



2006  FINANCIAL STATEMENTS

Management's Responsibility for Financial Statements

The accompanying consolidated financial statements and all information in the Annual Report are the responsibility of Management. The consolidated financial statements have been prepared by Management in accordance with the accounting policies in the notes to financial statements. When necessary, Management has made informed judgments and estimates in accounting for transactions which were not complete at the balance sheet date. In the opinion of Management, the financial statements have been prepared within acceptable limits of materiality, and are in accordance with Canadian generally accepted accounting principles (GAAP) appropriate in the circumstances. The financial information elsewhere in the Annual Report has been reviewed to ensure consistency with that in the consolidated financial statements.

Management has prepared Management's Discussion and Analysis (MD&A). The MD&A is based upon BlackWatch Energy Services Trusts financial results prepared in accordance with Canadian GAAP.

Management maintains appropriate systems of internal control. Policies and procedures are designed to give reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records properly maintained to provide reliable information for the preparation of financial statements.

Deloitte & Touche LLP, an independent firm of Chartered Accountants, was engaged to audit the consolidated financial statements in accordance with Canadian generally accepted auditing standards and provide an independent professional opinion.

The Audit Committee of the Board of Directors of BlackWatch Energy Services Trust, which is comprised of three independent directors, has discussed the consolidated financial statements, including the notes thereto, with Management and external auditors. The consolidated financial statements have been approved by the Board of Directors on the recommendations of the Audit Committee.

Signed "Paul D. Partlo"
Paul D. Partlo
Vice President and CFO

Signed "Robert Copeland"
Robert Copeland
Vice President and COO

March 27, 2007



Deloitte & Touche LLP
3000, 700 Second
Street SW
Calgary, AB Canada T2P 0S7
Telephone: +1-403-267-1700
Facsimile +1-403-264-2871

Auditors' Report

To the Unitholders of
BlackWatch Energy Services Trust:

We have audited the consolidated balance sheet of **BlackWatch Energy Services Trust** as at December 31, 2006 and the consolidated statements of operations and deficit and cash flow for the initial period then ended. These financial statements are the responsibility of the Trust's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2006 and the results of its operations and its cash flows for the initial period then ended in accordance with Canadian generally accepted accounting principles.

March 16, 2007

Signed "Deloitte & Touche LLP"
Chartered Accountants



BlackWatch Energy Services Trust
Consolidated Balance Sheet
(\$ thousands)

	As at December 31, 2006
ASSETS	
Current Assets	
Cash and cash equivalents	\$ 3,958
Accounts receivable	18,602
Inventory (Note 4)	2,418
Prepaid expenses and deposits	513
	<hr/>
	25,491
Deferred finance charges (Note 8)	336
Long term advance receivable (Note 5)	1,310
Property, plant and equipment (Note 6)	88,155
Intangible assets (Note 7)	6,744
Goodwill (Note 7)	6,289
	<hr/>
	\$ 128,325
LIABILITIES	
Current Liabilities	
Accounts payable and accrued liabilities	\$ 11,587
Income taxes payable	3,094
Distributions payable (Note 13)	2,270
Current portion of long-term debt (Note 8)	95
Current portion of obligations under capital leases and finance contracts (Note 9)	782
	<hr/>
	17,828
Long-term debt (Note 8)	40,121
Obligations under capital leases and finance contracts (Note 9)	865
	<hr/>
	58,814
Basis of presentation (Note 1)	
Commitments (Note 17)	
Subsequent events (Note 21)	
UNITHOLDERS' EQUITY	
Trust units (Note 11)	243,439
Contributed surplus (Note 12)	190
Deficit	(174,118)
	<hr/>
	69,511
	<hr/>
	\$ 128,325
	<hr/>
<i>See accompanying notes to the consolidated financial statements</i>	

Approved by the board of directors:

Signed "Kevin A. Bennett"
Kevin A. Bennett
Director

Signed "David J. Rain"
David J. Rain
Director



BlackWatch Energy Services Trust
Consolidated Statement of Operations and Deficit
(\$ thousands except per unit amounts)

	Initial period ended December 31, 2006
Revenue	
Service	\$ 27,485
Product	783
Rental	929
	<hr/> 29,197
Expenses	
Operating expenses	24,906
Selling, general and administration	2,213
Depreciation and amortization (Notes 6 & 7)	6,366
Impairment of goodwill	148,385
Impairment of intangibles	7,844
Unit based compensation (Note 10)	447
Other interest and bank charges (Note 8)	1,017
Interest on long-term debt (Note 8)	937
	<hr/> 192,115
Loss before other items	(162,918)
Other income	277
Loss on disposal of equipment	(231)
Loss for the period	<hr/> (162,872)
Distributions for the period (Note 13)	(11,246)
Deficit, end of period	<hr/> <hr/> \$ (174,118)
Loss per unit - basic and diluted (Note 11)	\$ 8.92

See accompanying notes to the consolidated financial statements



BlackWatch Energy Services Trust
Consolidated Statement of Cash Flow
(\$ thousands)

	Initial period ended
	December 31, 2006
Operating Activities	
Loss for the period	\$ (162,872)
Items not requiring an outlay of cash:	
Depreciation and amortization	6,366
Impairment of goodwill	148,385
Impairment of intangibles	7,844
Deferred financing expense	28
Loss on disposal of equipment	231
	(18)
Change in non-cash working capital (Note 20)	1,271
	1,253
Financing Activities	
Issue of Trust units, net of issue costs	28,259
Repayment of capital leases	(861)
Repayment of shareholder loans	(4,752)
Repayment of long-term debt acquired	(25,341)
Increase in long-term debt	39,983
Distributions to unitholders	(8,976)
Financing charges	(364)
	27,948
Investing Activities	
Business acquisitions	(4,857)
Investment in long-term advance receivable	(1,310)
Purchase of property, plant and equipment	(19,504)
Proceeds on disposal of property, plant and equipment	428
	(25,243)
Increase in cash, representing cash and cash equivalents end of period	\$ 3,958
Supplementary cash flow information	
Interest paid	\$ 983
Income taxes paid	\$ -

See accompanying notes to the consolidated financial statements



1. Nature of operations and basis of presentation

BlackWatch Energy Services Trust (the “Trust” or “BlackWatch”) is an open-ended unincorporated investment trust governed by the laws of the province of Alberta and created pursuant to a Trust Indenture dated June 23, 2006. The Trust commenced operations on August 4, 2006. The Trust and its subsidiaries provide a range of services to its customers operating in the Western Canadian Sedimentary Basin. These services include drilling, electric wireline services, rig transportation and hauling, coil tubing well servicing, production services and oilfield equipment rentals and leasing.

On August 4, 2006, 14,449,649 trust units and 6,615,496 Exchangeable Units were issued on a private placement basis for the acquisition of the shares of Austin’s Transport (1990) Ltd., Strata Completions Limited, Ammonite Assets Inc., Caliber Energy Services Corp., Brantfords Consolidated Inc. and Brantfords Consolidated Ltd. The Exchangeable Units are Class B exchangeable limited partnership units of the Investment Partnership of BlackWatch Energy Services Limited Partnership, one of the subsidiaries of the Trust. Exchangeable Units are issued from time to time in accordance with the Investment Limited Partnership Agreement. These Units are convertible into Class A Trust units on a one for one basis.

On August 11, 2006, the Trust completed its Initial Public Offering (“IPO”) whereby 2,500,000 Trust units were issued at \$10 per Trust unit for gross proceeds of \$25,000,000.

On October 6, 2006, 402,688 trust units and 172,581 Exchangeable Units were issued on a private placement basis for the acquisition of all of the outstanding shares of 1044802 Alberta Limited and 1044793 Alberta Limited, which were the sole holders of all the equity of Elite Oilfield Services Partnership.

The beneficiaries of the trust are the holders of Trust units.

The Trust’s financial statements as at and for the initial period ended December 31, 2006, have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of operations. In the initial period ended December 31, 2006, the Trust did not have positive cash flow from operations before changes in non cash working capital 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. At December 31, 2006, the Trust had borrowed approximately \$40 million under its existing credit facility (*Note 8*). 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 throughout 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. 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.



2. Significant accounting policies

a) Use of estimates

The financial statements of the Trust have been prepared by Management in accordance with Canadian generally accepted accounting principles (GAAP). Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements involves the use of estimates and approximations based on information available as of the date of the disclosure of assets and liabilities and revenues and expenses for the period reported.

The most significant of these are the estimates used for amortization, goodwill and intangibles. Accordingly, actual results could differ from those estimates. The financial statements have, in Management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the Trust's accounting policies summarized below.

b) Principles of consolidation

These consolidated financial statements include the accounts of all of the subsidiaries of the Trust, including BlackWatch Energy Services Holding Trust, BlackWatch Energy Services Commercial Trust, BlackWatch Energy Services Limited Partnership, BlackWatch Energy Services Operating Corp., BlackWatch Energy Services Ltd. and BlackWatch Energy Services Operating Limited Partnership. All significant inter-entity transactions and balances have been eliminated upon consolidation.

c) Cash and cash equivalents

Cash and cash equivalents consist of cash on deposit and short-term interest bearing securities with maturities less than three months at the date of issue.

d) Inventory

Inventory values are recorded at cost and are valued at the lower of cost and net realizable value, based on a valuation analysis done at least annually. Cost is determined using the weighted average method.

e) Property, plant and equipment

Property, plant and equipment are recorded at cost. The table below details the depreciation rates that are applied against the various asset classes recorded by the Trust.

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.

The Trust performs impairment testing on its property, plant and equipment at least annually and whenever events or changes in circumstances indicate that the carrying value of an asset, or group of assets, may not be recoverable. Impairment is measured as the amount by which the asset's carrying value exceeds its fair value. Any impairment is included in earnings for the period as additional depreciation.

f) Goodwill and intangibles

Goodwill represents the excess of the purchase price of acquired businesses over the fair value of net tangible and identifiable intangible assets acquired and is not subject to amortization.

Intangibles with a limited life consist of employment contracts and customer lists, which are amortized using the straight line method over their expected useful lives of 3 years.

Goodwill is tested for impairment at least annually to determine if events or circumstances indicate the asset might be impaired. The impairment test includes the application of a fair value test, with an impairment loss recognized when the carrying value of goodwill exceeds its estimated fair value. Impairment provisions are not reversed if there is a subsequent increase in the fair value of goodwill.

Intangibles with a limited life are tested for impairment whenever events and circumstances are deemed to have caused a permanent decrease in value.

g) Revenue recognition

The Trust recognizes revenue from all fixed price construction contracts using the percentage of completion method which is measured by the percentage of cost incurred to date compared to estimated total cost for each contract.

The Trust recognizes revenue from oilfield hauling upon delivery of hauled product to the contracted destination for contracted services.

The Trust recognizes revenue on the sale of products when title and ownership are transferred upon delivery.

The Trust recognizes revenue for all other services when services are performed.

h) Income taxes

The Trust follows the liability method to account for income taxes. Under this method, future tax assets and liabilities are determined based on differences between the carrying value and the tax bases of assets and liabilities together with any loss carry forwards available for tax purposes, and are measured using the substantively enacted tax rates expected to be in effect when the differences are expected to reverse or the losses realized. Changes to these balances are recognized in net earnings in the period in which they occur. The amount of any future income tax assets recognized is limited to the amount that is more likely than not to be realized.

The Trust is a mutual fund trust for the purposes of the Canadian Income Tax Act and is taxable only on income that is not distributed to the Unitholders and on income from certain subsidiaries. Income tax obligations relating to distributions from the Trust are the obligations of the Unitholders.



i) Unit-based compensation

Participants in the plan have the option to either purchase the Units at the exercise price or to receive a cash payment equal to the excess of the market value over the exercise price. As a result, issued rights are considered to be stock appreciation rights (SAR) and are revalued at each period end date. The revaluation is calculated by computing the intrinsic value of the rights, which is done by taking the difference between the market value of the Units and the exercise price of the right at the period end date.

The Trust determines compensation expense for the Trust Unit Incentive Plan and the Unit Award Incentive plan (*Note 10*) recognizing the intrinsic value in income and liabilities over the vesting period. After the rights have vested, further changes in the intrinsic value are recognized in income and liabilities in the period of change. As the expense is determined based on the period end price, large fluctuations, even recoveries, in compensation expense may occur. As the rights are exercised, cash payments are reflected against the liability previously recorded and any unit issuances are reflected as increases to Unitholders' capital.

Under the terms of the unit incentive plan, the exercise price of rights granted may be reduced in future periods based on the distributions made to Trust Unitholders.

j) Earnings per unit

Basic earnings per Trust unit are calculated using the weighted average number of Trust units and Exchangeable Units outstanding during the period. Diluted per unit amounts reflect the dilutive effect of options and unit awards outstanding. Diluted earnings per unit is calculated using the treasury stock method, which assumes that any proceeds obtained on exercise of options and unit awards would be used to purchase Trust units at the average market price during the periods. The weighted average number of Trust units outstanding is then increased by this change.

k) Recent accounting pronouncements

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.

3. Business acquisitions

a) 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. ("BCI") and Brantfords Consolidated Ltd ("BCL"). 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 date of acquisition.



BlackWatch Energy Services Trust
Notes to the Consolidated Financial Statements
As at and for the initial period ended December 31, 2006

The total purchase consideration was 14,449,649 Trust units valued at \$144.5 million and 6,615,496 Exchangeable Units valued at \$66.2 million less the cash acquired of \$70,000 for a total purchase consideration of \$210.6 million.

A summary of the allocation of the purchase price based on the fair value of the net assets acquired and the liabilities assumed follows:

(\$ thousands)	Strata	Caliber	Ammonite	BCI	BCL	Austins	Totals
Net working capital acquired	\$ 610	\$ 2,911	\$ 607	\$ 1,079	\$ 567	\$ 2,800	\$ 8,574
Property, plant and equipment	5,015	12,009	28,979	6,507	5,230	10,300	68,040
Intangible assets	552	2,086	4,491	1,685	1,749	4,426	14,989
Debt assumed, including current portion	(3,305)	(8,790)	(12,491)	(4)	(751)	-	(25,341)
Obligations under capital leases	(40)	-	(52)	(976)	(852)	(15)	(1,935)
Due to related parties	-	(825)	-	-	-	(3,927)	(4,752)
Goodwill	9,115	26,202	58,875	20,969	11,069	24,776	151,006
Fair value of net asset acquired	\$ 11,947	\$ 33,593	\$ 80,409	\$ 29,260	\$ 17,012	\$ 38,360	\$ 210,581
Purchase Price Paid:							
Cash ¹	\$ (149)	\$ (389)	\$ (194)	\$ 650	\$ 238	\$ (226)	\$ (70)
Trust units	8,467	20,828	56,422	20,027	11,742	27,010	144,496
Exchangeable Units	3,629	13,154	24,181	8,583	5,032	11,576	66,155
Purchase Consideration:	\$ 11,947	\$ 33,593	\$ 80,409	\$ 29,260	\$ 17,012	\$ 38,360	\$ 210,581

¹ Cash acquired as part of the working capital of the acquired companies.

b) On October 6, 2006, the Trust acquired 100% of the issued and outstanding common shares of the following private companies: 1044802 Alberta Limited (“1044802”) and 1044793 Alberta Limited (“1044793”) known collectively as “Elite”. 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 date of acquisition.

The total purchase consideration was 402,688 Trust units valued at \$3.3 million and 172,581 Exchangeable Units valued at \$1.4 million as well as cash of \$5 million for a total purchase consideration of \$9.7 million.

A summary of the allocation of the purchase price based on the fair value of the net assets acquired and the liabilities assumed follows:

(\$ thousands)	1044802	1044793	Totals
Net working capital acquired	\$ (170)	\$ (281)	\$ (451)
Property, plant and equipment	2,449	2,449	4,898
Intangible assets	917	917	1,834
Debt assumed, including current portion	(117)	(116)	(233)
Goodwill	1,834	1,834	3,668
Fair value of net asset acquired	\$ 4,913	\$ 4,803	\$ 9,716
Purchase Price Paid:			
Cash ¹	\$ 2,491	\$ 2,435	\$ 4,926
Trust Units	1,670	1,632	3,302
Exchangeable Units	716	700	1,416
Transaction Costs	36	36	72
Purchase Consideration:	\$ 4,913	\$ 4,803	\$ 9,716

¹ Cash paid less cash acquired as part of working capital of the acquired companies.



BlackWatch Energy Services Trust
Notes to the Consolidated Financial Statements
As at and for the initial period ended December 31, 2006

The above purchase price allocations are preliminary and have been allocated based upon a preliminary evaluation of the fair value of the assets acquired and liabilities assumed. The purchase price allocations will remain preliminary until the Trust completes a final evaluation of the fair value of the assets acquired and liabilities assumed.

The Trust has allocated goodwill acquired in the above acquisitions to each of its divisional segments described in *Note 14* as follows:

(\$ thousands)	Coil Tubing	Completion Services	Transport	Drilling	Production Services	Rental & Leasing	Corporate	Total
Goodwill	26,202	9,115	24,776	58,875	32,038	3,668	-	154,674

4. Inventory

Inventory of \$2.4 million is comprised of coil tubing held for resale. Coil tubing is sold as a by-product of coil tubing services that are performed or as a stand alone product sale.

5. Long term advance receivable

This advance receivable of \$1.3 million represents advances made to related parties during 2006. The related company is controlled by two senior employees of the Trust. These advances were made to facilitate the commencement of a business venture with the related party, which was structured as a partnership arrangement. The Trust injected cash funds of \$1 million and property, plant and equipment with a fair value of \$300,000 in anticipation of finalizing the partnership agreement prior to December 31, 2006. As at March 16, 2007, this agreement has not been finalized and as such the entire amount has been reflected as an advance receivable. Subsequent to December 31, 2006, one of the employees involved with the venture has terminated their employee relationship with the Trust. As such, it is expected that the full amount of the advance will either be repaid or settled via the return of equipment acquired using these funds. If amounts are not recovered, the realized loss, if any, will be recorded in the period of settlement.

6. Property, plant and equipment

(\$ thousands)	Cost	Accumulated Depreciation	Net book value December 31, 2006
Drilling rigs	\$ 29,856	\$ (418)	\$ 29,438
Coil tubing stands	411	(30)	381
Field service equipment	32,387	(1,799)	30,588
Shop tools and equipment	1,526	(118)	1,408
Computer equipment	542	(61)	481
Vehicles	13,312	(1,519)	11,793
Furniture and fixtures	357	(17)	340
Buildings	581	(8)	573
Rental and leasing equipment	4,572	(159)	4,413
Leaseholds	37	(2)	35
	\$ 83,581	\$ (4,131)	\$ 79,450
Land	258	-	258
Assets under construction	8,447	-	8,447
	\$ 92,286	\$ (4,131)	\$ 88,155



At December 31, 2006, \$2.9 million of equipment is under capital leases for which \$100,000 of accumulated depreciation was recognized (*Note 9*). These capital assets are included in the appropriate property, plant and equipment assets class and depreciated based on the specified rate for that asset class.

7. Goodwill and intangible assets

(\$ thousands)	Cost	Impairment Write-down	Net book value December 31, 2006
Goodwill	\$ 154,674	\$ (148,385)	\$ 6,289

(\$ thousands)	Cost	Accumulated Amortization	Impairment Write-down	Net book value December 31, 2006
Customer lists	\$ 14,263	\$ (1,942)	\$ (7,844)	\$ 4,477
Employee contracts	2,560	(293)	-	2,267
	\$ 16,823	\$ (2,235)	\$ (7,844)	\$ 6,744

During the period, Management determined that goodwill and intangibles were impaired as the estimated future cash flows are unable to support the value of these assets. Cash flows have decreased due to the fact that demand for equipment has dropped significantly and as a result the Trust has revised future forecasted results. As well in the period there has been a change in market fair value multiples for trusts due to recently announced trust taxation laws, which has led to a decreased enterprise value of the Trust. In the period, impairment for goodwill and intangibles of \$148 million and \$7.8 million, respectively, has been recorded. Detailed segmented information of the goodwill and intangible impairment recorded in the period by the Trust is disclosed in the table presented in *Note 14*.

8. Long-term debt

(\$ thousands)	December 31, 2006
Credit Facilities ⁽ⁱ⁾	\$ 40,000
Term debt acquired ⁽ⁱⁱ⁾	\$ 216
	\$ 40,216
Less: current portion of long-term debt	\$ 95
Long-term debt	\$ 40,121

(i) Credit Facilities

During the period, the Trust had three operating facilities. At December 31, 2006, the only existing facility remaining is the one described in paragraph c) below.

a) The initial operating facility that the Trust entered into was with Roynat Capital and was a 160-day bridge financing facility and is authorized to \$28.8 million. The facility was obtained on August 4, 2006, and was secured via a first charge right on all fixed assets and a first floating charge on all other assets of the Trust and its subsidiary entities. The interest rate charged on the facility was 3.125% plus the BA rate for the applicable period and interest was payable on the 15th day of each month. The Trust incurred financing fees of \$325,000 related to this credit facility, which were expensed in the period.



On October 17, 2006, the Trust amended the terms of this facility by converting it from a non-revolving to a revolving facility. The Trust was able to repay and borrow the principal amount without notice, bonus or penalty at any time prior to maturity. The facility was repaid in full on December 19, 2006, when the operating line noted in paragraph c) below was obtained.

b) The second operating facility the Trust entered into was a demand revolving credit facility with a Canadian chartered bank and is authorized to \$20 million. The facility was obtained on August 4, 2006, and was secured via a priority agreement between the Canadian chartered bank and Roynat Capital, which provided the bank with a first charge priority on all accounts receivable of the Trust and a second charge over all other assets. Interest was payable monthly and interest rates fluctuated based on a pricing grid that ranged from bank prime plus .25% to bank prime plus 1.375%, depending upon the Trust's funded debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") ratio. The Trust incurred financing fees of \$70,000 in relation to this credit facility which were expensed in the period. The facility was repaid in full on December 19, 2006, when the operating line noted in paragraph c) below was obtained.

c) The third operating facility entered into by the Trust is a 364-day syndicated revolving credit facility with three Canadian chartered banks effective December 19, 2006. Once the 364-day period has passed and if the facility is not renewed, the facility will term out over a three year period. The authorized borrowing amount under this facility is \$80 million, of which \$40 million was drawn as at December 31, 2006. Interest is payable monthly for borrowings through direct advances. Interest rates fluctuate based on a pricing grid and the type of drawing that is made by the Trust. For prime rate loans and U.S dollar loans, the interest rates range from bank prime plus .5% to bank prime plus 1.625%, depending upon the Trust's Funded Debt to EBITDA ratio. Under the credit facility, borrowings through the use of Bankers' Acceptances, LIBOR loans and standby letters of credit with maturities of 30 to 180 days are also available. Interest rates fluctuate based on the same pricing grid as documented above and range from the base rate of the debt obtained plus 2% to 3.125%. Security for the operating line is provided by a priority agreement that states that, subject only to permitted liens which have priority by operation of law, the obligations and the lender risk management obligations shall rank as the most senior secured debt of the borrower and guarantors.

The facility has a number of required financial covenants. As at December 31, 2006, the Trust was in full compliance of all financial covenants:

- (a) The ratio of Consolidated Current Assets to Consolidated Current Liabilities is not less than 1.25:1;
- (b) The Consolidated funded debt to EBITDA Ratio is not more than 2.00:1, calculated on a rolling four quarter basis at the end of the most recent Fiscal Quarter.
- (c) The Consolidated Debt Service Coverage Ratio is not at any time less than 1.25:1, calculated on a rolling four quarter basis at the end of the most recent Fiscal Quarter;
- (d) The ratio of consolidated Total Debt to capitalization is not greater than 0.50:1, measured as at the end of the most recent Fiscal Quarter.

The Trust's Management does not believe that the Trust will continue to be in compliance with the existing covenants throughout 2007. The Trust is currently renegotiating the covenants on the facility with its creditor and believes that it has the continued support of its creditor. Any negotiated adjustments to the existing covenants may also result in a reduction of the maximum borrowing limit on the facility.

The Trust incurred financing fees of \$364,000 in relation to this credit facility of which \$28,000 was expensed in the period and the remainder of \$336,000 was recorded as a deferred charge and will be expensed evenly over the next operating cycle of the Trust.



Other interest and banking charges are comprised of commitment fees incurred for the Trust's bridge debt financing and termination fees related to the early payout of credit facilities within the acquired companies that are detailed in *Note 3*.

(ii) Term debt acquired

As part of the acquisition of 1044802 and 1044793 (*Note 3*), two term loans were acquired. The first term loan was entered into on August 24, 2006, in the amount of \$150,000. Principal of \$4,334 is payable in equal installments over a period of 36 months. The interest charged on this term loan is prime plus 2% and is also payable monthly. The loan is secured by a truck with a net book value of \$215,591 and the outstanding principal amount of this term loan was \$137,499 as at December 31, 2006 of which \$50,000 has been classified as current.

The second term loan was entered into on September 1, 2005 in the amount of \$135,000. Principal of \$3,750 is payable in equal installments over a period of 36 months. The interest charged on this term loan is prime plus 2% and is also payable monthly. The loan is secured by a truck and a trailer with a net book value of \$185,835 and \$26,415 respectively. The outstanding principal amount of this term loan was \$78,750 as at December 31, 2006 of which \$45,000 has been classified as current.

All interest incurred on the current portion of long-term debt has been recorded by the Trust as long-term due to fact that the amount is immaterial.

9. Obligation under capital and financing agreements

During the period and through the acquisition of businesses detailed in *Note 3*, the Trust has entered into certain capital lease and finance contracts relating to specific assets. These contracts have varying expiry dates ranging from September 2007 to June 2011 and various monthly payments that are required that range from \$1,098 to \$44,000 per month. In addition, the contracts have varying interest rates that range from non-interest bearing to 14.2%. As at December 31, 2006 the principal and interest repayments on obligations under capital and financing agreements in each of the next five years required are:

(\$ thousands)			
Year	Total	Interest	Net
2007	\$ 869	\$ (87)	\$ 782
2008	438	(59)	379
2009	334	(31)	303
2010	147	(12)	135
2011	49	(1)	48
	\$ 1,837	\$ (190)	\$ 1,647



10. Employee unit incentive plans

a) Trust Unit Option Plan

The Trust Unit Option Plan provides that the maximum number of Trust units reserved for issuance from time to time pursuant to the rights granted and outstanding thereunder at any time shall not exceed a number of Trust units equal to 10% of the aggregate number of (i) issued and outstanding Trust units; plus (ii) the number of trust Units issuable upon exchange or conversion of outstanding exchangeable securities for a total of 2.5 million reserved rights. The Trust unit options are granted to employees with an exercise price equal to ten dollars or greater if the market price exceeds ten dollars on the date of grant and the maximum term of each option is 5 years. The Trust Unit options vest equally over four years commencing on the first anniversary of the grant date. The exercise price of Trust Unit options granted are reduced by an amount up to the amount of cash distributions made on the Trust Units subsequent to the date of grant of the respective Trust Unit option, provided the Trust's net operating cash flow for the month exceeds 0.833% of the Trust's recorded cost of capital assets less all debt, working capital deficiency (surplus) or debt equivalent instruments, depletion, depreciation and amortization charges, asset retirement obligations and any future income tax liability associated with such capital assets at the end of the month.

As at December 31, 2006, a total of 2,160,700 Trust unit options were outstanding under the Trust Unit Option Plan at an average exercise price of \$9.58.

The following summarizes the Trust units reserved for issuance under the Trust Unit Option Plan.

	Period ended December 31, 2006	
(thousands)	Options Outstanding	Weighted Average Exercise Price
Trust unit options outstanding as at August 4, 2006	-	\$ -
Granted	2,291	9.58
Exercised	-	-
Forfeited	(130)	9.54
Trust unit options outstanding as at December 31, 2006	2,161	\$ 9.58
Trust unit options exercisable at December 31, 2006	-	
Range of exercise prices (per unit)	\$9.54 - \$10.16	
Weighted average remaining contractual life (years)	4.61 - 4.94	

The Trust recorded unit-based compensation expense in respect of Trust unit options of \$nil for the initial period. No expense has been recorded as the weighted average exercise price of \$9.58 is greater than the December 31, 2006, closing price of Trust Units of \$6.09.



b) Unit Award Incentive Plan

As at December 31, 2006, a total of 29,880 awards (“Unit Awards”) were outstanding under the Unit Award Incentive Plan. The Unit Award Incentive Plan provides for the issuance of up to 0.5% of the aggregate number of issued and outstanding Trust units; plus the number of Trust Units issuable upon exchange or conversion of outstanding Exchangeable Units for a total of 100,000 reserved rights. Unit Awards vest annually over a four year period and upon vesting, entitle the holder to receive the number of Trust units subject to the award or the equivalent cash amount. The number of Trust units to be issued is adjusted at each distribution date for an amount approximately equal to the foregone distribution. The fair value associated with the Trust units granted under the Unit Award Incentive Plan is expensed in the statement of operations and deficit over the vesting period.

The following summarizes the Trust Units reserved for issuance under the Unit Award Incentive Plan.

Period ended December 31, 2006	
	Awards Outstanding (thousands)
Outstanding, beginning of period	-
Granted	41
Exercised	-
Cancelled	(13)
Outstanding, end of period	28
Adjusted for distributions	2
Total Trust Units issuable for Unit Awards	30

For the period ended December 31, 2006, the Trust recorded an expense and an accrued liability for the estimated cost associated with the Unit Award Incentive Plan of \$79,000. The expense includes the amount attributable to the 1,880 units that were adjusted for foregone distributions on the basis of the fair value of the units on the relevant distribution record date.

During the period an additional unit based expense in the amount of \$368,000 has been recorded. This amount relates to a receivable that was acquired in the purchase of Caliber. The receivable was for amounts owed by employees of Caliber for warrants that were issued by Caliber and vested on the date of acquisition of Caliber by the Trust. Upon acquisition, these warrants were then converted into Trust units and Exchangeable Units. The Trust has assessed the collectability of the receivable and has determined that it is uncertain and as a result an allowance has been provided for the entire receivable amount.



11. Trust units

Authorized:

An unlimited number of Class A Trust Units, Class B Exchangeable Units and Special Voting units. Special Voting Units shall not be entitled to any interest or share in the distributions or net assets of the Trust and shall be issued in conjunction with Exchangeable Units of the Investment Partnership.

Trust Units ¹		
(thousands)	Units	Amount
Units issued in the period	3,160,100	\$ 31,601
Consideration for acquisitions (Note 3)	14,852,337	147,799
Trust units returned to treasury (Note 12)	(13,274)	(132)
Conversion of Exchangeable Units	35,308	353
Unit issue costs	-	(3,341)
Balance, end of period	18,034,471	\$ 176,280
Exchangeable Units ²		
(thousands)	Units	Amount
Consideration for acquisitions (Note 3)	6,788,077	\$ 67,570
Exchangeable Units returned to treasury (Note 12)	(5,831)	(58)
Conversion of Exchangeable Units	(35,308)	(353)
Unit issue costs	-	-
Balance, end of period	6,746,938	67,159
Total units outstanding	24,781,409	\$ 243,439

¹Of the total Trust Units that were issued, 5,701,467 are escrowed and will be released one half on August 4, 2007, and one half on August 4, 2008.

²The Exchangeable Units are exchangeable into Trust units on a one to one basis at any time at the option of the holder. Of the Exchangeable Units that were issued, 2,628,332 of these units are escrowed and will be released and allowed to trade as to one half on August 4, 2007, and one half on August 4, 2008. The Exchangeable Units are entitled to receive the same distributions as the Trust units. The Exchangeable Units are not freely traded securities and must be converted to Trust units prior to trading.

The basic and diluted weighted average number of Trust units used in the calculation of loss per share for the period is 18.3 million. The following summarizes the calculation of the denominator for basic and dilutive weighted average shares:

(thousands)	For the period ended December 31, 2006
Numerator:	
Loss for the period	\$ (231)
Denominator:	
Weighted average units for basic net loss	18,253
Trust options convertible to Trust units	-
Unit awards convertible to Trust units	30
Weighted average Trust units for diluted net earnings	18,283



For the calculation of the weighted average number of diluted Trust units outstanding for 2006, 30,000 Unit Awards were excluded, as they were anti-dilutive and 2,161,000 Trust unit options were excluded as they were determined to not be dilutive (*Note 10*).

12. Contributed surplus

Contributed surplus of \$190,000 has been recorded in the current period. Employees of one of the acquired companies were granted warrants by virtue of their relation to the acquired company. These warrants were convertible into shares of the acquired company and therefore were exchangeable, upon receipt of payment of the exercise price, into Trust units and Exchangeable Units on the completion of the acquisition on August 4, 2006 (*Note 3*). Subsequent to the completion of the acquisition, certain employees chose not to exercise their rights to the Trust units and Exchangeable Units and this capital was cancelled and returned to Treasury. Due to the fact that the acquisition was successfully completed and no monies are owed to said employees, treatment of these forfeited assets is recorded as contributed surplus. The value of the units returned to treasury is detailed in *Note 11*.

13. Cash distributions

The Trust declared monthly distributions of cash to Unitholders and Exchangeable Unitholders of record as at the close of business on each distribution record date. During the period, the Trust paid distributions to its Unitholders and Exchangeable Unitholders as follows:

(\$ thousands, except per Unit amounts)				
Distribution Period	Distribution Record		Per Unit	Total
	Date	Date of Distribution		
August 11 to August 31	August 31, 2006	September 15, 2006	\$0.0916	\$2,219
September 1 to September 30	September 29, 2006	October 16, 2006	0.0916	2,217
October 1 to October 31	October 31, 2006	November 15, 2006	0.0916	2,270
November 1 to November 30	November 30, 2006	December 15, 2006	0.0916	2,270
December 1 to December 31	December 31, 2006	January 15, 2007	0.0916	2,270
Total distributions during period			\$0.46	\$11,246
Accumulated distributions, end of period				\$11,246

14. Segmented information

The Trust operates in six main industry segments which are in one geographic region as well as its general corporate segment. Management has identified reportable segments based on the type of service and the equipment that is used to perform the service. Revenue is generated in the identifiable segments from the following services:

Coil Tubing – perforating, cleaning, logging, stimulation and the installation of production and instrumentation strings. In addition Coil Tubing also has product sales made up of sales of tubing.

Completion Services – cased-hole logging, cement bond logging, fracturing, tube-conveyed fracturing, and other well completion and abandonment services.

Transport – rig relocation and general oil and gas hauling.

Drilling – contract drilling services.

Production Services – pipeline and facility construction, swab rig services, crude oil and water hauling, vacuum units, steamers, hot-oilers and high pressure washers.

Rental and Leasing - oilfield equipment rental and leasing services.

Corporate – provides support services for each of the Divisions in areas such as legal, operational, regulatory and financial reporting.



BlackWatch Energy Services Trust
Notes to the Consolidated Financial Statements
As at and for the initial period ended December 31, 2006

(\$ thousands)	Coil Completion		Production			Rentals/		Total
	Tubing	Services	Transport	Drilling	Services	Leasing	Corporate	
Revenue	\$ 3,464	\$ 2,816	\$ 3,609	\$ 6,019	\$ 12,044	\$ 1,245	\$ -	\$ 29,197
Operating expenses	3,521	2,218	2,657	5,420	10,133	957	-	24,906
Depreciation	1,111	414	1,796	1,202	1,404	412	27	6,366
Impairment of goodwill	26,202	6,494	24,776	58,875	32,038	-	-	148,385
Impairment of intangibles	375	-	2,186	3,912	960	411	-	7,844
Interest on long term debt	-	-	1	-	23	4	909	937
Other interest	72	132	3	328	69	-	413	1,017
Loss	(28,222)	(6,442)	(27,808)	(63,656)	(32,569)	(567)	(3,608)	(162,872)
Capital purchases	2,411	5,530	3	6,686	3,040	1,360	474	19,504
Goodwill	-	2,620	-	-	-	3,669	-	6,289
Total assets	21,344	14,834	12,633	39,721	24,760	12,191	2,842	128,325
NBV of intangibles	1,421	475	1,626	-	1,952	1,270	-	6,744
NBV of property, plant and equipment	13,592	10,207	9,122	34,702	14,144	5,941	447	88,155

15. Income taxes

The Trust is a taxable entity under the Income Tax Act (Canada) and is taxable only on earnings that are not distributed to Unitholders. The Trust does not record future income taxes as it 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 distribution 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.

16. Financial instruments

Fair Values

Financial instruments of the Trust consist of cash and cash equivalents, accounts receivable, income taxes recoverable, accounts payable and accrued liabilities, income taxes payable, distributions payable, obligations under capital lease and finance contracts and long-term debt.



The net carrying value of accounts receivable, net of the allowance for doubtful accounts, and income taxes recoverable, approximates fair value due to the short-term nature of these instruments.

The carrying value of accounts payable and accrued liabilities, income taxes payable and distributions payable approximates the fair value of these financial instruments due to their short-term nature. The carrying value of long-term debt approximates its fair as the revolving credit facility attracts rates that change with the prime lending rate.

Credit risk and credit concentration

A significant portion of the Trust’s revenues and trade accounts receivable are from the oil and gas industry and, as such, the Trust is exposed to many of the risks associated with that industry.

The majority of the Trust’s accounts receivable are due from entities in the oil and gas industry and are subject to normal industry credit risk. Concentration of credit risk is mitigated by having concentrations with credit worthy clients and a focus to continue to broaden the customer base. The Trust’s largest customer accounts for 18% and the Trust’s largest five customer’s account for 52% of operating revenue for the period ended December 31, 2006. In addition, as at December 31, 2006, the five largest accounts receivable balances account for 47% of all receivables and two customers have balances in excess of 10% of the total balance. These customers have outstanding balances of 17% and 11% of total accounts receivable.

Interest rate risk

The Trust is exposed to fluctuations in interest rates on its long-term debt. The Trust will be exposed to higher interest costs if the average prime rate should increase.

17. Commitments

The Trust is committed to future minimum payments under operating lease contracts for equipment, vehicles, office and shop space of \$4.3 million and future capital expenditures of \$4.4 million.

The required future commitment payments as at December 31, 2006 are as follows:

18. Related party transactions

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

During the period, the Trust incurred expenses of \$211,000 relating to the rental of land, buildings and equipment owned by certain officers who are also Unitholders of the Trust. In addition, the Trust has incurred expenses of \$25,000 in the normal course of business related to accounting services performed by principals and officers of the Trust. The Trust has incurred legal fees with a legal firm in which one of the Trusts directors is a partner in the amount of \$930,000. These fees relate to work completed for the initial public offering and general corporate matters. Of these fees \$876,000 is included in accounts payable as at December 31, 2006, the entire accounts payable balance has subsequently been paid by the Trust. The Trust has advanced funds to a company that is controlled by certain senior employees of the trust refer to *Note 5* for a description of this transaction. All transactions with related parties during the period have been recorded at exchange amounts.



19. Seasonality of operations

The Trusts operations are carried out exclusively in western Canada. The industry's ability to move heavy equipment in exploration and production areas is dependent on weather conditions. With the onset of spring, melting snow together with frost coming out of the ground render many secondary roadways incapable of supporting heavy equipment until sufficient time has passed for them to dry. In addition, the exploration areas in northern Canada are typically only accessible during winter months, when the surface is frozen enough to support the heavy equipment. As a result, the activity levels of the Company are directly impacted by weather, whereby activity is traditionally higher in the first and fourth quarters of the year and lower in the second and third quarters.

20. Supplementary information related to the statements of Cash Flows

(\$ thousands)		December 31, 2006
Changes in non-cash working capital relate to operating activities		
Accounts receivable	\$	(18,602)
Inventory		(2,418)
Prepaid expenses and deposits		(513)
Accounts payable and accrued liabilities		11,140
Accrued stock option expense liability		447
Income taxes payable		3,094
	\$	(6,852)
Less: Non cash working capital acquired ¹		8,123
	\$	1,271
¹ Non cash working capital acquired consists of the following balances:		
Accounts receivable	\$	19,617
Prepaid expenses and deposits		725
Inventory		1,348
Other assets		813
Income taxes payable		(3,401)
Accounts payable and accrued liabilities		(10,979)
	\$	8,123

(\$ thousands)		December 31, 2006
Financing Activities		
Deferred finance charges	\$	364
Less: amount expensed in the period as part of G&A		(28)
	\$	336

The Trust acquired \$1.9 million of capital lease obligations in the acquisitions explained in *Note 3*. In addition \$600,000 of non cash capital leases of acquired equipment has been recorded by the Trust as of December 31, 2006.

21. Subsequent events

On February 19, 2007, the Trust announced that effective immediately it would be suspending monthly distributions to unit holders until further notice.

On March 6, 2007, the Trust announced the resignation of its President, Chief Executive Officer and Director.

On March 9, 2007, the Trust repaid in full the entire outstanding balance of the long-term debt acquired in *Note 8 (ii)*.