Cathedral
Energy Services Income Trust

ANNUAL REPORT
For the year ended December 31, 2006

TRUST PROFILE

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

Annual and Special Meeting:

Unitholders are invited to attend the Annual and Special Meeting which will be held at 3:30 pm on May 10, 2007 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]	2006	2005	2004	2003	2002
Revenues	**138,254**	86,002	46,478	32,715	22,075
Gross Margin % (revenues less operating expenses)	**53%**	51%	52%	49%	57%
EBITDA [2]	**52,793**	31,580	15,108	8,269	6,942
Income before taxes	**39,679**	24,817	11,231	4,828	4,086
Net income	**35,348**	21,807	9,128	4,441	3,389
Basic per Trust Unit	**1.16**	0.76	0.39	0.20	0.24
Diluted per Trust Unit	**1.12**	0.76	0.38	0.20	0.16
Cash distributions declared per Trust Unit	**0.805**	0.385	0.245	0.22	0.0938
Distributable income [3]	**45,972**	27,551	12,924	6,373	3,535
Cash distributions declared	**24,681**	11,162	5,768	4,792	2,014
Payout ratio [4]	**54%** [5]	41%	45%	75%	57%
Property and equipment additions and corporate acquisitions:					
Paid or payable	**26,436**	31,244	8,472	7,986	3,516
Paid or payable in Trust Units	**1,820**	13,712	-	269	-
	28,256	44,956	8,472	8,255	3,516
Weighted outstanding Trust Units					
Basic ('000)	**30,578**	28,711	23,233	21,710	13,867
Diluted ('000)	**31,423**	28,712	23,783	22,004	21,516
Working capital	**15,051**	10,571	10,839	1,955	966
Total assets	**125,221**	102,908	46,822	33,080	24,811
Long-term debt and capital lease obligations excluding current portion	**15,552**	12,797	-	5,700	655
Unitholders' equity	**76,223**	59,615	33,564	16,589	16,375

(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 and capital lease obligations, 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) Distributable income is defined as cash flow from operating activities before changes in non-cash operating working capital less required principal repayments on long-term debt and capital lease obligations and maintenance capital expenditures. Distributable income does not have any standardized meaning within Canadian Generally Accepted Accounting Principles and therefore may not be comparable to similar measures presented by other trusts.

(4) Cash distributions declared as a percentage of distributable income.

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

REPORT TO UNITHOLDERS

Cathedral Energy Services Income Trust ("Cathedral" or the "Trust") is pleased to report its consolidated financial and operating results for the year ended December 31, 2006. The results for 2006 represent the best year in Cathedral's history. The growth that occurred during 2006 was the culmination of several significant factors including having the Trust's 2005 acquisitions included in operations for the complete 2006 year and the subsequent internal growth within these new divisions. Cathedral as well saw continued growth in its directional drilling business with market share gains in both the Canadian and U.S. Rocky Mountain markets. This growth resulted in the Trust increasing distributions to its unitholders several times during the year. The distributions increased from $0.60 per unit annually in January 2006 to $0.84 per unit annually by year-end - an increase of 40%.

The 2006 year saw, and 2007 continues to see, significant volatility in commodity prices. The swings in commodity prices (particularly natural gas) have certainly affected overall Canadian drilling activity levels. Oil and natural gas producers have seen a significant drop in their cash flows and subsequently reigned in their spending on drilling new wells.

In early 2007 the onslaught of some of the coldest weeks in recent North American history has aided in developing a more positive outlook towards commodity pricing, in particular the price of natural gas. Due to the cold weather, natural gas storage levels have been reduced significantly. Although they are not quite down to the 5 year historical average, storage levels are now significantly below the record high storage levels of a year ago. Also assisting to the positive outlook is the reduction to overall supply of natural gas from the Canadian basin. Due to the decline in drilling in the last six to nine months, coupled with the high decline rates of the basin, we are beginning to see a decline in the supply of natural gas. These declines will aid in bringing natural gas storage more in line with historic averages.

Despite the reduction in Canadian drilling activity the Trust has remained very active and has seen very little change to its overall operations. Cathedral has seen record activity levels and had record levels for both revenues and cash flow in each of the four quarters of 2006. The revenues for 2006 were over $138 million, an increase of 61% and this lead to growth in EBITDA per diluted unit from $1.10 to $1.68.

The acquisitions of Tier One Oil Services, Advance Wireline and Xtreme Wireline have set a framework for the Trust to continue growing its business and service lines for its customers. Each division within the organization continued expanding its job capacity to meet demands in 2006. As well, Cathedral continues to build out its infrastructure and strengthen its business with the addition of new facilities to house new areas of activity.

Our directional drilling division has continued to grow and expand with market gains in both Canada and the Rocky Mountain region of the U.S. Cathedral added 14 MWD systems to its directional drilling fleet in 2006 bringing the total number of systems to 68. The growth has been due to the success of our in-house developed EM-MWD system which is in high demand. Cathedral continues to focus on the development of the EM-MWD system as well as its positive pulse MWD system. The ongoing enhancement to these tools has allowed the Trust to expand its capability to offer its services in the lucrative under-balanced directional drilling market, as well as the ability to drill deeper and in more difficult environments.

The October 31, 2006 announcement by the Minister of Finance (Canada) with new tax proposals concerning the taxation of income trusts and other flow-thorough entities created a significant decline in the market value of the affected entities including Cathedral. Since then Cathedral's units have rebound to levels above the pre-announcement level. To date, the legislation tabled by the Federal government is incomplete and we will wait until the complete legislation is tabled before we assess our alternatives.

We look forward to another successful year and would like to thank everyone who has participated in the success of Cathedral.

Sincerely,

Mark L. Bentsen
President and Chief Executive Officer
Cathedral Energy Services Ltd.
March 7, 2007

GOVERNANCE

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

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

Composition of the Boards The Board of Directors of the Administrator is currently composed of seven members of which five are independent to the Administrator. All of the Board of Directors of the Administrator are also Trustees of the Trust. In addition, the Board of Directors has elected a lead director who is an independent director.

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

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. With the passing of Mr. Herman Hartley on June 6, 2006 a vacancy was created on the Audit Committee which was required to be immediately filled. Accordingly, Mr. Jay Zammit was temporarily appointed pursuant to section 3.5 of Multilateral Instrument 52-110 - Audit Committees ("MI 52-110") which allows Mr. Zammit (whom is not independent under MI 52-110) to serve on the Audit Committee until the next annual meeting of the Trust. It is the intention of the Trust to appoint a new independent member of the Audit Committee to replace Mr. Zammit. The remaining 2 members of the Audit Committee are independent 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. The Compensation Committee is comprised of independent directors.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") for the year ended December 31, 2006 provides an analysis of the consolidated results of operations, financial position and cash flows of Cathedral Energy Services Income Trust (the "Trust") and should be read in conjunction with the accompanying audited financial statements and notes thereto for the year ended December 31, 2006, as well as the Trust's 2006 interim MD&A's. Dollars are in '000's except for day rates and per Trust Unit amounts. This MD&A is dated March 7, 2007.

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

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

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

NON-GAAP MEASURES

This MD&A refers to certain financial measurements that do not have any standardized meaning within Canadian Generally Accepted Accounting Principles ("GAAP") and therefore may not be comparable to similar measures provided by other companies and/or trusts. These measures are provided to assist investors in determining the Trust's ability to generate cash from operations and to provide additional information regarding the use of its cash resources. The specific measures being referred to include the following i) "EBITDA" - defined as earnings before interest on long-term debt and capital lease obligations, taxes, non-cash compensation expense and depreciation and amortization; ii) "distributable income" - defined as cash flow from operating activities before changes in non-cash operating working capital less required principal repayments on long-term debt and capital lease obligations and maintenance capital expenditures; iii) "gross margin" - calculated as revenues less operating expenses; iv) "maintenance capital expenditures" - refers to capital expenditures required to maintain existing levels of service but excludes replacement cost of lost-in-hole equipment to the extent the replacement equipment is financed from the proceeds on disposal of the equipment lost-in-hole; and v) "payout ratio" - calculated as cash distributions declared divided by distributable income.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

SELECTED ANNUAL INFORMATION

	2006	**Increase (decrease)**	**2005**	**Increase (decrease)**	**2004**
Revenues	**$ 138,254**	$ 52,252	$ 86,002	$ 39,524	$ 46,478
% change		61%		85%	
EBITDA [1]	**52,793**	21,213	31,580	16,472	15,108
% change		67%		109%	
Income before taxes	**39,679**	14,862	24,817	13,586	11,231
% change		60%		121%	
Net income	**35,348**	13,541	21,807	12,679	9,128
% change		62%		139%	
Net income per Trust Unit -					
Basic	**1.16**	0.40	0.76	0.37	0.39
Diluted	**1.12**	0.36	0.76	0.38	0.38
% change - diluted		47%		100%	
Cash flow from operating activities before changes In non-cash operating working capital	**46,831**	18,889	27,942	14,954	12,988
% change		68%		115%	
Cash distributions declared per Trust Unit	**0.805**	0.42	0.385	0.14	0.245
Distributable income [2]	**45,972**	18,421	27,551	14,627	12,924
Cash distribution declared	**24,681**	13,519	11,162	5,394	5,768
Payout ratio [3]	**54%**	13%	41%	(4%)	45%
Working capital	**15,051**	4,480	10,571	(268)	10,839
Total assets	**125,221**	22,313	102,908	56,086	46,822
Long-term debt and capital lease obligations [4]	**15,552**	2,755	12,797	12,797	-
Unitholders' equity	**76,223**	16,608	59,615	26,051	33,564

(1) EBITDA, earnings before interest on long-term debt and capital lease obligations, 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 cash flow from operating activities before changes in non-cash operating working capital less required principal repayments on long-term debt and capital lease obligations and maintenance capital expenditures. Distributable 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) Cash distributions declared as a percentage of distributable income.

(4) Excludes current portion of long-term debt and capital lease obligations, which are included in working capital

RESULTS OF OPERATIONS

2006 COMPARED TO 2005

Overview

Cathedral Energy Services Income Trust completed fiscal 2006 with record results. On a year-over-year basis, revenues increased $52,252 or 61% to $138,254 from $86,002 in 2005. EBITDA for the year ended December 31, 2006 was $52,793 while the comparative figure for 2005 was $31,580 – an increase of $21,213 or 67%.

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

Revenues and operating expenses

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

The 2005 acquisitions of Tier One Oil Services, Advance Wireline and Xtreme Wireline contributed $26,994 or 52% of the $52,252 increase in revenues.

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

General and administrative expenses

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

The 2005 acquisitions of Tier One, Advance Wireline and Xtreme Wireline contributed to 53% of the year-over-year increase in general and administrative expenses. The balance of the increase is related the directional drilling business which experienced an increased level of business activity both in Canada and the United States as well as increased personnel, insurance and office/shop rental costs. As a percentage of revenues, general and administrative expenses were 16.0% in 2006 and 16.4% in 2005.

Depreciation and amortization

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

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

Interest

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

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

The $411 increase in other interest expense is related to the Trust's increased utilization of its operating line of credit.

Foreign exchange (gain) loss

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

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

Non-cash compensation expense

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

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

Gain on disposal of property and equipment

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

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

Taxes

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

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

2005 COMPARED TO 2004

Overview

On a year-over-year basis, revenues increased $39,524 or 85% to $86,002 from $46,478 in 2004. EBITDA for the year ended December 31, 2005 was $31,580 while the comparative figure for 2004 was $15,108 – an increase of $16,472 or 109%.

For the year ended December 31, 2005, net income was $21,807 ($0.76 per diluted Trust Unit) compared to $9,128 ($0.38 per diluted Trust Unit) for 2004 – an increase of 139%.

Revenues and operating expenses

	2005	2004	Change	%
Revenues	**$ 86,002**	$ 46,478	$ 39,524	85
Operating expenses	**(42,313)**	(22,453)	19,860	88
Gross margin - $	**$ 43,689**	$ 24,025	$ 19,664	82
Gross margin - %	**50.8%**	51.7%	(0.9)%	

The increase in revenues was mainly a result of: i) a 45% increase in directional drilling activity days to 8,472 (2004 – 5,845) activity days; ii) a 7.1% increase in the average day rate for directional drilling services to $7,935 (2004 - $7,406) per day; and iii) the inclusion of revenues from the Tier One and Advance acquisitions effective May 6, 2005 and September 8, 2005, respectively. The Tier One and Advance Wireline acquisitions account for 38% of the year-over-year increase in revenues. The acquisition of Xtreme Wireline occurred on December 22, 2005 and therefore did not contribute significantly to 2005 revenues. The increase in directional drilling activity days was a reflection of the strength in the oil and natural gas sector of the economy. The Rocky Mountain region of the U.S. was very active and the Trust's revenues from this region increased $9,714 on a year-over-year basis. The increase in the average day rate for directional drilling services was due to providing additional specialty services and tools as well as ancillary charges and modest day rate increases.

Despite an increase in the average day rate for directional drilling services the gross margin related to this revenue source only increased marginally due to increased field labour costs including training costs and general price increases for supplies purchased. On a product line basis, the gross margin percentage obtained from production testing and wireline services is marginally lower than that obtained from providing of directional drilling services and that accounts for the decrease in gross margin percentage on a year-over-year basis.

General and administrative expenses

	2005	2004	Change	%
General and administrative expenses	**$ 14,125**	$ 9,879	$ 4,246	43

The year-over-year increase in general and administrative expenses was mainly related to personnel costs, an overall increase in activity levels both in Western Canada and the Rocky Mountain region of the U.S. as well as the inclusion of general and administrative expenses related to the acquisitions of Tier One effective May 6, 2005 and Advance Wireline effective September 8, 2005. As a percentage of revenues, general and administrative expenses were 16.4% in 2005 and 21.3% in 2004.

Depreciation and amortization

		2005		2004		Change	%
Depreciation and amortization	**$**	**5,686**	$	3,582	$	2,104	59

This increase was related to a larger capital asset base due to the Trust's continued investment in property and equipment to meet demand as well as the inclusion of depreciation and amortization on property and equipment and intangibles acquired as a result of the acquisitions of Tier One effective May 6, 2005, Advance Wireline effective September 8, 2005 and Xtreme Wireline on December 22, 2005. Included in depreciation and amortization for 2005 was $46 related to the amortization of intangibles (non-competition agreements and customer relationships) acquired through the Advance Wireline acquisition. As a percentage of revenues, depreciation and amortization amounted to 6.6% for 2005 and 7.7% for 2004.

Interest

		2005		2004		Change	%
Interest - long-term debt and capital lease obligations	**$**	**235**	$	279	$	(44)	(16)
Interest - other	**$**	**71**	$	58	$	13	22

The year-over-year decrease in interest on long-term debt and capital lease obligations was the net result of an increase in the effective interest rate and a decrease in the average level of debt obligations outstanding (despite the inclusion of debt obligations assumed on the acquisitions of Advance Wireline and Xtreme Wireline).

The increase in other interest expense was due mainly to an increase in the use of the Trust's operating loan facility.

Foreign exchange loss

		2005		2004		Change	%
Foreign exchange loss	**$**	**25**	$	69	$	(44)	(64)

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 relatively small foreign exchange loss in 2005 in the amount of $25 (2004 - $69).

Non-cash compensation expense

		2005		2004		Change	%
Non-cash compensation expense	**$**	**842**	$	17	$	825	n/a

The increase in non-cash compensation expense is due to the expense related to Trust Unit options granted during 2005. Until the 2005 options were granted non-cash compensation expense was minimal. The overall increase in the value of non-cash compensation expense was due to: i) the significant appreciation in the market price for the underlying Trust Units which in turn has increased substantially the value attributed to the Trust Unit options granted during the period using the Black-Scholes option pricing model; and ii) the overall increase in the number of options granted. The value of the options is being amortized against income over the three-year vesting period.

Gain on disposal of property and equipment

		2005		2004		Change	%
Gain on disposal of property and equipment	**$**	**2,112**	$	1,088	$	1,024	94

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

Taxes

		2005		2004		Change	%
Taxes	**$**	**3,010**	$	2,103	$	907	43

The effective tax rate for 2005 was 12.1% while the comparative figure for 2004 was 18.7%. The 2005 tax provision includes the benefit of a reduction in future income taxes related to the June 16, 2005 internal reorganization. In addition, a portion of the post June 15, 2005 income from the Trust's Canadian operating entities was not subject to corporate income taxes within the corporate structure as this income flowed through to unitholders and was taxed in their hands. Accordingly, there was no tax provision within the Trust's financial statements for that portion of the income which was allocated to the unitholders. The decreased effective tax rate was due to a higher portion of the Trust's pre-tax income being allocated to unitholders.

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, 2006, the Trust had an operating line of credit with a major Canadian bank in the amount of $12,500 (2005 - $9,000) of which $6,460 (2005 - $5,310) was drawn. In addition, the Trust has a non-reducing revolving term loan facility in the amount of $25,000 (2005 - $12,000) of which $15,000 (2005 - $12,000) was drawn as at December 31, 2006. In addition, at December 31, 2006, the Trust had obligations under capital leases in the amount of $664 (2005 - $969) and other long-term debt of $171 (2005 - $383).

MANAGEMENT'S DISCUSSION AND ANALYSIS

Operating activities Cash provided by operating activities before changes in non-cash operating working capital in 2006 increased from $27,942 in 2005 to $46,831 – an increase of $18,889 or 68%. This increase is a direct reflection of the strong operating results of the Trust for 2006 which includes the contribution of the 2005 acquisitions for a full year. As a result of the increased level of operations in 2006 over 2005, the Trust invested an additional $6,902 (2005 - $6,333) in non-cash working capital related to operations in 2006. The Trust has a strong working capital position at December 31, 2006 at $15,051 which compares to $10,571 at the end of 2005.

Investing activities Cash used in investing activities for the year ended December 31, 2006 amounted to $24,366 which compares to $26,294 in 2005. Excluding the changes in non-cash working capital related to investing activities, cash used in investing activities decreased by $3,999 from $27,158 in 2005 to $23,159 in 2006. In 2006, The Trust's operating entities acquired $26,436 (2005- $18,583) of property and equipment. The 2006 property and equipment additions included: 14 MWD systems as well as additions to the mud motor and drill collar fleet to complement the increase in directional drilling job capacity; replacement of lost-in-hole directional drilling equipment, 3 production testing units; 7 wireline units and various specialty wireline logging tools and auxiliary wireline equipment; purchase of operating facilities in Whitecourt, Alberta and Vegreville, Alberta; leasehold improvements related to the relocation of the Calgary head office; and progress payments on equipment to be delivered in 2007.

Proceeds on disposal of property and equipment amounted to $3,277 (2005 - $4,086) and is mainly related to recovery of downhole equipment costs that were lost-in-hole in 2006 as well as previously expensed depreciation. Included in 2005 investing activities is the use of funds in the amount of $12,661 related to the acquisition of Tier One, Advance Wireline and Xtreme Wireline (figure excludes the value of Trust Units issued as part of the acquisitions in the amount of $13,712). The Advance Wireline acquisition structure includes additional contingent consideration of up to a maximum of $3,000, payable in Trust Units with an assigned value based upon an average trading price immediately prior to the issuance of the related Trust Units, and will be paid over a 2-year period based upon the financial results of Advance Wireline for the periods ended on the first and second anniversary of the closing date. In December 2006, the Trust issued 187,032 Trust Units with a total assigned value of $1,820 to satisfy the year 1 portion of the contingent consideration. Fluctuations in non-cash working capital related to investing activities are a function of when proceeds on disposal of property and equipment are received and when payments for property and equipment purchases are made.

The Trust is currently working on the 2nd generation of its Electro-Magnetic MWD ("EM-MWD") tool and expects to field test the tool in the first half of 2007. Once commercial the current systems will be retrofitted to the 2nd generation standard at minimal cost. The 2nd generation EM-MWD tool enhancements will allow the tool to be operated at deeper levels and reduce related operating costs.

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

	As at December 31	
	2006	**2005**
Directional drilling –		
MWD	**68**	54
Drilling mud motors	**299**	236
Production testing units	**19**	16
Wireline units	**21**	14

For 2007, the Board of Directors of the Administrator of the Trust have approved a capital budget of $11,600. The 2007 capex program will add: 2 MWD systems as well as additions to the mud motor and drill collar fleet to complement the increase in directional drilling job capacity; auxiliary production testing equipment; 8 wireline units as well as auxiliary wireline equipment and 4 explosive loading magazines which are related to the wireline operations. These capital expenditures are expected to be financed by way of cash flow from operations.

Financing activities Cash provided by (used in) financing activities for the year ended December 31, 2006 amounted to $(16,100) which compares to $3,625 (provided by) in 2005 – a change of $19,725. During 2006, the Trust received advances of long-term debt in the amount of $3,109 of which $3,000 related to an advance on the Trust's non-reducing revolving term loan facility. Repayments of long-term debt and capital lease obligations in 2006 amounted to $626 (2005 - $617). As at December 31, 2006, the Trust was in compliance with all covenants under its credit facility.

The capital asset additions in 2006 were financed by way of a combination of cash flow from operations, working capital, proceeds from the disposal of property and equipment, proceeds on exercise of Trust Unit options and the $3,000 advanced on the Trust's non-reducing revolving term loan facility.

Distributions declared for 2006 amounted to $26,719 (2005 - $14,810) and included cash distributions of $24,681 (2005 - $11,162) and a non-cash in-kind distribution of $2,038 (2005 - $3,648). The increase in distributions declared is mainly due to: i) three increases in the per Trust Unit distribution in 2006 (started January 2006 at $0.05; increased March 2006 to $0.06; increased June 2006 to $0.065; increased September 2006 to $0.07 and for December 2006 declared an additional special cash distribution of $0.05 per Trust Unit); and ii) the increased number of Trust Units outstanding as a result of options exercised, Trust Units issued as part of 2005 business acquisitions and Trust Units issued in satisfaction of the contingent consideration related to the Advance Wireline acquisition. Pursuant to the Trust's Declaration of Trust, the Trust is required to allocate all of its taxable income to Unitholders and in order to allocate all of its taxable income to Unitholders a non-cash in-kind distribution in the form of additional Trust Units was allocated to Unitholders of record on December 31, 2006 and 2005. The December 31, 2006, non-cash in-kind distribution was $0.06582 (2005 - $0.12139) per Trust Unit for a total of $2,038 (2005 - $3,648). The Declaration of Trust also requires there is an immediate consolidation of the Trust Units issued such that each Unitholder has the same number of Trust Units after the consolidation as they had prior to the non-cash in-kind distribution. Based upon a year-end Trust Unit price of $9.96 (2005 - $11.90) per Trust Unit the in-kind distribution represented the issuance of 204,667 (2005 - 306,534) Trust Units which were immediately consolidated.

Distributions paid to Unitholders for 2006 amounted to $22,467 (2005 - $10,281). The increase in distributions paid is directly related to the level of distributions declared which have increased significantly and the fact cash distribution are paid on or about the 15th of the month following the month they are declared as payable.

The following is a summary of distributions declared in 2006 and 2005.

	2006	2005	Change	%
Declared				
Cash	**$ 24,681**	$ 11,162	$ 13,519	121
In-kind	**2,038**	3,648	(1,610)	(44)
Total	**$ 26,719**	$ 14,810	$ 11,909	80
Declared per Trust Unit:				
Cash	**$ 0.80500**	$ 0.38500	$ 0.42000	109
In-kind	**0.06582**	0.12139	0.05557	(46)
Total	**$ 0.87082**	$ 0.50639	$ 0.36443	72

Contractual obligations In the normal course of business, the Trust's operating entities incur contractual obligations. The following is a summary of the Trust's contractual obligations as at December 31, 2006 for the following items:

	Total	**2007**	**2008**	**2009**	**2010**	**2011**	**There-after**
Capital asset additions	$ 4,159	$ 4,159	$ -	$ -	$ -	$ -	$ -
Operating lease obligations	9,738	2,546	2,278	1,651	1,288	505	1,470
Long-term debt and capital lease obligations(1)	15,835	283	2,745	5,160	5,147	2,500	-
	$ 29,732	$ 6,988	$ 5,023	$ 6,811	$ 6,435	$ 3,005	$ 1,470

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

The 2007 contractual obligations are expected to be financed by way of cash flow from operations.

DISTRIBUTABLE INCOME

Distributable income is calculated as follows:

	Year ended December 31	
	2006	**2005**
Cash flow from operating activities	**$ 39,929**	$21,609
Add: - changes in non-cash operating working capital (1)	**6,902**	6,333
Less: - required principal repayments on long-term debt and capital lease obligations	**(549)**	(177)
- maintenance capital expenditures	**(310)**	(214)
Distributable income	**$ 45,972**	$27,551
Cash distributions declared	**$24,681**	$11,162
Payout ratio	**54%**	41%

(1) Changes in non-cash operating working capital have been added back as such changes are financed using the Trust's bank indebtedness/line of credit facility. In addition, if changes in non-cash operating capital were excluded it would introduce cash flow variability and affect underlying cash flow from operating activities.

Cathedral's operations in Western Canada are subject to seasonality as activity levels in the oilfield services industry are generally lower during "spring breakup" which normally commences in late March and continues through to May. It is the Trust's policy to pay consistent distributions throughout the year despite the seasonality of a portion of Cathedral's business.

As a result of the Trust's equipment being relatively new and the extensive maintenance program for its equipment (such repairs and maintenance cost are expensed in operating expenses), expenditures for maintenance capital are currently minimal. Current maintenance capital expenditure levels may not be indicative of future maintenance capital expenditure levels.

The Administrator of the Trust (Cathedral Energy Services Ltd.) reviews 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, maintenance capital expenditures required to sustain performance and future growth capital expenditures. Currently cash distributions declared are less than distributable income as the Trustees, on the recommendation of management of the Administrator, have decided to retain a portion of distributable income to finance capital expenditures and debt repayment. It is not management's intent to distribute 100% of distributable income. Distributable income is not a standardized measure under Canadian GAAP 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.

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 2006 was $65 (2005 - $237).

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOURTH QUARTER RESULTS

The Trust completed 2006 Q4 with revenues of $35,327 which is an increase of $3,226 or 10% over the 2005 Q4 revenues of $32,101. In 2006 Q4, the Trust had 2,713 (2005 – 2,664) activity days related to providing directional drilling services with an average day rate of $8,825 (2005 - $7,963). The 2005 acquisitions of Tier One, Advance Wireline and Xtreme Wireline accounted for $821 or 25% of the quarter-over-quarter increase in revenues. In comparing Q4 of 2006 to 2005, in 2005 the Trust's operating entities did not shut down for an extended December holiday season as was experienced in December 2006. Quarter-over-quarter EBITDA increased $956 or 8% from $12,090 in 2005 to $13,046 in 2006. Included in 2006 Q4 results is a gain on disposal of property and equipment of $476 (2005 - $873) related mainly to directional drilling equipment lost-in-hole.

The payout ratio for Q4 of 2006 was 71%(2005 Q4 – 37%) while the ratio for the year ended December 31, 2006 was 54% (2005 – 41%). The payout ratio for Q4 of 2006 includes the $0.05 per Trust Unit "special" cash distribution declared in December 2006. If this "special" cash distribution was excluded from the payout ratio calculation then the ratio for Q4 of 2006 would have been 57%.

Net income for 2006 Q4 was $8,127 ($0.26 per diluted Trust Unit) which compares to $7,762 ($0.25 per diluted Trust Unit) in 2005 Q4. The effective tax rate decreased from 16.9% in 2005 Q4 to 15.1% in 2006 Q4 – the decrease is attributed to an increased portion of the tax burden has been shifted to unitholders as opposed to the Trust and its operating entities.

SUMMARY OF QUARTERLY RESULTS

	2006				2005			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenues	$38,682	$26,204	$38,041	$35,327	$16,458	$14,617	$22,826	$32,101
EBITDA	15,367	8,370	16,010	13,046	6,263	4,201	9,026	12,090
Net income	10,862	4,963	11,396	8,127	3,858	4,008	6,179	7,762
Net income per Trust Unit								
Basic	0.36	0.16	0.37	0.26	0.14	0.14	0.21	0.26
Diluted	0.35	0.16	0.36	0.26	0.14	0.14	0.21	0.25

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.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

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

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

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

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

Deferred development costs Costs associated with the development of downhole equipment are capitalized during the development process. These costs are identified as deferred development costs and are recorded with property and equipment. Once the equipment becomes commercial in nature, the related deferred development costs are amortized over 5 years. Cathedral undertakes periodic reviews of each project on which deferred development costs have been recorded to determine if the carrying value of the project can be recovered for the undiscounted expected net future cash flow generated from the related equipment. If there is no reasonable expectation that the costs can be recovered, the carrying value of the project is reduced and the excess is charged to earnings. This process of estimation is subject to significant judgment with respect to revenues and direct costs associated with the equipment as well as market acceptance.

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

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

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

FUTURE ACCOUNTING CHANGES

The Accounting Standards Board ("AcSB") of the Canadian Institute of Chartered Accountants ("CICA") continually amends and improves certain standards or guidelines contained in the CICA Handbook. We monitor these changes as they are proposed and will make changes to our accounting policies and disclosures as necessary.

Comprehensive Income The CICA issued section 1530 of the CICA Handbook, Comprehensive Income. The section is effective for fiscal years beginning on or after October 1, 2006. It describes how to report and disclose comprehensive income and its components. Comprehensive income is the change in a trust's net assets that results from transactions, events and circumstances from sources other than the trust's unitholders. It includes items that would not normally be included in net earnings, such as unrealized gains or losses on available-for-sale investments.

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

Adopting these sections on January 1, 2007, will require us to start reporting the following items in the consolidated financial statements:

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

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

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

We will adopt this section effective January 1, 2007 but we do not expect this section to materially impact on our consolidated financial statements.

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

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

Hedge accounting ensures that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the income statement in the same period. We will adopt this section effective January 1, 2007 but we do not expect this section to materially impact on our consolidated financial statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS

CONTROLS AND PROCEDURES

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

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

Internal controls over financial reporting Management is responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with Canadian GAAP. The Chief Executive Officer and Chief Financial Officer have designed or have caused such internal controls over financial reporting to be designed under their supervision to provide reasonable assurance regarding the reliability of financial reporting and preparation of the Trust's financial statements for external purposes in accordance with Canadian GAAP.

BUSINESS RISKS

Dependence of Cathedral Energy Services Ltd. and Cathedral Energy Services Limited Partnership The Trust is an open-ended, limited purpose mutual fund trust which is entirely dependent upon the operations and assets of Cathedral Energy Services Ltd. and Cathedral Energy Services Limited Partnership (collectively "Cathedral") through the ownership of the Cathedral Energy Services Ltd. shares and subordinated notes and an indirect wholly-owned partnership interest in Cathedral Energy Services Limited Partnership. Accordingly, the cash distributions to the Unitholders is dependent upon the ability of Cathedral Energy Services Ltd. to pay its interest obligations under the subordinated notes and to declare and pay dividends on its shares and the ability of Cathedral Energy Services Limited Partnership to provide cash distributions from partnership profits.

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

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

On October 31, 2006, the Minister of Finance (Canada) announced new tax proposals concerning the taxation of income trusts and other flow-through entities. This proposal was followed by the release of draft legislation by the Department of Finance on December 21, 2006. These proposed amendments, if enacted as currently drafted, will subject the Trust to taxation as of January 1, 2011. In addition, the taxable distributions received by Unitholders from the Trust would be treated as taxable dividends. If the proposed legislation is implemented, the Trust would be required to recognize, in the period on which the change is substantially enacted, future income taxes on temporary timing differences in the Trust

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

Non-resident ownership of Trust Units In order for the Trust to maintain its status as a mutual fund trust under the Tax Act (Canada), the Trust must not be established or maintained primarily for the benefit of non-resident of Canada ("non-residents") within the meaning of the Tax Act (Canada). The Declaration of Trust authorizes the Trust to take certain actions to maintain the non-resident ownership to less than 50% (refer to Declaration of Trust – Limitation on Non-resident Ownership filed on SEDAR). The current estimate of non-resident ownership is approximately 24%.

Unitholder liability The Declaration of Trust provides that no Trust Unitholder will be subject to any liability in connection with the Trust or its assets or obligations and, in the event that a court determines that Unitholders are subject to any such liabilities, the liabilities will be enforceable only against, and will be satisfied only out of, the Unitholder's share of the Trust's assets. On July 1, 2004, the Province of Alberta proclaimed the Income Trust Liability Act (Alberta) in force. This legislation provides that beneficiaries of Alberta based public income trusts are not liable, as beneficiaries, for any act, default, obligation or liability of the income trust. Unitholders of the Trust will have the benefit of this legislation with respect to liabilities arising on or after July 1, 2004. This legislation has not been subject to interpretation by courts in the Province of Alberta or elsewhere.

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

Crude oil and natural gas prices Demand for the services provided by Cathedral is directly impacted by the prices our customers receive for crude oil and natural gas they produce in that it has a direct relation to the cash flow available to invest in drilling activity and other oilfield services. World crude oil prices and 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. A significant portion of Cathedral fieldwork is performed by sub-contractors which allows us to operate with lower fixed overhead costs in seasonally low activity periods.

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

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

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

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

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

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

Weather and seasonality The majority of Cathedral's operations are carried on in Western Canada where activity levels in the oilfield services industry are subject to a degree of seasonality. Operating activities in Western Canada are generally lower during "spring breakup" which normally commences in late March and continues through to May. Operating activities generally increase in the fall and peak in the winter months from December till late March. Activity levels in the Rocky Mountain region of the U.S. are not subject to the seasonality to the extent that it occurs in the Western Canada region.

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

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

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

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

Customer mix Overall Cathedral has a good mix of customers with only one customer accounting for revenues in excess of 10% (at 13%) of the Trust's consolidated revenues for 2006 (2005 – one customer at 14%).

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 and complying with current environmental requirements.

OFF-BALANCE SHEET ARRANGEMENTS

As at December 31, 2006, the Trust's operating entities have entered into $9,738 of commitments under operating leases for premises and vehicles (refer to note 18 to the consolidated financial statements).

GOVERNANCE

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

SUPPLEMENTARY INFORMATION

As at March 7, 2007, the Trust had 31,049,279 Trust Units and 2,791,244 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 Petroleum Services Association of Canada ("PSAC") is forecasting a 10% decline in the number of wells drilled across Canada in 2007 from 23,441 in 2006 to 21,000 in 2007 and a shift in the type of wells being drilled – more oil drilling and a decline in gas drilling. This overall reduction is due to the concerns over weather and natural gas storage levels which have contributed to the decline in natural gas commodity prices. Overall drilling in the U.S. regions in which the Trust operates continues at a high level. On the oil side, commodity prices remain strong by historical standards despite the pull back from the highs in the USD$70 range. Industry experts are forecasting strong oil and natural gas prices for 2007 and into 2008 but not at the record prices that were attained for oil in 2006 and natural gas in 2005.

Demand for the Trust's directional drilling services continues to be strong in the both the Canadian and U.S. markets. With regard to the Canadian directional drilling market, in late 2006 the Trust's Directional Plus division has been assigned to a number of on-going projects which represented incremental work from previous activity levels from those customers. The Rocky Mountain region of the U.S. continues to be a growth area for the Trust and, subject to customer demand, additional directional drilling equipment will be added to the U.S. fleet. Activity levels in the southeast Saskatchewan which is oil based and where the Trust's The Directional Company division has a significant market share remains strong. PSAC's forecast calls for the number of wells drilled in the Saskatchewan market to be flat on a year-over-year basis. As a result of the wireline unit additions during 2006 and early 2007, we anticipate an overall increase in activity levels for the wireline division, despite the reduction in the number of wells drilled in Canada. Of all the Trust's divisions, the production testing division activity level is affected the most by the drilling activity for natural gas wells. Despite that fact, we are expecting this division to maintain its activity levels for 2007 that it attained in 2006.

The Trust's board of trustees has approved a $11,600 capital expenditure budget for 2007 with the major items being the addition of 2 MWD systems as well as additions to the mud motor and drill collar fleet to complement the increase in directional drilling job capacity; auxiliary production testing equipment; 8 wireline units as well as auxiliary wireline equipment and 4 explosive loading magazines which are related to the wireline operations.

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, 2006 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.

Per:
Mark L. Bentsen
President and Chief Executive Officer
March 7, 2007

Per:
P. Scott MacFarlane
Chief Financial Officer

AUDITORS' REPORT TO THE UNITHOLDERS

We have audited the consolidated balance sheets of Cathedral Energy Services Income Trust as at December 31, 2006 and 2005 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2006 and 2005 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 7, 2007

CONSOLIDATED BALANCE SHEETS

December 31, 2006 and 2005

	2006	2005
Assets		
Current assets:		
Cash and cash equivalents	**$ 1,554**	$ 2,091
Accounts receivable	**37,693**	31,070
Other receivables	**-**	612
Inventory	**3,050**	2,712
Prepaid expenses and deposits	**892**	525
	43,189	37,010
Property and equipment (note 4)	**61,488**	46,927
Intangibles, net of accumulated amortization of $194 (2005 - $46)	**736**	884
Goodwill	**19,775**	17,955
Other asset	**33**	132
	$ 125,221	$ 102,908
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness (note 5)	**$ 6,460**	$ 5,310
Accounts payable and accrued liabilities	**16,446**	17,788
Distributions payable to Unitholders (note 12)	**3,717**	1,503
Taxes payable	**1,232**	1,283
Current portion of capital lease obligations (note 6)	**212**	304
Current portion of long-term debt (note 7)	**71**	251
	28,138	26,439
Capital lease obligations (note 6)	**452**	665
Long-term debt (note 7)	**15,100**	12,132
Future income taxes (note 8)	**5,308**	4,057
Unitholders' equity:		
Unitholders' capital (note 9)	**44,667**	37,094
Contributed surplus (note 10)	**1,162**	756
Retained earnings (note 11)	**30,394**	21,765
	76,223	59,615
Commitments (note 18)		
	$ 125,221	$ 102,908

See accompanying notes to consolidated financial statements.

Approved by the Trustees:

Mark Bentsen Trustee   Rod Maxwell Trustee

Mark L. Bentsen   Rod Maxwell

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

Years ended December 31, 2006 and 2005

	2006	2005
Revenues	**$ 138,254**	$ 86,002
Expenses:		
Operating	**64,886**	42,313
General and administrative	**22,066**	14,125
Depreciation and amortization	**10,692**	5,686
Interest - long-term debt and capital lease obligations	**936**	235
Interest - other	**482**	71
Foreign exchange (gain) loss	**(27)**	25
Non-cash compensation expense	**1,486**	842
	100,521	63,297
	37,733	22,705
Gain on disposal of property and equipment	**1,946**	2,112
Income before taxes	**39,679**	24,817
Taxes (note 8):		
Current	**3,093**	1,267
Future income taxes	**1,238**	1,743
	4,331	3,010
Net income	**35,348**	21,807
Retained earnings, beginning of year	**21,765**	14,768
Less: Distributions declared (note 12)	**(26,719)**	(14,810)
Retained earnings, end of year	**$ 30,394**	$ 21,765
Net income per Trust Unit (note 13):		
Basic	**$ 1.16**	$ 0.76
Diluted	**$ 1.12**	$ 0.76

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2006 and 2005

	2006	2005
Cash provided by (used in):		
Operating activities:		
Net income	**$ 35,348**	$ 21,807
Items not involving cash:		
Depreciation and amortization	**10,692**	5,686
Future income taxes	**1,238**	1,743
Unrealized foreign exchange (gain) loss	**13**	(24)
Non-cash compensation expense	**1,486**	842
Gain on disposal of property and equipment	**(1,946)**	(2,112)
	46,831	27,942
Changes in non-cash operating working capital (note 15)	**(6,902)**	(6,333)
	39,929	21,609
Investing activities:		
Property and equipment additions	**(26,436)**	(18,583)
Proceeds on disposal of property and equipment	**3,277**	4,086
Acquisition of Tier One Oil Services Ltd. (note 3)	**-**	(3,193)
Acquisition of Advance Wireline Inc. (note 3)	**-**	(7,999)
Acquisition of Xtreme Wireline (note 3)	**-**	(1,469)
Changes in non-cash investing working capital (note 15)	**(1,207)**	864
	(24,366)	(26,294)
Financing activities:		
Advances under long-term debt	**3,109**	12,050
Repayments of long-term debt	**(321)**	(527)
Repayments of capital lease obligations	**(305)**	(90)
Distributions paid to Unitholders (note 12)	**(22,467)**	(10,281)
Trust Units issuance costs (note 9)	**-**	(17)
Proceeds on exercise of Trust Unit options (note 9)	**2,734**	637
Increase in bank indebtedness	**1,150**	1,853
	(16,100)	3,625
Decrease in cash and cash equivalents	**(537)**	(1,060)
Cash and cash equivalents, beginning of year	**2,091**	3,151
Cash and cash equivalents, end of year	**$ 1,554**	$ 2,091

See accompanying notes to consolidated financial statements.

1. General:

Cathedral Energy Services Income Trust (the "Trust") is an unincorporated, open-ended limited purpose mutual fund trust established under the laws of the Province of Alberta on June 24, 2002.

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

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

2. Significant accounting policies:

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

(a) Principles of consolidation:

These consolidated financial statements include the accounts of the Trust and its wholly-owned entities, Cathedral Energy Services Commercial Trust, Cathedral Energy Services Ltd., Cathedral Energy Services Limited Partnership, Advance Wireline Inc. and Cathedral Energy Services Inc.

(b) Foreign currency translation:

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

(c) Inventory:

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

2. Significant accounting policies (continued):

(d) Property and equipment:

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

Asset	Rate
Directional drilling equipment	10 - 25%
Production testing equipment	20 - 25%
Wireline equipment	20%
Automotive equipment	20 - 25%
Buildings	4%
Office and computer equipment	20%

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

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

(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:

The Trust has a Trust Unit based compensation plan as described in note 9. Trust Unit-based compensation expense is recorded for Trust Unit options issued to employees and non-employees using the fair value method. The fair value of employee Trust Unit options are valued on the date of grant and the resulting fair value is recorded as an expense over the vesting period of the option. The fair value of non-employee Trust Unit options are revalued each reporting date with the change in fair value on the vested options recorded in the income statement, and the change in fair value on unvested options expenses over the remaining vesting period. In determining the fair value of the Trust Unit options granted, the Black-Scholes model is used and assumptions regarding interest rates, underlying volatility of the Trust's Trust Units, distribution yield and expected life of the options are made.

(i) Cash and cash equivalents:

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

NOTES OF CONSOLIDATED FINANCIAL STATEMENTS

2. Significant accounting policies (continued):

(j) Distributions to Unitholders:

Distributions to Unitholders are 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 and income allocated from Cathedral Energy Services Commercial Trust through its investment in Cathedral Energy Services Limited Partnership, less administrative expenses incurred by the Trust and amounts paid in connection with any cash redemption of Trust Units is allocated to Unitholders.

(k) Goodwill:

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

(l) Intangible assets

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

(m) Use of estimates:

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

(n) Reclassification:

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

3. Acquisitions:

(a) Tier One Oil Services Ltd.:

Effective May 6, 2005, the Trust acquired all the issued and outstanding shares of Tier One Oil Services Ltd. ("Tier One"), a private company involved in providing production testing services in Western Canada, for consideration of $6,136 (net of a working capital adjustment). Consideration was comprised of $3,193 of cash and $2,943 of Trust Units (668,864 Trust Units with an assigned value of $4.40 per Trust Unit – assigned value is based upon a weighted average trading price immediately prior to the effective date of the acquisition). Included in the 668,864 Trust Units issued were 32,500 units issued to senior managers of Tier One pursuant to employment contracts entered into under the terms of the acquisition. In addition, 67,500 Trust Units have been issued and the unvested portions are being held in trust for senior managers of Tier One. These Trust Units vest over a three-year period from the date of the Tier One acquisition.

3. Acquisitions (continued):

(a) Tier One Oil Services Ltd. (continued):

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 effective date.

Details of the acquisition are as follows:

Net assets acquired:		
Net non-cash working capital deficiency, including bank indebtedness of $673	$	(334)
Equipment		2,523
Goodwill		4,224
Future income taxes		(277)
	$	6,136
Purchase price:		
668,864 Trust Units at $4.40 per Trust Unit	$	2,943
Cash (including transaction costs totaling $55 and net of acquired cash of $498)		3,193
	$	6,136

(b) Advance Wireline Inc.:

Effective September 8, 2005, the Trust acquired all the issued and outstanding shares of Advance Wireline Inc. ("Advance"), a private company involved in providing wireline services in Western Canada, for consideration of $16,999 (net of a working capital and long-term debt adjustment). Consideration was comprised of $7,999 of cash and $9,000 of Trust Units (1,072,706 Trust Units with an assigned value of $8.39 per Trust Unit – assigned value is based upon a weighted average trading price immediately prior to the effective date of the acquisition). The cash consideration noted above is net of a receivable from the former shareholders of Advance in the amount of $612. This amount has been included in the balance sheet under other receivables within current assets.

Additional contingent consideration of up to a maximum of $3.0 million, payable in Trust Units with an assigned value based upon a weighted average trading price immediately prior to the issuance of the related Trust Units, will be paid over a 2-year period based upon the financial results of Advance for the periods ended on the first and second anniversary of the closing date. During 2006, the first year annual maximum contingent consideration threshold was attained and was settled by way of issuing 187,032 Trust Units with an assigned value of $9.73 per Trust Unit for a total amount of $1,820. The additional contingent consideration was subsequently paid and 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 effective date.

3. Acquisitions (continued):

(b) Advance Wireline Inc. (continued):

Details of the acquisition are as follows:

Net assets acquired:		
Net non-cash working capital deficiency, including bank indebtedness of $2,785	$	(1,154)
Equipment		8,711
Intangibles		930
Goodwill		11,923
Future income taxes		(247)
Capital lease obligations		(485)
Long-term debt		(859)
	$	18,819
Purchase price:		
1,072,706 Trust Units at $8.39 per Trust Unit	$	9,000
Cash (including transaction costs totaling $110)		7,999
		16,999
Contingent consideration (187,032 Trust Units at $9.73 per Trust Unit)		1,820
	$	18,819

(c) Xtreme Wireline:

Effective December 22, 2005, the Trust acquired all the equipment and business of Xtreme Wireline ("Xtreme"), which is involved in providing slickline services in Western Canada, for consideration of $3,238. Consideration was comprised of $1,469 of cash and $1,769 of Trust Units (149,691 Trust Units with an assigned value of $11.82 per Trust Unit – assigned value is based upon a weighted average trading price immediately prior to the effective date of the acquisition).

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 effective date.

Details of the acquisition are as follows:

Net assets acquired:		
Equipment	$	1,808
Goodwill		2,004
Capital lease obligations		(574)
	$	3,238
Purchase price:		
149,691 Trust Units at $11.82 per Trust Unit	$	1,769
Cash (including transaction costs totaling $21)		1,469
	$	3,238

4. Property and Equipment:

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

Included in 2006 property and equipment are assets under capital leases with a cost of $2,166 and a net book value of $2,055.

NOTES OF CONSOLIDATED FINANCIAL STATEMENTS

5. Property and Equipment (continued):

2005	Cost	Accumulated depreciation	Net book value
Directional drilling equipment	$ 43,448	$ 14,878	$ 28,570
Production testing equipment	5,645	645	5,000
Wireline equipment	7,921	389	7,532
Automotive equipment	3,918	279	3,639
Office and computer equipment	1,689	689	1,000
Leasehold improvements	252	199	53
Deferred development costs	1,539	406	1,133
	$ 64,412	$ 17,485	$ 46,927

Included in 2005 property and equipment are assets under capital leases with a cost of $1,906 and a net book value of $1,228.

5. Bank indebtedness:

The Trust has a $12,500 (2005 - $9,000) operating line of credit that bears interest at the bank's prime rate per annum (December 31, 2006 – 6.0%; December 31, 2005 – 5.0%) with interest payable monthly and is secured as described in note 7.

6. Capital lease obligations:

	2006	2005
Capital lease obligations secured by related equipment are with interest rates ranging from 6.5% to 11.62% and maturing on various dates up to 2010	$ 664	$ 969
Less: current portion of capital lease obligations	(212)	(304)
	$ 452	$ 665

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

2007	$ 212
2008	197
2009	131
2010	124

7. Long-term debt:

	2006	2005
Bank revolving term loan at an authorized amount of $25,000 (2005 - $12,000), bearing interest at the bank's prime rate plus 0.5% (2005 – 1.0%) per annum (December 31, 2006 – 6.5%; December 31, 2005 – 6.0%), without repayment terms, maturing June 30, 2008 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	$ 15,000	$ 12,000
Non-interest bearing loans secured by the related automotive equipment with various maturity dates up to 2010	171	383
	15,171	12,383
Less: current portion of long-term debt	(71)	(251)
	$ 15,100	$ 12,132

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

7. Long-term debt (continued):

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

2007	$ 71
2008	2,548
2009	5,029
2010	5,023
2011	2,500

8. Taxes:

The Trust is a mutual fund trust as defined under the Income Tax Act (Canada). All taxable income earned by the Trust has been allocated to unitholders and such allocations are deducted for income tax purposes. The Trust does not recognize any future income tax assets or liabilities on “temporary differences” (differences between the accounting basis and tax basis of assets and liabilities) in the Trust. As at December 31, 2006, this “temporary difference” (accounting basis exceeds tax basis) is $13,221 (2005 - $8,040 - tax basis exceeds accounting basis). 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:

	2006	2005
Effective tax rate	34%	38%
Income before taxes	$ 39,679	$ 24,817
Income of Trust subject to tax in the hands of the Unitholders, not the Trust	(26,070)	(15,309)
Income before taxes of subsidiary companies	$ 13,609	$ 9,508
Effective tax rate applied to income before taxes of subsidiary companies	$ 4,627	$ 3,613
Adjustment to future income tax asset/liability for change in effected tax rates	(660)	184
Income taxed in jurisdictions with different tax rates	254	-
Non-deductible expenses	75	135
Non-taxable portion of gain on disposal of property and equipment	(31)	(92)
Capital taxes	151	75
Benefit of internal reorganization	-	(1,017)
Other	(85)	112
	$ 4,331	$ 3,010

The components of the net future income tax liability at December 31, 2006 and 2005 are as follows:

	2006	2005
Future income tax liability:		
Property and equipment	$ 997	$ 632
Partnership interests	1,105	1,179
Deferred partnership income	3,633	2,246
Loss carryforwards	(427)	-
Net future income tax liability	$ 5,308	$ 4,057

During 2006, the Canadian Federal government released for comments draft legislation which would result in a tax structure for trusts similar to that of corporations. If the proposed legislation is implemented, the Trust would be required to recognize, in the period on which the change is substantially enacted, future income taxes on temporary timing differences in the Trust

9. Unitholders' capital:

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

(b) Issued:

	Number of Trust Units	Amount
Balance, December 31, 2004	27,620,866	$ 18,776
Issued on acquisitions (note 3)	1,891,261	13,712
Issued as deferred compensation (note 3)	67,500	297
Issued on exercise of options	471,065	637
In-kind distribution (note 12)	306,534	3,648
Consolidation for in-kind distribution (note 12)	(306,534)	–
Contributed surplus on options exercised (note 10)	–	42
Less: Trust Unit issuance costs	–	(18)
Balance, December 31, 2005	30,050,692	37,094
Issued on acquisitions (note 3)	187,032	1,820
Issued on exercise of options	733,255	2,734
In-kind distribution (note 12)	204,667	2,038
Consolidation for in-kind distribution (note 12)	(204,667)	-
Contributed surplus on options exercised (note 10)	-	981
Balance, December 31, 2006	30,970,979	$ 44,667

(c) Trust Unit options:

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

Under the plan, the exercise price of each option at the date of issuance equals the fair market value of the Trust Units on the day immediately prior to the grant, subject to a potential future reduction, and has a maximum term till expiry of ten years. Options vest over a period of three 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 diluted Trust Unit for a fiscal year exceeds a prescribed threshold return for the fiscal year. The threshold return is between 10% and 15% (percentage is set annually by the Board of Directors of Cathedral Energy Services Ltd.) of the weighted average Unitholders' Equity for the fiscal year calculated on a diluted per Trust Unit basis. The reduction is calculated annually and is effective March 15 following each fiscal year. The March 15, 2007 reduction available to Unitholders was $0.86 (March 15, 2006 - $0.58) per option.

A summary of the status of the Trust Unit based compensation plan as at December 31, 2006 and 2005, and changes during the years then ended is presented below:

	2006		2005	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding, beginning of year	2,946,601	$ 5.41	786,833	$ 1.64
Granted	810,000	10.78	2,702,000	4.49
Exercised	(733,255)	3.73	(471,065)	1.35
Forfeited	(153,802)	6.03	(71,167)	2.59
Outstanding, end of year	2,869,544	$ 7.33	2,946,601	$ 5.41
Exercisable, end of year	331,002	$ 8.09	49,266	$ 1.72

9. Unitholders' capital (continued):

(c) Trust Unit options (continued):

During the year ended December 31, 2006, the Trust has recorded non-cash compensation expense of $1,387 (2005 - $776) for options granted on or after January 1, 2003.

The following table set out the assumptions used in applying the Black-Scholes model for options issued in 2006 and 2005 as well as the resulting fair value:

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

	Date of issue				
	Sep 29 2005	Aug 29 2005	Jul 15 2005	May 6 2005	Mar 14 2005
Number of options issued	15,000	237,000	470,000	360,000	1,620,000
Exercise price	$12.18	$9.98	$9.45	$4.96	$4.14
Fair value per option	$2.57	$1.92	$1.91	$0.79	$0.62
Expected distribution yield	4.93%	6.01%	4.76%	6.65%	7.25%
Risk-free interest rate	3.91%	3.94%	3.33%	3.40%	3.30%
Expected volatility	36%	36%	35%	33%	33%
Expected life (in years)	3.5	3.5	3.5	3.5	3.5

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

10. Contributed surplus:

Balance, December 31, 2004	$	22
Non-cash compensation expense related to Trust Unit option plan (note 9)		776
Less: Contributed surplus on options exercised		(42)
Balance, December 31, 2005		756
Non-cash compensation expense related to Trust Unit option plan (note 9)		1,387
Less: Contributed surplus on options exercised		(981)
Balance, December 31, 2006	$	1,162

11. Retained earnings:

	2006	2005
Accumulated income	$ 84,497	$ 49,149
Less: accumulated distributions	(54,103)	(27,364)
	$ 30,394	$ 21,765

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12. Distributions:

2006

Record Date	Payment date	Distribution per Trust Unit	Distribution paid/payable
January 31, 2006	February 15, 2006	$ 0.05	$ 1,503
February 28, 2006	March 15, 2006	0.05	1,505
March 31, 2006	April 17, 2006	0.06	1,829
April 30, 2006	May 15, 2006	0.06	1,832
May 31, 2006	June 15, 2006	0.06	1,840
June 30, 2006	July 17, 2006	0.065	1,994
July 31, 2006	August 15, 2006	0.065	1,997
August 31, 2006	September 15, 2006	0.065	1,999
September 30, 2006	October 16, 2006	0.07	2,155
October 31, 2006	November 15, 2006	0.07	2,155
November 30, 2006	December 15, 2006	0.07	2,155
December 31, 2006 - regular	January 15, 2007	0.07	2,168
December 31, 2006 - special	January 15, 2007	0.05	1,549
		0.805	24,681
December 31, 2006 (in-kind)	December 31, 2006	0.06582	2,038
		$ 0.87082	$ 26,719

2005

Record Date	Payment date	Distribution per Trust Unit	Distribution paid/payable
January 31, 2005	February 15, 2005	$ 0.025	$ 691
February 28, 2005	March 15, 2005	0.025	693
March 31, 2005	April 15, 2005	0.025	696
April 30, 2005	May 16, 2005	0.025	696
May 31, 2005	June 15, 2005	0.0275	786
June 30, 2005	July 15, 2005	0.0275	789
July 31, 2005	August 15, 2005	0.0275	789
August 31, 2005	September 15, 2005	0.0275	789
September 30, 2005	October 17, 2005	0.0375	1,118
October 31, 2005	November 15, 2005	0.0375	1,118
November 30, 2005	December 15, 2005	0.05	1,4934
December 31, 2005	January 15, 2006	0.05	1,503
		0.385	11,162
December 31, 2005 (in-kind)	December 31, 2005	0.12139	3,648
		$ 0.50639	$ 14,810

12. Distributions (continued):

Pursuant to the Trust's Declaration of Trust, the Trust is required to allocate all of its taxable income to Unitholders and in order to allocate all of its taxable income to Unitholders a non-cash in-kind distribution in the form of additional Trust Units was allocated to Unitholders of record on December 31, 2006 and 2005. The December 31, 2006, non-cash in-kind distributions was $0.06582 (2005 - $0.12139) per Trust Unit for a total of $2,038 (2005 - $3,648). The Declaration of Trust also requires there is an immediate consolidation of the Trust Units issued such that each Unitholder has the same number of Trust Units after the consolidation as they had prior to the non-cash in-kind distribution. Based upon a year-end Trust Unit price of $9.96 (2005 - $11.90) the in-kind distribution represented the issuance of 204,667 (2005 - 306,534) Trust Units which were immediately consolidated

13. 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, 2006, the basic weighted average number of Trust Units outstanding was 30,577,820 (2005 – 28,711,081). At December 31, 2006, the diluted weighted average number of Trust Units outstanding was 31,423,033 (2005 – 28,711,551), which includes the addition of 845,213 (2005 – 470) Trust Units to the basic weighted average number of Trust Units outstanding during the year ended December 31, 2006 for the dilutive effect of the Trust Unit options.

14. 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, 2006 and 2005 due to the relatively short period to maturity of the instruments. The fair value of long-term debt at December 31, 2006 approximated its carrying value as it bears interest at floating rates. The fair value of capital lease obligations at December 31, 2006 approximated its carrying value.

(c) Foreign currency exchange risk:

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

(d) Interest rate risk:

At December 31, 2006, the Trust was exposed to changes in interest rates on its bank indebtedness and long-term debt (see notes 5 and 7).

15. Supplemental cash flow disclosure:

	2006	2005
Components of changes in non-cash working capital are as follows:		
Accounts receivable	$ (6,623)	$ (8,517)
Other receivables	612	(612)
Inventory	(338)	(1,068)
Prepaid expenses and deposits	(367)	(78)
Accounts payable and accrued liabilities	(1,342)	5,345
Taxes payable	(51)	(539)
	(8,109)	(5,469)
Less: changes in working capital related to investing activities	(1,207)	864
Changes in working capital related to operating activities	(6,902)	$ (6,333)
Interest paid	$ 1,408	$ 286
Taxes paid	$ 3,299	$ 1,775

16. Segmented information:

The Trust, through its wholly-owned entities, Cathedral Energy Services Ltd. and Cathedral Energy Services Limited Partnership, is engaged in the business of providing selected oilfield drilling services to oil and natural gas 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.

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

Revenues	2006	2005
Canada	$ 108,007	$ 66,345
United States	30,247	19,657
	$ 138,254	$ 86,002

Property and equipment, goodwill and intangibles	2006	2005
Canada	$ 71,100	$ 57,953
United States	10,899	7,813
	$ 81,999	$ 65,766

During the year ended December 31, 2006, one customer accounted for 13% (2005 – 14%) of consolidated revenues.

17. 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 2006 was $65 (2005 - $237).

18. Commitments:

a) Leases:

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

2007	$	2,546
2008		2,278
2009		1,651
2010		1,288
2011		505
Thereafter		1,470

b) Property and equipment additions:

As at December 31, 2006, the Trust has committed to purchase $4,159 (2005 – $4,378) of property and equipment.

CORPORATE INFORMATION

TRUSTEES/DIRECTORS:

Rod Maxwell (1) (2) (4)
Managing Director
StoneBridge Merchant Capital Corp.
Calgary, Alberta

Jay Zammit (1) (3)
Partner
Burstall Winger LLP
Calgary, Alberta

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

Bob Chaisson (2)
Businessman
Calgary, Alberta

P. Daniel O'Neil
President and Chief Executive Officer
Breaker Energy Ltd.

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

Randal H. Pustanyk
Cathedral Energy Services Ltd.
Millet, Alberta

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

AUDITORS
KPMG LLP
Calgary, Alberta

LEGAL COUNSEL
Burstall Winger LLP
Calgary, Alberta

OFFICERS AND SENIOR MANAGEMENT OF CATHEDRAL ENERGY SERVICES LTD. AND CATHEDRAL ENERGY SERVICES LIMITED PARTNERSHIP:

Mark L. Bentsen
President and Chief Executive Officer

Randal H. Pustanyk
Vice President, Operations

P. Scott MacFarlane
Chief Financial Officer

Jeff Morden
Vice President, Engineering

David Diachok
Vice President, Sales

Ron Schell
General Manager – The Directional Company

Richard DeFreitas
President – Tier One Oil Services

Doug Hartle
Vice President, Sales – Advance Wireline

Lance McGuire
Vice President, Operations – Advance Wireline

Cory Loverin
General Manager – Xtreme Wireline

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

BANKER
The Bank of Nova Scotia

STOCK EXCHANGE LISTING
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