



May 9, 2006

## Rally Energy Reports First Quarter 2006 Operational and Financial Results

**Contact:** Abby Badwi, President & CEO

Douglas Urch, Vice President, Finance & CFO

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

Tel: (403) 538-0000

Fax: (403) 538-3705

[www.rallyenergy.com](http://www.rallyenergy.com)

Rally Energy announced today the Corporation's operational and financial results for the first quarter of 2006.

### HIGHLIGHTS

- ❑ Production of 2,741 boe/d is 25% higher than Q1-2005 production of 2,191 boe/d
- ❑ Revenue of \$10.1 million is 87% higher than Q1-2005 revenue of \$5.4 million
- ❑ Cash Flow of \$3.4 million is 302% higher than Q1-2005 cash flow of \$856,000
- ❑ Net Income of \$866,000 compared to Q1-2005 loss of \$895,000

First quarter production at the Issaran field in Egypt was 2,572 boe/d coupled with 169 boe/d produced in Canada. Current corporate production exceeds 4,500 boe/d. As previously reported, shut-ins of several high productivity wells during February, to install high performance pumps, had a temporarily negative impact on daily production. Following new pump installations, it also took several days to restore production and gradually increase volumes to current production levels.

Average prices during the first quarter were \$40.79/boe in 2006 compared to \$27.23/boe in the comparable 2005 quarter. The Corporation drilled six wells during the 2006 first quarter resulting in four oil wells in Egypt and two gas wells in Canada. Total capital expenditures were \$7.1 million.

Results of the February 13 bid round were announced and the Corporation was unsuccessful in its initial effort to acquire two blocks adjacent to the Issaran concession. Rally continues to pursue increasing its land holdings in Egypt and will examine other opportunities, including the evaluation of the next bid round lands, scheduled for October of this year.

---

*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 22.5% interest in the Safed Koh Block, where it is participating in the development of a large natural gas/condensate discovery. In Canada, Rally Energy is active in Alberta and Saskatchewan with varied working interests in several producing properties.*

---

### 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*

**RALLY ENERGY CORP.**  
**Management's Discussion and Analysis ("MD&A")**  
**For the Three Months ended March 31, 2006**

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, 2005. Additional information regarding the Corporation can be found at [www.sedar.com](http://www.sedar.com) and [www.rallyenergy.com](http://www.rallyenergy.com).

These financial statements of Rally Energy and the accompanying interim consolidated balance sheet as at March 31, 2006 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 include 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 9, 2006.

**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, 2005 MD&A and in the 2005 Annual Information Form filed on March 31, 2006.

## Production, Revenue and Netback

(thousands of dollars, unless otherwise stated)

	2006		2005					
	First Quarter		Fourth Quarter		Third Quarter		Second Quarter	
<b>Production:</b>								
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)
<b>Netback from operations</b>	<b>\$4,320</b>	<b>\$17.52</b>	<b>\$4,733</b>	<b>\$18.81</b>	<b>\$5,292</b>	<b>\$22.00</b>	<b>\$4,139</b>	<b>\$16.40</b>

	2005		2004					
	First Quarter		Fourth Quarter		Third Quarter		Second Quarter	
<b>Production:</b>								
Oil (bbls/d)	2,177		2,206		2,092		1,794	
Natural gas (mcf/d)	41		192		60		210	
Total BOE (boe/d)	2,191		2,238		2,102		1,829	
		<u>\$/boe</u>		<u>\$/boe</u>		<u>\$/boe</u>		<u>\$/boe</u>
Gross revenue	\$5,369	\$27.23	\$5,790	\$28.12	\$6,743	\$34.87	\$5,400	\$32.45
Production entitlement								
- GPC (Egypt)	(1,565)	(7.94)	(1,978)	(9.62)	(1,272)	(6.58)	(1,027)	(6.18)
Royalty (Egypt)	(347)	(1.76)	-	-	-	-	-	-
Marketing fees	(174)	(0.88)	(161)	(0.78)	(124)	(0.64)	(141)	(0.85)
Royalties (Canada)	(5)	(0.03)	(25)	(0.12)	(12)	(0.06)	(21)	(0.12)
Operating expenses	(1,404)	(7.12)	(1,296)	(6.29)	(961)	(4.97)	(1,026)	(6.16)
<b>Netback from operations</b>	<b>\$1,874</b>	<b>\$9.50</b>	<b>\$2,330</b>	<b>\$11.31</b>	<b>\$4,374</b>	<b>\$22.62</b>	<b>\$3,185</b>	<b>\$19.14</b>

Gross revenue for the first quarter 2006 was \$10.1 million (\$40.79/boe; production of 2,741 boe/d), up 87% from \$5.4 million (\$27.23/boe; production of 2,191 boe/d) for the comparable 2005 period. The revenue increase is attributable to an overall 25% production increase, of which 2,572 boe/d was from the Issaran oilfield in Egypt coupled with 169 boe/d produced in Canada, and a 50% increase in average commodity prices. Several high productivity wells in Egypt were shut-in during February to install high performance pumps having a temporarily negative impact on daily production. Following the new pump installations, it took several days to restore production and, by the end of March 2006, corporate production levels had exceeded 4,500 boe/d.

The heavy oil produced from the Issaran oilfield is marketed as the Ras Gharib blend. In the first three months of 2006, the Corporation's realized wellhead oil price represented 56% of the Brent oil price as compared to 46% for the comparable 2005 quarter.

### Production Entitlements, Marketing Costs and Royalties

For the quarter ended March 31, 2006, the production entitlement of The General Petroleum Co. SAE ("GPC") totaled \$2.7 million (\$10.93/boe), representing 27% of gross revenue. For the corresponding 2005 period, GPC's entitlement was \$1.6 million (\$7.94/boe), representing 29% of gross revenue.

Revenue-based royalty payment obligations of \$611,000 for the 2006 first quarter increased from \$347,000 in the 2005 first quarter, commensurate with the higher Issaran oil production and realized price. The capped revenue-based entitlement amount for 2006 is US\$1.5 million.

Pursuant to the terms of certain marketing agreements pertaining to Issaran oil sales, marketing fees, linked to realized oil prices and production, of \$171,000 (\$0.69/boe) were paid during the first quarter of 2006 as compared to \$174,000 (\$0.88/boe) for the comparable 2005 period. The obligations under one marketing agreement were fully satisfied at February 28, 2006 which will result in lower per-unit costs in future periods.

Royalty obligations on Canadian production for the first quarter of 2006 (169 boe/d) were \$142,000 (net of the Alberta Royalty Tax Credit). For the corresponding 2005 quarter, average Canadian production of 35 boe/d coupled with a one-year oil royalty holiday (expiring in January 2006) resulted in net royalty charges of \$5,000.

## Operating Expenses

Operating expenses for the three months ended March 31, 2006 were \$2.1 million (\$8.60/boe) as compared to \$1.4 million (\$7.12/boe) for the comparable 2005 period. On a general basis, costs have increased commensurate with the higher oil production in 2006 and are comparable, on a per-unit basis, with the fourth quarter of 2005. The largest contributor to this cost increase related to higher diesel fuel costs. Diesel fuel is used to power generators to provide electricity for field operations. The Corporation expects to utilize natural gas from nearby sources as an alternative to diesel fuel for generators by the end of 2006. This is expected to result in lower operating costs after conversion.

## General and Administrative Expenses

(thousands of dollars, unless otherwise stated)

		<b>Three months ended March 31</b>			
		<u>Total</u>	<u>Capitalized</u>	<u>Expensed</u>	<u>\$/boe</u>
<b>2006</b>	<b>Canada</b>	\$ 1,004	\$ 195	\$ 809	\$3.28
	<b>Egypt</b>	\$ 274	\$ -	\$ 274	\$1.11
	<b>Pakistan</b>	\$ 64	\$ 48	\$ 16	\$0.07
	<b>Total</b>	<u>\$ 1,342</u>	<u>\$ 243</u>	<u>\$ 1,099</u>	<u>\$4.46</u>
<b>2005</b>	<b>Canada</b>	\$ 628	\$ 110	\$ 518	\$2.63
	<b>Egypt</b>	\$ 375	-	\$ 375	\$1.90
	<b>Pakistan</b>	\$ 46	\$ 35	\$ 11	\$0.06
	<b>Total</b>	<u>\$ 1,049</u>	<u>\$ 145</u>	<u>\$ 904</u>	<u>\$4.59</u>

For the quarter ended March 31, 2006, consolidated general and administrative expenses were \$1.1 million (\$4.46/boe) as compared to \$904,000 (\$4.59/boe) for the comparable 2005 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 2006 were \$282,000 as compared to \$201,000 for the 2005 comparable period.

## Interest and Finance Charges

(thousands of dollars, unless otherwise stated)

		<b>Three months ended March 31</b>	
		<b>2006</b>	<b>2005</b>
Interest expense		\$ 53	\$ 203
Accretion expense on debentures		13	36
Amortization of deferred charge		13	36
Total expense		<u>79</u>	<u>275</u>
Interest income		9	9
Loss on foreign exchange		(15)	(121)
Total income (expense)		<u>(6)</u>	<u>(112)</u>
Net expense		<u>\$ 85</u>	<u>\$ 387</u>
\$/boe		<u>\$0.34</u>	<u>\$1.96</u>

Total interest and finance charges decreased to \$85,000 during the first quarter of 2006 from \$387,000 in the comparable 2005 quarter primarily as a result of lower outstanding debt amounts and fluctuations in foreign exchange rates. During the first quarter of 2006, only \$1.3 million of the Corporation's 12% unsecured convertible debentures were outstanding as compared to an average of \$4.9 million during the comparable 2005. Included in the 2006 amount are \$26,000 (2005 - \$72,000) of non-cash charges pertaining to the convertible debentures issued in 2003.

### Depletion, Depreciation and Accretion

(thousands of dollars, unless otherwise stated)

	Three months ended March 31	
	2006	2005
Depletion, depreciation and accretion	\$ 2,270	\$ 1,478
\$/boe	\$9.20	\$7.49

Total depletion, depreciation and accretion ("DD&A") charges for the first quarter of 2006 were \$2.3 million (\$9.20/boe), of which depletion pertaining to producing properties in Egypt represented \$1.2 million. The remainder represents depletion charges of \$948,000 for the Canadian production and fixed asset depreciation of \$108,000. DD&A charges for the first quarter of 2005 were \$1.5 million (\$7.49/bbl) and \$8.89/boe for the 2005 fourth quarter. The higher depletion rate is expected to decline when the reserve additions resulting from the \$7.1 million of capital expenditures incurred during the quarter, are recognized.

### Cash Flow from Operations

Cash flow from operations represents net income (loss) plus items not affecting cash which include accretion, depletion, depreciation and other non-cash items. For the quarter ended March 31, 2006, Rally Energy's cash flow from operations was \$3.4 million (\$0.04/share) an increase of over 300% compared to \$0.9 million (\$0.01/share) for the 2005 first quarter.

### Net Income

Rally Energy recorded net income of \$866,000 (\$0.01/share) for the first quarter of 2006 as compared to a net loss of \$895,000 ((\$0.01)/share) for the comparable 2005 quarter.

### SUMMARY OF QUARTERLY RESULTS

(thousands of dollars, unless otherwise stated)

	Revenue	Cash flow from operations	\$/share - basic	Income (loss)	\$/share - basic
2006: 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
Q1	\$5,369	\$ 856	\$0.01	\$ (895)	\$(0.01)
2004: Q4	\$5,790	\$1,170	\$0.02	\$ 1,138	\$0.02
Q3	\$6,743	\$3,187	\$0.05	\$ 687	\$0.01
Q2	\$5,400	\$2,202	\$0.03	\$ (28)	\$0.00

## Capital Expenditures

During the 2006 first quarter, Rally Energy drilled four successful oil wells (4 net) in Egypt and participated in the drilling of two successful gas wells (0.7 net) in Canada. Capital expenditures totaled \$7.1 million during the first quarter of 2006, up from \$5.9 million for the comparable 2005 period.

(thousands of dollars)	Three months ended	
	March 31	
	2006	2005
<b>Egypt</b>		
Drill, complete and workovers	\$5,430	\$3,137
Seismic, evaluation and other	839	272
Inventory change	(189)	(129)
Capitalized admin. costs	-	-
<b>Total</b>	<b>\$6,080</b>	<b>\$3,280</b>
<b>Canada</b>		
Drill and complete	\$753	\$1,464
Seismic, evaluation and other	5	230
Lease acquisition	-	467
Capitalized admin. costs	195	110
<b>Total</b>	<b>\$953</b>	<b>\$2,271</b>
<b>Pakistan</b>		
Drill and complete	\$ -	\$297
Seismic, evaluation and other	64	
Capitalized admin. costs	48	35
<b>Total</b>	<b>\$112</b>	<b>\$332</b>
<b>Grand Total</b>		
Drill, complete and workovers	\$6,183	\$4,898
Seismic, evaluation and other	908	502
Lease acquisition	-	467
Inventory change	(189)	(129)
Capitalized admin. costs	243	145
<b>Total</b>	<b>\$7,145</b>	<b>\$5,883</b>

Included in the above amounts are casing and tubing inventory costs of \$1.6 million at March 31, 2006 (2005 - \$441,000) to be used in future Issaran drilling programs.

At March 31, 2006 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, 2006, Rally Energy was utilizing \$2.3 million of its available US\$7.0 million bank credit facility. At December 31, 2005, the Corporation had a cash position of \$802,000 and no credit facility debt. Increased drilling activity, equipment additions and well optimization programs during the first quarter of 2006 have resulted in a higher level of accounts payable. The resulting working capital shortfall at March 31, 2006 was \$2.9 million, as compared to working capital of \$699,000 at December 31, 2005. The Corporation's remaining \$1.3 million of convertible debentures which mature on July 1, 2006 are classified as short term liabilities. At March 31, 2006, accounts payable includes amounts pertaining to \$1.6 million of casing and tubing inventory, recorded as fixed assets, acquired for future drilling operations.

During the 2006 first quarter, Rally Energy received proceeds of \$147,000 from the exercise of an aggregate of 189,000 common share options at an average price of \$0.78/share. Subsequent to March 31, 2006, the Corporation received \$453,000 and issued an additional 420,500 common shares pursuant to the exercise of 247,000 options (at an average of \$0.71 per share) and 173,500 warrants (at \$1.60 per share).

On April 11, 2006, the Corporation announced that it had received Board approval from the International Finance Corporation (the "IFC") (a member of the World Bank Group), for US\$25 million of long-term financing facilities. Completion of the applicable loan documentation is expected to occur by the end May 2006. The facilities will be used to fund working capital requirements and upcoming capital requirements for the Corporation's projects in Egypt and Pakistan.

In connection with the IFC facilities, the Corporation reserved for issuance three million common share purchase warrants for the IFC, subject to completion of the loan documentation. Once issued, each warrant will entitle the IFC to purchase one common share of the Corporation at a price of \$1.92 per common share until the earlier of three years from issuance or 30 days after the date on which the Corporation's common shares close at or above \$2.95 for ten consecutive trading days.

On May 2, 2006, \$750,000 of the 12% unsecured convertible subordinated debentures were converted into 681,818 common shares (at \$1.10/share), leaving a balance of \$564,000 which is expected to be converted before maturity on July 1, 2006.

## **2006 OUTLOOK**

A planned 22 well drilling program, combined with a continuation of steam pilots, is expected to convert probable reserves to the proved category and to increase production from our significantly increased 2005 Egypt oil reserves. Production from existing wells will continue to be enhanced through the installation of high performance pumps and through an on-going well optimization program. The Corporation is committed to increasing its land holdings in Egypt and will continue to examine available opportunities, including the evaluation of the October 2006 bid round lands, which, if successful, will further enhance opportunities for reserves and production growth in Egypt.

In Pakistan, the January 2006 "Commerciality Declaration" has now created an opportunity to proceed with construction of a tie-in pipeline for the sizable 2005 gas and associated condensate reserve discoveries. Sales are expected to commence in November 2006, and additional drilling is expected to commence in the 2006 third quarter. Initially, two development wells are expected to be drilled on the Salsabil (Rodho) discovery structure to increase deliverability from the recognized recoverable reserves and test deeper reservoir horizons. Subsequent exploration wells will follow immediately thereafter in the Afiband and Zindapir structures.



**Rally Energy Corp.**  
**Consolidated Statements of Income and Deficit**  
(unaudited)

Three months ended March 31

	2006	2005
<b>Oil and gas revenue</b>	<b>\$ 10,061,447</b>	<b>\$ 5,369,585</b>
Less: Royalties and related credits	<b>(3,619,419)</b>	<b>(2,091,165)</b>
	<b>6,442,028</b>	<b>3,278,420</b>
Operating expenses	<b>2,121,920</b>	<b>1,404,394</b>
	<b>4,320,108</b>	<b>1,874,026</b>
<b>Expenses</b>		
Administrative expenses:		
Administration	<b>816,950</b>	<b>703,067</b>
Stock-based compensation	<b>282,402</b>	<b>201,394</b>
	<b>1,099,352</b>	<b>904,461</b>
Interest expense	<b>52,946</b>	<b>202,690</b>
Depletion, depreciation and accretion	<b>2,270,295</b>	<b>1,478,061</b>
Accretion expense on convertible debentures	<b>13,224</b>	<b>35,919</b>
Amortization of deferred charge	<b>13,221</b>	<b>35,910</b>
	<b>3,449,038</b>	<b>2,657,041</b>
<b>Income (loss) before other items</b>	<b>871,070</b>	<b>(783,015)</b>
<b>Other items</b>		
Interest income	<b>9,431</b>	<b>9,278</b>
Loss on foreign exchange	<b>(14,709)</b>	<b>(121,330)</b>
	<b>(5,278)</b>	<b>(112,052)</b>
<b>Net income (loss) for the period</b>	<b>865,792</b>	<b>(895,067)</b>
Deficit, beginning of period	<b>(8,893,685)</b>	<b>(10,434,827)</b>
<b>Deficit, end of period</b>	<b>\$ (8,027,893)</b>	<b>\$ (11,329,894)</b>
<b>Income (loss) per share (Note 4(d))</b>		
Basic	<b>\$ 0.010</b>	<b>\$ (0.012)</b>
Diluted	<b>\$ 0.009</b>	<b>\$ n/a</b>

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

	<b>2006</b>	<b>2005</b>
<b>Cash flows from operating activities</b>		
Net income (loss) for the period	\$ 865,792	\$ (895,067)
Non-cash items:		
Stock-based compensation	282,402	201,394
Accretion expense on convertible debentures	13,224	35,919
Amortization of deferred charges	13,221	35,910
Depletion, depreciation and accretion	2,270,295	1,478,061
	<b>3,444,934</b>	<b>856,217</b>
Changes in non-cash working capital balances		
Accounts receivable	(802,418)	991,335
Notes receivable	-	257,270
Inventory	(51,410)	150,986
Prepaid expenses and deposits	(111,370)	(38,356)
Accounts payable - operations	(612,354)	515,352
	<b>1,867,382</b>	<b>2,732,804</b>
<b>Cash flows from investing activities</b>		
Oil and gas assets, net	(7,144,660)	(5,883,059)
Changes in accounts payable - capital	1,986,727	760,379
	<b>(5,157,933)</b>	<b>(5,122,680)</b>
<b>Cash flows from financing activities</b>		
Bank debt	2,349,306	1,219,614
Issuance of common shares, net of share issue costs	139,606	812,017
	<b>2,488,912</b>	<b>2,031,631</b>
<b>Decrease in cash</b>	<b>(801,639)</b>	<b>(358,245)</b>
Cash, beginning of period	<b>801,639</b>	<b>358,245</b>
<b>Cash, end of period</b>	<b>\$ -</b>	<b>\$ -</b>

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

**Rally Energy Corp.**  
**Selected Notes to Consolidated Financial Statements**  
**Three months ended March 31, 2006 (unaudited)**

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. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended December 31, 2005, unless otherwise stated below. The disclosure which follows is incremental to the disclosure included with the annual consolidated financial statements. The interim consolidated financial statements 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, 2005.

**1. Property and Equipment**

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

	<b>March 31, 2006</b>	December 31, 2005
<b>Petroleum and natural gas assets</b>	<b>\$ 75,983,888</b>	\$ 69,248,721
<b>Mining claims</b>	<b>1</b>	1
<b>Furniture, machinery and equipment</b>	<b>3,299,796</b>	2,855,712
	<b>79,283,685</b>	72,104,434
<b>Accumulated depletion, depreciation and write-downs</b>	<b>(26,030,639)</b>	(23,769,940)
<b>Net book value</b>	<b>\$ 53,253,046</b>	\$ 48,334,494

The Corporation has recorded deferred exploration expenditures of \$1,750,095 in Pakistan. Production is expected to commence in 2006 and these costs will be depleted on a unit-of-production basis thereafter.

During the three months ended March 31, 2006, the Corporation capitalized general and administrative expenditures in Canada of \$242,913 (March 31, 2005 - \$145,185), which were included in petroleum and natural gas assets. The Corporation did not capitalize any general and administrative expenditures related to its Egypt properties. No interest has been capitalized.

At March 31, 2006, the Corporation held \$1,988,512 (December 31, 2005 - \$2,126,159) of inventory available for future capital expenditures in the Issaran oilfield in Egypt. Of this amount, (i) \$1,632,041 relates to capital equipment, primarily pipe, and is included in property and equipment and (ii) \$356,471 represents consumable supplies to be used in oilfield operations and is recorded as inventory under current assets. The capital inventory is being utilized in the Corporation's ongoing drilling program. No amortization has been taken on such inventory.

Costs of unproved petroleum and natural gas properties, primarily in Canada, amounting to \$345,828 (2005 - \$266,521) have been excluded from the depletion calculation.

Impairment calculations were performed on the Corporation's petroleum and natural gas properties at March 31, 2006 and 2005 in which the estimated undiscounted future net cash flows associated with the proved and probable reserves exceeded the carrying amount of the Corporation's property and equipment.

**Rally Energy Corp.**  
**Selected Notes to Consolidated Financial Statements**  
**Three months ended March 31, 2006 (unaudited)**

**2. 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, is as follows.

	<b>March 31, 2006</b>	<u>Cost Incurrence</u>		<u>December 31, 2005</u>
		<u>Range</u>	<u>Majority</u>	
Egypt	<b>\$742,382</b>	2015-2017	2017	\$684,740
Pakistan	<b>39,251</b>	2015-2020	2020	39,251
Canada	<b>209,500</b>	2006-2019	2019	209,500
	<b><u>\$991,133</u></b>			<b><u>\$933,491</u></b>

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:

	<b>Three months ended March 31, 2006</b>	Year ended December 31, 2005
<i>Asset retirement obligations</i>		
Balance, beginning of period	<b>\$ 590,382</b>	\$ 289,846
Liabilities incurred in period	<b>34,590</b>	277,554
Accretion expense	<b>9,596</b>	22,982
Balance, end of period	<b><u>\$ 634,568</u></b>	<b><u>\$ 590,382</u></b>

**3. Bank Debt**

At March 31, 2006, the Corporation was utilizing \$2,349,306 (US\$2,010,000) (December 31, 2005 – nil) of the US\$7.0 million credit facility with a major Canadian bank which is secured by trade receivable insurance provided by Export Development Canada ("EDC"). Funds drawn on this facility bear interest at the US prime rate and a standby fee of 0.25% per annum applies to the unused portion of the facility. On March 30, 2006, the Corporation received approval for the secured credit facility term to be extended. The credit facility will expire on May 31, 2006.

**Rally Energy Corp.**  
**Selected Notes to Consolidated Financial Statements**  
**Three months ended March 31, 2006 (unaudited)**

**4. Equity Instruments**

(a) Issued and outstanding

	Three months ended March 31, 2006		Year ended December 31, 2005	
	Number of Shares	Amounts	Number of Shares	Amounts
<b>Common shares</b>				
Balance, beginning of period	91,025,379	\$56,908,614	74,350,379	\$38,332,943
Private placement – flow-through shares	-	-	1,120,000	2,016,000
Private placement	-	-	732,000	966,240
Prospectus issue	-	-	8,000,000	9,095,758
Stock options exercised	188,758	186,953	2,137,000	1,811,673
Debentures converted	-	-	4,686,000	4,686,000
	<u>91,214,137</u>	<u>57,095,567</u>	<u>91,025,379</u>	<u>56,908,614</u>
LESS: Share issue costs (net of tax effect)		<u>(2,275,594)</u>		<u>(1,562,887)</u>
		<u>54,819,973</u>		<u>55,345,727</u>
<b>Share purchase warrants – common shares</b>				
Balance, beginning of period	4,000,000	904,242	-	-
Issued	-	-	4,000,000	904,242
Exercised	-	-	-	-
	<u>4,000,000</u>	<u>904,242</u>	<u>4,000,000</u>	<u>904,242</u>
<b>Balance, end of year, all equity instruments</b>		<u>\$55,724,215</u>		<u>\$56,249,969</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 varying from two to five years.

The Corporation recorded an expense of \$282,402 for options vested in the first quarter of 2006. No options were granted during the three months ended March 31, 2006. The stock-based compensation expense associated with the value ascribed to options granted is recorded as contributed surplus.

	Three months ended March 31, 2006		Year ended December 31, 2005	
	Share Options	Weighted Average Exercise Price	Share Options	Weighted Average Exercise Price
Outstanding, beginning of period	7,356,759	\$1.02	6,327,757	\$0.63
Granted	-	-	3,361,000	\$1.48
Cancelled	(175,000)	\$1.34	(194,998)	\$0.60
Exercised	(188,758)	\$0.78	(2,137,000)	\$0.93
Outstanding, end of period	<u>6,993,001</u>	<u>\$1.02</u>	<u>7,356,759</u>	<u>\$1.02</u>

**Rally Energy Corp.**  
**Selected Notes to Consolidated Financial Statements**  
**Three months ended March 31, 2006 (unaudited)**

**4. Equity Instruments (continued)**

Exercise Price	Options Outstanding					
	March 31, 2006			December 31, 2005		
	Number of Options		Weighted Average Years to Expiry	Number of Options		Weighted Average Years to Expiry
Outstanding	Exercisable	Outstanding		Exercisable		
\$0.54	200,000	150,000	3.17	200,000	150,000	2.76
\$0.60	2,225,000	2,150,000	1.25	2,245,000	2,170,000	1.60
\$0.61	383,667	383,667	2.58	451,667	451,667	2.38
\$0.76	815,000	743,334	3.42	865,000	793,334	3.49
\$0.80	240,000	240,000	2.00	240,000	240,000	2.25
\$0.88	-	-	-	34,091	34,091	0.25
\$1.32	500,000	250,000	4.29	500,000	250,000	4.54
\$1.34	1,033,000	516,500	4.75	1,208,000	604,000	5.00
\$1.40	310,000	103,334	4.46	310,000	103,334	4.71
\$1.54	250,000	83,334	4.08	250,000	83,334	4.33
\$1.55	318,333	95,003	4.58	335,000	111,670	4.83
\$1.79	543,001	377,006	3.79	543,001	211,008	3.77
\$1.85	175,000	116,667	3.96	175,000	58,334	4.21
	<b>6,993,001</b>	<b>5,208,845</b>	<b>3.02</b>	<b>7,356,759</b>	<b>5,260,772</b>	<b>3.27</b>

(c) Contributed surplus

	Three months ended March 31, 2006	Year ended December 31, 2005
Balance, beginning of period	\$ 1,968,082	\$ 1,063,620
Stock-based compensation expense	282,402	1,435,925
Options exercised, transferred to share capital	(39,639)	(531,463)
Balance, end of period	<b>\$ 2,210,845</b>	<b>\$ 1,968,082</b>

(d) Per share amounts

The income 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.

**Rally Energy Corp.**  
**Selected Notes to Consolidated Financial Statements**  
**Three months ended March 31, 2006 (unaudited)**

**4. Equity Instruments (continued)**

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

	<b>Three months ended March 31</b>	
	<b>2006</b>	<b>2005</b>
Net income (loss) available to common shareholders	<b>\$ 865,792</b>	<b>\$ (895,067)</b>
Weighted-average number of common shares outstanding – basic	<b>91,093,488</b>	75,799,306
Dilution effect of stock options	<b>2,266,555</b>	2,970,175
Dilution effect of warrants	<b>73,620</b>	-
Dilution effect of convertible debentures	<b>1,194,546</b>	6,000,000
Weighted-average number of common shares outstanding – diluted	<b>94,628,209</b>	84,769,481
Net income (loss) per share (\$/share)		
Basic	<b>\$0.010</b>	(\$0.012)
Diluted	<b>\$0.009</b>	n/a

Outstanding stock options and common share purchase warrants are the only instruments that are currently dilutive to earnings per share. At March 31, 2006, no stock options, warrants or convertible debentures were antidilutive and excluded from the computation of diluted earnings per share (December 31, 2005 – 1,303,001).

**5. Related Party Transactions**

For the three months ended March 31, 2006, the Corporation paid consulting fees to companies, whose principals are directors and officers 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.

	<b>Three months ended March 31</b>	
	<b>2006</b>	<b>2005</b>
Included in general and administrative expenses	<b>\$ 55,300</b>	\$ 82,349
Capitalized	<b>62,250</b>	124,226
	<b>\$ 117,550</b>	\$ 206,575

**6. Income Taxes**

No provision for taxes has been recorded since the Corporation has adequate tax pools and non-capital loss carry forwards to offset any Canadian tax obligations. In February, 2006, the Corporation renounced \$2,016,000 of exploration expenditures, and utilized the \$705,000 future income tax asset that was recorded at December 31, 2005. Accordingly, the \$705,000 is recorded in share issue costs. All production in Egypt is subject to a royalty charge, pursuant to the terms of the P, which satisfies all tax liabilities. Upon commencement of production in Pakistan, local taxes will apply and cumulative tax pools will be utilized.

The Corporation is required to incur additional qualifying expenditures of \$334,551 in Canada prior to December 31, 2006 to meet its commitments under flow-through agreements.

**Rally Energy Corp.**  
**Selected Notes to Consolidated Financial Statements**  
**Three months ended March 31, 2006 (unaudited)**

**7. Segmented Information**

The Corporation operates in the oil and gas industry. Its reportable segments are identified on a geographic basis.

**Geographic Segments:**

The Corporation has operations in Egypt, Pakistan and Canada. Gross revenue for the three months ended March 31 and capital assets are summarized on a country basis below:

<b>March 31, 2006</b>	<b>Egypt</b>	<b>Canada</b>	<b>Pakistan</b>	<b>Total</b>
Gross revenue	\$ 9,173,860	\$ 887,587	\$ -	\$ 10,061,447
Income (loss)	\$ 2,095,221	\$ (1,215,000)	\$ (14,429)	\$ 865,792
Property and equipment	\$ 34,966,742	\$ 16,536,209	\$ 1,750,095	\$ 53,253,046
<b>March 31, 2005</b>	<b>Egypt</b>	<b>Canada</b>	<b>Pakistan</b>	<b>Total</b>
Gross revenue	\$ 5,212,429	\$ 157,156	\$ -	\$ 5,369,585
Income (loss)	\$ (120,407)	\$ (768,855)	\$ (5,805)	\$ (895,067)
Property and equipment	\$ 19,124,909	\$ 18,692,842	\$ 358,733	\$ 38,176,484

**8. Subsequent Events**

On April 11, 2006, the Corporation announced that it had received Board approval from the International Finance Corporation (the "IFC") (a member of the World Bank Group), for US\$25 million of long-term financing facilities. Completion of the applicable loan documentation is expected to occur by the end May 2006. The facilities will be used to fund working capital requirements and upcoming capital expenditures for the Corporation's projects in Egypt and Pakistan.

In connection with the IFC facilities, the Corporation reserved for issuance three million common share purchase warrants for the IFC, subject to completion of the loan documentation. Once issued, each warrant will entitle the IFC to purchase one common share of the Corporation at a price of \$1.92 per common share until the earlier of three years from issuance or 30 days after the date on which the Corporation's common shares close at or above \$2.95 for ten consecutive trading days.

**9. Statement of Cash Flows and Non-Cash Transactions**

	<b>Three months ended March 31</b>	
	<b>2006</b>	<b>2005</b>
Interest paid	\$ 111,415	\$ 522,559
Taxes paid	\$ -	\$ -