

BLACKWATCH ENERGY SERVICES TRUST
Highlights

(\$thousands, except per Trust unit amounts)

		58 day Operating Period Ended September 30 2006 ²
	\$	
Revenue	\$	11,141
Gross Margin	\$	3,020
EBITDA ¹	\$	1,408
Per Trust unit - basic	\$	0.06
Per Trust unit - diluted	\$	0.06
Net Loss ¹	\$	(1,233)
Per Trust unit - basic	\$	(0.05)
Per Trust unit - diluted	\$	(0.05)
Funds From Operations ¹	\$	1,114
Per Trust unit - basic	\$	0.05
Per Trust unit - diluted	\$	0.05
Net Debt	\$	4,902
Unitholders' equity	\$	233,468
Distributions declared	\$	4,436
Per Trust unit - basic	\$	0.18
Weighted average Trust units - basic		24,129
Weighted average Trust units - diluted		24,129
Trust units, end of period		24,206

¹ EBITDA refers to earnings of the Trust before interest, taxes and depreciation and amortization. Readers are cautioned that EBITA does not have a standardized meaning prescribed by GAAP and therefore may not be comparable to similar measures presented by other issuers. The EBITDA, Net Loss and Funds From Operations line items as per above, all include approximately \$1.2 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, insurance cancellation fees and recruitment costs for key management personnel. Excluding these non-recurring costs, Adjusted EBITDA would amount to \$2.6 million, the Net Earnings result for the period would approximate break-even and the Adjusted Funds From Operations would be \$2.3 million.

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

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*. Subsequent to the IPO, we have maintained a very strong balance sheet with low net debt levels.
- Excluding non-recurring costs related to the creation of the Trust and the consolidation of the acquired companies, we were able to achieve an Adjusted EBITDA of \$2.6 million and Adjusted Funds from Operations of \$2.3 million in the first 58 days of operations.
- A formal integration plan for the acquired companies was developed and has been implemented, encompassing all aspects of the ongoing operation. As of the date of this report, all key management positions have been filled, including the recent addition of our Vice President of Operations and General Sales Manager.
- 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 leasing and rental services. This acquisition led to the creation of our new Rental and Leasing Division and allowed us to expand our presence in the northwest sector of province.
- 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.
- We continued our market-driven organic growth program with \$4.9 million in expenditures on new equipment throughout our operating divisions.
- A \$29 million bridge financing facility was established with Roynat Capital to facilitate the initial acquisitions.
- Management is in the process of establishing a revolving debt facility with a group of major Canadian banks. This facility will replace the bridge facility and will provide additional capacity for internal growth and strategic growth through acquisitions.
- Development and implementation continues on our wireless service ticketing system that will be deployed throughout the Trust and will significantly improve the timing of cash flows and overall customer service levels
- On October 31, 2006, the Canadian government announced its intention to amend the Income Tax Act (Canada) to apply a Distribution Tax on distributions from publicly traded income trusts. Under the proposal, 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. BlackWatch intends to proactively respond to the tax law amendments to support the interests of our unitholders and other stakeholders.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is management's discussion and analysis ("MD&A") of the operating and financial results for the Initial period ended September 30, 2006 and its outlook based on information available as at November 13, 2006. The MD&A should be read in conjunction with the unaudited interim consolidated financial statements of BlackWatch Energy Services Trust (the "Trust" or "BlackWatch") as at and for the Initial period ended September 30, 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, however 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 intend, and does not assume any obligation, to update these forward-looking statements.

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 the 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. The Trust immediately commenced operations through the Operating Partnership. On August 11, 2006, the Trust completed its IPO and began trading on the Toronto Stock Exchange under the symbol *BWT.UN*.

On October 6, 2006, the Trust completed its acquisition of Elite Oilfield Rentals. Elite is engaged in oilfield equipment leasing and rental services. This acquisition led to the creation of our new 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 do not reflect the addition of Elite. In addition, less than two months of operations from the other operating divisions are included 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 the operations. In addition to the primary measures of net earnings and net earnings per unit in accordance with GAAP, management believes that certain measures not recognized under GAAP assist management and the reader in assessing the performance and understanding the Trust's results. Each of these measures provides the reader with additional insight into the Trust's ability to generate ongoing cash flows. Gross margin – This measure is considered a primary indicator of operating performance as calculated by revenue less operating expenses excluding depreciation and amortization.

- EBITDA (Earnings before interest, income taxes, depreciation and amortization) – This measure is used extensively in the Trust's financial covenants and is also considered an indicator of the Trust's ability to generate funds in order to meet distributions, ongoing operating commitments, servicing of debt and funding for capital programs.
- Adjusted EBITDA – This measure refers to EBITDA 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 make distributions, fund ongoing operating commitments, service debt, fund capital programs, and pay interest and income tax charges. Funds from operations is defined as cash flow from operations before changes in non-cash working capital.

- Adjusted 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 in order to refurbish or replace previously acquired capital assets. Such additions do not provide incremental increases in revenue. Maintenance capital is a key component to sustainability of the Trust as cash retained within the Trust must be sufficient to replenish assets for future cash generation.
- Growth capital – Growth capital is expenditures on equipment with expected incremental increases in revenue and funds from operations to the Trust.
- Payout ratio – This ratio is an indicator of the Trust’s ability to meet its distribution levels while still maintaining adequate cash flow to fund the Trust’s ongoing operations. It is calculated as the total distributions declared within a period divided by the funds from operations for the period.
- Working capital – This term is defined as current assets less current liabilities excluding the current portion of long-term debt.
- Distributable cash – Distributable cash is a key measure of the Trust’s ability to fund cash distributions to Unitholders. Distributable cash is determined by subtracting maintenance capital and scheduled debt repayments from funds from operations.
- Net debt – This term is defined as debt less working capital (see above).

These 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 leasing and rentals.

The Trust manages 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 not created until October 6, 2006, concurrent with the acquisition of Elite Oilfield Rentals. See the *Business Acquisitions* section below for detailed information on this purchase. As a result, the divisional information presented below includes only the five operating segments that were active as of September 30, 2006.

RESULTS FROM OPERATIONS

Summary of Quarterly Information

(\$ thousands, except per Trust unit amounts)	2006
58 operating days ended September 30	
Revenue	\$ 11,141
Gross margin	\$ 3,020
EBITDA ¹	\$ 1,408
Net loss ¹	\$ (1,233)
Per Trust unit - basic	\$ (0.05)
Per Trust unit - diluted	\$ (0.05)
Funds from operations ¹	\$ 1,114
Per Trust unit - basic	\$ 0.05
Per Trust unit - diluted	\$ 0.05
Net Debt	\$ 4,902
Unitholders' equity	\$ 233,468
Weighted average Trust units - basic	24,129
Weighted average Trust units - diluted	24,129
Trust units, end of period	24,206
¹ Includes non-recurring costs of approximately \$1.2 million. See discussion below for details.	

The Trust incurred an overall consolidated net loss of \$1.2 million in the period, primarily resulting from significant one-time costs of approximately \$1.2 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, recruitment costs for key management personnel within the Trust, development and deployment of Trust branding and logos, corporate office set-up and other costs related to the start-up of the Trust. While these expenditures were reasonable and expected, they resulted in overall selling, general and administrative ("SG&A") expenses that were well 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.

Within the energy services sector, the third quarter is typically the second slowest quarter in terms of utilization rates and overall activity. This was reflected in the Trust's initial operating period in combination with poor weather factors. The Coil Tubing and Transport Divisions in particular experienced lower activity levels than normal during this period due to unusually wet weather in their geographic regions. Wet weather limits access to well sites as the ground is unable to bear the weight of the equipment.

Consolidated gross margin of 27% was slightly below expected levels and was primarily due to lower than expected revenues in the period, combined with fixed operating costs that remain consistent despite reduced activity levels. Overall margins were also impacted by the volume of construction work that occurred in the Production Services Division during the period. Margins on pipeline and facility construction work are typically 20 to 25% and these services accounted for approximately 20% of our overall revenues in the period. Pricing for services in all divisions remained stable despite activity levels and the lower commodity prices.

Revenues

(\$ thousands)	2006	
58 operating days ended September 30		
Revenue		
Service	\$	10,926
Product		195
Rental		20
Total	\$	<u>11,141</u>

Divisional revenue contributions for this period were as follows:

- Coil Tubing 11%
- Completion Services 13%
- Drilling 28%
- Production Services 34%
- Transport 14%

On average, approximately 65% of the Trust's revenue-generating activity occurs during the five months of November through March with the remaining 35% occurring in April through October. The current reporting period was the Trust's initial operations start-up resulting in a 58 day operation period. During this reporting period, above average rainfall was experienced in the latter part of August and the month of September, resulting in a deferred demand for the Trust's services. Demand levels were also negatively impacted by the softening of commodity prices over the summer months.

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 primarily relates to waste bins and storage tanks. See the *Business Acquisitions* section of this MD&A for information on the recent acquisition of Elite Oilfield Rentals which will significantly increase rental revenues.

Operating Expenses

(\$ thousands)	2006	
58 operating days ended September 30		
Operating Expenses		
Labour	\$	3,766
Fuel		562
Repairs and maintenance		822
Sub-contractors		932
Other		2,039
Total	\$	<u>8,121</u>

Operating expenses on a consolidated basis were higher than expected due to one-time costs related to the initiation of the Trust, ongoing labour shortages which resulted in higher wages and record high fuel costs. All are described in more detail below.

The energy services labour market remained extremely competitive, but 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 HR and payroll systems was conducted to identify weaknesses and opportunities for improvement. A significantly upgraded benefits program will be 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.

The sharp rise in 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. Fuel costs have since moderated and should contribute to reduced operating expenses for the remainder of 2006. Labour and fuel costs account for approximately 53% of total operating expenses.

Also included in operating costs for the period are a number of non-recurring costs related to the start-up of the Trust. Insurance costs include approximately \$80,000 relating to premiums on run-out policies for pre-existing insurance programs and premiums for other policies that were cancelled upon consolidation of the acquired companies. It is expected that the majority of these overlapping premiums will be recovered in the fourth quarter.

Earnings Before Interest, Depreciation and Tax

(\$ thousands)	2006	
58 operating days ended September 30		
Net loss	\$	(1,233)
Add: Depreciation and amortization		2,347
Add: Interest, net		294
Add: Tax		-
EBITDA	\$	<u>1,408</u>

Non-cash depreciation and amortization expense as well as one-time costs were the primary contributors to the consolidated net loss for the period. Total consolidated EBITDA was \$1.4 million and was substantially impacted by the non-recurring costs explained in further detail in this MD&A within the *SG&A* and *Operating Expenses* sections. Excluding these non-recurring items, Adjusted EBITDA would have amounted to approximately \$2.6 million.

Selling, General and Administrative Expenses

(\$ thousands, except where otherwise indicated)	2006	
58 operating days ended September 30		
Selling, General and Administrative	\$	<u>1,586</u>
Percentage of revenue		<u>14%</u>

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 included commitment fees for the Trust's bridge debt facility, early payout fees on pre-existing debt facilities and recruitment costs for key management personnel within the Trust. These three items accounted for approximately \$1.1 million of the total SG&A expenses in the period. Costs were also incurred for the development of Trust branding and logos, corporate office setup-up, and other costs related directly to the start-up of the Trust.

Interest on Debt Expense

(\$ thousands)	2006
	58 operating days ended September 30
Interest on debt	\$ 317

Approximately \$312,000 of the total interest expense is attributable to the bridge debt facility with an outstanding balance of approximately \$26.6 million at September 30, 2006. The remaining \$5,000 relates to interest charges on various financing leases for vehicles and equipment. See the *Notes to the Interim Consolidated Financial Statements* for further details.

Depreciation and Amortization Expenses

(\$ thousands)	2006
	58 operating days ended September 30
Depreciation and Amortization	\$ 2,347

Of the total consolidated amount of \$2.3 million, \$1.5 million relates to depreciation of capital assets and \$826,000 relates to amortization of intangible assets. The Trust's depreciation and amortization methods are as follows:

<u>Asset Class</u>	<u>Rate</u>
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
Leaseholds	Straight line over the term of the lease
Intangibles	Straight line over three years

INCOME TAXES

An assessment of current and future tax provisions has been performed for the period ended September 30, 2006. It has been determined that due to the net loss, this reporting period will not give rise to current taxes. Further, a review of future tax consequences indicates that the only entity which will give rise to potential timing differences for accounting versus taxable income calculations is the Operating Partnership. The General Partner of the Operating Partnership, BlackWatch Energy Services Operating Corp., could potentially be impacted by future taxes as a result. Management has assessed any timing differences in correlation with the probability of these differences reversing in the future, thereby giving rise to taxes and has determined that the "more likely than not" criteria has not been met. As a result, no such provision has been booked at this time.

On October 31, 2006, the Canadian government announced its intention to amend the Income Tax Act (Canada) to apply a Distribution Tax on distributions from publicly traded income trusts. Under the proposal, 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. BlackWatch intends to proactively respond to the tax law amendments to support the interests of our unitholders and other stakeholders. 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.

INVESTING ACTIVITIES

Business Acquisitions

On August 4, 2006, the Trust acquired 100% of the issued and outstanding common shares of the following private companies: Austin's Transport (1990) Ltd. ("Austins"), Strata Completions Limited ("Strata"), Ammonite Assets Inc. ("Ammonite"), Caliber Energy Services Corp. ("Caliber"), Brantfords Consolidated Inc. ("Inc.") and Brantfords Consolidated Ltd ("Ltd."). These acquisitions 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 shares 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 Oilfield Rentals ("Elite"). Elite is engaged in oilfield equipment leasing and rental services. The purchase was funded with \$5.2 million in cash, the assumption of \$232,000 in debt and the issuance of 575,269 units of the Trust (of the total units issued, 172,581 are exchangeable units of the Investment Partnership).

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 \$5.1 million capital expenditures in the period ended September 30, 2006, approximately \$4.9 million were growth expenditures primarily consisting of:

- \$2.7 million related to ongoing fabrication of two new drilling rigs, including the new pad rig that was identified in the prospectus
- \$500,000 within the Drilling Division for the purchase of a shop in Leduc, Alberta, which was obtained via the exercise of a purchase option in the lease.
- \$231,000 on a new coil tubing rig that is currently under construction
- Approximately \$1.2 million within the Production Services Division related to various equipment including excavators, trailers and an additional swabbing rig and vacuum truck, both of which are under construction
- \$293,000 on new E-line units that are currently under construction within our Completion Services Division.

LIQUIDITY

(\$ thousands)	2006	
	58 operating days ended September 30	
Total debt	\$	27,486
Less: working capital		22,584
Net debt	\$	4,902
Unitholders' equity	\$	233,468
Total capitalization ⁽¹⁾	\$	238,370
⁽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 contributed an additional 21 million units (of which 6.6 million are via Exchangeable Partnership Units) for purchased asset values of \$211 million.

The Trust's liquidity at September 30, 2006, indicates a net debt position of approximately \$5 million resulting primarily from the outstanding bridge financing facility of \$26.6 million. The Trust's borrowing capacity as at September 30, 2006, amounts to \$22.2 million, comprised of a \$20 million credit facility and \$2.2 million available on the bridge facility described below.

On October 17, 2006 the Operating Partnership amended the terms of the 160 day bridge financing facility that was obtained by this subsidiary on August 4, 2006. The facility has been changed from a "non-revolving" to a "revolving" facility. The Operating Partnership is able to repay and borrow the principal amount up to \$28.8 million without notice, bonus or penalty at any time and from time to time prior to maturity. There has been no change to the interest rate that is charged on the facility.

Management is in the process of establishing a syndicated revolving debt facility with a group of major Canadian banks. This facility will completely replace the current bridge facility and will provide additional capacity for future organic growth and strategic growth through acquisitions. A term sheet related to this new facility has been received and approved. As of the date of this MD&A, the syndication of the facility has not been finalized. Finalization of the facility is expected by the end of November.

For further information regarding financing arrangements, see the *Notes to the Interim Consolidated Financial Statements*.

UNITHOLDERS' CAPITAL AND UNIT TRADING ACTIVITY

BlackWatch Energy Services Trust Units trade on the Toronto Stock Exchange under the symbol BWT.UN. The Trust had 24.2 million Units outstanding at September 30, 2006 and, with the Unit price closing at \$9.10 on that date, the market capitalization of the Trust was approximately \$220 million.

BlackWatch Energy Services Trust - Trading Activity	99 days ended		
	September 30,	September	August
	2006	2006	2006
Unit price			
High	\$ 10.95	\$ 10.53	\$ 10.95
Low	\$ 8.75	\$ 8.75	\$ 10.06
Close	\$ 9.10	\$ 9.10	\$ 10.50
Volume of Trust units traded (millions)	2.7	0.3	2.4
Weighted average Trust units outstanding (millions)	24.1	24.1	24.1

Of the total 24.2 million units outstanding, a total of 17.6 million units are Class A Trust Units and 6.6 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, 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 Operating Partnership, one of the Trust's subsidiaries, issued Unit options ("options") as part of its long-term incentive plan for employees. There were a net of 1,905,200 options granted in the period with a weighted average exercise price of \$9.82 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 Operating Partnership issued a net of 37,979 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 Interim Consolidated Financial Statements* for more information on the accounting treatment and financial impact on the Initial period ended September 30, 2006.

DISTRIBUTIONS

A total of \$4.4 million in distributions were declared in the period and \$2.2 million was paid out to unitholders on September 15, 2006. When determining distributions, the Trust takes into account growth and maintenance capital requirements as well as debt repayment requirements.

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 September 30, 2006.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The Trust has various vehicle and equipment obligations under capital lease with interest rates ranging from 0% to 14.2%. The leases have expiry dates ranging from December 29, 2006 through to April 18, 2011. All high interest rate leases with reasonable termination costs are to be replaced prior to year-end. The total lease obligations amount to \$1.9 million with \$954,000 as the current portion. Principal and interest repayments on the capital lease obligations in each of the next five years are:

Year	(\$ thousands)
2007	954
2008	367
2009	349
2010	132
2011	84
	<u>1,886</u>

The Trust has \$3.5 million committed to future minimum payments under lease contracts for office and shop space and \$16.8 million committed to future capital expenditure contracts. The required future commitment payments are as follows:

Year	(\$ thousands)
2007	17,624
2008	781
2009	737
2010	687
2011	454
	<u>20,283</u>

FINANCIAL RISKS AND UNCERTAINTIES

Customer Dependence

The top five customers of the consolidated Trust accounted for approximately 56% 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 affect 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-collectability, Management ensures that adequate provisions have been provided for and that appropriate collection activity is undertaken. As at September 30, 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 September 30, 2006, there was approximately \$26.6 million outstanding on a bridge term facility which incurs interest at an average BA rate plus percentage. In addition, debt of approximately \$1.9 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

Management has designed disclosure controls and procedures to provide reasonable assurance that material information relating to the Trust, including its subsidiaries, is made known to the Chief Executive Officer and the Chief Financial Officer in an accurate and timely manner in order for the Trust to comply with its disclosure and financial reporting requirements and in order to safeguard its assets. Management has concluded that the Trust's disclosure controls and procedures are effective in providing reasonable assurance that material information is accumulated and disclosed accurately.

FOREIGN OWNERSHIP

Based on information from the statutory declarations by Unitholders, we estimate that, as of November 2, 2006, approximately 3% of our Unitholders are non-Canadian residents with the remaining 97% 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 September 30, 2006, reflects the first 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 Interim Consolidated Financial Statements*.

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.

2006 OUTLOOK

BlackWatch's fourth quarter 2006 outlook is cautiously optimistic. Drilling and service work that was deferred due to wet weather in September and part of October is expected to be completed during the remainder of 2006. Although downward pressure on natural gas prices during the period affected activity levels, BlackWatch recognizes this was due to unusually high storage volumes driven by a warm 2005/2006 winter. We expect that a normal North American winter will alleviate this situation. Gas prices have continued to rise over the past several weeks, to prior levels, as winter approaches. As a result, we anticipate a normal winter drilling season.

We expect to benefit from increased revenues and cash flow during the winter drilling season and beyond and we will continue to deploy new capital equipment during the final quarter of 2006 and the first quarter of 2007. In the months of November and December our Completion Services Division will take delivery of five new electric wireline trucks. A sixth truck is expected by the end of January 2007, expanding our fleet to twelve E-line trucks. Our Drilling Division will take delivery of its tenth rig by the end of November, in time for the winter drilling season. The new 3,200 meter deep pad rig will be completed by the end of the first quarter of 2007. The Coil Tubing division will take delivery of rigs 17 and 18 early in the fourth quarter. We also expect to increase our truck count in the Production Services Division and substantially increase the rental fleet in our newly established Rental and Leasing Division to meet expected demand in the upcoming drilling season.

BlackWatch utilized the slower period for repair and maintenance of its equipment to prepare for the winter drilling season. We believe the combination of our capital additions and our maintenance program places BlackWatch in a strong position to meet the demand for our services and provide our customers with a high level of assistance in achieving their operational objectives during the coming drilling season and beyond.

BlackWatch has also made excellent progress in consolidating the original entities that joined the Company in August. Our recruitment program is now complete with the recent addition of our Vice President of Operations, our General Sales Manager and two experienced sales professionals. With the foundation in place, we expect our ongoing efforts to create more value for our stakeholders as we realize on efficiencies, reduce costs and gain market share.

The Trust is reviewing its 2007 business plan and capital expenditure forecast. We will provide guidance to Unitholders on the results of this review in the near future.

BlackWatch management is confident of the long term outlook for the oil and gas industry in North America. The Company is well positioned to continue its growth and create value for its stakeholders, as recovery of activity levels occurs throughout 2007. BlackWatch is committed to its business plan and will continue to add capital equipment driven by market demand.

On October 31, 2006, the Canadian government announced its intention to amend the Income Tax Act (Canada) to apply a Distribution Tax on distributions from publicly traded income trusts. Under the proposal, 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. BlackWatch intends to proactively respond to the tax law amendments to support the interests of our unitholders and other stakeholders.

BlackWatch Energy Services Trust

Earl Connors
President & Chief Executive Officer

Units Listed – Symbol: BWT.UN

Toronto Stock Exchange

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