Cathedral

Energy Services Income Trust

2004 ANNUAL REPORT

GENERAL INFORMATION

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

The Trust's units trade on the TSX under the symbol:

CET.UN

Annual and Special Meeting:

Unitholders are invited to attend the Annual and Special Meeting which will be held at 2:30pm on May 12, 2005 in the Royal Meeting Room of the Metropolitan Centre, 333 – 4th Avenue S.W., Calgary, Alberta.

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FINANCIAL HIGHLIGHTS

$ '000's except Trust Unit amounts (1)	2004	2003	2002	2001	2000
Revenues	46,478	32,715	22,075	23,444	19,036
Gross Margin % (revenues less operating expenses)	52%	49%	57%	54%	48%
EBITDA (2)	15,108	8,269	6,942	7,783	5,678
Operating income (3)	10,143	4,623	3,726	5,094	3,973
Income before taxes	11,231	4,828	4,086	5,102	4,107
Net income	9,128	4,441	3,389	5,206	4,471
Basic per Trust Unit	0.39	0.20	0.24	0.63	0.75
Diluted per Trust Unit	0.38	0.20	0.16	0.24	0.23
Cash distributions declared per Trust Unit	0.245	0.22	0.0938	n/a	n/a
Distributable income (4)	12,924	6,373	3,535	n/a	n/a
Distributions declared	5,768	4,792	2,014	n/a	n/a
Payout ratio (5)	45%	75%	57%	n/a	n/a
Capital asset additions and corporate acquisitions	8,472	7,968	3,516	7,276	9,102
Weighted outstanding Trust Units					
Basic ('000)	23,233	21,710	13,867	8,248	5,946
Diluted ('000)	23,783	22,004	21,516	21,479	19,395
Working capital	10,839	1,955	966	942	87
Total assets	46,822	33,080	24,811	25,278	20,247
Total long-term debt including current portion	-	5,700	2,721	5,110	3,431
Unitholders' equity	33,564	16,589	16,375	16,578	11,372

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

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

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

(4) Distributable income is defined as funds from operations less required principal repayments on long-term debt and maintenance capital expenditures. Distributable income does not have any standardized meaning within Canadian Generally Accepted Accounting Policies and therefore may not be comparable to similar measures presented by other trusts. Conversion to an income trust was effective July 30, 2002.

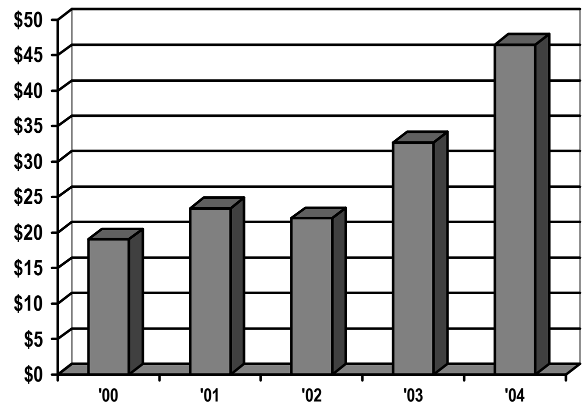
(5) Distributions declared as a percentage of distributable income.

FORWARD-LOOKING STATEMENTS

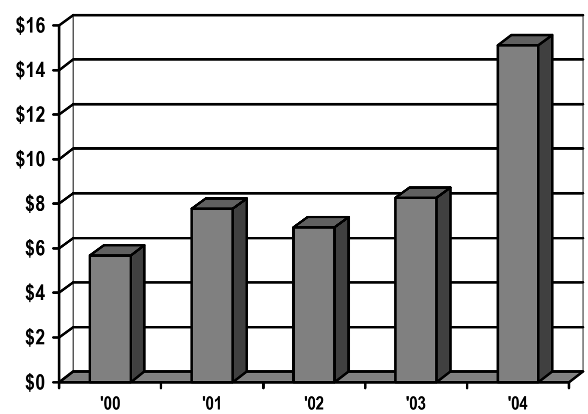
This annual report may contain forward-looking statements, including statements regarding the business and anticipated financial performance of the Trust. These forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance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

FINANCIAL HIGHLIGHTS

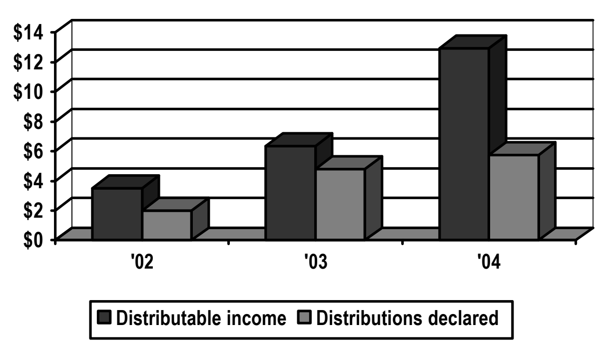
Revenues
($ in millions)



EBITDA
($ in millions)



Distributable income/Distributions declared
($ in millions)



REPORT TO UNITHOLDERS

2004 was a tremendous year for the oil and natural gas industry and again for Cathedral Energy Services Income Trust ("Cathedral"/the "Trust"). The oil and natural gas industry saw a record number of wells drilled in 2004 driven by extremely high oil and natural gas commodity prices. Commodity prices drove oil and natural gas producers to record revenues and cash flows. This in turn aided Cathedral in growing its number of activity days by over 40% in 2004. This growth was also driven by the successful launch and build out of our new Electro-Magnetic Measurement-While-Drilling ("EM-MWD") system that began in late 2003. The 18 EM-MWD systems added in 2004 allowed Cathedral to grow its market share in both Canada and the U.S.

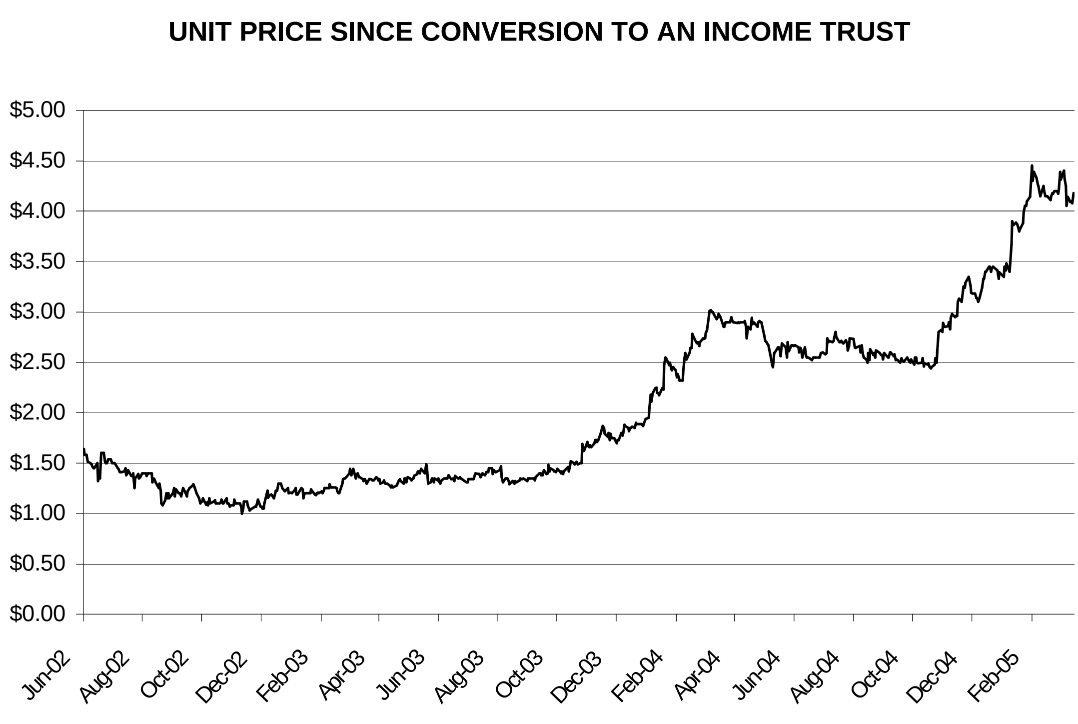
The highlights of 2004 for Cathedral Energy Services Income Trust include:

1) The build out of our EM technology
2) Completing two equity financings
3) Growth in market share
4) Unit price appreciation
5) Increase in distributions
6) Successful drilling of Steam-Assisted-Gravity-Drainage ("SAGD") wells and horizontal Coal Bed Methane ("CBM") wells

The 2004 addition of 18 EM-MWD systems was significant in Cathedral achieving the results that it did. Record revenues were generated due to the expansion of our overall job capacity. Significant in the addition of the new systems is that the EM-MWD has opened up several markets that would be difficult to compete in without this technology. The EM-MWD system has allowed Cathedral to expand the amount of shallow gas work it does as well as move into the SAGD market and the CBM market. Going forward we expect the EM-MWD tool to allow Cathedral to pursue the underbalanced drilling market.

During the year the Trust completed two equity financings one brokered and the other non-brokered for net proceeds of $12,402,000. Most of these monies were placed with institutions thus broadening Cathedral's unitholder base from one that was primarily retail dominated. The monies were utilized to expand the existing equipment base as well as to reduce long-term debt down to zero ($0).

As noted in the chart below, in the later part of 2004 Cathedral's unit price escalated significantly and eclipsed the $4.00/unit mark in January 2005. This gives Cathedral a much stronger "currency" as we look to expand and grow the organization.



REPORT TO UNITHOLDERS

Since the December 31, 2003 year-end, the Trust increased the monthly distribution level three times. The first was a 9% increase in January 2004, the second was a 12.5 % increase in November 2004 and finally there was another 11% increase in January of 2005. These increases were substantiated by the strong earnings of the organization and the Trust's low payout ratio for 2004 of 45% of distributable income.

Looking forward we see another tremendous year. The Canadian and American drilling industry is forecasting another record year as oil and natural gas commodity prices continue to expand the cash flows of oil and natural gas producers. Cathedral is poised to take advantage of this activity with the build out of another 12 MWD systems. Six of these systems will be EM-MWD and the other six will be the new positive pulse MWD system that Cathedral is co-developing. It is expected that in Q2/2005 Cathedral will commercialize its new positive pulse MWD system.

The new positive pulse MWD system combined with the existing EM and negative pulse MWD tools will give Cathedral complete flexibility in meeting customer's needs. As well, we will now control our own destiny in expanding and continuing to improve our fleet of equipment.

Cathedral has never been in a stronger position. With a clean balance sheet, a tremendous market place (record drilling levels) and a modern updated fleet of equipment, Cathedral is poised to capitalize on the situation.

In closing, I would like to thank Cathedral's staff and consultants for their outstanding effort and dedication that allowed Cathedral to reach its record results in 2004.

Yours truly,

Mark L. Bentsen
President and Chief Executive Officer
Cathedral Energy Services Ltd.
March 17, 2005

REVIEW OF OPERATIONS

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

Significant developments in 2004 included:

- Significant increase in job capability for directional and horizontal drilling
- Further growth in the Rocky Mountain region of the United States
- Successful completion of first extended Steam-Assisted Gravity Drainage ("SAGD") program
- Further expansion in Coal Bed Methane ("CBM") related drilling applications
- Completion of "earn-out" portion of the purchase price related to the February 2003 acquisition of The Directional Company, Inc. ("TDC")
- Commenced the co-development of a new positive pulse MWD system

Increased Job Capability During 2004, Cathedral's directional and horizontal drilling job capability increased from 23 to 40 with the increase being due to the expansion of the Electro-Magnetic Measurement-While-Drilling ("EM-MWD") fleet from 3 at the end of 2003 to 21 at December 31, 2004. Additional mud motors and drill collars were added to complement the increased job capability.

U.S. Expansion Due to increased demand in the U.S. market, Cathedral's U.S. job capability was increased from 4 at the start of 2004 to 9 at December 31, 2004. On a year-over-year basis, revenues from the U.S. market have increased 78% from $5,587,000 in 2003 to $9,943,000 in 2004. Our EM-MWD tool has been well received in the U.S. market. We expect the U.S. market to continue to be a growth area for Cathedral. During 2004 our U.S. directional drilling services were provided in Colorado and Wyoming and in early 2005 we commenced providing directional services in Montana.

SAGD Project SAGD is an area that Cathedral has identified as a tremendous niche market area for its growth and Cathedral is one of 3 suppliers that provide the related specialty horizontal drilling services. With the vast amount of heavy oil in place in northeastern Alberta, and much of it too deep to be mined, SAGD technology will be the preferred method of production. During 2004, Cathedral completed its first extended SAGD program and is scheduled to commence drilling SAGD wells in Q2 of 2005 for a second customer.

Coal Bed Methane Cathedral has been involved in drilling CBM wells since Q3 of 2003. During 2004, Cathedral completed the drilling of its first horizontal CBM well that from a drilling point of view was very successful and this has turned into a long-term project with that customer. CBM is seen as a growth area for drilling in the markets in which Cathedral operates as evidenced by the Petroleum Services Association of Canada's ("PSAC") 2005 well count forecast issued in October 2004 that includes 3,000 CBM wells being drilled in Canada during 2005 versus 1,000 in 2004.

The Directional Company The February 2003 acquisition of The Directional Company, Inc. ("TDC") has allowed Cathedral to enter into the southeast Saskatchewan market for providing horizontal and directional drilling services and results for 2004 represent a record year for TDC. The purchase price for the TDC acquisition included a 2-year "earn-out" with a maximum earn-out of $1.25 million and due to the strong TDC results for 2004 that maximum earn-out was reached.

New Positive Pulse MWD Tool In 2004 Cathedral commenced co-developing a new positive pulse MWD tool that is expected to be commercial in Q2 of 2005. This positive pulse MWD tool is based upon the same platform as the EM-MWD tool and therefore provides an increased level of flexibility in providing alternative methods of transmitting directional drilling information to surface and therefore meeting our customer's needs.

REVIEW OF OPERATIONS

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

	As at December 31		
	2004	**2003**	**2002**
Measurement-While-Drilling systems -			
Mud pulse	**19**	20	18
Electro-magnetic	**21**	3	-
	40	23	18
Drilling mud motors	**175**	149	95
Drilling jars	**43**	43	43
Shock tools	**34**	34	35

Personnel Cathedral's mandate from inception has been the supply of *"Best in Class, Best in Service"* equipment and personnel to its customers. Cathedral prides itself on the strengths of its personnel, whether in the field, service centers or head office. At December 31, 2004, Cathedral's staffing included in excess of 200 people including field consultants. Cathedral continues to utilize the services of consultants to perform substantially all fieldwork. As at December 31, 2004, Cathedral utilized the services of 124 directional drilling and MWD consultants. The strategy of using field consultants on a contract basis has allowed Cathedral to lower fixed overhead costs in seasonally low activity periods while taking advantage of the specialization these consultants have to offer.

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

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

GOVERNANCE

Pursuant to an administration agreement, the management and administration of Cathedral Energy Services Income Trust is delegated to the Board of Directors and management of Cathedral Energy Services Ltd. ("Cathedral"), as Administrator of the Trust. The Board of Directors of Cathedral are also Trustees of the Trust. The committees of Cathedral's Board of Directors extend their respective mandates to governance of the Trust. As a publicly traded entity, the Trust is required to disclose annually its alignment with a set of governance guidelines adopted by the Toronto Stock Exchange to assist an organization is assessing accountability to stakeholders. The Trust's statement of adherence to those guidelines is included in its 2005 Information Circular. The Trust is in compliance with those guidelines.

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

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

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

Audit Committee The Board of Directors have 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.

Compensation Committee The Board of Directors have 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.

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 and Cathedral; assessing the effectiveness of the Board of Directors as a whole, committees of the Board and the contributions of individual members; and identifying, recommending, orienting and educating new directors.

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") for the year ended December 31, 2004 provides an analysis of the consolidated results of operations, financial position and cash flows of Cathedral Energy Services Income Trust and its subsidiaries (the "Trust") and should be read in conjunction with the accompanying audited financial statements for the year ended December 31, 2004, as well as the Trust's 2004 interim MD&A's. This MD&A is dated March 17, 2005.

This MD&A is intended to assist the reader in the understanding and assessment of significant changes and trends, as well as the risks and uncertainties, related to the results of the operations and financial position of the Trust.

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

OVERVIEW

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

SELECTED ANNUAL INFORMATION (in $'000's except per Trust Unit amounts) -

	2004	Increase (decrease)	2003	Increase (decrease)	2002
Revenues	$ 46,478	$ 13,763	$ 32,715	$ 10,640	$ 22,075
% change		42%		48%	
EBITDA (1)	15,108	6,839	8,269	1,327	6,942
% change		83%		19%	
Income before taxes	11,231	6,403	4,828	742	4,086
% change		133%		18%	
Net income	9,128	4,687	4,441	1,052	3,389
% change		106%		31%	
Net income per Trust Unit -					
Basic	0.39	0.19	0.20	(0.04)	0.24
Diluted	0.38	0.18	0.20	0.04	0.16
% change - diluted		90%		25%	
Funds from operations	12,988	5,194	7,794	1,851	5,943
% change		67%		31%	
Cash distributions declared per Trust Unit	0.245	0.025	0.22	0.1262	0.0938
Distributable income (2)	12,924	6,551	6,373	2,838	3,535
Distribution declared	5,768	976	4,792	2,778	2,014
Payout ratio (3)	45%	(30%)	75%	18%	57%
Working capital	10,839	8,884	1,955	989	966
Total assets	46,822	13,742	33,080	8,269	24,811
Long-term debt (4)	–	(5,700)	5,700	5,045	655
Unitholders' equity	33,564	16,975	16,589	214	16,375

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

(2) Distributable income is defined as funds from operations less required principal repayments on long-term debt and maintenance capital expenditures. Distributable income does not have any standardized meaning within Canadian Generally Accepted Accounting Policies and therefore may not be comparable to similar measures presented by other trusts. Conversion to an income trust was effective July 30, 2002.

(3) Distributions declared as a percentage of distributable income.

(4) Excludes current portion of long-term debt, which is included in working capital; as at December 31, 2004 the Trust had no long-term debt including no current portion thereof.

MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

2004 COMPARED TO 2003

Overview

2004 was a very robust year for the energy service sector in general and specifically for Cathedral Energy Services Income Trust. The Trust completed fiscal 2004 with record annual net income of $9,128,000 ($0.38 per diluted Trust Unit) which compares to $4,441,000 ($0.20 per diluted Trust Unit) in 2003 – an increase of $4,687,000 or 106%. EBITDA for the year ended December 31, 2004 was also a record at $15,108,000 while the comparative figure for 2003 was $8,269,000 – an increase of $6,839,000 or 83%.

Revenues and operating expenses

$ '000's	**2004**	2003	Change	%
Revenues	**$ 46,478**	$ 32,715	$ 13,763	42
Operating expenses	**22,453**	16,681	5,772	35
Gross margin - $	**$ 24,025**	$ 16,034	$ 7,991	50
Gross margin - %	**51.7%**	49.0%	2.7%	

Revenues for fiscal 2004 were at a record level of $46,478,000 which compares to $32,715,000 in 2003 – an increase of $13,763,000 or 42%. As a result of an overall increase in the level of drilling in the regions in which the Trust operates (Western Canada and the Rocky Mountain region of the United States) which were at record levels, plus an increase in Cathedral's market share, Cathedral completed 2004 with 5,845 (2003 – 4,125) activity days related to providing horizontal and directional drilling services. The average day rate for providing horizontal and directional drilling services increased from $7,096 in fiscal 2003 to $7,406 in 2004. Also contributing to the increase in revenues is the inclusion of revenues from the February 12, 2003 acquisition of The Directional Company, Inc. ("TDC") for a full 12 months in 2004 as opposed to 10 ½ months in 2003.

During Q2 of 2004, Cathedral commenced its first extended duration SAGD project for a major Canadian integrated energy company. SAGD is an area that Cathedral has identified as a tremendous niche market area for its growth. With the vast amount of heavy oil in place in northeastern Alberta, and much of it too deep to be mined, SAGD technology will be the preferred method of production. Cathedral is scheduled to commence drilling additional SAGD wells for a second customer in Q2 of 2005.

The 2.7% increase in gross margin on a percentage basis from 49.0% in 2003 to 51.7% in 2004 is mainly attributed to less reliance on rented equipment and an increase in the average day rate in providing horizontal and directional drilling services and was partially offset by increased field labour costs as well as increased field training costs associated with the expansion of the Electro-Magnetic Measurement-While-Drilling ("EM-MWD") fleet. Cathedral will continue to review its cost structure with the goal of reducing operating costs.

General and administrative expenses

$ '000's	**2004**	2003	Change	%
General and administrative expenses	**$ 9,895**	$ 7,815	$ 2,080	27

The year-over-year increase in general and administrative expenses was $2,080,000. The increase is related to personnel costs (mainly related to bonus accruals) and an overall increase in activity levels both in Western Canada and the Rocky Mountain region of the U.S. As a percentage of revenues, general and administrative expenses were 21.3% in 2004 and 23.9% in 2003.

Depreciation

$ '000's	**2004**	2003	Change	%
Depreciation	**$ 3,582**	$ 3,118	$ 464	15

Depreciation for 2004 was $3,582,000 compared to $3,118,000 in 2003. This increase of $464,000 is related to a larger capital asset base due to the Trust's investment in capital assets over the past 12 months. As a percentage of revenues, depreciation amounted to 7.7% for 2004 and 9.5% for 2003 - this decrease is mainly the result of the increase in revenues on a year-over-year basis.

Interest expense

$ '000's	**2004**	2003	Change	%
Interest - long-term debt	**$ 278**	$ 319	$ (41)	(13)
Interest - other	**$ 69**	$ 96	$ (27)	(28)

The decrease in interest on long-term debt is the result of a decrease in both the effective interest rate and the average level of long-term debt outstanding. In Q4 of 2004, the Trust repaid all of its outstanding long-term debt and finished 2004 with no long-term debt. The decrease in other interest expense (non-long-term debt related) is due mainly to a decrease in the use of the Trust's operating loan facility.

Foreign exchange loss

$ '000's	**2004**	2003	Change	%
Foreign exchange loss	**$ 58**	$ 64	$ 6	(9)

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.

As a result of the decline in the U.S. dollar relative to the Canadian dollar, the Trust experienced a relative small foreign exchange loss in 2004 in the amount of $58,000 (2003 - $64,000).

Gain on disposal of capital assets

$ '000's	**2004**	2003	Change	%
Gain on disposal of capital assets	**$ 1,088**	$ 205	$ 883	431

The gain on disposal of capital assets 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 and this has resulted in a gain on disposal of capital assets of $1,088,000 in 2004 which compares to $205,000 in 2003.

Taxes

$ '000's	**2004**	2003	Change	%
Taxes	**$ 2,103**	$ 386	$ 1,717	445

The effective tax rate for 2004 was 18.7% while the comparative figure for 2003 was 8.0%. The Trust on a non-consolidated basis, as a mutual fund trust and pursuant to the Declaration of Trust, allocates all of its taxable income to the unitholders of the Trust. The Trust's operating subsidiaries are subject to statutory corporate income taxes and certain provincial capital taxes and recognizes future income taxes on "temporary differences" in the operating subsidiaries. As a result of the substantial increase in operating results of the Trust's subsidiaries in 2004 the interest on the subordinated note between the Cathedral Energy Services Ltd. and the Trust was not able to fully shelter the subsidiaries from current taxes and this resulted in a higher effective tax rate.

2003 COMPARED TO 2002

Overview

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

Revenues and operating expenses

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

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

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

The decline in gross margin on a percentage basis by 8.3% from 57.3% in 2002 to 49.0% in 2003 is mainly a function of an increase in equipment rental charges (mainly due to the rental of EM-MWD equipment) as well as a decrease in the average day rate obtained for directional and horizontal drilling services. Cathedral's EM-MWD system was deemed commercial in November 2003 and as a result did not contribute significantly to reduce EM-MWD rental costs in 2003.

General and administrative expenses

$ '000's	2003	2002	Change	%
General and administrative expenses	$ 7,815	$ 6,033	$ 1,782	30

The increase in general and administrative expenses was attributable to establishing an increased presence in the Rocky Mountain region of the United States and the inclusion of TDC related expenses effective February 12, 2003. As a percentage of revenues, general and administrative expenses were 23.9% and 27.35% for 2003 and 2002, respectively.

Depreciation

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

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

Interest expense

$ '000's	2003	2002	Change	%
Interest - long-term debt	$ 319	$ 197	$ 122	62
Interest - other	$ 96	$ 21	$ 75	357

The increase in interest on long-term debt was related to an increase in the average level of long-term debt outstanding in 2003 versus 2002 and an increase in the effective borrowing rate. The increase in the effective borrowing rate was attributed to an increase in the bank's prime lending rate while the increase in the average level of long-term debt outstanding was related to debt incurred with respect to the TDC acquisition in February 2003. The $75,000 increase in other interest (non-long-term debt related) was due to increased utilization of the Trust's operating loan facility in 2003 versus 2002.

Foreign exchange loss

$ '000's	2003	2002	Change	%
Foreign exchange loss	$ 64	$ 8	$ 56	700

The increase in foreign exchange loss was attributable to the decline in the U.S. dollar in 2003.

Gain on disposal of capital assets

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

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

Re-organization expenses

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

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

Taxes

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

LIQUIDITY AND CAPITAL RESOURCES

The Trust's principal source of liquidity is cash generated from operations. The Trust also has the ability to fund liquidity requirements through its credit facility and the issuance of debt and/or equity. At December 31, 2004, the Trust had an operating line of credit with a major Canadian bank in the amount of $4,500,000 (2003 - $3,500,000) of which the full amount (2003 - $3,205,000) was undrawn. In addition, the Trust has a non-reducing revolving term loan facility in the amount of $7,000,000 (2003 - $6,000,000) of which the full amount of $7,000,000 (2003 - $300,000) was undrawn as at December 31, 2004. As at December 31, 2004, the Trust had no long-term debt.

Operating activities Cash provided by operating activities (excluding changes in non-cash operating working capital) in 2004 increased $5,194,000 to $12,988,000 from $7,794,000 in 2003. This increase is a direct reflection of the increased level of drilling activity in Western Canada and the Rocky Mountain region of the United States, an overall increase in the average day rate obtained in providing horizontal and directional drilling services and an increase in market share in both operating regions. During 2004, the Trust invested an additional $4,178,000 in non-cash working capital related to operations – this increase is due to the increased level of operations in 2004 over 2003.

Working capital at December 31, 2004 was $10,839,000 which compares to $1,955,000 at the end of 2003. The increase of $8,884,000 is mainly attributable to the increased financial results for 2004 as well as the private placements that closed in Q3 and Q4 of 2004 for net proceeds of $12,402,000. Approximately $3,587,000 of the $9,287,000 net proceeds from the December 15, 2004 private placement was added to general working capital.

Investing activities Cash used in investing activities for the year ended December 31, 2004 amounted to $7,298,000 compared to $4,370,000 in 2003. Excluding the changes in non-cash working capital related to investing activities, cash used in investing activities decreased by $1,298,000 from $7,468,000 in 2003 to $6,170,000 in 2004. In 2004, The Trust's operating entities acquired $8,038,000 (2003- $4,712,000) of capital assets including 18 EM-MWD systems as well as additions to the mud motor and drill collar fleet to complement the increase in job capacity. As well, the additions include the replacement of tools that were lost-in-hole. Proceeds on the disposal of capital assets amounted to $2,302,000 (2003 - $500,000) and is mainly related to the recovery of downhole equipment costs, as well as previously expensed depreciation, that were lost-in-hole in 2004. Included in 2004 investing activities is the use of funds in the amount of $434,000 for the second and final year contingent consideration related to the acquisition of TDC. Included in the 2003 acquisition of TDC figure of $3,257,000 was first year contingent consideration in the amount of $751,000.

Financing activities Cash provided by financing activities for the year ended December 31, 2004 amounted to $1,251,000 compared to cash used in financing activities of $2,280,000 in 2003. In Q1 of 2003, Cathedral accessed $4,677,000 of new long-term debt with the majority of the proceeds used to finance the acquisition of TDC and the balance to finance capital asset additions. Long-term debt repayments in 2003 relate to scheduled repayments prior to the establishment of the non-reducing facility in late December 2003 as well as the repayment of long-term debt assumed on the acquisition of TDC. In Q2 of 2004, the Trust's accessed $300,000 of its non-reducing revolving long-term debt facility and repaid this facility in full in the amount of $6,000,000 in Q4 to have no long-term debt outstanding as at December 31, 2004. As well in 2004, the Trust repaid $295,000 in bank indebtedness to bring its operating line of credit to a $nil balance outstanding.

In 2004 the Trust completed two private placements: i) in Q3 completed a non-brokered private placement of 1,335,000 Trust Units at a price of $2.35 for net proceeds of $3,115,000; and ii) in late Q4 completed a brokered private placement of 3,333,333 Trust Units at a price of $3.00 for net proceeds of $9,287,000. The proceeds of these private placements were used to finance 2004 capital assets additions, repayment of $5,700,000 of long-term debt and the balance was included in general working capital.

The capital asset additions in 2004 were financed via a combination of the $300,000 draw on the revolving long-term debt facility, proceeds from the disposal of capital assets, proceeds on exercise of Trust Unit options (2004 - $1,197,000; 2003 - $289,000), net proceeds from private placement of Trust Units and cash flow from operations.

Distributions paid to Unitholders for 2004 amounted to $6,354,000 (2003 - $4,782,000). The 2004 increase over 2003 is due to: i) two increases in the per Trust Unit distribution in 2004 (approximate 9% increase effective January 2004 and a further 12.5% increase effective November 2004); ii) the increased number of Trust Units outstanding as a result of options exercised and the two private placements; and iii) Trust paying during Q1 of 2004 the 2003 Q4 distribution of $0.055 per Trust Unit (effective monthly distribution rate per Trust Unit is $0.01833) plus distributions for the months of January to November 2004. The December 2004 distribution was paid January 17, 2005. On a go forward basis, it is the intention of the Trust to have equal monthly distributions to Unitholders, subject to the operating results of Cathedral Energy Services Ltd.

The following is a summary of distributions declared in 2004 and 2003

$ '000's except per Trust Unit amounts	**2004**	2003	Change	%
Declared:				
Total	**$ 5,768**	$ 4,792	$ 976	20%
Per Trust Unit	**$ 0.245**	$ 0.22	$ 0.025	11%

MANAGEMENT'S DISCUSSION AND ANALYSIS

Effective January 2004, the Trust converted to a monthly distribution policy and increased its distribution to $0.02 per Trust Unit up from the equivalent of $0.0183 per Trust Unit (an approximate 9% increase). Monthly distributions of $0.02 per Trust Unit were declared for the months of January to October. In November 2004 the monthly distribution was increased by approximately 11% to $0.0225 per Trust Unit and the $0.0225 distribution per Trust Unit was also declared for December 2004. In January 2005, the per Trust Unit distribution level was increased a further approximate 11% to $0.025 per Trust Unit.

In 2003, the Trust had a quarterly distribution policy and declared quarterly distributions of $0.055 (equivalent of $0.01833 per month) per Trust Unit for all four quarters.

Contractual obligations In the normal course of business, the Trust incurs contractual obligations. The following is summary of the Trust's contractual obligations as at December 31, 2004 for the following items:

$ '000's	Total	2005	2006	2007	2008	2009	There-after
Capital asset additions	$ 2,082	$ 2,082	$ -	$ -	$ -	$ -	$ -
Operating lease obligations	1,165	515	242	179	98	98	33
	$ 3,247	$ 2,597	$ 242	$ 179	$ 98	$ 98	$ 33

DISTRIBUTABLE INCOME

Distributable income is calculated as follows:

$ '000's	Year ended December 31 2004	2003
Funds from operations	$12,988	$ 7,794
Less: - required principal repayments on long-term debt	-	(1,398)
- maintenance capital expenditures	(64)	(23)
Distributable income	$12,924	$ 6,373
Distributions declared	$ 5,768	$ 4,792
Payout ratio	45%	75%

As a result of the Trust's equipment being relatively new and the extensive maintenance program for its equipment (such repairs and maintenance costs are expensed in operating expenses), expenditures for maintenance capital are currently minimal.

The Trustees review the level and nature of distributions on an on-going basis giving consideration to current performance, historical and future trends in the business and the expected sustainability of those trends as well as required long-term debt repayments and maintenance capital expenditures required to sustain performance. Distributable income is not a standardized measure under Canadian Generally Accepted Accounting Principles and distributable income cannot be assured. The Trust's calculation of distributable income may differ from similarly titled measures used by other trusts. Distributable income is a main performance measurement used by management and investors to evaluate the performance of the Trust.

FOURTH QUARTER RESULTS

Results for 2004 Q4 represent record quarterly figures for any quarter in the history of the Trust and its predecessor. Record revenues came in at $16,092,000 which is an increase of $5,179,000 or 47% over the 2003 Q4 revenues of $10,913,000. In 2004 Q4, Cathedral had 2,003 (2003 – 1,393) activity days related to providing horizontal and directional drilling services with an average day rate of $7,598 (2003 - $6,995). The quarter-over-quarter increase in activity days is a reflection on the increased activity levels and the Trust's increased market share in both regions in which it operates. Quarter-over-quarter EBITDA increased $3,886,000 or 136% from $2,864,000 in 2003 to $6,750,000 in 2004. Included in 2004 Q4 results is a gain on disposal of capital assets of $431,000 (2003- $192,000) related to equipment lost-in-hole. The above items contributed to a 187% increase in pre-tax income to $5,686,000. The 2004 Q4 increases in EBITDA and pre-tax income demonstrate the ability of the Trust's operating entities to leverage off their organizational structure.

Net income for 2004 Q4 was $4,221,000 ($0.17 per diluted Trust Unit) which compares to $1,507,000 ($0.07 per diluted Trust Unit) in 2003 Q4. The effective tax rate increased from 23.9% in 2003 Q4 to 25.8% in 2004 Q4 – the increase is due to less income in 2004 being sheltered from the interest on the subordinated note between the Trust and Cathedral Energy Services Ltd. and therefore resulting in increased taxable income in the Trust's operating entities.

SUMMARY OF QUARTERLY RESULTS (in $ '000's except per Trust Unit amounts)

	2004				2003			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenues	$10,604	$ 8,016	$11,766	$16,092	$ 6,905	$ 5,043	$ 9,854	$10,913
Income before taxes	2,107	444	2,994	5,686	770	185	1,891	1,982
Net income	1,709	791	2,407	4,221	918	305	1,711	1,507
Net income per Trust Unit								
Basic	0.08	0.04	0.10	0.17	0.04	0.01	0.08	0.07
Diluted	0.07	0.03	0.10	0.17	0.04	0.01	0.08	0.07

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 region of the U.S. are not subject to the seasonality to the extent that it occurs in the Western Canada region.

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 2004 was $104,000 (2003 - $123,000).

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.

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

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

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

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

Income taxes The Trust uses the liability method of accounting for future income taxes whereby future income tax assets and liabilities are determined based on temporary differences between the accounting basis and the tax basis of the assets and liabilities, and are measured using substantively enacted tax rates and laws expected to apply when these differences reverse. 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 income 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.

ACCOUNTING CHANGES AND FUTURE ACCOUNTING CHANGES

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

In 2003, the CICA issued Handbook Section 3063, *Impairment of Long-Lived Assets* which establishes new standards for the recognition, measurement and disclosure of the impairment of long-lived assets and establishes new write-down provisions. This Handbook Section came into effect for 2004. Management adopted this Handbook section for fiscal 2004 and there has not been any affect on the consolidated financial statements.

BUSINESS RISKS

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

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

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

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

Interest rates Cathedral's non-reducing revolving term credit facility of which $nil is drawn upon, bears interest at a floating interest rate and, therefore, to the extent Cathedral 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.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

Technology Prior to Q3 of 2002 Cathedral did not develop its own equipment, instead it relied on external suppliers to design and supply, at a reasonable price, the equipment it requires to be competitive in the marketplace. In Q3 of 2002, Cathedral commenced with the assistance of third-parties to development of its own MWD platform. In November 2003, Cathedral announced that its EM-MWD system had reached commercial status. Cathedral decided to proceed with internally developing an EM-MWD systems (as opposed to purchasing a system from external sources) due to: 1) Cathedral having the internal expertise to develop such a tool; and 2) the lack of quality external produced EM-MWD systems being available to purchase by Cathedral at a reasonable price. In 2002, Cathedral determined that the inclusion of an EM-MWD system within its fleet was critical in light of management's assessment of the expected future demand by customers for such equipment. In 2004, Cathedral, with the assistance of a third-party, commenced the development of a new positive pulse MWD system which is designed around the same platform as the EM-MWD system. Going forward, there may be further developments in horizontal and directional drilling technology that will require Cathedral to develop and/or purchase equipment with the new technology. It should be noted that Cathedral competes with other more established companies which have greater financial resources to develop new technologies.

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

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.

Unitholder liability 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 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.

Customer mix Overall Cathedral has a good mix of customers with only one customer accounting for revenues in excess of 5% (at 22.2%) of the Trust's consolidated revenues for 2004 (2003 – two customers – one at 26.4% and the other at 5.1%).

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 the Cathedral's safety standards
- complying with current environmental requirements

GOVERNANCE

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

SUPPLEMENTARY INFORMATION

As at March 17, 2005, the Trust has 27,713,966 Trust Units and 2,313,733 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

The outlook for 2005 is very promising. Industry analysts are projecting a record level of drilling activity in Western Canada for 2005. Activity levels in the Rocky Mountain region of the United States are also anticipated to be significant for 2005. As demonstrated in Q4 of 2004, the Trust's operating entities have established an organizational structure that provides a significant level of economies of scale and therefore significantly improve the Trust's bottom line as activity levels increase. Overall, the fundamentals behind the oil and natural gas industry remain strong and industry analysts continue to forecast strong oil and natural gas prices for 2005.

Cathedral's positive pulse MWD system which is based upon the same platform as its successful EM-MWD system is expected to be commercial in 2005 Q2. Cathedral has delayed the commercialization of the positive pulse MWD system which was originally targeted for 2005 Q1 until early Q2 2005. Field-testing commenced in 2005 Q1 and management is please with the results to date. Further field testing is required prior to classifying the system as being at commercial status. The addition of this positive pulse MWD system is considered to be a very significant addition to our overall suite of tools as it will provide increased flexibility in meeting our customer's needs.

During 2005 Cathedral expects to add an additional 12 MWD systems to its fleet – 6 positive pulse and 6 EM. As well, additional mud motors and drill collars will be added to complement the increase in job capacity.

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

ADMINISTRATOR'S REPORT

The accompanying consolidated financial statements of Cathedral Energy Services Income Trust (the "Trust") for the year ended December 31, 2004 and all information in this annual report are the responsibility of Cathedral Energy Services Ltd. as administrator (the "Administrator") of the Trust.

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

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

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

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

Mark L. Bentsen
President and Chief Executive Officer
March 17, 2005

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, 2004 and 2003 and the consolidated statements of operations and accumulated income and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2004 and 2003 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 3, 2005

CONSOLIDATED BALANCE SHEETS

December 31, 2004 and 2003

	2004	2003
Assets		
Current assets:		
Cash and cash equivalents	$ 3,151,037	$ 388,116
Accounts receivable	17,606,834	10,184,310
Taxes receivable	–	15,724
Inventory	1,268,358	1,428,107
Prepaid expenses and deposits	255,969	264,898
	22,282,198	12,281,155
Capital assets (note 4)	22,915,640	19,673,562
Goodwill (note 3)	1,623,867	1,124,960
	$ 46,821,705	$ 33,079,677
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness (note 5)	$ –	$ 295,000
Accounts payable and accrued liabilities	10,043,493	8,823,934
Distribution payable to Unitholders (note 9)	621,469	1,207,158
Taxes payable	778,000	–
	11,442,962	10,326,092
Long-term debt (note 6)	–	5,700,000
Future income taxes (note 7)	1,814,463	464,952
Unitholders' equity:		
Unitholders' capital (notes 1 and 8)	18,774,751	5,175,597
Contributed surplus (note 8)	22,140	5,600
Accumulated income	27,342,287	18,214,470
Accumulated distributions (note 9)	(12,574,898)	(6,807,034)
	33,564,280	16,588,633
Contingency and commitments (note 15)		
	$ 46,821,705	$ 33,079,677

See accompanying notes to consolidated financial statements.

Approved by the Trustees:

Trustee　　　　Trustee

Mark L. Bentsen　　　　Rod Maxwell

CONSOLIDATED STATEMENTS OF INCOME AND ACCUMULATED INCOME

Years ended December 31, 2004 and 2003

	2004	2003
Revenues (note 13)	$ 46,477,855	$ 32,715,251
Expenses:		
Operating	22,452,594	16,681,295
General and administrative	9,895,130	7,814,429
Depreciation	3,582,210	3,117,514
Interest - long-term debt	278,554	319,340
Interest - other	69,124	96,013
Foreign exchange loss	57,663	64,114
	36,335,275	28,092,705
Operating income	10,142,580	4,622,546
Gain on disposal of capital assets	1,088,497	204,980
Income before taxes	11,231,077	4,827,526
Taxes (note 7):		
Current (recovery)	772,849	(21,451)
Future income taxes	1,330,411	407,852
	2,103,260	386,401
Net income	9,127,817	4,441,125
Accumulated income, beginning of year	18,214,470	13,773,345
Accumulated income, end of year	$ 27,342,287	$ 18,214,470
Net income per Trust Unit (note 10):		
Basic	$ 0.39	$ 0.20
Diluted	$ 0.38	$ 0.20
Cash distributions declared per Trust Unit (note 9):	$ 0.245	$ 0.220

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2004 and 2003

	2004	2003
Cash provided by (used in):		
Operating activities:		
Net income	$ 9,127,817	$ 4,441,125
Items not involving cash:		
Depreciation	3,582,210	3,117,514
Future income taxes	1,330,411	407,852
Unrealized foreign exchange loss	19,100	27,100
Non-cash compensation expense (note 8)	16,540	5,600
Gain on disposal of capital assets	(1,088,497)	(204,980)
Funds from operations	12,987,581	7,794,211
Changes in non-cash operating working capital (note 12)	(4,177,547)	(755,903)
	8,810,034	7,038,308
Investing activities:		
Capital asset additions	(8,037,955)	(4,711,626)
Proceeds on disposal of capital assets	2,302,164	500,022
Acquisition of The Directional Company, Inc. (note 3)	(434,324)	(3,256,547)
Changes in non-cash investing working capital (note 12)	(1,127,599)	3,098,295
	(7,297,714)	(4,369,856)
Financing activities:		
Advances under long-term debt	300,000	4,677,050
Repayments of long-term debt	(6,000,000)	(2,514,910)
Distributions paid to Unitholders (note 9)	(6,353,553)	(4,781,510)
Proceeds from the issuance of Trust Units (note 8)	12,402,129	–
Proceeds on exercise of Trust Unit options (note 8)	1,197,025	289,406
Increase (decrease) in bank indebtedness	(295,000)	49,628
	1,250,601	(2,280,336)
Increase in cash and cash equivalents	2,762,921	388,116
Cash and cash equivalents, beginning of year	388,116	–
Cash and cash equivalents, end of year	$ 3,151,037	$ 388,116

See accompanying notes to consolidated financial statements.

NOTES OF CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2004 and 2003

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 owns all of the subordinated notes and all of the issued and outstanding common shares of Cathedral Energy Services Ltd., which represents the right to receive cash flow available for distribution from Cathedral Energy Services Ltd.

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

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

2. Significant accounting policies:

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies:

(a) Principles of consolidation:

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

(b) Foreign currency translation:

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

(c) Inventory:

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

(d) Capital assets:

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

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

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

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

NOTES OF CONSOLIDATED FINANCIAL STATEMENTS

2. Significant accounting policies (continued):

(e) Future income taxes:

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

(f) Revenue recognition:

Revenue is recognized as services are rendered 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:

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

(i) Cash and cash equivalents:

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

(j) Distributions to Unitholders:

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

(k) Goodwill:

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

2. Significant accounting policies (continued):

(l) Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to the depreciation of capital assets, the cost recovery of capital assets and goodwill and determination of stock-based compensation. Actual results could differ from those estimates.

3. Acquisition of The Directional Company, Inc.:

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

Additional contingent consideration of up to a maximum of $1.25 million, payable in cash, was to be paid over a 2-year period based upon the financial results of TDC for the periods ended December 31, 2003 and 2004. As at December 31, 2004, the maximum contingent consideration in the amount of $1,250,000 has been recorded in the accounts of which $498,907 was recognized during the year ended December 31, 2004 and has been accordingly recorded as an additional cost of the purchase and allocated to goodwill.

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

Details of the acquisition are as follows:

Net assets acquired:		
Net non-cash working capital	$	873,053
Capital assets		2,500,000
Goodwill		1,623,867
Long-term debt		(816,655)
Future income taxes		(220,000)
	$	3,960,265
Purchase price:		
225,812 Trust Units at approximately $1.193 per Trust Unit	$	269,394
Cash (including transaction costs totaling $197,089 and net of acquired cash of $88,187)		2,440,871
Contingent consideration		1,250,000
	$	3,960,265

NOTES OF CONSOLIDATED FINANCIAL STATEMENTS

4. Capital Assets:

2004		Cost		Accumulated depreciation		Net book value
Downhole tools	$	33,097,390	$	11,847,463	$	21,249,927
Office and computer equipment		1,083,398		527,445		555,953
Leasehold improvements		207,701		166,755		40,946
Deferred development costs		1,268,390		199,576		1,068,814
	$	35,656,879	$	12,741,239	$	22,915,640
2003						
Downhole tools	$	27,359,994	$	8,947,753	$	18,412,241
Office and computer equipment		838,369		416,907		421,462
Leasehold improvements		203,151		125,897		77,254
Deferred development costs		788,902		26,297		762,605
	$	29,190,416	$	9,516,854	$	19,673,562

5. Bank indebtedness:

The Trust has a $4,500,000 (2003 - $3,500,000) operating line of credit that bears interest at the bank's prime rate (2003 – bank's prime rate) per annum with interest payable monthly and is secured as described in note 6.

6. Long-term debt:

		2004		2003
Bank revolving term loan at an authorized amount of $7,000,000 (2003 - $6,000,000), bearing interest at the bank's prime rate plus 1.00% per annum, without repayment terms, maturing June 30, 2006 subject to an annual extension upon agreement between the borrower and the bank for a further one-year period. Prior to maturity the borrower may convert to a non-revolving term loan repayable monthly over 36 months	$	–	$	5,700,000

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

NOTES OF CONSOLIDATED FINANCIAL STATEMENTS

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. Consequently, no provision for income taxes is required for the Trust. The Trust's wholly-owned subsidiaries are however, subject to income taxation and provide for income tax obligations based upon statutory corporate rates.

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:

	2004	2003
Effective tax rate	35.7%	37%
Income before taxes	$ 11,231,077	$ 4,827,526
Income of Trust subject to tax in the hands of the Unitholders, not the Trust	(5,242,144)	(3,696,135)
Income before taxes of subsidiary companies	$ 5,988,933	$ 1,131,391
Effective tax rate applied to income before taxes of subsidiary companies	$ 2,138,049	$ 418,615
Benefit for reduction of valuation allowance	–	(32,000)
Adjustment to future income tax asset/liability for change in effected tax rates	37,041	(45,469)
Non-deductible expenses	69,871	56,163
Non-taxable portion of gain on disposal of capital assets	(171,119)	(10,658)
Large corporations tax and capital taxes	58,975	54,000
Other	(29,557)	(54,250)
	$ 2,103,260	$ 386,401

The components of the net future income tax asset (liability) at December 31, 2004 and 2003 are as follows:

	2004	2003
Future income tax asset (liability):		
Capital assets	$ (1,814,463)	$ (1,421,497)
Loss carryforwards	–	956,545
Net future income tax liability	$ (1,814,463)	$ (464,952)

At December 31, 2003, the Trust's subsidiaries had non-capital loss carry forwards of approximately $2,715,000 some of which are restricted to operations in other countries and the benefit of all these loss carry forwards was recorded in the accounts. At December 31, 2004, the Trust's subsidiaries do not have any non-capital loss carry forwards.

8. Unitholders' capital:

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

(b) Issued:

	Number of Units		Amount
Balance, December 31, 2002	21,479,421	$	4,616,797
Issued on acquisition of TDC (note 3)	225,812		269,394
Issued on exercise of options	243,100		289,406
Balance, December 31, 2003	21,948,333	$	5,175,597
Issued on non-brokered private placements at $2.35 per Unit, net of issue costs of $22,357	1,335,000		3,114,893
Issued on brokered private placement at $3.00 per Unit, net of issue costs of $712,763	3,333,333		9,287,236
Issued on exercise of options	1,004,200		1,197,025
Balance, December 31, 2004	27,620,866	$	18,774,751

(c) Trust Unit options:

The Trust has a Trust Unit based compensation plan under which a combined total of 2,230,000 (2003 – 2,080,000) options to purchase Trust Units can be granted to employees, trustees and consultants. Under the plan, the exercise price of each option at the date of issuance equals the fair market value of the Trust Units on the day immediately prior to the grant, subject to a potential future reduction, and has a maximum term till expiry of ten years. Options vest over a period of three to five years from the date of grant as employees, trustees or consultants render continuous service to the Trust. At the option of the optionholder, the exercise price may be reduced annually by the amount by which the Trust's net income per fully diluted Trust Unit for a fiscal year exceeds a prescribed threshold return for the fiscal year. The threshold return is between 10% and 15% (percentage is set annually by the Board of Directors of Cathedral Energy Services Ltd.) of the weighted average Unitholders' Equity for the fiscal year calculated on a fully diluted per Trust Unit basis. The reduction is calculated annually and is effective March 15 following each fiscal year. The March 15, 2004 reduction available to Unitholders was $0.09 per option.

At the May 26, 2004 Annual and Special meeting of Unitholders, the Unitholders approved the adoption of "rolling number amendment" to the unit option plan. The rolling number amendment provides that 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. The adoption of this amendment was subject to the implementation of the "rolling number amendment" by the Toronto Stock Exchange ("TSX") and TSX implemented this amendment effective January 1, 2005.

8. Unitholders' capital (continued):

(c) Trust Unit options (continued):

A summary of the status of the Trust Unit based compensation plan as at December 31, 2004 and 2003, and changes during the years then ended is presented below:

	2004		2003	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding, beginning of year	1,605,900	$ 1.19	1,798,000	$ 1.19
Granted	260,000	2.59	125,000	1.20
Exercised	(1,004,200)	1.19	(243,100)	1.19
Forfeited	(74,867)	1.20	(74,000)	1.20
Outstanding, end of year	786,833	$ 1.64	1,605,900	$ 1.19
Exercisable, end of year	98,313	$ 1.20	659,014	$ 1.21

The range of exercise prices for options outstanding as at December 31, 2004 are as follows:

	Total options outstanding			Exercisable options	
Range of exercise prices	Number	Weighted average exercise price	Weighted average remaining contractual life (years)	Number	Weighted average exercise price
$2.59	260,000	$ 2.59	5.7	-	$ 2.59
$1.25	224,200	$ 1.25	2.1	67,680	$ 1.25
$1.20	83,500	$ 1.20	4.2	167	$ 1.20
$1.09	135,033	$ 1.09	3.3	18,366	$ 1.09
$1.06	84,100	$ 1.06	3.9	12,100	$ 1.06
	786,833	$ 1.64	3.9	98,313	$ 1.20

During the year ended December 31, 2004, the Trust has recorded compensation expense and contributed surplus of $16,540 (2003 - $5,600) for the 385,000 (2003 – 125,000) options granted on or after January 1, 2003. For options granted in 2002, the Trust has elected to disclose pro forma results as if the revised accounting recommendations had been applied retroactively. Had compensation expense been determined based upon the fair value method for awards granted in 2002, the Trust's net income and net income per Trust Unit for the year ended December 31, 2004 and 2003 would have been adjusted to the pro forma amounts noted below:

	2004	2003
Net income – as reported	$ 9,127,817	$ 4,441,125
Pro forma compensation expense	(100,000)	(100,000)
Net income – pro forma	$ 9,027,817	$ 4,341,125
Net income per Trust Unit – as reported	$ 0.39	$ 0.20
Net income per Trust Unit – pro forma	$ 0.39	$ 0.20
Diluted net income per Trust Unit – as reported	$ 0.38	$ 0.20
Diluted net income per Trust Unit – pro forma	$ 0.38	$ 0.20

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

8. Unitholders' capital (continued):

(c) Trust Unit options (continued):

The following table set out the assumptions used in applying the Black-Scholes model for options issued in 2004 and 2003:

	Date of issue	
	August 25 2004	February 21 2003
Expected dividend/distribution yield	9.27%	18.33%
Risk-free interest rate	3.826%	4.24%
Expected volatility	34%	60%
Expected life (in years)	5.0	5.0
Fair value per option	$ 0.34	$ 0.16

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

9. Accumulated Distributions:

Balance, December 31, 2002	$ 2,014,662
Cash distributions declared and paid	3,585,214
Cash distributions declared	1,207,158
Balance, December 31, 2003	$ 6,807,034
Cash distributions declared and paid	5,146,395
Cash distributions declared	621,469
Balance, December 31, 2004	$ 12,574,898

Cash distributions declared and unpaid at year-end (2004 - $621,469; 2003 - $1,207,158) were paid on or about January 15 of the following year.

Effective January 2004, the Trust converted to a monthly distribution policy and declared monthly distributions of $0.02 per Trust Unit for the months of January to October and $0.0225 per Trust Unit for the months of November and December. The date of record for the monthly distributions was the last day of the related month and was payable on or about the 15th of the following month.

In 2003, the Trust had a quarterly distribution policy and declared quarterly distributions of $0.055 per Trust Unit for all four quarters. The date of record for the quarterly distributions was the last day of the month in which the quarter ended and was payable on or about the 15th of the following month.

10. Per Trust Unit amounts:

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

At December 31, 2004, the basic weighted average number of Trust Units outstanding was 23,233,164 (2003 – 21,709,905). At December 31, 2004, the diluted weighted average number of Trust Units outstanding was 23,782,781 (2003 – 22,004,417) which includes the addition of 549,617 (2003 – 294,512) Trust Units to the basic weighted average number of Trust Units outstanding during the year ended December 31, 2004 for the dilutive effect of Trust Unit options.

NOTES OF CONSOLIDATED FINANCIAL STATEMENTS

11. Financial instruments:

(a) Credit risk:

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

(b) Fair values:

The carrying values of the Trust's current assets and current liabilities approximated their fair values as at December 31, 2004 and 2003 due to the relatively short period to maturity of the instruments. The fair value of long-term debt at December 31, 2003 approximated its carrying value as it bears interest at floating rates.

(c) Interest rate risk:

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

12. Supplemental cash flow disclosure:

	2004	2003
Components of changes in non-cash working capital are as follows:		
Accounts receivable	$ (7,487,107)	$ (2,466,625)
Inventory	159,749	(704,194)
Prepaid expenses and deposits	8,929	40,241
Accounts payable and accrued liabilities	1,219,559	4,576,359
Taxes payable/receivable	793,724	(41,025)
Working capital acquired (note 3)	–	937,636
	$ (5,305,146)	$ 2,342,392
Less: changes in working capital related to financing activities	(1,127,599)	3,098,295
	$ (4,177,547)	$ (755,903)
Interest paid	$ 344,727	$ 394,944
Taxes paid (recovered)	$ (20,967)	$ 324,918

13. Segmented information:

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

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

Revenues	2004	2003
Canada	$ 36,534,514	$ 27,127,715
United States	9,943,341	5,587,536
	$ 46,477,855	$ 32,715,251

NOTES OF CONSOLIDATED FINANCIAL STATEMENTS

13. Segmented information (continued):

Capital assets and goodwill		2004		2003
Canada	$	19,913,158	$	17,956,593
United States		4,626,349		2,841,929
	$	24,539,507	$	20,798,522

During the year ended December 31, 2004, one customer accounted for 22% (2003 – 26%) of consolidated revenues.

14. 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 2004 was $104,244 (2003 - $122,758).

15. Contingency and commitments:

a) Legal claim:

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

b) Leases:

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

2005	$	515,000
2006		242,000
2007		179,000
2008		98,000
2009		98,000
Thereafter		33,000

c) Capital additions:

As at December 31, 2004, the Trust has committed to purchase $2,082,000 of capital assets.

16. Prior year amounts:

Certain prior year amounts have been reclassified to conform to the current year's presentation.

CORPORATE INFORMATION

OFFICERS AND SENIOR MANAGEMENT OF CATHEDRAL ENERGY SERVICES LTD.

Mark L. Bentsen
President and Chief Executive Officer

Randal H. Pustanyk
Vice President, Operations

P. Scott MacFarlane
Chief Financial Officer

Jeff Morden
Vice President, Engineering

Ron Schell
TDC General Manager

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