



PRODUCTION ENHANCEMENT GROUP, INC.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE THREE MONTHS ENDED MARCH 31, 2006**

May 15, 2006

MANAGEMENTS' DISCUSSION AND ANALYSIS ("MD&A")

The accompanying Management Discussion and Analysis dated May 15, 2006 focuses on key statistics from the unaudited consolidated financial statements for Production Enhancement Group, Inc. ("PEGI" or "the Company") for the three months ended March 31, 2006, which have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") and pertains to known risks and uncertainties relating to the oilfield services industry. This discussion should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. This discussion and analysis of the financial condition and results of operations for the three months ended March 31, 2006 should be read in conjunction with the Company's December 31, 2005 audited consolidated financial statements and related notes. Notes referred to herein relate to the March 31, 2006 financial statements.

The Company has adopted the United States dollar as its reporting currency as all current operations are located in the United States and all numbers are United States dollar unless otherwise detailed.

FORWARD LOOKING STATEMENTS

Information which is contained in this MD&A contains estimates and assumptions which management is required to make concerning future events, and may constitute forward-looking statements under applicable securities laws. Forward-looking statements include plans, expectations, estimates, forecasts and other comments that are not statements of fact. Although such expectations are viewed as reasonable by the Company, no assurance can be given that such expectations will be realized. Such forward-looking statements are subject to risks and uncertainties and may be based on assumptions that may cause actual results to differ materially from those implied herein, and therefore are expressly qualified in their entirety by this cautionary statement.

Forward-looking statements may be influenced among other things, by the following assumptions, uncertainties and other factors: the level of services carried on by our customers; oil and gas prices; weather; availability of capital; manufacturing cycles of new equipment and availability of human resources. The preceding list is not comprehensive, and as such, investors and others who rely on these statements should consider other uncertainties and events.

Readers are cautioned not to place undue reliance on this forward-looking information, which is given as of the date it is expressed in this MD&A or otherwise, and the Company undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required by law.

OVERVIEW OF BUSINESS

The Company was incorporated on November 21, 2005. On the date of its incorporation, the Company acquired P.E.T. International, Inc. ("PETI"). The business activities of the Company and its wholly-owned subsidiary (PETI) in 2005 were concentrated in targeting acquisitions, raising funds and pursuing a public listing in Canada. Effective as of January 1, 2006, the Company acquired related company Production Enhancement Technology, LLC ("PET") and A to Z Pressure Pump Services, LLC ("A to Z") for cash and stock.

On April 19, 2006, the Company completed its Initial Public Offering (the "IPO") and became listed on the Toronto Stock Exchange (the "TSX") raising gross proceeds of CDN\$20.0 million at an issue price of CDN \$2.00 (USD \$1.75) per unit ("Unit"). Net proceeds to the Company were CDN\$18.4 million (USD\$16.1 million). Each Unit consisted of one common share ("Common Share") and one-half of one warrant ("Warrant"). Each whole Warrant entitles the holder to purchase a common share at an exercise price of CDN \$3.00 (USD \$2.57) until April 19, 2007 provided that if the average closing price of the common shares on the TSX is equal to or greater than CDN \$4.00 (USD \$3.43) for any period of thirty consecutive days that the TSX is open for trading (the "Trading Period"), then subject to the terms and conditions of the warrant indenture, the Company will have the option to accelerate the expiration date of the Warrants to the date which is thirty days following the last day of the Trading Period. The trading symbol for the Company's Common Shares is WIS and the trading symbol for the Company's Warrants is WIS.WT, both of which trade on the TSX.

SELECTED FINANCIAL INFORMATION

For the three months ended March 31, 2006 ^{(1) (2) (3)}	In USD \$
Revenue	\$ 3,826,407
EBITDAS	(166,801)
Income before income taxes	(829,036)
Net income (loss)	(570,732)
Net income (loss) per share (basic and diluted)	\$ (0.01)
Total assets	\$ 15,787,018
Debt	\$ 12,854,126
Number of common shares outstanding ⁽³⁾ :	
Weighted average for the year	38,899,322
As at December 31	38,899,322

- (1) EBITDAS means earnings from continuing operations before interest, taxes, amortization, and stock based compensation. Readers are cautioned that EBITDAS is generally regarded as an indirect measure of operating cash flow, and, as such, the Company believes it is a significant indicator of success of public companies, and is particularly relevant to readers within the investment community.
- (2) The Company became a Reporting Issuer on March 29, 2006, being the date of receipt for its initial public prospectus. Quarterly financial information has not been provided for 2005 as the Company did not prepare such information.
- (3) Includes both Common Shares and Class C non-voting Shares (which except for voting privileges has the same rights as the Common Shares).

RESULTS OF OPERATIONS

The corporate reorganization of PEGI and PETI dated November 21, 2005 has been accounted for using the continuity of interests method and accordingly, the consolidated accounts of PEGI and PETI have been reflected at their historical amounts. The acquisition of PET by PEGI has been accounted for as a capital transaction using the reverse take over accounting rules for transactions that do not constitute business combinations for accounting purposes. The acquisition of A to Z by PEGI has been accounted for using the purchase method of accounting for business combinations.

The audited consolidated balance sheet of the Company as at December 31, 2005 is based on the audited balance sheet of PET with an adjustment for future taxes of \$505,400. Prior to the reverse takeover, PET was not taxable as it was a limited liability company, but will be taxable under the new corporate structure in the future and therefore the audited financial statements have been adjusted to reflect the future tax benefit.

Revenue for the three months ended March 31, 2006 were \$3,826,407 and were adversely impacted by the continued lack of activity in the offshore Gulf of Mexico market due to the impact of Hurricanes Rita and Katrina in 2005.

EBITDAS for the three months ended March 31, 2006 was a loss of \$166,801 caused by the slowdown in offshore activity and increased rental costs associated with cranes, trucks and other rentals to meet customer demands. The Company is currently spending over \$100,000 monthly on rentals. To mitigate these costs, the Company purchased the assets of a tool rental company in May 2006 which supplied rentals to the Company.

Cost of services and direct labor were \$1,565,907 and \$1,149,156 respectively for the three months ended March 31, 2006. As mentioned, rental costs increased for the period as the Company was waiting completion of the IPO to purchase certain assets currently being rented.

Selling, general and administrative expenses were \$1,278,145 for the three months ended March 31, 2006. This amount consists primarily of salaries and costs associated with various operating activities and general corporate expenditures. The Company has ramped up spending by approximately \$80,000 for the quarter to hire sales people in advance of closing the Company's initial public

offering so that once funding occurred the Company would be staffed to compete in the sales force area and deploy additional equipment. Two hires in April were sales people who have many years experience in the offshore Gulf of Mexico market.

PEGI's interest expense and amortization costs were \$662,235 for the three months ended March 31, 2006. These amounts are associated with the debt assumed with the acquisitions of PET and A to Z, Bridge Notes issued in December 2004, March 2005 and June 2005 and debt owed to the owners of acquired companies. This debt was restructured in May 2006 by a new senior term facility, capital expenditure facility and working capital facility which will pay off all existing debt.

PEGI recorded net losses of \$570,732 for the three months ended March 31, 2006.

PEGI had cash and cash equivalents of \$516,569 and \$3,502 as of March 31, 2006 and December 31, 2005, respectively. Net cash used in operating activities was \$131,137 for the three months ended March 31, 2006. The impact is primarily attributable to the slowdown in offshore activity.

Cash flows used in investing activities were \$202,852 for the three months ended March 31, 2006. This increase is attributable to the cash assets acquired from the PET and A to Z acquisitions partially offset by property and equipment purchases.

Cash flows provided by financing activities were \$441,352 for the three months ended March 31, 2006. These cash flows primarily reflect the factoring of accounts receivable at A to Z until the new credit facility was put in place.

Financing Activities

During the three months ended March 31, 2006 the following financing activities occurred.

- On April 19, 2006, the Company completed its IPO. See "Overview of Business".
- On February 15, 2006, the Company entered into a non-binding term sheet ("Senior Credit Terms") from a major international financial institution to provide a senior credit facility of \$25 million, comprised of a working capital line of credit of \$5 million, an initial term loan of \$10 million and a capital expenditure line of \$10 million. The Senior Credit Terms provide for an interest rate on each of the components of 3.5% over 3-month LIBOR, a five year amortization on the term loan and capital expenditure line. In addition, the Senior Credit Terms provide for a warrant to be issued to the financial institution to acquire 1,100,000 common shares at an exercise price of Canadian \$2.00 per share. The warrants will have a term of five years. The facility is secured by all assets of the Company for a term of 5 years. This facility closed on May 2, 2006. The Company has acquired with the acquisitions notes payable of \$7,396,118, debt of \$3,253,427, factoring payable of \$721,355 and capitalized lease obligations of \$1,067,081 that is paid off May 2, 2006 with the facility described above and bridge notes of \$1,137,500 converted to stock at the Company's IPO.
- On March 15, 2006, the Company obtained \$508,344 of short-term interim financing in the form of a sale/leaseback of certain equipment acquired subsequent to year end and the financing of additional equipment in the form of a lease. The lessor will receive a one-year warrant for 10,000 shares of common stock exercisable at the IPO price of CDN \$2.00 per share. The financing was paid off in May 2006 as part of the senior term facility described above.
- On May 2, 2006, the Company entered into a debt facility from a major international financial institution to provide a senior credit facility of \$25 million, comprised of a working capital line of credit of \$5 million, an initial term loan of \$10 million and a capital expenditure line of \$10 million. The Senior Credit Terms provide for an interest rate on each of the components of 3.5% over 3-month LIBOR, a five year amortization on the term loan and capital expenditure line. In addition, the Company issued a warrant to the financial institution to acquire 1,100,000 common shares at an exercise price of Canadian \$2.00 (US \$1.73) per share for a term of five years. The facility is secured by all assets of the Company for a term of 5 years. As at March 31, 2006, the Company had advanced \$75,000 to cover the cost of due diligence. Subsequent to March 31, 2006, the Company advanced an additional \$50,000 in this regard.

The Company is required to pay a lending fee equal to:

- I. If the lender makes an election for the fee to be paid prior to May 2, 2009, an amount equal to \$2,920,000 less the greater of the current market value of 1,100,000 common shares of the Company or \$1,920,000.
- II. If the lender makes an election for the fee to be paid after May 2, 2009, an amount equal to \$3,929,000 less the greater of the current market value of 1,100,000 common shares of the Company or \$1,920,000.

Contractual Obligations

In January 2006, PETI signed a lease for premises requiring monthly minimum lease payments of \$6,000 over the term of the lease, which expires January 2011. This lease can be extended an additional five years at a rental rate of \$6,900 per month. This lease also requires PETI to pay its share of monthly operating costs.

On March 14, 2006, the Company signed a lease for the corporate office. The lease calls for payments of \$9,830 per month from May 1, 2006 to October 31, 2006 and \$10,680 per month from November 1, 2006 forward over the term of the lease expiring October 31, 2009. This lease provides two three year options to renew. This lease also requires the Company to pay its share of monthly operating costs.

In January 2006, PETI entered into a plan of exchange with the holders of Bridge Warrants whereby the holders agreed to exchange their Bridge Warrants for common shares of PEGI. As a result of accepting the plan of exchange, all of the Bridge Warrants were converted into 2,014,700 common shares at a deemed price of CDN\$2.00 (USD\$1.70). The plan of exchange offered the holders of Bridge Notes the option to receive, as payment for all or any portion of the outstanding principal and accrued interest, on their Bridge Notes, common shares of PEGI at a price per Common Share equal to CDN \$1.50 (USD\$1.27) per share. On January 20, 2006, PETI received confirmation that the Bridge Note holders had opted to convert \$1,137,500 of principal and \$186,900 of accrued interest (at April 19, 2006) into common shares. 1,038,731 Common Shares were issued in this regard on April 19, 2006.

Liquidity and Capital Resources

PEGI is funding its capital and operating needs with funds from the new senior term, capital expenditure and working capital facility entered into in May 2006 and with the net proceeds from the Company's IPO. Liquidity risk arises from our ability to meet general funding needs and manage the assets, liabilities and capital structure of the Company. Liquidity risk is managed to maintain sufficient liquid financial resources to fund obligations as they become due in the most cost effective manner. Our liquidity needs are met through a variety of sources, including: cash generated from operations, short-term borrowings against our credit facilities, and long-term borrowings against our capital expenditure line. Our primary uses of funds are operational expenses, capital expenditures, interest and principal payments on credit facilities.

We have a \$25 million total credit facility consisting of a \$5 million revolving credit facility, a \$10 million term loan and a \$10 million capital expenditure facility. We expect that our ability to generate adequate cash flow from operations in the short-term and the long-term and, when needed, to maintain financial capacity and flexibility to provide for planned growth remains substantially unchanged since December 31, 2005.

Use of IPO Proceeds

The USD\$16.1 million in net proceeds from the Company's IPO, should provide sufficient capital for PEGI to operate and implement its current business plan for the next two years unless service activities increase at a pace that requires additional working capital or investment in equipment, or in the event one or more acquisitions are made that require greater capital.

Share Capital

Shares issued and outstanding as of March 31, 2006 are as follows:

Common shares	Number of Shares	Amount
Balance, December 31, 2005	3,007,899	\$ -
Share exchange for Class C shares	(3,000,000)	-
Shares issued for acquisition of PET	649,070	-
Shares issued for acquisition of A to Z	545,301	601,096
Class B shares conversion on final receipt of IPO	1,784,331	-
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Balance, March 31, 2006	2,986,601	601,096
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Common shares - Class B		
Balance December 31, 2005	1,784,331	-
Conversion to common shares on final receipt of IPO	(1,784,331)	-
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Balance March 31, 2006	-	-
	<hr/>	
Common shares - Class C		
Balance December 31, 2005	27,071,085	-
Share exchange of common shares	3,000,000	-
Shares issued for acquisition of PET	5,841,636	-
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Balance March 31, 2006	35,912,721	-
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	38,899,322	\$ 601,096
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As a result of the accounting for the acquisition of PET as a capital transaction using the reverse take over rules for transactions that do not constitute a business combination, share capital reflects the number of shares outstanding of the Company as at January 1, 2006 with the share capital amount of PET. Since PET was an LLC prior to the acquisition, there was no share capital resulting in all of the Company's shares outstanding as at January 1, 2006 having no value.

On November 24, 2005, the Board approved a stock option plan (the "Plan") whereby the Company may grant options to purchase common shares to directors, officers, employees, and consultants. Under the terms of the plan, the Company has reserved 10% of the issued outstanding shares as the maximum stock options that can be granted. When granted, the Options will have a five year term. The exercise price will be determined by the Board and will not be less than the market price of the common shares at the grant date. The Board will determine the vesting terms at the time of grant. On February 13, 2006, the Board approved the granting of 4,175,000 stock options plus an additional 130,000 subject to the completion of the IPO, at a price of Canadian \$2.00 (US \$1.72), vesting over a period of one to three years. The options will be granted after the completion of the IPO. As at the reporting a date the number to be granted had decreased to 3,870,000.

On December 22, 2005, the Company completed a private placement of Class B convertible common voting shares, raising net proceeds of CDN \$2,440,982 (USD \$2,082,845). 1,784,331 shares at a price of Canadian \$1.50 (US \$1.27) were issued. The Agent was paid a fee of 7.0% of the gross proceeds of the sale of the private placement and received options to acquire 178,433 Class B shares at an exercise price of Canadian \$1.50 (US \$1.27) until December 21, 2006. A director subscribed for 100,000 class B shares.

On April 19, 2006, the Company completed its IPO. Each Unit consisted of one Common Share and one-half of one Warrant. Each whole Warrant entitles the holder to purchase a common share at an exercise price of CDN \$3.00 until April 19, 2007. 5,000,000 Warrants were issued. The Agent also received an option to acquire common shares equal to 10% (1,000,000 Warrants) of the total

number of Units distributed at an exercise price of Canadian \$2.00 per common share for a period of up to 12 months from the closing date.

RELATED PARTY TRANSACTIONS

The Company was involved in related party transactions for legal fees related to the Company's initial IPO charged by the law firm at which the Corporate Secretary is a partner for the three months ended March 31, 2006 totalled \$107,978 and have been included in deferred costs. Included in accounts payable at March 31, 2006 is \$136,154 payable to that firm.

COMMITMENTS

The Company acquired all of the outstanding limited liability units of PET through the eventual issuance of 904,506 Common shares, 8,140,553 of Class C non-voting convertible common shares and the issuance of \$5,411,990 of notes payable. The amount due to affiliate of \$2,358,008 reflected on the balance sheet of PET at January 1, 2006 will be netted against the note issued by the Company and therefore, the net amount due is \$3,053,982. As at March 31, 2006, 649,070 Common shares and 5,841,636 Class C shares had been issued. The Company sent a draft of the final purchase price to PET for their approval and expect that the settlement will occur by May 2006. The draft of the final purchase price has been used in the financials and is still subject to adjustment. In April 2006, \$4,529,840 of the notes payable were paid. The remainder of the consideration will be paid on approval of the final purchase price by both parties.

The Company purchased all outstanding limited liability units of A to Z for total estimated consideration of \$1,531,575 consisting of 471,448 common shares and the issuance of \$770,032 of notes payable but are still subject to adjustment. As at March 31, 2006, the Company had issued 545,601 common shares. The Company sent a draft of the final purchase price to A to Z for their approval and expect that the settlement will occur by May 2006. The draft of the final purchase price has been used in the financials and is still subject to adjustment. The purchase price is subject to adjustment to the extent that the A to Z does not meet the minimum working capital and net worth requirements as defined in the agreement. The agreement allows for the consideration to be increased if A to Z does not meet the maximum Earnings before income taxes, depreciation and amortization ("EBITDA") of \$756,000 at closing. The consideration can be increased by five times the difference between 2005 and 2006 EBITDA to a maximum amount of \$756,000. The contingency will be resolved once the final EBITDA for 2006 is determined. Any additional consideration paid will be accounted for at that time. The estimated maximum amount of additional consideration to be paid \$399,579 in cash and 244,640 shares valued at the price established in the agreement of \$2.00 CDN (\$1.70 US) based on the draft on the final purchase price. The agreement requires that the Company place the maximum amount of additional shares to be issued of 244,640, in Escrow based on conditions outlined in the agreement. When the final purchase price is determined in the second quarter of 2006, these shares will be released either at that time or in March 2007.

ACQUISITIONS

The following is a description of PET and A to Z which were both acquired by the Company on January 1, 2006:

PET

PET provides specialized coiled tubing well intervention services to oil and gas producers and operators in Southeast Texas, Louisiana and Mississippi and in the offshore waters of the Gulf of Mexico. PET was the original developer of the WISE™ Technologies and has constructed and deployed six patented, multifunctional coiled tubing units (four WISE™ II units for onshore use and two WISE™ III units for offshore use).

Since its organization in 2002, PET has designed, manufactured, tested and deployed (on land in Louisiana, Texas and Mississippi and in the offshore market of the Gulf of Mexico) four WISE™ II CT Units and two WISE™ III CT Units. Two additional WISE™ II CT Units and one WISE™ III CT Unit are currently being manufactured for delivery to the Company in May and June, at a total cost of approximately \$4.2 million, which will be funded out of the initial public offering proceeds and the capital expenditure facility the Company has arranged.

A to Z

A to Z provides pressure pumping and related well intervention services to oil and gas producers and operators in Texas, Louisiana and Mississippi and in the offshore waters of the Gulf of Mexico. A to Z has three pressure pumping units (one unit for onshore use and

two units for offshore use) and one thermal unit. On a go forward basis, A to Z's pressure pumping business will be conducted under the Company's "WISE™" trademarks and branding strategy even though the equipment used may not be proprietary.

Organized in 2003, A to Z currently operates three pressure pump units and one thermal unit (the WISE™ HOT unit) in both onshore oil and gas fields in Louisiana and in the offshore waters of the Gulf of Mexico. A to Z is also in the process of purchasing two single pump trucks (at a total cost of \$1,564,358 of which approximately \$854,788 has been funded) expected to be received in the third quarter of 2006. The balance of the funds required to acquire the pumping trucks will be funded out of the Offering proceeds and the capital expenditure facility the Company has arranged. The Company will utilize its WISE™ and Well Intervention Services and Equipment™ trademarks in connection with its pressure pumping equipment, but the equipment is being acquired from third parties and thus will not be proprietary to the Company in the same manner as the patented WISE™ CT Units.

EXPANSION /GROWTH

Using the combined infrastructures of PET and A to Z, the Company intends to continue its development and growth in Southeast Texas, Louisiana and Mississippi, and expand into markets in the balance of Texas, as well as Oklahoma, New Mexico, Alabama and Florida (collectively the "Southern Territory"). The Company also plans to expand its operations into western Canada, the mid continent area and the western United States through the acquisition of well intervention service companies already operating in those regions. The Company intends to enter the western Canadian market through the acquisition of an established energy service company, which would form the nucleus of a "Northern Territory" operating division (which is anticipated to include the United States Rockies and upper plains states markets). To the extent that it is successful in completing additional acquisitions, the Company plans to retain the management teams, technical services and expertise of any acquired entities. Additionally, the Company intends to market its CT and pressure pumping services to the customer bases of the acquired entities as a way to accelerate the growth of the Company in new geographic markets. Although some preliminary identification and development work has been commenced on potential acquisition candidates, there is no specific acquisition transaction pending at this time and there can be no assurances that any acquisition candidates will be acquired by the Company. The closing of additional acquisitions will depend on, among other factors, both an increase in the Company's existing credit facilities and the raising of additional equity or other capital (including subordinated debt facilities and/or subordinated notes to be offered to sellers for a portion of their purchase consideration).

The Company's operations as of the beginning of 2006 consist of six existing WISE™ CT Units, three WISE™ pressure pump units and one WISE™ thermal unit. The Company intends to grow its fleet of operating equipment. The actual number of units and pace of deployment will depend on demand, utilization rates of existing units, availability of financing, the pace of manufacturing and other variables beyond the Company's control in whole or in part.

The Company plans to fund this capital expansion through a combination of cash on hand, the proceeds of the IPO, cash flow from operations, additional equity financings and its capital expenditure facility

DISCLOSURE CONTROLS

An evaluation was performed under the supervision and with participation of the Company's senior management, including the President and Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as of March 31, 2006. Based on that evaluation, the Company's management concluded that the Company's disclosure controls and procedures were effective as of March 31, 2006.

There were no changes in the Company's internal control over financial reporting during the most recent fiscal quarter that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

ACCOUNTING POLICIES

The financial statements ending March 31, 2006, of PEGI have been prepared by management in accordance with Canadian generally accepted accounting principles in United States dollars. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared using careful judgment within reasonable limits of materiality.

In addition to the accounting policies discussed in the annual financial statements dated December 31, 2005, the Company adopted the following accounting policy during the period ending March 31, 2006 due to the acquisitions:

Revenue Recognition

The Company's services are generally sold based upon purchase orders or contracts with the customer that include fixed or determinable prices based upon daily, hourly or job rates. Customer contract terms do not include provisions for significant post-service delivery obligations. Revenue is recognized when services are rendered and only when collectibility is reasonably assured. Revenue collected in advance of rendering the service is deferred to a future period.

Prepaid Job Costs

Costs incurred in connection with coil tubing job costs have been capitalized and are being amortized using the straight-line method over the lives of the respective costs (six months).

Intangible assets

Intangible assets are recorded at cost less accumulated amortization. Amortization is provided for over the estimated useful life as follows:

Customer base from A to Z acquisition 5 years straight-line amortization

Impairment of long-lived assets

Long-lived assets, which include property and equipment, intangibles and goodwill are reviewed for impairment when events and circumstances indicate that the carrying amount of an asset may not be recoverable. The Company's policy is to record an impairment loss when it is determined that the carrying amount of the assets exceeds the sum of the expected undiscounted future cash flows resulting from use of the asset and its eventual disposition. Impairment losses are measured as the amount by which the carrying amount of the asset exceeds its fair value and is recognized as an expense in the period of impairment. Long-lived assets to be disposed of are reported at the lower of the carrying amount or fair market value less selling costs.

Valuation of accounts receivable

The Company performs periodic credit evaluations of its customers and grants credit based upon credit checks, past history and financial condition. Customer payments are monitored and a valuation allowance is established based upon specific situations. The Company's history of bad debt losses has been within expectations and generally limited to specific customer circumstances, however given the cyclical nature of the oil and gas services industry and the inherent risk of unforeseen circumstances, a customer's ability to fulfill its obligations can change suddenly and without notice.

Factoring payable

Since the sale of receivables are at full recourse, the transactions are considered to be a lending arrangement and not recorded as a sale.

Inventory

Inventories are valued at the lower of cost or market. Cost is determined by the first in, first out (FIFO) cost method.

Amortization

Property and equipment are recorded at cost. Property and equipment that is still undergoing development and has not been placed in service is shown on the balance sheets as work in process and is not amortized. Amortization, for financial statement purposes, is provided by the straight-line method and declining balance method over the estimated useful lives of the assets as follows:

	<u>Years</u>
Vehicles	5
Furniture and office equipment	3-5
Shop equipment and machinery	5-15
Coil tubing equipment	5-15
Leasehold improvements	5-15
Assets under capital leases	3-5

OUTLOOK

The key factors affecting the financial results for the remainder of 2006 are credit risk, environmental liability, employment retention and weather related risks.

Credit Risk

A substantial portion of the Company's accounts receivable are with customers involved in the oil and natural gas industry, whose revenues may be impacted by fluctuations in commodity prices. Although collection of these receivables could be influenced by economic factors affecting this industry, given the cyclical nature of the oil and gas services industry and the inherent risk of unforeseen circumstances, a customer's ability to fulfill its obligations can change suddenly and without notice.

Environmental Liability

Our business is significantly affected by national and state or provincial laws and other regulations relating to the oil and gas industry and by changes in such laws and the level of enforcement of such laws. We are unable to predict the level of enforcement of existing laws and regulations, how such laws and regulations may be interpreted by enforcement agencies or court rulings, or whether additional laws and regulations will be adopted. We are also unable to predict the effect that any such events may have on us, our business, or our financial condition. In addition, demand for our services is affected by changing taxes, price controls and other laws and regulations relating to the oil and gas industry generally. The adoption of laws and regulations curtailing exploration, development and drilling for oil and gas in our areas of operations for economic, environmental or other policy reasons could also adversely affect our operations by limiting demand for our services. We also have potential environmental liabilities with respect to our offshore and onshore operations. Certain environmental laws provide for joint and several liabilities for remediation of spills and releases of hazardous substances. These environmental statutes may impose liability without regard to negligence or fault. In addition, we may be subject to claims alleging personal injury or property damage as a result of alleged exposure to hazardous substances. We believe that our planned operations will substantially comply with applicable national and state or provincial pollution control and environmental protection laws and regulations with no material adverse effect on financial results. However, such environmental laws are changed frequently. Sanctions for non-compliance may include revocation of permits, corrective action orders, administrative or civil penalties and criminal prosecution. We are unable to predict whether environmental laws will materially adversely affect our future operations and financial results.

Employment Retention

Our ability to remain productive and profitable will depend substantially on our ability to attract and retain skilled workers. Our ability to expand our operations is in part impacted by our ability to increase our labour force. The demand for skilled oilfield employees is high, and the supply is presently very limited. A significant increase in the wages paid by competing employers could result in a reduction in our skilled labour force, increases in the wage rates paid by the Company, or both. If either of these events occurred, our capacity and profitability could be diminished, and our growth potential could be impaired.

Weather Related Risks

The Company's operations are carried out in the United States. Inclement weather can have a significant impact on the Company's ability to provide well intervention services in the effected area. For example, hurricanes typically affect the Company's business as crews and equipment are forced to evacuate manned platforms from the time the storms enter the Gulf of Mexico until they make landfall, disrupting revenues and adding costs of storm preparation and the potential risk of damage to equipment or injuries. Weather can also affect operations on land due to delays in projects, delays and increased costs of mobilization and other factors. Seasonal weather patterns and weather events common in other areas beyond the Gulf Coast may adversely affect the Company as it expands into new geographic markets.

ADDITIONAL INFORMATION

Additional information relating to the Company can also be found on the SEDAR system at www.sedar.com.



PRODUCTION ENHANCEMENT GROUP, INC.
WISE™ Patented Multifunction Coiled Tubing Units

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