BLACKWATCH

ENERGY SERVICES TRUST

2006 Management's Discussion & Analysis

Highlights

($ thousands, except per Trust unit amounts)

		Initial period ended December 31 2006 [2]
Revenue	$	29,197
Gross Margin	$	4,291
Normalized EBITDAC [1]	$	2,724
Per Trust unit - basic	$	0.15
Per Trust unit - diluted	$	0.15
Net Loss [3]	$	(162,872)
Per Trust unit - basic	$	(8.92)
Per Trust unit - diluted	$	(8.92)
Funds From Operations [3]	$	(18)
Per Trust unit - basic	$	(0.001)
Per Trust unit - diluted	$	(0.001)
Net Debt	$	33,323
Unitholders' equity	$	69,511
Distributions declared	$	11,246
Per Trust unit	$	0.458
Weighted average Trust units - basic		18,253
Weighted average Trust units - diluted		18,283
Trust units, end of period		24,781

1 See definition within the *Non-GAAP Measures* section of the Management's Discussion and Analysis document.

2 The Trust was created on June 23, 2006, but did not commence operations until August 4, 2006.

3 Includes approximately $1.6 million of non-recurring costs related to the initiation of the Trust and consolidation of the acquired companies, including commitment fees for the Trust's bridge debt facility, early payout fees on pre-existing debt facilities and recruitment costs for key management personnel. Excluding these non-recurring costs as well as the goodwill and intangibles impairment amounts of $156 million, the net loss would be $5 million. Excluding the non-recurring costs, the Normalized Funds From Operations would be $1.6 million.

HIGHLIGHTS:

- The Trust was created June 23, 2006, but did not commence operations until August 4, 2006, when it completed the acquisitions of Ammonite Assets Inc., Austin’s Transport (1990) Ltd., Brantford’s Consolidated Inc., Brantford’s Consolidated Ltd., Caliber Energy Services Corp. and Strata Completions Limited. These companies formed the foundation for five operating Divisions – Drilling, Transport, Production Services, Coil Tubing and Completion Services. Our sixth Division, Rentals and Leasing, commenced operations on October 6, 2006, as noted below.
- On August 11, 2006, the Trust completed its initial public offering (“IPO”) and began trading on the Toronto Stock Exchange under the symbol BWT.UN.

- Effective October 6, 2006, the Trust acquired Elite Oilfield Rentals ("Elite"), based in Valleyview, Alberta. This was our first corporate acquisition as a publicly traded trust. Elite is engaged in oilfield equipment rental and leasing services. This acquisition led to the creation of our Rental and Leasing Division and allowed us to expand our presence in the northwest sector of the province.
- Excluding non-recurring costs related to the creation of the Trust and the consolidation of the Acquired Companies, we were able to achieve a Normalized EBITDAC of $2.7 million and Normalized Funds from Operations of $1.6 million in the initial period ending December 31, 2006.
- A formal integration plan for the Acquired Companies was developed and implemented, encompassing all aspects of the ongoing operation. As per the Trust's February 19, 2007, announcement, a further reorganization of its Divisions was implemented to improve customer service and streamline operations. The number of operating Divisions has been reduced from six to four more focused service groups.
- The quality and effectiveness of our Sales and Marketing group continues to be a top priority with the recent promotion of Ron Dahl to the position of Vice President, Sales & Marketing, and the recruiting of sales personnel who have brought significant technical and sales skills to the Trust. Ron brings 30 years of service sector operating and sales experience to this position.
- $19.5 million was invested in new equipment and facilities throughout our operating Divisions during this period.
- BlackWatch is re-deploying equipment and manpower to geographic regions that provide opportunities for higher margins and utilization as part of our strategic plan to improve diversification within our customer base and become less dependent on shallow gas and CBM markets. We are establishing a presence in the busy northwest region of Alberta, including the Grande Prairie area, by re-deploying our new coil tubing rigs and e-line units. We will also increase our presence in central and southeast Saskatchewan, where drilling activity is expected to remain relatively static compared to 2006.
- The Trust implemented monthly distributions of $0.0916 per unit ($1.10 annualized) with the first distribution paid to our unitholders on September 15, 2006. These distributions were maintained throughout 2006, but as a result of weak demand in Q4 and an expectation of further uncertainty in the industry through 2007, the decision was made to suspend distributions effective February 2007. This step was taken to preserve cash flow, allow for debt repayment and ensure the long term financial strength of the Trust.
- A search is underway to replace the President and CEO position left vacant in early March.
- On October 31, 2006, the Canadian government announced its intention to amend the Income Tax Act (Canada) to apply a tax on distributions from publicly traded income trusts. On December 21, 2006, draft legislation was released for comment. Under the proposal distributions of non-portfolio earnings would not be deductible for tax purposes. Newly formed trusts would be subject to the tax in 2007, while existing trusts such as BlackWatch would benefit from a four year transition period and would not be subject to the new measures until the 2011 taxation year. BlackWatch intends to evaluate the alternatives to most effectively optimize value for our unitholders and other stakeholders.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is Management's discussion and analysis ("MD&A") of operating and financial results for the initial period ended December 31, 2006, and its outlook based on information available as at March 27, 2007. The MD&A should be read in conjunction with the audited consolidated financial statements of BlackWatch Energy Services Trust (the "Trust" or "BlackWatch") as at and for the initial period ended December 31, 2006.

ADVISORY- the MD&A contains certain forward-looking statements relating to the Trust's plans, strategies, objectives, expectations and intentions. Expressions such as "anticipate", "expect", "project", "believe", "estimate", and "forecast" should be used to identify these forward-looking statements. The Trust believes that the expressions reflected in those forward-looking statements are reasonable, but such statements are subject to a number of known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those anticipated in our forward-looking statements. These statements speak only as of the date of the MD&A and the Trust does not assume any obligation to update these forward-looking statements, except as required by law.

OVERVIEW

The Trust was created on June 23, 2006, as an unincorporated open-ended trust under the laws of the Province of Alberta pursuant to a Trust Indenture dated June 23, 2006. The principal undertaking of the Trust, through its indirect wholly-owned subsidiary BlackWatch Energy Services Operating Limited Partnership (the "Operating Partnership"), is to engage in the oilfield services business. Effective August 4, 2006, the Trust completed its acquisitions of Austin's Transport (1990) Ltd., Strata Completions Limited, Ammonite Assets Inc., Caliber Energy Services Corp., Brantford's Consolidated Inc. and Brantford's Consolidated Ltd., collectively the "Acquired Companies". The Trust immediately commenced operations through the Operating Partnership. On August 11, 2006, the Trust completed its initial public offering and began trading on the Toronto Stock Exchange under the symbol *BWT.UN*.

On October 6, 2006, the Trust completed its acquisition of 1044802 Alberta Ltd. and 1044793 Alberta Ltd., operating jointly as Elite Oilfield Rentals ("Elite"). Elite was engaged in oilfield equipment rental and leasing services. This acquisition led to the creation of our Rental and Leasing Division and allowed us to expand our presence in the northwest sector of Alberta.

The financial results presented in this MD&A and the related financial statements reflect less than five months of operations in the Trust's initial reporting period.

Non-GAAP Measures

Throughout this MD&A, certain terms that are not specifically defined in Canadian generally accepted accounting principles ("GAAP") are used to analyze operations. In addition to the primary measures of net earnings and net earnings per unit, as recognized under GAAP, Management believes that certain measures not recognized under GAAP assist Management and the reader in assessing the Trust's performance and understanding the Trust's results. Each of these measures provides the reader with additional insight into the Trust's performance.

- Gross margin – This measure is considered a primary indicator of operating performance and is calculated as revenue less operating and selling, general and administration expenses, excluding depreciation and amortization.
- EBITDAC (Earnings before interest, income taxes, depreciation and amortization, impairment of goodwill and intangibles and unit compensation) – This measure is considered an indicator of the Trust's ability to generate funds in order to meet ongoing operating commitments, servicing of debt, funding for capital programs and distributions.
- Normalized EBITDAC – This measure refers to EBITDAC as defined above, adjusted for non-recurring costs related to the initiation of the Trust and consolidation of the Acquired Companies. Further details regarding these adjustments can be found throughout the MD&A.

- Funds from operations – This measure is an indicator of the Trust's ability to generate funds in order to fund ongoing operating commitments, service debt, fund capital programs, pay interest and income tax charges and make distributions. Funds from operations is defined as cash flow from operations before changes in non-cash working capital.
- Normalized funds from operations – This measure refers to funds from operations as defined above, adjusted for non-recurring costs related to the initiation of the Trust and consolidation of the Acquired Companies. Further details regarding these adjustments can be found throughout the MD&A.
- Maintenance capital – Capital additions that are incurred to refurbish or replace previously acquired capital assets. Such additions do not provide incremental increases in revenue. Maintenance capital is a key component to the sustainability of the Trust as cash retained within the Trust must be sufficient to replenish assets for future cash generation.
- Growth capital – Growth capital includes expenditures on equipment with expected incremental increases in revenue and funds from operations to the Trust.
- Working capital – This term is defined as current assets less current liabilities excluding the current portion of long-term debt and lease and finance contract obligations.
- Net debt – This term is defined as total debt less working capital (see above).

The above noted measures are not recognized under GAAP. As a result, the method of calculation may not be comparable with other companies or Trusts. These measures should not be considered alternatives to net earnings and net earnings per unit as calculated in accordance with GAAP.

Operations

The Trust is a growth-oriented energy services trust that provides a range of services to its customers operating in the Western Canadian sedimentary basin including drilling, electric wireline services, rig transportation and hauling, coil tubing well servicing, production services and oilfield equipment rentals and leasing.

Throughout 2006 the Trust managed its oilfield services within the following six operating Divisions:

- Coil Tubing Division
- Completion Services Division
- Drilling Division
- Production Services Division
- Transport Division
- Rental and Leasing Division

The Rental and Leasing Division was created October 6, 2006, concurrent with the acquisition of Elite. See the *Business Acquisitions* section below for detailed information on this purchase.

Effective March 2007, the Coil Tubing and Completions Services Division were combined into a single service group. Production Services and Rental and Leasing were also combined. These changes were made to improve our overall performance and enhance service to our customers.

SELECTED ANNUAL INFORMATION

The financial information as presented in this document and the accompanying audited consolidated financial statements as at and for the initial period ending December 31, 2006, has been prepared in accordance with Canadian GAAP.

($ thousands, except per Trust unit amounts)		2006 [2]
		Initial period ended December 31
Revenue	$	29,197
Gross margin	$	4,291
Normalized EBITDAC [1]	$	2,724
Net loss [3]	$	(162,872)
Per Trust unit - basic	$	(8.92)
Per Trust unit - diluted	$	(8.92)
Funds from operations [3]	$	(18)
Per Trust unit - basic	$	(0.001)
Per Trust unit - diluted	$	(0.001)
Total assets	$	128,325
Total long-term financial liabilities	$	40,986
Net Debt	$	33,323
Unitholders' equity	$	69,511
Cash dividends declared per Trust unit	$	0.458
Weighted average Trust units - basic		18,253
Weighted average Trust units - diluted		18,283
Trust units, end of period		24,781

[1] See definition within the *Non-GAAP Measures* section of the Management's Discussion and Analysis document.

[2] The Trust was created on June 23, 2006, but did not commence operations until August 4, 2006.

[3] Includes approximately $1.6 million of non-recurring costs related to the initiation of the Trust and consolidation of the acquired companies, including commitment fees for the Trust's bridge debt facility, early payout fees on pre-existing debt facilities and recruitment costs for key management personnel. Excluding these non-recurring costs as well as the goodwill and intangibles impairment amounts of $156 million, the net loss would be $5 million. Excluding the non-recurring costs, the Normalized Funds From Operations would be $1.6 million.

The financial results for the initial period ending December 31, 2006, include 150 operating days.

The Trust incurred an overall consolidated net loss of $163 million in the period, primarily resulting from a non-cash $156 million charge for goodwill and intangibles impairment. This impairment is described in detail later in this document, but is directly driven by the downturn experienced within the services sector in the second half of 2006 and the decline in our overall market capitalization value.

The Trust experienced a significant decrease in demand for its services caused by above average rainfall in the third quarter, depressed natural gas prices, producer budget cutbacks and an overall slowdown in drilling activity. During the fourth quarter, drilling rig utilization rates within the industry averaged 49% and that utilization rate was even lower in the shallow gas drilling market, where BlackWatch's drilling equipment has significant exposure. This represented a significant decline from the 71% utilization experienced by the industry during the same quarter of 2005. These conditions perpetuated reduced demand for oil and gas services and lower charge-out rates. BlackWatch's drilling utilization rates were additionally impacted by the suspension of shallow gas and CBM drilling and development activity by key customers within the Drilling and Transport Divisions. Although BlackWatch immediately began efforts to replace that lost demand, the combination of these influences resulted in financial performance well below expectations during the period.

This industry impact combined with the Canadian government's trust taxation announcement of October 31, 2006, and the subsequent suspension of distributions announced by the Trust on February 19, 2007, resulted in a substantial decline in the Trust's market capitalization. The impairment test performed at December 31, 2006, determined that the carrying value of goodwill and intangibles required a significant reduction. The Trust will continue to review the carrying value of goodwill and intangibles annually or more frequently if events or changes in circumstances indicate that goodwill and intangibles might be further impaired.

During the initial reporting period, the Trust also incurred one-time, non-recurring costs of approximately $1.6 million related to the initiation of the Trust and the consolidation of Acquired Companies. These expenses were largely comprised of commitment fees for the Trust's bridge debt facility, termination fees related to the payout of credit facilities within the Acquired Companies, recruitment costs for key personnel within the Trust, development and deployment of Trust branding and logos, legal and professional fees related to initial regulatory reporting requirements, professional fees incurred to meet initial CEO and CFO certification requirements for internal controls, corporate office setup and other costs related to the start-up of the Trust. While these expenditures were reasonable and expected, they resulted in overall expenses that were above normal levels. In addition, operating expenses saw a slight increase from non-recurring insurance cancellation fees. These expenses are discussed in further detail below along with a review of the impact of non-cash depreciation and amortization on net earnings.

Consolidated gross margin of 14.7% was below expected levels and was primarily due to lower than expected revenues in the period, combined with fixed operating costs that remained consistent despite reduced activity levels. A key component of the fixed cost structure was compensation costs related to field operating staff who were retained during the fourth quarter to ensure that the Trust was prepared to fully staff equipment for the busy winter season. In addition, some variable operating costs experienced increases as explained further in the *Operating Expenses* section below. Downward pressure on pricing was also experienced during the period and is explained further within the *Revenues* section.

Total assets have been reduced substantially from the values presented in our *Interim Unaudited Financial Statements for the Period Ending September 30, 2006*. Included in this reduction is the goodwill and intangibles impairment noted above of $156 million. Offsetting this decrease was the acquisition of Elite Rentals (see *Business Acquisitions* section below), which gave rise to approximately $10.4 million of total assets and our internal capital program that added $11.8 million in equipment during the fourth quarter period. Total property, plant and equipment additions, from other than business acquisitions, totaled $19.5 million for the entire period ending December 31, 2006. Significant equipment additions for the year-to-date period included six electric wireline units totaling $5.1 million, two coil tubing units totaling $2 million, capital additions to our drilling fleet totaling $5.8 million, $500,000 for the purchase of a shop in Leduc, Alberta, within our Drilling Division, rental equipment totaling $675,000, two picker trucks totaling $500,000 as well as approximately $2.8 million within our Production Services Division relating to excavators, trailers, a coil tubing unit, a vacuum truck, a tank truck as well as an additional swabbing rig and hot oiler, both of which are still under construction.

Total long-term financial liabilities have increased by approximately $40 million from the presentation in our *Unaudited Interim Financial statements for the Period Ending September 30, 2006*, primarily due to a long-term classification of the Trust's credit facility compared to the current liability presentation of the bridge term financing that existed prior to our December syndicated facility placement. Further contributing to the increase were additional credit facility draws of approximately $13 million in the period.

SUMMARY OF QUARTERLY RESULTS

($ thousands, except per Trust unit amounts)	2006		
	Q3 [2]	Q4	Annual
Revenue	$ 11,141	$ 18,056	$ 29,197
Gross margin	$ 3,020	$ 1,271	$ 4,291
Selling, general and administrative expenses [4]	$ 1,586	$ 627	$ 2,213
Net loss [1]	$ (1,233)	$ (161,639)	$ (162,872)
Per Trust unit - basic	$ (0.10)	$ (6.54)	$ (8.92)
Per Trust unit - diluted	$ (0.10)	$ (6.54)	$ (8.92)
Funds from operations [3]	$ 1,114	$ (1,132)	$ (18)
Per Trust unit - basic	$ 0.09	$ (0.05)	$ (0.001)
Per Trust unit - diluted	$ 0.09	$ (0.05)	$ (0.001)
Weighted average Trust units - basic	12,188	24,724	18,253
Weighted average Trust units - diluted	12,323	24,754	18,283
Trust units, end of period	24,206	24,781	24,781

[1] Q3 includes non-recurring costs of approximately $1.5 million and Q4 includes non-recurring costs of approximately $100,000 as well as non-cash impairment costs of $156 million

[2] Includes 58 operating days.

[3] Q3 includes non-recurring costs of approximatley $1.5 million and Q4 includes non-recurring costs of approximately $100,000.

[4] Q3 includes non-recurring costs of approximatley $500,000 and Q4 includes non-recurring costs of approximately $100,000.

Variances experienced between the third and fourth quarters of 2006 are the result of three main factors. The third quarter included only 58 operating days as the initial acquisitions did not occur until August, 4, 2006. Secondly, the fourth quarter results were significantly impacted by a non-cash impairment of goodwill and intangibles of approximately $156 million. The final impact related to the acquisition of Elite in October of 2006.

Revenue for the fourth quarter increased 62% over the third quarter. The fact that an additional month of operations is reflected in the fourth quarter results accounts for most of this variance. The acquisition of our Rental & Leasing Division on October 6, 2006, also accounted for an additional $1.2 million of the increased revenues. Despite these facts, the differential between third quarter and fourth quarter was smaller than normally expected due to the significant decline in demand that was experienced in the fourth quarter as explained previously. Further details on revenues and activity levels are provided in the *Revenues* analysis below.

Gross margin for the fourth quarter reflects a 58% decrease compared to the third quarter despite increased revenues. Margins were directly impacted by pricing pressures experienced as a result of the general slowdown in the services sector in the fourth quarter. As utilization rates declined, a surplus of available equipment developed that increased competitive pressures and allowed customers to demand and receive lower rates for services. The Drilling, Transport and Production Services Divisions were most directly impacted by the increased competition and related pricing decline. Significant repairs and maintenance expenditures were also incurred in the fourth quarter as the operating Divisions ensured that equipment was fully functional for the winter drilling season. Fourth quarter margins were also negatively impacted by fixed operating and compensation costs that were maintained as all Divisions attempted to keep equipment and staff in place to effectively deal with the winter drilling season. Other factors included higher labour costs and the introduction of a market competitive employee benefits program to enhance recruitment and retention of operating staff. See the *Operating Expenses* section below for further detail.

Funds from operations experienced a 202% decrease in the fourth quarter as a result of the factors discussed above related to revenue and gross margin.

Selling, general and administration expenses include non-recurring costs of $500,000 and $100,000 in the third and fourth quarters respectively. These costs are discussed in further detail below within the *Selling, General and Administration Expenses* section. In addition, the third quarter includes approximately $1 million of financing-related fees that have now been presented within a separate item on the consolidated income statement. Once these costs are excluded from the variance, there is an increase in SG&A costs for the fourth quarter of approximately $400,000. This variance is largely the result of the fact that the third quarter only reflects 58 operating days versus the 92 operating days in the fourth quarter. Other factors include the employee benefits program introduced on December 1, 2006, as part of the Trust's integration plan, 2006 bonus accruals, increased sales and promotions activities as well as consulting fees related to internal controls analysis, design and implementation as part of our ongoing CEO/CFO certification requirements.

RESULTS FROM OPERATIONS

Revenues

($ thousands)	2006
	Initial period ending December 31
Revenue	
Service	$ 27,485
Product	783
Rental	929
Total	$ 29,197

Segmented Information						
($ thousands)	2006					
	Initial period ending December 31					
	Coil Tubing	**Completion Services**	**Drilling**	**Production Services**	**Transport**	**Rental & Leasing**
Revenue						
Service	$ 3,247	$ 2,816	$ 6,019	$ 11,358	$ 3,609	$ 436
Product	217	-	-	566	-	-
Rental	-	-	-	120	-	809
Total	$ 3,464	$ 2,816	$ 6,019	$ 12,044	$ 3,609	$ 1,245

The initial reporting period for the Trust includes 150 operating days from August 4 through December 31, 2006.

During the second half of 2006, the Western Canadian oil and gas industry was affected by depressed natural gas prices and falling oil prices that resulted in producer budget cutbacks and a slowdown in activity levels. During the fourth quarter, drilling rig utilization rates within the industry averaged only 49%, down dramatically from 71% during the same quarter of 2005. These conditions perpetuated reduced demand for oil and gas services and lower charge-out rates. BlackWatch's drilling utilization rates were additionally impacted by the suspension of shallow gas and CBM drilling and development activities by key customers of our Drilling and Transport Divisions. Although BlackWatch continues to solicit new customers to replace this work, the combination of these influences resulted in fourth quarter activity levels and revenues that were significantly below expectations. Weather also influenced activity levels during the period as the result of above average rainfall experienced in the latter part of August and the month of September and an unseasonably warm winter, both of which resulted in reduced demand for the Trust's services.

In addition to softening demand, revenue levels in the period were also negatively impacted by pricing pressures experienced as a result of the general slowdown in the services sector in the fourth quarter. As utilization rates declined, a surplus of available equipment developed that increased competitive pressures and allowed customers to demand and receive lower rates on their services. Drilling, Transport and Production Services were most directly impacted by the increased competition and related pricing decline.

Product revenue relates primarily to the sale of coil tubing within the Coil Tubing Division and the sale of fluid products within the Production Services Division.

Rental revenue is currently being generated within the Production Services Division and the Rental and Leasing Division and primarily relates to waste bins and storage tanks. The Rental and Leasing Division was formed on October 6, 2006, and reflects only 87 operating days. See the *Business Acquisitions* section of this MD&A for information on the Trust's acquisitions.

Management expects 2007 revenues to be in the $80 to $85 million range. This represents a decrease in revenues from 2006 on an annualized basis and is the result of reduced demand and competitive pricing pressures that are detailed throughout this document.

Operating Expenses

($ thousands)	**2006**
	Initial period ending December 31
Operating Expenses	
Labour	$ 10,418
Fuel	1,520
Repairs and maintenance	2,687
Sub-contractors	3,578
Other	6,703
Total	$ 24,906

Segmented Information

($ thousands)	**2006**					
	Initial period ending December 31					
	Coil Tubing	**Completion Services**	**Drilling**	**Production Services**	**Transport**	**Rental & Leasing**
Operating Expenses						
Labour	$ 1,711	$ 1,198	$ 2,995	$ 3,408	$ 741	$ 365
Fuel	264	45	21	729	382	79
Repairs and maintenance	344	38	1,061	600	539	105
Sub-contractors	108	25	-	2,821	474	150
Other	1,094	912	1,343	2,575	521	258
Total	$ 3,521	$ 2,218	$ 5,420	$ 10,133	$ 2,657	$ 957

Operating expenses during the period were higher than expected due to several factors. Ongoing labour shortages within the industry resulted in higher wages throughout the Trust. Although the softening industry demand has moderated some of this shortage, labour costs have yet to show any noticeable decline. Sub-contractor costs are also directly impacted by the limited supply of labour in the industry. In several Divisions within the Trust, sub-contractor services are utilized when employees are not available to deal with demand. This impact was particularly apparent in the Production Services and Transport Divisions where sub-contractors were heavily utilized for pipeline construction and rig moving. Another labour cost issue related to fact that the Trust experienced a significant reduction in demand in the quarter but it was imperative that staffing levels be maintained to deal with the activity increase that was anticipated as we entered the winter drilling season. Fixed labour costs remained high during that period of low demand as a result of this retention program. Coil Tubing, Drilling and Transport were directly impacted by these continued labour costs in a relatively slow period. Repairs and maintenance expenses comprised 11% of total operating expenses and more than one-third of these costs were expended within our Drilling Division. These costs were higher than anticipated due to unexpected repairs on several of our rigs. The “Other” category as presented above is largely comprised of consumable parts and supplies of $2.1 million, insurance premiums related to field property, plant and equipment of $800,000, field office costs of $860,000, travel and accommodation costs relating to field services of $630,000 and communications costs of approximately $500,000 for field telephones and similar connectivity items.

The Trust has taken a number of specific steps to attract and retain employees. Immediately following the consolidation of the Acquired Companies, a full review of all human resource and payroll systems was conducted to identify weaknesses and opportunities for improvement. A significantly upgraded benefits program was made available to all Trust personnel on December 1, 2006. This program provides a more comprehensive set of benefits for all employees. The Trust’s programs will substantially enhance competitiveness in the labour market and allow us to retain experienced staff.

The sharp rise in crude oil prices experienced throughout the summer had a direct impact on the cost of fuel required to operate all vehicles and equipment used in the operating Divisions. These costs declined in the fourth quarter as commodity prices moderated and the Trust was able to take advantage of pricing discounts negotiated with major fuel suppliers. Labour and fuel costs account for approximately 48% of total operating expenses for the initial period ending December 31, 2006.

There were also a number of increases that were anticipated by the Trust in the initial operating period. Costs related to shop parts and supplies were high during the period due to the outfitting of a new shop for the Rental and Leasing Division. The new shop accounted for approximately $150,000 of expenses in the fourth quarter. Additionally, increased repairs and maintenance costs were incurred in both the Coil Tubing and Drilling Divisions related to planned equipment repair and maintenance programs in advance of the winter drilling season. Facility rental and operating costs were also unusually high due to redundant shop facilities at the field locations. In the Coil Tubing, Production Services and Transport Divisions, multiple shops existed within close proximity as a result of the amalgamation of several smaller companies. Due to existing lease contracts and the approach of the winter season, consolidation of the facilities was deferred until the close of the first quarter of 2007.

Throughout the Trust, insurance costs became a larger component of the operating cost structure. Although substantial premium savings were achieved through the amalgamation, new insurance policies required for a public entity were introduced such as directors and officers’ liability insurance. Coverage was also increased substantially in areas such as general liability, contractors’ equipment and vehicles to ensure that the value of the Trust’s asset base was properly insured. Not unexpectedly, the insurance coverage carried by some of the Acquired Companies was inadequate as a result of the significant increase in equipment value that occurred during 2006 due to industry demand and the significant capital addition programs.

Management expects that 2007 gross margin percentages will improve over those attained in the initial period ending December 31, 2006.

Earnings Before Interest, Depreciation and Impairment of Goodwill and Intangibles, Tax and Unit Compensation

($ thousands)		2006
		Initial period ending December 31
Net loss	$	(162,872)
Add: Depreciation and amortization and impairment of goodwill and intangibles		162,595
Add: Interest		1,954
Add: Tax		-
Add: Unit compensation		447
EBITDAC	$	2,124

Non-cash goodwill and intangibles impairment expenses, depreciation and amortization and one-time costs related to the acquisition of the Acquired Companies were the primary contributors to the consolidated net loss for the period. Total consolidated EBITDAC was $2.1 million and was substantially impacted by $600,000 of non-recurring Trust setup costs, explained in the *Selling, General and Administration Expenses* section below. Excluding these non-recurring items, Normalized EBITDAC is $2.7 million.

Excluding the impact of one-time costs, the largest impact on the Trust's EBITDAC came from operating margins that were well below expectations for the reasons discussed in preceding sections of this MD&A.

Selling, General and Administration Expenses

($ thousands, except where otherwise indicated)		2006
		Initial period ending December 31
Selling, General and Administrative	$	2,213
Percentange of revenue		8%

The Corporate Services Division generates all expenses within this category. Any costs related directly to the operation of the other Divisions are classified as operating expenses.

The Trust incurred significant one-time costs in this reporting period related to the initiation of the Trust and the consolidation of the Acquired Companies. These expenses were largely comprised of acquisition reporting audit and consulting fees, recruitment costs for key personnel within the Trust, development and deployment of Trust branding and logos, legal and professional fees related to initial regulatory reporting requirements, professional fees incurred to meet initial CEO/CFO certification requirements for internal controls, corporate office setup and other costs related to the start-up of the Trust. These non-recurring costs totaled $600,000 of the total SG&A expenses in the period. Total SG&A expenses, once normalized for these one-time costs, would have totaled $1.6 million or approximately 5% of revenue. This percentage is representative of Management's expectations for future SG&A costs.

Interest on Debt Expense

($ thousands)	2006
	Initial period ending December 31
Interest on long-term debt	$ 937

Approximately $910,000 of the total interest expense was incurred on the bridge debt facility. That facility was repaid in full on December 19, 2006, in conjunction with the placement of the Trust's new syndicated credit facility. Of the total available amount, $40 million was drawn on the syndicated facility at December 31, 2006. Interest on the syndicated facility is incurred on a sliding scale based on the Trust's ratio of funded debt to EBITDA. The remaining $27,000 relates to interest charges on various financing leases for vehicles and equipment. See the *Notes to the Audited Consolidated Financial Statements* for further details.

Depreciation, Amortization and Impairment of Goodwill and Intangible Assets

($ thousands)	2006
	Initial period ending December 31
Depreciation, amortization and impairment charges	$ 162,595

This item contains depreciation of capital assets as well as the charge incurred as a result of the Trust's analysis of impairment of both goodwill and intangible assets. Of the $163 million total, $148.4 million relates to impairment of goodwill, $7.8 million relates to impairment of intangible assets, $4.1 million relates to regular depreciation of capital assets and $2.2 million relates to regular amortization of intangible assets. The Trust's depreciation and amortization methods are as follows:

Asset Class	**Rate**
Drilling rigs	3,300 drill days
Coil tubing stands	20% declining balance
Field service equipment	15% declining balance
Shop tools and equipment	20% declining balance
Computer equipment	40% declining balance
Vehicles	30% declining balance
Furniture and fixtures	20% declining balance
Buildings	4% declining balance
Rental and leasing equipment	15% declining balance
Leaseholds	Straight line over the term of the lease

Assets recorded in property, plant and equipment as part of capital lease transactions are included in the appropriate property, plant and equipment assets class and depreciated based on the specified rate for that asset class.

A significant impairment charge resulted this period upon analysis by Management of both the goodwill and other intangibles book values as at December 31, 2006. This impairment was directly driven by the downturn experienced within the services sector in the second half of 2006 and the decline in our overall market capitalization value.

INCOME TAXES

The Trust is a taxable entity under the Canadian Income Tax Act and is taxable only on earnings that are not distributed to Unitholders. The Trust is contractually committed to annually distribute sufficient amounts to eliminate income taxes. An analysis of the Trust's subsidiaries indicates that no future tax implications exist at this point due to the fact that all taxable income is contractually obligated to be paid out to the Trust.

As at December 31, 2006, the following are estimated balances available for deduction against future taxable income:

($ thousands)		2006
		As at December 31
Undepreciated capital costs	$	44,921
Loss carryforwards [1]		9,449
Equity issue costs		3,341
Debt issue costs		358

[1] These expire as of the December 31, 2016 tax year.

On October 31, 2006, the Canadian government announced its intention to amend the Income Tax Act (Canada) to apply a tax on distributions from publicly traded income trusts. On December 21, 2006, draft legislation was released for comment. Under the proposal distributions of non-portfolio earnings would not be deductible for tax purposes. Newly formed trusts would be subject to tax in 2007, while existing trusts such as BlackWatch would benefit from a four year transition period and would not be subject to the new measures until the 2011 taxation year. In simplified terms, under the proposed tax amendment, income distributions from certain trusts will be taxed at the trust level at an estimated rate of 31.5% commencing in 2011 for existing trusts such as BlackWatch. Such income distributions to unitholders will then be treated as dividends from a taxable Canadian corporation and will be eligible for the applicable dividend tax credits. The net impact on taxable Canadian unitholders is expected to be minimal. However, as a result of the 31.5% tax at the trust level, distributions to tax exempt unitholders and non-residents of Canada will be subject to tax.

BlackWatch intends to evaluate the alternatives to most effectively optimize value for our unitholders and other stakeholders.

INVESTING ACTIVITIES

Business Acquisitions

On August 4, 2006, the Trust acquired 100% of the issued and outstanding common shares of each of the Acquired Companies which were accounted for by the purchase method. The results of the operations of the Acquired Companies have been included in the consolidated financial statements from the dates of acquisitions. The total purchase consideration was Trust units valued at $144.5 million and exchangeable units valued at $66.2 million, less the cash acquired of $70,000, for a total purchase consideration of $211 million.

On October 6, 2006, the Trust, through its indirect wholly-owned subsidiary, Black Watch Energy Services Limited Partnership (the "Investment Partnership"), acquired all of the issued and outstanding shares of Elite. Elite was engaged in oilfield equipment rental and leasing services. The purchase was funded with $5 million in cash, and the issuance of 575,269 units (of the total units issued, 172,581 are exchangeable units of the Investment Partnership) valued at $4.7 million for a total purchase consideration of $9.7 million.

Capital Expenditures

Capital costs consist of either growth or maintenance expenditures. Maintenance capital expenditures reflect the costs of replacing existing assets to sustain existing levels of operating cash flows. Growth capital expenditures reflect investment costs to generate incremental operating cash flows.

Of the total $19.5 million capital expenditures in the period ending December 31, 2006, approximately $17.4 million were growth expenditures primarily consisting of:

- $5.8 million related to ongoing fabrication of three drilling rigs, including the new pad rig that was identified in the Trust's prospectus dated July 27, 2006.
- $2 million on two new coil tubing rigs.
- Approximately $2.8 million within the Production Services Division related to various equipment including excavators, a coil tubing unit, a vacuum truck, a tank truck and an additional swabbing rig and hot oiler, both of which are under construction.
- $5 million on 6 new E-line units within our Completion Services Division.
- $1.3 million within the Rental and Leasing Division of which $675,000 relates to new rental equipment and $595,000 was for three picker trucks and trailers.

Funding for the majority of the Trust's growth capital expenditures for 2006 was via facility draws on our syndicated facility as described in further detail below within the *Liquidity* section.

LIQUIDITY

($ thousands)		2006
		Initial period ended December 31
Total debt (including current portion of long-term debt and lease obligations)	$	41,863
Less: working capital		8,540
Net debt	$	33,323
Unitholders' equity	$	69,511
Total capitalization (1)	$	102,834

(1) Net debt plus unitholders' equity

The Trust's capital structure underwent a significant change as a result of the IPO discussed in the *Overview* section of this MD&A. The public offering resulted in the issuance of 3.2 million units for gross proceeds of $31.6 million. In addition, the acquisitions of the Acquired Companies and Elite resulted in the issuance of an additional 21.6 million units (of which 6.8 million are via Exchangeable Partnership Units) for purchased asset values of $220.3 million.

On December 19, 2006, the Operating Partnership established an $80 million syndicated credit facility with a group of major Canadian banks. This facility replaced both the $29 million bridge financing facility and the $20 million credit facility both of which are described in the *Notes to the Audited Consolidated Financial Statements*.

This facility is subject to interest at either an average BA rate plus a specified percentage or a prime plus percentage depending on the type of instrument the Trust requests at the time of each borrowing request. This is a 364-day revolving facility with an automatic three year term-out if no renewal notice is given by either party. This debt is subject to certain financial covenants restricting the ratios of working capital, funded debt to EBITDA, debt service and total debt to capitalization.

Additional debt of approximately $1.6 million is outstanding related to lease financing and loans payable for capital expenditure purchases, all of which are subject to fixed interest rates. See the payment schedules for these loans detailed below within the *Contractual Obligations and Commitments* section.

As part of the acquisition of Elite, two term loans were acquired. Both of these loans related to capital equipment financing and are subject to a prime plus percentage basis. The principal amounts are $150,000 and $135,000 and were established on September 5, 2005, and August 24, 2006, respectively. Payment terms are over 36 months and both loans are secured by the underlying assets that were purchased. In March of 2007, both of these loans were paid in full through the syndicated credit facility.

The Trust's net debt position at December 31, 2006, was approximately $33 million consisting primarily of the outstanding credit facility of $40 million.

In early 2007 it was identified that earnings performance in the fourth quarter of 2006 was well below expectations due to the factors discussed above. Combined with expected soft industry demand in 2007, significant steps were taken in early 2007 to maintain the Trust's financial flexibility and long term viability. The targeted net debt level for December 31, 2007, is approximately $25 million in contrast to the December 31, 2006, level of $33 million. This reduction in net debt is to be achieved through a significantly restricted capital expenditure program, suspension of distributions to Unitholders as announced in February 2007 and improved earnings in all Divisions through diversified market penetration and the achievement of significant operating efficiencies. Funds from operations will be the primary source of funding for all 2007 expenditures.

In the initial period ended December 31, 2006, the Trust did not have positive cash flow from operations and had an accumulated deficit of approximately $174 million. The Trust has a positive working capital at December 31, 2006, which, combined with the available lines of credit , would be sufficient to meet the Trust's obligations as they came due. The credit facility requires the Trust to be in compliance with certain financial covenants. While the Trust was in compliance with these covenants at December 31, 2006, the Trust's Management does not believe that the Trust will continue to be in compliance with the existing covenants in 2007. Should the Trust not be able to renegotiate its existing covenants and those covenants were to be breached in the future, the creditor has the ability to demand immediate repayment on the outstanding balances drawn on the facility. The Trust is currently renegotiating the covenants on the facility with its creditor and believes that it will have the continued support of its creditor, subject to certain conditions. Any negotiated adjustments to the existing covenants may also result in a reduction of the maximum borrowing limit on the facility. Management estimates that this limit may be reduced to approximately $50 million until such a time as the Trust is able to comply with the original covenants. The continued support of its creditor, or an ability to re-finance the existing bank debt, is necessary for the Trust to continue its operations. The ultimate outcome of the negotiations currently underway cannot be predicted with certainty at this time.

Given the Trust's significant investment in new equipment during 2006, combined with the softening of demand for the Trust's services, BlackWatch is proceeding with only selected capital commitments in 2007 including reconfiguration of some of our coil tubing rigs to allow more complex, higher margin work. The Trust is also upgrading several drilling rigs to increase operational flexibility and improve utilization rates. See details further below within the *Contractual Obligations and Commitments* section.

For further details on the Trust's liquidity see *Distributions, Contractual Obligations and Commitments, Financial Risks and Uncertainties* and the *2007 Outlook* sections below.

UNITHOLDERS' CAPITAL AND UNIT TRADING ACTIVITY

The Trust's units trade on the Toronto Stock Exchange under the symbol BWT.UN. The Trust had 24.8 million Units outstanding at December 31, 2006 and, with the Unit price closing at $6.09 on that date, the market capitalization of the Trust was approximately $151 million.

BlackWatch Energy Services Trust Trading Activity	Initial period ending December 31 2006	December 2006	November 2006	October 2006	September 2006	August 2006
Unit price						
High	$ 10.95	$ 6.60	$ 8.80	$ 9.45	$ 10.53	$ 10.95
Low	$ 5.00	$ 5.00	$ 6.20	$ 7.90	$ 8.75	$ 10.06
Close	$ 6.09	$ 6.09	$ 6.49	$ 9.25	$ 9.10	$ 10.50
Volume of Trust units traded (millions)	4.6	0.8	0.6	0.5	0.3	2.4
Weighted average Trust units outstanding (millions)	18.3	24.5	24.5	24.5	24.1	24.1

Of the total 24.8 million units outstanding, a total of 18 million units are Class A Trust Units and 6.8 million units are Class B Exchangeable Units. The Exchangeable Units were issued in a private placement arrangement as partial consideration for the business acquisitions that took place on August 4, 2006, and October 6, 2006, as described above. The Units convert to Trust Units on a one-to-one basis and are escrowed for conversion purposes. One-half of the Units are escrowed for one year from the original date of grant and the remainder for two years following the original date of grants. These Unitholders receive distributions in the same amount and timing as the Class A Unitholders and conversion to Class A units is mandatory.

Unit-based Compensation

The Trust issued Unit options ("options") as part of its long-term incentive plan for employees. There were a net of 2,161,000 options granted in the period with a weighted average exercise price of $9.58 per option. Each option represents the right of the optionholder to purchase a Unit at the exercise price determined at the date of grant. The exercise price is further reduced by distributions over the vesting period. The options vest equally over a four year period following the date of grant and expire five years from the date of grant.

In addition, the Trust issued a net of 30,000 Unit Award Incentive Plan rights ("UAIPs") in the period. These UAIPs are earned over a four-year vesting period from the date of grant. These rights have a $nil exercise price and the vested UAIPs are granted on an equivalent Trust Unit basis (or cash settlement thereof) adjusted for a conversion factor equal to distributions paid out by the Trust over the vesting period.

Both of the future compensation plans described above allow for cash settlement at the discretion of the option holder. See the *Notes to the Audited Consolidated Financial Statements* for more information on the accounting treatment and financial impact on the initial period ended December 31, 2006.

DISTRIBUTIONS

A total of $11.2 million in distributions were declared in the period and $9 million was paid to unitholders in the period. When determining distributions, the Trust takes into account growth and maintenance capital requirements as well as debt repayment requirements.

As detailed in a February 19, 2007, press release, the Trust halted distributions effective for the month of February 2007 until further notice. The Trust did declare a $0.065 per Unit distribution for the month of January 2007 and this amount was paid to Unitholders on February 15, 2007.

Funding sources utilized to facilitate the 2006 distribution payments were as follows:

($ thousands)		2006
		Initial period ending December 31
Cash funds from operations	$	(18)
Add (deduct):		
Property, plant and equipment, net of proceeds from disposals		(19,076)
Changes in working capital		1,271
Financing charges		(364)
Business acquisitions		(4,857)
Investment in long-term asset		(1,310)
Net debt financing		9,028
Net equity financing		28,259
Current period cash sources available for distribution	$	12,933
Opening balance available cash source		1
Total available cash for distribution	$	12,934
Actual cash distributions paid		(8,976)
Undistributed cash available	$	3,958

The 2006 distributions declared of $11.2 million were comprised of $8.2 million pertaining to distributions on Trust units and $3 million pertaining to distributions to Exchangeable Partnership unitholders, a subsidiary of the Trust.

The $8.2 million Trust unit distributions exceeded the available earned income of the Trust and, thus, a portion of the dividends received was a return of the original capital investment by our Unitholders. Our assessment indicates that 53.85% of the total distributions received in respect of the 2006 reporting period will be treated as taxable income and the remaining 46.15% will be considered a tax deferred return of capital and should be treated as a reduction of the Unitholders' adjusted cost bases of their investments.

The $3 million Exchangeable Partnership unit distributions exceeded the available earned income of the Partnership and, thus, a portion of the dividends received was a return of the original capital investment by our Unitholders. Our assessment indicates that 72.46% of the total distributions received in respect of the 2006 reporting period will be treated as taxable income and the remaining 27.54% will be considered a tax deferred return of capital and should be treated as a reduction of the Unitholders' adjusted cost bases of their investments.

COMPARATIVE INFORMATION

The Trust commenced operations on June 23, 2006 and as such does not have any comparative financial statements for the initial period ended December 31, 2006.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The Trust has various vehicle and equipment obligations under capital leases with interest rates ranging from non-interest bearing to 14.2%. The leases have expiry dates ranging from September 2007 through June 2011. Principal and interest repayments on the capital lease obligations in each of the next five years are:

Year	($ thousands)
2007	782
2008	379
2009	303
2010	135
2011	48
	1,647

The Trust has $4.3 million committed to future minimum payments under lease contracts for office and shop space and $4.4 million committed to future capital expenditure contracts. The required future commitment payments are as follows:

Year	($ thousands)
2007	5,784
2008	1,095
2009	858
2010	726
2011	259
	8,722

Based on the Trust's forecasted earnings for 2007, the entire settlement of all 2007 commitments will be done using operational cash flows and no additional debt financing will be required on a net basis.

FINANCIAL RISKS AND UNCERTAINTIES

Customer Dependence

The top five customers of the Trust accounted for approximately 52% of the reported revenues. With the exception of take-or-pay contract arrangements within the Drilling Division, the Trust will not generally enter into long-term contracts with its customers and there can be no assurance of continued relationships. The loss of one or more major customers, or any significant decrease to services provided to a customer, prices paid or any other changes to the terms of services with customers, could have a material adverse effect on the Trust's business, financial condition, results of operations and cash flows and, therefore, on distributable income to be distributed to Unitholders.

Management regularly reviews the status of all outstanding aged accounts receivable. When it is determined that there is evidence of non-collectibilty, Management ensures that adequate provisions have been provided and that appropriate collection activity is undertaken. As at December 31, 2006, Management has determined that there is no evidence that suggests that additional allowances for doubtful accounts are required.

Commodity Price Risk

Lower commodity prices have a direct impact on the Trust's customers' ability to generate cash flows, which in turn directly impacts the demand for services. These factors are beyond the Trust's control and, therefore, represent significant business uncertainty.

Legislation

Both federal and provincial legislation in respect of Trust taxation, environmental regulation and health and safety matters have a direct impact on the Trust's processes by which it conducts its operations and its ability to generate distributable cash flow.

Foreign Currency

The Trust does not currently engage in any significant purchases or sales transactions impacted by a non-domestic currency.

Interest Rate Risk

The Trust's net income and funds from operations are impacted by interest rate changes based on the amount of floating rate debt outstanding. At December 31, 2006, there was approximately $40 million outstanding on a credit facility which incurs interest at either an average BA rate plus percentage or a prime plus percentage depending on the type of instrument the Trust requests for a given borrowing request. In addition, debt of approximately $1.6 million is outstanding related to lease financing and loans payable for capital expenditure purchases all of which are subject to fixed interest rates.

DISCLOSURE CONTROLS

The Chief Operating Officer and the Chief Financial Officer are responsible for establishing and maintaining the Trust's disclosure controls and procedures to provide reasonable assurance that material information related to the Trust is made known. In addition, internal controls over financial reporting have been designed by or have been caused to be designed under the supervision of the COO and CFO to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with Canadian GAAP.

The COO and CFO have evaluated the effectiveness of the Trust's disclosure controls and procedures and assessed the design of the Trust's internal control over financial reporting as of December 31, 2006, pursuant to the requirements of Multilateral Instrument 52-109.

Management has concluded that, as of December 31, 2006, a weakness existed in the design of internal control over financial reporting caused by failure of the Trust to formally communicate its policies and procedures documentation, including the Trust's expectations regarding standards of business conduct, whistle blowing practices, as well as various human resources policies including vacation and other leaves, formal compensation and performance review procedures and other personnel policy items.

This identified weakness is mitigated by several factors including, strong entity level controls comprised of significant officer and senior Management review of financial reporting items, expansive industry and corporate governance knowledge, and formal and extensive annual forecasting processes. It should be noted that these mitigating factors will not necessarily prevent the likelihood that a material misstatement will occur as a result of the aforesaid weakness.

Management and the Board are in the process of ensuring dissemination of all key policies including the creation of an intranet, requirement for annual acknowledgement of existence and understanding of said documents, as well as ongoing communication with senior Management to ensure any pertinent changes are made available to all personnel.

FOREIGN OWNERSHIP

Based on information from the statutory declarations by Unitholders, we estimate that, as of December 29, 2006, approximately 2% of our Unitholders are non-Canadian residents with the remaining 98% being Canadian residents. The statutory declarations are only as of a specific record date, and therefore may still not reflect the current ownership level of the Trust's Units; however, given the limitations in the securities registration system and the lack of any process for real-time residency information to flow to the trustee and transfer agent, the Trust is of the view that statutory declarations are currently the most appropriate method of determining the residency status of its Unitholders.

The Trust Indenture provides that not more than 49% of its Units can be held by non-Canadian residents. The Trust intends to require its Unitholders to complete statutory declarations as to their residency status each quarter to enable the Trust to monitor its level of non-Canadian resident ownership. The Trust Indenture requires all Unitholders to provide such statutory declarations when requested to do so by the trustee and transfer agent.

SEASONALITY

The geographical region that the Trust operates within is subject to significant changes in activity levels as a result of seasonal weather patterns. Spring weather, due to melting snow and rain, impacts the accessibility of work sites due to road bans implemented to avoid damage to secondary roads to support the weight of heavy equipment. These conditions are normally seen during the months of April and May, however, the timing and duration may vary. In addition, the temperature conditions experienced within the winter season can impact the levels of services in demand. Abnormally cold or warm temperatures can impact the ability to perform work and, therefore, decrease activity and utilization rates.

CHANGE IN ACCOUNTING POLICIES

The initial period ended December 31, 2006, reflects the first annual reporting period of the Trust with operational activities. Field operations officially commenced on August 4, 2006. The accounting policies adopted are disclosed in the *Notes to the Audited Consolidated Financial Statements.*

Accounting Developments

The Canadian Institute of Chartered Accountants ("CICA") has pronounced the following future accounting standards changes effective for 2007 reporting:

i. CICA Handbook Section 1530, "Comprehensive Income" establishes standards for the reporting and presentation of comprehensive income and defines other comprehensive income to include revenues, expenses, gains and losses that are recognized in comprehensive income, but excluded from net income.
ii. CICA Handbook Section 3855, "Financial Instruments - Recognition and Measurement" describes the standards for recognizing, measuring and presenting financial assets, financial liabilities and non-financial derivatives.
iii. CICA Handbook Section 3865, "Hedges" provides guidance on when and how hedge accounting may be applied.

The Trust is currently evaluating the impact of these new standards in its financial position and results of operations but believes that any impact would not be material.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the consolidated financial statements requires that certain estimates and judgements be made with regard to the reported amount of revenues and expenses and the carrying values of assets and liabilities. These estimates are based on historical experience and Management judgement. Anticipating future events involves uncertainty and consequently the estimates used by Management in the preparation of the consolidated financial statements may change as future events unfold, additional experience is acquired or the Trust's operating environment changes.

2007 OUTLOOK

The reduction in demand for energy services that began in the second half of 2006 has continued into the first quarter of 2007 as a result of high natural gas storage levels and the resulting softening of natural gas commodity prices compared to 2006. The Petroleum Services Association of Canada ("PSAC") is forecasting a decline of at least 10% in the number of wells drilled within Canada in 2007 compared to 2006. A shift in the type of wells being drilled is also expected with a shift to more drilling for oil where prices have remained strong by historical standards despite the decline from the record highs of mid 2006. While the reduction in drilling combined with continued declines in production rates on existing wells is expected to eventually resolve the natural gas storage overhang, that improvement may not occur until late 2007 or early 2008.

Since inception, BlackWatch has been significantly impacted by this industry decline and by more specific factors such as suspended drilling and capital programs of some key customers. Earnings levels and cash flow from all operating Divisions were significantly reduced in 2006 and were below the levels achieved by the individual companies in 2005 and early 2006. Reduced activity levels, combined with the completion of a significant capital addition program and unusual expenditure levels related to the consolidation of the Acquired Companies resulted in distributable cash flow levels well below expectations for the initial reporting period. As a result, several significant and immediate decisions were made by Management and the Board of Directors of the Trust to address these factors.

BlackWatch has implemented several programs to streamline overall operations, improve customer service levels and ultimately improve the financial performance and cash flow generating capability of the Trust, even in the challenging environment that is expected in 2007. As a result of the termination of drilling programs by certain key customers in late 2006, we commenced efforts to replace that lost demand and diversify our customer base, in the Drilling and Transport Divisions specifically. The quality and effectiveness of our Sales and Marketing group continues to be a top priority with the recent promotion of Ron Dahl to the position of Vice President, Sales & Marketing and the recruiting of sales personnel who have brought significant technical and sales skills to the Trust. Ron brings 30 years of service sector operating and sales experience to this position.

BlackWatch is also redeploying equipment and manpower to geographic regions that will provide opportunities for higher margins and utilization as part of our strategic plan to improve diversification within our customer base and become less dependent on shallow gas and CBM markets. We are establishing a presence in the busy northwest region of Alberta, including the Grande Prairie area, by re-deploying our new coil tubing rigs and e-line units. We will also increase our presence in central and southeast Saskatchewan, where drilling activity is expected to remain relatively static compared to 2006.

At the inception of the Trust, a formal integration plan for the Acquired Companies was developed and implemented, encompassing all aspects of the ongoing operation. As per the Trust's February 19, 2007, announcement, a further reorganization of its Divisions was implemented to improve customer service and streamline operations. The number of operating Divisions has been reduced from six to four more focused service groups. This reorganization allowed the Trust to reduce the size of the senior Management team, combine Divisions with significant synergies or similarities in operations and provide a clearer picture of the Trust's service offerings to the customer base.

The Trust's 2007 capital expenditure program was also reduced to account for the oversupply of equipment in the energy services industry that is expected to occur in conjunction with reduced demand. Capital spending has been restricted to amounts previously committed, maintenance capital and growth capital that will have significant and immediate positive impact on the Trust's performance. While the capital program will be monitored throughout 2007 to determine if additional opportunities arise for value added expenditures, the Trust has forecast total capital spending of $7.3 million, of which $4.5 million relates to the completion of committed capital projects carried over from 2006.

Effective February 2007, distributions to unitholders were suspended until further notice. The Trust's original distribution rate was unsustainable based on distributable cash flow produced in 2006 and the significant reduction in expected future cash flows that resulted from a detailed review and reforecast of our 2007 results. Given the current state of the energy services industry and the expectation that demand will stay soft until late 2007, earnings and cash flow forecasts were reduced to reflect the reality of the 2007 environment. Utilization rates and pricing levels were reduced to conservative levels across all Divisions. The suspension of distributions is a critical part of our 2007 business strategy which will focus on preserving cash, reducing debt levels and maximizing utilization of the equipment fleet that has been substantially increased since inception.

All strategic and financial efforts noted above are intended to improve the Trust's performance during 2007, improve cash flow and reduce overall debt to more conservative levels in anticipation of improved market conditions in late 2007 and early 2008. Although 2007 is expected to be a challenging year throughout the industry, Management remains confident about the long term outlook and possibilities for the oil and gas industry in North America. Through the substantial capital investment since inception, the Trust has built up a fleet of equipment that leaves it positioned to successfully compete in this challenging environment, allowing growth and the creation of value for its stakeholders.

BlackWatch Energy Services Trust
Paul Partlo,
Vice President Finance & Chief Financial Officer

Robert Copeland
Vice President and Chief Operating Officer

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