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Rally Energy Reports Record Production and Earnings for First Quarter 2007

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“RAL” - TSX Exchange “RLE” - Frankfurt Stock Exchange

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Rally Energy (the “Corporation”) is pleased to announce the following operational and financial results for the First Quarter of 2007:

HIGHLIGHTS

	<u>Quarter ended March 31</u>		
	<u>2007</u>	<u>2006</u>	<u>Change</u>
Production (boe/d)	6,294	2,741	+130%
Average Price (\$/boe)	40.67	40.79	0%
Revenue (\$ million)	23.0	10.0	+129%
Cash Flow (\$ million)	8.8	3.4	+155%
Net Earnings (\$ million)	4.7	0.9	+439%
Capital Expenditures (\$ million)	27.1	7.1	+280%

Working capital at the end of the first quarter was \$18.3 million with no bank debt. An additional \$12.4 million was held in drilling and facilities inventory to be used for future capital expenditures in Egypt and Pakistan.

During the first quarter, in Egypt the Corporation drilled eight successful conventional oil wells, constructed facilities to accommodate low cost gas use in field operations, and completed the first train of the central production facility. The second train of the central production facility is expected to commence operations this month and brings total facility handling capacity to 5,000 bbls/d. Additionally, at the Issaran oilfield a water disposal well and three water supply wells, for use in the thermal recovery program, were drilled. Steam generation facilities have been installed and steam operations are currently underway with the first cyclic steam stimulation (“CSS”) production from three new wells expected by the end of June for a total of five on-production cycle steam wells. This number of on-production CSS wells will increase to nine by the end of July. Three additional CSS wells will commence drilling next week; these will be followed by a Lower Dolomite development location and three delineation wells at the West Issaran discovery. Current production from the West Issaran-1 well is 190 bbls/d and improving.

In Pakistan, the Dewan-5 development location was abandoned subsequent to the end of the first quarter at shallow depth after encountering drilling problems. The off-set location will commence drilling next month. Several meetings are scheduled for the week of May 15 in Islamabad, Pakistan to finalize the new off-set well location and design and to meet with Government of Pakistan officials to resolve the gas price agreement, with an objective to start first gas production next month.

Based in Calgary, Alberta, Canada, Rally Energy is an oil and gas exploration, development and production company. The Corporation's primary area of operations is in Egypt, where it has a 100% operating interest in the Issaran Oilfield, a significant heavy oil development opportunity with strong growth potential. In Pakistan, the Corporation holds a 30% interest in the Safed Koh Block, where it is participating in the development of a large natural gas/condensate discovery.

FORWARD-LOOKING STATEMENTS

Except for statements of historical fact, all statements in this news release - including, without limitation, statements regarding production estimates, potential reserves and future plans and objectives of Rally - are forward-looking statements that involve various risks and uncertainties. There can be no assurance that such statements will prove to be accurate; actual results and future events could differ materially from those anticipated in such statements. Important factors that could cause actual results to differ materially from anticipated results include risks and uncertainties most of which are beyond Rally's control such as: risks relating to estimates of reserves and recoveries; production rates and operating cost assumptions; development risks and costs; the risk of commodity price and currency fluctuations; general economic and industry conditions; political and regulatory risks; environmental risks; stock market volatility; access to sufficient capital from internal and external sources; and other risks and uncertainties as disclosed under the heading "Risk Factors" and elsewhere in Rally's documents filed from time-to-time with the Toronto Stock Exchange and other regulatory authorities. The reader is cautioned that assumptions used in the preparation of such information, while considered reasonable by Rally at the time, may prove to be incorrect. The Corporation disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

The TSX has neither approved nor disapproved of the contents of this news release.

RALLY ENERGY CORP.
Management's Discussion and Analysis ("MD&A")
For the Three Months ended March 31, 2007

This discussion and analysis outlines management's assessment of the consolidated financial and operating results of Rally Energy Corp. ("Rally Energy" or the "Corporation") and its subsidiaries, including its future opportunities and risks, and should be read in conjunction with the audited consolidated financial statements and MD&A for the year ended December 31, 2006. Additional information regarding the Corporation can be found at www.sedar.com and www.rallyenergy.com.

These financial statements and the accompanying interim consolidated balance sheet as at March 31, 2007 and the interim consolidated statements of operations and deficit and cash flows for the three month period then ended, are the responsibility of the Corporation's management.

The financial information contained herein has been prepared by management and includes the selection of appropriate accounting principles, judgments and estimates necessary to prepare these financial statements in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP"). Unless otherwise indicated, all dollar amounts in this report are in thousands of Canadian dollars. The majority of the Corporation's production is heavy oil (reported in barrels), however, the Corporation also uses the "barrels of oil equivalent" ("BOE") reference in this report to reflect Canadian natural gas sales. All BOE conversions are derived by converting gas to oil in the ratio of six thousand cubic feet of gas to one barrel of oil, representing the approximate energy equivalency. This MD&A is dated May 14, 2007.

Non-GAAP Measures

Certain measures in this MD&A do not have any standardized meaning as prescribed by Canadian GAAP such as cash flow, cash flow per share, cash flow from operations, and netback from operations. Therefore, they are considered non-GAAP measures and may not be comparable to similar information presented by other issuers. These measures have been described and presented in order to provide shareholders and potential investors with additional information regarding the Corporation's liquidity and its ability to generate funds to finance its operations. Management's use of these measures is disclosed further in this MD&A.

Forward-Looking Statements

This disclosure contains certain forward-looking statements that involve substantial known and unknown risks and uncertainties, including the impact of general economic conditions in all the jurisdictions in which the Corporation operates, changes in industry conditions, changes in laws and regulations including the adoption of new environmental laws, increased competition, the lack of availability of qualified personnel or management, fluctuations in foreign exchange or interest rates, stock market volatility and the Corporation's ongoing ability to obtain financing for its operations. Rally Energy's actual results, performance or achievements could differ materially from those expressed in or implied by these forward-looking statements. Accordingly, no assurance can be given that any of the events anticipated will transpire or occur, or that benefits, including the amount of revenues or proceeds, will be derived therefrom. These factors, many of which are outside the control of the Corporation, are discussed further in the December 31, 2006 MD&A and in the 2006 Annual Information Form filed on April 30, 2007.

Production, Revenue and Netback

(thousands of dollars, unless otherwise stated)

	2007		2006					
	First Quarter		Fourth Quarter		Third Quarter		Second Quarter	
Production:								
Oil (bbls/d)	6,294		5,289		5,658		4,509	
Natural gas (mcf/d)	-		258		348		396	
Total BOE (boe/d)	6,294		5,332		5,716		4,575	
		<u>\$/boe</u>		<u>\$/boe</u>		<u>\$/boe</u>		<u>\$/boe</u>
Gross revenue	\$23,037	\$40.67	\$19,420	\$39.58	\$25,708	\$48.89	\$19,605	\$47.09
Production entitlement								
- GPC (Egypt)	(6,630)	(11.70)	(5,692)	(11.61)	(7,397)	(14.08)	(5,585)	(13.41)
Royalty (Egypt)	(416)	(0.74)	-	-	-	-	(1,061)	(2.55)
Marketing fees	(448)	(0.79)	(247)	(0.50)	(257)	(0.49)	(213)	(0.51)
Royalties (Canada)	(1)	-	(35)	(0.07)	(108)	(0.21)	(105)	(0.25)
Operating expenses	(5,062)	(8.94)	(4,612)	(9.40)	(3,601)	(6.85)	(2,898)	(6.96)
Netback from operations	\$10,480	\$18.50	\$8,834	\$18.00	\$14,345	\$27.26	\$9,743	\$23.41

	2006		2005					
	First Quarter		Fourth Quarter		Third Quarter		Second Quarter	
Production:								
Oil (bbls/d)	2,676		2,656		2,558		2,734	
Natural gas (mcf/d)	388		462		330		240	
Total BOE (boe/d)	2,741		2,733		2,613		2,774	
		<u>\$/boe</u>		<u>\$/boe</u>		<u>\$/boe</u>		<u>\$/boe</u>
Gross revenue	\$10,061	\$40.79	\$10,019	\$39.85	\$10,698	\$44.51	\$8,813	\$34.91
Production entitlement								
- GPC (Egypt)	(2,695)	(10.93)	(2,631)	(10.47)	(2,898)	(12.07)	(2,380)	(9.43)
Royalty (Egypt)	(611)	(2.48)	(255)	(1.02)	(629)	(2.62)	(558)	(2.21)
Marketing fees	(171)	(0.69)	(159)	(0.63)	(103)	(0.43)	(186)	(0.74)
Royalties (Canada)	(142)	(0.57)	(143)	(0.57)	(104)	(0.43)	(5)	(0.01)
Operating expenses	(2,122)	(8.60)	(2,098)	(8.35)	(1,672)	(6.96)	(1,545)	(6.12)
Netback from operations	\$4,320	\$17.52	\$4,733	\$18.81	\$5,292	\$22.00	\$4,139	\$16.40

Gross revenue for the first quarter 2007 was \$23.0 million (\$40.67/boe; production of 6,294 boe/d), up 129% from \$10.1 million (\$40.79/boe; production of 2,741 boe/d) for the comparable 2006 period. The revenue increase is attributable to a corresponding production increase, all of which was from the Issaran oilfield in Egypt.

Heavy oil produced from the Issaran oilfield is marketed as the Ras Gharib blend. In the first three months of 2007, the Corporation's realized wellhead oil price represented 62% of the Brent oil price as compared to 56% for the comparable 2006 quarter.

Production Entitlements, Marketing Costs and Royalties

For the quarter ended March 31, 2007, the production entitlement of The General Petroleum Co. SAE ("GPC") totaled \$6.6 million (\$11.70/boe), representing 29% of gross revenue. For the corresponding 2006 period, GPC's entitlement was \$2.7 million (\$10.93/boe), representing 27% of gross revenue.

Revenue-based royalty payment obligations of \$416,000 (\$0.74/boe) for the 2007 first quarter decreased from \$611,000 (\$2.48/boe) in the 2006 first quarter, a significant reduction on a per-barrel of production basis. Commencing January 1, 2007 and continuing until December 31, 2012, the revenue-based royalty declined from 10% of Issaran oil revenues (net of marketing fees and GPC entitlement) to 2.6%. No revenue-based royalty is charged on production above 7,000 boe/d.

Pursuant to the terms of certain marketing agreements pertaining to Issaran oil sales, marketing fees, linked to realized oil prices and production, of \$448,000 (\$0.79/boe) were paid during the first quarter of

2007 as compared to \$171,000 (\$0.69/boe) for the comparable 2006 period. The obligations increased commensurate with the higher Issaran production.

Operating Expenses

Operating expenses for the three months ended March 31, 2007 were \$5.1 million (\$8.94/boe) as compared to \$2.1 million (\$8.60/boe) for the comparable 2006 period. On a general basis, costs have increased commensurate with the higher oil production in 2007 and are lower, on a per-unit basis, than costs reported in the fourth quarter of 2006. Primary contributors to operating expenses are workovers, diesel fuel costs, trucking costs and health, safety and environmental programs. Diesel fuel is used to for steam generation and to power generators that provide electricity for field operations in the Issaran oilfield and, in the second quarter of 2007, Rally Energy commenced utilization of lower cost natural gas from nearby sources as an alternative, cheaper than diesel, fuel supply. Trucking rates for the Corporation's Issaran oil deliveries are expected to decline, on a per-unit basis, in future quarters as a result of completion of the new Central Production Facility, commissioned in April, 2007, which allows for shipping of oil with lower water cuts.

General and Administrative Expenses

(thousands of dollars, unless otherwise stated)

		Three months ended March 31			
		<u>Total</u>	<u>Capitalized</u>	<u>Expensed</u>	<u>\$/boe</u>
2007					
	Canada	\$ 1,165	\$ (188)	\$ 977	\$1.73
	Egypt	\$ 645	\$ -	\$ 645	\$1.14
	Pakistan	\$ 213	\$ (143)	\$ 70	\$0.12
	Total	<u>\$ 2,023</u>	<u>\$ (331)</u>	<u>\$ 1,692</u>	<u>\$2.99</u>
2006					
	Canada	\$ 1,004	\$ (195)	\$ 809	\$3.28
	Egypt	\$ 274	\$ -	\$ 274	\$1.11
	Pakistan	\$ 64	\$ (48)	\$ 16	\$0.07
	Total	<u>\$ 1,342</u>	<u>\$ (243)</u>	<u>\$ 1,099</u>	<u>\$4.46</u>

For the quarter ended March 31, 2007, consolidated general and administrative expenses were \$1.7 million (\$2.99/boe) as compared to \$1.1 million (\$4.46/boe) for the comparable 2006 quarter. The increased cost is primarily attributable to staff additions and annual wage increases. Non-cash expenses related to the valuation of share options vesting during the first quarter of 2007 were \$295,000 as compared to \$282,000 for the 2006 comparable period.

Interest and Finance Charges

(thousands of dollars, unless otherwise stated)

		Three months ended March 31	
		2007	2006
	Interest expense	\$ 472	\$ 53
	Amortization of deferred charge	253	13
	Accretion expense on debentures	-	13
	Total expense	<u>725</u>	<u>79</u>
	Interest income	90	9
	Gain (loss) on foreign exchange	20	(15)
	Total income (expense)	<u>110</u>	<u>(6)</u>
	Net expense	<u>\$ 615</u>	<u>\$ 85</u>
	\$/boe	<u>\$1.09</u>	<u>\$0.34</u>

Total interest and finance charges increased to \$615,000 during the first quarter of 2007 from \$85,000 in the comparable 2006 quarter primarily as a result of higher average outstanding debt amounts and related deferred charges. Included in the 2007 amount are \$253,000 (2006 - \$26,000) of non-cash charges pertaining to deferred charges related to the revolving credit facility. The revolving credit facility was entirely paid down on March 26, 2007, therefore no ongoing interest expenses are anticipated, only minimal standby charges.

Depletion, Depreciation and Accretion

(thousands of dollars, unless otherwise stated)

	Three months ended March 31	
	2007	2006
Depletion, depreciation and accretion	\$ 3,407	\$ 2,270
\$/boe	\$6.01	\$9.20

Total depletion, depreciation and accretion ("DD&A") charges for the first quarter of 2007 were \$3.4 million (\$6.01/boe), of which depletion pertaining to producing properties in Egypt represented \$3.2 million. The remainder represents fixed asset depreciation of \$229,000. DD&A charges for the first quarter of 2006 were \$2.3 million (\$9.20/boe).

The significant increase in the Corporation's proved reserve base at December 31, 2006, as evaluated by DeGolyer and MacNaughton Canada Limited, an independent reservoir evaluation firm, including the anticipated future capital requirements, has resulted in a lower consolidated DD&A rate for 2007.

Cash Flow from Operations

Cash flow from operations represents net earnings plus items not affecting cash which include accretion, depletion, depreciation and other non-cash items. For the quarter ended March 31, 2007, Rally Energy's cash flow from operations was \$8.8 million (\$0.09/share) an increase of 155% compared to \$3.4 million (\$0.04/share) for the 2006 first quarter.

Net Earnings

Rally Energy recorded net earnings of \$4.7 million (\$0.05/share) for the first quarter of 2007, a five-fold increase over net earnings of \$866,000 (\$0.01/share) for the comparable 2006 quarter.

SUMMARY OF QUARTERLY RESULTS

(thousands of dollars, unless otherwise stated)

	Revenue	Cash flow from operations	\$/share - basic	Earnings (loss)	\$/share - basic
2007: Q1	\$23,037	\$8,792	\$0.09	\$ 4,665	\$0.045
2006: Q4	\$19,420	\$6,347	\$0.06	\$ 1,534	\$0.016
Q3	\$25,708	\$13,092	\$0.14	\$ (505)	\$(0.00)
Q2	\$19,605	\$8,362	\$0.09	\$ 4,213	\$0.046
Q1	\$10,061	\$3,445	\$0.04	\$ 866	\$0.010
2005: Q4	\$10,019	\$3,405	\$0.05	\$ 618	\$0.007
Q3	\$10,693	\$4,387	\$0.05	\$ 1,334	\$0.016
Q2	\$8,813	\$3,235	\$0.04	\$ 484	\$0.005

Capital Invested

During the 2007 first quarter, Rally Energy drilled eight successful oil wells (8 net) in Egypt. The Corporation also drilled a water disposal well and three water supply wells for use in the thermal recovery program. In Pakistan, Rally Energy participated (30%) in commencement of drilling a development well during the first quarter. Capital expenditures totaled \$27.1 million during the first quarter of 2007, up from \$7.1 million for the comparable 2006 period.

(thousands of dollars)	Three months ended	
	March 31	
	2007	2006
Egypt		
Drill, complete and workovers	\$ 8,551	\$ 5,430
Seismic, evaluation and other	3,917	839
Thermal project	2,944	-
Inventory change	4,419	(189)
Capitalized admin. costs	187	-
Total	\$20,018	\$ 6,080
Canada		
Drill and complete	\$ 18	\$ 753
Seismic, evaluation and other	162	5
Lease acquisition	-	-
Capitalized admin. costs	-	195
Total	\$ 180	\$ 953
Pakistan		
Drill and complete	\$ 1,218	\$ -
Seismic, evaluation and other	4,094	64
Inventory	1,438	1
Capitalized admin. costs	146	48
Total	\$ 6,896	\$ 112
Grand Total		
Drill, complete and workovers	\$ 9,787	\$ 6,183
Seismic, evaluation and other	8,173	908
Thermal project	2,944	-
Inventory change	5,857	(189)
Capitalized admin. costs	333	243
Total	\$27,094	\$ 7,145

Included in the above amounts are capital-related inventory costs of \$12.9 million at March 31, 2007 (2006 - \$1.6 million) for supplies and equipment intended to be used for future capital expenditures in Egypt and Pakistan.

At March 31, 2007 the Corporation continued to meet the asset impairment test for the capitalized costs and no ceiling test write-down was required.

Liquidity and Capital Resources

At March 31, 2007, Rally Energy had cash and cash equivalents of \$26.1 million and has a fully available US\$20 million reserve-based revolving bank credit facility with the International Finance Corporation (a member of the World Bank group). At December 31, 2006, the Corporation had cash and cash equivalents of \$17.7 million and was utilizing the entire US\$20 million facility debt. Increased drilling activity, equipment additions and well optimization programs during the first quarter of 2007 have resulted in a higher level of accounts payable as compared to March 31, 2006, but lower than December 31, 2006. Working capital at March 31, 2007 was \$18.3 million, as compared to working capital of \$3.3 million at December 31, 2006.

On March 13, 2007, the Corporation issued 11 million common shares at \$5.00 per share for gross proceeds of \$55 million, pursuant to the terms of a short-form prospectus. Agent commissions of \$2.8 million were paid in relation to common share subscriptions. Proceeds of the Offering will be used to fund the Corporation's exploration and development programs in Egypt and Pakistan, for potential acquisitions, and for general corporate purposes.

During the 2007 first quarter, Rally Energy received proceeds of \$1.6 million from the exercise of an aggregate of 1,630,500 common share options at an average price of \$0.96/share. Subsequent to March 31, 2007, the Corporation received \$988,000 pursuant to the exercise of 780,000 common share options (at an average price of \$1.33/share).

Financial Reporting

Effective January 1, 2007, Rally Energy adopted the Canadian Institute of Chartered Accountants ("CICA") Section 3855, *Financial Instruments – Recognition and Measurement*, Section 3251, *Equity*, Section 3865, *Hedges*, Section 1530, *Comprehensive Income*; and Section 3861, *Financial Statements – Disclosure and Presentation*. These standards have been adopted prospectively. See Note 1 to the consolidated financial statements.

Accounting Changes

The Corporation also adopted, effective January 1, 2007, the revised recommendations of CICA Section 1506, *Accounting Changes*. The new recommendations permit voluntary changes in accounting policy only if they result in financial statements which provide more relevant and reliable financial information. Accounting policy changes must be applied retrospectively unless it is impractical to determine the period or cumulative impact of the change in policy. Additionally, when an entity has not applied a new primary source of GAAP that has been issued but is not yet effective, the entity must disclose that fact along with information relevant to assessing the possible impact that application of the new primary source of GAAP will have on the entity's financial statements in the period of initial application.

Disclosure Controls and Procedures

Rally Energy's President and Chief Executive Officer ("CEO") and Vice President, Finance and Chief Financial Officer ("CFO") are responsible for establishing and maintaining disclosure controls and procedures and internal controls over financial reporting as defined in Multilateral Instrument 52-109. The Corporation's CEO and CFO have designed disclosure controls and procedures, or caused them to be designed under their supervision, to provide reasonable assurance that information to be disclosed by Rally Energy is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. The CEO and CFO have also designed internal controls over financial reporting, or caused them to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. During the quarter ended March 31, 2007, there have been no changes to Rally Energy's internal controls over financial reporting that have materially, or are reasonably likely to, materially affect the internal controls over financial reporting.

Because of their inherent limitations, disclosure controls and procedures and internal controls over financial reporting may not prevent or detect misstatements, error or fraud. Control systems, no matter how well conceived or operated, can provide only reasonable, not absolute assurance, that the objectives of the control system are met.

2007 OUTLOOK

The 2007 capital program is expected to include drilling up to 30 conventional and 30 thermal wells in Egypt and a development and an exploration well in Pakistan. In Egypt, additional thermal and production facilities are also planned to accommodate higher production expected from phased development of the CSS thermal expansion program. In addition to the existing 10 CSS wells at December 31, 2006, the 2007 drilling program will increase the CSS program to a total of 40 CSS wells by the end of 2007. In Pakistan, production facilities will be completed to accommodate gas production from the Salsabil development program. Exploration drilling results on the Safed Koh Concession will determine any additional production facility requirements.

Rally Energy Corp.
Consolidated Balance Sheets
(unaudited)

March 31,
2007 December 31,
2006

Assets

Current

Cash and cash equivalents	\$ 26,073,903	\$ 17,743,645
Restricted cash (Note 2)	629,257	1,169,768
Accounts receivable	22,195,523	20,594,214
Inventory (Note 4)	557,169	617,427
Prepaid expenses and deposits	750,531	627,228
	50,206,383	40,752,282

Long-term investments (Note 3)	1,905,500	1,905,500
Property, plant and equipment (Note 4)	113,551,836	89,853,531
Deferred costs (Note 6)	2,315,846	2,568,325
	\$ 167,979,565	\$ 135,079,638

Liabilities and Shareholders' Equity

Current

Accounts payable and accrued liabilities		
– operations	\$ 6,459,964	\$ 6,780,795
– capital	25,494,004	30,626,765
	31,953,968	37,407,560

Asset retirement obligations (Note 5)	865,112	770,740
Long-term debt (Note 6)	-	23,308,000
	32,819,080	61,486,300

Shareholders' equity

Equity instruments (Note 7(a))	130,345,516	73,248,886
Contributed surplus (Note 7(e))	2,935,972	3,130,482
Retained earnings (deficit)	1,878,997	(2,786,030)
	135,160,485	73,593,338
	\$ 167,979,565	\$ 135,079,638

The accompanying notes are an integral part of these consolidated financial statements.

Rally Energy Corp.
Consolidated Statements of Earnings and Retained Earnings (Deficit)
(unaudited)

Three months ended March 31

	2007	2006
Oil and natural gas revenue	\$ 23,037,021	\$ 10,061,447
Less: Royalties and related credits	<u>(7,495,205)</u>	<u>(3,619,419)</u>
	15,541,816	6,442,028
Operating expenses	<u>5,062,055</u>	<u>2,121,920</u>
	<u>10,479,761</u>	<u>4,320,108</u>
Expenses		
Administrative expenses:		
Administration	1,497,602	816,950
Stock-based compensation	<u>294,640</u>	<u>282,402</u>
	1,792,242	1,099,352
Interest expense	472,421	52,946
Depletion, depreciation and accretion	3,406,751	2,270,295
Amortization of deferred charges	253,447	13,221
Accretion expense on convertible debentures	<u>-</u>	<u>13,224</u>
	<u>5,924,861</u>	<u>3,449,038</u>
Income before other items and taxes	<u>4,554,900</u>	<u>871,070</u>
Other items		
Interest income	90,438	9,431
Foreign exchange gain (loss)	<u>19,689</u>	<u>(14,709)</u>
	<u>110,127</u>	<u>(5,278)</u>
Net earnings	4,665,027	865,792
Other comprehensive income	<u>-</u>	<u>-</u>
Comprehensive earnings	4,665,027	865,792
Retained earnings (deficit), beginning of period	<u>(2,786,030)</u>	<u>(8,893,685)</u>
Retained earnings (deficit), end of period	\$ 1,878,997	\$ (8,027,893)
Net earnings per share (Note 7(f))		
Basic	\$ 0.045	\$ 0.010
Diluted	\$ 0.044	\$ 0.009

The accompanying notes are an integral part of these consolidated financial statements.

Rally Energy Corp.
Consolidated Statements of Cash Flows
(unaudited)

Three months ended March 31

	2007	2006
Cash flows from operating activities		
Net earnings for the period	\$ 4,665,027	\$ 865,792
Non-cash items:		
Stock-based compensation	294,640	282,402
Accretion expense on convertible debentures	-	13,224
Amortization of deferred charges	253,447	13,221
Depletion, depreciation and accretion	3,406,751	2,270,295
Unrealized foreign exchange loss	172,067	-
	8,791,932	3,444,934
Changes in non-cash working capital balances		
Accounts receivable	(1,601,309)	(802,418)
Inventory	60,258	(51,410)
Prepaid expenses and deposits	(123,303)	(111,370)
Accounts payable - operations	(320,831)	(612,354)
	6,806,747	1,867,382
Cash flows from investing activities		
Oil and gas assets	(23,894,324)	(7,144,660)
Restricted cash increase (decrease)	540,511	-
Changes in accounts payable - capital	(5,235,033)	1,986,727
	(28,588,846)	(5,157,933)
Cash flows from financing activities		
Issuance of equity instruments (Note 7(a))	53,603,225	-
Bank debt increase (decrease) (Note 6)	(23,308,000)	2,349,306
Increase in deferred financing charges	(968)	-
Redemption of convertible debentures	-	139,606
Changes in accounts payable - financing	(112,105)	-
	30,182,152	2,488,912
Foreign exchange gain (loss) on cash held in a foreign currency	(69,795)	-
Increase in cash	8,330,258	(801,639)
Cash and cash equivalents, beginning of period	17,743,645	801,639
Cash and cash equivalents, end of period	\$ 26,073,903	\$ -

The accompanying notes are an integral part of these consolidated financial statements.

The interim consolidated financial statements of Rally Energy Corp. (the "Corporation") have been prepared by management in accordance with accounting principles generally accepted in Canada on a consistent basis with the audited consolidated financial statements for the fiscal year ended December 31, 2006, unless otherwise stated below. The disclosure which follows does not conform in all respects to the requirements of generally accepted accounting principles ("GAAP") for annual consolidated financial statements and, as such, should be read in conjunction with the consolidated financial statements and notes thereto in the Corporation's annual report for the year ended December 31, 2006.

1. Changes in Accounting Policies

- (a) Effective January 1, 2007 the Corporation adopted the Canadian Institute of Chartered Accountants ("CICA") Section 1530, *Comprehensive Income*; Section 3251, *Equity*; Section 3855, *Financial Instruments – Recognition and Measurement*; Section 3861, *Financial Instruments – Disclosure and Presentation*; and Section 3865, *Hedges*. The Corporation has adopted these standards prospectively and the comparative interim consolidated financial statements have not been restated. Transition amounts have been recorded in accumulated other comprehensive income.

The adoption of these standards has had no material impact on net earnings or cash flows. The other effects of the implementation of the new standards are discussed below.

(i) Financial instruments

Under the new standards, financial assets and financial liabilities are initially recognized at fair value and are subsequently accounted for based on their classification as described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition.

Held-for-trading

Financial assets that are purchased and incurred with the intention of generating profits in the near term are classified as held-for-trading. These instruments are accounted for at fair value with the change in the fair value recognized in net earnings during the period. Cash and cash equivalents, and restricted cash are classified as held-for-trading as at January 1, 2007.

Available-for-sale

Financial assets classified as available-for-sale are carried at fair value with the changes in fair value recorded in other comprehensive income. When a decline in fair value is determined to be other than temporary, the cumulative loss included in accumulated other comprehensive income is removed and recognized in net income. Gains and losses realized on disposal of available-for-sale securities are recognized in other income. Long-term investments are classified as available-for-sale as at January 1, 2007.

Held-to-maturity

Financial assets that have a fixed maturity date and which the Corporation has the intention and the ability to hold to maturity are classified as held-to-maturity and accounted for at amortized cost using the effective interest rate method. There were no financial assets classified as held-to-maturity.

1. Changes in Accounting Policies (continued)

Loans and receivables

Loans and receivables are accounted for at amortized cost. This classification is consistent with the classification under the prior accounting standards. Accounts receivable are classified as loans and receivables as at January 1, 2007.

Other liabilities

Other liabilities are accounted for at amortized cost and include all liabilities, other than derivatives. This classification is consistent with the classification under the prior accounting standards. Accounts payable and accrued liabilities and long-term debt are classified as other liabilities.

(ii) Derivative instruments and hedging activities

The Corporation did not have any outstanding derivative or hedging contracts during the first quarter ended March 31, 2007.

(iii) Embedded derivatives

Embedded derivatives are derivatives embedded in a host contract. The embedded derivatives are measured at their fair value with subsequent changes recognized directly in earnings. The Corporation has elected July 10, 2002 as its transition date for accounting for any potential embedded derivatives. No material embedded derivatives requiring separate recognition and measures were identified. The adoption of this new standard had no impact on the Corporation's consolidated financial statements.

(iv) Determination of fair value

The Corporation's financial instruments recognized in the Consolidated Balance Sheet consist of cash and cash equivalents, restricted cash, accounts receivable, long-term investments, current liabilities, and long-term debt. Unless otherwise noted, carrying values reflect the current fair value of the financial instruments. The estimated fair values of recognized financial instruments have been determined based on the Corporation's assessment of available market information and appropriate methodologies, or through comparisons to similar instruments. The current fair value of short-term financial instruments is equal to their carrying value due to their short-term nature; long-term debt will fluctuate with market rates and therefore, approximate fair value.

(v) Comprehensive income

Comprehensive income consists of net earnings and other comprehensive income and represents the change in shareholders' equity, which results from transactions and events from sources other than the Corporation's shareholders. These transactions and events include changes in the currency translation adjustment and unrealized gains and losses resulting from changes in fair value of available-for-sale financial instruments and the effective portion of the change in fair value of any designated cash flow hedges. The adoption of this new standard had no impact on the Corporation's consolidated financial statements.

1. Changes in Accounting Policies (continued)

- (b) Effective January 1, 2007 the Corporation adopted the revised recommendations of CICA Section 1506, *Accounting Changes*.
- (i) The new recommendations permit voluntary changes in accounting policy only if they result in financial statements which provide more relevant and reliable financial information. Accounting policy changes must be applied retrospectively unless it is impractical to determine the period or cumulative impact of the change in policy. Additionally, when an entity has not applied a new primary source of GAAP that has been issued but is not yet effective, the entity must disclose that fact along with information relevant to assessing the possible impact that application of the new primary source of GAAP will have on the entity's financial statements in the period of initial application.
- (ii) As of January 1, 2008, the Corporation will be required to adopt two new CICA requirements, Section 3862, *Financial Instruments – Disclosures* and Section 3863, *Financial Instruments – Presentation*, which will replace current Section 3861. The new standards require disclosure of the significance of financial instruments to an entity's financial statements, the risks associated with the financial instruments, and how those risks are managed. The new presentation standard essentially carries forward the current presentation requirements. The Corporation is assessing the impact of these new standards in its consolidated financial statements and anticipates that the main impact will be in terms of additional disclosures required.
- (iii) As of January 1, 2008 the Corporation will be required to adopt CICA Section 1535, *Capital Disclosures*, which requires entities to disclose their objectives, policies and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements. The Corporation is assessing the impact of this new standard on its consolidated financial statements and anticipates that the main impact will be in terms of additional disclosures required.

2. Restricted Cash

As security for letters of credit issued to secure equipment orders for Egyptian drilling operations and work commitments in Pakistan, \$629,257 is held on deposit with Foreign chartered banks. The funds are invested in interest-bearing revolving term deposits and will expire on or before February 1, 2008.

3. Long-term Investments

The Corporation holds minority equity positions in a private independent company and a public independent company. At March 31, 2007, the valuation was reviewed and considered adequate.

4. Property, Plant and Equipment

The Corporation holds various working interests in developed and undeveloped petroleum and natural gas properties and facilities and has deferred costs related to the Petroleum Service Agreement ("PSA"), the Concession and Canada. The carrying amounts of these assets are as follows:

	March 31, 2007	December 31, 2006
Petroleum and natural gas assets	\$ 156,457,997	\$ 130,283,985
Furniture, machinery and equipment	5,816,598	4,896,264
	<u>162,274,595</u>	<u>135,180,249</u>
Accumulated depletion, depreciation and write-downs	(48,722,759)	(45,326,718)
Net book value	<u>\$ 113,551,836</u>	<u>\$ 89,853,531</u>

4. Property, Plant and Equipment (continued)

At March 31, 2007, the Corporation has recorded deferred exploration expenditures of \$28,415,784 (December 31, 2006 - \$21,546,349) in Pakistan. These costs are excluded from depletion until production commences in Pakistan and will be depleted on a unit-of-production basis thereafter.

During the three months ended March 31, 2007, the Corporation capitalized general and administrative expenditures pertaining to activities in Egypt and Pakistan of \$330,988 (March 31, 2006 - \$242,913), which were included in petroleum and natural gas assets. No interest has been capitalized.

At March 31, 2007, the Corporation held \$12,914,454 (December 31, 2006 - \$7,117,814) of inventory available for future capital expenditures in Egypt and Pakistan. Of this amount, (i) \$12,357,285 (December 31, 2006 - \$6,500,387) relates to capital equipment, primarily pipe, and is included in property and equipment and (ii) \$557,169 (December 31, 2006 - \$617,427) represents consumable supplies to be used in oilfield operations and is recorded as inventory under current assets. Capital inventory is being utilized in the Corporation's ongoing drilling program. No amortization has been taken on such inventory.

5. Asset Retirement Obligations

The Corporation has asset retirement obligations in Egypt (resulting from the PSA), Pakistan (resulting from the Concession Agreement) and in Canada, from net ownership interests in petroleum and natural gas assets. The Corporation estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations and time frame, as follows.

	March 31, 2007	<u>Cost Incurrence</u>		<u>December 31, 2006</u>
		<u>Range</u>	<u>Majority</u>	
Egypt	\$1,374,909	2015-2018	2018	\$1,222,824
Pakistan	39,332	2015-2020	2020	39,332
Canada	40,000	2009-2014	2014	40,000
	<u>\$1,454,241</u>			<u>\$1,302,156</u>

A credit-adjusted risk-free rate of 7% and an inflation rate of 2% were used to calculate the fair value of the asset retirement obligations. A reconciliation of the discounted asset retirement obligations is provided below:

	Three months ended March 31, 2007	Year ended December 31, 2006
<i>Asset retirement obligations</i>		
Balance, beginning of period	\$ 770,740	\$ 590,382
Liability adjustments from prior period	-	57,829
Liability adjustments from disposition of assets	-	(186,486)
Liabilities incurred in period, net	81,881	282,591
Accretion expense	12,491	26,424
Balance, end of period	\$ 865,112	\$ 770,740

6. Long-term Debt

The Corporation has a reserve-based US\$20 million revolving credit facility with the International Finance Corporation ("IFC") (a member of the World Bank Group) that matures on October 15, 2009. At March 31, 2007, the entire facility remains available. Setup costs pertaining to these facilities have been recorded as deferred financing costs and will be amortized over the life of the facility.

Rally Energy Corp.
Selected Notes to Consolidated Financial Statements
Three months ended March 31, 2007 (unaudited)

7. Equity Instruments

(a) Issued and outstanding

	Three months ended March 31, 2007		Year ended December 31, 2006	
	Number of Shares	Amounts	Number of Shares	Amounts
Common shares				
Balance, beginning of period	100,697,648	\$75,524,480	91,025,379	\$56,908,614
Private placement (Note 7(c))	1,372,846	3,116,360	-	-
Prospectus issue (Note 7(d))	11,000,000	55,000,000	-	-
Stock options exercised	1,630,500	2,055,341	1,484,093	1,589,758
Debentures converted	-	-	1,188,176	1,743,993
Warrants exercised	-	-	7,000,000	15,282,115
	<u>114,700,994</u>	<u>135,696,181</u>	<u>100,697,648</u>	<u>75,524,480</u>
LESS: Share issue costs		<u>(5,350,665)</u>	-	<u>(2,275,594)</u>
		<u>130,345,516</u>	<u>100,697,648</u>	<u>73,248,886</u>
Share purchase warrants – common shares				
Balance, beginning of period	-	-	4,000,000	904,242
Issued	-	-	3,000,000	2,217,873
Exercised	-	-	(7,000,000)	(3,122,115)
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance, end of period, all equity instruments		<u><u>\$130,345,516</u></u>		<u><u>\$73,248,886</u></u>

(b) Options

The shareholders of the Corporation have annually approved a formal stock option plan under which directors, officers, employees and consultants are eligible to receive grants. Stock option agreements have vesting periods varying from immediate to three years and expiration terms of up to five years.

For the three months ended March 31, 2007, there were 2,604,000 options granted with an average exercise price of \$4.51/share and an estimated fair value of \$1.65/share using the Black-Scholes option pricing model. In the pricing model, assumptions were as follows: risk free interest rate was 5.0%; average volatility was 47%; and an expected life was 5 years. The Corporation recorded an expense of \$294,640 (2006 - \$282,402) for options vested in the first quarter of 2007. The stock-based compensation expense associated with the value ascribed to options granted is recorded as contributed surplus.

	Three months ended March 31, 2007		Year ended December 31, 2006	
	Share Options	Weighted Average Exercise Price	Share Options	Weighted Average Exercise Price
Outstanding, beginning of period	6,862,666	\$1.30	7,356,759	\$1.02
Granted	2,604,000	\$4.51	1,165,000	\$2.36
Cancelled	(25,000)	\$0.61	(1,484,093)	\$0.73
Exercised	(1,630,500)	\$0.96	(175,000)	\$1.34
Outstanding, end of period	<u>7,811,166</u>	<u>\$2.45</u>	<u>6,862,666</u>	<u>\$1.30</u>

7. Equity Instruments (continued)

(c) Private placement

On March 2, 2007, having received the requisite approvals from relevant Pakistan government agencies to close a property purchase, the purchase price of US\$11.4 million accrued at December 31, 2006 was satisfied by way of US\$8.55 million in cash and 1,372,846 common shares of Rally Energy Corp. The shares are subject to a four month hold, and were valued at \$2.27 per share, the prevailing price when announced in June 2006.

(d) Prospectus issue

On March 13, 2007, the Corporation issued 11 million common shares at \$5.00 per share for gross proceeds of \$55 million, pursuant to the terms of a short-form prospectus. Agent commissions of \$2.8 million and \$254,943 of other share issue costs were incurred in relation to common share subscriptions.

(e) Contributed surplus

	Three months ended March 31, 2007	Year ended December 31, 2006
Balance, beginning of period	\$ 3,130,482	\$ 1,968,082
Stock-based compensation expense	294,640	2,103,992
Options exercised, transferred to share capital	(489,150)	(504,592)
Debentures exercised, transferred to share capital	-	(437,000)
Balance, end of period	\$ 2,935,972	\$ 3,130,482

(f) Per share amounts

Earnings per share figures have been calculated using the weighted average number of common shares outstanding during the periods. Diluted per share amounts reflect the potential dilution that could occur if in-the-money securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments. Anti-dilutive options or instruments are not included in the calculation.

The following table summarizes the calculation of basic and diluted net earnings per share.

	Three months ended March 31	
	2007	2006
Net earnings (loss) available to common shareholders	\$ 4,665,027	\$ 865,792
Weighted-average number of common shares outstanding – basic	103,781,952	91,093,488
Dilution effect of stock options	3,233,187	2,266,555
Dilution effect of warrants	-	73,620
Dilution effect of convertible debentures	-	1,194,546
Weighted-average number of common shares outstanding – diluted	107,015,139	94,628,209
Net earnings per share (\$/share)		
Basic	\$0.045	\$0.010
Diluted	\$0.044	\$0.009

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7. Equity Instruments (continued)

Outstanding stock options are the only instruments that are currently dilutive to earnings per share. At March 31, 2007, no stock options were antidilutive and excluded from the computation of diluted earnings per share.

8. Related Party Transactions

For the three months ended March 31, 2007 and 2006, the Corporation paid consulting fees to a company, whose principal is a director of the Corporation. The transactions occurred in the normal course of business operations and represent consideration established and agreed to by the related parties which is similar to those negotiated with third parties.

	Three months ended March 31	
	2007	2006
Included in general and administrative expenses	\$ 41,250	\$ 55,300
Capitalized	-	62,250
	\$ 41,250	\$ 117,550

9. Segmented Information

The Corporation operates in the petroleum and natural gas industry and has operations in Egypt, Pakistan and Canada. Its reportable segments are identified on a geographic basis. Gross revenue for the three months ended March 31 and capital assets are summarized on a country basis below:

March 31, 2007	Egypt	Canada	Pakistan	Total
Gross revenue	\$ 23,032,842	\$ 4,179	\$ -	\$ 23,037,021
Net earnings (loss)	\$ 5,879,944	\$ (1,292,939)	\$ 78,022	\$ 4,665,027
Property, plant and equipment	\$ 84,325,200	\$ 785,375	\$ 28,441,261	\$ 113,551,836
March 31, 2006	Egypt	Canada	Pakistan	Total
Gross revenue	\$ 9,173,860	\$ 887,587	\$ -	\$ 10,061,447
Net earnings (loss)	\$ 2,095,221	\$ (1,215,000)	\$ (14,429)	\$ 865,792
Property, plant and equipment	\$ 34,966,742	\$ 16,536,209	\$ 1,750,095	\$ 53,253,046

10. Statement of Cash Flows and Non-Cash Transactions

	Three months ended March 31	
	2007	2006
(a) Interest paid	\$ 468,149	\$ 111,415
(b) Taxes paid	\$ -	\$ -
	March 31, 2007	December 31, 2006
(c) Cash and cash equivalents		
Cash	\$ 21,163,829	\$ 9,549,396
Term deposits	4,910,074	8,194,249
Cash and cash equivalents	\$ 26,073,903	\$ 17,743,645