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**FRIDAY MARCH 30, 2007**

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## **DEEPWELL ENERGY SERVICES TRUST ANNOUNCES FINANCIAL RESULTS**

**Calgary, Alberta** - Deepwell Energy Services Trust (the "Trust") (TSX:DWL.UN) is pleased to announce financial results for the fourth quarter and period ended December 31, 2006. Deepwell posted positive income and cash flow from operations for the quarter, and for its first 247 days of operation.

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## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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The following Management's Discussion and Analysis ("MD&A") of Deepwell Energy Services Trust (the "Trust") has been prepared taking into consideration information available to March 30, 2007 and should be read in conjunction with the Trust's audited consolidated financial statements as at and for the 247 days ended December 31, 2006. This MD&A discusses operations and events for the 247 day period ended December 31, 2006. Unless otherwise noted, references to the "year" in this MD&A refer to the 247 day period ended December 31, 2006, and references to the "quarter" in this MD&A refer to the three months ended December 31, 2006.

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### **Non-GAAP measures**

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The MD&A has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Certain supplementary information and measures not recognized under GAAP are also provided where management believes they assist the reader in understanding the Trust's results. These measures include:

- Earnings before interest, taxes, depreciation and amortization (EBITDA); and
- Funds from operations, which refers to cash flow from operating activities before changes in non-cash working capital;

These measures are identified and presented, where appropriate, together with reconciliations to the equivalent GAAP measure. However, they should not be used as an alternative to GAAP, because they may not be consistent with calculations of other companies or Trusts.

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### **Deepwell overview**

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The Trust is an unincorporated investment trust governed by the laws of the Province of Alberta. The business of the Trust is conducted through its direct and indirect wholly owned subsidiaries, Deepwell Energy Services Commercial Trust, Deepwell Energy Services Ltd., and Deepwell Energy Services LP ("Deepwell LP"). The Trust and its subsidiaries (collectively "Deepwell") are based in Calgary, Alberta and were established to acquire and operate businesses that engage in oilfield waste management services. The principal undertaking of Deepwell is to provide a variety of services to oil and natural gas exploration and production companies in western Canada.

On April 27, 2006, Deepwell completed its private placement which raised \$40,000,000 in gross proceeds. On April 28, 2006, Deepwell closed the acquisition of the oilfield waste management businesses operated by Producers Oilfield Services Inc. for cash consideration of approximately \$43,000,000. The acquisition was funded with approximately \$37,000,000 in net proceeds from the April 27, 2006 private placement, and approximately \$6,000,000 drawn from the Trust's credit facilities. The acquisition included three operating facilities in Alberta located at Grande Cache, Mayerthorpe, and Rycroft

The Mayerthorpe and Grande Cache facilities are oilfield waste management facilities and are operated in association with Class 1B disposal wells. These facilities are designed to receive, treat and separate oilfield wastes into recoverable oil and disposable water and solids. Recovered oil is shipped from the facility and sold into the oil market at prevailing market rates. The solids are transported and disposed of in a landfill approved by the Alberta Energy and Utilities Board (EUB) and the water is injected into a Deepwell LP Class 1B disposal well. Deepwell LP's facilities can also receive, treat and separate oil/water emulsions to obtain pipeline specification crude oil. Treated oil is then shipped from the facility and sold into the oil market at prevailing market rates and credited back to the customer and the separated water is injected into a Deepwell LP Class 1B disposal well.

The Rycroft facility is a water injection facility operated in association with a Class 1B disposal well. This facility is designed to receive and treat produced water to recover residual amounts of oil. The residual oil is shipped from the facility and then sold into the oil market at prevailing market rates. The water is disposed of in the Deepwell LP Class 1B disposal well at Rycroft.

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## **Strategy**

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Deepwell is committed to building value for its Unitholders through disciplined management and the implementation of its long-term strategy. The key aspects of Deepwell's strategy are:

- Focus on oilfield waste management: Deepwell currently operates exclusively in the oilfield waste management business, and intends to continue that focus;
- Growth: Deepwell is primarily focused on organic growth through adding new facilities, and increasing capacity and services provided at existing facilities;
- Operational efficiency: Attain and maintain efficient operations and a high standard of customer service within a safe working environment; and
- Environmental stewardship: Meet or exceed regulatory requirements and industry standards.

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## Selected financial information

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The following is a summary of selected financial information that has been derived from, and should be read in conjunction with, the consolidated financial statements of the Trust.

| Financial Highlights  | For the three months<br>ended Dec 31, 2006 | For the 247 days<br>ended Dec 31, 2006 |
|---|--|--|
| Revenue   | \$ 4,059,296                               | \$ 9,647,020                           |
| Operating costs   | 1,605,492                                  | 4,594,714                              |
| <b>Gross Margin</b>   | <b>2,453,804</b>                           | <b>5,052,306</b>                       |
| Selling and administrative  | 730,354                                    | 1,409,031                              |
| <b>Earnings before interest, taxes<br/>depreciation &amp; amortization (EBITDA)</b> | <b>1,723,450</b>                           | <b>3,643,275</b>                       |
| Depreciation, accretion and amortization  | 993,621                                    | 2,186,578                              |
| Unit-based compensation   | 197,812                                    | 251,432                                |
| Interest  | 149,325                                    | 359,740                                |
| Loss on sale of assets  | 34,295                                     | 34,295                                 |
| Future income taxes   | (47,799)                                   | (47,799)                               |
| <b>Net income</b>   | <b>396,196</b>                             | <b>859,029</b>                         |
| Add:  |  |  |
| Depreciation, accretion and amortization  | 993,621                                    | 2,186,578                              |
| Unit based compensation expense   | 197,812                                    | 251,432                                |
| Loss on sale of property and equipment  | 34,295                                     | 34,295                                 |
| Future income taxes   | (47,799)                                   | (47,799)                               |
| <b>Funds from operations</b>  | <b>\$ 1,574,125</b>                        | <b>\$ 3,283,535</b>                    |
| <b>Net income</b>   | <b>\$ 647,628</b>                          | <b>\$ 859,029</b>                      |
| Per unit, basic   | 0.15                                       | 0.25                                   |
| Per unit, diluted   | 0.15                                       | 0.25                                   |
| <b>EBITDA</b>   | <b>\$ 1,723,450</b>                        | <b>\$ 3,643,275</b>                    |
| Per unit, basic   | 0.40                                       | 0.84                                   |
| Per unit, diluted   | 0.40                                       | 0.84                                   |
| <b>Funds from operations</b>  | <b>\$ 1,574,125</b>                        | <b>\$ 3,283,535</b>                    |
| Per unit, basic   | 0.36                                       | 0.81                                   |
| Per unit, diluted   | 0.36                                       | 0.81                                   |
| <b>Cash distributions paid to unitholders</b>                                       | <b>\$ 1,251,915</b>                        | <b>\$ 2,949,085</b>                    |
| Per unit, basic   | 0.29                                       | 0.68                                   |
| Per unit, diluted   | 0.29                                       | 0.68                                   |
| Gross margin as a percentage of revenue   | 60%  | 52%                                    |
| Selling and administrative as a percentage of revenue                               | 17%  | 15%                                    |
| Capital expenditures  | \$ 3,416,125                               | \$ 6,808,996                           |
| Total assets  |  | \$ 54,491,681                          |
| Long-term debt - ending   |  | \$ 11,500,000                          |
| Total long-term liabilities   |  | \$ 12,300,945                          |
| Unitholders' capital - ending   |  | \$ 40,490,377                          |
| Weighted average Trust units, basic   | 4,356,000                                  | 4,356,000                              |
| Weighted average Trust units, diluted   | 4,356,000                                  | 4,357,187                              |

Revenues for the year were \$9,647,020, with a gross margin of \$5,052,306 (52 percent of revenue), EBITDA of \$3,643,275 (38 percent of revenue) and net income of \$859,029 (9 percent of revenue). Revenues for the quarter were \$4,059,296, with a gross margin of \$2,453,804 (60 percent of revenue),

EBITDA of \$1,723,450 (42 percent of revenue) and net earnings of \$396,196 (10 percent of revenue). Revenues improved for the quarter, relative to results in the prior quarters due to seasonally higher levels of activity in the fourth quarter in the industry, partially offset by lower prices on the sale of recovered oil compared to the second and third quarters of 2006.

On a basic and diluted per unit basis, earnings for the year were \$0.20 per unit (\$0.09 per unit for the quarter), and funds from operations for the year was \$0.75 per unit (\$0.36 per unit for the quarter). Basic and diluted distributions declared to unitholders for the year were \$3,366,393 or \$0.77 per unit (\$0.29 per unit for the quarter). Distributions paid for the year were \$2,949,085, or \$0.68 cents per unit, basic and diluted (\$0.29 per unit for the quarter).

In general, demand in the oilfield waste management business was strong for the year, although as is typically the case, seasonal fluctuations and weather conditions had an impact on activity at certain times.

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## **Results of operations**

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### **Revenue**

Revenues for the year were \$9,647,020 (\$4,059,296 for the quarter) comprising approximately 60 percent from processing and disposal fees and 40 percent from the sale of recovered oil (57 percent and 43 percent respectively for the quarter).

During the year, the Trust experienced a number of challenges at the Grande Cache facility. In June the pipeline running from the plant to the disposal well breached. There was no exposure to the environment, as the inner fiberglass pipeline was enclosed in a steel casing, however in order to minimize the risk of future pipeline breaches at the facility, the entire inner fiberglass pipeline was replaced. This resulted in a significant impact to revenues as the pipeline was not brought back on-line until September 28, 2006. During this time, Grande Cache was still receiving limited amounts of production fluids and trucking the water from the plant to the well site. Small volumes of oilfield waste were being processed during this period as well.

In October and November, a solids treatment pad was installed at Grande Cache to improve solid waste handling and treatment abilities; however, the installation disrupted the ability to receive and process waste in October and November.

On December 7, 2006, an explosion and subsequent fire occurred at the Grande Cache facility. The damage was isolated to a single tank in the vacuum truck unloading system, and the facility resumed operations on December 14, 2006. For the remainder of the year, the facility was only capable of receiving waste transported in tanker trucks, which could be offloaded directly into Deepwell's tanks. On February 1, 2007, Deepwell resumed receiving waste transported in vacuum trucks.

The above-noted operational issues at Grande Cache negatively impacted revenues by an estimated \$743,000 for the year, and \$473,000 for the quarter.

The Mayerthorpe facility provided consistent operational and financial results for the year and the quarter, and generally exceeded expectations. The Rycroft facility provided strong results except in June, when the facility was out of operation for two weeks during stimulation of the disposal well. The downtime while the well was stimulated decreased revenues, however at year end the facility was at a "run-rate" significantly beyond original expectations.

### **Expenses**

#### ***Operating expenses***

Operating expenses were \$4,594,714 for the year, and the relationship to revenues is generally consistent with management's expectations. Operating expenses include \$1,133,828 in oil credits

repaid to customers (\$371,068 for the quarter), which mitigates the impact of oil prices on Deepwell's revenues. Certain expenses, such as oil credits, trucking, and landfill expenses are activity driven; however a significant portion of expenses can be considered fixed. Additional trucking costs of approximately \$166,000 were incurred during the third quarter of the year, to transport water to the wellhead for disposal, while the disposal pipeline at the Grande Cache facility was out of service.

### ***Selling and administrative***

Selling and administrative costs for the year were \$1,409,031 or 15 percent of revenue (\$730,354 and 18 percent for the quarter). Professional fees, audit fees, wages and benefits for head office personnel, office supplies, and computer related expenses were the most significant cash costs.

### ***Depreciation, amortization and accretion***

Depreciation, amortization and accretion expense was \$2,186,578 for the period (\$993,621 for the quarter) and consists of depreciation of fixed assets of \$1,875,595 (\$867,586 for the quarter), amortization of intangible assets of \$218,963 (\$82,160 for the quarter), accretion of \$36,188 (\$14,243 for the quarter), amortization of deferred financing charges of \$55,832 (\$29,632 for the quarter). Intangible assets consist of regulatory approvals, customer relationships, and non-competition agreements.

### ***Interest***

Total cash interest expense for the year was \$359,740 (\$149,325 for the quarter) comprised of interest on long-term debt of \$341,375 and interest on the Trust's operating loan of \$18,365. Interest rates are floating, with a range from 0.125 percent to 1.4 percent over the lender's prime rate, depending on the Trust's ratio of consolidated funded debt to earnings before interest, taxes depreciation, amortization, accretion, and unit-based compensation. Actual interest rates during the year ranged from 0.125 percent to 0.625 percent over the lender's prime rates.

### ***Loss on sale of assets***

During the fourth quarter, a plant vehicle and a tractor loader were sold, for total proceeds of \$55,500, and recognized losses on disposal were \$34,295.

### ***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.

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 partnership that is not a "Canadian partnership" for purposes of the Tax Act, generally will be subject to Canadian withholding tax.

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### **Distributions to Unitholders**

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During the year, distributions declared to unitholders were \$3,366,393, and distributions paid during the year were \$2,949,085. Since inception, the Trust has made monthly distributions of \$0.0958 per unit, with the first payment prorated for the two days following acquisition to the end of April, 2006. On March 19, 2007 the Trust announced a change in the monthly distribution and that the cash distribution for the period of March 1 to March 31, 2007 has been set at \$0.06 per Trust unit; this cash distribution is payable on April 13, 2007 to unitholders of record on March 30, 2007.

Upon review of Deepwell's opportunities for growth, the Trustees concluded that retention of more cash to provide capital for growth would be most appropriate. A reduction in the cash distribution will provide greater financial flexibility to exploit Deepwell's high-return growth opportunities.

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### **Investing activities**

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Net cash used in investing activities during the year was \$49,215,940.

#### **Business acquisitions**

On April 27 the Trust purchased all of the issued and outstanding shares of Deepwell Disposal Services Inc. in exchange for 356,000 Class B Trust Units valued at \$3,560,000. The Trust incurred transaction costs of \$57,068.

On April 28, 2006, the Trust purchased the oilfield waste management assets of Producers Disposal Services Ltd. and Rycroft Disposal Well Inc. ("PDS" and "Rycroft" respectively) for cash consideration of \$42,754,509. The Trust also incurred transaction costs of \$241,279. The Trust acquired all of the assets of PDS and Rycroft, excluding security deposits held by the EUB. The Trust assumed the asset retirement obligations of PDS and Rycroft; however the Trust assumed only those operating liabilities accruing to PDS and Rycroft subsequent to March 31, 2006. The Trust also did not assume any bank indebtedness or amounts due to affiliates.

#### **Capital expenditures**

Excluding investment on the original acquisition, (which is detailed above) the Trusts' capital expenditures for purchase of property and equipment for the year were \$6,808,967.

In the third quarter of 2006, a new pipeline from the Grande Cache facility to the disposal well was installed at a cost of approximately \$1,290,000.

To increase capacity at Grande Cache, a second disposal well was placed into operation by stimulating an out-of-service disposal well at a cost of approximately \$1,900,000. The well was put into service in late September and some productivity increases were realized in the fourth quarter, although the positive impact was mitigated by the operational downtime at Grande Cache in the fourth quarter. In March, 2007, Deepwell received EUB approval to increase wellhead pressure at this well, and further increases in injection rate are expected as a result.

A solids treatment pad was installed at Grande Cache in the fourth quarter at a cost of approximately \$390,000. The pad allows solids to be treated, such that landfill disposal costs can be significantly

reduced. The pad was damaged in the December 7, 2006 fire, but should be repaired and placed back into service in the second quarter of 2007.

Approximately \$350,000 was invested in computers, furniture and other head office equipment upon the establishment of the Trust's head office location in August, 2006.

Approximately \$170,000 was invested in preliminary costs for acquisition and conversion of a second disposal well at Rycroft. An application was made in 2006 to the EUB for approval to add the second well into service, and approval was granted in March, 2007. The existing well at Rycroft was stimulated in June, 2006 at a cost of approximately \$260,000, and the well's performance has improved substantially since that time.

Approximately \$730,000 was invested in preparation of the well, and application to the EUB for approval of Deepwell's planned facility at Claresholm., Alberta. An additional \$30,000 was invested in costs related to other future facilities.

The remaining cost relate primarily to improvements of drainage and retention ponds at the facilities, new injection pumps, new tanks, mobile equipment.

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### **Unitholders' equity**

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On April 27, 2006, the Trust completed a private placement offering of 4,000,000 Class B Trust units at \$10 per unit, for total gross proceed of \$40,000,000 less agents' commission of \$2,400,000 and other expenses of \$669,133. The net proceeds of \$36,930,367 were used to complete the acquisition of PDS and Rycroft. An additional 356,000 Class B Trust units were issued as purchase consideration for Deepwell Disposal Services Inc.

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. As of the March 28, 2007, the Trust had 4,356,000 Units outstanding.

### **Trust unit option plan**

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 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. Compensation expense is offset with a corresponding increase to contributed surplus. 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 Unitholders' capital.

As at December 31, 2006 a total of 314,500 options issued pursuant to the Trust incentive stock 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 are exercisable at December 31, 2006, and the weighted average contractual life remaining is 4.65 years. The total number of outstanding options shall not exceed 10% 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% of the amount of distributions paid on outstanding Trust Units. As at December 31, 2006, the exercise prices of outstanding options range from \$9.62 to \$10.26 per unit and the weighted average exercise price of granted options is \$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%; volatility of 35%; life of 5

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.

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## Liquidity

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As at December 31, 2006, the Trust had cash of \$28,861. The Trust also has credit facilities in place in the aggregate of \$17,500,000.

Net cash provided by financing activities for the year was \$45,385,577. The Trust realized \$36,930,377 in net proceeds of its private placement on April 27, 2006. At December 31, 2006, the Trust had drawn \$11,500,000 million on its long term credit facility. Deferred financing costs of \$95,711 were paid relating to the establishment of the Trust's credit facilities. A total of \$55,841 of deferred financing costs was amortized during the period. Other financing activities include the payment of \$2,949,088 in distributions to Unitholders related to the periods from April 29, 2006 to December 31, 2006.

## Credit facilities

Deepwell LP established credit facilities on April 27, 2006 with a Canadian chartered bank (the "credit facilities") which consist of a \$2,000,000 demand revolving operating loan and a \$15,500,000 364-day extendible revolving term loan, as well as a credit card facility. As of December 31, 2006, the borrowing base for the demand revolving loan was at \$1,808,000 and the amount drawn was nil. As at December 31, 2006, an aggregate of \$11,500,000 was drawn on the revolving term loan.

The operating loan bears interest ranging from the lender's prime rate plus 0.125 percent to prime plus 0.625 percent depending on the rate of debt to EBITDA, with interest payable monthly. The extendible revolving facility does not require principal payments thereunder until May 31, 2007, unless otherwise extended. If extended, the facility will continue not to require the payment of principal. If not extended, the credit facility reverts to a three-year term with principal payments thereunder commencing monthly after the date such facility is not renewed.

As security for the credit facilities, Deepwell LP granted the lenders a security interest over all of its assets. In addition, each of the Trust, Deepwell Energy Services Commercial Trust and the Deepwell Energy Services Ltd. 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 enforcement of the Credit Facilities or the above-mentioned guarantees, the lenders, as creditors, will have a prior-ranking claim relative to the Unitholders.

The credit facility is subject to customary terms and conditions for borrowings of this nature, including limits on incurring additional indebtedness, granting liens or selling assets without the consent of the lender and maintenance of certain interest coverage and leverage ratios.

## Interest rate risk

The operating loan and the extendible revolving term loan bear interest at a floating interest rate. Therefore, the extent that the Trust borrows under these facilities, the Trust is at risk to rising interest rates.

## Contractual obligations

| Payments due by period               | Total               | Less than         |                     |                     |               |
|--------------------------------------|---------------------|-------------------|---------------------|---------------------|---------------|
|                                      |                     | 1 year            | 1 - 3 years         | 4 - 5 years         | After 5 years |
| Long term debt                       | \$11,500,000        | \$ -              | \$ 9,347,222        | \$ 2,152,778        | \$ -          |
| Operating leases                     | 753,056             | 168,972           | 335,906             | 248,178             | -             |
| <b>Total contractual obligations</b> | <b>\$12,253,056</b> | <b>\$ 168,972</b> | <b>\$ 9,683,128</b> | <b>\$ 2,400,956</b> | <b>\$ -</b>   |

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**Quarterly information**

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|   | 64 days<br>ended<br>Jun 30, 2006 | Three months<br>ended<br>Sept 30, 2006 | Three months<br>ended<br>Dec 31, 2006 | 247 days<br>ended<br>Dec 31, 2006 |
|---|----------------------------------|--|---------------------------------------|-----------------------------------|
| <b>Revenues</b>   | \$ 1,778,929                     | \$ 3,808,795                           | \$ 4,059,296                          | \$ 9,647,020                      |
| <b>Expenses</b>   |                                  |  |                                       |                                   |
| Operating   | 948,937                          | 2,040,285                              | 1,605,492                             | 4,594,714                         |
| Selling and administrative                                    | 229,889                          | 448,788                                | 730,354                               | 1,409,031                         |
| Depreciation and accretion                                    | 469,705                          | 560,249                                | 881,829                               | 1,911,783                         |
| Amortization of intangible assets                             | -                                | 136,803                                | 82,160                                | 218,963                           |
| Unit-based compensation                                       | -                                | 53,620                                 | 197,812                               | 251,432                           |
| Interest on short term debt                                   | -                                | 4,601                                  | 13,764                                | 18,365                            |
| Interest on long term debt                                    | 107,946                          | 97,868                                 | 135,561                               | 341,375                           |
| Amortization of deferred financing costs                      | 10,612                           | 15,588                                 | 29,632                                | 55,832                            |
| Loss on sale of assets  | -                                | -                                      | 34,295                                | 34,295                            |
|   | 1,767,089                        | 3,357,802                              | 3,710,899                             | 8,835,790                         |
| <b>Income before taxes</b>                                    | 11,840                           | 450,993                                | 348,397                               | 811,230                           |
| Future income tax recovery                                    | -                                | -                                      | (47,799)                              | (47,799)                          |
| <b>Net income</b>   | \$ 11,840                        | \$ 450,993                             | \$ 396,196                            | \$ 859,029                        |
| Distributions to unitholders                                  | (445,258)                        | (1,669,145)                            | (1,251,990)                           | (3,366,393)                       |
| <b>Deficit, end of period</b>                                 | \$ (433,418)                     | \$ (1,651,570)                         | \$ (2,507,364)                        | \$ (2,507,364)                    |
| <b>Net income per trust unit:</b>                             |                                  |  |                                       |                                   |
| Basic   | \$ 0.00                          | \$ 0.10                                | \$ 0.09                               | \$ 0.20                           |
| Diluted   | \$ 0.00                          | \$ 0.10                                | \$ 0.09                               | \$ 0.20                           |
| <b>Weighted average number of Trust<br/>Units outstanding</b> |                                  |  |                                       |                                   |
| Basic   | 4,356,000                        | 4,356,000                              | 4,356,000                             | 4,356,000                         |
| Diluted   | 4,356,000                        | 4,477,793                              | 4,356,000                             | 4,357,187                         |

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**Financial instruments**

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All of the Trust's financial instruments as at December 31, 2006 relate to standard working capital and credit facility items. There are no significant differences between the carrying value of these financial instruments and their estimated fair values. There are no unusual off-balance sheet arrangements and the Trust does not use any financial instruments such as derivatives. Of the Trust's financial instruments, only accounts receivable represents credit risk, and management views the credit risk related to accounts receivable as minimal. The operating loan and the extendible revolving term loan bear interest at a floating interest rate. Therefore, the extent that the Trust borrows under these facilities, the Trust is at risk to rising interest rates.

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## **Outlook**

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The outlook for the Trust is positive. Demand for services has remained strong to date in 2007, and Deepwell implemented a general price increase of approximately 10 percent on processing fees on January 1, 2007.

The addition of the second well and solids treatment pad at the Grande Cache facility should add to capacity and efficiency, and the facility was back up to full operations on February 1, 2007, following the outage of the vacuum truck unloading system from the December 7, 2006 fire. In addition, Deepwell received approval from the EUB to increase wellhead pressure at the second well at Grande Cache. The cost to upgrade equipment for the increased operating pressure is estimated at approximately \$100,000, and the upgrades were put into service on March 26, 2007. Assuming that the upgraded Grande Cache facility operates at full capacity, Deepwell estimates that the increase in capacity can result in additional annualized EBITDA of approximately \$400,000.

Deepwell received approval from the EUB for a second Class 1b disposal well at its Rycroft facility. A second well adds significant capacity without requiring an immediate increase in staff, or a significant investment in infrastructure at the facility site. Tests indicate that the well will increase injection capacity at Rycroft by approximately 40 percent. Construction of a 1.2 km pipeline to the well will commence as soon as crews and equipment are available. Costs to complete the project are estimated at approximately \$900,000. Assuming completion of the pipeline and that the expanded Rycroft facility operates at full capacity, Deepwell estimates that the increase in capacity provided by the second well can result in additional annualized earnings before interest, taxes, depreciation and amortization (EBITDA) of approximately \$800,000.

Deepwell is also in the final stages of the EUB approval process for its fourth facility, near Claresholm, Alberta. Deepwell believes that it is nearing approval of the facility, although no date for approval has been provided by the EUB. Construction commencement cannot be confirmed at this time, but Deepwell remains optimistic that construction of the facility will be completed during 2007.

In addition, Deepwell owns rights to a location and disposal well for future expansion after Claresholm, and anticipates that an application for approval of this facility may be submitted to the EUB in the second quarter of 2007.

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## **Critical accounting estimates**

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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 periods. The most significant estimates relate to depreciation, amortization, asset retirement obligations, and accretion. Actual results could differ from those estimates. The consolidated 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 as disclosed in the Trust's financial statements.

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## **Risks and uncertainties**

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### **Cyclicality of the oil and natural gas industry**

The demand for oilfield services is largely dependent on the activity levels of oil and natural gas exploration and development companies. Industry conditions are influenced by numerous factors over which the Trust has no control, including: the level of oil and natural gas prices and production; expectations about future oil and natural gas prices; the cost of exploring for, producing and delivering oil and natural gas; the expected rates of declining production from maturing basins; the discovery of new oil and natural gas reserves; available pipeline and other oil and natural gas transportation capacity; weather conditions; global political stability, military actions, regulatory and economic conditions; the ability of oil and natural gas companies to raise capital fuel conservation measures,

alternative fuel requirements, increasing consumer demand for alternatives to oil and natural gas; and technological advances in fuel economy and energy generation devices.

### **Oil and natural gas prices**

The revenue, cash flow and earnings of the Trust are substantially dependent upon and affected by the level of activity associated with oil and natural gas exploration and production. Both short-term and long-term trends in oil and natural gas prices affect the level of such activity. Worldwide military, political and economic events, including initiatives by the Organization of Petroleum Exporting Countries, may affect both the demand for and the supply of oil and natural gas. Weather conditions, governmental regulation, levels of consumer demand, the availability of pipeline capacity and other factors beyond Deepwell's control may also affect the supply of and demand for oil and natural gas lead to future price volatility.

### **Seasonal weather**

In Canada, the level of activity in the oil and natural gas industry is influenced by seasonal weather patterns. Spring break-up during the second quarter of each year leaves many secondary roads temporarily incapable of supporting the weight of heavy equipment, which results in severe restrictions in the level of energy services. The timing and duration of spring break-up is dependent on weather patterns and the duration of this period will have an impact on the level of business of the Trust.

### **Dependence on key personnel**

The success of the Trust will likely continue to be dependent on the skills and expertise of the officers of the Trust. Deepwell does not currently carry "key man" insurance that would compensate the Trust for the loss of any senior executives.

### **Competition for human resources**

During periods of high activity for oil and natural gas exploration and development, demand for experienced and skilled employees increases. The success of the Trust is dependent upon the ability to retain the services of experienced and skilled employees and the ability to recruit and retain other key employees.

### **Reliance on major customers**

It is estimated that the top 10 customers of Deepwell accounted for approximately 49.8 percent of revenue for the year, with no single customer accounting for more than approximately 8.5 percent. Deepwell does not generally enter into long-term contracts with their customers and there can be no assurance that the current customers will continue their relationships with Deepwell.

































