



**STONEHAM**  
DRILLING TRUST

TSX SYMBOL: SDG.UN



**2006 QUARTERLY REPORT**

## **STONEHAM DRILLING TRUST MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE THREE MONTHS ENDED MARCH 31, 2006**

Management's Discussion and Analysis (MD&A) should be read in conjunction with the Consolidated Financial Statements and Notes thereto of Stoneham Drilling Trust for the year ended December 31, 2005, Management's Discussion and Analysis for the year ended December 31, 2005, and the unaudited Consolidated Financial Statements for the three months ended March 31, 2006 and 2005. The Consolidated Financial Statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). Throughout this report the term "Stoneham" has been used to refer to Stoneham Drilling Trust, its subsidiaries, Stoneham Drilling Limited Partnership, Stoneham Drilling Inc. and Stoneham Administration Inc., as the context requires.

The information in this MD&A was prepared on May 5, 2006, and incorporates all relevant considerations to that date. This discussion provides management's analysis of Stoneham's historical financial and operating results and provides estimates of Stoneham's future financial and operating performance based on information currently available. Certain statements in this report may constitute forward-looking statements. Such forward-looking statements involve risks, uncertainties and other factors which may cause actual results to vary significantly from the results implied by such forward looking statements. Consequently readers should not place undue reliance on any forward-looking statements. Readers should also be aware that historical results are not necessarily indicative of future performance. Forward-looking statements are based on the estimates and opinions of management at the date the statements are made, and, subject to its obligations under applicable law, Stoneham does not intend, and does not assume any obligation to update these forward looking statements if conditions or opinions should change.

Additional information relating to Stoneham, including the annual information form for the year ended December 31, 2005, may be found on Stoneham's website at [www.stonehamdrilling.com](http://www.stonehamdrilling.com) or on the Canadian System for Electronic Document Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com).

### ***Overview***

Stoneham Drilling Trust (the "Trust") is an open-ended investment trust governed by the laws of the Province of Alberta pursuant to the Declaration of Trust. The Trust was established for the purpose of investing in property including the securities of Stoneham Drilling Limited Partnership (the "Partnership"), Stoneham Drilling Inc., and Stoneham Administration Inc., the manager of the Trust. The Trust is the limited partner in the Partnership holding a 99.99% interest. Stoneham Drilling Inc. is the general partner of the Partnership (the "General Partner") holding the remaining 0.01% interest. Valiant Trust Company (the "Trustee") is the Trustee of the Trust. The beneficiaries of the Trust are the holders of the trust units.

## ***Selected Financial Information***

	Three months ended	
	March 31, 2006	March 31, 2005
\$ 000s except for per trust unit data and trust units outstanding	(unaudited)	(unaudited)
Revenue	16,308	8,794
Net earnings	5,807	2,112
Per trust unit (basic and diluted)	0.72	0.43
Cash flow from operations (1)	7,515	2,932
Per trust unit (diluted)	0.94	0.59
Total assets	109,710	66,547
Long term debt (2)	919	3,389
Weighted average trust units outstanding		
Basic and diluted	8,023,261	4,965,120
EBITDA (3)	7,300	2,991

(1) Readers are advised that cash flow from operations does not have a standardized meaning prescribed by GAAP and therefore may not be comparable to other companies. However, Stoneham does compute cash flow from operations on a consistent basis for each reporting period.

(2) Long term debt includes obligations under capital lease and callable debt, including the current portion of each.

(3) EBITDA means earnings before interest, taxes, depreciation and amortization. Readers are cautioned that EBITDA does not have a standardized meaning prescribed by GAAP and therefore may not be comparable to other companies. However, Stoneham does compute EBITDA on a consistent basis for each reporting period. A reconciliation to a GAAP measure can be found on page 5 of this MD&A.

## ***Highlights***

- Net earnings for the first quarter of 2006 more than doubled to \$5.8 million from \$2.1 million during the same period in 2005 as a result of the new drilling rigs deployed in 2005, improved rig utilization and price increases.
- Cash flow from operations increased 156% to \$7.5 million for the three months ended March 31, 2006, compared to \$2.9 million in the previous year.
- On a diluted trust unit basis, net earnings in the first quarter of 2006 increased 67% to \$0.72 (2005 - \$0.43), while cash flow from operations rose 59% to \$0.94 (2005 - \$0.59).
- During the first quarter of 2006 Stoneham's rig utilization was 89.2%, which continued to exceed the industry average of 81.1% as reported by the Canadian Association of Oilwell Drilling Contractors ("CAODC").
- Stoneham declared distributions of \$3.0 million or \$0.375 per trust unit to unitholders during the first quarter of 2006.

### *Operational Highlights*

	Three months ended March 31,		%
	2006	2005	Change
Average number of rigs (1)	<b>10.0</b>	6.5	54%
Number of rigs at quarter end	<b>10.0</b>	7.0	43%
Operating days (2)	<b>803</b>	476	69%
Stoneham rig utilization rate (2)	<b>89.2%</b>	79.5%	12%
CAODC industry average (2)	<b>81.1%</b>	71.3%	14%

(1) Rig 7 was deployed in February 2005.

(2) Rig utilization is calculated using operating days (spud to rig release). It does not include stand-by, moving, rig-up or rig-out days.

Rig operating days increased 69% year-over-year as a result of the full quarter inclusion of the drilling rigs deployed throughout 2005 and a later spring break up. Utilization increased 12% to 89.2% in the first quarter of 2006 from 79.5% for the same period in 2005 because spring break-up began later in the year compared to 2005. Stoneham continues to operate at a utilization rate higher than the industry average and expects that this trend will continue for the remainder of the year.

The Canadian drilling industry is seasonal with activity building over the summer and fall and peaking during the winter months as northern transportation routes become accessible. The peak Canadian drilling season ends with spring break-up, at which time drilling operations are curtailed due to seasonal road bans (temporary prohibitions on road use). As warm weather returns in the spring many secondary roads are incapable of supporting the weight of heavy equipment until they have completely dried out. This spring break-up usually occurs in April and May and generally lasts from four to eight weeks.

### *Revenue and Operating Expenses*

\$ 000s	Three months ended March 31,		%
	2006	2005	Change
Revenue	<b>16,308</b>	8,794	85%
Operating expenses	<b>8,179</b>	5,190	58%

As a result of the increase in operating days, price increases, and higher day rates associated with the new rigs, revenue for the first quarter of 2006 grew 85% to \$16.3 million. Revenue increased to \$20,309 per operating day in the first quarter of 2006, from \$18,474 per operating day for the same period in 2005.

Operating expenses rose 58% to \$8.2 million in the first quarter of 2006. Operating expenses, which are mainly variable in nature, increased in large part due to the increase in activity but also due to wage increases and higher costs for rig consumables. Despite these increases, operating expenses per operating day declined slightly to \$10,186 in 2006 from \$10,903 in 2005. In 2005, nearly 70% of the costs resulting from the recertification of Rigs 1, 2 and 3 were incurred in the first quarter with the balance in the second quarter. Similar costs to be incurred on Rigs 4, 5 and 6 in 2006 are all expected in the second quarter. As well, changes in contract terms with certain customers resulted in largely offsetting reductions in both revenue and operating expenses relating to fuel costs.

### ***General and Administrative Expenses***

\$ 000s	Three months ended March 31,		%
	2006	2005	Change
General and administrative expenses	<b>830</b>	613	35%

General and administrative expenses increased to \$0.8 million for the three month period ended March 31, 2006, compared to \$0.6 million for the same period in 2005. The increase is attributable to the full quarter impact of additional staff hired throughout 2005 to manage our larger fleet and other costs, including insurance, associated with Stoneham's growth.

### ***Amortization***

\$ 000s	Three months ended March 31,		%
	2006	2005	Change
Amortization	<b>1,709</b>	819	109%

Amortization of property, plant and equipment more than doubled to \$1.7 million for the three month period ended March 31, 2006. The increase is partially a result of the increase in operating days in the first quarter of 2006, because the majority of Stoneham's capital assets are amortized on a unit-of-production basis. Per operating day amortization on this equipment also rose reflecting the higher cost of the new equipment.

### ***Interest Expense (Income)***

\$ 000s	Three months ended March 31,		%
	2006	2005	Change
Interest on term and callable debt	<b>19</b>	106	-82%
Other interest (income)	<b>(234)</b>	(46)	409%

Interest on term and callable debt, including capital leases, decreased 82% to \$.02 million in the first quarter of 2006. The reduction reflects reduced levels of term debt resulting from the repayments made during 2005. Other interest is comprised of interest income derived from investing cash from the equity financings completed during 2005 that is not immediately required for Stoneham's capital expenditure program. The cash is invested in short-term low risk instruments.

### ***Interest Rate Risk Management***

Stoneham is exposed to fluctuations in interest rates on our floating rate callable debt. Stoneham manages interest rate risk by utilizing a mixture of fixed and floating rate debt.

### ***Income Taxes***

The Trust distributes all of its taxable income to its unitholders, therefore the only income taxes recognized are those incurred by the General Partner. Taxable income of the General Partner was nil, therefore no income tax has been recognized for the three month periods ended March 31, 2006 and 2005.

### ***Liquidity and Capital Resources***

At March 31, 2006, Stoneham's working capital was \$37.6 million, compared to \$40.8 million at December 31, 2005. A significant portion of the December 31, 2005 balance was as a result of the December 2005 equity issue in contemplation of Stoneham's 2006 rig construction program. The decrease in working capital in the first quarter of 2006 is attributable to capital expenditures on the rig construction program. As construction costs are incurred Stoneham

expects the working capital balance to further decrease. During the three months ended March 31, 2006, \$0.6 million of debt was repaid.

At March 31, 2006, Stoneham had available to it operating line facilities totaling \$9.5 million of which no amounts were drawn. During the quarter, Stoneham entered into an agreement to restructure its credit facilities. Subject to completion of formal loan documentation, the Trust's obligations under capital lease and callable debt will be replaced with a \$30.0 million, 364-day extendable revolving credit facility. In addition, as part of the agreement the operating loan will be increased to \$12.0 million. Proceeds from the credit facility will be used to fund the balance of the rig construction program.

### *Operating Activities*

\$ 000s	Three months ended March 31,		% Change
	2006	2005	
Net earnings	<b>5,807</b>	2,112	175%
Cash flow from operations	<b>7,515</b>	2,932	156%

Additional operating days associated with the new drilling rigs, improved rig utilization and price increases are responsible for the increase in both net earnings and cash flow from operations. Earnings and cash flow from operations are sensitive to the demand for Stoneham's services.

### Reconciliation of Non-GAAP Measure

\$ 000s	Three months ended March 31,	
	2006	2005
Net earnings	<b>5,807</b>	2,112
Add (deduct):		
Amortization	<b>1,708</b>	819
Interest on term and callable debt	<b>19</b>	106
Other interest (income)	<b>(234)</b>	(46)
EBITDA (1)	<b>7,300</b>	2,991

(1) EBITDA is defined as earnings before interest, taxes, depreciation and amortization.

The above table reconciles the non-GAAP measure EBITDA to net earnings, a GAAP measure. Management believes in addition to net earnings, EBITDA and cash flow from operations provide supplemental financial information that is useful in the evaluation of Stoneham's operations. Cash flow from operations is derived from our Consolidated Statements of Cash Flows, and represents cash provided by operating activities, before changes in non-cash working capital items. Investors should be cautioned however, that EBITDA and cash flow from operations should not be construed as an alternative to net earnings determined in accordance with GAAP as an indicator of Stoneham's performance.

### *Investing Activities*

\$ 000s	Three months ended March 31,		% Change
	2006	2005	
Capital expenditures	<b>7,623</b>	9,699	-21%

During the first quarter of 2006 Stoneham continued to incur costs on its rig construction program with the majority of the expenditures being deposits and progress payments on five of the seven drilling rigs currently under

construction. These rigs are expected to be deployed during the fourth quarter of 2006. During the quarter, the supplier constructing the other two drilling rigs was acquired by a Stoneham competitor. Timing of completion of these drilling rigs is currently under review with the supplier. During the same period in 2005, construction of Rigs 7 and 8 were completed and deposits made on Rigs 9, 10 and 11.

### *Financing Activities*

\$ 000s	Three months ended March 31,		% Change
	2006	2005	
Net change in term debt (1)	<b>(608)</b>	(10,410)	94%
Changes in capital	-	39,270	-100%

(1) Includes long-term debt, callable debt, capital leases and amounts due to unitholders.

Term debt repayments of \$0.6 million for the three months ended March 31, 2006 were \$9.8 million less than those of \$10.4 million for the same period in 2005. In the first quarter of 2005 Stoneham raised \$39.3 million from its initial public offering and a follow up private placement. A portion of the funds from the initial public offering were used to improve Stoneham's balance sheet by repaying certain debt facilities.

### *Distributions*

\$ 000s, except for per trust unit amounts	Three months ended March 31,		% Change
	2006	2005	
Net earnings	<b>5,807</b>	2,112	175%
Cash flow from operations	<b>7,515</b>	2,932	156%
Distributions paid and payable	<b>3,009</b>	2,013	49%
Distributions per trust unit	<b>0.375</b>	0.375	-

Stoneham makes monthly distributions to unitholders from cash flow from operations, after withholding a portion of cash flow to repay debt and fund capital expenditures. The level of cash flow retained will vary based on debt levels and anticipated capital expenditures. Stoneham is prepared to adjust the payout levels in an effort to balance desired distributions with the requirement to maintain an appropriate capital structure. Stoneham maintains a policy of paying out up to 75% of its cash flow from operations in distributions. For the three months ended March 31, 2006 the payout ratio was 40%. Stoneham currently makes monthly cash distributions of \$0.125 per trust unit (\$1.50 per trust unit per annum).

At March 31, 2006 and at May 5, 2006, the Trust had 8,023,261 trust units outstanding compared to 6,156,561 trust units outstanding at March 31, 2005. The Trust does not have an equity option plan for directors, officers or employees.

***Selected Quarterly Financial Information***

\$ 000s except per trust unit data and utilization	Three Months Ended		Three Months Ended		Three Months Ended		Three Months Ended	
	March 31		December 31		September 30		June 30	
	2006	2005	2005	2004	2005	2004	2005	2004
Revenue	<b>16,308</b>	8,794	13,631	7,758	9,791	5,225	5,144	6,028
Net earnings	<b>5,807</b>	2,112	5,133	1,938	2,662	523	867	1,096
Per trust unit (basic)	<b>0.72</b>	0.43	0.77	0.69	0.43	0.19	0.14	0.39
Per trust unit (diluted)	<b>0.72</b>	0.43	0.77	0.60	0.43	0.17	0.14	0.35
Cash flow from operations	<b>7,515</b>	2,932	6,479	2,715	3,730	1,138	1,332	1,808
Per trust unit (diluted)	<b>0.94</b>	0.59	0.98	0.84	0.61	0.36	0.22	0.57
Utilization:								
Stoneham	<b>89%</b>	80%	84%	82%	71%	61%	47%	63%
Industry	<b>81%</b>	71%	71%	62%	63%	47%	32%	30%

**Stoneham Drilling Trust**  
**Consolidated Balance Sheets**

	March 31, 2006 (unaudited)	December 31, 2005 (audited)
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 24,375,649	\$ 35,658,986
Accounts receivable	20,219,676	14,595,531
Prepaid expenses	411,629	512,728
	45,006,954	50,767,245
<b>Property, plant and equipment</b>	<b>64,703,197</b>	<b>58,789,021</b>
	<b>\$ 109,710,151</b>	<b>\$ 109,556,266</b>
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 5,810,141	\$ 7,846,657
Distributions payable	1,002,908	1,002,908
Current portion of obligations under capital lease	396,828	391,251
Callable debt	245,000	757,000
	7,454,877	9,997,816
<b>Obligations under capital lease</b>	<b>277,303</b>	<b>378,626</b>
	<b>7,732,180</b>	<b>10,376,442</b>
<b>UNITHOLDERS' EQUITY</b>		
Unitholders' capital	89,198,008	89,198,008
Accumulated earnings	24,961,166	19,154,295
Accumulated distributions to unitholders	(12,181,203)	(9,172,479)
	101,977,971	99,179,824
	<b>\$ 109,710,151</b>	<b>\$ 109,556,266</b>

**Stoneham Drilling Trust**  
**Consolidated Statements of Earnings and Accumulated Earnings**

	<b>Three months ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>
<b>REVENUE</b>	<b>\$ 16,308,359</b>	<b>\$ 8,793,685</b>
<b>EXPENSES</b>		
Operating	8,178,570	5,189,749
Amortization	1,708,539	819,250
General and administrative	829,571	612,730
Interest on term and callable debt	19,214	106,051
Other interest (income)	(234,406)	(46,346)
	<b>10,501,488</b>	<b>6,681,434</b>
<b>Net earnings</b>	<b>5,806,871</b>	<b>2,112,251</b>
Accumulated earnings, beginning of period	<b>19,154,295</b>	<b>8,379,797</b>
Accumulated earnings, end of period	<b>\$ 24,961,166</b>	<b>\$ 10,492,048</b>
Earnings per unit		
Basic and diluted	<b>\$ 0.72</b>	<b>\$ 0.43</b>

**Stoneham Drilling Trust**  
**Consolidated Statements of Cash Flows**

	Three months ended March 31,	
	2006	2005
	(unaudited)	(unaudited)
<b>OPERATING ACTIVITIES</b>		
Net earnings for the period	\$ 5,806,871	\$ 2,112,251
Adjustments for items not affecting cash		
Amortization	1,708,539	819,250
<b>Cash flow from operations</b>	<b>7,515,410</b>	2,931,501
Changes in non-cash working capital	(4,723,893)	(998,380)
	<b>2,791,517</b>	1,933,121
<b>INVESTING ACTIVITIES</b>		
Purchase of property, plant and equipment	(7,622,716)	(9,698,901)
Changes in accounts payable relating to investing activities	(2,835,668)	2,306,333
	<b>(10,458,384)</b>	(7,392,568)
<b>FINANCING ACTIVITIES</b>		
Term and callable debt repayments	(607,746)	(10,386,683)
Trust unit issue	-	39,269,830
Proceeds on exercise of Trust unit options	-	200,000
Distributions paid and payable to Trust unitholders	(3,008,724)	(2,013,010)
Due to Trust unitholders	-	(22,978)
Changes in accounts payable relating to financing activities	-	769,570
	<b>(3,616,470)</b>	27,816,729
(Decrease) Increase in cash and cash equivalents	(11,283,337)	22,357,282
Cash and cash equivalents (Bank indebtedness), beginning of period	35,658,986	(1,919,015)
<b>Cash and cash equivalents, end of period</b>	<b>\$ 24,375,649</b>	\$ 20,438,267

**Stoneham Drilling Trust**  
**Notes to the Consolidated Financial Statements**  
**March 31, 2006 and March 31, 2005**  
(unaudited)

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**1. Basis of Presentation**

These interim financial statements were prepared using accounting policies and methods of their application consistent with those used in the preparation of the Stoneham Drilling Trust (the "Trust") audited consolidated financial statements for the year ended December 31, 2005. These interim financial statements conform in all respects to the requirements of generally accepted accounting principles in Canada for annual financial statements with the exception of certain note disclosures. As a result, these interim financial statements should be read in conjunction with the Trust's audited financial statements for the year ended December 31, 2005, contained in the Trust's 2005 annual report.

**2. Seasonality of Operations**

All of the Trust's operations are carried out in Canada. The ability to move heavy equipment in the Canadian oil and natural gas fields is dependent on weather conditions. As warm weather returns in the spring, the winter frost comes out of the ground rendering many secondary roads incapable of supporting the weight of heavy equipment until they have thoroughly dried out. The duration of this spring break-up has a direct impact on the Trust's activity levels. In addition, many exploration and production areas in northern Canada are accessible only in winter months when the ground is frozen sufficiently to support drilling equipment and services. The timing of freeze up and spring break-up affects the ability to move drilling equipment in and out of these areas. As a result, April through May is traditionally our slowest time.

**3. Accumulated Distributions to Unitholders**

The following table shows the cumulative distributions to unitholders.

	<u>\$/unit</u>	<u>Amount</u>
Amount declared during the year ended December 31, 2005	1.500	\$ 9,172,479
January, 2006	0.125	1,002,908
February, 2006	0.125	1,002,908
March, 2006 (declared and payable in April, 2006)	0.125	1,002,908

**4. Supplemental Cash Flow Information**

Changes in non-cash working capital

	Three months ended	
	<u>March 31,</u>	<u>March 31,</u>
	<u>2006</u>	<u>2005</u>
(Increase) decrease in current assets		
Accounts receivable	\$ (5,624,145)	\$ (1,280,824)
Prepaid expenses	101,099	413,614
Increase (decrease) in current liabilities		
Accounts payable and accrued liabilities	799,153	(131,170)
	<u>\$ (4,723,893)</u>	<u>\$ (998,380)</u>
Interest paid	<u>\$ 19,214</u>	<u>\$ 109,539</u>