DALRADA FINANCIAL CORP
Form 10QSB
February 20, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2006
or
[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

COMMISSION FILE NO. 0-12641

DALRADA FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	38-3713274
(State or other jurisdiction of incorporation or organization)	(IRS Employer ID Number)

9449 BALBOA AVENUE, SUITE 210
SAN DIEGO, CA 92123
(Address of principal executive offices)

Registrant's telephone number, including area code:
(858) 427 8700

N/A
(Former name and address, if changed since last report)

Check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

The number of shares outstanding of the registrant's common stock as of February 15, 2007 was 4,970,066.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). (Check one): Yes [ ] No [X]

Transitional Small Business Disclosure Format (check one): Yes [ ] No [X]

PART I - FINANCIAL INFORMATION

Page

ITEM 1. Consolidated Financial Statements

Consolidated Balance Sheet - December 31, 2006 (unaudited)	2
Consolidated Statements of Operations - three and six months ended December 31, 2006 and 2005 (unaudited)	3
Consolidated Statement of Stockholders' Deficit -- six months ended December 31, 2006 (unaudited)	4
Consolidated Statements of Cash Flows - six months ended December 31, 2006 and 2005 (unaudited)	5
Notes to Consolidated Financial Statements (unaudited)	6
ITEM 2. Management's Discussion and Analysis or Plan of Operations	18
ITEM 3. Controls and Procedures	24
PART II - OTHER INFORMATION	25
ITEM 1. Legal Proceedings	25
ITEM 2. Unregistered Sale of Equity Securities and Use of Proceeds	26
ITEM 3. Defaults Upon Senior Securities	26
ITEM 4. Submission of Matters To A Vote of Security Holders	26
ITEM 5. Other Information	26
ITEM 6. Exhibits	26
SIGNATURES	26
CERTIFICATIONS	

PART I. - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
DECEMBER 31, 2006
(unaudited)

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheet
(in thousands, except share data)

	December 31, 2006

	(unaudited)
ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	$ 2,023
Accounts receivable, net of allowance of $248	9,410
Debt issue costs	249
Other current assets	1,847
TOTAL CURRENT ASSETS	13,529
CUSTOMER LIST, net of accumulated amortization of $164	852
PROPERTY AND EQUIPMENT, net of accumulated depreciation of $431	714
WORKER'S COMPENSATION DEPOSIT	3,009
INVESTMENT IN ALLIANCE INSURANCE GROUP	1,400
RECEIVABLE FROM RELATED PARTY	1,400
OTHER LONG-TERM ASSETS	932
TOTAL ASSETS	$ 21,836
LIABILITIES AND STOCKHOLDERS' DEFICIT	
CURRENT LIABILITIES	
Notes payable, current portion	2,108
Line of Credit	500
Accounts payable	1,620
PEO payroll taxes and other payroll deductions	8,666
Accrued payroll and related payroll taxes and deductions	17,353
Other accrued expenses	4,583
Warrant liability	4,746
Accrued derivative liability	2,465
TOTAL CURRENT LIABILITIES	42,041
CONVERTIBLE DEBENTURES, net of discounts of $4,895	4,220
NOTES PAYABLE, net of current portion (includes related party note of $100)	503
TOTAL LIABILITIES	46,764
MINORITY INTEREST	550
COMMITMENTS AND CONTINGENCIES	--
STOCKHOLDERS' DEFICIT	
Series A convertible, redeemable preferred stock, $1,000 par value, 7,500 shares authorized 420.5 shares issued and outstanding	420
Common stock; $0.005 par value; 1,000,000,000 shares authorized; 4,970,066 shares issued and outstanding	25
Common stock warrants	475
Additional paid-in capital	87,014
Prepaid consulting	(170)
Accumulated deficit	(113,242)
TOTAL STOCKHOLDERS' DEFICIT	(25,478)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 21,836

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

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
DECEMBER 31, 2006
(unaudited)

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Operations and Other Comprehensive Loss
(in thousands, except share data)

	Three Months		Six
	December 31, 2006	December 31, 2005	December 31 2006
	(unaudited)	(unaudited)	(unaudited)
REVENUES			
Temporary staffing services	$ 33,515	$ 17,002	$ 66,597
PEO Services	25,237	387	28,230
Products and other	196	445	1,079
TOTAL REVENUES	58,948	17,834	95,906
COST OF REVENUES			
Cost of temporary staffing	29,103	14,477	59,138
Cost of PEO services	24,649	299	27,004
Cost of products and other	9	7	20
TOTAL COST OF REVENUES	53,761	14,783	86,162
GROSS PROFIT	5,187	3,051	9,744
OPERATING EXPENSES			
Selling, general and administrative	4,213	2,537	8,085
TOTAL OPERATING EXPENSES	4,213	2,537	8,085
INCOME (LOSS) FROM OPERATIONS	974	514	1,659
OTHER INCOME (EXPENSES):			
Interest expense	(1,822)	(140)	(3,089
Note payable settlement	--	(316)	--
Penalties and interest	--	(294)	--
Gain on extinguishment of debt	257	4,262	608

Change in derivative and warrant liabilities	329	--	(2,590
Other, net	(15)	(187)	13
TOTAL OTHER INCOME (EXPENSE)	(1,251)	3,325	(5,058
INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES AND DISCONTINUED OPERATIONS	(277)	3,839	(3,399
PROVISION FOR INCOME TAXES	--	--	--
INCOME (LOSS) BEFORE MINORITY INTEREST AND DISCONTINUED OPEATIONS	(277)	3,839	(3,399
MINORITY INTEREST IN SUBSIDIARY (INCOME)	(402)	--	(550
NET INCOME (LOSS) FROM CONTINUING OPERATIONS	(679)	3,839	(3,949
DISCONTINUED OPERATION:			
Loss from discontinued operation	--	(420)	(22
	--	(420)	(22
NET INCOME (LOSS)	(679)	3,419	(3,971
OTHER COMPREHENSIVE INCOME (LOSS)			
Foreign currency translation	--	3	--
COMPREHENSIVE INCOME (LOSS)	(679)	3,422	(3,971
PREFERRED STOCK DIVIDENDS	(5)	(5)	(10
NET INCOME (LOSS) ATTRIBUTED TO COMMON STOCKHOLDERS	$ (684)	$ 3,414	$ (3,981
EARNINGS (LOSS) PER SHARE - BASIC			
Continuing operations	$ (0.14)	$ 0.99	$ (0.80
Discontinued operations	--	(0.11)	(0.00
	$ (0.14)	$ 0.88	$ (0.81
WEIGHTED AVERAGE COMMON EQUIVALENT SHARES OUSTANDING - BASIC	4,919,911	3,859,135	4,918,983

The accompanying notes are an integral part of these consolidated financial stateme

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(unaudited)

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statement of Stockholders' Deficit
(in thousands, except share data)
(Unaudited)

	Series A Preferred Stock		Common Stock		Common Stock	Additional Paid-in
	Shares	Amount	Shares	Amount	Warrants	Capital
Balance, June 30, 2006	420.5	420	4,920,066	25	475	86,976
Amortization of prepaid consulting						
Common stock issued for:						
Conversion of notes payable			50,000	--		38
Net loss						
Balance, December 31, 2006	420.5	$ 420	4,970,066	25	$ 475	$ 87,014

The accompanying notes are an integral part of these consolidated financia

4

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOW
(unaudited)

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows
(in thousands, except share data)

	Six Months Ended	
	December 31, 2006	Decembe 2005
	(uanudited)	(uanudi
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss) from continuing operations	$ (3,949)	$ 3
Adjustment to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization	174	
Stock issued for services	--	

Amortization of prepaid consulting	75	
Amortization of debt discounts	2,069	
Change in value of warrant and accrued derivative liabilities	2,590	
Gain on extinguishment of debt	(608)	(5
Minority interest	550	
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(6,418)	
Prepaid worker's compensation premiums	--	
Other current assets	1,649	(1
Worker's compensation deposit	432	
Other assets	(713)	
Increase (decrease) in:		
Accounts payable and accrued expenses	(1,127)	4
Accrued payroll and related payroll taxes and deductions	8,050	
PEO liabilities	215	1
Net cash provided by operating activities from continuing operations	2,989	2
Net cash used in operating activities from discontinued operations	--	
Net cash provided by operating activities	2,989	2
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash acquired with (paid for) acquisition	(178)	
Purchase of furniture and equipment	(38)	
Net cash used in investing activities from continuing operations	(216)	
Net cash used in investing activities from discontinued operations	--	
Net cash used in investing activities	(216)	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in cash overdraft, net	--	
Line of credit, net	--	
Proceeds from notes payable	--	
Repayments of notes payable	(4,010)	(2
Repayment of borrowings under bank notes payable	(483)	
Repayments of capital lease obligations	--	
Net cash used in financing activities from continuing operations	(4,010)	(1
Net cash used in financing activities from discontinued operations	--	
Net cash used in financing activities	(4,010)	(1
EFFECT OF EXCHANGE RATE CHANGES ON CASH	--	
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,237)	
CASH AND CASH EQUIVALENTS, Beginning of period	3,260	
CASH AND CASH EQUIVALENTS, End of period	$ 2,023	$

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

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows, Continued
(in thousands, except share data)

	Six Months Ended	
	December 31, 2006	December 31, 2005
	(uanudited)	(uanudited)
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest paid	$ --	$ --
Income taxes paid	$ --	$ --
SUPPLEMENTAL NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Conversion of convertible debentures into common stock	$ --	$ 50
Conversion of accounts payable and accrued liabilities into common stock	$ --	$ 29
Net assets acquired in business combinations:		
Cash	$ 72	$ --
Receivables	1,781	--
Other current assets	477	--
Property and equipment	384	--
Worker's compensation deposit	369	--
Customer list	377	--
Other assets	205	--
Accounts payable	30	--
Accrued expenses	2,397	--
Line of credit	500	--
Notes payable	238	--

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

6

DALRADA FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
(IN THOUSANDS, EXCEPT SHARE DATA)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Dalrada Financial Corporation and Subsidiaries (the "Company" or "DFCO") have been

prepared pursuant to the rules of the Securities and Exchange Commission (the "SEC") for quarterly reports on Form 10-QSB and do not include all of the information and note disclosures required by accounting principles generally accepted in the United States of America. These financial statements and notes herein are unaudited, but in the opinion of management, include all the adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company's financial position, results of operations, and cash flows for the periods presented. These financial statements should be read in conjunction with the Company's audited financial statements and notes thereto for the year ended June 30, 2006 included in the Company's annual report on Form 10-KSB filed with the SEC. Interim operating results are not necessarily indicative of operating results for any future interim period or for the full year ended June 30, 2007. The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All inter-company transactions have been eliminated.

MINORITY INTEREST

On April 1, 2005, the Company contributed its wholly-owned subsidiary, Solvis Group, Inc. a Michigan corporation, to QPI, an 85%-owned subsidiary of the Company. QPI subsequently changed its name to The Solvis Group, Inc., a Nevada corporation ("Solvis"). In the consolidated statement of operations, the Company has only recognized the minority interests' share of the net loss to the extent of the minority interest recorded on the consolidated balance sheet. Solvis had net income for the six months ended December 31, 2006 of which 15% or $661 is attributed to minority interest. The net income attributed to minority interest for the six months ended December 31, 2006 of $550 that has been separately designated in the accompanying statement of operations is the current year net income related to minority interest of $661 offset by the unrecorded loss of $111 from the year ended June 30, 2006.

STOCK SPLIT

On September 15, 2006, the Company authorized a one for two hundred (1 for 200) reverse stock split of its common stock. There was no change made to the par value of the Company's common stock. All share information for common shares has been retroactively restated for this reverse stock split.

RECLASSIFICATIONS

Certain reclassifications have been made to the prior years' financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or retained earnings.

COMPREHENSIVE INCOME

The Company has adopted SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for reporting and presentation of comprehensive income and its components in a full set of financial statements. During the six months ended December 31, 2006, the Company had no elements of comprehensive income.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2005, the Financial Accounting Standards Board ("FASB") issued SFAS No. 154, "Accounting Changes and Error Corrections." This statement applies to all voluntary changes in accounting principle and requires retrospective application to prior periods' financial statements of changes in accounting principle,

unless this would be impracticable. This statement also makes a distinction between "retrospective application" of an accounting principle and the "restatement" of financial statements to reflect the correction of an error. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. SFAS No. 154 is not expected to have a material effect on the financial position or results of operations of the Company.

In February 2006, FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments". SFAS No. 155 amends SFAS No 133, "Accounting for Derivative Instruments and Hedging Activities", and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". SFAS No. 155, permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interest in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends SFAS No. 140 to eliminate the prohibition on the qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This statement is effective for all financial instruments acquired or issued after the beginning of the Company's first fiscal year that begins after September 15, 2006. SFAS No. 155 is not expected to have a material effect on the financial position or results of operations of the Company.

In March 2006 FASB issued SFAS 156 `Accounting for Servicing of Financial Assets' this Statement amends FASB Statement No. 140, ACCOUNTING FOR TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITIES, with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement:

1. Requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract.

2. Requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable.

3. Permits an entity to choose 'Amortization method' or 'Fair value measurement method' for each class of separately recognized servicing assets and servicing liabilities:

4. At its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value.

5. Requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of

financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities.

This Statement is effective as of the beginning of the Company's first fiscal year that begins after September 15, 2006. Management believes that this statement will not have a significant impact on the financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement clarifies the definition of fair value, establishes a framework for measuring fair value and expands the disclosures on fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. Management has not determined the effect, if any, the adoption of this statement will have on the financial statements.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans-an amendment of FASB Statements No. 87, 88, 106, and 132(R)". One objective of this standard is to make it easier for investors, employees, retirees and other parties to understand and assess an employer's financial position and its ability to fulfill the obligations under its benefit plans. SFAS No. 158 requires employers to fully recognize in their financial statements the obligations associated with single-employer defined benefit pension plans, retiree healthcare plans, and other postretirement plans. SFAS No. 158 requires an employer to fully recognize in its statement of financial position the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. This Statement also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. SFAS No. 158 requires an entity to recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost pursuant to SFAS No. 87. This Statement requires an entity to disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation. The Company is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures for fiscal years ending after December 15, 2006. Management believes that this statement will not have a significant impact on the financial statements.

NOTE 2. GOING CONCERN CONSIDERATIONS

The accompanying unaudited consolidated financial statements have been prepared assuming that the Company will continue as a going concern. For the six months ended December 31, 2006, the Company had a net loss of $3,971. As of December 31, 2006, the Company had a working capital deficiency of $28,512 and had a stockholders' deficit of $25,478. In addition, the Company is delinquent on payroll tax obligations and has been sued by trade creditors for nonpayment of amounts due. The Company is also delinquent in its payments relating to payroll tax liabilities. These conditions raise substantial doubt about its ability to continue as a going concern. Management believes that it can continue to raise debt and equity financing to support its operations.

The Company must obtain additional funds to provide adequate working capital and finance operations. However, there can be no assurance that the Company will be able to complete any additional debt or equity financings on favorable terms or at all, or that any such financings, if completed, will be adequate to meet the Company's capital requirements. Any additional equity or convertible debt financings could result in substantial dilution to the Company's stockholders. If adequate funds are not available, the Company may be required to delay, reduce or eliminate some or all of its planned activities. The Company's inability to fund its capital requirements would have a material adverse effect on the Company. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

NOTE 3. STOCK BASED COMPENSATION

The Company adopted SFAS No. 123 (Revised 2004), SHARE BASED PAYMENT ("SFAS No. 123R"), under the modified-prospective transition method on January 1, 2006. SFAS No. 123R requires companies to measure and recognize the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value. Share-based compensation recognized under the modified-prospective transition method of SFAS No. 123R includes share-based compensation based on the grant-date fair value determined in accordance with the original provisions of SFAS No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, for all share-based payments granted prior to and not yet vested as of January 1, 2006 and share-based compensation based on the grant-date fair-value determined in accordance with SFAS No. 123R for all share-based payments granted after January 1, 2006. SFAS No. 123R eliminates the ability to account for the award of these instruments under the intrinsic value method prescribed by Accounting Principles Board ("APB") Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, and allowed under the original provisions of SFAS No. 123. Prior to the adoption of SFAS No. 123R, the Company accounted for our stock option plans using the intrinsic value method in accordance with the provisions of APB Opinion No. 25 and related interpretations.

For periods presented prior to the adoption of SFAS No. 123R, pro forma information regarding net loss and loss per share as required by SFAS No. 123R has been determined as if the Company had accounted for its employee stock options under the original provisions of SFAS No. 123. The fair value of these options was estimated using the Black-Scholes option pricing model. For purposes of pro forma disclosure, the estimated fair value of the options is amortized to expense over the option's vesting period. The pro forma information regarding the effect on operations that is required by SFAS 123 has not been presented since there is no pro forma expense to be shown for the six months ended December 31, 2005. There were no options granted during the six months ended December 31, 2006

NOTE 4. EARNINGS (LOSS) PER COMMON SHARE

The Company reports earnings (loss) per share in accordance with SFAS No. 128, "Earnings per Share." Basic earnings (loss) per share are computed by dividing income (loss) available to common stockholders by the weighted average number of common shares available. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. The following potential common shares have been excluded from the computation of diluted net loss per share for the six months ended

December 31, 2006: warrants - 7,330,000 and stock options - nil. All warrants are anti-dilutive at December 31, 2006 since the Company incurred a net loss.

Basic and diluted loss per share are the same for the six months ended December 31, 2006. Below is the computation of basic and diluted earnings per share:

	THREE MONTHS ENDED DECEMBER 3			
	2006			
	INCOME/ (LOSS)	SHARES	PER SHARE	INCOME/ (LOSS)
BASIC EARNINGS (LOSS) PER SHARE				
Net income (loss) from continuing operations	$ (679)			$ 3,839
Preferred stock dividends	(5)			(5)
	(684)			3,834
Discontinued operations	--			(420)
Net income (loss) attributed to common stockholders	$ (684)			$ 3,414
Weighed shares outstanding		4,919,911		
Continuing operations			$ (0.14)	
Discontinued operations			$ --	
			$ (0.14)	
DILUTED EARNINGS (LOSS) PER SHARE				
Net income (loss) from continuing operations		N/A		$ 3,839
Preferred stock dividends				(5)
Interest on convertible debentures				30
Amortization of discounts on convertible debentures				28
				3,892
Discontinued operations				(420)
Net income (loss) attributed to common stockholders				$ 3,472
Weighed shares outstanding				
Conversion of convertible debentures into common stock				
Continuing operations				

Discontinued operations

10

	SIX MONTHS ENDED DECEMBER 31			
	2006			
	INCOME/ (LOSS)	SHARES	PER SHARE	INCOME/ (LOSS)
BASIC EARNINGS (LOSS) PER SHARE				
Net income (loss) from continuing operations	$ (3,949)			$ 3,679
Preferred stock dividends	(10)			(10)
	(3,959)			3,669
Discontinued operations	(22)			(520)
Net income (loss) attributed to common stockholders	$ (3,981)			$ 3,149
Weighed shares outstanding		4,918,983		
Continuing operations			$ (0.80)	
Discontinued operations			$ (0.00)	
			$ (0.81)	
DILUTED EARNINGS (LOSS) PER SHARE				
Net income (loss) from continuing operations		N/A		$ 3,679
Preferred stock dividends				(10)
Interest on convertible debentures				60
Amortization of discounts on convertible debentures				58
				3,787
Discontinued operations				(520)
Net income (loss) attributed to common stockholders				$ 3,267
Weighed shares outstanding				
Conversion of convertible debentures into common stock				

Continuing operations

Discontinued operations

NOTE 5. ACQUISITION

On September 12, 2006, DFCO acquired all the outstanding stock for All Staffing Inc., a Tennessee corporation for $500 in cash and note payable and a warrant to purchase 450,000 shares to DFCO's stock, to be valued at $3,000 36 months after issuance (closing), subject to adjustment.

All Staffing Inc, established in 1991, is a Professional Employer Organization (PEO) located in Lansford, PA. The Company has clients in PA, NJ and NY. All Staffing provides comprehensive outsourcing of human resource and benefit administration, as well as payroll and tax processing as a co-employer with its client companies. All Staffing will undertake certain employment processes and administration for the benefit of all the Dalrada Financial companies.

The operating results of All Staffing beginning September 12, 2006 are included in the accompanying consolidated statements of operations.

The total purchase price was valued at $500 and is summarized as follows in accordance with SFAS No. 141 and 142:

Cash	$ 72
Accounts receivable	1,781
Other current assets	477
Property and equipment	384
Worker's compensation deposit	369
Customer list	377
Other assets	205
Accounts payable	(30)
Accrued expenses	(2,397)
Line of credit	(500)
Notes payable	(238)
Purchase price	$ 500

The customer list is being amortized over 48 months.

NOTE 6. CONVERTIBLE DEBT FINANCING AND DERIVATIVE LIABILITIES

In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended ("SFAS 133"), the holder's conversion right provision, interest rate adjustment provision, liquidated damages clause, cash premium option, and the redemption option (collectively, the debt features) contained in the terms governing the Notes are not clearly and closely related to the characteristics of the Notes. Accordingly, the features qualified as embedded derivative instruments at issuance and, because they do not qualify for any scope exceptions within SFAS 133, they were required by SFAS 133 to be accounted for separately from the debt instrument and recorded as derivative

financial instruments.

During the six months ended December 31, 2006, we recorded an other expense item of $982 and $1,608, which relates to the convertible debt features and warrants, respectively, to reflect the change in fair value of the derivative liability.

At each balance sheet date, we adjust the derivative financial instruments to their estimated fair value and analyze the instruments to determine their classification as a liability or equity. As of December 31, 2006, the estimated fair value of our derivative liability was $2,465, as well as a warrant liability of $4,746..

NOTES PAYABLE

During the year ended June 30, 2006, the Company issued notes to third parties, which included eight investors. As part of the several financing transactions, the Company also issued warrants to purchase shares of stock at various exercise prices.

Date of Note	Amount of Notes	Conversion Price(1)	Term of Note
January 27, 2006 (1)	$ 112	$ 0.452	2 years
February 9, 2006 (1)	$ 246	$ 0.452	2 years
February 13, 2006	$ 7,545	75% (3)	2 years

Date of Warrants Issued	Number of Warrants	Exercise Price	Term of Warrants
February 13, 2006	6,760,000	$ 1.00	7 years
February 13, 2006 (2)	520,000	$ 1.00	7 years
May 1, 2006 (4)	50,000	$ 20.00	7 years

(1) = no warrants issued with this financing transaction.
(2) = no debt associated with these warrants.
(3) = 75% of 20-day pre-conversion market-based price.
(4) = warrants issued in connection with SSL acquisition

The notes contain provisions on interest accrual at the "prime rate" published in The Wall Street Journal from time to time, plus three percent (3%). The Interest Rate shall not be less than fifteen percent (15%). Interest shall be calculated on a 360 day year. Interest on the Principal Amount shall be payable monthly, commencing 120 days from the closing and on the first day of each consecutive calendar month thereafter (each, a "Repayment Date") and on the Maturity Date.

Following the occurrence and during the continuance of an Event of Default (as discussed in the Note), the annual interest rate on the Note shall automatically be increased by two percent (2%) per month until such Event of Default is cured.

12

The Notes also provide for liquidated damages on the occurrence of several events. During the six months ended December 31, 2006, the Company has recorded an expense of $508 as a non-registration penalty.

Debt features. The Holder shall have the right, but not the obligation, to convert all or any portion of the then aggregate outstanding Principal Amount of this Note, together with interest and fees due hereon, into shares of Common Stock.

The proceeds from the financing transactions were allocated to the debt features and to the warrants based upon their fair values. After the latter allocations, the remaining value, if any, is allocated to the Note on the financial statements.

The debt discount is being accreted using the effective interest method over the term of the note.

The value of the discount on the converted notes on the books is being accreted over the term of the note (two years). For the six months ended December 31, 2006, the Company accreted $1,959, of debt discount related to the Notes.

WARRANTS ISSUED

The estimated fair value of the warrants at issuance were as follows:

Date of Warrants Issued	Number of Warrants	Value at Issuance	Volatility Factor
February 13, 2006	6,760,000	$ 3,582	72%
February 13, 2006	520,000	$ 302	72%

These amounts have been classified as a derivative instrument and recorded as a liability on the Company's balance sheet in accordance with current authoritative guidance. The estimated fair value of the warrants was determined using the Black-Scholes option-pricing model with a closing price of on the date of issuance and the respective exercise price, a 7.0 year term, and the volatility factor relative to the date of issuance. The model uses several assumptions including: historical stock price volatility (utilizing a rolling 120 day period), risk-free interest rate (3.50%), remaining time till maturity, and the closing price of the Company's common stock to determine estimated fair value of the derivative liability. In valuing the warrants at December 31, 2006, the Company used the closing price of $0.71, the respective exercise price, as well as the remaining term on each warrant, as well as a volatility of 140%. In accordance with the provisions of SFAS No. 133, Accounting for Derivative Instruments, the Company is required to adjust the carrying value of the instrument to its fair value at each balance sheet date and recognize any change since the prior balance sheet date as a component of Other Income (Expense). The warrant derivative liability at December 31, 2006, had increased to a fair value of $4,746, due in part to an increase in the market value of the Company's common stock to $0.71 from $0.15 at June 30, 2006 amount, as well as an increase in the volatility from 90% to 140% which resulted in other expense of $1,608 on the Company's books.

The recorded value of such warrants can fluctuate significantly based on fluctuations in the market value of the underlying securities of the issuer of the warrants, as well as in the volatility of the stock price during the term used for observation and the term remaining for the warrants.

DEBT FEATURES

In accordance with Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended ("SFAS 133"), the debt features provision (collectively, the features) contained

in the terms governing the Notes are not clearly and closely related to the characteristics of the Notes. Accordingly, the features qualified as embedded derivative instruments at issuance and, because they do not qualify for any scope exception within SFAS 133, they were required by SFAS 133 to be accounted for separately from the debt instrument and recorded as derivative financial instruments.

Pursuant to the terms of the Notes, these notes are convertible at the option of the holder, at anytime on or prior to maturity. There is an additional interest rate adjustment feature, a liquidated damages clause, a cash premium option, as well as the redemption option. The debt features represents an embedded derivative that is required to be accounted for apart from the underlying Notes. At issuance of the Notes, the debt features had an estimated initial fair value as follows, which was recorded as a discount to the Notes and a derivative liability on the consolidated balance sheet.

Date of Note	Amount of Notes	Debt Features Value at Issuance	Carrying Value
January 27, 2006	$ 112	$ 69	$ 43
February 9, 2006	$ 246	$ 133	$ 113
February 13, 2006	$ 7,545	$ 2,515	$ 1,448

In subsequent periods, if the price of the security changes, the embedded derivative financial instrument related to the debt features will be adjusted to the fair value with the corresponding charge or credit to other expense or income. In valuing the debt features at December 31, 2006, the company used the closing price of $0.71 and the respective conversion price, a remaining term coinciding with each contract, and a volatility of 0%. For the six months ended December 31, 2006, due in part to an increase in the market value of the Company's common stock to $0.71 the Company recorded other expense on the consolidated statement of operations for the change in fair value of the debt features of approximately $982. At December 31, 2006, the estimated fair value of the debt features was approximately $2,465.

The recorded value of the debt features related to the Notes can fluctuate significantly based on fluctuations in the fair value of the Company's common stock, as well as in the volatility of the stock price during the term used for observation and the term remaining for the warrants.

The significant fluctuations can create significant income and expense items on the financial statements of the Company.

Because the terms of the convertible notes ("notes") require such classification, the accounting rules required additional convertible notes and non-employee warrants to also be classified as liabilities, regardless of the terms of the new notes and / or warrants. This presumption has been made due to the company no longer having the control to physical or net share settle subsequent convertible instruments because it is tainted by the terms of the notes. Were the notes to not have contained those terms or even if the transactions were not entered into, it could have altered the treatment of the other notes and the conversion features of the latter agreement may have resulted in a different accounting treatment from the liability classification. The notes and warrants, as well as any subsequent convertible notes or warrants, will be treated as derivative liabilities until all such provisions are settled.

For the six months ended December 31, 2006, we recorded other expense of $1,608 and $982, related to the increase in value of the debt features and warrants. A tabular reconciliation of this adjustment follows:

For the six months ended December 31, 2006:

$ 1,608	expense, increase in value of warrant liability
$ 982	expense, increase in value of derivative liability

$ 2,590	other expense related to convertible debt

For the six months ended December 31, 2006, the Company recorded $1,959 of interest expense related to the accretion of debt related to the convertible financing.

For the six months ended December 31, 2006:

$ 1,959	of interest expense related to accretion of convertible debt
-------	
$ 1,959	of interest expense related to convertible debt

The balance of the carrying value of the convertible debt as of December 31, 2006 is:

$ 1,605	original carrying value on convertible debt
$ (228)	converted to equity
$ 2,843	accretion of convertible debt

$ 4,220	December 31, 2006 carrying value of debt

The balance of the carrying value of the derivative liability as of December 31, 2006 is:

$ 2,717	original value of derivative liability
$(1,234)	income, decrease in value of derivative liability

$ 1,483	June 30, 2006 value of derivative liability
$ 982	expense, increase in value of derivative liability

$ 2,465	December 31, 2006 value of derivative liability

The balance of the carrying value of the warrant liability as of December 31, 2006 is:

$ 3,892	original carrying value of warrant liability
$ (754)	income, decrease in value of warrant liability

$ 3,138	June 30, 2006 value of warrant liability
$ 1,608	expense, increase in value of warrant liability

$ 4,746	December 31, 2006 value of warrant liability

NOTE 7. NOTES PAYABLE

The following summarizes notes payable (including amounts due to a related

party) at December 31, 2006:

Note payable in connection with All Staffing acquisition	$ 250
Notes payable to related party	100
Note payable to investor, interest at 10% per quarter, payable upon demand	70
Note payable to bank related to financing of worker's compensation deposit, interest at 7.5%, payable over 10 months through March 2007	638
Note payable to a former director	750
Note payable to individuals assumed with acquisition of All Staffing	238
Other	565
	2,611
Less current portion	(2,108)
Long-term portion	$ 503

NOTE 8. STOCKHOLDERS' DEFICIENCY

STOCK ISSUANCES

During the six months ended December 31, 2006, the Company issued 50,000 shares of stock for the settlement of certain notes payable.

COMMON STOCK WARRANTS

The following is a summary of the warrant activity:

	PRICE PER SHARE	UNDERLYING COMMON SHARES
JUNE 30, 2006	$1.00 - $20.00	7,330,000
Granted	-	-
Exercised	-	-
Canceled	-	-
EXERCISABLE AT DECEMBER 31, 2006		7,330,000

The weighted average remaining contractual life of warrants outstanding at December 31, 2006 is 6.10 years. The intrinsic value of the outstanding warrants at December 31, 2006 was $0. The exercise prices for warrants outstanding at December 31, 2006 are as follows:

NUMBER OF WARRANTS	EXERCISE PRICE
7,280,000	$1.00
50,000	$20.00
7,330,000	

Stock Option Activity

The following is a summary of the stock option activity:

	STOCK OPTION PLANS	
	PRICE PER SHARE	UNDERLYING COMMON SHARES
JUNE 30, 2005	$2.00 - $5.00	135,000
Granted	-	-
Exercised	-	-
Canceled/Expired	$2.00 - $5.00	(135,000)
EXERCISABLE AT DECEMBER 31, 2006		-

The Company has implemented SFAS 123R for future grants of options to employees. No unvested option grants to employees were outstanding at December 31, 2006.

NOTE 9. SEGMENT INFORMATION

The Company managed and internally reported the Company's business has four reportable segments, principally, (1) temporary staffing, (2) PEO services, (3) products, and (4) corporate. Segment information for the six months ended December 31, 2006 is as follows:

Six months ended December 31, 2006

	TEMPORARY STAFFING	PEO SERVICE	PRODUCTS	CORPORATE
Revenues	$66,597	$28,230	$1,079	$0
Operating income (loss)	4,623	(13)	(178)	(2,773)

Six months ended December 31, 2005

	TEMPORARY STAFFING	PEO SERVICE	PRODUCTS	CORPORATE
Revenues	$28,545	$682	$631	$5
Operating income (loss)	1,543	53	(1,881)	(34)

NOTE 10. RELATED PARTY TRANSACTIONS

WARNING MANAGEMENT SERVICES, INC.

The Company's CEO and Chairman, Mr. Brian Bonar, is also the Chairman of Warning Management Services, Inc. Warning a public company, located in Southern California. Warning's operations consist of a modeling agency and providing temporary staffing services to government agencies and private companies.

ADMINISTRATIVE PAYROLL SERVICE AGREEMENT WITH WARNING

In September, 2006, the Company entered into a new Agreement to provide Administrative Payroll Services to Employment Systems, Inc., ("ESI") a wholly owned subsidiary of Warning. For the six months ended December 31, 2006 and 2005, the Company invoiced ESI for services rendered of $298 and $274, respectively.

NOTE 11. LITIGATION

The Company and its SourceOne Group ("SOG") subsidiary have been sued by the Arena Football 2 Operating Company, LLC ("Arena") in Wayne County Circuit Court, Michigan. In April 2006, Dalrada and SourceOne Group, Inc. entered into a settlement with AF2 Operating Company, LLC and other parties involved in the matter of AF2 Operating Company, LLC v. SourceOne Group Inc., et al. The net result of the settlement was that Dalrada and SourceOne Group, Inc. are obligated to make a net settlement payment of $203.

The Company and SOG have been sued by Liberty Mutual Insurance Company ("Liberty") in the United States District Court for the Northern District of Illinois. The initial claim by Liberty was estimated by Liberty to be $829 and is now claimed to exceed $1,000. In July 2006, the judge dismissed Dalrada from the litigation and dismissed many, but not all, of the claims against SourceOne Group. Management has vigorously contested the claims made by Liberty. Trial is scheduled for January 2007.

On March 17, 2005, Greenland Corporation ("Plaintiff"), filed an amended complaint in the Superior Court of California, County of San Diego, Case No. GIC842605, against the Company and multiple other individuals and entities resulting from a transaction as evidenced by the "Agreement to Acquire Shares" dated August 9, 2002, whereby the Company obtained a controlling equity interest in Plaintiff. Plaintiff contends that the Company engaged in various forms of wrongdoing including breach of fiduciary duty, conversion, conspiracy and aiding and abetting. The Company has filed a cross-complaint alleging various causes of action against Plaintiff and its officers, directors and/or managing agents including Thomas J. Beener, Gene Cross, George Godwin, and Edward Sano. The subject cross-complaint seeks pecuniary and punitive damages resulting from various fraudulent transactions as well as legal malpractice against Mr. Beener. In July 2006, the matter was settled with Dalrada paying $150 of legal fees incurred by Greenland.

On August 29, 2005, United Bank & Trust filed suit against the Company and other parties. The allegations of the lawsuit are that the Company guaranteed certain debt owed by InfoServices, Inc. and is liable in the amount of $678. The Company has settled this matter and at December 31, 2006, the remaining amount due is $236.

The Company was in a dispute with former creditors regarding the amount of debt converted into common stock. These creditors were seeking damages totaling $316. The Company proposed a settlement in the amount of $316, based on the advice of

the Company's legal counsel. Consequently, $316 was charged to operations in the accompanying financial statements for the year ended June 30, 2006. The plaintiffs have accepted the settlement offer.

NOTE 12. GAIN ON SETTLEMENT OF DEBT

During the six months ended December 31, 2006 and 2005, the Company recognized a gain on settlement of debt of $608 and $5,603, respectively, which resulted primarily from the write off of stale accounts payable and judgments and the settlement of certain notes payable. The Company, based upon an opinion provided by independent legal counsel, has been released as the obligator of these liabilities. Accordingly, management has elected to adjust its accounts payable and to classify such adjustments as settlement of debt.

NOTE 13. DISCONTINUED OPERATIONS

In November 2005, the Company determined to discontinue operations of Master Staffing, its executive recruiting division. The decision was based on the Master Staffing lack of ability to generate sufficient revenue and the Company's lack of expertise in the executive recruiting business. The Company is completely exiting the executive recruiting business. The Company plans to wind down the operations of Master Staffing and close its only office over the next few months.

For the six months ended December 31, 2005, Master Staffing's revenues were $11 and losses from operations were $256. The results of operations of Master Staffing have been reported separately as discontinued operations.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(in thousands, except share data)

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto included on Form 10-KSB for the year ended June 30, 2006. The statements contained in this Report on Form 10-QSB that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding our expectations, hopes, intentions or strategies regarding the future. Forward-looking statements include statements regarding: future product or product development; future research and development spending and our product development strategies, and are generally identifiable by the use of the words "may", "should", "expect", "anticipate", "estimates", "believe", "intend", or "project" or the negative thereof or other variations thereon or comparable terminology. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements (or industry results, performance or achievements) expressed or implied by these forward-looking statements to be materially different from those predicted. The factors that could affect our actual results include, but are not limited to, the following: general economic and business conditions, both nationally and in the regions in which we operate; competition; changes in business strategy or development plans; our inability to retain key employees; our inability to obtain sufficient financing to continue to expand operations;

and changes in demand for products by our customers.

OVERVIEW

We provide financial and human resource management services, including staffing services and PEO services. Staffing services revenues are generated primarily from short-term staffing, contract staffing, and on-site management. PEO service fees are generated from contractual agreements with clients under which we act as a co-employer of our client's workforce with responsibility for some or all of the client's human resource functions. We recognize revenues from our staffing services for all amounts invoiced, including direct payroll, employer payroll-related taxes, workers' compensation coverage and an administrative fee). PEO service fee revenues are recognized on a net basis in accordance with Emerging Issues Task Force No.99-19, "REPORTING REVENUES GROSS AS A PRINCIPAL VERSUS NET AS AN AGENT " ("EITF No.99-19"). Therefore PEO service fee revenues represent the gross margin generated from our PEO services after deducting the amounts invoiced to PEO customers for direct payroll expenses such as salaries, wages, health insurance and employee out-of-pocket expenses incurred incidental to employment. These amounts are also excluded from cost of revenues. PEO service fees also include amounts invoiced to our clients for employer payroll-related taxes and workers' compensation coverage.

Our business is conducted in California, Michigan, Colorado, Pennsylvania and Texas. In addition to seeking new markets, we expect to derive most of our revenues from our current markets for the near term. Any weakness in economic conditions or changes in the regulatory environments in these regions could have a material adverse effect on our financial results.

Our services and products are marketed through our operating divisions and subsidiaries. PEO services are marketed by Dalrada Financial Services (formerly Strategic Staff Leasing), and All Staffing (acquired subsequent to year -end). Our staffing services revenues are obtained by: Heritage Staffing and our Solvis subsidiary (which includes CallCenterHR, Solvis Medical Staffing, and Solvis Home Health Care).

Our business continues to experience some liquidity problems. Accordingly, year-to-year comparisons may be of limited usefulness as our business continues to experience rapid growth.

Our current strategy is to expand our financial service business, including staff leasing, PEO services, and value added products and services to small and medium-size businesses.

To successfully execute our current strategy, we will need to improve our working capital position. The report of our independent auditors accompanying our June 30, 2006 financial statements included in Form 10KSB for the year ended June 30, 2006 includes an explanatory paragraph indicating there is a substantial doubt about our ability to continue as a going concern, due primarily to a working capital deficiency and negative net worth, which is exacerbated by our losses in prior years. In addition, we are late in our filing of payroll tax returns for certain of our PEO divisions and are delinquent on the payment of payroll tax withholdings. We plan to overcome the circumstances that impact our ability to remain a going concern through a combination of achieving profitability and renegotiating existing obligations. In addition, we continue to work with the Internal Revenue Service and State taxing Authorities to reconcile and resolve all open accounts and issues.

We have sought to reduce our debt through debt to equity conversions. In February 2006 we issued promissory notes for $7,545, which consisted of a rolling over of approximate $2,545 in existing debt and $5,000 in cash. The proceeds were used primarily to pay off promissory notes, convertible note debt, factoring debt, and other debt and to establish collateral backed ACH credit lines.

There can be no assurance that we will be able to complete any additional debt or equity financings on favorable terms or at all, or that any such financings, if completed, will be adequate to meet our capital requirements. Any additional equity or convertible debt financings could result in substantial dilution to our shareholders. If adequate funds are not available, we may be required to delay, reduce or eliminate some or all of our planned activities, including any potential mergers or acquisitions. Our inability to fund our capital requirements would have a material adverse effect on the Company.

SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

Discussion and Analysis of Financial Condition and Results of Operations discuss our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments, including those related to allowance for doubtful accounts, value of intangible assets and valuation of non-cash compensation. We base our estimates and judgments on historical experiences and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The most significant accounting estimates inherent in the preparation of our consolidated financial statements include estimates as to the appropriate carrying value of certain assets and liabilities which are not readily apparent from other sources, primarily allowance for doubtful accounts, estimated fair value of equity instruments used for compensation, estimated tax liabilities from PEO operations and estimated liabilities associated with worker's compensation liabilities. These accounting policies are described at relevant sections in this discussion and analysis and in the notes to the consolidated financial statements included elsewhere in this Form 10-KSB.

REVENUE RECOGNITION

PEO SERVICE FEES AND WORKSITE EMPLOYEE PAYROLL COSTS

We recognize our revenues associated with our PEO business pursuant to EITF 99-19 "Reporting Revenue Gross as a Principal versus Net as an Agent." Our revenues are reported net of worksite employee payroll cost (net method). Pursuant to discussions with the Securities and Exchange Commission staff, we changed our presentation of revenues from the gross method to an approach that presents our revenues net of worksite employee payroll costs (net method) primarily because we are not generally responsible for the output and quality of work performed by the worksite employees.

In determining the pricing of the markup component of the gross billings, we take into consideration our estimates of the costs directly associated with our worksite employees, including payroll taxes, benefits and workers' compensation costs, plus an acceptable gross profit margin. As a result, our operating results are significantly impacted by our ability to accurately estimate,

control and manage our direct costs relative to the revenues derived from the markup component of our gross billings.

Consistent with our revenue recognition policy, our direct costs do not include the payroll cost of our worksite employees. Our direct costs associated with our revenue generating activities are comprised of all other costs related to our worksite employees, such as the employer portion of payroll-related taxes, employee benefit plan premiums and workers' compensation insurance premiums.

TEMPORARY STAFFING

We record gross revenue for temporary staffing. We have concluded that gross reporting is appropriate because we (i) have the risk of identifying and hiring qualified employees, (ii) have the discretion to select the employees and establish their price and duties and (iii) bear the risk for services that are not fully paid for by customers. Temporary staffing revenues are recognized when the services are rendered by our temporary employees. Temporary employees placed by us are our legal employees while they are working on assignments. We pay all related costs of employment, including workers' compensation insurance, state and federal unemployment taxes, social security and certain fringe benefits. We assume the risk of acceptability of our employees to our customers.

WORKERS' COMPENSATION RESERVES

We are self-insured for workers' compensation coverage in a majority of our PEO and staffing employees up to $250 per occurrence and up to an aggregate total of $4 million for plan year 2006, ended April 30, 2006, and up to $6 million for plan year ending April 30, 2007. Accruals for workers' compensation expense are made based upon our claims experience and a quarterly independent actuarial analysis, utilizing past experience, as well as claim cost development trends and current workers' compensation industry loss information. We believe the amount accrued is adequate to cover all known and unreported claims at December 31, 2006. However, if the actual costs of such claims and related expenses exceed the amount estimated, additional reserves may be required, which could have a material adverse effect on our operating results.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

We are required to make estimates of the collectibility of accounts receivables. Management analyzes historical bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in the customers' payment tendencies when evaluating the adequacy of the allowance for doubtful accounts. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make payments, additional allowances may be required.

INTANGIBLE ASSETS AND GOODWIL

We assess the recoverability of intangible assets and goodwill annually and whenever events or changes in circumstances indicate that the carrying value might be impaired. Factors that are considered include significant underperformance relative to expected historical or projected future operating results, significant negative industry trends and significant change in the manner of use of the acquired assets. Management's current assessment of the carrying value of intangible assets and goodwill indicates there was no impairment as of December 31, 2006. If these estimates or their related

assumptions change in the future, we may be required to record impairment charges for these assets.

SALES OF PRODUCTS

Revenue is recognized when earned. Our revenue recognition policies are in compliance with all applicable accounting regulations, including American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, Software Revenue Recognition, and SOP 98-9, Modification of SOP 97-2, Revenue from packaged product sales to and through distributors and resellers is recorded when related products are shipped. Maintenance and subscription revenue, if any, is recognized ratably over the contract period. When the revenue recognition criteria required for distributor and reseller arrangements are not met, revenue is recognized as payments are received. Provisions are recorded for returns and bad debts. Our software arrangements do not contain multiple elements, and we do not offer post contract support.

RESULTS OF OPERATIONS (IN $000)

THREE MONTHS ENDED DECEMBER 31, 2006 COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2005

REVENUES

Total revenues were $58,948 and $17,834 for the three months ended December 31, 2006 and 2005, respectively; an increase of $41,114 (230.5%). The principal reason for the increase is due an overall increase in revenue in our staffing businesses.

STAFFING

Revenues from our staffing business units were $33,515 and $17,002 for the three months ended December 31, 2006 and 2005, respectively; an increase of $16,513 (97.1%). The principal reason for the increase is due to an increase in revenue from our staffing activities and our focus on this segment of our business - in California and in medical staffing.

PEO SERVICES

PEO revenues were $25,237 and $387 for the three months ended December 31, 2006 and 2005, respectively; an increase of $24,850 (6,421%) due primarily to the addition of new clients and associated worksite employees and the acquisition of All Staffing in September 2006.

Under current GAAP rules, we are required to book PEO revenues on a net fee basis rather than as gross billed payrolls.

PRODUCTS AND MANGEMENT FEES

Sales of products and software were generated from sales of imaging products in Solvis (imaging unit) and from management fees charged to a related party. Products and other revenues were $196 and $445 for the three months ended December 31, 2006 and 2005, respectively; a decrease of $249 (56.0%). The decrease is principally due to decreased management fees.

COST OF PRODUCTS SOLD

Costs of staffing for the three months ended December 31, 2006 and 2005 was $29,103 (86.8% of temporary staffing revenue) and $14,477 (85.1% of temporary staffing revenue), respectively. The increase in gross profit is due primarily to lower workers' compensation costs and reduced FUTA and SUI cost during the quarter ended December 31, 2006.

Cost of PEO services for the three months ended December 31, 2006 and 2005 was $24,649 (97.7% of PEO revenues) and $299 (77.3% of PEO revenues), respectively. The decrease in gross profit is due primarily to higher workers' compensation costs.

Cost of products and software for the three months ended December 31, 2006 and 2005 was $9 (4.6% of product revenue) and $7 (1.6% of product revenue), respectively.

OPERATING EXPENSES

Operating expenses for the three months ended December 31, 2006 and 2005 were $4,213 and $2,537, respectively; an increase of $1,676 (66.1%). The increase is due to expenditures associated with building our business infrastructure (systems and staff) to accommodate our anticipated revenue growth.

OTHER INCOME AND EXPENSE

Interest expense and financing costs for the three months ended December 31, 2006 and 2005 was $1,822 and $140 respectively; an increase of $1,682 (1,201%). The increase was principally due to the increase in debt associated with the February 2006 refinancing, the amortization of debt discount and debt issue cost associated with the February 2006 refinancing and a non-registration penalty.

GAIN ON EXTINGUISHMENT OF DEBT

During the three months ended December 31, 2006 and 2005, the Company recognized a gain on settlement of debt of $257 and $4,262, respectively, which resulted primarily from the write off of stale accounts payable and judgments for the three months ended December 31, 2005 and the write off of certain notes payable for the three months ended December 31, 2006. We based upon an opinion provided by independent legal counsel, have been released as the obligator of these liabilities. Accordingly, management has elected to adjust its accounts payable and to classify such adjustments as settlement of debt.

CHANGES IN DERIVATIVES AND WARRANTY LIABILITIES

For the three months ended December 31, 2006, we recorded other income of $329 related to the change in the value of the debt features and warrants principally a result of the decrease in our stock price.

SIX MONTHS ENDED DECEMBER 31, 2006 COMPARED TO SIX MONTHS ENDED DECEMBER 31, 2005

REVENUES

Total revenues were $95,906 and $29,863 for the six months ended December 31, 2006 and 2005, respectively; an increase of $66,043 (221.2%). The principal reason for the increase is due an overall increase in revenue in our staffing and PEO businesses.

STAFFING

Revenues from our staffing business units were $66,597 and $28,545 for the six months ended December 31, 2006 and 2005, respectively; an increase of $38,052

(133.3%). The principal reason for the increase is due to an increase in revenue from our staffing activities and our focus on this segment of our business - in California and in medical staffing.

PEO SERVICES

PEO revenues were $8,230 and $682 for the six months ended December 31, 2006 and 2005, respectively; an increase of $27,548 (4,039%) due primarily to the addition of new clients and associated worksite employees and the acquisition of All Staffing in September 2006.

Under current GAAP rules, we are required to book PEO revenues on a net fee basis rather than as gross billed payrolls.

21

PRODUCTS AND MANGEMENT FEES

Sales of products and software were generated from sales of imaging products in Solvis (imaging unit) and from management fees charged to a related party. Products and other revenues were $1,079 and $636 for the six months ended December 31, 2006 and 2005, respectively; an increase of $443 (69.7%). The increase is principally due to increased management fees.

COST OF PRODUCTS SOLD

Costs of staffing for the six months ended December 31, 2006 and 2005 was $59,138 (88.8% of temporary staffing revenue) and $25,303 (88.6% of temporary staffing revenue), respectively. The change in gross profit percentage is not significant.

Cost of PEO services for the six months ended December 31, 2006 and 2005 was $27,004 (95.7% of PEO revenues) and $653 (95.7% of PEO revenues), respectively. The change in gross profit percentage is not significant.

Cost of products and software for the six months ended December 31, 2006 and 2005 was $20 (1.9% of product revenue) and $18 (2.8% of product revenue), respectively. The increase in gross profit was due to the significant growth in management fees.

OPERATING EXPENSES

Operating expenses for the six months ended December 31, 2006 and 2005 were $8,085 and $4,208, respectively; an increase of $3,877 (92.1%). The increase is due to expenditures associated with building our business infrastructure (systems and staff) to accommodate our anticipated revenue growth.

OTHER INCOME AND EXPENSE

Interest expense and financing costs for the six months ended December 31, 2006 and 2005 was $3,089 and $564 respectively; an increase of 2,525 (447.7%). The increase was principally due to the increase in debt associated with the February 2006 refinancing, the amortization of debt discount and debt issue cost associated with the February 2006 refinancing and a non-registration penalty.

GAIN ON EXTINGUISHMENT OF DEBT

During the six months ended December 31, 2006 and 2005, the Company recognized a

gain on settlement of debt of $608 and $5,603, respectively, which resulted primarily from the write off of stale accounts payable and judgments and during the six months ended December 31, 2006 included the settlement of certain notes payable by issuing common stock. We based upon an opinion provided by independent legal counsel, have been released as the obligator of these liabilities. Accordingly, management has elected to adjust its accounts payable and to classify such adjustments as settlement of debt.

CHANGES IN DERIVATIVES AND WARRANTY LIABILITIES

For the six months ended December 31, 2006, we recorded other expense of $1,608 and $982, related to the increase in value of the debt features and warrants. A tabular reconciliation of this adjustment follows:

For the six months ended December 31, 2006:

$ 1,608	expense, increase in value of warrant liability
$ 982	expense, increase in value of derivative liability

$ 2,590	other expense related to convertible debt

For the six months ended December 31, 2006, the Company recorded $1,959 of interest expense related to the accretion of debt related to the convertible financing.

For the six months ended December 31, 2006:

$ 1,959	of interest expense related to accretion of convertible debt
------	
$ 1,959	of interest expense related to convertible debt

The balance of the carrying value of the convertible debt as of December 31, 2006 is:

$ 1,605	original carrying value on convertible debt
$ (228)	converted to equity
$ 2,843	accretion of convertible debt

$ 4,220	December 31, 2006 carrying value of debt

The balance of the carrying value of the derivative liability as of December 31, 2006 is:

$ 2,717	original value of derivative liability
$(1,234)	income, decrease in value of derivative liability

$ 1,483	June 30, 2006 value of derivative liability
$ 982	expense, increase in value of derivative liability

$ 2,465	December 31, 2006 value of derivative liability

The balance of the carrying value of the warrant liability as of December 31, 2006 is:

$ 3,892	original carrying value of warrant liability
$ (754)	income, decrease in value of warrant liability

```
------
$ 3,138        June 30, 2006 value of warrant liability
$ 1,608        expense, increase in value of warrant liability
------
$ 4,746        December 31, 2006 value of warrant liability
```

LIQUIDITY AND CAPITAL RESOURCES

Historically, we have financed our operations primarily through cash generated from operations, debt financing, and the sale of equity securities. Additionally, in order to facilitate our growth and future liquidity, we have made some strategic acquisitions.

As a result of some of our financing activities, there has been a significant increase in the number of issued and outstanding shares. During the year ended June 30, 2006 and the year ended June 30, 2005, we issued an additional 1,241,283 and 914,450 post split shares, respectively. These shares of common stock were issued primarily for corporate expenses in lieu of cash, for acquisition of businesses, for the conversion of convertible debentures and other debt, and for the exercise of warrants.

As of December 31, 2006, we had negative working capital of $28,512, a decrease in working capital of $3,596 since June 30, 2006.

The Company is late on filing payroll tax returns and owes approximately $8.7 million in payroll taxes.

Net cash provided by operating activities was $2,989 for the six months ended December 31, 2006 as compared to net cash provided by activities of $2,515 for the six months ended December 31, 2005; an increase of $474. The principal reasons are the increase is due to us generating income from operation during the six months ended December 31, 2006.

Cash used in financing activities was $4,010 for the six months ended December 31, 2006 as compared to $1,817 for the six months ended December 31, 2005, a increase of $2,193 from the six months ended December 31, 2005. The primary reason for the increase was due to the paydown of notes payable during the six months ended December 31, 2006.

We have no material commitments for capital expenditures. Our 5% convertible preferred stock (which ranks prior to our common stock), carries cumulative dividends, when and as declared, at an annual rate of $50 per share. The aggregate amount of such dividends in arrears at December 31, 2006, was approximately $484.

Our capital requirements depend on numerous factors, including market acceptance of our products and services, the resources we devote to marketing and selling our products and services, and other factors. The report of our independent auditors accompanying our June 30, 2006 financial statements includes an explanatory paragraph indicating there is a substantial doubt about our ability to continue as a going concern, due primarily to the deficit in our working capital and net worth.

CONTINGENT LIABILITY

The Company accrues and discloses contingent liabilities in its consolidated financial statements in accordance with Statement of Financial Accounting Standards ("SFAS") No. 5, Accounting for Contingencies. SFAS No. 5 requires accrual of contingent liabilities that are considered probable to occur and that can be reasonably estimated. For contingent liabilities that are considered reasonably possible to occur, financial statement disclosure is required, including the range of possible loss if it can be reasonably determined. The Company has disclosed in its audited financial statements several issues that it believes are reasonably possible to occur, although it cannot determine the range of possible loss in all cases. As these issues develop, the Company will continue to evaluate the probability of future loss and the potential range of such losses. If such evaluation were to determine that a loss was probable and the loss could be reasonably estimated, the Company would be required to accrue its estimated loss, which would reduce net income in the period that such determination was made. During the fiscal year ended June 30, 2006, the Company recorded $530,000 in loss reserves, as opposed FY 2005 in which the Company recorded approximately $463,000 in loss reserves.

OFF-BALANCE ARRANGEMENTS

There are no off balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors, except for the following.. As of September 8, 2004, Warning Management Services, Inc. ("Warning") purchased all of the issued and outstanding shares of Employment Systems, Inc. ("ESI") for $1,500. The purchase was $750 cash paid at the closing and a $750 note payable. In connection with this transaction, the Company agreed to be a guarantor of the $750 note payable. Our CEO, Brian Bonar, is also the CEO of Warning. As inducement to enter into this guarantee, we were given a non-cancelable 2-year payroll processing contract with ESI. Currently the $750 note payable is in dispute. Warning is claiming that certain representations made by ESI were not correct and is proposing that the purchase price be reduced, thus reducing the $750 note payable to $258. Management has evaluated this contingent liability and has determined that no loss is anticipated as a result of this guarantee.

Warning Model Management, Inc. reached a settlement with Berryman & Henigar Enterprises, during the six months ended December 31, 2006, to pay the aggregate sum of $380, which has been paid in full. Accordingly, Dalrada's guarantee of this indebtedness in no longer applicable.

ITEM 3. CONTROLS AND PROCEDURES

Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the period ended December 31, 2006, covered by this quarterly report (the "Evaluation Date"), and based on such evaluation, such officers have concluded, as of the Evaluation Date, that our disclosure controls and procedures were not effective in ensuring that all information required to be disclosed in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

The material weaknesses in internal control over financial reporting resulting from the Chief Executive Officer and Chief Financial Officer's evaluation are described below. In addition there are inherent limitations to the effectiveness of any system of disclosure controls and procedures. Even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Except as described below, during our third quarter of fiscal 2006, there were no changes made in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Attached as Exhibits 31.1 and 31.2 to this annual report are certifications of the Chief Executive Officer and Chief Financial Officer required in accordance with Rule 13a-14(a) of the Exchange Act. This portion of the Company's quarterly report includes the information concerning the controls evaluation referred to in the certifications and should be read in conjunction with the certifications for a more complete understanding of the topics presented.

In conjunction with their audit of our fiscal year 2005 consolidated financial statements, PMB & Co., LLP (PMB), our independent registered public accounting firm, identified and orally reported to management and the Audit Committee the material weaknesses under standards established by the Public Company Accounting Oversight Board (PCAOB). A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects our ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is a more than a remote likelihood that a misstatement of our annual or interim financial statements that is more than inconsequential will not be prevented or detected.

The material weaknesses were identified as:

(1) Planning and implementation of our Accounting System; (2) Financial Statement closing process; (3) Ineffective Information Technology control environment, including the design of our information security and data protection controls; (4) Untimely detection and assessment of impairment of intangible assets (i.e., patents where indicators of impairment are present; (5) Inadequate review of the valuation of certain payroll tax liabilities that resulted in post-closing journal entries to properly reflect our payroll tax liabilities; (6) Proper recording of conversion of debt into shares of common stock, including the ability of certain managers to record journal entries without adequate review or supporting documentation and an inability by management to adequately review the issuance of common stock; and, (7) Lack of the necessary depth of personnel with sufficient technical accounting experience with U.S. GAAP to perform an adequate and effective secondary review of technical accounting matters. We will continue to evaluate the material weaknesses and will take all necessary action to correct the internal control deficiencies identified. We will also further develop and enhance our internal control policies, procedures, systems and staff to allow us to mitigate the risk that material accounting errors might go undetected and be included in our consolidated financial statements.

We contemplate undertaking a thorough review of our internal controls as part of our preparation for compliance with the requirements under Section 404 of the Sarbanes-Oxley Act of 2002 and we are using this review to further assist in identifying and correcting control deficiencies. At this time, we have not completed our review of the existing controls and their effectiveness. Unless and until the material weaknesses described above, or any identified during this review, are completely remedied, evaluated and tested, there can be no assurances that we will be able to assert that our internal control over

financial reporting is effective, pursuant to the rules adopted by the SEC under Section 404, when those rules take effect.

At present, we have taken steps to improve our internal controls through the acquisition and implementation of new accounting systems and additional personnel in our finance departments.

PART II - OTHER INFORMATION

(in thousands, except per share data)

ITEM 1. LEGAL PROCEEDINGS

The Company and its SourceOne Group ("SOG") subsidiary have been sued by the Arena Football 2 Operating Company, LLC ("Arena") in Wayne County Circuit Court, Michigan. In April 2006, Dalrada and SourceOne Group, Inc. entered into a settlement with AF2 Operating Company, LLC and other parties involved in the matter of AF2 Operating Company, LLC v. SourceOne Group Inc., et al. The net result of the settlement was that Dalrada and SourceOne Group, Inc. are obligated to make a net settlement payment of $203.

The Company and SOG have been sued by Liberty Mutual Insurance Company ("Liberty") in the United States District Court for the Northern District of Illinois. The initial claim by Liberty was estimated by Liberty to be $829 and is now claimed to exceed $1,000. In July 2006, the judge dismissed Dalrada from the litigation and dismissed many, but not all, of the claims against SourceOne Group. Management has vigorously contested the claims made by Liberty. Trial is scheduled for January 2007.

On March 17, 2005, Greenland Corporation ("Plaintiff"), filed an amended complaint in the Superior Court of California, County of San Diego, Case No. GIC842605, against the Company and multiple other individuals and entities resulting from a transaction as evidenced by the "Agreement to Acquire Shares" dated August 9, 2002, whereby the Company obtained a controlling equity interest in Plaintiff. Plaintiff contends that the Company engaged in various forms of wrongdoing including breach of fiduciary duty, conversion, conspiracy and aiding and abetting. The Company has filed a cross-complaint alleging various causes of action against Plaintiff and its officers, directors and/or managing agents including Thomas J. Beener, Gene Cross, George Godwin, and Edward Sano. The subject cross-complaint seeks pecuniary and punitive damages resulting from various fraudulent transactions as well as legal malpractice against Mr. Beener. In July 2006, the matter was settled with Dalrada paying $150 of legal fees incurred by Greenland.

On August 29, 2005, United Bank & Trust filed suit against the Company and other parties. The allegations of the lawsuit are that the Company guaranteed certain debt owed by InfoServices, Inc. and is liable in the amount of $678. The Company has settled this matter and at December 31, 2006, the remaining amount due is $236.

The Company was in a dispute with former creditors regarding the amount of debt converted into common stock. These creditors were seeking damages totaling $316. The Company proposed a settlement in the amount of $316, based on the advice of the Company's legal counsel. Consequently, $316 was charged to operations in the accompanying financial statements for the year ended June 30, 2006. The plaintiffs have accepted the settlement offer.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the three months ended December 31, 2006, the Company issued 50,000 shares of common stock for the settlement of certain notes payable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

a) Exhibits

31.1 Rule 13a-14(a) Certification of CEO

31.2 Rule 13a-14(a) Certification of CFO

32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of CEO

32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of CFO

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: February 20, 2007

DALRADA FINANCIAL CORPORATION
(Registrant)

By: /S/ Brian Bonar

Brian Bonar
Chairman and Chief Executive Officer

By: /S/ David P. Lieberman

David P. Lieberman
Chief Financial Officer