2000 ANNUAL REPORT

Cathedral
Energy Services Ltd.

ANNUAL MEETING

Shareholders are invited to attend the Annual General Meeting which will be held at 11:00 a.m. on June 25, 2001 in the Lakeview Endroom at the Westin Hotel, 320 – 4th Avenue S.W., Calgary, Alberta.

Cathedral trades on the TSE under the symbol "CAT".

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Building momentum.

Pursuing growth.

Cathedral Energy Services Ltd., through its Directional Plus division, is a leading provider of horizontal, directional and under-balanced drilling services to oil and gas exploration and production companies in western Canada.

Renowned for developing horizontal and directional drilling technologies, Cathedral Energy Services Ltd. provides oil and gas producers with value-added technologies that meet their drilling requirements.

FINANCIAL HIGHLIGHTS

Figures in thousands of dollars, except per share amounts

	2000	1999	(8 months) 1998
Revenue	19,036	5,793	1,561
Earnings before income taxes	4,107	1,007	135
Net earnings	4,471	602	105
Earnings per share – basic	0.75	0.28	0.06
Earnings per share – diluted	0.23	0.06	0.01
EBITDA	5,678	1,526	280
Funds from operations	5,282	1,133	221
Total assets	20,247	7,607	2,235
Total long-term debt	3,431	1,676	615
Shareholders' equity	11,372	3,013	345

Cathedral enjoyed great success in 2000. It was a remarkable year of change with tremendous growth. Revenue increased 228% to $19 million in 2000 from $5.8 million in 1999 and net earnings increased 643% to $4.5 million in 2000 from $0.6 million in 1999. The Company increased revenues and earnings, expanded operations, solidified its customer base, secured new markets, and our growth is just gaining momentum.

In this rapidly changing market, our focus is on remaining flexible and on maintaining the high standards that have made Cathedral a leading provider of drilling services to oil and gas exploration and production companies in western Canada. As we create the momentum for further change and growth, it is important that we never lose sight of the key strengths that have made us successful.

Fiscal 2000 was a year of milestone accomplishments. Our greatest change was the acquisition of Directional Plus Ltd. in June 2000, with Directional Plus becoming the reporting entity. The amalgamated entity was continued under the name of Cathedral Energy Services Ltd., and with the takeover now behind us, the Company can focus on growth and maintaining our high level of customer service while continuing to focus on remaining efficient from a financial and operational standpoint.

In 2000, the Company invested a record amount on capital asset additions to purchase equipment to meet the growing needs of our customers. This investment is already paying for itself, with the increased services available to our customers helping us increase our market share. We have also greatly reduced reliance on third-party rental equipment, which has allowed us to improve our operating margin from 43% to 48% of revenues. It is expected that this trend will continue as the Company adds additional capacity. Cathedral will expand its fleet of equipment to meet the growing demand for services. Complimented with a strategic push to improve operating margins, we anticipate a strong year ahead. We have ensured the infrastructure is in place to continue growth with few changes to existing operations.

Another significant milestone was in May of 2000 when Cathedral opened a mud motor repair facility in Nisku, Alberta. This facility has allowed the Company to reduce costs and improve the turn-around time on repairing equipment. This improvement in efficiency has reduced the reliance on third-party motor suppliers and the need to have a larger motor fleet to service the same number of jobs.

Mark L. Bentsen
President and Chief Executive Officer

One of our greatest strengths is our exceptional staff and we are proud of our strong management team with their tremendous amount of oilfield experience. Through this significant experience, the management and operating personnel have been able to develop an innovative and efficiency-oriented approach to the day to day operations of the Company. The importance of dedicated, skilled and experienced personnel is paramount to providing the level of service necessary to achieve and maintain customer relationships.

This commitment, along with the Company's ongoing training program, ensures the highest level of service and results available to the Company's customers. We have committed Cathedral to ensuring a safe work environment for both our employees and the public at large, and were awarded a Certificate of Recognition ("COR") on October 5, 2000. In 2000, Cathedral was proud to report no lost time accidents or incidents.

While 2000 was a great year, we look forward to 2001 being even better. With fundamentals never more positive, the outlook for Cathedral and the oil and gas industry has never been stronger. OPEC continues to act in a unified manner and is committed to crude oil prices in the US$22/bbl to US$28/bbl range. Demand for natural gas for heat and power generation is growing. Industry analysts are predicting record levels for commodity prices and the number of wells to be drilled. The combined result of these strong fundamentals offers a growing market for Cathedral.

We would like to thank all of our employees who have dedicated their services to building the Company we have today. We look forward to the challenges ahead as we continue to grow in this robust market. We are confident that with hard work and dedication of everyone involved that our customers will be rewarded with unmatched service and our shareholders will be rewarded with superior returns.

Mark L. Bentsen
President and Chief Executive Officer

May 2, 2001

Working with energy and innovation.

At Cathedral, the importance of highly dedicated, skilled and experienced personnel is paramount to achieve and maintain customer relationships.

Best in class, best in service

The June 2000 acquisition of Directional Plus Ltd. transformed Cathedral from a precious metals exploration and development company to an energy services company. Since the acquisition, Cathedral has strategically been operating under the trademarked name "Directional Plus".

Directional Plus is a provider of horizontal, directional and underbalanced drilling services to the oil and natural gas industry in western Canada. In addition to providing the necessary equipment, the company also provides its customers with well planning and engineering services.

For 2000, Directional Plus had set goals to expand its job capacity, improve equipment utilization and reduce dependency on third-party rental suppliers. We are proud to say that, as result of combined teamwork and a remarkable turn-around in the oil and gas industry in 2000, we were able to achieve and surpass those goals and provide the Company with a marked increase in both gross revenues and operating margins.

During the year ended December 31, 2000, the Company's Directional Plus division generated revenues of $19,036,000 as compared to $5,793,000 for the year ended December 31, 1999. This represents an increase of $13,243,000 or 228%.
The operating margin increased from 43% in 1999 to 48% in 2000.

During 2000, the Company had 2,289 activity days compared to 741 for 1999. Average revenues per activity day increased from $7,818 in 1999 to $8,207 in 2000, an increase of 5%.

PERSONNEL

Experienced Management

The mandate of Directional Plus is to supply “Best in Class - Best in Service” equipment and personnel to the industry. The Company has been extremely effective in securing new clients and maintaining existing relationships by adhering to these basic principles. The management group, operations and support personnel and field staff are recognized by clients and competitors as being among the best in the industry.
The Company is committed to ensuring exceptional service and will continue to offer ongoing training for its personnel to ensure industry standards are continually met and surpassed.

Field Operations Staff

As of December 31, 2000, the Company utilized the services of 33 directional drilling and 23 MWD field consultants. The strategy of using field consultants on contract has allowed the Company to operate with low fixed overhead costs and remain financially profitable in seasonal low activity periods while taking advantage of the specialization these consultants have to offer.

TECHNOLOGY

Directional Plus provides Measurement While Drilling Systems (MWD), Electromagnetic Measurement While Drilling Systems (EM-MWD), Logging While Drilling Systems, Positive Displacement Drilling Motors, Non-magnetic Drill Collars, Directional and Horizontal Drilling Services, Re-entry Drilling Services, Performance Drilling Services, Well Planning and Engineering Services and Directional and Horizontal Drilling Supervision.

Horizontal drilling involves drilling a well horizontal to the vertical wellbore allowing access previously unattainable. Penetration is significantly increased, allowing for substantially better drainage of the reservoir. Directional drilling is the controlled drilling of a wellbore to a prescribed bottom hole location. Horizontal and directional drilling operations require three distinct and separate systems to steer the drill bit below

SERVICES

- Directional and horizontal drilling
- Underbalanced drilling
- Re-entry drilling
- Relief well drilling
- Performance drilling
- Well planning and engineering

Reliable, state-of-the-art equipment

EQUIPMENT

- Negative pulse Orienteer MWD Systems
- Directional/Gamma Systems
- Logging While Drilling systems
- Electromagnetic Measurement While Drilling (“EM-MWD”)
- Positive displacement drilling motors

the earth’s surface to a pre-determined target – a positive displacement mud motor, measurement-while-drilling (MWD) technology and occasionally a gamma ray system. The economic performance of horizontal and directional drilling results in a significant advantage over conventional drilling.

Conventional drilling uses weighted mud, which provides sufficient pressure to offset wellbore pressure and also to prevent a blowout. Weighted muds are frequently not required for low-pressure reservoirs. One of the challenges with many low-pressure reservoirs is to avoid mud based wellbore pressure at the reservoir which exceeds reservoir pressure. If the pressure of the mud column exceeds the reservoir pressure, mud may penetrate from the wellbore into the reservoir causing formation damage which can negatively impact rates of production and recoverable reserves. To avoid this problem, Underbalanced Drilling is utilized.

Underbalanced drilling is utilized to minimize formation damage. The drilling mud is made lighter by injecting nitrogen and other inert gases into the wellbore. In making the drilling mud lighter, the ability of fluid based transmissions to make their way to the surface becomes more difficult. Hence, the use of "Electromagnetic Measurement While Drilling" (EM-MWD). Benefits are seen as the result of a reduction in drilling time, greater rates of drilling, increased bit life, the rapid indication of productive reservoir zones and the potential for dynamic flow testing while drilling.

Horizontal Re-entry Drilling is an economical method of increasing the recovery from an existing well. The efficiency of drilling horizontal re-entry wells increases dramatically as the depth of the horizontal target increases. The cost of drilling horizontal re-entries is approximately half the cost of drilling primary horizontal wells due to the utilization of the existing vertical well, which allows for a decrease in drilling time.

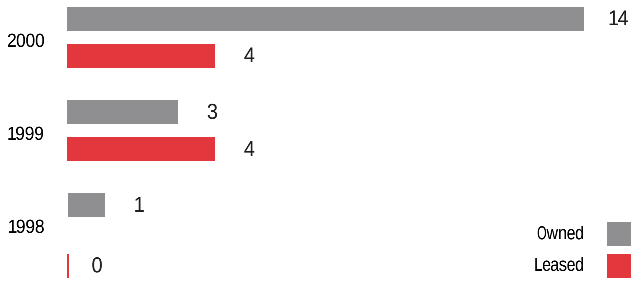
Measurement While Drilling (MWD) Services

In 2000, Directional Plus was able to increase the number of owned MWD systems from 3 to 14 at year-end and had 4 additional leased systems which, when combined with third-party rentals, increased concurrent job capacity to 20 jobs. Additional equipment was added in 2000 to allow Directional Plus to supply services in hole sizes from 98 mm (3-1/8") to 444 mm (17-1/2").

The Company utilizes the Orienteer System manufactured by Geolink UK Ltd., which is reputed to have one of the best reliability track records in the industry.

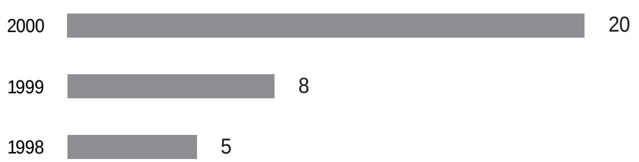
In addition to standard directional MWD services, the Company has a combination of owned/leased Gamma Ray MWD equipment to operate nine jobs. Gamma Ray MWD systems allow oil and gas

Number of MWD Systems
as at December 31



Positive Displacement Motors
as at December 31 (all owned)

Concurrent Job Capacity
as at December 31



exploration and development companies to determine the type of formation being drilled by measuring the natural gamma rays being emitted, a process known as “geo-steering”.

Positive Displacement Motors (PDM)

At the end of 2000, Directional Plus had 62 owned drilling motors as compared to 17 at the same time in 1999. A high percentage (85%) of the motor fleet consists of performance drilling motors, which have upwards of double the torque capacity of conventional drilling motors. Use of performance motors allows the customer to select more aggressive bits, and drill with substantially higher weights, resulting in significantly reduced drilling time and costs. This gives Directional Plus a competitive advantage in overall cost performance as compared to competitors. As with the MWD equipment, drilling motors were strategically added to increase job capacity, reduce third-party rentals, and allow the Company to service hole size ranges from 98mm (3-1/8”) to 444mm (17-1/2”).

FACILITIES

The Company currently operates three facilities in western Canada: two in Calgary, Alberta and our new mud motor repair facility in Nisku, Alberta.

Calgary Main

In January 2001, the Company moved its head office to accommodate the growth of personnel required to support the marked increase in activity in 2000 and expected for 2001.
The main facility houses the operations, engineering, and administrative personnel, allowing for effective service delivery to the client base located primarily in downtown Calgary. At year-end, 15 personnel were located in this facility.

Calgary South

The benefits of opening the Calgary south facility in 1999 were realized in 2000. The facility now employs 4 service and co-ordinating personnel who maintain the Company’s fleet of MWD tools. The impact of having complete control of the MWD maintenance has markedly improved utilization and reliability which is now upwards of 4 times that of competitors.

Nisku, Alberta

In May 2000, the Company opened its Nisku, Alberta repair and maintenance facility that allowed the Company to assume 100% control of equipment maintenance and repair. Employing 11 full-time personnel, this facility has allowed the Company to reduce operational costs and increase utilization of drilling tools by reducing the service turn-around time.

Record drilling forecast for 2001

DOMESTIC OUTLOOK

Directional Plus plans to add additional MWD systems and drilling motors to meet anticipated increase in demand that is expected to result from strong commodity prices in the oil and gas sector. The Company plans to add retrievable MWD systems, which allow the down-hole instrumentation sections to be recovered in the event of the drill string becoming stuck. In addition, an agreement has been made with Geolink UK Ltd. to field test and purchase Electro-Magnetic Measurement While Drilling ("EM-MWD") systems. These systems will allow the Company to expand into the under-balanced drilling market, and compete with other EM-MWD suppliers in niche market applications.

The Company remains focused in supplying value-added services to junior, intermediate and major oil and gas exploration and development companies in western Canada, which distinguishes it from competitors. With an expanding client base, the Company believes that 2001 will bring significant growth in revenue and operations.

INTERNATIONAL OUTLOOK

The Company is reviewing opportunities to provide services into the lucrative US market. Currently plans are in place to supply services to Canadian oil and gas producers operating in the United States. This approach will allow the Company to achieve low risk expansion into new markets.

HEALTH, SAFETY, ENVIRONMENT

Cathedral undertook an initiative in 2000 to implement a comprehensive system, which effectively combines Health, Safety and Environment policies with Loss Control. The system encompasses a continuous improvement process that has allowed the Company to manage and minimize losses in all aspects of the Company's business, including, most importantly, ensuring a safe work environment for both our employees and the public at large.

The culmination of this effort was the granting of the Company's Certificate of Recognition ("COR") on October 5, 2000 through the partnerships program with Alberta Human Resources and Employment and the Petroleum Industry Training Service.

(Left to right)

Graham Challand – Operations Co-ordinator

Randy Pustanyk – Vice President, Operations

Aurele Maurice – Vice President, Sales and Marketing

Jeff Morden – Vice President, Engineering

Paul Thebeau – Operations Manager

Scott MacFarlane – Chief Financial Officer

Innovation and leadership

In June 2000, Cathedral Gold Corporation ("CAT") purchased 100% of the issued and outstanding shares of Directional Plus Ltd. ("DPL").

In June 2000, Cathedral Gold Corporation ("CAT") purchased 100% of the issued and outstanding shares of Directional Plus Ltd. ("DPL"). As result of the acquisition, the previous shareholders of DPL control the largest percentage of the total issued and outstanding shares of CAT and therefore DPL was deemed to be the acquirer. Accordingly, the transaction has been accounted for as a reverse takeover using the purchase method of accounting.

Historical financial statements of the resulting company are the financial statements of DPL and therefore references to 1999 figures within this Management's Discussion & Analysis refer to those of DPL. CAT and DPL were amalgamated and the amalgamated entity continued under the name of Cathedral Energy Services Ltd. ("Cathedral"/"Company").

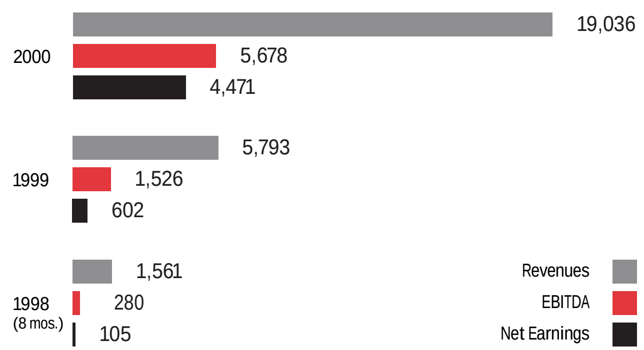
REVENUES

Revenues for the year ended December 31, 2000, were $19,036,000, which is an increase of $13,243,000 or 228% from $5,793,000 reported in 1999. The increase in revenues resulted from: a) an increase in the number owned and leased MWD systems from 7 to 18; b) increased day rates; and c) an increase in equipment utilization.

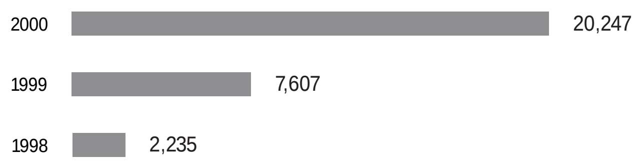
EXPENSES

Operating expenses increased $6,543,000 or 199% from $3,283,000 in 1999. As a percentage of revenues, operating expenses were 51.6% and 56.7% for 2000 and 1999, respectively.

Revenues, EBITDA and Net Earnings
Thousands of dollars



Total Assets
as at December 31, Thousands of dollars



Excellent growth and profit potential

Operating expenses increased due to the higher number of operating days and decreased as a percentage of revenues due to higher average revenues per day and less reliance on leased/rental equipment due to significant capital asset additions in 2000.

General and administrative expenses increased from $1,047,000 in 1999 to $3,666,000 in 2000. The increase of $2,619,000 or 250% is due to: a) increased staffing levels to accommodate growth; b) implementation of a comprehensive safety program; c) Calgary field office expenses included for a full year (3 months for 1999); and d) the set-up of the Nisku field office in May 2000.

DEPRECIATION

Depreciation of $1,348,000 was charged in 2000 compared to $425,000 in 1999. The increase of $923,000 or 217% is consistent with the growth in the capital asset base which resulted from the $8,370,000 of net capital additions in 2000.

As a percentage of revenues, depreciation expense has decreased marginally from 7.3% in 1999 to 7.1% in 2000.

INTEREST ON LONG-TERM DEBT

Interest on long-term debt increased $129,000 to $223,000 in 2000 compared to $94,000 reported in 1999. The increase is due to a higher average debt level and an increase in the effective borrowing rates resulting from fluctuations in the bank prime lending rate.

ACQUISITION

As part of the June 2000 CAT acquisition of DPL and the use of reverse takeover accounting principles, the assets acquired from CAT included cash of $1,723,000, capital mining assets of $200,000 and a future income tax asset of $4,500,000. The Company also assumed a deferred credit in the amount of $2,535,000 which is related to the future income tax asset acquired. The purchase price of $3,888,000 was satisfied by way of issuing a combination of Common Shares and Special Shares, Series 1 to the former shareholders of DPL.

The acquired cash of $1,723,000 was utilized along with term loan financing to acquire capital assets.

During 2000, the capital mining asset acquired from CAT, was sold for a gain of $50,000.

INCOME TAXES

Both the future income tax asset and deferred credit relate to non-capital loss carry forwards and resource deductions acquired from CAT. As a result of a reduction in the valuation allowance related to the future income tax asset and the amortization of a portion of the deferred credit, the Company was able to reduce its overall income taxes for 2000 to a $364,000 recovery position. Income tax expense for 1999 was $405,000 which provided for an effective tax rate of 40.2% .

During 2001, the Company expects to utilize a significant portion of the future income tax asset recorded in the accounts at December 31, 2000. As well, a significant portion of the related deferred credit will be amortized into income as a reduction of future income tax expense.

As a result, aside from a minimal amount of Large Corporations Tax, the Company does not expect to have current taxes until 2002.

FINANCIAL CONDITION AND LIQUIDITY

Funds from operations was $5,282,000 in 2000 compared to $1,133,000 in 1999. This significant increase is mainly attributable to the increase in activity levels and improved operating margins for 2000 over 1999. The Company maintains an operating line of credit with a major Canadian chartered bank in the amount of $1,500,000 of which $726,000 had been utilized at December 31, 2000 ($360,000 at December 1999).

During 2000, the Company obtained $2,504,000 of bank term loan financing related to its acquisition of capital assets. These loans require monthly principal payments over periods ranging from 35 to 48 months and monthly interest payments at bank prime rate plus 1.5%.

Shareholders' equity increased $8,359,000 in 2000 to $11,372,000 from $3,013,000 in 1999. The increase is due to net earnings of $4,471,000 and the issuance of share capital in the amount of $3,888,000 as part of the acquisition of CAT. In November 2000, the Company consolidated its Common Shares and Special Shares, Series 1 on a five for one basis.

CAPITAL ASSETS

Capital additions, net of dispositions, were $ 8,370,000 in 2000 compared with $3,329,000 in 1999. $8,059,000 of the current year net additions relate to directional drilling equipment which included: a) increasing the number of owned MWD systems to 14 from 3; b) increasing mud motors to 62 from 17; and c) setting up a field office in Nisku, Alberta. The balance of the 2000 net additions related to office and computer equipment required due to increased staffing levels and leasehold improvements to head office and the Nisku, Alberta field office.

In 2000, the Company sold capital assets for proceeds of $1,025,000 and a gain of $135,000. The comparable figures for 1999 were $289,000 and $62,000, respectively.

BUSINESS RISKS MANAGEMENT

The Company's revenues are directly impacted by the level of capital expenditures of oil and gas exploration and production companies. In turn, the level of capital expenditures is affected by factors including, but not limited to, oil and gas prices, access to capital markets, government policies and weather.

The Company's success is also dependent on other factors such as competition, changes in technology and operational and environmental risks.

Cathedral manages these risks by:

- providing the highest level of service and results available to the customer
- attracting and retaining experienced and skilled employees both in the field and in head office
- providing those employees with effective training, technology and tools
- monitoring and adjusting to changes in technology
- maintaining a comprehensive insurance program
- strict adherence to the Company's safety standards
- complying with current environmental requirements

FUTURE OUTLOOK

It is industry consensus that oil and gas prices for 2001 will remain relatively strong. This should result in strong cash flows for oil and gas exploration and production companies and therefore allow these companies to continue with high levels of expenditures on drilling and related services. As a result of the Company's capital asset additions in 2000 and planned for 2001, it is expected that the Company will be in a position to capitalize on the anticipated high levels of expenditures on drilling and related services.

MANAGEMENT'S REPORT

The Annual Report, including the financial statements, is the responsibility of management of the Company. The financial statements were prepared by management in accordance with Canadian generally accepted accounting principles and, where appropriate, reflect estimates based upon management's judgment. Financial information presented elsewhere in this Annual Report has been prepared by management and is consistent with the information in the financial statements.

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

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

External auditors have examined the financial statements and their report is presented below.

Mark L. Bentsen
President and Chief Executive Officer

Scott MacFarlane
Chief Financial Officer

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of Cathedral Energy Services Ltd. (formerly Cathedral Gold Corporation) as at December 31, 2000 and 1999 and the statements of operations and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2000 and 1999 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

KPMG LLP
Chartered Accountants
Calgary, Canada

February 16, 2001

BALANCE SHEETS

Years ended December 31, 2000 and 1999

	2000	1999
Assets		
Current assets:		
Accounts receivable (note 3)	$ 4,329,860	$ 3,283,073
Inventory	892,435	–
Prepaid expenses and deposits	275,790	148,436
	5,498,085	3,431,509
Capital assets (note 4)	11,239,859	4,175,969
Future income tax asset (notes 2 and 7)	3,508,759	–
	$ 20,246,703	$ 7,607,478
Liabilities and Shareholders' Equity		
Current liabilities:		
Bank indebtedness (note 5)	$ 725,853	$ 359,560
Accounts payable and accrued liabilities	3,405,548	2,150,567
Income taxes payable	–	236,500
Current portion of long-term debt (note 6)	1,279,365	430,000
	5,410,766	3,176,627
Long-term debt (note 6)	2,151,390	1,246,031
Future income tax liability (note 7)	–	171,500
Deferred credit (notes 2 and 7)	1,312,537	–
Shareholders' equity:		
Share capital (note 8):		
Common shares	3,062,344	7
Special series shares	3,131,370	–
Special warrants	–	2,306,299
Retained earnings	5,178,296	707,014
	11,372,010	3,013,320
Commitment (note 12)		
	$ 20,246,703	$ 7,607,478

See accompanying notes to financial statements.

On behalf of the Board:

Rod Maxwell

Rod Maxwell, Director

Mark Bentsen

Mark L. Bentsen, Director

STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

Years ended December 31, 2000 and 1999

	2000	1999
Revenues	$ 19,035,566	$ 5,793,042
Expenses:		
Operating	9,826,240	3,282,752
General and administrative	3,665,716	1,046,852
Depreciation	1,348,085	424,558
Interest on long-term debt	222,986	93,915
	15,063,027	4,848,077
Operating earnings	3,972,539	944,965
Gain on disposal of capital assets	134,642	62,065
Earnings before income taxes	4,107,181	1,007,030
Income taxes (note 7):		
Current	39,087	236,500
Future	(403,188)	168,568
	(364,101)	405,068
Net earnings	4,471,282	601,962
Retained earnings, beginning of year	707,014	105,052
Retained earnings, end of year	$ 5,178,296	$ 707,014
Net earnings per share (note 9):		
Basic	$ 0.75	$ 0.28
Diluted	$ 0.23	$ 0.06

See accompanying notes to financial statements

STATEMENTS OF CASH FLOWS

Years ended December 31, 2000 and 1999

	2000	1999
Cash provided by (used in):		
Operations:		
Net earnings	$ 4,471,282	$ 601,962
Items not involving cash:		
Depreciation	1,348,085	424,558
Future income taxes	(403,188)	168,568
Gain on disposal of capital assets	(134,642)	(62,065)
Funds from operations	5,281,537	1,133,023
Changes in non-cash operating working capital (note 11)	(1,048,095)	(772,346)
	4,233,442	360,677
Investments:		
Capital asset additions	(9,102,178)	(3,597,416)
Proceeds on disposal of capital assets	1,024,845	288,706
	(8,077,333)	(3,308,710)
Financing:		
Advances under long-term debt	2,503,675	2,014,706
Net cash acquired on acquisition of CAT	1,722,874	–
Issue of common shares and special warrants, net of issue costs	–	1,744,539
Repayments of long-term debt	(748,951)	(954,134)
Advances from shareholders	–	419,993
Purchase of common shares	–	(239,994)
Increase (decrease) in bank indebtedness	366,293	(37,077)
	3,843,891	2,948,033
Change in cash	–	–
Cash, beginning and end of year	$ –	$ –
Funds from operations per share (note 9):		
Basic	$ 0.89	$ 0.53
Diluted	$ 0.27	$ 0.10

See accompanying notes to financial statements

Years ended December 31, 2000 and 1999

GENERAL:

Cathedral Energy Services Ltd. (the "Company"), was incorporated under the Alberta Business Corporations Act (Alberta) as 762732 Alberta Ltd. Pursuant to Articles of Amendment dated April 4, 1998, the name of the Company was changed to Directional Plus Ltd. ("Directional"). On June 16, 2000, Cathedral Gold Corporation ("CAT") acquired all the issued and outstanding shares of Directional (see note 2). On June 16, 2000 CAT and Directional amalgamated and the amalgamated entity is continuing under the name of Cathedral Energy Services Ltd.

Cathedral is engaged in the business of providing drilling services to oil and gas exploration companies in Western Canada.

1. SIGNIFICANT ACCOUNTING POLICIES:

The financial statements have been prepared in accordance with generally accepted accounting principles in Canada and include the following significant accounting policies:

(a) Inventory:

Inventory is valued at the lower of cost and market, with market represented by replacement value.

(b) Capital assets:

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

Asset	Rate
Directional drilling equipment	10-25%
Office and computer equipment	20%

Leasehold improvements are depreciated on a straight-line basis over the term of the lease.

1. SIGNIFICANT ACCOUNTING POLICIES: (continued)

(c) Future income taxes and deferred credit:

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

The deferred credit, which arose on the purchase transaction (see note 2) will be recognized in income in proportion to the realization of the future income tax asset recorded at that date. The original deferred credit represented the excess of future income taxes over the value of assets purchased.

(d) Revenue recognition:

Revenue is recognized as services are rendered and includes estimates for services provided on contracts using the percentage of completion method.

(e) Per share amounts:

Basic earnings per common share and cash flow from operations per common share are computed by dividing earnings and cash flow from operations by the weighted average number of common shares outstanding for the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determined the dilutive effect of stock options and other dilutive instruments.

(f) Stock-based compensation plans:

The Company has a stock based compensation plan, which is described in note 8. No compensation expense is recognized for this plan when stock options are issued. Any consideration received on exercise of the stock options is credited to share capital.

(g) Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. ACQUISITION OF CAT:

Effective June 16, 2000, CAT acquired 100% of the outstanding common shares of Directional in exchange for 15,973,359 common shares and 66,158,746 special shares series 1. Upon acquisition, each shareholder of Directional received, in exchange for each Directional common share held, 2.75 common shares of CAT and 11.39 special series non-voting shares of CAT.

As a result of the acquisition, the previous shareholders of Directional control the largest percentage of the total issued and outstanding shares of CAT and therefore Directional was deemed to be the acquirer. Accordingly, the transaction has been accounted for as a reverse takeover using the purchase method whereby the assets and liabilities of CAT have been recorded at their fair market values and the operating results have been included in the Company's financial statements from the effective date of purchase.

Details of the acquisition are as follows:

	Purchase transaction
Net assets acquired:	
Cash	$ 1,722,874
Capital assets	200,000
Future income tax asset	4,500,000
Deferred credit	(2,535,466)
	$ 3,887,408
Consideration rendered:	
15,973,359 common shares at an ascribed value of approximately $0.05 per share	$ 756,038
66,158,746 special series shares, at an ascribed value of approximately $0.05 per share	3,131,370
	$ 3,887,408

3. ACCOUNTS RECEIVABLE:

At December 31, 1999, accounts receivable included amounts due from employees of $214,500. The amounts were unsecured, non-interest bearing and due on demand and were repaid in full during the year ended December 31, 2000.

4. CAPITAL ASSETS:

2000	Cost	Accumulated depreciation	Net book value
Directional drilling equipment	$ 12,445,525	$ 1,664,837	$ 10,780,688
Office and computer equipment	511,598	121,866	389,732
Leasehold improvements	84,065	14,626	69,439
	$ 13,041,188	$ 1,801,329	$ 11,239,859

1999	Cost	Accumulated depreciation	Net book value
Directional drilling equipment	$ 4,386,304	$ 445,907	$ 3,940,397
Office and computer equipment	256,751	47,090	209,661
Leasehold improvements	27,684	1,773	25,911
	$ 4,670,739	$ 494,770	$ 4,175,969

At December 31, 2000, directional drilling equipment and office and computer equipment included assets held under capital leases with a net book value in the amount of $16,875 (1999 - $33,549).

5. BANK INDEBTEDNESS:

The Company has a $1,500,000 operating line of credit that bears interest at the bank prime rate plus 0.5% per annum with interest payable monthly and is secured as described in note 6.

6. LONG-TERM DEBT:

	2000	1999
Bank term loan, bearing interest at bank prime rate plus 1.50%, repayable in 48 equal monthly instalments of $35,000 plus interest	$ 1,225,000	$ 1,645,000
Bank term loan, bearing interest at bank prime rate plus 1.50%, repayable in 35 equal monthly instalments of $55,555 plus interest	1,777,780	–
Bank term loan, bearing interest at bank prime rate plus 1.50%, repayable in 48 equal monthly instalments of $10,400 plus interest	406,400	–
Obligations under capital leases bearing interest rates varying between 9.6% and 21.5% per annum, repayable in monthly instalments ranging from $127 to $1,330 at various dates to June 2002 secured by specific assignments over the related capital assets	21,575	31,031
	3,430,755	1,676,031
Less current portion	(1,279,365)	(430,000)
	$ 2,151,390	$ 1,246,031

Principal repayments over the next four years are as follows:

	Long-term debt	Capital leases	Total
2001	$ 1,267,215	$ 12,150	$ 1,279,365
2002	1,211,460	9,425	1,220,885
2003	898,705	–	898,705
2004	31,800	–	31,800
	$ 3,409,180	$ 21,575	$ 3,430,755

The bank term loans and the operating line of credit are secured by a general security agreement over all personal property with a first charge over directional drilling equipment.

Interest of $4,942 (1999 - $2,826) relating to capital lease obligations has been included in interest on long-term debt.

7. INCOME TAXES AND DEFERRED CREDIT:

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

	2000	1999
Effective tax rate	45%	45%
Basic rate applied to earnings before income taxes	$ 1,832,625	$ 449,337
Amortization and adjustment of deferred credit	(1,222,929)	–
Benefit for reduction of valuation allowance	(1,037,748)	
Adjustment to net future income tax asset for change in enacted tax rates	107,741	–
Non-deductible expenses	16,731	8,447
Small business deduction	(23,270)	(51,000)
Non-taxable portion of gain on disposal of capital assets	(10,382)	(11,032)
Other	(26,869)	9,316
	$ (364,101)	$ 405,068

The components of the net future income tax liability at December 31, 2000 and 1999 are as follows:

	2000	1999
Future tax assets:		
Capital assets	$ 3,989,923	$ –
Loss carryforwards	1,537,192	–
Share issue costs	7,000	1,768
Financing costs	–	5,145
Other	–	71
	5,534,115	6,984
Future tax liabilities:		
Capital assets	–	(178,484)
Future tax asset (liability) before valuation allowance	5,534,115	(171,500)
Valuation allowance	(2,025,356)	–
Net future tax asset (liability)	$ 3,508,759	$ (171,500)

7. INCOME TAXES AND DEFERRED CREDIT: (continued)

The non-capital loss carry-forwards and resource deductions amounting to $12,327,109 at December 31, 2000, expire in various amounts up to 2006.

The balance of the deferred credit, arising from the Company's acquisition of CAT, as described in note 2, is summarized as follows:

Original balance	$	2,535,466
Amortization in 2000		(1,162,228)
Adjustment for change in enacted income tax rates		(60,701)
	$	1,312,537

8. SHARE CAPITAL:

(a) Authorized:

(i) An unlimited number of common shares without nominal or par value;

(ii) An unlimited number of special shares issuable in series without nominal or par value, with the directors having the right to determine the number, designation and attributes of each series of shares; and

(iii) 80,000,000 non-voting, cumulative, non-convertible special shares series 1, redeemable at the option of the Company at a price per share equal to the weighted average price at which the Company's common shares have traded on The Toronto Stock Exchange during the ten consecutive trading days ending five days prior to the redemption date, together with all declared and unpaid dividends.

8. SHARE CAPITAL: (continued)

(b) Issued:

	Issued Number		Amount
Common shares:			
Balance, December 31, 1998	2,400,000	$	240,000
Issued for cash	10		1
Purchase on conversion of shareholder loans	(2,399,940)		(239,994)
Issued on 50,000:1 stock split	3,499,930		–
Balance, December 31, 1999	3,500,000		7
Conversion of warrants into common shares	2,308,494		2,306,299
	5,808,494		2,306,306
Common share capital of Cathedral at time of acquisition	25,228,463		–
Issued in exchange for common shares of Directional (note 2)	15,973,359		756,038
Effect of 5:1 share consolidation	(32,954,258)		–
Balance, December 31, 2000	8,247,564	$	3,062,344

	Issued Number		Amount
Special series shares:			
Balance, December 31, 1999	–	$	–
Issued in exchange for common shares of Directional (note 2)	66,158,746		3,131,370
Effect of 5:1 share consolidation	(52,926,996)		–
Balance December 31, 2000	13,231,750	$	3,131,370
Special warrants:			
Issued on conversion of shareholder loans	559,993	$	559,993
Issued for cash	1,748,501		1,748,501
Special warrants issue costs, net of future tax benefit totaling $1,768	–		(2,195)
Balance, December 31, 1999	2,308,494		2,306,299
Converted into common shares	(2,308,494)		(2,306,299)
Balance December 31, 2000	–	$	–

8. SHARE CAPITAL: (continued)

(c) Stock options:

The Company has a stock based compensation plan under which a combined total of 1,260,000 options to purchase common shares can be granted to employees and directors. Under the plan, the exercise price of each option equals the fair market value of the Company's stock on the date of the grant and the maximum term till expiry is ten years. Options vest over a period of five years from the date of grant as employees or directors render continuous service to the Company.

A summary of the status of the stock based compensation plan as at December 31, 2000 and 1999, and changes during the years then ended is presented below:

	Options outstanding	Range of exercise price	Weighted average exercise price	Options exercizable
Outstanding at December 31, 1999 and 1998	–	$ –	$ –	–
Granted	1,000,000	1.25	1.25	–
Outstanding at December 31, 2000	1,000,000	$ 1.25	$ 1.25	–

The range of exercise prices for options outstanding as at December 31, 2000 are as follows:

	Total options outstanding			Exercizable options	
Range of exercise prices	Number	Weighted average exercise price	Weighted average remaining contractual life (years)	Number	Weighted average exercise price
$ 1.25	1,000,000	$ 1.25	4.5	–	$ –

9. PER SHARE AMOUNTS:

The Canadian Institute of Chartered Accountants has approved a new standard for the computation, presentation and disclosure of earnings per share. Under the new standard, the treasury stock method is used instead of the imputed earnings method to determine the dilutive effect of stock options and other dilutive instruments. Under the treasury stock method, only "in the money" dilutive instruments impact the diluted calculations.

At December 31, 2000, the weighted average number of common shares outstanding was 5,945,611 (1999 – 2,125,937). In computing diluted earnings and cash flow from operations per share, 13,449,307 (1999 – 8,805,246) shares were added to the weighted average number of common shares outstanding during the year ended December 31, 2000 for the dilutive effect of employee stock options and the possible issuance of common shares on redemption of special series shares. No adjustments were required to reported earnings or cash flow from operations in computing diluted per share amounts.

Had the imputed earnings method been used to calculate earnings per share and cash flow per share amounts, there would be no difference to the reported amounts.

10. FAIR VALUES:

The carrying values of the Company's current assets and current liabilities approximated their fair values as at December 31, 2000 and 1999 due to the relatively short period to maturity of the instruments. The fair value of long-term debt approximated its carrying value as it bears interest at floating rates.

11. SUPPLEMENTAL CASH FLOW DISCLOSURE:

	2000	1999
Components of changes in non-cash working capital are as follows:		
Accounts receivable	$ (1,046,787)	(2,295,549)
Inventory	(892,435)	–
Prepaid expenses	(127,354)	(130,497)
Accounts payable and accrued liabilities	1,254,981	1,442,700
Income taxes payable	(236,500)	211,000
	$ (1,048,095)	$ (772,346)
Cash interest paid	$ 265,665	$ 105,968
Cash income taxes paid	275,587	25,500

12. COMMITMENT:

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

2001	$ 550,000
2002	530,000
2003	305,000
2004	217,000
2005	169,000

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(2) Compensation Committee

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