



MANAGEMENT'S REPORT

TO THE UNITHOLDERS OF DEEPWELL ENERGY SERVICES TRUST

The audited consolidated financial statements of Deepwell Energy Services Trust and all information contained in this annual report for the period from April 27, 2006 to December 31, 2006 have been prepared by management. It is management's responsibility to ensure that sound judgement, appropriate accounting principles and methods, and reasonable estimates have been used in the preparation of this information. Management also ensures that all information presented is consistent.

Management is also responsible for developing internal controls over the financial reporting process. Management believes the system of internal controls, review procedures and established policies provides reasonable assurance as to the reliability and relevance of the financial reports. Management also believes that the Trust's operations are conducted in conformity with the law and with a high standard of business conduct.

The Board of Trustees is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control. The Board carries out this responsibility principally through the Audit Committee of its administrator. The Committee, which consists of non-management members, reviews the financial statements and annual report, and recommends them to the Board for approval. The Committee meets with management and external auditors to discuss internal controls, auditing matters and financial reporting issues. External auditors have full and unrestricted access to the Audit Committee. The Committee also recommends a firm of external auditors to be appointed by the Unitholders.

(signed) "Robert Dodds"

Robert Dodds, President and CEO
Deepwell Energy Services Trust
Calgary, Alberta
March 30, 2007



AUDITORS' REPORT

TO THE UNITHOLDERS OF DEEPWELL ENERGY SERVICES TRUST

We have audited the consolidated balance sheet of Deepwell Energy Services Trust as at December 31, 2006 and the consolidated statements of income and accumulated earnings (deficit), and cash flows for the period from April 27, 2006 to December 31, 2006. 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 cash flows for the period from April 27, 2006 to December 31, 2006 in accordance with Canadian generally accepted accounting principles.

(signed) "Grant Thornton LLP"

Chartered Accountants
Calgary, Canada
March 30, 2007

CONSOLIDATED BALANCE SHEET

| December 31, | 2006 |
|--|---------------------|
| Assets | |
| Current assets: | |
| Cash | \$ 28,861 |
| Accounts receivable | 2,729,106 |
| Inventory | 80,205 |
| Prepaid expenses and deposits | 242,990 |
| | <hr/> 3,081,162 |
| Property and equipment (Note 4) | 39,565,606 |
| Intangible assets (Note 5) | 3,254,037 |
| Goodwill (Note 3) | 7,157,402 |
| Financial security deposits | 1,433,474 |
| | <hr/> \$ 54,491,681 |
| Liabilities | |
| Current liabilities: | |
| Accounts payable and accrued liabilities | \$ 3,538,986 |
| Distributions payable | 417,305 |
| | <hr/> 3,956,291 |
| Long-term debt (Note 8) | 11,500,000 |
| Future income taxes (Note 7) | 87,201 |
| Asset retirement obligations (Note 9) | 713,744 |
| | <hr/> 16,257,236 |
| Unitholders' Equity | |
| Trust units (Note 6) | 40,490,377 |
| Contributed surplus (Note 6) | 251,432 |
| Deficit | (2,507,364) |
| | <hr/> 38,234,445 |
| Commitments (Note 12) | |
| | <hr/> \$ 54,491,681 |

See accompanying notes to consolidated financial statements.

On behalf of the Board of Trustees:

(signed) "Murray W. Montgomery"

Murray W. Montgomery, Trustee

(signed) "Jay B. Simmons"

Jay B. Simmons, Trustee

CONSOLIDATED STATEMENT OF INCOME AND ACCUMULATED EARNINGS (DEFICIT)

| For the period from April 27 to December 31, | 2006 |
|--|-----------------------|
| Revenues | \$ 9,647,020 |
| Expenses | |
| Operating | 4,594,714 |
| Selling and administrative | 1,409,031 |
| Depreciation and accretion | 1,911,783 |
| Amortization of intangible assets (Note 5) | 218,963 |
| Unit-based compensation | 251,432 |
| Interest on short-term debt (Note 8) | 18,365 |
| Interest on long-term debt (Note 8) | 341,375 |
| Amortization of deferred financing costs | 55,832 |
| Loss on sale of property and equipment | 34,295 |
| | 8,835,790 |
| Income before taxes | 811,230 |
| Future income tax recovery (Note 7) | (47,799) |
| Net income | 859,029 |
| Distributions to unitholders | (3,366,393) |
| Accumulated earnings (deficit), end of period | \$ (2,507,364) |
| Net income per trust unit: | |
| Basic | \$ 0.20 |
| Diluted | \$ 0.20 |
| Weighted average number of trust units outstanding: | |
| Basic | 4,356,000 |
| Diluted | 4,357,187 |

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

| For the period from April 27 to December 31, | 2006 |
|--|---------------------|
| Operating activities | |
| Net income | \$ 859,029 |
| Non-cash items: | |
| Depreciation and accretion | 1,911,783 |
| Amortization of deferred financing costs | 55,832 |
| Amortization of intangibles | 218,963 |
| Future income tax recovery (Note 7) | (47,799) |
| Unit-based compensation | 251,432 |
| Loss on sale of property and equipment | 34,295 |
| Change in non-cash working capital | 575,718 |
| Cash flow from operating activities | 3,859,253 |
| Investing activities | |
| Financial security deposits | (1,408,120) |
| Business acquisitions (net of cash of \$259,925) | (42,792,931) |
| Purchase of property and equipment | (6,808,996) |
| Proceeds on sale of property and equipment | 55,500 |
| Change in non-cash investing working capital | 1,738,578 |
| Cash flow from investing activities | (49,215,969) |
| Financing activities | |
| Net proceeds from issuance of units | 36,930,377 |
| Net proceeds from long-term debt | 11,404,288 |
| Distributions to unitholders | (2,949,088) |
| Cash flow from financing activities | 45,385,577 |
| Change in cash | 28,861 |
| Cash, end of period | \$ 28,861 |
| Supplementary Information | |
| Cash interest paid | \$ 359,740 |

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the period from April 27, 2006 to December 31, 2006

1. Nature of the organization

Deepwell Energy Services Trust (the "Trust" or "Deepwell") is an open-ended unincorporated investment trust governed by the laws of the Province of Alberta and created pursuant to a Declaration of Trust dated April 21, 2006. The principal undertaking of the Trust is to engage in the oilfield waste management business indirectly through its wholly owned subsidiary, Deepwell Energy Services LP ("Deepwell LP") and its subsidiaries Deepwell Energy Services Commercial Trust and Deepwell Energy Services Ltd. Deepwell LP provides oilfield waste management services, including treating, processing and disposing of oilfield wastes and custom treating of oil/water emulsions

On April 27, 2006, the Trust completed its private placement offering (the "Offering") whereby 4,000,000 Trust units were issued at \$10 per Trust unit for gross proceeds of \$40,000,000.

On April 27 and April 28, 2006, the Trust completed two acquisitions which provided substantially all of the basis of the operating business. These consolidated financial statements reflect the operations and activities of the Trust from the dates of these acquisitions.

2. Significant accounting policies

(A) BASIS OF PRESENTATION

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and are reported in Canadian dollars. Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. The most significant estimates relate to depreciation, amortization, asset retirement obligations, and accretion. Actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the Trust's accounting policies summarized below.

(B) PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Trust and its subsidiaries. All subsidiaries are directly or indirectly wholly owned and their operations are fully reflected in the consolidated financial statements. All inter-company transactions and balances have been eliminated.

(C) CASH

Cash includes cash on hand, balances with banks, cheques issued in excess of bank balance, and cash held in trust.

(D) INVENTORY

Inventory consists of drilling fluids, oilfield supplies and crude oil, all of which are valued at the lower of weighted average cost and net realizable value.

(E) PROPERTY AND EQUIPMENT

Property and equipment is recorded at cost. Depreciation is provided at the following rates:

| Assets | Method | Rate |
|-----------------------------|---|------------|
| Buildings | Declining balance | 4% |
| Tanks | Declining balance | 4% |
| Oilfield services equipment | Declining balance | 20% |
| Vehicles | Declining balance | 20% |
| Disposal wells | Straight-line over estimated life of well | 5-20 years |
| Site improvements | Declining balance | 8% |
| Pipelines | Declining balance | 5% |
| Furniture and fixtures | Declining balance | 20% |
| Computer equipment | Declining balance | 30% |
| Leasehold improvements | Straight-line | 5 years |

Depreciation is calculated starting the month after the date of purchase.

(F) LONG-LIVED ASSETS

Management assesses the carrying value of long-lived assets for impairment when events or circumstances indicate that the carrying value of those assets may not be recoverable. Such events or circumstances include items such as an ongoing lack of profitability and significant changes in technology. When an indication of impairment is present, the Trust tests for impairment by comparing the carrying value of the asset to its net recoverable amount. Impairment is recognized if the carrying value of the asset exceeds the sum of the undiscounted cash flows expected to result from that asset. If the carrying amount is greater than the net recoverable amount, the asset is written down to its estimated fair value.

(G) INTANGIBLES

Intangible assets are comprised of values attributable to customer relationships, certificates of approval or completion, and non-competition agreements. The carrying value of these assets will be assessed whenever an event or changes in circumstances indicate their carrying value may not be recoverable. Amortization is provided at the following annual rates:

| | |
|----------------------------|---------------------|
| Completions and contracts | 5% – Straight line |
| Non competition agreements | 33% – Straight line |
| Customer relationships | 17% – Straight line |

(H) GOODWILL

Goodwill is recognized when the total purchase price of a business acquisition exceeds the fair value of the net identifiable assets and liabilities of the acquired business. The goodwill balance is assessed for impairment annually at year-end or as events occur that may result in impairment. To assess impairment, the fair value of the Trust is compared to the respective book value. If the fair value is less than the book value a second test is performed to determine the amount of impairment. The amount of impairment is measured by allocating the fair value of identifiable assets and liabilities as if they had been acquired in a business combination for a purchase price equal to their fair value to determine the implied fair value of goodwill. If the goodwill determined in this manner is less than the carrying value of goodwill, an impairment loss is recognized in the period in which it occurs. Goodwill is stated at cost less impairment and is not amortized.

(I) ASSET RETIREMENT OBLIGATION

The Trust recognizes as a liability the estimated fair value of the future retirement obligations associated with property and equipment. The fair value is capitalized and amortized over the same period as the underlying asset. The Trust estimates the liability based on the estimated costs to abandon and reclaim its net ownership interest in all wells and facilities and the estimated timing of the costs to be incurred in future periods. This estimate is evaluated on a periodic basis and any adjustment to the estimate is prospectively applied. As time passes, the change in net present value of the future retirement obligation is expensed through accretion. Retirement obligations settled during the period reduce the future retirement liability.

(J) REVENUE RECOGNITION

The Trust's services include the processing and separation of oilfield waste, the disposal of oilfield waste water and the custom treating of oil. Revenue is recorded in the period when treatment services are provided or performed and when collectibility is reasonably assured. Processing and disposal revenue are recorded at the time of sale. Oil sales are recorded at the time of sale.

(K) INCOME TAXES

The Trust is a taxable entity under the Income Tax Act (Canada) but is taxable only on income that is not distributed to the Unitholders. Any taxable income is distributed to the Unitholders and therefore no provision for income taxes relating to the Trust is included in these financial statements.

Income taxes in the Trust's corporate subsidiary are accounted for under the asset and liability method. Future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement and income tax basis of assets and liabilities. Future tax assets and liabilities are measured using enacted or substantially enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment or substantive enactment date.

(L) DEFERRED FINANCING COSTS

Costs associated with establishing long-term debt arrangements are deferred and amortized over the term of the related obligation.

(M) UNIT-BASED COMPENSATION

The Trust has established a unit option plan for trustees, directors, officers, employees and consultants. The Trust recognizes unit-based compensation expense in the Consolidated Statement of Income and Accumulated Earnings (Deficit) for all unit options granted based upon their fair value at the time of grant. The fair value is determined using an accepted option pricing model, with total compensation expense recognized over the period the options vest. Consideration paid by the option-holder upon the exercise of the options, together with the amount previously recognized in contributed surplus, is recognized as an increase in Trust Units.

(N) INCOME PER UNIT

Basic net income per Trust Unit is computed by dividing net income by the weighted average number of Trust Units outstanding during each reporting period. Trust Units issued during the year and Trust Units reacquired during the year are weighted for the portion of the year that they were outstanding. Diluted net income per Trust Unit is calculated using the treasury stock method.

(O) RECENT ACCOUNTING PRONOUNCEMENTS

In January 2005, the Canadian Institute of Chartered Accountants (“CICA”) issued new accounting standards: Handbook Section 1530 “Comprehensive Income” and Handbook Section 3251 “Equity”, for the reporting and disclosure of comprehensive income. Unrealized gains and losses on financial assets that will be held as available for sale, unrealized foreign currency translation amounts arising from self-sustained foreign operations, and changes in the fair value of cash flow hedging instruments, will be in a Consolidated Statement of Other Comprehensive Income until recognized in the consolidation statements of earnings. These standards are effective for the Trust as of January 1, 2007. The Trust has determined these standards are not expected to have a material impact on its consolidated financial statements.

In January 2005, the CICA issued new accounting standards: Handbook Section 3855 “Financial Instruments – Disclosure and Presentation”. Under the new standards, all financial instruments will be classified as one of the following: held-to-maturity, loans and receivables, held for trading and available for sale. Financial assets and liabilities held for trading will be measured at fair value with gains and losses recognized in net income. Financial assets held-to-maturity, loans and receivables and financial liabilities other than those held-for-trading will be measured at amortized cost. Available for sale instruments will be measured at fair value with gains and losses recognized in other comprehensive income. These standards are effective for the Trust as of January 1, 2007. As a result of these standards, the balance of deferred financing charges, currently included in prepaids and deposits, will be netted against the corresponding balances in the respective credit facility. The Trust has determined that these standards are not expected to have a material impact on its consolidated financial statements.

3. Business acquisitions

On April 27, 2006, the Trust purchased all of the issued and outstanding shares of Deepwell Disposal Services Inc. (“DDSI”) in exchange for 356,000 Class B Trust Units valued at \$3,560,000.

On April 28, 2006, the Trust purchased the oilfield waste management assets of Producers Disposal Services Ltd. (“PDS”) and Rycroft Disposal Well Inc. (“Rycroft”) for cash consideration of \$42,754,509. The Trust acquired all of the assets of PDS and Rycroft excluding security deposits held by the Alberta Energy and Utilities Board. The Trust assumed the asset retirement obligations of PDS and Rycroft; however, the Trust was only responsible for those operating liabilities accruing to PDS and Rycroft subsequent to March 31, 2006.

| Purchase Price | PDS/Rycroft | DDSI | Total |
|--------------------|---------------|--------------|---------------|
| Cash | \$ 42,754,509 | \$ – | \$ 42,754,509 |
| Transaction costs | 241,279 | 57,068 | 298,347 |
| | 42,995,788 | 57,068 | 43,052,856 |
| Trust Units issued | – | 3,560,000 | 3,560,000 |
| | \$ 42,995,788 | \$ 3,617,068 | \$ 46,612,856 |

The consolidated financial statements have been prepared using the estimated fair values of assets and liabilities. Due to common management and directors, the Trust and DDSI were related parties at the time of the acquisition. The exchange amount was used for financial reporting purposes because the change in the ownership interests in the assets transferred is substantive, and estimated fair values of property, plant and equipment, intangibles and goodwill for both acquisitions were provided by an independent evaluator.

| Allocation of Purchase Price | PDS/Rycroft | DDSI | Total |
|-------------------------------------|----------------------|---------------------|----------------------|
| Cash | \$ – | \$ 259,925 | \$ 259,925 |
| Working capital | 1,823,356 | (35,625) | 1,787,731 |
| Property and equipment | 34,547,000 | 175,000 | 34,722,000 |
| Intangible assets | 3,160,500 | 312,500 | 3,473,000 |
| Goodwill | 4,135,200 | 3,022,202 | 7,157,402 |
| Deposits | – | 25,354 | 25,354 |
| Future income taxes | – | (135,000) | (135,000) |
| Asset retirement obligations | (670,268) | (7,288) | (677,556) |
| | \$ 42,995,788 | \$ 3,617,068 | \$ 46,612,856 |

4. Property and equipment

| December 31, 2006 | Cost | Accumulated depreciation | Net book value |
|----------------------------|----------------------|---------------------------------|-----------------------|
| Disposal wells | \$ 28,122,383 | \$ 1,240,536 | \$ 26,881,847 |
| Pipelines | 3,152,585 | 103,490 | 3,049,095 |
| Tanks | 2,685,586 | 62,499 | 2,623,087 |
| Oilfield service equipment | 2,630,147 | 290,086 | 2,340,061 |
| Site improvements | 2,270,902 | 81,218 | 2,189,684 |
| Future sites | 1,009,241 | – | 1,009,241 |
| Buildings | 963,750 | 26,193 | 937,557 |
| Computer equipment | 246,023 | 25,303 | 220,720 |
| Vehicles | 229,411 | 25,385 | 204,026 |
| Furniture and fixtures | 106,185 | 7,775 | 98,410 |
| Leasehold improvements | 12,784 | 906 | 11,878 |
| | \$ 41,428,997 | \$ 1,863,391 | \$ 39,565,606 |

5. Intangible assets

| December 31, 2006 | Cost | Accumulated amortization | Net book value |
|----------------------------|---------------------|---------------------------------|-----------------------|
| Completions and contracts | \$ 2,115,000 | \$ 68,750 | \$ 2,046,250 |
| Non-competition agreements | 48,000 | 9,460 | 38,540 |
| Customer relationships | 1,310,000 | 140,753 | 1,169,247 |
| | \$ 3,473,000 | \$ 218,963 | \$ 3,254,037 |

Completions and contracts of \$312,500 have not been amortized during the period but amortization will commence once the related assets are placed into service.

6. Unitholders' equity

(A) CLASS B TRUST UNITS

The Trust is authorized to issue an unlimited number of Class B Trust Units.

On April 27, 2006, the Trust issued 4,000,000 Class B Trust Units at a price of \$10.00 per Unit by way of private placement for gross proceeds of \$40,000,000. An aggregate of 161,670 Class B Trust Units were issued to trustees of the Trust, or directors or officers of subsidiaries of the Trust, directly or indirectly for proceeds of \$1,616,700.

On April 27, 2006, the Trust acquired all the issued and outstanding shares of Deepwell Disposal Services Inc. Consideration of \$3,560,000 was paid by the issuance of 356,000 Class B Trust Units at an ascribed value of \$10.00 per Unit.

Each Class B Unit was exchangeable into one Trust Unit on the earlier of one day from the date of issuance of a receipt for a final prospectus filed by the Trust on a public stock exchange, or August 28, 2006. If The Trust's Units were not listed on a public stock exchange by August 25, 2006, the Trust agreed to issue to each holder of Class B Units an additional 0.10 of a regular Trust Unit. Pursuant to the Trust's prospectus dated August 18, 2006, the Trust exchanged all outstanding Class B Trust Units on a one-for-one basis for Units of Deepwell Energy Services Trust. Subsequent to the exchange of units, the Trust received approval to list the Units for trading on the TSX, and the Units commenced trading on the TSX on August 24, 2006.

| | Number | Amount |
|-----------------------------------|-------------|--------------|
| Issued to settlor of the Trust | 1 | \$ 10 |
| Cancelled | (1) | (10) |
| Issued on business acquisition | 356,000 | 3,560,000 |
| Issued on private placement | 4,000,000 | 40,000,000 |
| Redemption of Class B Trust Units | (4,356,000) | (43,560,000) |
| Balance, December 31, 2006 | - | \$ - |

(B) REGULAR TRUST UNITS

The Trust is authorized to issue an unlimited number of Regular Trust Units.

| | Number | Proceeds |
|---------------------------------------|-----------|---------------|
| Issued on redemption of Class B units | 4,356,000 | \$ 43,560,000 |
| Trust Unit issue costs | | (3,069,623) |
| Balance, December 31, 2006 | 4,356,000 | \$ 40,490,377 |

On August 22, 2006, the Trust exchanged each outstanding Class B Trust Unit on a one-for-one basis with Regular Trust Units.

Trust Units are redeemable at any time at the option of the unitholder. The redemption price is equal to the lesser of 90 percent of the average market price for the 10 days immediately prior to the date the units were tendered for redemption or the closing market price on the date the units were tendered for redemption.

(C) SPECIAL VOTING UNITS

The Trust is authorized to issue an unlimited number of Special Voting Units, which will enable the Trust to provide voting rights to holders of any exchangeable shares that may be issued by any direct or indirect subsidiaries of the Trust. Except for the right to vote, the Special Voting Units do not confer any rights. No Special Voting Units have been issued since inception of the Trust.

(D) TRUST UNIT OPTIONS AND UNIT-BASED COMPENSATION

As at December 31, 2006 a total of 314,500 options issued pursuant to the Trust's incentive unit option plan ("Option Plan") were outstanding at an average exercise price of \$10.01. All of these units were issued during the period and remain outstanding at December 31, 2006. No options were exercisable at December 31, 2006, and the weighted average contractual life remaining was 4.65 years. The total number of outstanding options shall not exceed 10 percent of the outstanding Trust Units. The options carry a five-year term and vest equally over a period of three years from the date of grant. The exercise price of each option is based upon the weighted average trading price for a period prior to the date of grant. The exercise price is adjusted downwards by 100 percent of the amount of distributions paid on outstanding Trust Units. As at December 31, 2006, the exercise prices of outstanding options ranged from \$9.62 to \$10.26 per unit and the weighted average exercise price of granted options was \$9.63 per unit

The Trust recorded unit option compensation expense and contributed surplus of \$251,432 during the period. The fair value of options issued during the period was estimated using the Black-Scholes pricing model with the following assumptions: risk-free interest rate of 4.25 percent; volatility of 35 percent; life of five years; the impact of monthly distributions and corresponding changes in exercise price during the life of the options are assumed to be equal and offsetting, and so no provision is made in the pricing model for either factor. The weighted average fair value of options granted during the year was \$3.81 per option.

(E) CASH DISTRIBUTIONS

The Trust declares monthly distributions of cash to Unitholders of record as at the close of business on each Distribution Record Date. Pursuant to the declaration of trust, the Trust is required to pay to Unitholders the net income of the trust determined pursuant to the provisions of the Income Tax Act (Canada). Such distributions are recorded as reductions of equity upon declaration of the distribution. During the period, the Trust declared and paid distributions to the Unitholders in accordance with the following schedule:

| Period | Record date | Payment date | Cash per Trust Unit | Amount |
|---|--------------------|--------------------|---------------------|--------------|
| April 28 – 30, 2006 | April 30, 2006 | May 15, 2006 | \$ 0.0064 | \$ 27,953 |
| May 1 – 31, 2006 | May 30, 2006 | June 15, 2006 | 0.0958 | 417,305 |
| June 1 – 30, 2006 | July 6, 2006 | July 14, 2006 | 0.0958 | 417,305 |
| July 1 – 31, 2006 | July 28, 2006 | August 15, 2006 | 0.0958 | 417,305 |
| August 1 – 31, 2006 | August 31, 2006 | September 15, 2006 | 0.0958 | 417,305 |
| September 1 – 30, 2006 | September 29, 2006 | October 13, 2006 | 0.0958 | 417,305 |
| October 1 – 31, 2006 | October 31, 2006 | November 15, 2006 | 0.0958 | 417,305 |
| November 1 – 30, 2006 | November 30, 2006 | December 15, 2006 | 0.0958 | 417,305 |
| December 1 – 31, 2006 | December 29, 2006 | January 15, 2007 | \$ 0.0958 | 417,305 |
| Distributions to unitholders declared during the period | | | | \$ 3,366,393 |

7. Income taxes

The provision for income taxes in the consolidated financial statements differs from the result that would have been obtained by applying the combined federal and provincial tax rate to the net income before income taxes. The difference results from the following items:

| | 2006 |
|---|-------------|
| Income before income tax | \$ 811,230 |
| Combined federal and provincial income tax rate | 32.49% |
| Expected tax | 263,569 |
| Increase (decrease) in income taxes resulting from: | |
| Non-taxable portion of net income | (313,509) |
| Changes in tax rate | (1,303) |
| Non-deductible items and other | 3,444 |
| Future income tax recovery | \$ (47,799) |

The components of the future income tax liability for the corporate subsidiary of the Trust are as follows:

| As at December 31, | 2006 |
|------------------------|-----------|
| Property and equipment | \$ 25,100 |
| Intangible assets | 108,500 |
| Non-capital losses | (41,760) |
| Other | (4,639) |
| | \$ 87,201 |

On December 21, 2006, the federal Minister of Finance released draft legislation to implement proposals originally announced on October 31, 2006 relating to the taxation of certain distributions from certain trusts and partnerships (the "Trust Taxation Proposal"). Subject to the Trust Taxation Proposal, returns on capital are generally taxed as ordinary income in the hands of a unitholder who is resident in Canada for purposes of the Income Tax Act (Canada) (the "Tax Act"). Pursuant to the Trust Taxation Proposal, commencing January 1, 2011 (provided the Trust only experiences "normal growth" and no "undue expansion" before then) certain distributions from the Trust which would otherwise have been taxed as ordinary income generally will be characterized as dividends in addition to being subject to tax at corporate rates at that trust level. Returns of capital generally are (and under the Trust Taxation Proposal will continue to be) tax-deferred for unitholders who are resident in Canada for purposes of the Tax Act (and reduce such unitholder's adjusted cost based in the Trust Unit for purposes of the Tax Act). Distributions, whether of income or capital to a unitholder who is not resident in Canada for purposes of the Tax Act, or that is a partnership that is not a "Canadian partnership" for purposes of the Tax Act, generally will be subject to Canadian withholding tax.

8. Credit facilities

The Trust established credit facilities on April 27, 2006 with a Canadian chartered bank (the "credit facilities") which consist of the following:

(A) DEMAND LOAN

Under the credit facilities, the Trust has a \$2,000,000 demand revolving operating loan. During the period, interest ranged from the lender's prime rate plus 0.125 percent to 0.625 percent as it is dependent on the funded debt to EBITDA ratio. No principal repayments are required until May 2007 unless otherwise extended. As of December 31, 2006 the borrowing base for the demand loan was at \$1,808,000 and the amount drawn was nil.

(B) LONG-TERM DEBT

Under the credit facilities, the Trust has a \$15,500,000 364-day extendible revolving term loan committed to May 31, 2010. No set principal repayment has been established and the Trust has the ability to repay, borrow and repay again until the 364-day term expires. Interest ranged from the lender's prime rate plus 0.125 percent to 0.625 percent per annum. Interest is calculated monthly and paid in arrears. As at December 31, 2006 an aggregate of \$11,500,000 principal amount was drawn on the loan. The revolving period extends to May 31, 2007, at which time the credit facility, unless renewed, reverts to three-year term with the monthly principal repayments, if necessary, commencing on June 26 under the three-year term. The effective interest rate on the long-term credit facility for the period was 6.12 percent.

As security for the credit facilities, Deepwell LP granted lenders a security interest over all of its assets. In addition, the Trust and its subsidiaries guaranteed the indebtedness of Deepwell LP under the credit facilities with such guarantee being secured by all of the assets of each such guarantor. In respect of any proceeds resulting from the enforcement of the credit facilities or the above-mentioned guarantees, the lenders, as creditors, will have a prior-ranking claim relative to the Unitholders.

Included in prepaid expenses and deposits are deferred financing costs of \$39,880 representing costs incurred to secure the various credit facilities. During the period, \$55,832 was amortized in relation to the financing.

9. Asset retirement obligation

It is management's estimate that the remaining lives of the disposal sites are approximately 20 years, at which time the cost to close and reclaim the disposal sites will approximate \$3,430,000. The discounted cash flows required to retire the assets were determined using a credit-adjusted rate of 8.50 percent and an inflation rate of 2 percent. The accrued liability for closure of the disposal sites is recognized over the estimated remaining life of the assets. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived assets and are depreciated over their estimated useful life.

Changes in the asset retirement obligation balance are summarized below:

| | 2006 |
|---|------------|
| Asset retirement obligation, upon acquisition | \$ 677,556 |
| Accretion expense | 37,982 |
| Asset retirement obligation, end of period | \$ 715,538 |

10. Financial instruments

The Trust's financial instruments consist of cash, accounts receivable, financial security deposits, accounts payable and accrued liabilities and long-term debt. These financial instruments approximate their fair value.

(A) CREDIT RISK

The Trust's accounts receivable are comprised of two primary streams, oil sales and waste disposal and processing charges. Oil sales accumulated as shipped by the marketer are paid in full the month following receipt. Waste and disposal processing sales are exposed to typical industry credit risks. The Trust manages this risk by entering into sales contracts with credit-worthy counterparties, reviewing its exposure to individual entities on a regular basis, and delaying repayment of oil credits beyond settlement date.

(B) INTEREST RATES

Deepwell LP is exposed to interest rate risk through the utilization of floating-rate credit facilities to finance operations.

11. Related party transactions

During the period the Trust made payments in the amount of \$318,954 for legal expenses to a Partnership of which one of the Trustees is a partner. These transactions were conducted in the normal course of operations, on commercial terms established and agreed to by the parties. As at December 31, 2006, \$6,176 was outstanding in accounts payable and accrued liabilities.

12. Commitments

The Trust is committed to the following future minimum payments under lease contracts for office space and a vehicle with varying expiration dates:

| | |
|------------|------------|
| 2007 | \$ 168,972 |
| 2008 | 168,972 |
| 2009 | 166,934 |
| 2010 | 156,744 |
| 2011 | 91,434 |
| Thereafter | - |
| | <hr/> |
| | \$ 753,056 |

13. Subsequent events

The Trust declared a cash distribution for the period January 1, 2007 to January 31, 2007 at \$0.0958 per unit, to be paid on February 15, 2007 to Unitholders of record on January 31, 2007.

The Trust declared a cash distribution for the period February 1, 2007 to February 28, 2007 at \$0.0958 per unit, to be paid on March 15, 2007 to Unitholders of record on February 28, 2007.

The Trust declared a cash distribution for the period March 1, 2007 to March 31, 2007 at \$0.06 per unit, to be paid on April 15, 2007 to Unitholders of record on March 30, 2007.