

SAHARA ENERGY LTD. MANAGEMENT'S DISCUSSION AND ANALYSIS

Third Quarter September 30,2006

Management's Discussion and Analysis ("MD&A") of financial results is presented by Sahara Energy Ltd. ("Sahara" or the "Company") to review financial results for the three-month period ended September 30, 2006. The information has been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") and should be read in conjunction with the audited financial statements for the period ended December 31, 2005.

Forward-looking Statements

This disclosure includes statements about expected future events and/or financial results that are forward-looking in nature and subject to substantial risks and uncertainties that may cause the actual results, performance or achievements expressed or implied by such forward-looking statements to differ. These risks include, but are not limited to: petroleum and natural gas price volatility, interest rate fluctuations, availability of services and supplies, market competition, uncertainties in the estimates of reserves, the timing of capital expenditures, production levels and the adequacy of funding for capital investments. Sahara Energy Ltd. cautions that actual performance will be affected by a number of factors, many of which are beyond its control.

Non-GAAP Financial Measures

This MD&A includes references to financial measures commonly used in the oil and gas industry. The terms "net petroleum and natural gas revenue" (petroleum and natural gas sales less royalties, production expenses and transportation costs) and "funds from (used by) operations" (net loss for the period adjusted for non-cash items in the statement of operations) are not GAAP measures and do not have standardized meanings prescribed by GAAP.

BOE Presentation

The term barrel of oil equivalent ("boe") may be misleading, particularly if used in isolation. All boe conversions in this report are derived by converting natural gas to oil in the ratio of six thousand cubic feet of natural gas to one barrel of oil. This conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Overview

As at September 30, 2006, the Company reported a cash balance of \$1,657,622 and a working capital position of \$528,003. The Company had net revenues of \$215,744 for the three months ended September 30, 2006 and \$381,402 for the nine month period

and a net loss of \$92,590 for the three months ended September 30, 2006 and \$902,551 net loss for the nine month period.. Adjusting the net loss for non-cash items of depletion, depreciation, accretion and stock based compensation the Company had a net income of \$103,875 for the three months ended September 30, 2006 and a net loss of \$271,872 for the nine month period. The Company incurred capital expenditures totaling \$6,703,754 for the nine month period with expenditures of \$4,469,358 for the three month period ended September 30. For the three month period ended September 30, 2006 the Company spent \$394,774 on land acquisitions \$3,574,809 on exploration and development drilling and \$499,775 for well equipment and facilities.

During the third quarter of 2006, Sahara participated in drilling 17 wells (32% WI), resulting in 14 heavy oil wells, 2 gas wells and 1 abandoned well. Production for the third quarter averaged 85 bopd. Sahara's current production is 200 bopd (heavy oil), 40 bopd (light oil), with behind pipe capacity of 110 bopd (heavy oil) and 1 mmcf/d of gas, for a total capacity of 500 boepd.

Sahara currently has an interest (40%) in 27 producing heavy oil wells in the Lloydminster/ Provost areas of Alberta and the Lashburn/Buzzard area of western Saskatchewan. It also has an interest in 11 heavy oil wells (40%) waiting on completion. Sahara has a 40% working interest in a further 32 heavy oil development locations to be drilled within the next year.

Sahara drilled two gas wells in the quarter and now has an average 30% interest in 8 gas wells. Sahara operated a deep Halfway gas test at Gold Creek (20% WI) and participated in an Eilerslie gas prospect (17.5%) at Willisden Green, with both wells currently being completed.

During the period Sahara also operated two light oil prospects west of the Fifth Meridian in Alberta. One Cardium test well at Pembina (50% interest) and one Montney test well at Tangent (30% interest). Both of these wells are currently on production.

In southern Alberta, Sahara has acquired a seismic option on 13 sections of land with full 3D seismic coverage. Sahara has committed to a Mississippian re-entry test as an earning well (45% WI). Sahara has identified other locations on this large land base with multi-zone potential.

Sahara's current well count is 54 wells to date with an average working interest of 38%. Sahara currently has an inventory of 67 locations to be drilled, (average 40% working interest) that have been identified with either 2D or 3D seismic. Prior to year end Sahara will participate in the drilling of 8 oil test wells. In Alberta, three test wells will be operated by Sahara at Hayter (50%) and one non-operated test well will be drilled at Gold Creek (17.5%). In Saskatchewan, Sahara will participate in three wells at Buzzard (30%) and one horizontal oil test at Macoun (12.5%). Also in Alberta, Sahara will participate in drilling one gas test at Sinclair (20%) and two gas tests at Red Deer (10%).

With the above 11 wells to be drilled in December Sahara's well count at year end will be at 65 wells with an average 38% working interest.

Production

Sahara's production during the quarter averaged 85 BOEPD. Current production is 240 BOEPD with capacity of another 260 BOEPD behind pipe. Sahara's production breakdown is 200 bopd (heavy oil), 40 bopd (light oil), with behind pipe of 110 bopd (heavy oil) and 1 mmcf/d of gas, for total production capacity of 500 boepd..

Revenue and Royalties

Oil sales represented 100% of the total gross revenues for the first nine months. Crown royalties averaged 9.4% of gross sales and all other royalties averaged 8.5%. Revenues continue to increase as production behind pipe is tied in and wells drilled are completed and placed on production.

Production Expenses

Production expenses totaled \$91,848 for the three month period ended September 30, 2006 and \$224,806 for the nine month period to September 30,2006. The production costs are expected to lessen as the wells are no longer in start up phase.

General and Administrative Costs

General and administrative ("G & A") expenses for the three months ended September 30, 2006 were \$117,615 and totaled \$423,591 for the nine month period ended September 30,2006. The Company also received overhead recoveries of \$130,164 for the nine month period.

Depletion

Depletion costs were \$60,718 for the Quarter ended September 30,2006 and \$211,262 for the nine months ended September 30,2006. Depletion costs are expected to decrease as the Company's proven reserve based increases.

Capital Expenditures

	Nine Months Ended <u>September 30,2006</u>	Three months Ended <u>September 30,2006</u>
Land acquisitions	\$854,200	\$394,774
Exploration & Development drilling	\$5,434,291	\$3,574,809
Well equipment and facilities	<u>\$605,830</u>	<u>\$499,775</u>
Total	<u>\$6,894,321</u>	<u>\$4,469,358</u>

Cash Flow from Operations	Nine Months	Three Months
	September 30,2006	September 30,2006
Gross revenues	\$465,736	\$262,825
Royalties	\$84,334	\$47,081
Operating Expenses	<u>\$211,468</u>	<u>\$83,103</u>
Net Cash Flow from Operations	\$169,934	\$132,641
Cash flow per weighted average share	\$0.012	\$0.008

Source and Use of Funds

Issue of convertible debentures	\$1,035,080	
Exercise of Options	\$121,937	\$75,000
Exercise of Warrants	\$ 2,296,563	\$ -
Flow through shares issue	\$1,999,950	\$ -
Funds provided (used) by operations	\$ (271,872)	\$103,875
Change in non-cash working capital	\$1,134,471	\$(288,120)
Additions to property and equipment	<u>(\$6,703,750)</u>	<u>\$(4,469,358)</u>
Use of cash	(\$387,621)	\$(4,578,603)
Cash balance December 31,2005	<u>\$2,045,244</u>	<u>\$6,236,226</u>
Cash balance September 30,2006	<u>\$1,657,623</u>	<u>\$1,657,623</u>

Future Taxes

Balance at December 31, 2005	\$135,000
Flow through share renouncement (\$3,038,000)	<u>\$1,024,948</u>
Balance at September 30,2006	<u>\$1,159,948</u>

Reserves

The Company's reserves were internally evaluated at September 30, 2006. In November DeGolyer & McNaughton were retained to provide a Reserve Report which will be issued by the Company at year end.

Liquidity and Capital Resources

The Company had a cash balance of \$1,657,623 and working capital of \$528,003 as of September 30, 2006. The Company has sufficient working capital to meet all commitments to which it is currently committed.

On January 26, 2006 the Company issued 1,035 10% convertible Debentures at a price of \$1,000 per Debenture for aggregate gross proceeds of \$1,035,000. The Debentures mature on December 31, 2007 and are convertible, in whole or in part, at any time prior to maturity at the option of the holder. The Debentures are also automatically convertible at the option of the holder at any time and in the event that the Company fails to pay interest or fails to repay the principal amount and accrued interest on the maturity date. When converted, the Debentures shall be convertible into units comprised of common shares and common share purchase warrants on the basis of \$0.57 per common share together with one warrant for each common share issued. Each warrant shall be convertible into one common share of the Company at a price of \$0.57 until December 31, 2007. The holder may also convert the Debentures into cash at any time after September 30, 2006 on the basis of repayment of the principal amount together with accrued and unpaid interest to the date of conversion.

During the period, \$145,000 in debentures were exercised and converted into 254,383 common shares by the holders of the debentures.

Critical Accounting Estimates

Management is required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company.

Full Costing

The Company follows the full-cost method of accounting for oil and natural gas properties, whereby all costs associated with the exploration for, and development of, petroleum and natural gas reserves, whether productive or unproductive, are capitalized in cost centers. Costs capitalized include land acquisitions costs, geological and geophysical expenditures, rentals on undeveloped properties and drilling and overhead expenses related to exploration and development activities. Proceeds from disposition of property are credited to the net book value of the property and equipment. Gains and losses are not recognized upon disposition of oil and gas properties, unless the disposition would significantly alter the rate of depletion.

Costs capitalized are depleted and amortized using the unit-of-production method based on gross proved oil and gas reserves as determined by independent engineers. For purposes of the depletion calculation, proved oil and gas reserves are converted to a common unit of measure on the basis of the relative energy content of 6,000 cubic feet of natural gas per barrel of oil.

In applying the full cost method, the Company calculates a ceiling test for each cost centre whereby the carrying value of property and equipment is compared at each reporting period to the sum of the undiscounted cash flows expected to result from the future production of proved reserves and the sale of unproved properties. Cash flows are estimated using third party quoted forward prices, adjusted for transportation and quality, less estimated costs directly associated with the development, production and sale of reserves. Should the ceiling test result in an excess carrying value, the Company would then measure the amount of impairment for the cost centre by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the sale of unproved properties. A risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying amount would be recorded as a permanent impairment.

Stock-based Compensation

The Company uses the fair value method of accounting for options granted to employees and consultants. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model and charged to earnings over the vesting period with a corresponding increase in contributed surplus. Upon the exercise of the stock options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk, which even with a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that expenditures made on future exploration by Sahara will result in new discoveries of oil and natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones, tools lost in the hole and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

The long-term commercial success of Sahara depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. No assurance can be given that Sahara will be able to continue to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, Sahara may determine that current markets, terms of acquisition and participations or pricing conditions make such acquisitions or participations uneconomic. Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recover of drilling, completion and operating cost. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and

various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rate over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

In addition, oil and gas operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, blowouts, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

Subsequent events

On November 1, 2006 the Company closed a private placement which comprised of 1,000,000 flow-through shares, renounced as Canadian Development Expense (CDE) at \$1.20 per share and 1,000,000 Canadian Exploration Expense at \$1.33 per share for total proceeds of \$2,530,000.

On November 13, 2006 entered into an agreement with Leede Financial Markets Inc. and Blackmont Capital Inc. (collectively, the "Agents") to issue, on a best efforts basis, a minimum of 620,000 units ("Units") and a maximum of 820,000 Units at a price of \$4.90 per Unit for minimum gross proceeds of \$3,038,000 and maximum gross proceeds of up to \$4,018,000 (the "Offering"). In addition, the Agents have been granted an option, exercisable in whole or in part, at any time up to 48 hours prior to closing, to increase the total Offering by up to 10%, or 82,000 Units at a price of \$4.90 per Unit for additional proceeds of \$401,800.

Each Unit consists of two (2) flow-through shares, each representing \$1.60 of Canadian Development Expenses and one (1) flow through share representing \$1.70 of Canadian Exploration Expenses.

The Agents will receive a fee equal to 6% of the proceeds of the Offering along with an option (the "Agents' Option") to acquire that number of common shares of the Company equal to 6% of the total number of flow-through shares sold under the Offering. Each Agent's Option shall entitle the Agents to purchase one common share of the Company at a price of \$1.50 for a period of twelve months from the date of the closing of the Offering.