Cathedral

Energy Services Income Trust

2003 ANNUAL REPORT

Cathedral

Directional Plus
CAT Downhole Tools
THE Directional Company

Divisions of Cathedral Energy Services Ltd.

Annual Meeting

Unitholders are invited to attend the Annual General and Special Meeting which will be held at 2:30 p.m. on May 26, 2004, in the Royal Meeting Room of the Metropolitan Centre, 333-4th Avenue S.W., Calgary, Alberta

Table of Contents

GENERAL INFORMATION

Cathedral Energy Services Income Trust (the "Trust") is a limited purpose trust which owns the securities of Cathedral Energy Services Ltd. ("Cathedral") representing the right to receive cash flow available for distribution from Cathedral. Cathedral is engaged in the business of providing drilling services and related equipment rentals to oil and natural gas companies in western Canada and the Rocky Mountain region of the United States. Cathedral's services are marketed under three brand names: ***Directional Plus*** and ***The Directional Company*** which provide horizontal and directional drilling services; and ***CAT Downhole Tools*** which provides downhole equipment including drilling jars, shock subs and high performance drilling motors on a rental basis. Cathedral strives to provide its clients with value added technologies and solutions to meet their drilling requirements. Its mandate since inception has been to supply ***"Best in Class, Best in Service"*** equipment and personnel to its clients.

The Trust's units ("Trust Units") trade on the TSX under the symbol: CET.UN.

FINANCIAL HIGHLIGHTS

Figures in thousands of dollars, except Trust Unit amounts *	2003	2002	2001	2000	1999
Revenues	32,715	22,075	23,444	19,036	5,793
Gross margin % (revenues less operating expenses)	49%	57%	54%	48%	43%
EBITDA**	8,269	6,942	7,783	5,678	1,526
Operating income ***	4,623	3,726	5,094	3,973	945
Income before taxes	4,828	4,086	5,102	4,107	1,007
Net income	4,441	3,389	5,206	4,471	602
Basic per Trust Unit	0.20	0.24	0.63	0.75	0.28
Diluted per Trust Unit	0.20	0.16	0.24	0.23	0.06
Cash distributions per Trust Unit					
Declared	0.2200	0.0938	n/a	n/a	n/a
Paid	0.2207	0.0381	n/a	n/a	n/a
Capital asset additions and corporate aquisitions	7,969	3,516	7,276	9,102	3,597
Weighted outstanding Trust Units					
Basic (`000)	21,710	13,867	8,248	5,946	2,126
Diluted (`000) ****	22,004	21,516	21,479	19,395	10,931
Total assets	33,080	24,811	25,278	20,247	7,607
Total long-term debt including current portion	5,700	2,721	5,110	3,431	1,676
Unitholders' equity	16,589	16,375	16,578	11,372	3,013

* Effective July 30, 2002, Cathedral Energy Services Ltd. was reorganized into an unincorporated, open-ended limited purpose mutual fund trust. The results of the Trust are presented based upon the continuity of interests method of accounting and, accordingly, the comparative figures are that of Cathedral Energy Services Ltd.

** EBITDA, earnings before interest, taxes, non-cash compensation expense, depreciation and amortization, is provided to assist investors in determining the ability of the Trust to generate cash from operations. EBITDA does not have any standardized meaning within Canadian Generally Accepted Accounting Principles and therefore may not be comparable to similar measures presented by other companies and/or trusts.

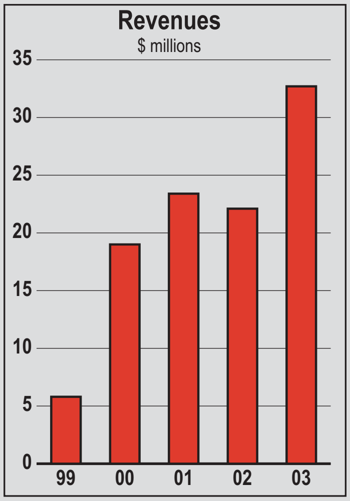
*** Operating income, as disclosed on the consolidated statement of operations, is defined as revenues less expenses relating to operating, general and administrative, depreciation and interest on long-term debt. Operating income does not have any standardized meaning within Canadian Generally Accepted Account policies and therefore may not be comparable to similar measures provided by other companies and/or trusts.

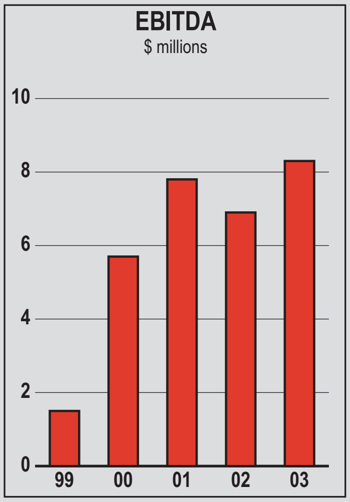
**** For the dilutive effect of Trust Unit/Share options and Special Shares, Series 1 that were outstanding prior to the conversion to an income trust on July 30, 2002.

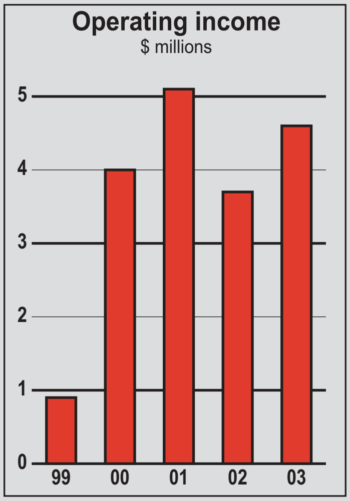
FORWARD-LOOKING STATEMENTS

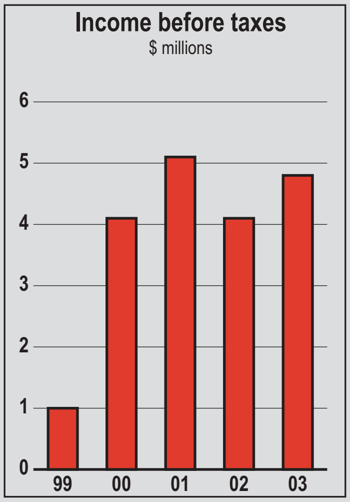
This annual report may contain forward-looking statements, including statements regarding the business and anticipated financial performance of the Trust. These forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Trust to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. A number of factors could cause actual results to differ materially from those in the forward-looking statements, including, but not limited to, fluctuations in world oil and North American natural gas prices, weather, access to capital markets, competition, changes in technology and government policies. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by the Trust or any other person that the objectives and plans of the Trust will be achieved.

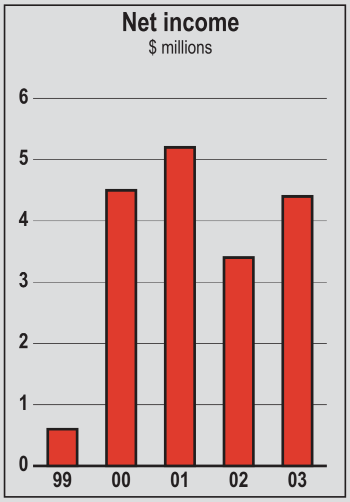
FINANCIAL HIGHLIGHTS

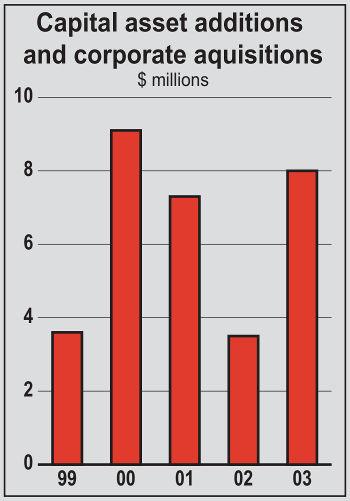












REPORT TO UNITHOLDERS

What a difference a year makes in the drilling industry. When we look back at 2002 and our expectations for 2003, all areas of our business exceeded those expectations.

With oil and natural gas prices for 2003 remaining at extremely high levels, cash flow available to oil and natural gas producers for 2003 were at record levels and this in turn lead to driving drilling activity for 2003 well beyond the expectations of industry analysts. On the technology side, Cathedral developed and brought to market an Electro-Magnetic Measurement-While-Drilling ("EM-MWD") system ahead of schedule and under budget. In addition, we successfully moved into the Steam-Assisted Gravity Drainage ("SAGD") market, closed our first acquisition and finally had some recognition in our trust unit price. All of this made for a tremendous 2003 for Cathedral.

2003 was an exceptional year for pricing of both oil and natural gas commodities. Oil was held well above the USD $30.00/bbl throughout the year due to several reasons including, the war in Iraq, continued Middle East turmoil, Venezuelan oil strikes and growth in the U.S. economy. All factors helped hold prices at a level above most industry analysts' expectations. Natural gas pricing also remained high due to continued supply and storage concerns.

For 2004 we do not expect to see much change for pricing for either commodity. Oil is seeing significant demand increases from the world's two largest populated countries, India and China. Both of these countries are growing at alarming rates and will certainly have large increases in energy consumption. As well the U.S. economy continues to show signs of strength and the Middle East does not appear to be making any headway on the peace process. Natural gas is expected to remain within the same pricing region as in 2003 with weather having the largest effect including how the weather effects natural gas storage levels. This all sets the parameters for another very active year of drilling in 2004.

The most significant achievement of 2003 was the successful commercialization of an internally developed EM-MWD system. This tool will set the stage for future growth of Cathedral. It gives Cathedral an opportunity to expand into markets that were not previously available without the use of expensive third-party rental equipment. This system will not only create growth opportunities but will aid in reducing rental costs. Currently Cathedral is finalizing the build out of fifteen EM-MWD systems which will be ready to go as the industry comes out of spring break up in mid to late May. The addition of these 15 EM-MWD systems will give Cathedral a concurrent job capacity of 35.

With now having our own MWD platform the next stage of development will be a positive pulse MWD system. Having a positive pulse MWD system and an EM-MWD system based on the same technology platform will give Cathedral unprecedented flexibility in potential future developments in this area. Having the versatility to move in different directions and at our own pace will allow Cathedral to continue to meet the growing needs of our customers.

One of the key areas for utilization of the EM-MWD system is in the drilling of SAGD wells. SAGD technology was developed to recover some of the vast amount of heavy oil reserves in northeastern Alberta. The drilling of SAGD wells requires the drilling of parallel horizontal well bores and maintaining specific distances between them. Steam is then injected into the upper well bore, to aid in the flow of the oil, and production occurs through the lower well bore. This was an area that Cathedral identified and targeted several years back as a niche growth area that we wanted to be involved in. Cathedral completed its first program in Q4 of 2003 and is currently drilling (as of April 15, 2004) its first long-term program. We continue to market this area and expect to add additional SAGD programs during 2004.

The Rocky Mountain region of the U.S. is a growing market for Cathedral. In 2003 we opened a repair and operations facility in Casper, Wyoming and moved our sales office into downtown Denver, Colorado. These moves have created efficiencies in equipment utilization and reduced our operating costs. We recently began to move EM-MWD equipment into the region to meet growing demands as well as give us a technical advantage over our competition. 2004 should be a tremendous year of growth for Cathedral in this region.

In February 2003 Cathedral closed the acquisition of The Directional Company, Inc. ("TDC"). This has been a tremendous addition to Cathedral in that it allowed us to further penetrate the southeast Saskatchewan market and should prove to be counter cyclical to the operations of Cathedral's traditional directional business.

2003 was Cathedral's first full year as an income trust. Our objective for the year was to show the market place that an oilfield service company can belong in the trust space. This was accomplished by showing the stability in our earnings and distributions. Since inception the trust has paid equal quarterly distributions amounting to an annualized amount of $0.22 per trust unit. In January 2004 Cathedral converted to monthly distributions and increased the distribution by approximately 9% based upon the sound financial performance of Cathedral.

In the later half of 2003 Q3 and continuing into 2004 the market place began to recognize the accomplishments of Cathedral by pushing the value of the trust units into the trading range (based on yield) of our peers. Although pleased with this movement we look forward to creating additional value throughout 2004.

REPORT TO UNITHOLDERS

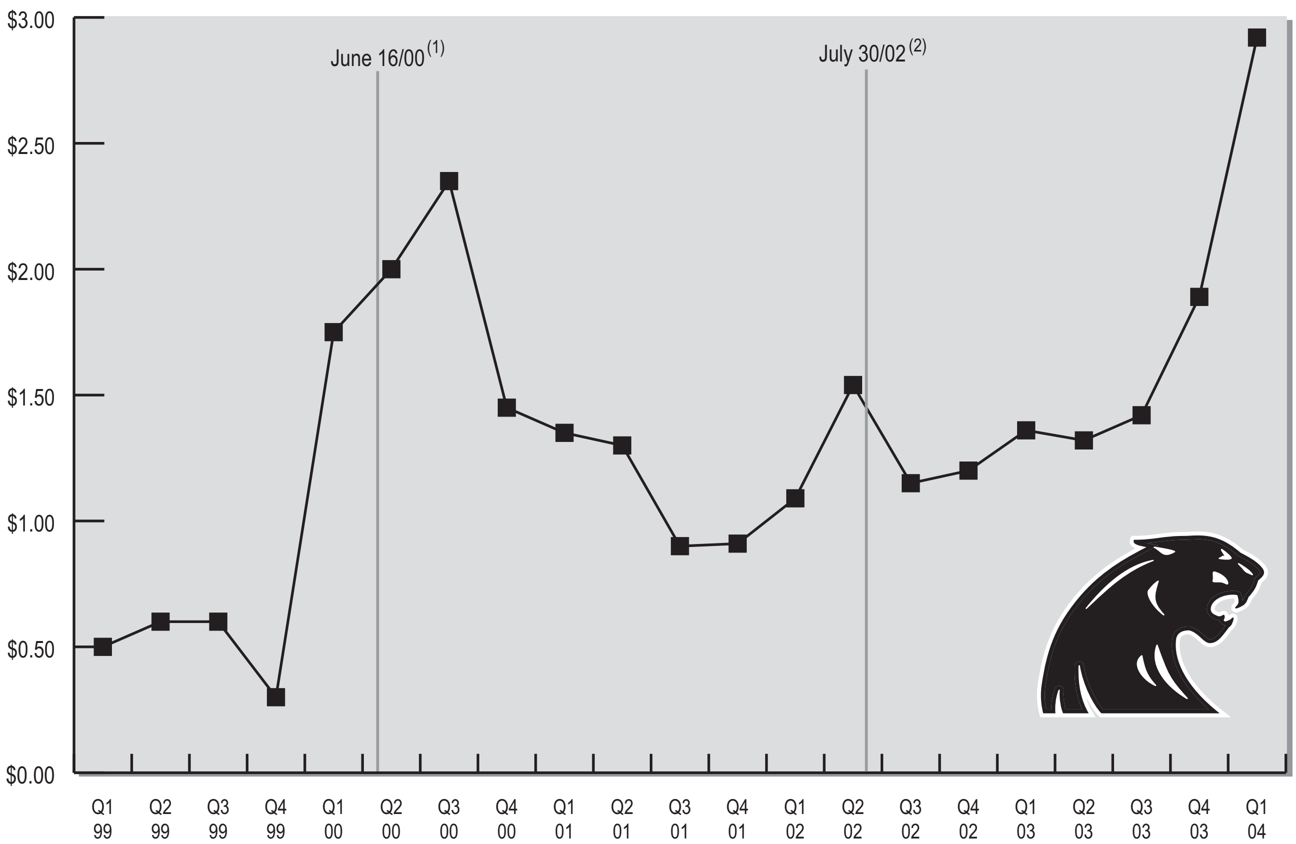
For the remainder of 2004 Cathedral intends to push forward in the marketplace based on its strengths in personnel and equipment. We continue to focus on quality of service, which has been the underlying factor in the growth of Cathedral. As well we continue to look for strategic acquisition opportunities that will enhance the value of the organization.

2004 should prove to be one of the industries and Cathedral's best. We thank everyone associated with the organization for their participation and support.

Yours truly,

Mark L. Bentsen
President and Chief Executive Officer
Cathedral Energy Services Ltd.
April 15, 2004

Quarter-end Trust Unit/Share Price



(1) Effective date of reverse takeover of Cathedral Gold Corporation.
(2) Effective date of conversion to an income trust.

REVIEW OF OPERATIONS

Cathedral is engaged in the business of providing drilling services and related equipment rentals to oil and natural gas companies in western Canada and the Rocky Mountain region of the United States. Cathedral's services are marketed under three brand names: ***Directional Plus*** and ***The Directional Company*** which provide horizontal and directional drilling services; and ***CAT Downhole Tools*** which provides downhole equipment including drilling jars, shock subs and high performance drilling motors on a rental basis. Cathedral strives to provide its clients with value added technologies and solutions to meet their drilling requirements. Its mandate since inception has been to supply "***Best in Class, Best in Service***" equipment and personnel to its clients.

2003 was a year of significant developments for Cathedral including:

- Acquisition of The Directional Company, Inc. effective February 12, 2003
- Opening of a U.S. operations facility in Casper, Wyoming
- Successful completion of our first Steam-Assisted Gravity Drainage ("SAGD") program
- Commercialization of a proprietary Electro-Magnetic Measurement-While-Drilling ("EM-MWD") system
- Commencement of a build program for 15 EM-MWD systems of which 3 systems were received by December 31, 2003
- Addition of significant new customers

The Directional Company, Inc. The acquisition of privately owned The Directional Company, Inc. ("TDC") on February 12, 2003 allowed Cathedral to enter into the southeast Saskatchewan market for providing horizontal and directional drilling services. TDC's operating equipment included 2 owned Geolink MWD systems (same equipment utilized by Cathedral) and 24 drilling motors. Cathedral's management is very pleased with the contribution of TDC to the operating results for 2003. The purchase price for the TDC acquisition was comprised of fixed consideration of $2,775,000 and additional contingent consideration of up to a maximum of $1.25 million, payable in cash, that will be paid over a 2-year period based upon the financial results of TDC for the periods ended December 31, 2003 and 2004. Fixed consideration comprised $2,506,000 of cash which was financed by way of bank debt and $269,000 of Trust Units. Contingent consideration related to the period February 13, 2003 to December 31, 2003 amounted to $751,000 and has been recorded in the accounts. In relation to the acquisition of TDC, Cathedral has recorded $1,125,000 of goodwill.

U.S. operations facility Effective April 1, 2003, Cathedral opened a leased operations facility in Casper, Wyoming. The ability to repair and coordinate equipment in Casper has allowed Cathedral to reduce operating costs as well as reduce the turnaround time related to repairing equipment. In addition to the Casper, Wyoming facility, Cathedral maintains a U.S. sales office in Denver, Colorado.

SAGD project In late 2003, Cathedral completed its first SAGD project which was comprised of three pairs of horizontal well bores for a major Canadian oil and natural gas producer. SAGD is an area that Cathedral has identified as a tremendous niche market area for its growth. With the vast amount of heavy oil in place in northeastern Alberta, and much of it too deep to be mined, SAGD technology will be the preferred method of production. Cathedral commenced drilling its first long-term SAGD program for another customer in Q2 of 2004.

EM-MWD tool In early 2002, Cathedral determined that the inclusion of an EM-MWD system within its fleet was critical in light of management's assessment of the expected future demand by customers for such equipment. In Q3 of 2002, Cathedral commenced with the assistance of a third-party the development of a proprietary EM-MWD system to supplement its existing externally supplied MWD systems. In November 2003, Cathedral announced that its EM-MWD system had reached commercial status and by December 31, 2003 had added 3 EM-MWD systems to its MWD fleet with another 12 to be built in 2004. Aside from increasing our overall MWD job capability, the addition of owned EM-MWD equipment to Cathedral's MWD fleet will reduce expensive third-party equipment rentals and therefore contribute to higher future operating margins. The ability of Cathedral to internally develop an EM-MWD system with the assistance of a third-party demonstrates the technical capabilities of Cathedral's team.

REVIEW OF OPERATIONS

In February 2004, Cathedral completed a successful deep test of the EM-MWD tool. The EM-MWD tool was operated in the Brazeau field in Alberta to a total depth of 3,270m without the use of repeater subs or a long wire assist. In addition, this depth was achieved using less than half the power available to the tool. Since commercialization the EM-MWD tool has worked in over 95 wells and the tool has worked flawlessly in all applications and its success has definitely exceeded the expectations of Cathedral. The EM-MWD tool has been successfully tested in the Rocky Mountain region of the United States where Cathedral currently operates. Operators in this region are directing Cathedral to provide more EM-MWD systems as their projects grow in scope.

Customer additions During 2003, Cathedral was able to add a number of customers which included junior and senior oil and natural gas exploration and development companies to its customer base.

Equipment The following is a summary of major downhole equipment owned by Cathedral:

	As at December 31		
	2003	2002	2001
Measurement-While-Drilling systems -			
Negative pulse	**16**	14	14
Positive pulse	**4**	4	3
Electro-magnetic	**3**	-	-
	23	18	17
Drilling mud motors	**149**	95	89
Drilling jars	**43**	43	43
Shock tools	**34**	35	35

Health, safety and environment Within the operations of Cathedral, health, safety and environment are a very important issue. Cathedral maintains a comprehensive system which effectively combines Health, Safety and Environment policies with Loss Control. The system involves a continuous improvement process that has allowed Cathedral to manage and minimize losses in all aspects of our business, including most importantly, ensuring a safe work environment for both our employees and the public at large.

Cathedral continues to maintain its Certificate of Recognition ("COR"), which is issued through the partnerships program with Alberta Human Resources and Employment and the Petroleum Industry Training Service. Cathedral successfully passed an external three year audit and the COR was re-issued on October 17, 2003. The COR program is a formal acknowledgement that the employer has successfully implemented a basic workplace health and safety management system. A COR is often a pre-requisite for a company's services being considered for contract purposes.

GOVERNANCE

Pursuant to an administration agreement, the management and administration of Cathedral Energy Services Income Trust is delegated to the Board of Directors and management of Cathedral Energy Services Ltd. ("Cathedral"), as Administrator of the Trust. The Board of Directors of Cathedral are also Trustees of the Trust. The committees of Cathedral's Board of Directors extend their respective mandates to governance of the Trust. As a publicly traded entity, the Trust is required to disclose annually its alignment with a set of governance guidelines adopted by the Toronto Stock Exchange to assist the organization in assessing accountability to stakeholders. The Trust's statement of adherence to those guidelines is included in the 2004 Information Circular. The Trust is in substantial compliance with those guidelines.

Mandate of the Board The Board of Directors of the Administrator has approved a mandate which includes among other duties and responsibilities: to approve and monitor the strategic, business and financial plans of Cathedral; supervise performance and succession planning of senior officers; assessment of principal risk factors relating to the business of Cathedral; and to monitor and oversee the integrity of the financial reporting and disclosure. Every Director and Trustee is required to act honestly and in good faith and in the best interests of the Administrator and the Trust and to exercise the care, diligence and skill of a reasonably prudent person. Responsibilities not delegated to senior management or to a committee of the Board remain those of the full Board.

Composition of the Board and Trustees The Board of Directors of the Administrator is currently composed of six members of which four are unrelated (independent from management and free from conflicting interests) to the Administrator. All of the Board of Directors of the Administrator are also Trustees of the Trust. In addition, the Board of Directors has elected a Lead Director who is an outside unrelated director.

Board Committees The Board of Directors of Cathedral has established three committees – Audit, Compensation and Governance. All committees of the Cathedral Board of Directors are comprised of outside unrelated directors.

Audit Committee The Board of Directors has approved a mandate which includes among other duties and responsibilities: monitoring the financial reporting process and systems of internal controls; monitoring the independence and performance of the external auditors; and reviewing interim and year end financial statements and other regulatory filings and furthermore recommending such financial statements and filings for approval by the Board of Directors.

Compensation Committee The Board of Directors has approved a mandate which includes among other duties and responsibilities: monitoring the performance and compensation of senior management; and reviewing and providing recommendations to the Board of Directors with respect to implementation and variation of option, compensation and incentive plans.

Governance Committee The Board of Directors has approved a mandate which includes among other duties and responsibilities: monitoring the effectiveness of the system of governance within the Trust and Cathedral; assessing the effectiveness of the Board of Directors as a whole, committees of the Board and the contributions of individual members; and identifying, recommending, orienting and educating new directors.

MANAGEMENT'S DISCUSSION & ANALYSIS

This Management's Discussion and Analysis ("MD&A") for the year ended December 31, 2003 provides an analysis of the consolidated results of operations, financial position and cash flows of Cathedral Energy Services Income Trust and its subsidiaries (the "Trust") and should be read in conjunction with the accompanying audited consolidated financial statements for the year ended December 31, 2003, as well as the Trust's 2003 interim MD&A's. This MD&A is intended to assist the reader in the understanding and assessment of significant changes and trends, as well as the risks and uncertainties, related to the results of the operations and financial position of the Trust.

Certain statements within this MD&A may contain forward-looking statements, including (without limitation) statements concerning possible or assumed future results of operations of the Trust preceded by, followed by or that include the words "believes", "expects", "anticipates", "estimates", "intends", "plans", "forecasts" or similar expressions. Forward-looking statements are based on the estimates and opinions of management at the date the statements are made. These involve risks and uncertainties and the Trust's results may differ materially from those anticipated in the forward-looking statements.

Overview

Cathedral Energy Services Income Trust is an unincorporated, open-ended mutual fund trust established under the laws of the Province of Alberta pursuant to a Declaration of Trust dated June 24, 2002. The Trust is publicly traded on the Toronto Stock Exchange under the symbol CET.UN. The Trust, through its wholly-owned subsidiary, Cathedral Energy Services Ltd. ("Cathedral"), is engaged in the business of providing drilling services and related equipment rentals to oil and natural gas exploration and development companies in western Canada and the Rocky Mountain region of the United States. Cathedral markets its services under three brand names: Directional Plus and The Directional Company which provide horizontal and directional drilling services; and CAT Downhole Tools which provides downhole equipment including drilling jars, shock subs and high performance drilling motors on a rental basis. Cathedral strives to provide its clients with value added technologies and solutions to meet their drilling requirements. Its mandate is to supply "Best in Class, Best in Service" equipment and personnel to its clients.

Selected Annual Information (in '000 of $ except per Trust Unit amounts)

	2003	Increase (decrease)	2002	Increase (decrease)	2001
Revenues	$ 32,715	$ 10,640	$ 22,075	$ (1,369)	$ 23,444
% change		48%		(6%)	
EBITDA (1)	8,269	1,327	6,942	(841)	7,783
% change		19%		(11%)	
Income before taxes	4,828	742	4,086	(1,016)	5,102
% change		18%		(20%)	
Net income	4,441	1,052	3,389	(1,817)	5,206
% change		31%		(35%)	
Net income per Trust Unit -					
Basic	0.20	(0.04)	0.24	(0.39)	0.63
Diluted	0.20	0.04	0.16	(0.08)	0.24
% change - diluted		25%		(33%)	
Funds from operations	7,794	1,851	5,943	(1,548)	7,491
% change		31%		(21%)	
Working capital	1,955	989	966	24	942
Total assets	33,080	8,269	24,811	(467)	25,278
Long-term debt (2)	5,700	5,045	655	(2,066)	2,721
Unitholders' equity	16,589	214	16,375	(203)	16,578
Cash distributions declared per Trust Unit	0.2200	0.1262	0.0938	0.0938	n/a

(1) EBITDA, earnings before interest, taxes, non-cash compensation expense, depreciation and amortization, is provided to assist investors in determining the ability of the Trust to generate cash from operations. EBITDA does not have any standardized meaning within Generally Accepted Accounting Policies and therefore may not be comparable to similar measures presented by other companies and/or trusts.

(2) Excludes current portion of long-term debt, which is included in working capital.

Results of operations

2003 compared to 2002

Overview

The Trust completed fiscal 2003 with net income of $4,441,000 ($0.20 per diluted Trust Unit) which compares to $3,389,000 ($0.16 per diluted Trust Unit) in 2002 – an increase of $1,052,000 or 31%. EBITDA for the year ended December 31, 2003 was $8,269,000 while the comparative figure for 2002 was $6,942,000 – an increase of $1,327,000 or 19%. Due to Cathedral's share structure prior to the conversion to an income trust on July 30, 2002 (common shares and non-voting dilutive special shares outstanding), in management's opinion, comparison of basic earnings per Trust Unit from 2002 to 2003 does not provide meaningful information and comparison should be performed at the per diluted Trust Unit level. The fluctuations in net income per diluted Trust Unit from 2002 to 2003 is substantially in line with the related fluctuation in net income for the period.

Revenues and operating expenses

‘000	**2003**	2002	Change	%
Revenues	**$ 32,715**	$ 22,075	$ 10,640	48
Operating expenses	**16,681**	9,430	7,251	77
Gross margin - $	**$ 16,034**	$ 12,645	$ 3,389	27
Gross margin - %	**49.0%**	57.3%	(8.3%)	

The Trust completed 2003 with record revenues of $32,715,000 which compares to $22,075,000 in 2002 – an increase of $10,640,000 or 48%. The increase was mainly attributed to an increased level of drilling activity in western Canada and the Rocky Mountain region of the United States and the contribution of revenues from The Directional Company, Inc. (“TDC”) acquisition that occurred on February 12, 2003 and was partially offset by a decrease in the average day rate for horizontal and directional drilling services. For 2003, Cathedral had 4,125 (2002 – 2,627) activity days related to providing horizontal and directional drilling services with an average day rate of $7,096 (2002 - $7,402). The decline in the average day rate is due to market related pricing issues; particularly within the Canadian market. For the year ended December 31, 2003, 21,805 wells were drilled in western Canada which is a 39% increase from 2002's level of 15,682 wells drilled. In the past 5 years, horizontal and directionally drilled wells accounted for 22-28% of all wells drilled in western Canada.

Cathedral continued to add a number of junior and senior oil and natural gas exploration and development companies to its customer list in 2003 and expects to do the same in 2004.

In late 2003, Cathedral completed its first Steam-Assited Gravity Drainage ("SAGD") project which was comprised of three pairs of horizontal well bores for a major Canadian oil and natural gas producer. SAGD is an area that Cathedral has identified as a tremendous niche market area for its growth. With the vast amount of heavy oil in place in northeastern Alberta, and much of it too deep to be mined, SAGD technology will be the preferred method of production. Cathedral commenced drilling its first long-term SAGD program for another customer in Q2 of 2004.

The decline in gross margin on a percentage basis by 8.3% from 57.3% in 2002 to 49.0% in 2003 is mainly a function of an increase in equipment rental charges (mainly due to the rental of Electro-Magnetic Measurement-While-Drilling (“EM-MWD”) equipment) as well as a decrease in the average day rate obtained for directional/horizontal drilling services and a shift to more horizontal drilling services which has a lower gross margin. Cathedral's EM-MWD system was deemed commercial in November 2003 and as a result did not contribute significantly to reduce EM-MWD rental costs in 2003. Going forward MWD rental costs are expected to reduce significantly although at peak operating levels rental of equipment from third parties will be required. As well, Cathedral is continually reviewing its cost structure with the goal of reducing overall operating costs.

General and administrative expenses

‘000	**2003**	2002	Change	%
General and administrative expenses	**$ 7,975**	$ 6,062	$ 1,913	32

The increase in general and administrative expenses is attributed to establishing an increased presence in the Rocky Mountain region of the United States and the inclusion of TDC related expenses effective February 12, 2003. As a percentage of revenues, general and administrative expenses were 24.4% and 27.5% for 2003 and 2002, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Depreciation

'000	**2003**	2002	Change	%
Depreciation	**$ 3,118**	$ 2,659	$ 459	17

The increase in depreciation is related mainly to the inclusion of depreciation related to TDC capital assets that were part of the February 2003 acquisition of TDC. As a percentage of revenues, depreciation expense has decreased from 12.0% in 2002 to 9.5% in 2003 - this decrease is a direct result of increased revenues.

Interest on long-term debt

'000	**2003**	2002	Change	%
Interest on long-term debt	**$ 319**	$ 197	$ 122	62

The increase is related to an increase in the average level of long-term debt outstanding in 2003 versus 2002 and an increase in the effective borrowing rate. The increase in the effective borrowing rate is attributed to an increase in the bank's prime lending rate while the increase in the average level of long-term debt outstanding is related to debt incurred with respect to the TDC acquisition in February 2003.

Gain on disposal of capital assets

'000	**2003**	2002	Change	%
Gain on disposal of capital assets	**$ 205**	$ 659	$ (454)	(69)

In comparison to 2002 less downhole equipment was lost-in-hole in 2003. Cathedral has recovered lost-in-hole equipment costs and this has resulted in a gain on disposal of capital assets of $205,000 which compares to $659,000 in 2002.

Re-organization expenses

'000	**2003**	2002	Change	%
Re-organization expenses	$ –	$ 300	$ (300)	n/a

In Q2 of 2002, the Trust incurred $300,000 of one-time costs associated with the re-organization into an income trust. No such expenses were incurred in 2003.

Taxes

'000	**2003**	2002	Change	%
Taxes	**$ 386**	$ 697	$ (311)	(45)

The effective tax rate for 2002 was 17.1% while the comparative figure for 2003 was 8.0%. The fluctuation in the effective tax rates is the result of the shift of the majority of the tax burden to the Trust's unitholders upon conversion to an income trust on July 30, 2002.

2002 compared to 2001

Overview

Net income for fiscal 2002 amounted to $3,389,000 ($0.16 per diluted Trust Unit) which is a $1,817,000 decrease from fiscal 2001 net income of $5,206,000 ($0.24 per diluted Trust Unit). Included in 2001 net income is the benefit of a $2,618,000 valuation allowance and deferred credit adjustment. EBITDA for the year ended December 31, 2002 was $6,942,000 while the comparative figure for 2001 was $7,783,000. Net income from 2001 to 2002 declined 35% which is more than the 20% decline in income before taxes. This decline is due to the fluctuation in the effective tax rate for the two years – 17.1% for 2002 and a 2.1% recovery in 2001. The variance in the effective tax rates was the net result of: i) a $2,618,000 reduction in 2001 tax provision for a valuation allowance adjustment and benefit of amortization and adjustment of the deferred credit; and ii) the shift of tax burden to the Trust's unitholders effective July 30, 2002.

Due to Cathedral's share structure prior to the conversion to an income trust on July 30, 2002 (common shares and non-voting dilutive special shares outstanding), in management's opinion, comparison of basic earnings per Trust Unit from 2001 to 2002 does not provide meaningful information and comparison should be performed at the per diluted Trust Unit level. The fluctuations in net income per diluted Trust Unit from 2001 to 2002 is substantially in line with the related fluctuation in net income for the period.

Revenues and Operating Expenses

'000	2002	2001	Change	%
Revenues	$ 22,075	$ 23,444	$ (1,369)	(6)
Operating expenses	9,430	10,703	(1,273)	(12)
Gross margin - $	$ 12,645	$ 12,741	$ (96)	(1)
Gross margin - %	57.3%	54.3%	3.0%	

For the year ended December 31, 2002, revenues were $22,075,000 which is a $1,369,000 or 6% decrease from 2001 revenues of $23,444,000. This 6% decline in revenues occurred in an environment that saw the number of wells completed in western Canada during 2002 decreased 19% from levels in 2001. In 2002, Cathedral had 2,627 (2001 – 2,824) activity days related to horizontal and directional drilling services with an average day rate of $7,402 (2001 - $8,074). The Rocky Mountain region of the United States contributed $2,510,000 of revenues in 2002 which compares to $145,000 in 2001. In Q4 of 2001, Cathedral commenced renting downhole equipment in the U.S. market and in January 2002, commenced providing directional drilling services in the same region. During 2002, Cathedral was able to add a number of junior and senior oil and natural gas exploration and development companies to its customer list.

Cathedral was able to increase its gross margin on a percentage basis by 3.0% from 54.3% in 2001 to 57.3% in 2002. Significant gains in gross margin have been experienced over the past years with the main contributing factor being less reliance on third-party rented equipment. In addition, Cathedral has increased the level of revenues from the rental of downhole equipment which generates a gross margin higher than that from providing horizontal and directional drilling services.

General and administrative expenses

'000	2002	2001	Change	%
General and administrative expenses	$ 6,062	$ 4,966	$ 1,096	22

For the year ended December 31, 2002, general and administrative expenses were $6,062,000 which is an increase of $1,096,000 over 2001 expense of $4,966,000. The majority of the increased general and administrative expenses is attributed to an increase in personnel costs related to staffing of CAT Downhole Tools and establishing an increased presence in the Rocky Mountain region of the United States. As a percentage of revenues, general and administrative expenses were 27.5% and 21.2% for 2002 and 2001, respectively.

Depreciation

'000	2002	2001	Change	%
Depreciation	$ 2,659	$ 2,417	$ 242	10

Depreciation has increased from $2,417,000 in 2001 to $2,659,000 in 2002. The $242,000 or 10% increase is a result of Cathedral's continued investment in its capital asset base.

As a percentage of revenues, depreciation expense has increased from 10.3% in 2001 to 12.0% in 2002. This increase is a direct result of Cathedral purchasing more revenue producing capital assets, and therefore reducing its reliance on leased/rented equipment to produce revenues, as well as a $1,369,000 decrease in revenues.

Interest on long-term debt

'000	2002	2001	Change	%
Interest on long-term debt	$ 197	$ 264	$ (67)	(25)

Interest on long-term debt decreased $67,000 to $197,000 for the year ended December 31, 2002 compared to $264,000 in 2001. This decrease is related to a decrease in the average level of long-term debt outstanding in 2002 versus 2001 and a reduction in the effective borrowing rate. The decrease in the effective borrowing rate is attributed to: i) reductions in the bank prime lending rate; and ii) a renegotiation of Cathedral's credit facility effective June 2001 that provided for a decrease in the interest rate formula from prime plus 1.5% to prime plus 0.75%.

Gain on disposal of capital assets

'000	2002	2001	Change	%
Gain on disposal of capital assets	$ 659	$ 8	$ 651	n/a

2002 saw a significant amount of downhole equipment being lost-in-hole. Cathedral has recovered lost-in-hole equipment costs and this has resulted in a gain on disposal of capital assets of $659,000 (2001 - $8,000). A majority of the equipment lost-in-hole was replaced within 2002 and the balance was replaced in 2003 Q1.

Re-organization expenses

'000	2002	2001	Change	%
Re-organization expenses	$ 300	$ –	$ 300	n/a

One-time costs associated with the re-organization into an income trust amounted to $300,000 for the year ended December 31, 2002 and have been disclosed separately on the consolidated statements of operations and accumulated income. These expenses were incurred in Q2 of 2002.

Taxes

'000	2002	2001	Change	%
Taxes (recovery)	$ 697	$ (105)	$ 802	n/a

The effective tax rate for 2002 was 17.1% while the comparative figure for 2001 was a recovery of 2.1%. The fluctuation in the effective tax rates is a net result of: i) a reduction in the 2001 tax provision for a $1,640,000 valuation allowance adjustment and the benefit of amortization and adjustment of the deferred credit of $978,000; and ii) the shift of tax burden to the Trust's unitholders effective July 30, 2002.

Liquidity and Capital Resources

The Trust's principal source of liquidity is cash generated from operations. The Trust also has the ability to fund liquidity requirements through its credit facility and the issuance of debt and/or equity. At December 31, 2003, the Trust had an operating line of credit with a major Canadian bank in the amount of $3,500,000 of which $3,205,000 was undrawn. In addition, at December 31, 2003 the undrawn portion of the Trust's revolving non-reducing term loan was $300,000. The ratio of long-term debt (including current portion) to unitholders' equity at December 31, 2003 was a conservative 0.34 to 1 while the comparative ratio in 2002 was 0.17 to 1 – the increase was due to the additional long-term debt incurred in relation to the acquisition of TDC.

Operating activities Cash provided by operating activities (including changes in non-cash operating working capital) in 2003 increased $1,402,000 to $7,038,000 from $5,636,000 in 2002. This increase is a direct reflection of the increased level of drilling activity in western Canada and the Rocky Mountain region of the United States as well as the contribution of TDC that was aquired in 2003 and was partially offset by a reduction in the average day rate obtained in providing horizontal and directional drilling services and a further investment in non-cash operating working capital.

Working capital at December 31, 2003 was $1,955,000 which compares to $966,000 at the end of 2002. The increase of $989,000 is directly related to the restructuring of the Trust's long-term debt facility into a non-reducing term facility that does not require principal payments until maturity in June 2005 and therefore, there is no current portion of long-term debt included within current liabilities. Also included in 2003 payables is an accrual for contingent consideration of $751,000 related to the TDC acquisition.

Investing activities Cash used in investing activities for the year ended December 31, 2003 amounted to $4,370,000 compared to $3,020,000 in 2002. Excluding the changes in non-cash working capital related to investing activities, cash used in investing activities increased from $1,838,000 in 2002 to $7,468,000 in 2003 – an increase of $5,630,000. This increase is the result of an increase of $1,196,000 in our investment in capital asset additions, the acquisition of TDC on February 2003 at a cost of $3,257,000 and a $1,177,000 decrease in proceeds on disposal of capital assets. In the first half of 2004, the Trust anticipates adding 12 EM-MWD systems to its fleet which will bring the total number of MWD systems to 35.

Financing activities Cash used in financing activities for the year ended December 31, 2003 amounted to $2,280,000 compared to $2,961,000 in 2002. During 2003 the Trust accessed $4,677,000 of new long-term debt with the majority of the proceeds used to finance the acquisition of TDC and the balance to finance capital asset additions. Also during 2003, the Trust repaid $2,515,000 of long-term debt.

Fiscal 2003 was the first full year of Cathedral operating under the trust structure (conversion effective July 30, 2002) and therefore, on year-over-year basis, distributions declared and paid have increased significantly. During 2003, the Trust had a quarterly distribution policy with equal quarterly distributions declared of $0.055 per Trust Unit. On January 19, 2004, the Trust announced that is was converting to a monthly distribution policy with the first monthly distribution payable on February 16, 2004 to Unitholders of record on January 31, 2004 at a rate of $0.02 per Trust Unit. The $0.02 per Trust Unit represents an increase of approximately 9% from the distribution level in 2003 and is a direct reflection on the Trust's strong cash flow and earnings. On a go forward basis, it is the intention of the Trust to have equal monthly distributions to Unitholders, subject to the operating results of Cathedral Energy Services Ltd.

The following is a summary of distributions declared and paid in 2003 and 2002:

'000 of $ except per Trust Unit amounts	**2003**	2002	Change	%
Declared:				
Total	$ **4,792**	$ 2,015	$ 2,777	138
Per Trust Unit	**0.2200**	0.0938	0.1262	135
Paid:				
Total	**4,782**	818	3,964	485
Per Trust Unit	**0.2207**	0.0381	0.1826	479

The following is a summary of cash distributions since the Trust's inception on July 30, 2002:

	Amount		**Date Record**	**Date Paid/Payable**
2004 April	$ 0.0200		April 30 , 2004	May 17, 2004
2004 March	$ 0.0200		March 31, 2004	April 15, 2004
2004 February	$ 0.0200		February 29, 2004	March 15, 2004
2004 January	$ 0.0200		January 31, 2004	February 16, 2004
2003 Q4	$ 0.0550	*	December 31, 2003	January 15, 2004
2003 Q3	$ 0.0550	*	September 30, 2003	October 15, 2003
2003 Q2	$ 0.0550	*	June 30, 2003	July 15, 2003
2003 Q1	$ 0.0550	*	March 31, 2003	April 15, 2003
2002 Q4	$ 0.0557		December 31, 2002	January 15, 2003
2002 Q3 (approx. 2 month period)	$ 0.0381		September 30, 2002	October 15, 2002

* Effective monthly distribution rate per Trust Unit is $0.01833.

Contractual obligations In the normal course of business, the Trust incurs contractual obligations. The following is summary of the Trust's contractual obligations as at December 31, 2003 for the following items:

'000's	**Total**	**2004**	**2005**	**2006**	**2007**	**2008**	**There-after**
Long-term debt	$ 5,700	$ -	$ 950	$ 1,900	$ 1,900	$ 950	$ -
Operating lease obligations	1,133	515	429	119	70	-	-
	$ 6,833	$ 515	$1,379	$ 2,019	$ 1,970	$ 950	$ -

Effective in late December 2003 the Trust's operating entity, Cathedral Energy Services Ltd., renegotiated its credit facility and converted its term loans into a $6,000,000 non-reducing revolving term loan facility. Subject to compliance with standard debt covenants, this new non-reducing revolving term loan facility does not require debt repayment until maturity in June 2005. Annually the maturity date of the non-reducing revolving term loan can be extended for an additional year by agreement between Cathedral and its bank. Prior to maturity Cathedral can convert this credit facility into a term loan repayable over a 36-month period. The above noted long-term debt contractual obligations assumes the bank non-reducing revolving term loan is converted to a reducing non-revolving term loan on June 29, 2005 (immediately prior to maturity date).

MANAGEMENT'S DISCUSSION & ANALYSIS

In addition, Cathedral has a continuing obligation related to the February 2003 acquisition of TDC. The purchase and sale agreement provided for contingent consideration of up to a maximum of $1.25 million, payable in cash, which is to be paid over a 2-year period based upon the financial results of TDC for the periods ended December 31, 2003 and 2004. Contingent consideration related to the period February 13, 2003 to December 31, 2003 in the amount of $751,000 has been accrued in the 2003 accounts and has been accordingly recorded as an additional cost of the purchase. The maximum contingent consideration payable for the year ended December 31, 2004 is $499,000.

Summary of Quarterly Results (in '000 of $ except per Trust Unit amounts)

	2003				2002			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenues	$ 6,905	$ 5,043	$ 9,854	$ 10,913	$ 7,818	$ 5,082	$ 3,811	$ 5,364
Income (loss) before taxes	770	185	1,891	1,982	2,419	756	(57)	968
Net income	918	305	1,711	1,507	1,572	491	267	1,059
Net income per Trust Unit								
Basic	0.04	0.01	0.08	0.07	0.19	0.06	0.02	0.05
Diluted	0.04	0.01	0.08	0.07	0.07	0.02	0.01	0.05

The majority of Cathedral's operations are carried on in western Canada where activity levels in the oilfield services industry are subject to a degree of seasonality. Operating activities in western Canada are generally lower during "spring breakup" which normally commences in late March and continues through to May. Operating activities generally increase in the fall and peak in the winter months from December till late March.

Critical Accounting Policies and Estimates

The Trust's consolidated financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and significant accounting policies utilized by the Trust are described in Note 2 to the Trust's consolidated financial statements. Management believes the accounting principles selected are appropriate under the circumstances and the Audit Committee of Cathedral has approved the policies selected.

Under Canadian GAAP, the Trust is required to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. The estimates and assumptions utilized are based on past experience and other information available to management at the time the estimate or assumption is made. The estimates and assumptions used by management are constantly evaluated for relevance under the circumstances and if circumstances on which the estimates or assumptions were based change, the impact is included in the results of operations for the period in which the change occurs. Management believes the estimates, judgments and assumptions involved in its financial reporting are reasonable.

The following accounting policies require management's more significant judgments and estimates in the preparation of the Trust's consolidated financial statements, and as such, are considered to be critical.

Continuity of interest method of accounting With the conversion of Cathedral Energy Services Ltd. to an income trust effective July 30, 2002, the Administrator has used the continuity of interest method of accounting in preparing the Trust's consolidated financial statements and, accordingly, the comparative figures include the operations of Cathedral Energy Services Ltd.

Deferred development costs Costs associated with the development of downhole equipment are capitalized during the development process. These costs are identified as deferred development costs and are recorded with capital assets. Once the equipment becomes commercial in nature, the related deferred development costs are amortized over 5 years.

Cathedral undertakes periodic reviews of each project on which deferred development costs have been recorded to determine if the carrying value of the project can be recovered for the undiscounted expected net future cash flow generated from the related equipment. If there is no reasonable expectation that the costs can be recovered, the carrying value of the project is reduced and the excess is charged to income. This process of estimation is subject to significant judgment with respect to revenues and direct costs associated with the equipment as well as market acceptance.

Goodwill The carrying value of goodwill on acquisitions is compared to its fair value at least annually to determine if a permanent impairment exists, at which time the impairment would be recorded as a charge to earnings. Valuations are inherently subjective and necessarily involve judgments and estimates regarding future cash flows and other operational variables.

Impairment of long-lived assets Capital assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value of assets may not be recoverable. In the assessment process management is required to make certain judgments, assumptions and estimates in identifying such events and changes in circumstances, and in assessing their impact on the valuations and economic lives of the affected assets. Impairments are recognized when the book values exceed management's estimate of the undiscounted future cash flows, or net recoverable amounts, associated with the affected assets.

Taxes The Trust uses the liability method of accounting for future income taxes whereby future income tax assets and liabilities are determined based on temporary differences between the accounting basis and the tax basis of the assets and liabilities, and are measured using substantively enacted tax rates and laws expected to apply when these differences reverse. As a result, a projection of taxable income is required for those years, as well as an assumption of the ultimate recovery/settlement period for the temporary differences. The projection of future taxable income is based on management's best estimate and may vary from actual taxable income. On an annual basis, the Trust assesses its need to establish a valuation allowance for its deferred income tax assets and if it is deemed more likely than not that its deferred income tax assets will not be realized on its taxable income projections a valuation allowance is recorded. As at December 31, 2003, the Trust expects that its deferred income tax assets will be recovered from future taxable income and therefore, had not set up a valuation allowance.

In addition, Canadian and U.S. tax rules and regulations are subject to interpretation and require judgment by management that may be challenged by the taxation authorities. Management believes that its provisions for taxes are adequate pertaining to any assessments from the taxation authorities.

Accounting Changes and Future Accounting Changes

Effective the fourth quarter of 2003, the Trust elected early adoption of the revised recommendations of Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3870, *Stock-based compensation and other stock-based payments* which requires that a fair value method of accounting be applied to all stock-based compensation payments to both employees and non-employees. In accordance with the transitional provisions of the revised recommendations, the Trust has prospectively applied the fair value method of accounting for option awards granted on or after January 1, 2003, and, accordingly, has recorded the related compensation expense during 2003 of $5,600. Prior to January 1, 2003, the Trust accounted for its employee options using the settlement method and no compensation expense was recognized. For awards granted in 2002, the revised recommendations require the disclosure of pro forma net income and net income per Trust Unit information as if the Trust had accounted for employee options under the fair value method and this information is disclosed in note 8 to the consolidated financial statements. The pro forma effect of awards granted prior to January 1, 2002 has not been included in the pro forma net income and net income per Trust Unit information.

In 2003, the CICA issued Handbook Section 3063, *Impairment of Long-Lived Assets* which establishes new standards for the recognition, measurement and disclosure of the impairment of long-lived assets and establishes new write-down provisions. This Handbook Section comes into effect in 2004 for the Trust, but the CICA encourages earlier adoption. Management will adopt this Handbook section for fiscal 2004 and does not expect that adopting the new standards will affect our consolidated financial statements.

Business Risks

Dependence on Cathedral Energy Services Ltd. The Trust is an open-ended, limited purpose mutual fund trust which is entirely dependent upon the operations and assets of Cathedral Energy Services Ltd. through the ownership of the Cathedral Energy Services Ltd. shares and subordinated notes. Accordingly, the cash distributions to the unitholders is dependent upon the ability of Cathedral Energy Services Ltd. to pay its interest obligations under the subordinated notes and to declare and pay dividends on its shares.

Specific business risks relating to Cathedral Energy Services Ltd are as follows:

Crude oil and natural gas prices Demand for the services provided by Cathedral is directly impacted by the prices our customers receive for crude oil and natural gas they produce in that it has a direct relation to the cash flow available to invest in drilling activity. World crude oil prices and North American natural gas prices are not subject to control by Cathedral. With that in mind, Cathedral attempts to partially manage this risk by way of maintaining a low cost structure and a variable cost structure that can be adjusted to reflect activity levels. Almost all of Cathedral fieldwork is performed by subcontractors which allows us to operate with lower fixed overhead costs and remain financially profitable in seasonally low activity periods.

MANAGEMENT'S DISCUSSION & ANALYSIS

Workforce availability Providing quality services is a major foundation behind Cathedral's "Best In Class, Best in Service" mandate. Historically, Cathedral has not had any significant issues with respect to attracting and maintaining quality office, shop and field staff. During high levels of activity, attracting quality staff can be challenging due to competition for such services. Cathedral provides its staff with a quality working environment, effective training, tools with current technology and competitive remuneration packages that allows it to attract and maintain the quality of its workforce, whether in the field, shop or office.

Weather The majority of Cathedral's operations are carried on in western Canada where activity levels in the oilfield services industry are subject to a degree of seasonality. Operating activities in western Canada are generally lower during "spring breakup" which normally commences in late March and continues through to May. Operating activities generally increase in the fall and peak in the winter months from December till late March.

Technology Traditionally, Cathedral has not developed its own equipment, instead it relied on external suppliers to design and supply, at a reasonable price, the equipment it requires to be competitive in the marketplace. In Q3 of 2002, Cathedral commenced with the assistance of a third-party the development of an EM-MWD system to supplement its existing externally supplied MWD systems. In November 2003, Cathedral announced that its EM-MWD system had reached commercial status. Cathedral decided to proceed with internally developing an EM-MWD system (as opposed to purchasing a system from external sources) due to: i) Cathedral having the internal expertise to develop such a tool; and ii) the lack of quality external produced EM-MWD systems being available to purchase by Cathedral at a reasonable price. In 2002, Cathedral determined that the inclusion of an EM-MWD system within its fleet was critical in light of management's assessment of the expected future demand by customers for such equipment. Going forward, there may be further developments in horizontal and directional drilling technology that will require Cathedral to develop and/or purchase equipment with the new technology. It should be noted that Cathedral competes with other more established companies which have greater financial resources to develop new technologies.

Foreign currency exchange rates Cathedral derives revenues from the U.S. which are denominated in the local currency. This causes a degree of foreign currency exchange rate risk which Cathedral attempts to mitigate by matching local purchases in the same currency. Furthermore, Cathedral's Canadian operations are subject to foreign currency exchange rate risk in that some purchases for parts, supplies and components in the manufacture of equipment are denominated in U.S. dollars.

Interest rates As at December 31, 2003, Cathedral had $5.7 million of long-term debt which is at a floating interest rate and, therefore is at risk of rising interest rates. Management continually monitors interest rates and would consider locking in the rate of its term debt. A 1% change in interest rates has a $57,000 impact on the Trust's income before taxes.

Competition The oil and natural gas service industry in which Cathedral operates is highly competitive. Cathedral competes with other more established companies which have greater financial, marketing and other resources and certain of which are large international oil and natural gas services companies which offer a wider array of oil and natural gas services to their clients than does Cathedral.

Unitholder liability Current provincial legislation does not provide limited liability to income trust unitholders in the same way granted to shareholders of equities. On March 24, 2004 the Alberta government announced in its 2004 budget that they would be proposing legislation to grant limited liability to income trust unitholders. There is no certainty that such legislation will be passed into law. The Declaration of Trust provides that no Trust unitholder will be subject to any liability in connection with the Trust or its assets or obligations and, in the event that a court determines that unitholders are subject to any such liabilities, the liabilities will be enforceable only against, and will be satisfied only out of, the unitholder's share of the Trust's assets.

Customer mix Overall Cathedral had a good mix of customers with only two customers accounting for revenues in excess of 5% of the Trust's consolidated revenues for 2003 (one customer at 26.4% and the other at 5.1%).

In addition the comments noted above, Cathedral manages its business risks by:

- providing the highest level of service and results available to the customer.
- maintaining a comprehensive insurance program.
- strict adherence to Cathedral's safety standards.
- complying with current environmental requirements.

Supplementary Information

As at April 15, 2004, the Trust has 22,311,233 Trust Units and 1,243,000 options to purchase Trust Units outstanding.

Additional information regarding the Trust, including our Annual Information Form ("AIF"), is available on SEDAR at www.sedar.com.

Outlook for 2004

For 2004, independent forecasts are suggesting that 20,300 wells will be drilled in western Canada. By historical standards that would be the second highest level of drilling – second only to 2003 when 21,805 wells were drilled. Activity levels in the Rocky Mountain region of the United States are also anticipated to be significant for 2004 and Cathedral is in a position to increase its market share in the region. Overall, the fundamentals behind the oil and natural gas industry remain strong. Industry analysts continue to forecast strong oil and natural gas prices for the balance of 2004.

The SAGD market is an area that Cathedral has identified as a tremendous niche market area for its growth. With the vast amount of heavy oil in place in Northeastern Alberta, and much of it too deep to be mined, SAGD technology will be the preferred method of production. Cathedral has the personnel and technology to participate in this market as evidenced by the successful completion in 2003 Q4 of its first SAGD project which was comprised of three pairs of horizontal well bores for a major Canadian oil and natural gas producer. Cathedral commenced drilling its first long-term SAGD program for another customer in Q2 of 2004 and expects to build on that base into the future.

During 2004, Cathedral expects to add an additional 12 EM-MWD systems to its fleet which would bring the number of owned MWD systems to 35 (including 15 EM-MWD systems). The EM-MWD tool has been well received by customers in both Canada and the United States and will contribute to expanding Cathedral's revenues and reducing operating costs.

During 2003 Cathedral added a number of junior and senior oil and gas exploration and development companies to its customer list and expects to add the same in 2004.

The Trust will continue to pursue opportunities offering an expanded range of services to its customers, increased market share, entry into new geographic territories, and strategic acquisitions.

On behalf of the management of Cathedral Energy Services Ltd., Administrator of Cathedral Energy Services Income Trust

P. Scott MacFarlane, CA
Chief Financial Officer

April 15, 2004

ADMINISTRATOR'S REPORT

The consolidated financial statements have been prepared by the Administrator in accordance with Canadian generally accepted accounting principles and, where appropriate, reflect estimates based upon the Administrator's judgment. Financial information contained elsewhere in the annual report has been prepared on a consistent basis with that in the consolidated financial statements.

The Administrator is also responsible for a system of internal controls which is designed to provide reasonable assurance that the Trust's assets are safeguarded and accounting systems provide timely, accurate financial reports.

The Audit Committee of the Board of Trustees has reviewed in detail the consolidated financial statements with the Administrator and the external auditor. The Board of Trustees has approved the consolidated financial statements on the recommendation of the Audit Committee.

KPMG LLP, an independent firm of chartered accountants, have examined the Trust's consolidated financial statements in accordance with Canadian generally accepted auditing standards and provided an independent professional opinion. The auditors have full and unrestricted access to the Audit Committee to discuss their audit and their related findings as to the integrity of the financial reporting process.

Mark L. Bentsen
President and Chief Executive Officer
April 15, 2004

P. Scott MacFarlane
Chief Financial Officer

AUDITORS' REPORT TO UNITHOLDERS

We have audited the consolidated balance sheets of Cathedral Energy Services Income Trust as at December 31, 2003 and 2002 and the consolidated statements of operations and accumulated income and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Calgary, Canada
February 6, 2004

CONSOLIDATED BALANCE SHEETS

December 31, 2003 and 2002

	2003	2002
Assets		
Current assets:		
Cash and cash equivalents	**$ 388,116**	$ –
Accounts receivable	**10,184,310**	7,717,685
Taxes receivable	**15,724**	–
Inventory	**1,428,107**	723,913
Prepaid expenses and deposits	**264,898**	305,139
	12,281,155	8,746,737
Capital assets (note 4)	**19,673,562**	15,874,492
Goodwill (note 3)	**1,124,960**	–
Future income tax asset (note 7)	**–**	190,000
	$ 33,079,677	$ 24,811,229
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness (note 5)	**$ 295,000**	$ 245,372
Accounts payable and accrued liabilities	**8,823,934**	4,247,575
Distribution payable to Unitholders (note 9)	**1,207,158**	1,196,296
Taxes payable	**–**	25,301
Current portion of long-term debt (note 6)	**–**	2,066,305
	10,326,092	7,780,849
Long-term debt (note 6)	**5,700,000**	654,900
Future income taxes (note 7)	**464,952**	–
Unitholders' equity:		
Unitholders' capital (notes 1 and 8)	**5,175,597**	4,616,797
Contributed surplus (note 8)	**5,600**	–
Accumulated income	**18,214,470**	13,773,345
Accumulated distributions (note 9)	**(6,807,034)**	(2,014,662)
	16,588,633	16,375,480
Contingency and commitments (note 14)		
	$ 33,079,677	$ 24,811,229

See accompanying notes to consolidated financial statements.

Approved by the Trustees:

Trustee

Trustee

Cathedral

CONSOLIDATED STATEMENTS OF OPERATIONS AND ACCUMULATED INCOME

Years ended December 31, 2003 and 2002

	2003	2002
Revenues (note 13)	**$ 32,715,251**	$ 22,075,218
Expenses:		
Operating	**16,681,295**	9,430,248
General and administrative	**7,974,556**	6,062,268
Depreciation	**3,117,514**	2,659,248
Interest on long-term debt	**319,340**	196,967
	28,092,705	18,348,731
Operating income	**4,622,546**	3,726,487
Other items:		
Gain on disposal of capital assets	**204,980**	659,350
Re-organization expenses (note 1)	**–**	(300,095)
Income before taxes	**4,827,526**	4,085,742
Taxes (note 7):		
Current (recovery)	**(21,451)**	143,122
Future income taxes	**407,852**	553,958
	386,401	697,080
Net income	**4,441,125**	3,388,662
Accumulated income, beginning of year	**13,773,345**	10,384,683
Accumulated income, end of year	**$ 18,214,470**	$ 13,773,345
Net income per Trust Unit (note 10):		
Basic	$ **0.20**	$ 0.24
Diluted	**$ 0.20**	$ 0.16
Cash distributions declared per Trust Unit (note 9):	**$ 0.2200**	$ 0.0938

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2003 and 2002

	2003	2002
Cash provided by (used in):		
Operations:		
Net income	**$ 4,441,125**	$ 3,388,662
Items not involving cash:		
Depreciation	**3,117,514**	2,659,248
Future income taxes	**407,852**	553,958
Foreign exchange loss	**27,100**	–
Non-cash compensation expense (note 8)	**5,600**	–
Gain on disposal of capital assets	**(204,980)**	(659,350)
Funds from operations	**7,794,211**	5,942,518
Changes in non-cash operating working capital (note 12)	**(755,903)**	(306,475)
	7,038,308	5,636,043
Investing:		
Capital asset additions	**(4,711,626)**	(3,515,818)
Proceeds on disposal of capital assets	**500,022**	1,677,652
Acquisition of The Directional Company, Inc. (note 3)	**(3,256,547)**	–
Changes in non-cash investing working capital (note 12)	**3,098,295**	(1,182,252)
	(4,369,856)	(3,020,418)
Financing:		
Advances under long-term debt	**4,677,050**	–
Repayments of long-term debt	**(2,514,910)**	(2,388,468)
Distributions paid to Unitholders (note 9)	**(4,781,510)**	(818,366)
Proceeds from the issuance of Trust Units (note 8)	**–**	100
Proceeds on exercise of Trust Unit options (note 8)	**289,406**	–
Increase in bank indebtedness	**49,628**	245,372
	(2,280,336)	(2,961,362)
Increase (decrease) in cash and cash equivalents	**388,116**	(345,737)
Cash and cash equivalents, beginning of year	**–**	345,737
Cash and cash equivalents, end of year	**$ 388,116**	$ –

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2003 and 2002

1. General:

Cathedral Energy Services Income Trust (the "Trust") is an unincorporated, open-ended limited purpose mutual fund trust established under the laws of the Province of Alberta on June 24, 2002. The Trust was created for the purpose of effecting a Plan of Arrangement (the "Arrangement") under the Business Corporations Act (Alberta) whereby 990401 Alberta Ltd., a wholly-owned subsidiary of the Trust, acquired from the shareholders of Cathedral Energy Services Ltd.(the "Company") all of the issued and outstanding Common Shares and Special Shares in return for subordinated notes (the "Notes"). The Trust then acquired these Notes from the holders in exchange for units of the Trust (the "Trust Units") on a one-for-one basis. Subsequently, 990401 Alberta Ltd. and Cathedral Energy Services Ltd. were amalgamated with the amalgamated company retaining the name Cathedral Energy Services Ltd. As a result of this Arrangement, the Trust owns all of the subordinated notes and all of the issued and outstanding common shares of Cathedral Energy Services Ltd., which represents the right to receive cash flow available for distribution from Cathedral Energy Services Ltd.

The Arrangement is described in the Cathedral Energy Services Ltd. Information Circular dated June 26, 2002. The Arrangement was approved by the securityholders of Cathedral Energy Services Ltd. on July 29, 2002 and was effective as of July 30, 2002.

The management of Cathedral Energy Services Ltd. is responsible for the administration of the Trust and the management of Cathedral Energy Services Ltd. (an internal management structure).

Cathedral Energy Services Ltd. is engaged in the business of providing drilling services to oil and natural gas exploration companies in western Canada and the Rocky Mountain region of the United States. The Company markets its services under three brand names: *Directional Plus* and *The Directional Company* which provide horizontal and directional drilling services; and *CAT Downhole Tools* which provides downhole equipment including drilling jars, shock tools and high performance drilling motors on a rental basis.

2. Significant accounting policies:

The Trust is considered to be a continuation of Cathedral Energy Services Ltd. following the continuity of interests method of accounting and accordingly, the comparative figures are that of Cathedral Energy Services Ltd. These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies:

(a) Principles of consolidation:

These consolidated financial statements include the accounts of the Trust and its wholly-owned subsidiaries, Cathedral Energy Services Ltd., Cathedral Energy Services Inc. and The Directional Company, Inc. Effective January 1, 2004, Cathedral Energy Services Ltd. and The Directional Company, Inc. were amalgamated to form Cathedral Energy Services Ltd.

(b) Foreign currency translation:

The Trust's United States subsidiary, Cathedral Energy Services Inc., is considered to be an integrated foreign operation and is translated using the temporal method. Under this method, monetary assets and liabilities are translated at the year-end exchange rate and non-monetary assets and liabilities at exchange rates prevailing on the transaction dates. Revenues and expenses (other than depreciation which is translated at the rate applicable to the related asset) are translated at the average exchange rate during the year. Gains and losses arising from the translation are included in income for the current year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Significant accounting policies (continued):

(c) Inventory:

Inventory is comprised of parts to be used in repairing capital assets. Inventory is valued at the lower of cost and market, with market represented by replacement value.

(d) Capital assets:

Capital assets are stated at cost less accumulated depreciation. Depreciation is provided using the declining balance method at the following annual rates:

Asset	Rate
Downhole tools	10-25%
Office and computer equipment	20%

Leasehold improvements are depreciated on a straight-line basis over the term of the lease. Deferred development costs are expenses incurred with respect to pre-commercialization of proprietary downhole equipment. These costs are amortized on a straight-line basis over 5 years upon commercialization of the equipment.

(e) Future income taxes:

The Trust uses the liability method of accounting for future income taxes whereby future income tax assets and liabilities are determined based on temporary differences between the accounting basis and the tax basis of the assets and liabilities, and are measured using substantively enacted tax rates and laws expected to apply when these differences reverse. Tax expense is the sum of the Trust's provision for current taxes and the difference between the opening and ending balances of the future income tax assets and liabilities.

(f) Revenue recognition:

Revenue is recognized as services are rendered and includes estimates for services provided on contracts using the percentage of completion method. Revenue related to the rental of downhole tools is recognized in the period during which the rental hours/days occur.

(g) Per Trust Unit amounts:

Basic net income per Trust Unit is computed by dividing net income by the weighted average number of Trust Units outstanding for the period. Diluted per Trust Unit amounts reflect the potential dilution that could occur if securities or other contracts to issue Trust Units were exercised or converted to Trust Units. The treasury stock method is used to determine the dilutive effect of Trust Unit options and other dilutive instruments.

2. Significant accounting policies (continued):

(h) Unit-based compensation plan:

Effective the fourth quarter of 2003, The Trust elected early adoption of the revised recommendations of the Canadian Institute of Chartered Accountants Handbook Section 3870, *Stock-based compensation and other stock-based payments* which requires that a fair value method of accounting be applied to all stock-based compensation payments to both employees and non-employees. In accordance with the transitional provisions of the revised recommendations, the Trust has prospectively applied the fair value method of accounting for option awards granted on or after January 1, 2003, and, accordingly, has recorded the related compensation expense during 2003. Prior to January 1, 2003, the Trust accounted for its employee options using the settlement method and no compensation expense was recognized. For awards granted in 2002, the revised recommendations require the disclosure of pro forma net income and net income per Trust Unit information as if the Trust had accounted for employee options under the fair value method and this information is disclosed in note 8 to the consolidated financial statements. The pro forma effect of awards granted prior to January 1, 2002 has not been included in the pro forma net income and net income per Trust Unit information.

(i) Cash and cash equivalents:

Cash and cash equivalents consist of cash and highly liquid investments which have maturities of less than three months at the date of acquisition.

(j) Distributions to Unitholders:

For 2003, distributions to Unitholders were declared on the last business date of each quarter and paid on or about the 15th of the following month. Commencing January 2004, distributions for Unitholders will be declared on the last business day of each month and paid on or about the 15th of the following month. The amount of the distributions to Unitholders is as declared and approved by the Trustees of the Trust. On an annual basis the net income of the Trust, being equal to the total interest earned by the Trust on the Notes, dividends, if any, from its wholly-owned subsidiaries, less administrative expenses incurred by the Trust and amounts paid in connection with any cash redemption of Trust Units is allocated to Unitholders.

(k) Goodwill:

Goodwill represents the excess of the purchase price over the value attributed to the net tangible and intangible assets acquired. Goodwill is not subject to amortization but is subject to an annual review for impairment (or more frequently if events or changes in circumstances indicate that goodwill is impaired) which consists of a comparison of the Trust's fair value of the net assets to their carrying value. The net carrying value of goodwill would be written down if the value is determined to be impaired.

(l) Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. Acquisition of The Directional Company, Inc.:

On February 12, 2003, the Trust acquired all the issued and outstanding shares of The Directional Company, Inc. ("TDC"), a private company involved in providing horizontal and directional drilling services in western Canada, for fixed consideration of $2,774,848 (including a working capital adjustment). The fixed consideration comprised $2,505,454 of cash and $269,394 of Trust Units (225,812 Trust Units with an assigned value of $1.193 per Trust Unit).

Additional contingent consideration of up to a maximum of $1.25 million, payable in cash, will be paid over a 2-year period based upon the financial results of TDC for the periods ended December 31, 2003 and 2004. As at December 31, 2003, contingent consideration in the amount of $751,093 has been accrued in the accounts and has been accordingly recorded as an additional cost of the purchase and allocated to goodwill as will any additional contingent consideration determined.

The acquisition has been accounted for by the purchase method whereby the assets and liabilities were recorded at their fair market values as at the effective date and the operating results are included in the Trust's consolidated financial statements from the closing date of the acquisition.

Details of the acquisition are as follows:

Net assets acquired:	
Net non-cash working capital	$ 937,636
Capital assets	2,500,000
Goodwill	1,124,960
Long-term debt	(816,655)
Future income taxes	(220,000)
	$ 3,525,941
Purchase price:	
225,812 Trust Units at approximately $1.193 per Trust Unit	$ 269,394
Cash (including transaction costs totaling $197,089 and net of acquired cash of $88,187)	2,505,454
Contingent consideration accrued in accounts payable and accrued liabilities	751,093
	$ 3,525,941

4. Capital assets:

2003	Cost	Accumulated depreciation	Net book value
Downhole tools	$ 27,359,994	$ 8,947,753	$ 18,412,241
Office and computer equipment	838,369	416,907	421,462
Leasehold improvements	203,151	125,897	77,254
Deferred development costs	788,902	26,297	762,605
	$ 29,190,416	$ 9,516,854	$ 19,673,562

2002	Cost	Accumulated depreciation	Net book value
Downhole tools	$ 21,149,695	$ 6,132,840	$ 15,016,855
Office and computer equipment	766,824	324,421	442,403
Leasehold improvements	201,563	85,266	116,297
Deferred development costs	298,937	–	298,937
	$ 22,417,019	$ 6,542,527	$ 15,874,492

5. Bank indebtedness:

The Trust has a $3,500,000 (2002 - $3,500,000) operating line of credit that bears interest at the bank's prime rate (2002 – bank's prime rate) per annum with interest payable monthly and is secured as described in note 6.

6. Long-term debt:

	2003	2002
Bank revolving term loan at an authorized amount of $6,000,000, bearing interest at the bank's prime rate plus 1.00% per annum, without repayment terms, maturing June 30, 2005 subject to an annual extension upon agreement between the borrower and the bank for a further one-year period. Prior to maturity the borrower may convert to a non-revolving term loan repayable monthly over 36 months	**$ 5,700,000**	$ –
Bank term loans, bearing interest at the bank's prime rate plus 0.75% per annum (2002 - 0.75%) repayable in monthly instalments of $198,255 plus interest	**–**	2,721,205
	5,700,000	2,721,205
Less: current portion	**–**	(2,066,305)
	$ 5,700,000	$ 654,900

Assuming the bank revolving term loan is converted to a non-revolving term loan on June 29, 2005 (immediately prior to maturity date), the Trust's contractual minimum repayments of long-term debt in the next five years are as follows:

2004	$ –
2005	950,000
2006	1,900,000
2007	1,900,000
2008	950,000
	$ 5,700,000

The bank revolving term loan and the operating line of credit are secured by a general security agreement over all present and future personal property with a first charge over downhole tool capital assets and are subject to certain covenants regarding the payment of dividends, cash distributions and the maintenance of certain financial ratios.

7. Taxes:

The Trust is a mutual fund trust as defined under the Income Tax Act (Canada). For the period July 30, 2002 (the effective date of the reorganization into an income trust) to December 31, 2003, all taxable income earned by the Trust has been distributed to unitholders and such distributions are deducted for income tax purposes. Consequently, no provision for income taxes is required for the Trust. The Trust's wholly-owned subsidiaries are however, subject to income taxation and provide for income tax obligations based upon statutory corporate rates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. **Taxes (continued):**

The provision for taxes differs from the result that would have been obtained by applying the combined federal and provincial income tax rate for the following reasons:

		2003		2002
Effective tax rate		**37%**		39%
Income before taxes	**$**	**4,827,526**	$	4,085,742
Income of Trust subject to tax in the hands of the Unitholders, not the Trust		**(3,696,135)**		(2,014,662)
Income before taxes of subsidiary companies	**$**	**1,131,391**	$	2,071,080
Effective tax rate applied to income before taxes of subsidiary companies	**$**	**418,615**	$	807,721
Amortization and adjustment of deferred credit		**–**		(146,493)
Benefit for reduction of valuation allowance		**(32,000)**		–
Adjustment to future income tax asset/liability for change in enacted tax rates		**(45,469)**		5,812
Non-deductible expenses		**56,163**		68,640
Non-taxable portion of gain on disposal of capital assets		**(10,658)**		(65,130)
Benefit of capital loss carryforward not previously recognized		**–**		(21,060)
Large corporations tax and capital taxes		**54,000**		49,108
Other		**(54,250)**		(1,518)
	$	**386,401**	$	697,080

The components of the net future income tax asset (liability) at December 31, 2003 and 2002 are as follows:

		2003		2002
Future income tax asset (liability):				
Capital assets	**$**	**(1,421,497)**	$	(665,000)
Loss carryforwards		**956,545**		887,000
		(464,952)		222,000
Valuation allowance		**–**		(32,000)
Net future income tax asset (liability)	**$**	**(464,952)**	$	190,000

At December 31, 2003, the Trust's subsidiaries had non-capital loss carry forwards of approximately $2,715,000 (2002 - $2,274,000) some of which are restricted to operations in other countries. The benefit of $2,715,000 (2002 - $2,192,000) of these loss carry forwards has been recorded in the accounts.

8. Unitholders' capital:

(a) Authorized: An unlimited number of Trust Units without nominal or par value.

(b) Issued:

	Number of Units/Shares	Amount
Common Shares:		
Balance, December 31, 2001	8,247,563	$ 3,062,344
Converted to Trust Units	(8,247,563)	(3,062,344)
Balance, December 31, 2002	–	$ –
Special Shares, Series 1:		
Balance, December 31, 2001	13,231,758	$ 3,131,370
Converted to Trust Units	(13,231,758)	(3,131,370)
Balance, December 31, 2002	–	$ –
Trust Units:		
Balance, December 31, 2001	–	$ –
Issued for cash	100	100
Issued on conversion of Common Shares	8,247,563	3,062,344
Issued on conversion of Special Shares, Series 1	13,231,758	3,131,370
Write-down of future income tax asset, net of related deferred credit, on re-organization into an income trust	–	(1,577,017)
Balance, December 31, 2002	21,479,421	$ 4,616,797
Issued on acquisition of TDC (note 3)	225,812	269,394
Issued on exercise of options	243,100	289,406
Balance, December 31, 2003	21,948,333	$ 5,175,597

The conversion to an income trust in 2002 created a situation in which certain tax pools of Cathedral Energy Services Ltd. could only be claimed against income from assets which were previously sold. Accordingly, in 2002 the future income tax asset created by these tax pools, net of the related deferred credit of $188,346, has been charged against Unitholders' capital in the amount of $1,577,017.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. Unitholders' Capital (continued):

(c) Trust Unit options:

The Trust has a Trust Unit based compensation plan under which a combined total of 2,080,000 (2002 – 2,080,000) options to purchase Trust Units can be granted to employees, trustees and consultants. Under the plan, the exercise price of each option at the date of issuance equals the fair market value of the Trust Units on the day immediately prior to the grant, subject to a potential future reduction, and has a maximum term till expiry of ten years. Options vest over a period of three to five years from the date of grant as employees, trustees or consultants render continuous service to the Trust. At the June 17, 2003 Annual and Special meeting of Unitholders, the Unitholders approved an amendment to the option plan to provide for a reduction in the exercise price by the amount by which the Trust's net income per fully diluted Trust Unit for a fiscal year exceeds a prescribed threshold return for the fiscal year. The threshold return is between 10% and 15% (percentage is set annually by the Board of Directors of Cathedral Energy Services Ltd.) of the weighted average Unitholders' Equity for the fiscal year calculated on a fully diluted per Trust Unit basis. The reduction is calculated annually and is effective March 15 following each fiscal year.

A summary of the status of the Trust Unit based compensation plan as at December 31, 2003 and 2002, and changes during the years then ended is presented below:

	2003		2002	
	Number of options	**Weighted average exercise price**	Number of options	Weighted average exercise price
Outstanding, beginning of year	**1,798,000**	**$ 1.19**	1,190,000	$ 1.25
Granted	**125,000**	**1.20**	738,000	1.08
Exercised	**(243,100)**	**1.19**	–	–
Forfeited	**(74,000)**	**1.20**	(130,000)	1.17
Outstanding, end of year	**1,605,900**	**$ 1.19**	1,798,000	$ 1.19
Exercisable, end of year	**659,014**	**$ 1.21**	414,000	$ 1.25

8. Unitholders' capital (continued):

(c) Trust Unit options (continued):

The range of exercise prices for options outstanding as at December 31, 2003 are as follows:

	Total options outstanding			Exercisable options	
Range of exercise prices	Number	Weighted average exercise price	Weighted average remaining contractual life (years)	Number	Weighted average exercise price
$1.25	914,300	$ 1.25	3.1	508,880	$ 1.25
$1.20	125,000	$ 1.20	5.2	–	$ 1.20
$1.09	372,100	$ 1.09	4.3	99,634	$ 1.09
$1.06	194,500	$ 1.06	4.9	50,500	$ 1.06
	1,605,900	$ 1.18	3.7	659,014	$ 1.21

During the year ended December 31, 2003, the Trust has recorded compensation expense and contributed surplus of $5,600 for the 125,000 options granted on or after January 1, 2003. For options granted in 2002, the Trust has elected to disclose pro forma results as if the revised accounting recommendations had been applied retroactively. Had compensation expense been determined based upon the fair value method for awards granted in 2002, the Trust's net income and net income per Trust Unit for the year ended December 31, 2003 and 2002 would have been adjusted to the pro forma amounts noted below:

	2003	2002
Net income – as reported	**$ 4,441,125**	$ 3,388,662
Pro forma compensation expense	**(100,000)**	(72,000)
Net income – pro forma	**$ 4,341,125**	$ 3,316,662
Net income per Trust Unit – as reported	**$ 0.20**	$ 0.24
Net income per Trust Unit – pro forma	**$ 0.20**	$ 0.24
Diluted net income per Trust Unit – as reported	**$ 0.20**	$ 0.16
Diluted net income per Trust Unit – pro forma	**$ 0.20**	$ 0.15

The pro forma amounts exclude the effect of options granted prior to January 1, 2002.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. Unitholders' capital (continued):

(c) Trust Unit options (continued):

The following table set out the assumptions used in applying the Black-Scholes model for options issued in 2003 and 2002:

	Date of issue		
	February 21 2003	November 26 2002	March 28 2002
Expected dividend/distribution yield	18.33%	20.75%	0.0%
Risk-free interest rate	4.24%	4.250%	5.0%
Expected volatility	60%	60%	60%
Expected life (in years)	5.0	5.0	5.1

The Black-Scholes option valuation model used by the Trust to determine fair value was developed for use in estimating the fair value of freely traded options, which are fully transferable and have no vesting restrictions. The Trust's options are not transferable, cannot be traded and are subject to vesting restrictions and exercise restrictions under the Trust's blackout policy which would tend to reduce the fair value of the Trust's options. In addition, this model requires the input of highly subjective assumptions, including future stock price volatility and expect time until exercise, that can cause a significant variation in the estimate of the fair value of

9. Accumulated Distributions:

Balance, December 31, 2001	$	–
Cash distributions declared and paid		818,366
Cash distributions declared		1,196,296
Balance, December 31, 2002	$	2,014,662
Cash distributions declared and paid		3,585,214
Cash distributions declared		1,207,158
Balance, December 31, 2003	$	6,807,034

Cash distributions declared and unpaid at year-end (2003 - $1,207,158; 2002 - $1,196,296) were paid on January 15 of the following year.

The following is a summary of cash distributions since the Trust's inception on July 30, 2002 to December 31, 2003:

		Date	
	Amount	**Record**	**Paid**
2003 Q4	$ 0.0550	December 31, 2003	January 15, 2004
2003 Q3	$ 0.0550	September 30, 2003	October 15, 2003
2003 Q2	$ 0.0550	June 30, 2003	July 15, 2003
2003 Q1	$ 0.0550	March 31, 2003	April 15, 2003
2002 Q4	$ 0.0557	December 31, 2002	January 15, 2003
2002 Q3 (approx. 2 month period)	$ 0.0381	September 30, 2002	October 15, 2002

10. Per Trust Unit amounts:

In calculating per Trust Unit amounts, the Trust utilizes the treasury stock method to determine the dilutive effect of Trust Unit options and other dilutive instruments. Under the treasury stock method, only "in the money" dilutive instruments impact the diluted calculations.

At December 31, 2003, the basic weighted average number of Trust Units outstanding was 21,709,905 (2002 – 13,866,571). At December 31, 2003, the diluted weighted average number of Trust Units outstanding was 22,004,417 (2002 – 21,516,399) which includes the addition of 294,512 (2002 – 7,649,828) Trust Units to the basic weighted average number of Trust Units outstanding during the year ended December 31, 2003 for the dilutive effect of employee Trust Unit options and, prior to the conversion to an income trust in 2002, the possible issuance of common shares on redemption of special series shares.

11. Financial instruments:

(a) Credit risk:

Substantially all of the Trust's accounts receivable are due from customers in the oil and gas industry and are subject to normal industry credit risks. The carrying value of accounts receivable reflects management's assessment of the associated credit risks.

(b) Fair values:

The carrying values of the Trust's current assets and current liabilities approximated their fair values as at December 31, 2003 and 2002 due to the relatively short period to maturity of the instruments. The fair value of long-term debt approximated its carrying

(c) Interest rate risk:

At December 31, 2003 and 2002, the Trust was exposed to changes in interest rates on its bank indebtedness and long-term debt (see notes 5 and 6).

12. Supplemental cash flow disclosure:

	2003	2002
Components of changes in non-cash working capital are as follows:		
Accounts receivable	**$ (2,466,625)**	$ (2,457,179)
Inventory	**(704,194)**	110,779
Prepaid expenses and deposits	**40,241**	(159,719)
Accounts payable and accrued liabilities	**4,576,359**	1,012,091
Taxes payable/receivable	**(41,025)**	5,301
Working capital acquired (note 3)	**937,636**	–
	$ 2,342,392	$ (1,488,727)
Less: changes in working capital related to financing activities	**3,098,295**	(1,182,252)
	$ (755,903)	$ (306,475)
Cash interest paid	**$ 394,944**	$ 198,094
Cash taxes paid	**$ 324,918**	$ 138,055

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. Segmented information:

The Trust, through its wholly-owned subsidiary, Cathedral Energy Services Ltd., is engaged in the business of providing drilling services to oil and natural gas exploration companies in western Canada and the Rocky Mountain region of the United States and is viewed as a single operating segment by the chief operating decision maker of Cathedral Energy Services Ltd. for the purpose of resource allocation and assessing performance.

Drilling services are provided in both Canada and the United States. The amounts related to each segment are as follows:

Revenues	**2003**	2002
Canada	**$ 27,127,715**	$ 19,565,380
United States	**5,587,536**	2,509,838
	$ 32,715,251	$ 22,075,218

Capital assets and goodwill	**2003**	2002
Canada	**$ 17,956,593**	$ 13,704,492
United States	**2,841,929**	2,170,000
	$ 20,798,522	$ 15,874,492

During the year ended December 31, 2003, one customer accounted for 26% (2002 – 43%) of consolidated revenues.

14. Contingency and commitments:

a) Legal claim:

The Cathedral Energy Services Ltd. is the co-defendant in a personal injury claim, the outcome of which is indeterminable. The plaintiff is claiming damages of $300,000 and any cost will be covered by insurance.

b) Leases:

The Trust has commitments under operating leases for office space and vehicles. Amounts to be paid under these leases during the next five years are approximately as follows:

2004	$ 515,000
2005	429,000
2006	119,000
2007	70,000
2008	–

Cathedral

CORPORATE INFORMATION

Trustees/Directors

Rod Maxwell (1) (2) (4)
Vice President Corporate Finance
StoneBridge Merchant Capital Corp.
Calgary, Alberta

Herman S. Hartley (1) (2)
Secretary-Treasurer
Linvest Resources Corp.
Calgary, Alberta

Jay Zammit (3)
Partner
Burstall Winger LLP
Calgary, Alberta

Scott Sarjeant (1) (2) (3)
President and Chief Executive Officer
Premiax Financial Corp.
Calgary, Alberta

Mark L. Bentsen
President and Chief Executive Officer
Cathedral Energy Services Ltd.
Calgary, Alberta

Randal H. Pustanyk
Vice President, Operations
Cathedral Energy Services Ltd.
Millet, Alberta

(1) Member, Audit Committee
(2) Member, Compensation Committee
(3) Member, Governance Committee
(4) Lead Director

Legal Counsel

Burstall Winger LLP
Calgary, Alberta

Officers and Senior Management of Cathedral Energy Services Ltd.

Mark L. Bentsen
President and Chief Executive Officer

Randal H. Pustanyk
Vice President, Operations

P. Scott MacFarlane
Chief Financial Officer

Jeff Morden
Vice President, Engineering

Paul Thebeau
Operations Manager

Graham Challand
Operations Co-ordinator

Ron Schell
TDC General Manager

Stock Exchange Listing

The Toronto Stock Exchange
Symbol - **CET.UN**

Registrar and Transfer Agent

Computershare Trust Company of Canada
Calgary, Alberta

Banker

The Bank of Nova Scotia
Calgary, Alberta

Auditors

KPMG LLP
Calgary, Alberta

Cathedral Energy Services Income Trust
2800, 715 - 5th Avenue S.W.
Calgary, Alberta
T2P 2X6

Tel: 403.265.2560 Fax: 403.262.4682

www.cathedralenergyservices.com