



Cathedral

Energy Services Income Trust

2004 Q1 INTERIM REPORT

CATHEDRAL ENERGY SERVICES REPORTS RESULTS FOR THE THREE MONTHS ENDED MARCH 31, 2004

FINANCIAL HIGHLIGHTS

'000's of dollars except per Trust Unit amounts

	Three months ended March 31	
	2004	2003
Revenues	\$ 10,604	\$ 6,905
EBITDA *	\$ 2,989	\$ 1,561
Operating income**	\$ 1,944	\$ 758
Income before taxes	\$ 2,107	\$ 770
Net income	\$ 1,709	\$ 918
Per Trust Unit – basic	\$ 0.08	\$ 0.04
Per Trust Unit – diluted	\$ 0.07	\$ 0.04
Cash distributions declared per Trust Unit	\$ 0.060	\$ 0.055
Capital asset additions and corporate acquisitions	\$ 2,660	\$ 4,861
Weighted average Trust Units outstanding:		
Basic ('000)	22,032	21,598
Diluted ('000)	22,867	21,706

	March 31 2004	December 31 2003
Working capital	\$ 1,527	\$ 1,956
Long-term debt including current portion	\$ 5,700	\$ 5,700
Unitholders' equity	\$ 17,380	\$ 16,589

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

** Operating income, as disclosed on the consolidated statement of operations, is defined as revenues less expenses related to operating, general and administration, depreciation and interest on long-term debt. Operating 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 companies and/or trusts.

MANAGEMENT'S DISCUSSION & ANALYSIS

This Management's Discussion & Analysis ("MD&A") for the three months ended March 31, 2004 should be read in conjunction with the annual audited consolidated financial statements for the year ended December 31, 2003, as well as the MD&A in the Trust's 2003 Annual Report, and with the unaudited interim consolidated financial statements for the three months ended March 31, 2004. This MD&A has been prepared as of April 30, 2004.

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

OVERVIEW

For 2004 Q1, the Trust had record Q1 revenues and net income of \$10,604,000 and \$1,709,000 (\$0.07 per diluted Trust Unit), respectively. Comparative figures for 2003 Q1 were \$6,905,000 and \$918,000 (\$0.04 per diluted Trust Unit), respectively. On a quarter-over-quarter basis revenues are up \$3,699,000 or 54% and net income was up \$791,000 or 86%. Effective February 12, 2003, the Trust acquired The Directional Company, Inc. ("TDC") and therefore, the results for 2004 Q1 includes the results of operations from TDC for the full quarter versus approximately one and a half months in 2003 Q1. For the three months ended March 31, 2004, EBITDA was \$2,989,000 and this compares with \$1,561,000 in 2003 – an increase of \$1,428,000 or 91%.

RESULTS OF OPERATIONS

Revenues Record Q1 revenues in 2004 of \$10,604,000, which represented an increase of \$3,699,000 or 54% over 2003 Q1 revenues of \$6,905,000, were a result of a significant increase in the number of activity days (2004 – 1,416; 2003 – 834) while partially offset by a decrease in the average day rate obtained for horizontal and directional drilling services (2004 - \$6,841; 2003 - \$7,386). The increase in activity days is a direct result of increased drilling activity in western Canada as well as an increase in market share in the Rocky Mountain region of the U.S.

Gross margin The gross margin (revenues less operating expenses) for 2004 Q1 was 49% which compares to 51% in 2003 Q1. The decrease in gross margin percentage is attributed to the decline in the average day rate obtained for horizontal and directional drilling services as well as realizing a lower gross margin in the U.S. market.

General and administrative expenses General and administrative expenses increased from \$1,987,000 in 2003 Q1 to \$2,371,000 in 2004 Q1 – an increase of \$384,000. The increase is related to: i) personnel costs; ii) workers' compensation costs in the U.S. which is tied to increase operating levels in that market; and iii) the inclusion of TDC general and administrative expenses for a full quarter in 2004. As a percentage of revenues, general and administrative expenses were 22.4% in 2004 Q1 and 28.8% in 2003 Q1.

Depreciation Depreciation for 2004 Q1 was \$803,000 compared to \$721,000 in 2003 Q1. This increase is related to the inclusion of depreciation on TDC related assets for the full quarter in 2004 and a larger capital asset base due to the Trust's investment in capital assets over the past 12 months. As a percentage of revenues, depreciation amounted to 7.6% for 2004 and 10.4% for 2003 - this decrease is mainly the result of the increase in revenues on a quarter-over-quarter basis.

Interest on long-term debt Interest on long-term debt has increased marginally from \$70,000 in 2003 to \$75,000 in 2004. This increase is mainly the result of an increase in the average level of long-term debt outstanding.

Gain on disposal of capital assets During 2004 Q1 the Trust had a gain on disposal of capital assets of \$163,000 which compares to \$12,000 in 2003 Q1. These gains are related to recoveries of lost-in-hole equipment costs, including previously expensed depreciation on the related assets.

Taxes For 2004 Q1 the Trust had a tax expense of \$398,000 which compares to a tax recovery of \$148,000 in 2003 Q1. The increased tax provision is due to the increase in pre-tax income. The Trust's tax provision is calculated net of income of the Trust allocated to Unitholders which is subject to tax in their hands.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2004, the Trust had an operating line of credit with a major Canadian bank in the amount of \$3,500,000 of which \$1,305,000 was undrawn. In addition, the undrawn portion of the Trust's revolving non-reducing term loan was \$300,000. In April 2004, the Trust drew upon the balance of the revolving facility and therefore increased its long-term debt from \$5,700,000 to \$6,000,000. The ratio of long-term debt to unitholders' equity at March 31, 2004 was a conservative 0.33 to 1 while the comparative ratio at December 31, 2003 was 0.34 to 1. Working capital at March 31, 2004 was \$1,527,000 which compares to \$1,956,000 at December 31, 2003.

Operating activities Cash from operating activities (including changes in non-cash operating working capital) was \$2,734,000 which is a decrease of \$171,000 over the comparative figure in 2003. The \$171,000 decrease is the net result of: i) an increase in funds from operations (which excludes changes in non-cash operating working capital) of \$1,293,000 or 89% from \$1,458,000 in 2003 Q1 to \$2,751,000 in 2004 Q1; and ii) use of funds as a further investment in operating working capital. The principal reason for the increase in funds from operations is increased earnings.



LIQUIDITY AND CAPITAL RESOURCES (continued)

Investing activities Cash used in investing activities for the three months ended March 31, 2004 amounted to \$3,118,000 compared to \$3,059,000 in 2003. Excluding the changes in non-cash working capital related to investing activities, cash used in investing activities decreased from \$4,837,000 in 2003 Q1 to \$2,258,000 in 2004 Q1 – a decrease of \$2,579,000. The decrease is mainly due to the 2003 Q1 figure including \$2,420,000 related to the acquisition of TDC which was effective February 12, 2003. In 2004 Q1 the Trust's operating entities acquired \$2,660,000 of capital assets for use in operations which included 6 Electro-Magnetic Measurement-While-Drilling ("EM-MWD") systems, additions to the mud motor and drill collar fleet to complement the increased job capacity and costs associated with the development of a positive pulse MWD system. With now having our own MWD platform Cathedral is progressing to the next stage of development by way of a positive pulse MWD system. Having a positive pulse MWD system and an EM-MWD system based on the same technology platform will give Cathedral unprecedented flexibility in potential future developments in this area. Having the versatility to move in different directions and at our own pace will allow Cathedral to continue to meet the growing needs of our customers. In Q2 of 2004, the Trust anticipates adding an additional 6 EM-MWD systems to its fleet which will bring the total number of MWD systems to 35.

Financing activities Cash provided by financing activities for the three months ended March 31, 2004 amounted to \$227,000 compared with \$2,093,000 in Q1 of 2003. During 2004 Q1 there was no activity within the Trust's long-term debt facility. Effective in late December 2003 the Trust's operating entity, Cathedral Energy Services Ltd., renegotiated its credit facility and converted its term loan into a \$6,000,000 non-reducing revolving term loan facility. Subject to compliance with standard debt covenants, this new non-reducing revolving term loan facility does not require debt repayments until maturity in June 2005. Annually the maturity date of the non-reducing revolving term loan can be extended for an additional year by agreement between Cathedral and its bank. Prior to maturity Cathedral can convert this credit facility into a term loan repayable over a 36-month period. During Q1 of 2003, Cathedral accessed \$4,677,000 of new long-term debt with the majority of the proceeds used to finance the acquisition of TDC and the balance to finance capital asset additions. During that same period Cathedral repaid \$1,165,000 of long-term debt. During 2004 Q1 the Trust accessed an additional \$1,900,000 in bank indebtedness through its operating loan facility while in 2003 Q1 the Trust repaid \$245,000 of the same credit facility.

Distributions to Unitholders for 2004 Q1 amounted to \$2,077,000 which is an increase of \$881,000 from 2003 Q1's level of \$1,196,000. The increase is due to: i) the movement to a monthly distribution policy effective January 2004 and therefore during 2004 Q1 the Trust paid the 2003 Q4 distribution of \$0.055 per Trust Unit (effective monthly distribution rate per Trust Unit is \$0.01833) plus distributions for the months of January and February 2004 at a rate of \$0.02 per Trust Unit per month; and ii) the fact the movement to \$0.02 per month per Trust Unit represented an approximate 9% increase in the level of cash distributions. On a go forward basis, it is the intention of the Trust to have equal monthly distributions to Unitholders, subject to the operating results of Cathedral Energy Services Ltd.

Contractual obligations In the normal course of business, the Trust incurs contractual obligations and aside from those disclosed in the Trust's MD&A for the year ended December 31, 2003 the Trust has a further commitment as at March 31, 2004 to purchase approximately \$1,157,000 of capital assets.

BUSINESS RISKS

The MD&A for the year ended December 31, 2003, which is included in the Trust's 2003 Annual Report, includes an overview on business risks associated with the Trust. Those business risks remain in effect as at March 31, 2004.

GOVERNANCE

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

OUTLOOK

2004 has started on a strong note and we anticipate the same to continue for the balance of 2004. Industry analysts continue to forecast near record levels of drilling activity in western Canada for 2004. As well, activity levels in the Rocky Mountain region of the United States are anticipated to be significant for 2004. Cathedral is in a position, as evidenced by the 2004 Q1 quarter-over-quarter increase in U.S. sourced revenues, to increase its market share in the region. Overall, the fundamentals behind the oil and natural gas industry remain strong.

Cathedral will continue to target the Steam Assisted Gravity Drainage ("SAGD") market and we anticipate obtaining additional SAGD work in addition to the project that commenced in 2004 Q2.

During 2004 Q2, Cathedral expects to add an additional 6 EM-MWD systems to its fleet which would bring the number of owned MWD systems to 35 (including 15 EM-MWD systems). The EM-MWD tool has been well received by customers in both Canada and the United States and will contribute to expanding Cathedral's revenues and reducing operating costs.

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.



REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim consolidated financial statements of the Trust have been prepared by and are the responsibility of the Trust's Administrator, Cathedral Energy Services Ltd. and its management.

The Trust's independent auditor has not performed a review of the accompanying unaudited interim consolidated financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

CONSOLIDATED BALANCE SHEETS

'000's of dollars

	March 31 2004 (unaudited)	December 31 2003
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 231	\$ 388
Accounts receivable	10,989	10,185
Taxes receivable	20	16
Inventory	1,288	1,428
Prepaid expenses and deposits	187	265
	12,715	12,282
Capital assets	21,291	19,673
Goodwill	1,125	1,125
	\$ 35,131	\$ 33,080
LIABILITIES AND UNITHOLDERS' EQUITY		
Current liabilities:		
Bank indebtedness	\$ 2,195	\$ 295
Accounts payable and accrued liabilities	8,547	8,824
Distribution payable to Unitholders	446	1,207
	11,188	10,326
Long-term debt	5,700	5,700
Future income taxes	863	465
	17,751	16,491
Unitholders' equity:		
Unitholders' capital (note 3)	5,580	5,176
Contributed surplus (note 3)	10	6
Accumulated income	19,923	18,214
Accumulated distributions	(8,133)	(6,807)
	17,380	16,589
	\$ 35,131	\$ 33,080



CONSOLIDATED STATEMENTS OF OPERATIONS AND ACCUMULATED INCOME

'000's of dollars except per Trust Unit amounts
(unaudited)

	Three months ended	
	March 31	
	2004	2003
Revenues (note 4)	\$ 10,604	\$ 6,905
Expenses:		
Operating	5,411	3,369
General and administrative	2,371	1,987
Depreciation	803	721
Interest on long-term debt	75	70
	8,660	6,147
Operating income	1,944	758
Gain on disposal of capital assets	163	12
Income before taxes	2,107	770
Taxes:		
Current	-	21
Future income taxes (reduction)	398	(169)
	398	(148)
Net income for the period	1,709	918
Accumulated income, beginning of period	18,214	13,774
Accumulated income, end of period	\$ 19,923	\$ 14,692
Net income per Trust Unit:		
Basic	\$ 0.08	\$ 0.04
Diluted	\$ 0.07	\$ 0.04
Cash distributions declared per Trust Unit	\$ 0.060	\$ 0.055



CONSOLIDATED STATEMENTS OF CASH FLOWS

'000's of dollars
(unaudited)

Three months ended
March 31
2004 2003

Cash provided by (used in):

Operating activities:

Net income for the period	\$ 1,709	\$ 918
Items not involving cash:		
Depreciation	803	721
Future income taxes (reduction)	398	(169)
Non-cash compensation expense	4	-
Gain on disposal of capital assets	(163)	(12)
Funds from operations	2,751	1,458
Changes in non-cash operating working capital	(17)	1,447
	2,734	2,905

Investing activities:

Capital asset additions	(2,660)	(2,441)
Proceeds on disposal of capital assets	402	24
Acquisition of The Directional Company, Inc. net of purchased cash of \$89	-	(2,420)
Changes in non-cash investing working capital	(860)	1,778
	(3,118)	(3,059)

Financing activities:

Advances under long-term debt	-	4,677
Repayment of long-term debt	-	(1,165)
Distributions paid to Unitholders	(2,077)	(1,196)
Trust Unit options exercised	404	22
Increase (decrease) in bank indebtedness	1,900	(245)
	227	2,093
Change in cash and cash equivalents	(157)	1,939
Cash and cash equivalents, beginning of period	388	-
Cash and cash equivalents, end of period	\$ 231	\$ 1,939



SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Three months ended March 31, 2004 and 2003

('000's of dollars except per Trust Unit amounts)

(unaudited)

1. Significant accounting policies:

These unaudited interim consolidated financial statements for the period ended March 31, 2004 do not include all disclosures required in the annual financial statements and should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2003 included in the Trust's 2003 Annual Report. These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and using the same accounting policies as outlined in note 2 of the annual consolidated financial statements for the year ended December 31, 2003.

Unit-based compensation plan:

Effective the fourth quarter of 2003, The Trust elected early adoption of the revised recommendations of the Canadian Institute of Chartered Accountants Handbook Section 3870, *Stock-based compensation and other stock-based payments* which requires that a fair value method of accounting be applied to all stock-based compensation payments to both employees and non-employees. In accordance with the transitional provisions of the revised recommendations, the Trust has prospectively applied the fair value method of accounting for option awards granted on or after January 1, 2003, and, accordingly, has recorded the related compensation expense during 2003. Prior to January 1, 2003, the Trust accounted for its employee options using the settlement method and no compensation expense was recognized. For awards granted in 2002, the revised recommendations require the disclosure of pro forma net income and net income per Trust Unit information as if the Trust had accounted for employee options under the fair value method and this information is disclosed in note 3 to these interim consolidated financial statements. The pro forma effect of awards granted prior to January 1, 2002 has not been included in the pro forma net income and net income per Trust Unit information.

2. Seasonality of Operations:

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.

3. Unitholders' capital:

(a) Issued:

	Three months ended March 31			
	2004		2003	
	Number of Trust Units	Amount	Number of Trust Units	Amount
Balance, beginning of period	21,948,333	\$ 5,176	21,479,421	\$ 4,617
Trust Units issued on acquisition of TDC	-		225,812	269
Issued on exercise of options	341,400	404	20,000	22
Balance, end of period	22,289,733	\$ 5,580	21,725,233	\$ 4,908

At April 30, 2004, the Trust had 22,311,233 Trust Units outstanding.

(b) Trust Unit options:

	Three months ended March 31	
	2004	2003
	Number of options	Number of options
Outstanding, beginning of period	1,605,900	1,798,000
Issued	-	125,000
Exercised	(341,400)	(20,000)
Outstanding, end of period	1,264,500	1,903,000

At April 30, 2004, the Trust had 1,243,000 Trust Unit options outstanding.



SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Three months ended March 31, 2004 and 2003

('000's of dollars except per Trust Unit amounts)

(unaudited)

3. Unitholders' capital (continued):

(b) Trust Unit options (continued):

During the three months ended March 31, 2004, the Trust has recorded compensation expense and contributed surplus of \$4 for the 125,000 options granted on or after January 1, 2003. During the three months ended March 31, 2004, no Trust Unit options were granted. For options granted in 2002, the Trust has elected to disclose pro forma results as if the revised accounting recommendations had been applied retroactively. Had compensation expense been determined based upon the fair value method for awards granted in 2002, the Trust's net income and net income per Trust Unit for the three months ended March 31, 2004 and 2003 would have been adjusted to the pro forma amounts noted below:

	Three months ended March 31	
	2004	2003
Net income for the period - as reported	\$ 1,709	\$ 918
Pro forma compensation expense	(25)	(25)
Net income for the period - pro forma	\$ 1,684	\$ 893
Net income per Trust Unit- as reported	\$ 0.08	\$ 0.04
Net income per Trust Unit - pro forma	\$ 0.08	\$ 0.04
Diluted net income per Trust Unit - as reported	\$ 0.07	\$ 0.04
Diluted net income per Trust Unit - pro forma	\$ 0.07	\$ 0.04

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

4. Segmented information:

The Trust, through its wholly owned subsidiary, Cathedral Energy Services Ltd., operates in two geographic segments within one industry. Drilling services are provided in both Canada and the United States. The amounts related to each segment are as follows:

Revenues	Three months ended March 31	
	2004	2003
Canada	\$ 8,173	\$ 6,007
United States	2,431	898
	\$ 10,604	\$ 6,905
Capital assets and goodwill	March 31 2004	December 31 2003
Canada	\$ 19,471	\$ 17,956
United States	2,945	2,842
	\$ 22,416	\$ 20,798

During the three months ended March 31, 2004, one customer accounted for 19% (2003 - 22%) of consolidated revenues.

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

