. The current income tax obligation was \$150,645 and future tax obligation was \$874. The company has utilized tax loss carry forwards as at April 30, 2006, the benefit of which has been recognized in the consolidated financial statements.

### Summary of Quarterly Results

	Q4, 06 Period Ended Apr 30 2006	Q3, 06 Period Ended Jan 31, 2006	Q2, 06 Period Ended Oct 31, 2005	Q1, 06 Period Ended Jul 31 2005
<b>(000's Cdn Dollars, except per share)</b>				
Revenue	4,018	4,533	3,472	2,807
Net income (loss)	535	411	30	(238)
Net income per share - basic	0.08	0.06	0.005	(0.04)
Net income per share - diluted	0.07	0.05	0.004	(0.04)

#### Selected Period Information

	*Q6, 05 Period Ended Apr 30 2005	Q5, 05 Period Ended Mar 31, 2005	Q4, 05 Period Ended Dec 31, 2004	Q3, 05 Period Ended Sept 30 2004
<b>For the periods ended (Cdn Dollars)</b>				
Revenue	784	4,442	2,084	0
Net income (loss)	(-296)	628	(226)	(73)
Net income per share - basic	(0.07)	0.151	(0.04)	(0.02)
Net income per share - diluted	(0.07)	0.130	(0.04)	(0.02)

\* The quarter endings do not conform to a normal fiscal year due to the year end changes associated with the qualifying transaction which resulted in a 16 month year.

#### Description of Quarterly Results

##### Revenue by Quarter (000)

<u>Q4, 2006</u>	<u>Q6, 2005</u>
\$4,018	\$784

The fourth quarter, depending on when spring break up, can be the busiest quarter. In February and March 2006 we received the balance of the new equipment purchases (\$0.7 million). In 2006 spring breakup began early. From the 2<sup>nd</sup> week of April to the May long weekend road bans were in effect which had the result of bring operations to a near crawl. Q6, 2005 was a one month quarter due to the timing of the 16 month year end in 2005.

<u>Q3, 2006</u>	<u>Q5, 2005</u>
\$4,533	\$4,442

The third quarter is generally the second busiest quarter. In 2006 this was not the case because of an early spring break in April. The winter months are the busiest because they allow access into various terrains which are not accessible in other seasons, i.e. such as swamp and muskeg. Q3, 2006 represented the months of November, December and January where Q5, 2005 represented the months of January, February and March. In Q3, 2006, we received the bulk of the \$2.7 new equipment purchases. (\$2.0 million)

<u>Q2, 2006</u>	<u>Q4, 2005</u>
\$3,472	\$2,084

The second quarter is traditionally Dalmac's 3rd busiest quarter. It usually marks the preparation for winter activity. Q2, 2006 represented the months of August, September and October where Q4, 05 represented the months of October, November and December. In Q4, 2005, Dalmac completed its qualifying transaction on November 4, 2004, and as such there was only 2 months of operational revenue claimed.

<u>Q1, 2006</u>	<u>Q3, 2005</u>
\$2,807	\$0

The first quarter is traditionally the slowest quarter. It marks the spring breakup and the generally slower summer holiday season. In 2006, the spring break up was relatively short and the activity levels started increasing soon after. The summer months were exceptionally busy. Q1, 2006 represented the months of May, June and July. In Q3, 2005, which ended September 30, 2004, Dalmac was a Capital Pool Company with no revenue to report.

### Liquidity and Capital Resources

Dalmac's capital requirements consist primarily of working capital necessary to fund operations, capital expenditures related to the purchase and manufacture of operating equipment, and capital to finance strategic acquisitions. Sources of funds to meet these capital requirements include cash flow from operations, external lines of credit, equipment financing, term loans and equity financings.

The Company has a banking facility of \$3.0 million, which consists of a \$1.5 million line of credit and a \$1.5 million demand Revolving Term Loan. The interest rate on the line of credit is a floating rate of 1% above the bank's prime lending rate (which prime lending rate is presently 6%) and the rate on the term loan is a floating rate equal to 1.25% above the bank's prime lending rate. In addition the Company has a \$4.0 million leasing line of credit with GE Canada Equipment Financing. As of April 30, 2006 bank indebtedness decreased by \$559,733 to \$597,000 or 48% less than the \$1,156,733 outstanding at end of the previous period.

At April 30, 2006, long term debt decreased by \$0.7 million to \$3.7 million or 16% from the \$4.4 million in the preceding period. The callable debt consisted of , bank loans payable for equipment purchases The callable debt decreased by \$49,397 to \$307,080 or 14% lower than the \$356,477 outstanding as at April 30, 2005.

On September 27, 2005 the Company 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 Company 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.

On February 28, 2006, Dalmac completed a bought deal private placement with Research Capital Company for total proceeds of \$6,000,000 through the sale of 4,800,000 units at \$1.25 per unit. Each unit consists of one common share and one half of one common share purchase warrant of the Company. Each common share purchase warrant entitles the holder to purchase one common share at \$1.50 and is valid for 24 months from closing. Underwriting fees consisted of 8% cash commission on the gross proceeds with options to acquire 480,000 units at an exercise price of \$1.25, such options expire February 28, 2008.

### Working Capital

At April 30, 2006, the Company had a positive working capital of \$5.4 million, compared to a deficit of \$1.3 million at April 30, 2005. A substantial part of the working capital increase resulted from the financings in September of 2005 and February of 2006.

The Company believes that it has adequate capital resources available to meet its working capital and capital expenditure requirements as they arise.

### Shareholders' Equity

At April 30, 2006, shareholders' equity increased by \$7.5 million to \$9.5 million or 365% over the \$2.0 million reported at April 30, 2005. Retained earnings increased \$742,060 to \$992,266 or 297% over \$250,206 reported at April 30, 2005. The Short Form offering of \$1.0 million which closed in September 27, 2005 and the private placement of \$6.0 million completed February 28, 2006 contributed significantly to the increase in equity.

#### 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 April 30, 2006	Outstanding as at April 30, 2005
Dalmac Common Shares	Unlimited	12,373,978	5,795,964
Preferred Shares	Unlimited	Nil	Nil

As of the date of this MD&A the following table summarizes the issued and outstanding shares options and warrants:

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Common Shares	Options	Warrants
12,427,833	904,189	3,074,616

### Related Party Transactions

During this reporting period Company leased premises from 1010417 Alberta Ltd., a company owned by a director of the Company, for a total consideration of \$81,600. As of April 30, 2006, the Company was indebted to a director of the Company for an amount of \$140,000. There was no interest due on this loan during the year ended April 30 2006.

In accordance with a management and consulting contract with a company controlled by a director, the Company paid or accrued \$160,380 ( 2005 - \$51,000). The Company pays consulting fees of \$9,350 per month, increasing by 10% per year, pursuant to a contract agreement which expires on November 14, 2009. In addition, if the Company's net earnings before tax reach \$500,000, the contract 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 \$1,000,000.

The aforementioned transactions are in the normal course of operations and have been valued in the April 30, 2006 financial statements at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

### **Critical Accounting Policies**

The Company'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 Developments**

On May 25, 2006, Dalmac announced the acquisition of \$5.0 million of new operating equipment, of which delivery is expected in Q3 and Q4 of 2007. All the equipment will not be finished at the same time and the delivery will be spread out from late October, 2007 to January 2008. This equipment will consist of hot oiler units, pressure trucks, sour sealed tri drive haulers, chemical trucks, combination vacs, sour sealed bulkers and various other equipment.

### **Subsequent Events**

There have been no subsequent events of any significance since April 30, 2006.

### **Business Risks**

Dalmac's business varies directly with production, exploration and drilling activity in northwestern Alberta and is subject to the risks and variables inherent in the oilfield services industry. The demand for Dalmac's products and services is directly affected by factors such as oil and gas commodity prices, weather, changes in legislation, exchange rates, the general state of domestic and world economies, concerns regarding fuel surpluses or shortages, substitution through imports or alternative energy sources, changes to taxation or regulatory regimes and the broad sweep of international political risks such as war, civil unrest, nationalization and expropriation or confiscation, which are all beyond the control of the Company and cannot be predicted. The oil market is influenced by global supply and demand considerations and by the supply management practices of OPEC. The natural gas market is primarily influenced by North American supply and demand and by the price of competing fuels.

The Company focuses mainly on production services rather than exploratory work, so the demand for its products and services is slightly insulated from the affects of changes in commodity prices. 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 may attempt 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 Company also mitigates business risks by establishing strategic alliances with qualified partners, developing new technologies and methodologies as well as investigating new business opportunities.

## **Outlook**

Dalmac believes it has adequate working capital, cash flow from operations, and access to capital to fund its ongoing business requirements. Management believes the Company has a cost structure that has sufficient variability to be able to adapt to the volatility of the industry. Dalmac has experienced management at all levels of operations.

High commodity prices continue to bode well for the oil and gas industry. Exploration and production from the Western Canadian Sedimentary Basin is also continuing at record levels. This, in turn, creates a healthy environment for Dalmac's products and services in the foreseeable future. The Company's ability to meet the demands for its products and services is limited by its current capacity. This invariably results in work turn downs because of lack of equipment. This indicates excellent growth opportunities for Dalmac. Fiscal 2007 is expected to replicate last year's demand levels for the Company's products and services. With the additional equipment purchases expected to be delivered in the winter of fiscal 2007, Dalmac is encouraged by the expected growth in revenue.

Dalmac is currently reviewing expansion opportunities, including possible acquisitions, which may involve the requirement for capital expenditures beyond the normal course for the Company. Dalmac may pursue any or all these opportunities that may present themselves. In doing so the Company may incur debt, issue equity, or any combination of the foregoing.

## **Disclosure Controls and Procedures**

As defined in Multilateral Instrument 52-109, disclosure controls and procedures require controls and other procedures be designed to provide reasonable assurance that financial and non-financial information required to be disclosed is duly recorded, processed, summarized, accumulated and communicated to management. Such information must be disclosed on a timely basis and be in accordance with provincial and territorial securities legislation.

The Company has designed and evaluated the effectiveness of its disclosure controls and procedures, as defined, and has concluded they were effective as of the end of the period covered by this report.