Cathedral

Energy Services Income Trust

2007 Annual Report

TRUST PROFILE

Cathedral Energy Services Income Trust (the "Trust") is a limited purpose trust which directly and indirectly owns the securities of Cathedral Energy Services Ltd., Cathedral Energy Services Inc. and Cathedral Energy Services Limited Partnership (collectively "Cathedral") representing the right to receive cash flow available for distribution from Cathedral. Cathedral is engaged in the business of providing selected oilfield services to oil and natural gas exploration and development entities in western Canada and the Rocky Mountain and Williston Basin regions of the United States and currently provides directional drilling services and related equipment rentals, production testing services and wireline services. Cathedral markets its services under six brand names: ***Directional Plus*** *and* ***The Directional Company*** *which provide horizontal and directional drilling services;* ***CAT Downhole Tools*** *which provides downhole equipment including drilling jars, shock subs and high performance drilling motors on a rental basis;* ***Tier One Oil Services*** *which provides oil and natural gas production testing services;* ***Advance Wireline*** *which provides cased hole logging and perforating, casing integrity inspection logging and complete slickline services; and* ***Xtreme Wireline*** *which provides slickline services. Cathedral strives to provide its clients with value added technologies and solutions to meet their drilling, production testing and wireline requirements. Its mandate is to supply* ***"Best in Class, Best in Service"*** *equipment and personnel to its clients. The Trust's units trade on the TSX under the symbol:* ***CET.UN*****.**

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Annual and Special Meeting:

Unitholders are invited to attend the Annual and Special Meeting which will be held at 3:00pm on April 17, 2008 in the Royal Meeting Room of the Metropolitan Centre, 333 – 4th Avenue S.W., Calgary, Alberta.

FINANCIAL HIGHLIGHTS

In '000's of dollars except Trust Unit amounts	2007	2006	2005	2004	2003
Revenues	**145,106**	138,254	86,002	46,478	32,715
Gross margin % (revenues less operating expenses)	**49%**	53%	51%	52%	49%
EBITDAS (1)	**46,731**	52,793	31,580	15,108	8,269
Per Trust Unit – diluted	**1.47**	1.68	1.10	0.64	0.38
Income before taxes	**31,990**	39,679	24,817	11,231	4,828
Net income	**24,863**	35,348	21,807	9,128	4,441
Basic per Trust Unit	**0.79**	1.16	0.76	0.39	0.20
Diluted per Trust Unit	**0.78**	1.12	0.76	0.38	0.20
Cash distributions declared per Trust Unit	**0.84**	0.805	0.385	0.245	0.22
Distributable cash (2)	**38,993**	45,972	27,551	12,924	6,373
Cash distributions declared	**26,405**	24,681	11,162	5,768	4,792
Payout ratio (3)	**68%**	54% (4)	41%	45%	75%
Property and equipment additions and corporate acquisitions:					
Paid or payable	**19,857**	26,436	31,244	8,472	7,986
Paid or payable in Trust Units	**-**	1,820	13,712	-	269
	19,857	28,256	44,956	8,472	8,255
Weighted outstanding Trust Units					
Basic ('000)	**31,402**	30,578	28,711	23,233	21,710
Diluted ('000)	**31,781**	31,423	28,712	23,783	22,004
Working capital	**16,947**	15,051	10,571	10,839	1,955
Total assets	**131,032**	125,221	102,908	46,822	33,080
Long-term debt and capital lease obligations excluding current portion	**17,441**	15,552	12,797	-	5,700
Unitholders' equity	**79,250**	76,223	59,615	33,564	16,589

(1) EBITDAS, earnings before interest on long-term debt and capital lease obligations, taxes, depreciation, amortization and non-cash compensation expense is provided to assist investors in determining the ability of the Trust to generate cash from operations. EBITDAS 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. During 2007 the Trust re-named "EBITDA" to "EBITDAS" but the formula used to calculate both terms are the same.

(2) Distributable cash is defined as cash flow from operating activities before changes in non-cash operating working capital less required principal repayments on long-term debt and capital lease obligations and maintenance capital expenditures. Distributable cash does not have any standardized meaning within Canadian Generally Accepted Accounting Principles and therefore may not be comparable to similar measures presented by other trusts. During 2007 the Trust re-named "distributable income" to "distributable cash" but the formula used to calculate both terms are the same.

(3) Cash distributions declared as a percentage of distributable cash.

(4) Payout ratio is 50% for the year ended December 31, 2006 if the December 2006 "special" cash distribution of $0.05 per Trust Unit is excluded (see distributable cash definition above).

REPORT TO UNITHOLDERS

The year 2007 was one of the most challenging years that Cathedral Energy Services has seen since its inception. It seemed as though we would come to grips with one issue and then another would pop up. Some of the issues that we faced include: 1) the Canadian Government changing the rules on royalty and business trusts (late 2006); 2) reduced natural gas pricing which affected the level of natural gas drilling; 3) a warm winter that shut down drilling activity early last spring; and 4) the Alberta government announcement of proposed changes to their royalty structure. All of these issues kept the industry off balance for most of the year. Despite these challenges our performance in 2007 was extremely positive with Cathedral achieving record revenues. This was accomplished because of our diversification regionally in Canada as well as our growing U.S. market and increased demand for directional drilling services in western Canada.

Commodity prices, both oil and natural gas, were certainly a big part of determining the direction of the industry in 2007. Natural gas pricing played a significant role in reducing the number of wells drilled in western Canada this year from 22,127 in 2006 to 19,144 in 2007. Natural gas prices have ranged from highs of $14/mcf in 2005 to lows of $5/mcf in 2007 and this has significantly affected the cash flows of our customers. One of the causes of this pricing reduction was the record high Canadian and U.S. gas storage levels. Storage levels were pushed to their limits as a record amount of LNG (liquefied natural gas) found its way into the U.S. market because of a warm 2006/2007 winter season in Europe. The supply of natural gas, only several years back, was restricted to North American production and supply, however natural gas is now considered more of a global commodity. With the ability to liquefy natural gas it is now being transferred around the globe. Therefore natural gas will migrate to regions of the world where the best pricing is being offered.

The positives of late have been that with depressed North American natural gas pricing and high demand for LNG in Europe and Asia we have seen a reduction in the LNG imports into this continent. This coupled with a reasonably cold winter in North America will likely leave storage levels at a lower level than last spring. The reduction in storage levels has created increased optimism in the market as well as improved pricing for the commodity. This improving natural gas market should drive the amount of gas related drilling to higher levels in 2008. Oil on the other hand has seen record high pricing throughout the year. This has been the bright spot of the year. With pricing for oil bouncing between $80 and $100 the amount of oil related drilling increased significantly.

Despite the reduction in Canadian drilling and the various challenges affecting the industry, Cathedral as a whole has not been affected that significantly. Cathedral's activity levels have varied across product lines and by region. Cathedral's three main business lines were all affected in different fashions.

Cathedral continued to expand its directional capacity in both Canada and the U.S. We added 10 Electro Magnetic Measurement While Drilling ("EM-MWD") systems to the fleet, with 5 of these systems being added to the U.S. market. At the close of 2007 there were 78 MWD systems in the fleet with 23 of these MWD systems operating in the U.S. Subsequent to year end, the board of Cathedral has approved the addition of another 10 EM-MWD systems. These new systems will all be second generation ("G2") EM-MWD systems. This enhanced tool has bi-directional communication that allows Cathedral to drill deeper and with reduced operating costs. The requirement for additional equipment is because of increased demand for Cathedral's directional services in both the Canadian and U.S. markets. In December 2007 we announced the commercialization of our Remote Drilling System ("RDS") which allows the secure transmission of drilling data from the rig site to Cathedral's Calgary operations centre. This permits the full experience of MWD supervisors and directional coordinators to manage directional drilling activities in real time from a central location. This system allows us to reduce the number of field personnel required on a job, thereby reducing the costs to both Cathedral and its customers.

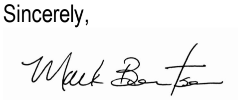
The production testing division activity levels are directly tied to the number of natural gas wells being completed. With the reduction in natural gas wells being drilled there has been a decline in this division's overall activity levels. However despite this the division has performed extremely well within this sector due to its strong relationships with its customers and the high quality of its personnel and equipment. During 2007 Cathedral replaced 5 low pressure production testing units with high pressure units thus enhancing the capabilities of this division. In February 2008 the board approved the build out of an additional 5 high pressure production testing units. These units will be moving into the Rocky Mountain district of the U.S. market where natural gas activity is extremely high and continues to grow.

Cathedral added 7 wireline units to its fleet in 2007 bringing the total to 27 wireline units. In Q3 of 2007 we opened a new operating station in Casper, Wyoming with 2 wireline units moving into this district. Subsequent to year end a second U.S. station was opened up in North Dakota with one wireline unit. This division suffered the largest decline in activity due to the reduced Canadian activity levels. However with the movement into the U.S. market we expect to see improved activity in 2008.

The Trust intends to maintain distributions at $ 0.84 per Trust Unit annually. As well, we have the capital resources to fund our growth opportunities from internally generated cash flow.

We are looking forward to 2008 and we see some excitement coming back into the market. We expect to see a rebound in Canadian activity levels which will provide upside for our existing fleet of equipment. We also see tremendous opportunity to continue to expand our services into the U.S. market. The foot print has been established and only requires the continued push into this region. We look forward to an exciting 2008 year as well as setting the course for the years beyond. As always we would like to thank everyone who has participated in the success of Cathedral and look forward to your continued support.

Sincerely,



Mark L. Bentsen
President and Chief Executive Officer
Cathedral Energy Services Ltd.
March 6, 2008

GOVERNANCE

Pursuant to an administration agreement, the management and administration of Cathedral Energy Services Income Trust is delegated to Cathedral Energy Services Ltd. ("Company"), as Administrator of the Trust. The Board of Directors of the Company are also Trustees of the Trust. The committees of the Company's Board of Directors extend their respective mandates to governance of the Trust. The Trust strives to comply with National Instrument 58-101 ("NI 58-101") on Corporate Governance and currently is in compliance with NI 58-101.

Mandate of the Board The Board of Directors of the Administrator has approved a mandate which includes among other duties and responsibilities: the approval and monitoring of the strategic, business and financial plans of the Company and Cathedral Energy Services Limited Partnership (collectively, "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 Boards The Board of Directors of the Administrator is currently composed of seven members of which five are independent 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 Mr. Rod Maxwell as lead director and Mr. Maxwell is an independent director. The independent board members meet during the year without the presence of non-independent directors and management.

Board Committees The Board of Directors has established three committees – Audit, Compensation and Governance.

Audit Committee The Board of Directors has approved a mandate for the Audit Committee 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 of the Board of Directors. The Audit Committee is comprised of Messrs. Rod Maxwell, Scott Sarjeant and Dan O'Neil all of which are independent directors and are considered to be financially literate under Multilateral Instrument 52-110 - Audit Committees ("MI 52-110").

As a result of the passing of a member of the Audit Committee on June 6, 2006 a vacancy was created on the Audit Committee which was required to be immediately filled. Accordingly, Mr. Jay Zammit was temporarily appointed pursuant to section 3.5 of MI 52-110 which allows Mr. Zammit (whom is not independent under MI 52-110) to serve on the Audit Committee. Effective July 1, 2007 Mr. Zammit was replaced on the Audit Committee by Mr. Dan O'Neil who is an independent director.

Compensation Committee The Board of Directors has approved a mandate for the Compensation Committee 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. The Compensation Committee is comprised of Messrs. Bob Chaisson, Rod Maxwell and Scott Sarjeant all of which are independent directors.

Governance Committee The Board of Directors have approved a mandate for the Governance Committee which includes among other duties and responsibilities: monitoring the effectiveness of the system of governance within the Trust; 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. The Governance Committee is comprised of Messrs. Scott Sarjeant and Jay Zammit both of which are independent directors.

Trustees/Directors

Rod Maxwell (1) (2) (4)
Managing Director
StoneBridge Merchant Capital 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

Bob Chaisson (2)
Businessman
Calgary, Alberta

P. Daniel O'Neil (1)
President and Chief Executive Officer
Breaker Energy Ltd.
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.
Chestermere, Alberta

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") for the year ended December 31, 2007 provides an analysis of the consolidated results of operations, financial position and cash flows of Cathedral Energy Services Income Trust (the "Trust") and should be read in conjunction with the accompanying audited financial statements and notes thereto for the year ended December 31, 2007, as well as the Trust's 2007 interim MD&A's. Dollars are in '000's except for day rates and per Trust Unit amounts. This MD&A is dated March 6, 2008.

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 in this MD&A including (i) statements that may contain words such as "anticipate", "could", "expect", "seek", "may" "intend", "will", "believe", "should", "project", "forecast", "plan" and similar expressions, including the negatives thereof, (ii) statements that are based on current expectations and estimates about the markets in which the Trust/Cathedral operates and (iii) statements of belief, intentions and expectations about developments, results and events that will or may occur in the future, constitute "forward-looking statements" and are based on certain assumptions and analysis made by the Trust/Cathedral. Forward-looking statements in this MD&A include, but are not limited to, statements with respect to future capital expenditures, including the amount, nature and timing thereof; oil and natural gas prices and demand; other development trends within the oil and natural gas industry; business strategy; expansion and growth of the Trust's/Cathedral's business and operations including the Trust/Cathedral's market share and position in the oilfield service market; and other such matters. Such forward-looking statements are subject to important risks and uncertainties, which are difficult to predict and that may affect the Trust's/Cathedral's operations, including, but not limited to: the impact of general economic conditions in Canada and the United States; industry conditions, including the adoption of new environmental, safety and other laws and regulations and changes in how they are interpreted and enforced; volatility of oil and natural gas prices; oil and natural gas product supply and demand; risks inherent in the Trust's/Cathedral's ability to generate sufficient cash flow from operations to meet its current and future obligations; increased competition; the lack of availability of qualified personnel or labor unrest; fluctuation in foreign exchange or interest rates; stock market volatility; opportunities available to or pursued by the Trust/Cathedral and other factors, many of which are beyond the control of the Trust/Cathedral. The Trust's/Cathedral's actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do transpire or occur, what benefits the Trust/Cathedral will derive therefrom. Subject to applicable law, the Trust disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

All forward-looking statements contained in this document are expressly qualified by this cautionary statement. Further information about the factors affecting forward-looking statements is available in the Trust's current Annual Information Form which has been filed with the applicable Canadian provincial securities commissions and are available on www.sedar.com.

NON-GAAP MEASURES

This MD&A refers to certain financial measurements that do not have any standardized meaning within Canadian Generally Accepted Accounting Principles ("GAAP") and therefore may not be comparable to similar measures provided by other companies and/or trusts.

The specific measures being referred to include the following:

i) "Gross margin" - calculated as revenues less operating expenses is considered a primary indicator of operating performance (see tabular calculation under Results of Operations);

ii) "EBITDAS" - defined as earnings before interest on long-term debt and capital lease obligations, taxes, depreciation, amortization and non-cash compensation expense; this measure is considered an indicator of the Trust's ability to generate funds flow from operations prior to consideration of how activities are financed, how the results are taxed and measured and non-cash expenses (see tabular calculation under EBITDAS); during 2007 the Trust re-named "EBITDA" to "EBITDAS" but the formula used to calculate both terms are the same;

iii) "Distributable cash" - defined as cash flow from operating activities before changes in non-cash operating working capital less required principal repayments on long-term debt and capital lease obligations and maintenance capital expenditures; distributable cash is a key performance measurement used by management, analysts and investors to evaluate the financial performance of the Trust (see tabular calculation under Distributions); during 2007 the Trust re-named "distributable income" to "distributable cash" but the formula used to calculate both terms are the same;

iv) "Maintenance capital expenditures" – refers to capital expenditures required to maintain existing levels of service but excludes replacement cost of lost-in-hole equipment to the extent the replacement equipment is financed from the proceeds on disposal of the equipment lost-in-hole;

v) "Payout ratio" - calculated as cash distributions declared divided by distributable cash, is an indicator of the Trust's ability to fund its distributions from the Trust's ongoing operations excluding changes in non-cash working capital (see tabular calculation under Distributions) (see distributable cash definition above); and

vi) "Funds from operations" - calculated as cash flow from operating activities before changes in non-cash working capital is considered an indicator of the Trust's ability to generate funds flow from operations but excluding changes in non-cash working capital which is financed using the Trust's bank indebtedness/line of credit facility.

MANAGEMENT'S DISCUSSION AND ANALYSIS

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 subsidiaries, Cathedral Energy Services Ltd. and Cathedral Energy Services Inc. and indirectly wholly-owned entity, Cathedral Energy Services Limited Partnership (collectively "Cathedral"), are engaged in the business of providing selected oilfield services to oil and natural gas exploration and development entities in western Canada and the Rocky Mountain and Williston Basin regions of the United States and currently provides directional drilling services and related equipment rentals, production testing services and wireline services. Cathedral markets its services under six brand names: *Directional Plus* and *The Directional Company* which provide horizontal and directional drilling services; *CAT Downhole Tools* which provides downhole equipment including drilling jars, shock subs and high performance drilling motors on a rental basis; *Tier One Oil Services* which provides oil and natural gas production testing services; *Advance Wireline* which provides cased hole logging and perforating, casing integrity inspection logging and complete slickline services; and *Xtreme Wireline* which provides slickline services. Cathedral strives to provide its clients with value added technologies and solutions to meet their drilling, production testing and wireline requirements. Its mandate is to supply *"Best in Class, Best in Service"* equipment and personnel to its clients.

SELECTED ANNUAL INFORMATION

	2007	Increase (decrease)	2006	Increase (decrease)	2005
Revenues	**$ 145,106**	$ 6,852	$ 138,254	$ 52,252	$ 86,002
% change		5%		61%	
EBITDAS (1)	**46,731**	(6,062)	52,793	21,213	31,580
% change		(12%)		67%	
Income before taxes	**31,990**	(7,689)	39,679	14,862	24,817
% change		(19%)		60%	
Net income	**24,863**	(10,485)	35,348	13,541	21,807
% change		(30%)		62%	
Net income per Trust Unit -					
Basic	**0.79**	(0.37)	1.16	0.40	0.76
Diluted	**0.78**	(0.34)	1.12	0.36	0.76
% change - diluted		(30%)		47%	
Cash flow from operating activities before changes In non-cash operating working capital	**39,693**	(7,138)	46,831	18,889	27,942
% change		(15%)		68%	
Cash distributions declared per Trust Unit	**0.84**	0.035	0.805	0.42	0.385
Distributable cash (2)	**38,993**	(6,979)	45,972	18,421	27,551
Cash distribution declared	**26,405**	1,724	24,681	13,519	11,162
Payout ratio (3)	**68%**	14%	54%	13%	41%
Working capital	**16,947**	1,896	15,051	4,480	10,571
Total assets	**131,032**	5,811	125,221	22,313	102,908
Long-term debt and capital lease obligations (4)	**17,441**	1,889	15,552	2,755	12,797
Unitholders' equity	**79,250**	3,027	76,223	16,608	59,615

(1) EBITDAS, earnings before interest on long-term debt and capital lease obligations, taxes, depreciation, amortization and non-cash compensation expense, is provided to assist investors in determining the ability of the Trust to generate cash from operations. Refer to Non-GAAP Measures.
(2) Distributable cash is defined as cash flow from operating activities before changes in non-cash operating working capital less required principal repayments on long-term debt and capital lease obligations and maintenance capital expenditures. Refer to Non-GAAP Measures.
(3) Cash distributions declared as a percentage of distributable cash. Refer to Non-GAAP Measures.
(4) Excludes current portion of long-term debt and capital lease obligations, which are included in working capital.

RESULTS OF OPERATIONS

2007 COMPARED TO 2006

Overview

Despite a significant decrease in oilfield services activity in western Canada, the Trust was able to achieve record annual revenues in 2007. On a year-over-year basis, revenues increased $6,852 or 5.0% to $145,106 from $138,254 in 2006. This increase was led by our directional drilling business in both Canada and the U.S. EBITDAS for the year ended December 31, 2007 was $46,731 while the comparative figure for 2006 was $52,793 – a decrease of $6,062 or 11.5%. The decline in EBITDAS was mainly due to compression in the gross margins of all divisions and increased general and administrative expenses. For the year ended December 31, 2007, net income was $24,863 ($0.78 per diluted Trust Unit) which compares to $35,348 ($1.12 per diluted Trust Unit) for 2006. Considering the environment in which the Trust operated in 2007, management is pleased with the operating results for the year.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Revenues and operating expenses

	2007	2006	Change	%
Revenues	**$ 145,106**	$ 138,254	$ 6,852	5
Operating expenses	**(73,482)**	(64,886)	8,596	13
Gross margin - $	**$ 71,624**	$ 73,368	$ (1,744)	(2)
Gross margin - %	**49.4%**	53.1%	3.7%	

For 2007 the Trust continued to generate record annual revenues of $145,106 which represented an increase of 5.0% over 2006 revenues. The increase was mainly a result of: i) a 4.6% increase in the average day rate for directional drilling services to $8,857 per day (2006 - $8,470) and ii) a 11.1% increase in directional drilling activity days to 12,274 activity days (2006 – 11,046 days). The largest portion of the increase in the average day rate is related to a shift towards providing premium and specialized services as opposed to an increase in the overall base day rate. In Canada the Trust's 2007 activity levels decreased by 2.5% which was significantly less than the overall decline in drilling activity in the Canadian market. Despite the decline in natural gas drilling in western Canada, the Trust was able to minimize the market decline from prior year activity levels due to the continuing strength of the Trust's client base, involvement in multi-well programs and an increase in the percentage of wells drilled in western Canada that are horizontal or directional versus vertical in nature. The Rocky Mountain region of the United States is the Trust's main area of operations in the U.S. and it remains a very active area. The Trust's U.S. operations have now been expanded to provide directional drilling services in North Dakota and Michigan. The Trust's directional revenues from the U.S. were $41,519 in 2007, an $11,272 (37.3%) increase from 2006 revenues of $30,247. Due to demand in the U.S. market, 5 Measurement-While-Drilling ("MWD") systems were transferred to the U.S. in 2007 and an additional MWD system was transferred to the U.S. in early 2008; the Trust now has 24 MWD systems in the U.S. market. The Trust's geographic diversification, by way of providing directional drilling services in southeast Saskatchewan and U.S., has been a significant factor in its ability to organically grow its revenues within the directional drilling division.

In 2007, a competitor of the Trust purchased the ranging tool technology used by the Trust in drilling SAGD wells. During 2007 Cathedral was allowed to use this technology to complete projects it had in place but effective in 2008 this technology will not be available to Cathedral. In 2007 SAGD related revenues were $1,863 (2006 – $nil). Cathedral is currently pursuing alternative technologies to allow it to return to the SAGD market.

The continued decline in natural gas drilling expenditures in the western Canada market resulted in lower revenues for both of the Trust's production testing and wireline divisions. The Trust's production testing division, Tier One, contributed $12,051 in revenues during 2007 which is a 24.0% decline from 2006 revenues of $15,847. Advance Wireline and Xtreme Wireline combined to generate total Canadian and U.S. revenues of $21,682 for 2007 compared to $26,188 for 2006, a 17.2% decrease. Late in 2007 Q2, one wireline unit was transferred from the Canadian operations to the newly formed U.S. division of Advance Wireline but revenue generating operations did not commence until 2007 Q3. A second wireline unit was transferred to the U.S. in 2007 Q3 and in early 2008 Q1 a third wireline unit was also transferred. As result of this expansion the U.S. wireline division generated $790 in revenues for 2007.

The gross margin for 2007 was 49.4%, which compares to 53.1% in 2006. The decrease is attributed to a number of factors including: i) shift to providing more horizontal drilling services (versus directional) which provide a lower gross margin than from directional drilling; ii) increases in directional field labour rates; iii) increase in wireline field labour costs as a percentage of revenues due to a portion of these labour charges being fixed in nature; and iv) offsetting the previous items was an increase in the average day rate for directional drilling services.

General and administrative expenses

	2007	2006	Change	%
General and administrative expenses	**$ 25,774**	$ 22,066	$ 3,708	17

General and administrative expenses increased from $22,066 in 2006 to $25,774 in 2007 – an increase of $3,708. The increase was mainly related to the Trust's directional/horizontal drilling business and the contributing factors to that increase were the result of increased personnel and facility rental costs as well as an overall increase in directional drilling activity level of the U.S. directional drilling operations. Other items contributing to the overall increase were: i) a $630 increase in costs related to bad debt write-offs; ii) costs related to the set-up of the U.S. wireline division in 2007; iii) approximately $300 of professional fees incurred in 2007 Q3 related to an aborted corporate acquisition, and iv) costs associated with pursuing international business opportunities. As a percentage of revenues, general and administrative expenses were 17.8% in 2007 and 16.0% in 2006.

Depreciation and amortization

	2007	2006	Change	%
Depreciation and amortization	**$ 12,054**	$ 10,692	$ 1,362	13

This increase is related to the Trust's investment in property and equipment over the past 12 months including 10 MWD systems along with the expansion of the mud motor and drilling collar fleet to complement the increase in directional drilling job capacity, upgrade of low pressure production testing units to higher pressure units and the purchase of 7 wireline units (one older wireline unit was sold in 2007) and auxiliary wireline equipment. As a percentage of revenues, depreciation and amortization amounted to 8.3% for 2007 and 7.7% for 2006.

Interest

	2007	2006	Change	%
Interest - long-term debt and capital lease obligations	**$ 1,084**	$ 936	$ 148	16
Interest - other	**$ 404**	$ 482	$ (78)	(16)

The main contributing factor to the increase in interest related to long-term debt and capital lease obligations is an increase in the average level of debt outstanding on a year-over-year basis. The $78 decrease in other interest expense is related to the Trust's decreased utilization of its operating line of credit.

Foreign exchange loss (gain)

	2007	2006	Change	%
Foreign exchange loss (gain)	**$ 492**	$ (27)	$ 519	n/a

The Trust derives revenues from the U.S. which are denominated in the local currency and a significant portion of the U.S. operations costs are also denominated in the same local currency. In addition, the Trust'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. On a consolidated basis, the Trust has an exposure to foreign currency fluctuations related to its net monetary investment in its U.S. subsidiary. The 2007 foreign exchange loss is due mainly to the U.S. dollar weakening significantly against the Canadian dollar in 2007 versus 2006 and the Trust's net monetary investment in its U.S. subsidiary.

Non-cash compensation expense

	2007	2006	Change	%
Non-cash compensation expense	**$ 1,603**	$ 1,486	$ 117	8

The Trust Unit options granted are valued using the Black-Scholes option pricing model and such value is being amortized against income over their three-year vesting period.

Gain on disposal of property and equipment

	2007	2006	Change	%
Gain on disposal of property and equipment	**$ 1,777**	$ 1,946	$ (169)	(9)

The gain on disposal of property and equipment can vary significantly from year-to-year as almost all of the disposals relate to downhole equipment lost-in-hole. Cathedral recovers lost-in-hole equipment costs including previously expensed depreciation on the related assets.

Taxes

	2007	2006	Change	%
Taxes	**$ 7,127**	$ 4,331	$ 2,796	65

For 2007, the Trust had a tax expense of $7,127 (effective tax rate of 22.3%) which compares to $4,331 (effective tax rate of 10.9%) in 2006. The 2007 tax provision includes a cumulative non-cash adjustment of $2,754 ($0.09 per diluted Trust Unit) related to the substantive enactment of the previously announced changes to the taxation of income and royalty trusts, other than real estate investment trusts. Removing the 2007 adjustment noted above the effective tax rate for 2007 was 13.7%. The adjusted effective tax rate has increased 10.9% in 2006 to 13.7% in 2007 due mainly to the continuing growth in the U.S. operations which are taxed at a higher rate as well as some expenses not being deductible for tax purposes.

2006 COMPARED TO 2005

Overview

On a year-over-year basis, revenues increased $52,252 or 61% to $138,254 from $86,002 in 2005. EBITDAS for the year ended December 31, 2006 was $52,793 while the comparative figure for 2005 was $31,580 – an increase of $21,213 or 67%.

For the year ended December 31, 2006, net income was $35,348 ($1.12 per diluted Trust Unit) which compares to $21,807 ($0.76 per diluted Trust Unit) for 2005 – an increase of 62%.

Revenues and operating expenses

	2006	2005	Change	%
Revenues	$ 138,254	$ 86,002	$ 52,252	61
Operating expenses	(64,886)	(42,313)	22,573	53
Gross margin - $	$ 73,368	$ 43,689	$ 29,679	68
Gross margin - %	53.1%	50.8%	2.3%	

The Trust generated annual revenues of $138,254 which represented an increase of 61% over 2005 revenues. The increase was mainly a result of: i) a 30% increase in directional drilling activity days to 11,046 activity days (2005 – 8,472 days); ii) a 6.7% increase in the average day rate for directional drilling services to $8,470 per day (2005 - $7,935); and iii) the full year inclusion of revenues from the 2005 acquisitions of Tier One Oil Services (May 6, 2005), Advance Wireline (September 8, 2005) and Xtreme Wireline (December 22, 2005).

Day rate increases related to providing directional drilling services that were put in place in the later portion of 2005 and early 2006 were partially offset by a shift to providing more directional (versus horizontal) drilling services. Day rates for directional drilling are lower than that for horizontal drilling. The increased activity days are the result of increased demand from customers in both operating regions. During 2006, the Trust added 14 (2005 – 14) Measurement-While-Drilling ("MWD") systems to bring the overall fleet to 68 at December 31, 2006. The Rocky Mountain region of the U.S. was a very active area and the Trust's revenues from this region increased $10,590 or 54% on a year-over-year basis. Due to increased demand, in 2006 5 MWD systems and related directional drilling equipment were added to the U.S. fleet. At December 31, 2006, the U.S. fleet of MWD systems was 18. The 2005 acquisitions of Tier One Oil Services, Advance Wireline and Xtreme Wireline contributed $26,994 or 52% of the $52,252 increase in revenues.

The increase in gross margin percentage is the net result of: i) a higher average day rate received in providing directional drilling services; ii) a higher gross margin from providing directional drilling services as there was a higher ratio of directional drilling services provided as opposed to horizontal drilling services (directional, as opposed to horizontal, drilling generates higher gross margins) as well lower repair costs to directional drilling equipment; and iii) offset by an increased contribution by the wireline and production testing divisions which have gross margins that are lower than that obtained from providing directional drilling services.

General and administrative expenses

	2006	2005	Change	%
General and administrative expenses	$ 22,066	$ 14,125	$ 7,941	56

The 2005 acquisitions of Tier One, Advance Wireline and Xtreme Wireline contributed to 53.0% of the year-over-year increase in general and administrative expenses. The balance of the increase is related to the directional drilling business which experienced an increased level of business activity both in Canada and the United States as well as increased personnel, insurance and office/shop rental costs. As a percentage of revenues, general and administrative expenses were 16.0% in 2006 and 16.4% in 2005.

Depreciation and amortization

	2006	2005	Change	%
Depreciation and amortization	$ 10,692	$ 5,686	$ 5,006	88

This increase is related to the combination of: i) the Trust's investment in property and equipment over the past 12 months; and ii) the inclusion of depreciation and amortization on property and equipment and intangibles acquired as a result of the 2005 acquisitions of Tier One, Advance Wireline and Xtreme Wireline for a full year in 2006. Included in depreciation and amortization for 2006 is $148 (2005 - $46) related to the amortization of intangibles acquired through the Advance Wireline acquisition. As a percentage of revenues, depreciation and amortization amounted to 7.7% for 2006 and 6.6% for 2005.

Interest

	2006	2005	Change	%
Interest - long-term debt and capital lease obligations	$ 936	$ 235	$ 701	298
Interest - other	$ 482	$ 71	$ 411	579

The main contributing factors to the increase in interest related to long-term debt and capital lease obligations is: i) increase in the effective interest rate related to the Trust's revolving, non-reducing term loan facility; and ii) increase in the amount of debt outstanding on a year-over-year basis. Until the September 8, 2005 acquisition of Advance Wireline the Trust had minimal long-term debt and no capital lease obligations. As part of the Advance Wireline acquisition the Trust incurred $12 million of debt related to its revolving, non-reducing term loan facility plus the assumption of $885 (net of repayments on closing) of long-term debt and capital lease obligations. In addition, the Trust assumed $574 of capital lease obligations related to the acquisition of Xtreme Wireline. In Q3 2006 the Trust accessed an additional $3,000 of its available revolving non-reducing term loan facility - proceeds of which were used to finance the Trust's acquisition of land and buildings. The $411 increase in other interest expense is related to the Trust's increased utilization of its operating line of credit.

Foreign exchange (gain) loss

	2006	2005	Change	%
Foreign exchange (gain) loss	$ (27)	$ 25	$ (52)	(208)

The Trust derives revenues from the U.S. which are denominated in the local currency. This causes a degree of foreign currency exchange rate risk which the Trust attempts to mitigate by matching local purchases in the same currency. Furthermore, the Trust'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. Foreign exchange rates did not fluctuate significantly during 2006 and as a result the Trust's foreign exchange gain/loss was minimal.

Non-cash compensation expense

	2006	2005	Change	%
Non-cash compensation expense	$ 1,486	$ 842	$ 644	76

The overall increase in the value of non-cash compensation expense is due to: i) the significant appreciation in the market price for the underlying Trust Units which in turn has increased substantially the value attributed to the Trust Unit options granted during the period using the Black-Scholes option pricing model; and ii) the overall increase in the number of options granted. The value of the options is being amortized against income over the three-year vesting period.

Gain on disposal of property and equipment

	2006	2005	Change	%
Gain on disposal of property and equipment	$ 1,946	$ 2,112	$ (166)	(8)

The gain on disposal of property and equipment can vary significantly from year-to-year as almost all of the disposals relate to downhole equipment lost-in-hole. Cathedral recovers lost-in-hole equipment costs including previously expensed depreciation on the related assets.

Taxes

	2006	2005	Change	%
Taxes	$ 4,331	$ 3,010	$ 1,321	44

The effective tax rate for 2006 was 10.9% while the comparative figure for 2005 was 12.1%. The 2005 tax provision includes the benefit of a reduction in future income taxes related to the June 16, 2005 internal reorganization. Also in relation to 2005, a portion of the Trust's income from its Canadian operating entities for the period June 15, 2005 (effective date of the reorganization) to December 31, 2005 is not subject to corporate income taxes within the corporate structure as this income flows through to Unitholders and is taxed in their hands. Accordingly, there is no tax provision within the Trust's financial statements for that portion of the income which is allocated to the Unitholders. For 2006, the period for which a portion of the Trust's income from its Canadian operating entities is not subject to corporate income taxes within the corporate structure was the full year as opposed to the approximate 6 1/2 months in 2005. Also contributing to the decreased effective tax rate is a higher portion of the Trust's pre-tax income being allocated to Unitholders (as opposed to be taxed within the Trust's legal entities) as well as a reduction in Canadian enacted tax rates in 2006 Q2. Most of the tax provision for fiscal 2006 relates to taxation of profits from the Trust's U.S. operations.

LIQUIDITY AND CAPITAL RESOURCES

The Trust's principal source of liquidity is cash generated from operations and also has the ability to fund liquidity requirements through its credit facility and the issuance of debt and/or equity. At December 31, 2007, the Trust had an operating line of credit with a major Canadian bank in the amount of $12,500 (2006 - $12,500) of which $6,030 (2006 - $6,460) was drawn. The Trust has a non-reducing revolving term loan facility in the amount of $25,000 (2006 - $25,000) of which $17,000 (2006 - $15,000) was drawn as at December 31, 2007. In addition, at December 31, 2007, the Trust had obligations under capital leases in the amount of $451 (2006 - $664) and other long-term debt of $283 (2006 - $171).

Operating activities Cash flow from operating activities decreased from $39,929 in 2006 to $39,729 – a decrease of $200 or 0.5%. Funds from operations (see Non-GAAP Measures) for 2007 was $39,693 which compares to $46,831 for 2006; the decline of $7,138 is attributable to a decline in operating profits due to compression of the gross margin realized in 2007 and an increase in general and administrative expenses. The Trust has a strong working capital position at December 31, 2007 at $16,947 which compares to $15,051 at the end of 2006.

Investing activities Cash used in investing activities for the year ended December 31, 2007 amounted to $16,607 compared to $24,366 in 2006. During 2007 the Trust invested an additional $19,857 (2006 – $26,436) in property and equipment. For 2007 the significant property and equipment additions included progress payments on construction of a new mud motor repair facility in Nisku, Alberta, 10 MWD systems along with the expansion of the mud motor and drilling collar fleet to complement the increase in directional drilling job capacity, upgrade of low pressure production testing units to higher pressure units and the purchase of 7 wireline units (one older wireline unit was sold in 2007) and auxiliary wireline equipment. With the exception of the $2,000 draw on non-reducing revolving term loan facility which was used to finance the construction of the Nisku mud motor repair facility, and the $228 of 0% financing for automotive equipment additions, all of the 2007 additions to property and equipment have been financed from cash flow from operations. Fluctuations in non-cash working capital related to investing activities are a function of when proceeds on disposal of property and equipment are received and when payments for property and equipment purchases are made.

Proceeds on disposal of property and equipment amounted to $3,575 (2006 - $3,277) and is mainly related to recovery of downhole equipment costs that were lost-in-hole in 2007 as well as previously expensed depreciation.

In late 2007 the Trust completed field testing and put the 2nd generation ("G2") of its Electro-Magnetic MWD ("EM-MWD") tool into commercial use. The G2 EM-MWD tool enhancements will allow the tool to be operated at deeper levels with increased efficiency and power management. The G2 EM-MWD system includes bi-directional (talk down) communication which allows for surface control of the tool to change data rates, power levels and data formats. The result is increased efficiency and power management, which by default, allows for greater depth capability.

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

	As at December 31	
	2007	2006
Directional drilling equipment -		
MWD systems	**78**	68
Drilling mud motors	**349**	299
Production testing units	**19**	19
Wireline units	**27**	21

For 2008, the Board of Directors of the Administrator of the Trust has approved a capital budget of $12,300 including approximately $400 for maintenance capital. The 2008 capital budget is targeted for expanding the current fleet of directional drilling equipment including at least 10 G2 EM-MWD systems to meet the Trust's additional demand as well as 5 production testing units which will be deployed in the U.S. market. The Trust will also be adding to its mud motor and drill collar fleet to complement the expanded directional drilling job capacity. Three of these MWD systems will be allocated to the U.S. operations. These capital expenditures are expected to be financed by way of cash flow from operations.

Financing activities Cash used in financing activities for the year ended December 31, 2007 amounted to $23,370 which compares to $16,100 in 2006 – a change of $7,270. During 2007, the Trust received advances of long-term debt in the amount of $2,228 (2006 - $3,109) of which $2,000 (2006 - $3,000) related to an advance on the Trust's non-reducing revolving term loan facility. Repayments of long-term debt and capital lease obligations in 2007 amounted to $330 (2006 - $626). As at December 31, 2007, the Trust was in compliance with all covenants under its credit facility. During 2007 the Trust received cash inflows of $3,065 (2006 - $2,734) on the exercise of Trust Unit options.

The capital asset additions in 2007 were financed by way of a combination of cash flow from operations, working capital, proceeds from the disposal of property and equipment, proceeds on exercise of Trust Unit options and $2,228 of long-term debt.

Distributions declared for 2007 amounted to $26,405 (2006 - $26,719). All of the 2007 distributions declared were cash in nature while the 2006 distributions included a non-cash in-kind distribution of $2,038. Pursuant to the Trust's Declaration of Trust, the Trust is required to allocate all of its taxable income to Unitholders and in order to allocate all of its taxable income to Unitholders a non-cash in-kind distribution in the form of additional Trust Units was allocated to Unitholders of record on December 31, 2006. The December 31, 2006, non-cash in-kind distribution was $0.06582 per Trust Unit for a total of $2,038. The Declaration of Trust also requires there is an immediate consolidation of the Trust Units issued such that each Unitholder has the same number of Trust Units after the consolidation as they had prior to the non-cash in-kind distribution. Based upon a December 31, 2006 Trust Unit price of $9.96 per Trust Unit the 2006 in-kind distribution represented the issuance of 204,667 Trust Units which were immediately consolidated. For the year-ended December 31, 2007 the Trust did not have a non-cash in-kind distribution.

Distributions paid to Unitholders for 2007 amounted to $27,903 (2006 - $22,467). The increase in distributions paid is related to a combination of: i) increases in the per Trust Unit "regular" distribution level during 2006; ii) the payment of a "special" $0.05 per Trust Unit cash distribution declared in December 2006 ($1,549) and paid on January 15, 2007; and iii) an increase in the number of Trust Units outstanding. Since January 2006 the Trust has increased its per month Trust Unit distribution level from $0.05 per Trust Unit to $0.07 per Trust Unit for December 2007 (increased to $0.07 level in September 2006) – a 40% increase. Cash distributions paid have been financed from funds from operations and management currently expects future cash distributions will also be financed by way of funds from operations.

The following is a summary of distributions declared in 2007 and 2006.

	2007	2006	Change	%
Declared				
Cash	**$ 26,405**	$ 24,681	$ 1,724	7
In-kind	-	2,038	(2,038)	(100)
Total	**$ 26,405**	$ 26,719	$ (314)	(1)
Declared per Trust Unit:				
Cash	**$ 0.84000**	$ 0.80500	$ 0.03500	4
In-kind	**-**	0.06582	(0.06582)	(100)
Total	**$ 0.84000**	$ 0.87082	$(0.03082)	4

Contractual obligations In the normal course of business, the Trust's operating entities incur contractual obligations. The following is a summary of the Trust's contractual obligations as at December 31, 2007 for the following items:

	Total	**2008**	**2009**	**2010**	**2011**	**2012**	**There-after**
Capital asset additions	$ 2,802	$ 2,802	$ -	$ -	$ -	$ -	$ -
Operating lease obligations	9,962	2,594	1,945	1,576	899	567	2,381
Long-term debt and capital lease obligations (1)	17,734	293	3,049	5,866	5,693	2,833	-
	$ 30,498	$ 5,689	$ 4,994	$ 7,442	$ 6,592	$ 3,400	$ 2,381

(1) Minimum principal amounts to be paid under long-term debt assumes the Trust elects prior to the maturity date of the revolving term loan to repay the loan over 36 months.

The 2008 contractual obligations are expected to be financed by way of cash flow from operations.

MANAGEMENT'S DISCUSSION AND ANALYSIS

DISTRIBUTIONS

The Administrator of the Trust reviews the level and nature of distributions (cash, in-kind or a combination of cash and in-kind) on an on-going basis giving consideration to current performance, historical and future trends in the business, the expected sustainability of those trends and enacted tax legislation which will affect future taxes payable as well as required long-term debt repayments, maintenance capital expenditures required to sustain performance and future growth capital expenditures. Despite the seasonality of the Trust's business, it is the Trust's policy to pay consistent distributions throughout the year. The Trust's operations in western Canada are subject to seasonality as activity levels in the oilfield services industry are generally lower during "spring breakup" which normally commences in late March and continues through to May (mainly in the 2nd quarter of the fiscal year). The net result of the Trust's policy to pay consistent distributions throughout the year despite the seasonality of its operations is that in Q2 cash distributions declared may exceed net income, cash flow from operating activities and/or distributable cash for the quarter.

Distributable cash is a supplemental non-GAAP measurement that management considers a key measure in demonstrating the Trust's ability to generate the cash necessary to pay distributions, fund future capital investments and the repayment of long-term debt and capital lease obligations. Distributable cash as presented is not intended to represent operating profit for the period nor should it be viewed as an alternative to operating profit, net income or other measures of financial performance calculated in accordance with Canadian GAAP. Distributable cash does not have any standardized meaning within Canadian GAAP and therefore may not be comparable to similar measures presented by other trusts (refer to Non-GAAP Measures).

The Trust intends to pay cash distributions to Unitholders but the payment of cash distributions cannot be guaranteed.

The following is a comparison of cash distributions declared and certain defined amounts:

		Years ended December 31		
	2007 Q4	2007	2006	2005
Cash flow from operating activities	$ 12,501	$ 39,729	$ 39,929	$ 21,609
Net income for the period	$ 10,365	$ 24,863	$ 35,348	$ 21,807
Distributable cash	$ 12,043	$ 38,993	$ 45,972	$ 27,551
Cash distributions declared	$ 6,649	$ 26,405	$ 24,681	$ 11,162
Excess of cash flow from operating activities over cash distributions declared	$ 5,852	$ 13,324	$ 15,248	$ 10,447
Excess (short-fall) of net income over cash distributions declared	$ 3,716	$ (1,542)	$ 10,667	$ 10,645
Excess of distributable cash over cash distributions declared	$ 5,394	$ 12,588	$ 21,291	$ 16,389

Net income exceeded cash distributions declared by $5,852 for the three months ended December 31, 2007 and cash distributions declared exceeded net income by $1,542 for the year ended December 31, 2007. Net income includes significant non-cash charges which for the three months ended December 31, 2007 were $2,544 and for the year ended December 31, 2007 were $16,607 that do not impact cash flow. Included in these non-cash charges is a provision for depreciation that is not a reasonable proxy for the cost of maintaining existing levels of service (i.e. maintenance capital expenditures). Therefore, in certain periods cash distributions declared may exceed net income. Management does not consider the excess of cash distributions declared over net income for the year ended December 31, 2007 to be an economic return of capital. Instead the excess is considered a function of the timing of cash flows versus accounting income.

Currently cash distributions declared are less than distributable cash as the Trustees, on the recommendation of management of the Administrator, have decided to retain a portion of distributable cash to finance capital expenditures and debt repayment. It is not management's intent to distribute 100% of distributable cash.

Distributable cash (refer to Non-GAAP Measures) is calculated as follows:

	Years ended December 31	
	2007	2006
Cash flow from operating activities	**$ 39,729**	$ 39,929
Add (deduct): - changes in non-cash operating working capital (1)	**(36)**	6,902
Less: - required principal repayments on long-term debt and capital lease obligations	**(313)**	(549)
- maintenance capital expenditures	**(387)**	(310)
Distributable cash	**$ 38,993**	$ 45,972
Cash distributions declared	**$ 26,405**	$ 24,681
Payout ratio	**68%**	54% (2)

(1) Changes in non-cash operating working capital have been added back (deducted) as such changes are financed using the Trust's bank indebtedness/line of credit facility. In addition, if changes in non-cash operating working capital were not excluded from the calculation of distributable cash it would introduce cash flow variability and affect underlying cash flow from operating activities.

(2) Payout ratio is 57% for 2006 Q4 and 50% for the year ended December 31, 2006 if the December 2006 "special" cash distribution of $0.05 per Trust Unit is excluded.

EBITDAS

EBITDAS (refer to Non-GAAP Measures) is calculated as follows:

	Years ended December 31 2007	2006
EBITDAS as reported	**$ 46,731**	$ 52,793
Deduct: - depreciation and amortization	**(12,054)**	(10,692)
- interest – long-term debt and capital lease obligations	**(1,084)**	(936)
- non-cash compensation expense	**(1,603)**	(1,486)
- provision for taxes	**(7,127)**	(4,331)
Net income	**$ 24,863**	$ 35,348

RELATED PARTY TRANSACTION

A Trustee of the Trust and Director of Cathedral Energy Services Ltd., is a partner in a law firm and, through that law firm, is involved in providing and managing the legal services provided to the Trust at market rates. The total cost of these legal services in 2007 was $204 (2006 - $65).

FOURTH QUARTER RESULTS

The 10.6% or $3,727 increase in revenues from $35,327 in 2006 Q4 to $39,054 in 2007 Q4 is the net result of increased revenues from the Trust's directional drilling division in Canada and the U.S. and revenue declines for the production testing and wireline divisions. Directional related revenues increased due to a 27.9% increase in activity days (2007 Q4 - 3,470 vs. 2006 Q4 - 2,713) which was offset by a 2.6% decrease in the average day rate (2007 Q4 - $8,596 vs. 2006 Q4 - $8,825). Revenue for 2007 Q4 by division is as follows: directional drilling $30,551 (2006 - $24,616); wireline $5,133 (2006 - $6,702) and production testing $3,370 (2006 - $4,009). The decreases realized in production testing and wireline revenues are a direct result of the decline in drilling activity in western Canada due to low natural gas prices. The consolidated gross margin compressed 2.8% to 49.5% for 2007 Q4 from 52.3% in 2006 Q4. The decrease in quarter-over-quarter gross margin was primarily due to increased labour charges in the wireline division as a portion of the field labour charges are fixed in nature and did not decrease the same percentage as sales decreased and higher directional drilling field labour costs due to market pressures.

General and administrative charges increased 5.8% from $5,886 in 2006 Q4 to $6,227 in 2007 Q4 due to an increase in bad debt write-offs, facility rental costs and costs associated with exploring international business opportunities which were offset by a decrease in employee related incentive expenses. As a percentage of revenues, general and administrative expenses were 15.9% in 2007 Q4 compared to 16.7% in 2006 Q4.

Quarter-over-quarter EBITDAS increased $661 or 5.1% from $13,046 in 2006 to $13,707 in 2007.

The payout ratio for Q4 of 2007 was 55% (2006 Q4 – 71%) while the ratio for the year ended December 31, 2007 was 68% (2006 – 54%). The payout ratio for Q4 of 2006 includes the $0.05 per Trust Unit "special" cash distribution declared in December 2006. If this "special" cash distribution was excluded from the payout ratio calculation then the ratio for 2006 Q4 and 2006 would have been 57% and 50%, respectively.

For 2007 Q4, the Trust recorded a tax recovery of $593 which compares to a tax expense of $1,446 in 2006. The 2007 Q4 recovery was primarily the result of Federal income tax rate reductions that were substantively enacted in December 2007 as well as a reduction in the cumulative non-cash adjustment related to the substantive enactment of the previously announced changes to the taxation of income and royalty trusts, other than real estate investment trusts to reflect changes in timing differences that are expected to exist as at December 31, 2010.

Net income for 2007 Q4 was $10,365 ($0.33 per diluted Trust Unit) which compares to $8,127 ($0.26 per diluted Trust Unit) 2006 Q4.

SUMMARY OF QUARTERLY RESULTS

	2007				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenues	$42,712	$24,985	$38,355	$39,054	$38,682	$26,204	$38,041	$35,327
EBITDAS	14,412	4,837	13,775	13,707	15,367	8,370	16,010	13,046
Net income (loss)	9,787	(2,415)	7,126	10,365	10,862	4,963	11,396	8,127
Net income (loss) per Trust Unit								
Basic	0.32	(0.08)	0.23	0.33	0.36	0.16	0.37	0.26
Diluted	0.31	(0.08)	0.22	0.33	0.35	0.16	0.36	0.26

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. Activity levels in the Rocky Mountain and Williston Basin regions of the U.S. are not subject to the seasonality to the extent that it occurs in the western Canada region.

MANAGEMENT'S DISCUSSION AND ANALYSIS

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.

Property and equipment Property and equipment are recorded at cost less accumulated depreciation. Depreciation is computed based upon the Trust's depreciation policies (see note 2 to consolidated financial statements). The depreciation policies selected are intended to depreciate the related property and equipment over their useful life. The use of different assumptions with regard to the useful life could result in different carrying amount for these assets as well as for depreciation expense.

Impairment of long-lived assets Property and equipment 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.

Goodwill and intangibles The carrying value of goodwill and intangibles 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.

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 within property and equipment. 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 earnings. 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.

Income taxes The Trust uses the asset and 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.

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.

Stock-based compensation Stock-based compensation is calculated using the fair value method based upon the Black-Scholes model. In order to establish fair value, we use estimates and assumptions to determine risk-free interest rate, expected term, anticipated volatility and anticipated distribution yield. The use of different assumptions could result in different book values for stock-based compensation.

CURRENT YEAR ACCOUNTING CHANGES

The Accounting Standards Board ("AcSB") of the Canadian Institute of Chartered Accountants ("CICA") continually amends and improves certain standards or guidelines contained in the CICA Handbook. We monitor these changes as they are proposed and will make changes to our accounting policies and disclosures as necessary. The following summarizes accounting changes that were relevant to the Trust's consolidated financial statements for the year ended December 31, 2007.

Comprehensive Income This standard was effective for fiscal years beginning on or after October 1, 2006. It describes how to report and disclose comprehensive income and its components. Comprehensive income is the change in a trust's net assets that results from transactions, events and circumstances from sources other than the trust's Unitholders. It includes items that would not normally be included in net earnings, such as unrealized gains or losses on available-for-sale investments.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The CICA also made changes to section 3250, Surplus, and reissued it as section 3251, Equity. This standard is also effective for fiscal years beginning on or after October 1, 2006. This standard provides for changes in how to report and disclose equity and changes in equity to be consistent with the new requirements of section 1530, Comprehensive Income.

Adopting these standards on January 1, 2007, required the Trust to start reporting the following items in the consolidated financial statements:

- Comprehensive income and its components; and
- Accumulated other comprehensive income and its components.

The Trust has no comprehensive income and therefore the adoption of these standards did not have an effect on the Trust's consolidated financial statements.

Financial Instruments - Recognition and Measurement This standard was effective for fiscal years beginning on or after October 1, 2006. It describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. This standard requires that:

- All financial assets be measured at fair value, with some exceptions, such as loans and investments that are classified as held-to-maturity;
- All financial liabilities be measured at fair value if they are derivatives or classified as held for trading purposes. Other financial liabilities are measured at their carrying value; and
- All derivative financial instruments be measured at fair value, even when they are part of a hedging relationship.

The Trust adopted this standard effective January 1, 2007 and it had no impact on the Trust's consolidated financial statements.

Hedges This standard is effective for fiscal years beginning on or after October 1, 2006, and describes when and how hedge accounting can be used. Hedging is an activity used by a company to change an exposure to one or more risks by creating an offset between:

- Changes in the fair value of a hedged item and a hedging item;
- Changes in the cash flows attributable to a hedged item and a hedging item; or
- Changes resulting from a risk exposure relating to a hedged item and a hedging item.

Hedge accounting ensures that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the income statement in the same period. The Trust adopted this standard effective January 1, 2007 and since the Trust has no hedges the adoption of this standard did not have an effect on the Trust's consolidated financial statements.

FUTURE ACCOUNTING CHANGES

The following summarizes accounting changes that will be relevant to the Trust's consolidated financial statements subsequent to December 31, 2007.

Inventories This standard requires inventory to be measured at lower of cost and net realizable value. The standard also provides guidance on costs that can be capitalized. In addition, previous inventory write-downs must be reversed if the economic circumstances have changed to support an increase in the previously impaired inventory value. The standard is effective for fiscal years beginning on or after January 1, 2008. The Trust is currently evaluating the impact of this standard on the Trust's consolidated financial statements.

Capital Disclosures This standard provides for disclosure regarding an entity's capital and how it is managed. Enhanced disclosure with respect to the objectives, policies and processes for managing capital and quantitative disclosures about what an entity regards as capital is required. This standard is effective for fiscal years beginning on or after October 1, 2007. The Trust is currently evaluating the impact of this standard on the Trust's consolidated financial statements.

Financial Instruments - Disclosures and Presentation These standards will be effective for the Trust commencing January 1, 2008 and they provide additional guidance on disclosing risks related to recognized and unrecognized financial instruments and how those risks are managed. The Trust is currently evaluating the impact of this standard on the Trust's consolidated financial statements.

CONTROLS AND PROCEDURES

In order to ensure that information with regard to reports filed or submitted under securities legislation present fairly in all material respect the financial information of the Trust, management including the Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures, as well as internal controls over financial reporting.

Disclosure controls and procedures Disclosure controls and procedures have been designed to ensure that relevant and accurate information needed to comply with the Trust's continuous disclosure obligations is accumulated and summarized to allow timely decisions regarding disclosure and to ensure that the risk of a material error or fraud is minimal. Management of the Trust's Administrator have concluded that the Trust's disclosure controls and procedures, as of the end of the period covered by the annual filings are effective in ensuring that material information is accumulated and disclosed accurately. Management of the Trust's Administrator believe that "cost effective" disclosure controls, disclosure procedures and internal control systems can only provide reasonable assurance, and not absolute assurance, that the objective of controls and procedures are met.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Internal controls over financial reporting Management is responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with Canadian GAAP. The Chief Executive Officer and Chief Financial Officer have designed or have caused such internal controls over financial reporting to be designed under their supervision to provide reasonable assurance regarding the reliability of financial reporting and preparation of the Trust's financial statements for external purposes in accordance with Canadian GAAP. There has been no change in the Trust's internal controls over financial reporting during the year ended December 31, 2007 that has materially affected, or is reasonably likely to materially affect, the Trust's internal controls over financial reporting.

BUSINESS RISKS

Dependence of Cathedral Energy Services Ltd., Cathedral Energy Services Inc. and Cathedral Energy Services Limited Partnership 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., Cathedral Energy Services Inc. and Cathedral Energy Services Limited Partnership (collectively "Cathedral") through the ownership of the Cathedral Energy Services Ltd. shares and subordinated notes and an indirect wholly-owned partnership interest in Cathedral Energy Services Limited Partnership. 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 and the ability of Cathedral Energy Services Limited Partnership to provide cash distributions from partnership profits.

Distributions are not guaranteed and will fluctuate with Cathedral's performance There can be no assurance regarding the amounts of income which will be generated by Cathedral and paid to the Trust. The actual cash amount distributed in respect of the Trust Units will depend upon numerous factors, including, but not limited to, profitability, determination of taxable income and taxes payable, fluctuations in working capital, the sustainability of margins and capital expenditures as well as the actual cash amount distributed from Cathedral. In addition, the Trust's bank facility includes restrictions on the payment of cash distributions if the Trust is in default, or would be in default, if a cash distribution was made.

Income tax matters There can be no assurance that the treatment of mutual fund trusts will not be changed in a manner which adversely affects Unitholders. If the Trust ceases to qualify as a "mutual fund trust" under the Tax Act (Canada), the Trust Units will cease to be qualified investments for registered retirement savings plans, deferred profit sharing plans and registered retirement income funds.

On October 31, 2006, the Minister of Finance (Canada) announced new tax proposals concerning the taxation of income trusts and other flow-through entities. This proposal was followed by the release of draft legislation by the Department of Finance on December 21, 2006. These proposed amendments were substantially enacted in June 2007 and therefore the Trust will be subject to taxation as of January 1, 2011. In addition, the taxable distributions received by Unitholders from the Trust would be treated as taxable dividends. As a result of these provisions being substantially enacted as at December 31, 2007, the Trust has recorded additional future income taxes in the amount of $2,754 which represents future income taxes on temporary timing differences in the Trust that are expected to exist at December 31, 2010. This legislation effectively transfers the liability for tax on income earned by the Trust that is currently paid by Unitholders to the Trust. At this point, the Trust expects to convert to a corporation, subject to Unitholder approval, on or before December 31, 2010. Effective January 1, 2011 (and earlier if the Trust converts to a corporation prior to January 1, 2011), the Trust will be subject to taxes and this may require the Trust to adjust its level of cash distributions.

There is no assurance that the Trust will be able to retain the benefit of the deferred application of the new tax regime until 2011. If the Trust is deemed to have undergone "undue expansion" during the period November 1, 2006 to December 31, 2010, as described in the Normal Growth Guidelines issued by the Department of Finance on December 15, 2006, the proposed tax amendments would become effective on a date earlier than January 1, 2011.

Normal Growth Guidelines indicate that the Trust will not lose the benefit of the deferred application of the new tax regime to 2011 if the equity capital of the Trust does not grow as a result of the issuance of new equity (includes trust units, debt that is convertible into trust units, and potentially other substitutes of such equity) before 2011 by an amount that exceeds the greater of $50 million and an objective "safe harbour" amount based on a percentage of the Trust's October 31, 2006 market capitalization. The Normal Growth Guidelines provide for a "safe harbour" amount equal to 40% of the October 31, 2006 market capitalization for the period from November 1, 2006 to December 31, 2007, and 20% for each of the 2008 to 2010 calendar years. These amounts of "safe harbour" are cumulative during the transition period. The Trust's market capitalization at October 31, 2006 was approximately $289 million. It is therefore assumed, for the purposes of this summary that the Trust will not be subject to this proposed tax regime until January 1, 2011. However, in the event that the Trust issues additional Trust Units or convertible debentures or other equity substitutes on or before 2011, the Trust may become subject to this proposed tax regime prior to 2011. No assurance can be given that the proposed tax regime will not apply to the Trust prior to 2011. Loss of the deferred application of the proposed tax regime until 2011 could have a material and adverse effect on the value of the Trust Units of the Trust.

Taxation of the Trust and Cathedral Energy Services Income fund structures such as the Trust's involve significant amounts of inter-entity debt, which may generate substantial interest expense, which services to reduce earnings and therefore income tax payable. There can be no assurance that the taxation authorities will not seek to challenge the amount of interest expense deducted. If such a challenge were to succeed against Cathedral, it could have a materially adverse affect of the amount of distributable cash available.

Deductibility of expenses Although management of the Trust and Cathedral are of the view that substantially all of the expense claimed by the Trust and Cathedral, respectively will be reasonable and deductible, there can be no assurance that the tax authorities will agree. If taxation authorities successfully challenge the deductibility of any such expenses, the return to Unitholders may be adversely affected.

Non-resident ownership of Trust Units In order for the Trust to maintain its status as a mutual fund trust under the Tax Act (Canada), the Trust must not be established or maintained primarily for the benefit of non-residents of Canada ("non-residents") within the meaning of the Tax Act (Canada). The Declaration of Trust authorizes the Trust to take certain actions to maintain the non-resident ownership to less than 50% (refer to Declaration of Trust – Limitation on Non-resident Ownership filed on SEDAR). The current estimate of non-resident ownership is approximately 31%.

Unitholder liability 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. On July 1, 2004, the Province of Alberta proclaimed the Income Trust Liability Act (Alberta) in force. This legislation provides that beneficiaries of Alberta based public income trusts are not liable, as beneficiaries, for any act, default, obligation or liability of the income trust. Unitholders of the Trust will have the benefit of this legislation with respect to liabilities arising on or after July 1, 2004. This legislation has not been subject to interpretation by courts in the Province of Alberta or elsewhere.

Specific business risks relating to Cathedral Energy Services Ltd and Cathedral Energy Services Limited Partnership 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 and other oilfield services. World crude oil prices and 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. A significant portion of Cathedral fieldwork is performed by sub-contractors which allows us to operate with lower fixed overhead costs in seasonally low activity periods.

Key personnel and employee/sub-contractor relationships Unitholders must rely upon the ability, expertise, judgment, discretion, integrity and good faith of the management of Cathedral. The success of Cathedral is dependent upon its personnel and key sub-contractors. The unexpected loss or departure of any of Cathedral's key officers, employees or sub-contractors could be detrimental to the future operations of Cathedral. Cathedral does not maintain key man insurance on its officers. The success of Cathedral's business will depend, in part, upon Cathedral's ability to attract and retain qualified personnel as they are needed. Historically, Cathedral has not had any significant issues with respect to attracting and maintaining quality office, shop and field staff (including sub-contractors). 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. There can be no assurance that Cathedral will be able to engage the services of such personnel or retain its current personnel.

Environmental Risks There can be no assurance that the provincial, state and local governments or the Federal Governments of Canada and United States and other jurisdictions in which Cathedral enters into to provide its services will not adopt a new environmental regulations, rules or legislation or make modifications to existing regulations, rules or legislation which could increase costs paid by the Trust's customers. An increase in environmental related costs could reduce the Trust's customers' earnings and/or it could make capital expenditures by the Trust's customers uneconomic.

The Canadian Federal Government has announced its intention to regulate greenhouse gases ("GHG") and other air pollutants. The Government is currently developing a framework that outlines its clean air and climate change action plan. As this federal program is under development, the Trust is unable to predict the total impact of the potential regulations upon its business. It is possible that the Trust's customers could face increases in operating costs in order to comply with GHG emissions legislation which could have the effect of curtailing exploration and development by oil and natural gas producers and that in turn, could adversely effect the Trust's operations by reducing demand for its services.

Changes to Royalty Regimes There can be no assurance that the provincial, state and local governments or the Federal Governments of Canada and United States and other jurisdictions in which Cathedral enters into to provide its services will not adopt a new royalty regime or modify the methodology of royalty calculation which could increase the royalties paid by the Trust's customers. An increase in royalties could reduce the Trust's customers' earnings and/or it could make capital expenditures by the Trust's customers uneconomic.

On October 25, 2007, the Government of Alberta unveiled a new royalty regime. The new regime will introduce new royalties for conventional oil, natural gas and bitumen effective January 1, 2009 that are linked to price and production levels and will apply to both new and existing oil sands projects and conventional oil and gas activities. Additionally, certain proposed changes contemplate further public and/or industry consultation. There may be modifications introduced to the proposed royalty structure prior to the implementation thereof. Ultimately the implementation of this new royalty regime could have the effect of curtailing exploration and development in Alberta by oil and natural gas producers and that in turn, could adversely effect the Trust's operations by reducing demand for its services.

Interest rates The Trust's operating loan and its non-reducing revolving term credit facility bear interest at a floating interest rate and, therefore, to the extent the Trust borrows under this facility, is at risk of rising interest rates. Management continually monitors interest rates and would consider locking in the rate of its term debt.

Debt service Cathedral and its affiliates may, from time to time, finance a significant portion of their growth (either from acquisitions or capital expenditure additions) through debt. Amounts paid in respect of interest and principal on debt incurred by Cathedral and its affiliates may impair Cathedral's ability to satisfy its obligations under its debt instruments. Variations in interest rates and scheduled principal repayments could result in significant changes in the amount required to services debt before payment of inter-company debt. This may result in lower levels of cash for distributions by the Trust. Ultimately, the Trust's credit agreements could preclude distributions altogether.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Additional financing The Trust may require additional financing which may not be available or, if available, may not be available on favorable terms.

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

Access to parts, consumables and technology and relationships with key suppliers The ability of the Trust to compete and expand will be dependant on the Trust having access, at a reasonable cost, to equipment, parts and components, which are at least technologically equivalent to those utilized by competitors and to the development and acquisition of new competitive technologies. Although the Trust has very good relationships with its key suppliers, there can be no assurances that those sources of equipment, parts, components or relationships with key suppliers will be maintained. If these are not maintained, the Trust's ability to compete may be impaired. If the relationships with key suppliers come to an end, the availability and cost of securing certain parts, components and equipment may be adversely affected. It should be noted that Cathedral competes with other more established companies which have greater financial resources to develop new technologies.

Operating risks and insurance The Trust has an insurance and risk management plan in place to protect its assets, operations and employees. The Trust also has programs in place to address compliance with current safety and regulatory standards. The Trust has a safety coordinator responsible for maintaining and developing policies and monitoring operations vis-a-vis those policies. However, the Trust's oilfield services are subject to risks inherent in the oil and gas industry, such as equipment defects, malfunctions, failure and natural disasters. These risks could expose the Trust to substantial liability for personal injury, loss of life, business interruption, property damage or destruction, pollution and other environmental damages. In addition, the Trust's operating activities includes a significant amount of transportation and therefore is subject to the inherent risks including potential liability which could result from, among other things, personal injury, loss of life or property damage from motor vehicle accidents.

Weather and seasonality 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. Activity levels in the Rocky Mountain and Williston Basin regions of the U.S. are not subject to the seasonality to the extent that it occurs in the western Canada region.

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.

Acquisitions The Trust makes acquisitions of businesses and assets in the ordinarily course of business. Achieving the benefits of acquisitions depends in part on successfully consolidating functions and integrating operations and procedures in a timely and efficient manner. Such integration may require substantial management effort, time and resources and may divert management's focus from other strategic opportunities and operational matters. Management continually assesses the value and contribution of services provided and assets required to provide such services.

Implementing strategy In implementing its strategy the Trust may pursue new business opportunities or growth opportunities in new geographic markets and may not be successful in implementing those opportunities. The Trust may have difficulty executing the strategy because of, among other things, increased global competition, difficulty entering new markets, barriers to entry into geographic markets, and changes in regulatory requirements.

Credit risk The Trust's accounts receivable are with customers involved in the oil and natural gas industry, whose revenue may be impacted by fluctuations in commodity prices. The Trust may experience a significant financial loss if customers fail to pay for the Trust's services and products.

Customer mix Overall Cathedral has a good mix of customers with only one customer accounting for revenues in excess of 10% (at 22%) of the Trust's consolidated revenues for 2007 (2006 – one customer at 13%). Mergers and acquisitions activity in the oil and natural gas exploration and production sector can impact demand for our services as customers focus on internal reorganization prior to committing funds to significant oilfield services including those provided by Cathedral. In addition, demand for Cathedral's services could be negatively affected in that customers involved in mergers and acquisitions may re-direct their work to Cathedral's competitors.

In addition to 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 and complying with current environmental requirements.

OFF-BALANCE SHEET ARRANGEMENTS

As at December 31, 2007, the Trust's operating entities have entered into $9,962 of commitments under operating leases for premises and vehicles (refer to note 17 to the consolidated financial statements).

Cathedral has indemnified obligations to its directors and officers. Pursuant to such obligation, Cathedral indemnifies these individuals, to the extent permitted by law, against any and all claims or losses (including amounts paid in settlement of claims) incurred as a result of their service to Cathedral. The maximum amount payable under these indemnities cannot be reasonably estimated. Cathedral expects that it would be covered by insurance for most tort liabilities.

MANAGEMENT'S DISCUSSION AND ANALYSIS

GOVERNANCE

The Audit Committee of the Board of Trustees has reviewed this MD&A and the related audited consolidated financial statements and recommended they be approved by the Board of Trustees. Following a review by the full Board, the MD&A and audited consolidated financial statements were approved.

SUPPLEMENTARY INFORMATION

As at March 6, 2008, the Trust had 31,672,918 Trust Units and 2,766,269 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

Going forward management is expecting the Trust's directional drilling division, which accounted for 77% of 2007 consolidated revenues, to continue to show strong financial results and as natural gas prices improve, the financial results of the wireline and production testing divisions should improve accordingly. During 2007 the Trust expanded its wireline division to the Rocky Mountain region of the U.S. with 2 wireline units transferred from the western Canada operations. In early 2008 our U.S. wireline expansion moved into the Williston Basin region with the establishment of an operating facility in North Dakota and an additional wireline unit was transferred to the U.S. operations. As demand in the U.S. market increases we will consider transferring additional units to this area or building new units.

As previously announced the Trust's current 2008 capital budget is at $12,300 and includes at least 10 G2 EM-MWD systems along with the expansion of the mud motor and drill collar fleet to complement the expanded directional drilling job capacity and 5 production testing units. Three of these MWD systems will be allocated to the U.S. operations. The 5 production testing units will be deployed in the Rocky Mountain region of the U.S. and will be the Trust's first expansion of its production testing division to the U.S. Cathedral is pursuing directional drilling business opportunities in South America and in the near term expects to provide guidance on the status thereof.

In 2007 significant technology enhancements were made to the Trust's EM-MWD system and this resulted in the commercialization of its G2 version. As part of the Trust's continuing drive to provide state-of-art technology to its customers we are currently working on further enhancements to the overall EM-MWD platform.

The Trust continues to actively pursue opportunities to offer an expanded range of services to its customers, increase its market share, enter new geographic territories and make strategic acquisitions.

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 Bentsen

Per:
Mark L. Bentsen
President and Chief Executive Officer
March 6, 2008

Per:
P. Scott MacFarlane
Chief Financial Officer

AUDITORS' REPORT TO THE UNITHOLDERS

We have audited the consolidated balance sheets of Cathedral Energy Services Income Trust as at December 31, 2007 and 2006 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these consolidated 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, 2007 and 2006 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
March 6, 2008

CONSOLIDATED BALANCE SHEETS

December 31, 2007 and 2006
Dollars in '000's

	2007	2006
Assets		
Current assets:		
Cash and cash equivalents	**$ 1,306**	$ 1,554
Accounts receivable	**37,359**	37,693
Inventory	**3,584**	3,050
Prepaid expenses and deposits	**781**	892
	43,030	43,189
Property and equipment (note 3)	**67,639**	61,488
Intangibles, net of accumulated amortization of $342 (2006 - $194)	**588**	736
Goodwill	**19,775**	19,775
Other asset	**-**	33
	$ 131,032	$ 125,221
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness (note 4)	**$ 6,030**	$ 6,460
Accounts payable and accrued liabilities	**17,203**	16,446
Distributions payable to Unitholders (note 11)	**2,216**	3,717
Taxes payable	**341**	1,232
Current portion of capital lease obligations (note 5)	**194**	212
Current portion of long-term debt (note 6)	**99**	71
	26,083	28,138
Capital lease obligations (note 5)	**257**	452
Long-term debt (note 6)	**17,184**	15,100
Future income taxes (note 7)	**8,258**	5,308
Unitholders' equity:		
Unitholders' capital (note 8)	**48,193**	44,667
Contributed surplus (note 9)	**2,205**	1,162
Retained earnings (note 10)	**28,852**	30,394
	79,250	76,223
Commitments (note 17)		
	$ 131,032	$ 125,221

See accompanying notes to consolidated financial statements.

Approved by the Trustees:

Mark L. Bentsen
Trustee

Rod Maxwell
Trustee

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

Years ended December 31, 2007 and 2006
Dollars in '000's except per Trust Unit amounts

	2007	2006
Revenues	**$ 145,106**	$ 138,254
Expenses:		
Operating	**73,482**	64,886
General and administrative	**25,774**	22,066
Depreciation and amortization	**12,054**	10,692
Interest - long-term debt and capital lease obligations	**1,084**	936
Interest - other	**404**	482
Foreign exchange loss (gain)	**492**	(27)
Non-cash compensation expense	**1,603**	1,486
	114,893	100,521
	30,213	37,733
Gain on disposal of property and equipment	**1,777**	1,946
Income before taxes	**31,990**	39,679
Taxes (note 7):		
Current	**3,982**	3,093
Future income taxes	**3,145**	1,238
	7,127	4,331
Net income	**24,863**	35,348
Retained earnings, beginning of year	**30,394**	21,765
Less: Distributions declared (note 11)	**(26,405)**	(26,719)
Retained earnings, end of year	**$ 28,852**	$ 30,394
Net income per Trust Unit (note 12):		
Basic	**$ 0.79**	$ 1.16
Diluted	**$ 0.78**	$ 1.12

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2007 and 2006
Dollars in '000's

	2007	2006
Cash provided by (used in):		
Operating activities:		
Net income	**$ 24,863**	$ 35,348
Items not involving cash:		
Depreciation and amortization	**12,054**	10,692
Future income taxes	**3,145**	1,238
Unrealized foreign exchange (gain) loss	**(195)**	13
Non-cash compensation expense	**1,603**	1,486
Gain on disposal of property and equipment	**(1,777)**	(1,946)
	39,693	46,831
Changes in non-cash operating working capital (note 14)	**36**	(6,902)
	39,729	39,929
Investing activities:		
Property and equipment additions	**(19,857)**	(26,436)
Proceeds on disposal of property and equipment	**3,575**	3,277
Changes in non-cash investing working capital (note 14)	**(325)**	(1,207)
	(16,607)	(24,366)
Financing activities:		
Advances under long-term debt	**2,228**	3,109
Repayments of long-term debt	**(116)**	(321)
Repayments of capital lease obligations	**(214)**	(305)
Distributions paid to Unitholders (note 11)	**(27,903)**	(22,467)
Proceeds on exercise of Trust Unit options (note 8)	**3,065**	2,734
Increase (decrease) in bank indebtedness	**(430)**	1,150
	(23,370)	(16,100)
Decrease in cash and cash equivalents	**(248)**	(537)
Cash and cash equivalents, beginning of year	**1,554**	2,091
Cash and cash equivalents, end of year	**$ 1,306**	$ 1,554

See accompanying notes to consolidated financial statements.

Dollars in '000's except per Trust Unit amounts

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's operating entities, Cathedral Energy Services Ltd., Cathedral Energy Services Limited Partnership and Cathedral Energy Services Inc. (collectively the "Company") are engaged in the business of providing selected oilfield services to oil and natural gas companies in western Canada and the Rocky Mountain and Williston Basin regions of the United States. The Company markets its services under six brand names: *Directional Plus* and *The Directional Company* which provide horizontal and directional drilling services; *CAT Downhole Tools* which provides downhole equipment including drilling jars, shock tools and high performance drilling motors on a rental basis; *Tier One Oil Services* which provides oil and natural gas production testing services; *Advance Wireline* which provides cased hole logging and perforating, complete slickline services and casing integrity inspection logging; and *Xtreme Wireline* which provides slickline services.

The Trust owns, directly and indirectly, 100% of the common shares and subordinated notes of Cathedral Energy Services Ltd., 100% of the common shares of Cathedral Energy Services Inc., Directional Plus International Ltd. and Directional Plus de Venezuela, C.A. and 100% of the partnership units of Cathedral Energy Services Limited Partnership. Pursuant to a note indenture, the Trust is entitled to an interest payment from Cathedral Energy Services Ltd. in relation to the subordinated notes.

2. Significant accounting policies:

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 entities, Cathedral Energy Services Commercial Trust, Cathedral Energy Services Ltd., Cathedral Energy Services Limited Partnership, Advance Wireline Inc., Cathedral Energy Services Inc., Directional Plus International Ltd. and Directional Plus de Venezuela, C.A.

(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 and amortization 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.

(c) Inventory:

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

(d) Property and equipment:

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

Asset	Rate
Directional drilling equipment	10 - 25%
Production testing equipment	20 - 25%
Wireline equipment	20%
Automotive equipment	20 - 25%
Buildings	4%
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 the pre-commercialization of downhole equipment. These costs are amortized on a straight-line basis over 5 years upon commercialization of the equipment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Significant accounting policies (continued):

(e) Future income taxes:

The Trust uses the asset and 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 based upon daily, hourly or job rates. 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 year. 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.

(h) Unit-based compensation plan:

The Trust has a Trust Unit based compensation plan as described in note 8. Trust Unit based compensation expense is recorded for Trust Unit options issued to employees and non-employees using the fair value method. The fair value of employee Trust Unit options are valued on the date of grant and the resulting fair value is recorded as an expense over the vesting period of the option. The fair value of non-employee Trust Unit options are revalued each reporting date with the change in fair value on the vested options recorded in the income statement, and the change in fair value on unvested options expensed over the remaining vesting period. In determining the fair value of the Trust Unit options granted, the Black-Scholes model is used and assumptions regarding interest rates, underlying volatility of the Trust's Trust Units, distribution yield and expected life of the options are made.

(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:

Distributions to Unitholders are 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 subordinated notes, dividends, if any, from its wholly-owned subsidiaries and income allocated from Cathedral Energy Services Commercial Trust through its investment in Cathedral Energy Services Limited Partnership, 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) Intangible assets:

Intangible assets are comprised of values attributed to customer relationships and non-compete agreements and are amortized on a straight-line basis over 8 and 4 years, respectively. Management assesses the carrying value of intangible assets on a periodic basis for indications of impairment. When an indication of impairment is present, a test for impairment is carried out by comparing the carrying value of the asset to its expected future cash flows. If the carrying amount is greater than the expected future cash flow, the asset would be considered impaired and an impairment loss would be realized to reduce the asset's carrying value to its estimated fair value.

(m) 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. The most significant estimates relate to the depreciation of property and equipment, the cost recovery of property and equipment, goodwill and intangible assets and the determination of stock-based compensation. Actual results could differ from those estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Significant accounting policies (continued):

(n) Accounting policy developments in 2007:

The following summarizes accounting changes that were relevant to the Trust's consolidated financial statements for the year ended December 31, 2007:

i) The Canadian Institute of Chartered Accountants ("CICA") issued section 1530, Comprehensive Income. This standard was effective for fiscal years beginning on or after October 1, 2006. It describes how to report and disclose comprehensive income and its components. Comprehensive income includes items that would not normally be included in net earnings, such as unrealized gains or losses on available-for-sale investments.

The CICA also made changes to section 3250, Surplus, and reissued it as section 3251, Equity. This standard is also effective for fiscal years beginning on or after October 1, 2006. This standard provides for changes in how to report and disclose equity and changes in equity to be consistent with the new requirements of section 1530, Comprehensive Income.

Adopting these standards on January 1, 2007, required the Trust to start reporting the following items in the consolidated financial statements:

- Comprehensive income and its components; and
- Accumulated other comprehensive income and its components.

The Trust has no comprehensive income and therefore the adoption of these standards did not have an effect on the Trust's consolidated financial statements.

ii) The CICA issued section 3855, Financial Instruments - Recognition and Measurement. This standard was effective for fiscal years beginning on or after October 1, 2006. It describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. This standard requires that:

- All financial assets be initially measured at fair value;
- Subsequent measurement of financial assets is at fair value except for loans and receivables and investments held to maturity which are measured at amortized cost;
- All financial liabilities be measured at fair value if they are derivatives or classified as held for trading purposes. Other financial liabilities are measured at their amortized cost; and
- All derivative financial instruments are measured at fair value, even when they are part of a hedging relationship.

The Trust adopted this standard effective January 1, 2007 and it had no material impact on the Trust's consolidated financial statements.

iii) The CICA issued section 3865, Hedges. This standard is effective for fiscal years beginning on or after October 1, 2006, and describes when and how hedge accounting can be used. Hedging is an activity used by a company to change an exposure to one or more risks by creating an offset between:

- Changes in the fair value of a hedged item and a hedging item;
- Changes in the cash flows attributable to a hedged item and a hedging item; or
- Changes resulting from a risk exposure relating to a hedged item and a hedging item.

Hedge accounting ensures that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the income statement in the same period. The Trust adopted this standard effective January 1, 2007 and since the Trust has no hedges the adoption of this standard did not have an effect on the Trust's consolidated financial statements.

(o) Future accounting policy developments:

The following summarizes accounting changes that will be relevant to the Trust's consolidated financial statements subsequent to December 31, 2007.

i) The CICA issued section 3031, Inventories, which requires inventory to be measured at lower of cost and net realizable value. The standard also provides guidance on costs that can be capitalized. In addition, previous inventory write-downs must be reversed if the economic circumstances have changed to support an increase in the previously impaired inventory value. The standard is effective for fiscal years beginning on or after January 1, 2008. The Trust is currently evaluating the impact of this standard on the Trust's consolidated financial statements.

ii) The CICA issued section 1535, Capital Disclosures, which provides standards for disclosure regarding an entity's capital and how it is managed. Enhanced disclosure with respect to the objectives, polices and processes for managing capital and quantitative disclosures about what an entity regards as capital is required. This standard is effective for fiscal years beginning on or after October 1, 2007. The Trust is currently evaluating the impact of this standard on the Trust's consolidated financial statements.

iii) The CICA issued section 3862, Financial Instruments - Disclosures and section 3863 Financial Instruments - Presentation. These standards will be effective for the Trust commencing January 1, 2008 and they provide additional guidance on disclosing risks related to recognized and unrecognized financial instruments and how those risks are managed. The Trust is currently evaluating the impact of this standard on the Trust's consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. Property and Equipment:

2007	Cost	Accumulated depreciation	Net book value
Directional drilling equipment	$ 57,893	$ 24,489	$ 33,404
Production testing equipment	9,829	3,323	6,506
Wireline equipment	26,373	7,232	19,141
Automotive equipment	442	113	329
Office and computer equipment	2,633	1,240	1,393
Leasehold improvements	631	176	455
Deferred development costs	1,986	1,060	926
Buildings	4,538	109	4,429
Land	1,056	-	1,056
	$ 105,381	$ 37,742	$ 67,639

Included in 2007 property and equipment are assets under capital leases with a cost of $1,429 and a net book value of $901.

2006	Cost	Accumulated depreciation	Net book value
Directional drilling equipment	$ 52,423	$ 19,642	$ 32,781
Production testing equipment	10,240	2,160	8,080
Wireline equipment	17,832	3,398	14,434
Automotive equipment	271	103	168
Office and computer equipment	2,206	945	1,261
Leasehold improvements	636	79	557
Deferred development costs	1,794	746	1,048
Buildings	2,133	30	2,103
Land	1,056	-	1,056
	$ 88,591	$ 27,103	$ 61,488

Included in 2006 property and equipment are assets under capital leases with a cost of $2,084 and a net book value of $1,609.

4. Bank indebtedness:

The Trust has a $12,500 (2006 - $12,500) operating line of credit that bears interest at the bank's prime rate per annum (December 31, 2007 – 6.0%; December 31, 2006 – 6.0%) with interest payable monthly and is secured as described in note 6.

5. Capital lease obligations:

	2007	2006
Capital lease obligations secured by related equipment are with interest rates ranging from 6.5% to 11.62% and maturing on various dates up to 2012	$ 451	$ 664
Less: current portion of capital lease obligations	(194)	(212)
	$ 257	$ 452

Principal amounts to be paid under these capital leases until maturity are approximately as follows:

2008	$ 194
2009	133
2010	124
2011	-
2012	-

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. Long-term debt:

		2007		2006
Bank revolving term loan at an authorized amount of $25,000 (2006 - $25,000), bearing interest at the bank's prime rate plus 0.5% (2006 – 0.5%) per annum (December 31, 2007 – 6.5%; December 31, 2006 – 6.5%), without repayment terms, maturing June 30, 2009 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	$	17,000	$	15,000
Non-interest bearing loans secured by the related automotive equipment with various maturity dates up to 2010		283		171
		17,283		15,171
Less: current portion of long-term debt		(99)		(71)
	$	17,184	$	15,100

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 property and equipment and are subject to certain covenants regarding the payment of dividends, cash distributions and the maintenance of certain financial ratios.

Minimum principal amounts to be paid under long-term debt (assuming the Trust elects prior to the maturity date of the revolving term loan to repay the loan over 36 months) during the next five years are approximately as follows:

2008	$	99
2009		2,916
2010		5,742
2011		5,693
2012		2,833

7. Taxes:

The Trust is a mutual fund trust as defined under the Income Tax Act (Canada). All taxable income earned by the Trust has been allocated to Unitholders and such allocations are deducted for income tax purposes. The Trust's wholly-owned subsidiaries are however, subject to income taxation and provide for income tax obligations based upon statutory corporate rates. In June 2007, the Government of Canada's Bill C-52 Budget Implementation Act, 2007 (the "Bill"), was enacted and this will result in the taxation of existing income and royalty trusts, other than real estate investment trusts, at effective rates similar to Canadian corporations. Enactment of the Bill resulted in the recognition of future income tax amounts based on estimated net taxable temporary differences which are expected to reverse after 2010 and for which no tax has previously been recorded in the Trust's financial statements. Accordingly, a future income tax expense and a net future income tax liability of $2,754 has been recognized in accounts for the year ended December 31, 2007.

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:

		2007		2006
Effective tax rate		32.6%		34%
Income before taxes	$	31,990	$	39,679
Income of Trust subject to tax in the hands of the Unitholders, not the Trust		(20,045)		(26,070)
Income before taxes of subsidiary companies	$	11,945	$	13,609
Effective tax rate applied to income before taxes of subsidiary companies	$	3,894	$	4,627
Adjustment to future income tax asset/liability for change in effected tax rates		(470)		(660)
Income taxed in jurisdictions with different tax rates		501		254
Adjustment to future income tax liability for change in tax legislation		2,754		-
Non-deductible expenses		448		75
Non-taxable portion of gain on disposal of property and equipment		(20)		(31)
Capital taxes		47		151
Other		(27)		(85)
	$	7,127	$	4,331

7. Taxes (continued):

The components of the net future income tax liability at December 31, 2007 and 2006 are as follows:

	2007	2006
Future income tax liability:		
Property and equipment	$ 4,132	$ 997
Partnership interests	734	1,105
Deferred partnership income	3,392	3,633
Loss carry forwards	-	(427)
Net future income tax liability	$ 8,258	$ 5,308

8. Unitholders' capital:

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

(b) Issued:

	Number of Trust Units	Amount
Balance, December 31, 2005	30,050,692	$ 37,094
Issued on acquisitions	187,032	1,820
Issued on exercise of options	733,255	2,734
In-kind distribution (note 11)	204,667	2,038
Consolidation for in-kind distribution (note 11)	(204,667)	-
Contributed surplus on options exercised (note 9)	-	981
Balance, December 31, 2006	30,970,979	44,667
Issued on exercise of options	691,938	3,065
Contributed surplus on options exercised (note 9)	-	461
Balance, December 31, 2007	31,662,917	$ 48,193

(c) Trust Unit options:

The Trust's Trust Unit based compensation plan is a "rolling number" type option plan which provides for the number of authorized but unissued Trust Units that may be subject to options granted under the unit option plan at anytime can be up to 10% of the number of Trust Units outstanding from time to time.

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 years from the date of grant as employees, trustees or consultants render continuous service to the Trust. At the option of the optionholder, the exercise price may be reduced annually by the amount by which the Trust's net income per 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 diluted per Trust Unit basis. The reduction is calculated annually and is effective March 15 following each fiscal year. The March 15, 2008 reduction available to Unitholders was $0.49 (March 15, 2007 - $0.86) per option.

A summary of the status of the Trust Unit based compensation plan as at December 31, 2007 and 2006, and changes during the years then ended is presented below:

	2007		2006	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding, beginning of year	2,869,544	$ 7.33	2,946,601	$ 5.41
Granted	764,600	8.49	810,000	10.78
Exercised	(691,938)	4.43	(733,255)	3.73
Forfeited	(129,269)	9.54	(153,802)	6.03
Outstanding, end of year	2,812,937	$ 8.25	2,869,544	$ 7.33
Exercisable, end of year	797,861	$ 9.00	402,669	$ 7.80

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. Unitholders' capital (continued):

(c) Trust Unit options (continued):

The range of exercise prices for the Trust unit options outstanding at December 31, 2007 is as follows:

		Total options outstanding		Exercisable	
Range	Number	Weighted average exercise price	Weighted average remaining life (years)	Number	Weighted average exercise price
$2.59	34,768	$ 2.59	2.65	34,768	$ 2.59
$4.14 to $4.96	685,684	$ 4.28	3.23	107,331	$ 4.29
$8.20 to $9.98	1,281,685	$ 8.93	4.82	406,498	$ 9.64
$10.26 to $10.87	713,000	$ 10.65	4.59	211,664	$ 10.68
$11.30 to $12.18	97,800	$ 11.77	4.35	37,600	$ 11.82
$2.59 to $12.18	2,812,937	$ 8.25	4.33	797,861	$ 9.00

During the year ended December 31, 2007, the Trust has recorded non-cash compensation expense of $1,504 (2006 - $1,387) for options granted on or after January 1, 2003.

The following table sets out the assumptions used in applying the Black-Scholes model for options issued in 2007 and 2006 as well as the resulting fair value:

	Date of issue		
	Nov 22 2007	Sep 10 2007	Mar 9 2007
Number of options issued	150,000	536,600	78,000
Exercise price	$8.50	$8.20	$10.44
Fair value per option	$1.15	$1.07	$1.77
Expected distribution yield	9.88%	10.24%	8.05%
Risk-free interest rate	4.22%	4.28%	3.94%
Expected volatility	34%	34%	37%
Expected life (in years)	3.5	3.5	3.5

	Date of issue					
	Dec 15 2006	Sep 29 2006	Aug 29 2006	Jul 17 2006	May 23 2006	Mar 28 2006
Number of options issued	70,000	21,000	311,000	10,000	98,000	300,000
Exercise price	$10.26	$9.24	$10.60	$11.30	$11.75	$10.87
Fair value per option	$1.71	$1.42	$1.92	$2.17	$2.27	$2.00
Expected distribution yield	8.19%	9.1%	7.36%	6.9%	6.13%	6.62%
Risk-free interest rate	3.85%	4.01%	4.25%	4.53%	4.15%	4.0%
Expected volatility	37%	36%	37%	37%	36%	36%
Expected life (in years)	3.5	3.5	3.5	3.5	3.5	3.5

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 expected time until exercise, that can cause a significant variation in the estimate of the fair value of the options.

9. Contributed surplus:

Balance, December 31, 2005	$ 756
Non-cash compensation expense related to Trust Unit option plan (note 8)	1,387
Less: Contributed surplus on options exercised	(981)
Balance, December 31, 2006	1,162
Non-cash compensation expense related to Trust Unit option plan (note 8)	1,504
Less: Contributed surplus on options exercised	(461)
Balance, December 31, 2007	$ 2,205

10. Retained earnings:

	2007	2006
Accumulated income	$ 109,360	$ 84,497
Less: accumulated distributions (note 11)	(80,508)	(54,103)
	$ 28,852	$ 30,394

11. Distributions:

The following is a summary of distributions for the years ended December 31, 2007 and 2006:

	2007	2006
Accumulated distributions, beginning of year	$ 54,103	$ 27,384
Distributions declared	26,405	26,719
Accumulated distributions, end of year	$ 80,508	$ 54,103
Regular monthly cash distributions per Trust Unit	$ 0.84	$ 0.75500
Special year-end cash distributions per Trust Unit	-	0.05000
Cash distributions declared per Trust Unit	$ 0.84	$ 0.80500
In-kind distribution declared per Trust Unit	-	0.06582
Distributions declared per Trust Unit	$ 0.84	$ 0.87082

Pursuant to the Trust's Declaration of Trust, the Trust is required to allocate all of its taxable income to Unitholders and in order to allocate all of its taxable income to Unitholders a non-cash in-kind distribution in the form of additional Trust Units was allocated to Unitholders of record on December 31, 2006. The December 31, 2006, non-cash in-kind distribution was $0.06582 per Trust Unit for a total of $2,038. The Declaration of Trust also requires there is an immediate consolidation of the Trust Units issued such that each Unitholder has the same number of Trust Units after the consolidation as they had prior to the non-cash in-kind distribution. Based upon a December 31, 2006 year-end Trust Unit price of $9.96, the in-kind distribution in 2006 represented the issuance of 204,667 Trust Units which were immediately consolidated. For the year ended December 31, 2007 the Trust did not have a non-cash in-kind distribution.

12. 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, 2007, the basic weighted average number of Trust Units outstanding was 31,402,445 (2006 – 30,577,820). At December 31, 2007, the diluted weighted average number of Trust Units outstanding was 31,781,320 (2006 – 31,423,033), which includes the addition of 378,875 (2006 – 845,213) Trust Units to the basic weighted average number of Trust Units outstanding during the year ended December 31, 2007 for the dilutive effect of the Trust Unit options.

13. 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, 2007 and 2006 due to the relatively short period to maturity of the instruments. The fair value of long-term debt at December 31, 2007 approximated its carrying value as it bears interest at floating rates. The fair value of capital lease obligations at December 31, 2007 approximated its carrying value.

(c) Foreign currency exchange risk:

The Trust has an exposure to fluctuations in the Canada/United States foreign currency exchange rate primarily due its operations in the United States. Management attempts to mitigate this exposure by matching local purchases in the same currency. Currently, the Trust's net foreign currency exposure risk is not significant enough to warrant an active management program to mitigate the foreign currency exchange exposure.

(d) Interest rate risk:

At December 31, 2007, the Trust was exposed to changes in interest rates on its bank indebtedness and long-term debt (see notes 4 and 6).

14. Supplemental cash flow disclosure:

	2007	2006
Components of changes in non-cash working capital are as follows:		
Accounts receivable	$ 334	$ (6,623)
Other receivables	-	612
Inventory	(534)	(338)
Prepaid expenses and deposits	45	(367)
Accounts payable and accrued liabilities	757	(1,342)
Taxes payable	(891)	(51)
	(289)	(8,109)
Less: changes in working capital related to investing activities	(325)	(1,207)
Changes in working capital related to operating activities	$ 36	$ (6,902)
Interest paid	$ 1,481	$ 1,408
Taxes paid	$ 4,873	$ 3,299

15. Segmented information:

The Trust, through its wholly-owned entities, Cathedral Energy Services Ltd. and Cathedral Energy Services Limited Partnership, is engaged in the business of providing selected oilfield services to oil and natural gas companies in western Canada and the Rocky Mountain and Williston Basin regions 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.

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

Revenues	2007	2006
Canada	$ 102,797	$ 108,007
United States	42,309	30,247
	$ 145,106	$ 138,254

Revenues by operating division	2007	2006
Directional drilling (including rental of related equipment)	$ 111,373	$ 96,219
Wireline	21,682	26,188
Production testing	12,051	15,847
	$ 145,106	$ 138,254

Property and equipment, goodwill and intangibles	2007	2006
Canada	$ 72,788	$ 71,100
United States	15,214	10,899
	$ 88,002	$ 81,999

During the year ended December 31, 2007, one customer accounted for 22% (2006 – 13%) of consolidated revenues.

16. Related party transaction:

A Trustee of the Trust and Director of Cathedral Energy Services Ltd., is a partner in a law firm and, through that law firm, is involved in providing and managing the legal services provided to the Trust at market rates. The total cost of these legal services in 2007 was $204 (2006 - $65).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

17. Commitments:

(a) Leases:

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

2008	$ 2,594
2009	1,945
2010	1,576
2011	899
2012	567
Thereafter	2,381

(b) Property and equipment additions:

As at December 31, 2007 the Trust has committed to purchase $2,802 (2006 – $4,159) of property and equipment.

CORPORATE INFORMATION

OFFICERS AND SENIOR MANAGEMENT

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

David Diachok
Vice President, Sales

Ron Schell
General Manager – The Directional Company

Richard DeFreitas
President – Tier One Oil Services

Doug Hartle
Vice President, Sales – Advance Wireline

Lance McGuire
Vice President, Operations – Advance Wireline

Cory Loverin
General Manager – Xtreme Wireline

AUDITORS
KPMG LLP
Calgary, Alberta

LEGAL COUNSEL
Burstall Winger LLP
Calgary, Alberta

REGISTRAR AND TRANSFER AGENT
Computershare Trust Company of Canada
Calgary, Alberta

BANKER
The Bank of Nova Scotia

STOCK EXCHANGE LISTING
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