



Cathedral

Energy Services Income Trust

2007 Q3 INTERIM REPORT

FINANCIAL HIGHLIGHTS

\$ in 000's except per Trust Unit amounts

	Three months ended		Nine months ended	
	September 30		September 30	
	2007	2006	2007	2006
Revenues	\$ 38,355	\$ 38,041	\$106,052	\$102,927
EBITDA ⁽¹⁾	\$ 13,775	\$ 16,010	\$ 33,024	\$ 39,747
Per Trust Unit – diluted	\$ 0.43	\$ 0.51	\$ 1.04	\$ 1.26
Income before taxes	\$ 10,073	\$ 12,671	\$ 22,218	\$ 30,106
Net Income	\$ 7,126	\$ 11,396	\$ 14,498	\$ 27,221
Per Trust Unit – basic	\$ 0.23	\$ 0.37	\$ 0.46	\$ 0.89
Per Trust Unit – diluted	\$ 0.22	\$ 0.36	\$ 0.46	\$ 0.86
Cash distributions declared per Trust Unit	\$ 0.21	\$ 0.20	\$ 0.63	\$ 0.545
Distributable Cash ⁽²⁾	\$ 10,747	\$ 14,211	\$ 26,950	\$ 34,683
Cash distributions declared	\$ 6,626	\$ 6,150	\$ 19,756	\$ 16,655
Payout ratio ⁽³⁾	62%	43%	73%	48%
Property and equipment additions and corporate acquisitions:				
Paid or payable in cash	\$ 4,364	\$ 6,950	\$ 14,652	\$ 21,988
Paid or payable in Trust Units	-	-	-	1,500
	<u>\$ 4,364</u>	<u>\$ 6,950</u>	<u>\$ 14,652</u>	<u>\$ 23,488</u>
Weighted average Trust Units outstanding:				
Basic ('000)	31,515	30,730	31,318	30,493
Diluted ('000)	31,734	31,478	31,735	31,580

	September 30 2007	December 31 2006
Working capital	\$14,941	\$15,051
Long-term debt and capital lease obligations excluding current portion	\$ 17,471	\$15,552
Unitholders' equity	\$75,012	\$76,223

⁽¹⁾ EBITDA is defined as earnings before interest on long-term debt and capital lease obligations, taxes, non-cash compensation expense and depreciation and amortization and 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.

⁽²⁾ Distributable Cash is defined as cash flow from operating activities before changes in non-cash working capital less required principal repayments on long-term debt and capital lease obligations and Maintenance Capital Expenditures. Distributable Cash does not have any standardized meaning within Canadian Generally Accepted Accounting Policies ("GAAP") and therefore may not be comparable to similar measures presented by other trusts. Distributable Cash is a main performance measurement used by management, analysts and investors to evaluate the performance of the Trust.

⁽³⁾ Cash distributions declared as a percentage of Distributable Cash.

MANAGEMENT'S DISCUSSION & ANALYSIS

This Management's Discussion & Analysis ("MD&A") for the three and nine months ended September 30, 2007 should be read in conjunction with the annual audited consolidated financial statements and notes thereto for the year ended December 31, 2006, as well as the MD&A in the Trust's 2006 Annual Report, and with the unaudited interim consolidated financial statements and notes thereto for the three months and nine months ended September 30, 2007. This MD&A has been prepared as of November 12, 2007. Dollar amounts are in '000's except for day rates and per Trust Unit amounts.

FORWARD-LOOKING INFORMATION

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 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 are not limited to: the impact of general economic conditions; industry conditions; government and regulatory developments; oil and natural gas product supply and demand; competition; and the Trust's/Cathedral's ability to attract and retain qualified personnel. 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 and Annual Report which have been filed with Canadian provincial securities commissions and are available on www.sedar.com.

NON-GAAP FINANCIAL MEASUREMENTS

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 performance including its 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 Cash" - defined as cash flow from operating activities before changes in non-cash 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; v) "Payout Ratio" - calculated as cash distributions declared divided by distributable cash and vi) "Funds From Operations" - calculated as cash flow from operating activities before changes in non-cash working capital.

OVERVIEW

Despite a significant decline in drilling activity in western Canada, the Trust was able to increase revenues on a Q3 year-to-date basis from \$102,927 in 2006 to \$106,052 in 2007 - 3.0% increase. The major items contributing to these results have been the strong performance of the U.S. operations, exposure to drilling for oil, particularly in southeastern Saskatchewan, and the provision of specialty directional drilling services that has resulted in an increase in the average day rate obtained for such services. For Q3, revenues increased \$314 or 0.8% from \$38,041 in 2006 to \$38,355 in 2007. EBITDA for the nine months ended September 30, 2007 was \$33,024 which compares to \$39,747 in 2006 - 16.9% decrease. The Trust's net income for the nine months ended September 30, 2007 was \$14,498 (\$0.46 per diluted Trust Unit) which compares to \$27,221 (\$0.86 per diluted Trust Unit) in 2006. The 2007 year-to-date tax provision includes a non-cash \$3,560 (\$0.11 per diluted Trust Unit) provision for future income taxes related to the tax legislation included in Bill C-52, the Budget Implementation Act, 2007 (the "Bill"), that was substantively enacted in 2007 Q2 which results in the taxation of existing income and royalty trusts, other than real estate investment trusts, at effective rates similar to Canadian corporations.

RESULTS OF OPERATIONS - THREE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006

Revenues In 2007 Q3, revenues increased over Q2 as operations resumed following spring breakup but remained impacted by lower Canadian drilling activity as a result of concerns related to natural gas commodity prices. Continued strength in the directional drilling portion of the Trust's operations resulted in an increase in consolidated revenues from 2006 Q3 of \$38,041 to \$38,355 in 2007 Q3.

The directional drilling portion of the Trust's operations contributed revenues of \$28,485 in 2007 Q3 which compares to \$25,674 in Q3 2006 - an increase of 10.9%. Activity increased 8.7% from 3,024 days to 3,287 days, and the average day rate received for providing directional drilling services increased 2.1% to \$8,667 (2006 - \$8,492). The largest portion of the increase in the average day rate is related to a shift towards providing premium services such as underbalanced and Steam-Assisted Gravity Drainage ("SAGD") drilling services as opposed to an increase in the overall base day rate. In the Canadian market the Trust's 2007 Q3 activity levels decreased by 7.9% which was



significantly less than the overall decline in drilling activity in the Canadian market. Despite the decline in natural gas drilling in western Canada, the Trust was able to minimize the market decline from prior year activity levels due to the continuing strength of the Trust's client base and involvement in multi-well programs. The Rocky Mountain region of the United States is the Trust's main area of operations in the U.S. and it remains a very active area. The Trust's U.S. operations have now been expanded to provide directional drilling services in North Dakota and Michigan. The Trust's revenues from the U.S. were \$10,359 in 2007 Q3, a \$3,590 (53.0%) increase from 2006 revenues of \$6,769. Due to demand in the U.S. market, 5 Measurement-While-Drilling ("MWD") systems were transferred to the U.S. at the end of 2007 Q1 and the Trust now has 23 MWD systems in the U.S. market. The Trust's geographic diversification, by way of providing directional drilling services in southeast Saskatchewan and U.S., has been a significant factor in its ability to organically grow its revenues within the directional drilling division.

The continued decline in natural gas drilling expenditures in the western Canada market resulted in lower revenues for both of the Trust's production testing and wireline divisions. The Trust's production testing division, Tier One, contributed \$2,875 in revenues during 2007 Q3 which is a 35.5% decline from 2006 Q3 revenues. Advance Wireline and Xtreme Wireline combined to generate revenues of \$6,404 for 2007 Q3 compared to \$7,067 for 2006 Q3, a 9.4% decrease. Late in 2007 Q2, one wireline unit was transferred from the Canadian operations to the newly formed U.S. division of Advance Wireline but revenue generating operations did not commence until 2007 Q3. A second wireline unit was transferred to the US in 2007 Q3.

Gross Margin The Gross Margin for 2007 Q3 was 51.5% which compares to 55.2% in 2006 Q3. The decrease is attributed to a number of factors including: i) shift to providing more horizontal drilling services (versus directional) which provide a lower Gross Margin than from directional drilling; ii) increases in directional field labour rates; iii) increase in wireline field labour costs as a percentage of revenues due to the fixed nature of a portion of these labour charges; and iv) offsetting the previous items was an increase in the average day rate for directional drilling services.

General and administrative expenses General and administrative expenses increased from \$5,607 in 2006 Q3 to \$6,533 in 2007 Q3 – an increase of \$926 (16.5%). The increase was primarily related to increased personnel, office/shop rental costs, increased directional drilling activity in the U.S., costs related to the set-up of the U.S. wireline division and approximately \$300 of professional fees incurred in 2007 Q3 related to an aborted corporate acquisition. As a percentage of revenues, general and administrative expenses were 17.0% in 2007 Q3 and 14.7% in 2006.

Depreciation and amortization Depreciation for 2007 Q3 was \$3,110 which compares to \$2,849 in 2006 Q3. This increase is related to expansion of the Trust's depreciable asset base over the past 12 months. As a percentage of revenues, depreciation amounted to 8.1% for 2007 and 7.5% for 2006.

Interest expense Interest expense related to long-term debt and capital leases increased from \$236 in 2006 Q3 to \$269 in Q3 2007 due to the combined effect of: i) an increase in the average level of debt outstanding; and ii) a marginal increase in the effective interest rate on the related debt. Other interest expense has decreased on a quarter-over-quarter basis due to decreased utilization of the Trust's operating line of credit.

Foreign exchange The Trust's foreign exchange gain/loss increased from a gain of \$1 in 2006 Q3 to a \$302 loss in 2007 Q3. The increased foreign exchange loss is due to: i) the U.S. dollar weakening against the Canadian dollar to a larger extent in 2007 Q3 versus 2006 Q3; and ii) an overall increase in the Trust's U.S. operations which has resulted in an increase in the Trust's net monetary assets that are denominated in U.S. dollars.

Non-cash compensation expense For 2007 Q3 the Trust had non-cash compensation expense of \$323 which compares to \$254 for the comparable quarter in 2006. The value of Trust Unit options is being amortized against income over their three-year vesting period.

Gain on disposal of property and equipment During 2007 Q3 the Trust had a gain on disposal of property and equipment of \$973, which compares to \$760 in 2006 Q3. These gains are mainly due to recoveries of lost-in-hole equipment costs including previously expensed depreciation on the related assets. The timing of lost-in-hole recoveries is not in the control of the Trust and therefore can fluctuate significantly from quarter-to-quarter.

Taxes For 2007, the Trust had a tax expense of \$2,947 (effective tax rate of 29.3%) which compares to \$1,275 (effective tax rate of 10.1%) in 2006. The 2007 Q3 tax provision includes a \$316 adjustment to the 2007 Q2 tax adjustment related to the substantive enactment of the previously announced changes to the taxation of income and royalty trusts, other than real estate investment trusts. Removing the 2007 Q3 adjustment noted above the effective tax rate for 2007 Q3 is 26.1%. The adjusted effective tax rate has increased from 10.1% in 2006 to 26.1% in 2007 due to the continuing growth in the U.S. operations which are taxed at a higher rate.

RESULTS OF OPERATIONS – NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006

Revenues 2007 Q3 year-to-date revenues were \$106,052 which represented an increase of \$3,125 or 3.0% over 2006 Q3 year-to-date revenues of \$102,927. Ongoing activity reductions in the Canadian markets were offset by continued growth and expansion in the U.S. operations. The U.S. Q3 year-to-date revenues increased from \$22,131 in 2006 to \$30,722 in 2007, a 38.8% increase.

The directional drilling division revenues have increased from \$69,621 in 2006 to \$78,872 in 2007. This increase is the result of: i) a 5.7% increase in activity days from 8,334 in 2006 to 8,804 in 2007; and ii) a 7.2% increase in the average day rate from \$8,354 in 2006 to \$8,959 in 2007. The decrease in Canadian activity days from 5,686 to 5,267 was more than offset by the growth in U.S. activity days from 2,648 to 3,537.



The continued decline in natural gas drilling expenditures in the western Canada market resulted in lower revenues for both of the Trust's production testing and wireline divisions. The Trust's production testing division, Tier One, contributed \$8,681 in revenues during 2007 Q3 year-to-date which is a 26.7% decline from 2006 revenues of \$11,838. Advance Wireline and Xtreme Wireline combined to generate revenues of \$16,549 for 2007 Q3 year-to-date which compares to \$19,486 for 2006 which represents a 15.1% decline.

Gross Margin The Gross Margin for 2007 was 49.3%, which compares to 53.3% in 2006. The decrease is attributed to a number of factors including: i) shift to providing more horizontal drilling services (versus directional) which provide a lower Gross Margin than from directional drilling; ii) increases in directional field labour rates; iii) increase in wireline field labour costs as a percentage of revenues due to the nature of a portion of these labour charges; and iv) offsetting the previous items was an increase in the average day rate for directional drilling services.

General and administrative expenses General and administrative expenses increased from \$16,180 in 2006 to \$19,547 in 2007 – an increase of \$3,367. The increase was mainly related to the Trust's directional/horizontal drilling business and the contributing factors to that increase were the result of increased personnel and office/shop rental costs as well as an overall increase in directional drilling activity level in the Rocky Mountain region of the U.S. Other items contributing to the overall increase were costs related to the set-up of the U.S. wireline division in 2007 and approximately \$300 of professional fees incurred in 2007 Q3 related to an aborted corporate acquisition. As a percentage of revenues, general and administrative expenses were 18.4% in 2007 and 15.7% in 2006.

Depreciation and amortization Depreciation and amortization for 2007 was \$8,809 compared to \$7,755 in 2006. The \$1,054 increase is related to the Trust's investment in property and equipment over the past 12 months. As a percentage of revenues, depreciation and amortization amounted to 8.3% for 2007 and 7.5% for 2006.

Interest expense Interest on long-term debt has increased from \$672 in 2006 to \$792 in 2007. The major factor contributing to this increase is an increase in the average level of debt outstanding. Other interest expense has decreased mainly due to a decline in the utilization of the Trust's operating line of credit.

Foreign exchange The Trust's foreign exchange loss has increased from \$57 in 2006 to \$586 in 2007. The increased foreign exchange loss is due to: i) the U.S. dollar weakening against the Canadian dollar to a larger extent in 2007 Q3 year-to-date versus 2006 Q3 year-to-date; and ii) an overall increase in the Trust's U.S. operations which has resulted in an increase in the Trust's net monetary assets that are denominated in U.S. dollars.

Non-cash compensation expense Non-cash compensation expense for 2007 was \$1,205 which compares to \$1,214 in 2006. The Trust Unit options granted are valued using the Black-Scholes option pricing model and such value is being amortized against income over their three-year vesting period.

Gain on disposal of property and equipment For the nine months ended September 30, 2007 the Trust had a gain on disposal of property and equipment of \$1,157 which compares to \$1,470 in 2006. These gains are mainly due to recoveries of lost-in-hole equipment costs, including previously expensed depreciation on the related assets. The timing of lost-in-hole recoveries is not in the control of the Trust and therefore can fluctuate significantly from quarter-to-quarter and year-to-year basis.

Taxes For 2007, the Trust had a tax expense of \$7,720 (effective tax rate of 34.8%) which compares to \$2,885 (effective tax rate of 9.6%) in 2006. The 2007 tax provision includes a cumulative non-cash adjustment of \$3,560 (\$0.11 per diluted Trust Unit) related to the substantive enactment of the previously announced changes to the taxation of income and royalty trusts, other than real estate investment trusts. Removing the 2007 adjustment noted above the effective tax rate for 2007 Q3 year-to-date is 18.7%. Included in the 2006 Q3 year-to-date provision is a reduction in the overall tax provision of \$517 related to enacted income tax rate decreases. If this income tax rate adjustment is eliminated the effective tax rate for 2006 Q3 year-to-date is 11.3%. The adjusted effective tax rate has increased from 11.3% in 2006 to 18.7% in 2007 due to the continuing growth in the U.S. operations which are taxed at a higher rate.

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 September 30, 2007, the Trust had an operating line of credit with a major Canadian bank in the amount of \$12,500 (December 31, 2006 - \$12,500) of which \$10,005 (December 31, 2006 - \$6,460) was drawn. In addition, the Trust has a non-reducing revolving term loan facility in the amount of \$25,000 (December 31, 2006 - \$25,000) of which \$17,000 (December 31, 2006 - \$15,000) was drawn as at September 30, 2007. In addition, at September 30, 2007 the Trust had obligations under capital leases in the amount of \$499 (December 31, 2006 - \$664) and other long-term debt of \$250 (December 31, 2006 - \$171). The Trust's balance sheet remains strong with a current ratio (current assets to current liabilities) of 1.52:1 and a trailing four quarters EBITDA to long-term debt/capital lease obligations of 2.63:1. As at September 30, 2007 the Trust was in compliance with the financial covenants included in its credit facility agreement.

Operating activities Cash flow from operating activities for the three and nine months ended September 30, 2007 was \$3,156 (2006 - \$4,144) and \$27,228 (2006 - \$25,926) respectively. The Trust has a strong working capital position at September 30, 2007 at \$14,941 which compares to \$15,051 at December 31, 2006.

Investing activities Cash used in investing activities for the three and nine months ended September 30, 2007 amounted to \$6,908 and \$15,254, respectively which compares to \$6,062 and \$20,903 for the same period in 2006. During 2007 Q3 the Trust invested an additional \$4,364 (2006 - \$6,950) for a total Q3 year-to-date \$14,652 (2006 - \$21,988) in property and equipment. For 2007 Q3 the significant property and equipment additions included progress payments on construction of a new repair facility in Nisku, Alberta, expansion of the mud motor and drilling collar fleet, progress payments on upgrade of low pressure production testing units to higher pressure units and the



purchase of auxiliary wireline equipment. At September 30, 2007, the Trust's operating entities had 73 MWD systems, 19 production testing units and 27 wireline units. With the exception of the \$2,000 draw on non-reducing revolving term loan facility which was used to finance the construction of the Nisku repair facility, and the \$173 of 0% financing of automotive equipment additions, all of the 2007 Q3 year-to-date additions to property and equipment have been financed from cash flow from operations. Fluctuations in non-cash working capital related to investing activities are a function of when proceeds on disposal of property and equipment are received and when payments for property and equipment purchases are made.

Financing activities For the three months ended September 30, 2007 financing activities provided \$3,616 of cash flow which compares to \$548 for the three months ended September 30, 2006. Cash used in financing activities for the nine months ended September 30, 2007 amounted to \$12,883 (2006 - \$6,299). Distributions paid to Unitholders for 2007 Q3 amounted to \$6,616 (2006 - \$5,990) bringing year-to-date distributions for the nine months ended September 30, 2007 to \$21,258 (2006 - \$16,004). The increase in distributions paid are related to a combination of: i) increases in the per Trust Unit "regular" distribution level; ii) the payment of a "special" \$0.05 per Trust Unit cash distribution declared in December 2006 (\$1,549) and payable January 15, 2007; and iii) an increase in the number of Trust Units outstanding. Since January 2006 the Trust has increased its per Trust Unit distribution level from \$0.05 per Trust Unit to \$0.07 per Trust Unit for September 2007 (increased to \$0.07 level in September 2006) - a 40% increase. Cash distributions paid have been financed from Funds From Operations and management currently expects future cash distributions will also be financed by way of Funds From Operations. For the nine months ended September 30, 2007 financing cash inflows resulted from: i) \$ 2,916 (2006 - \$2,715) cash received on the exercise of Trust Unit options, ii) a \$2,173 (2006 - \$3,000) increase in new long-term debt, and iii) increase in bank indebtedness \$3,545 (2006 - \$4,460). Offsetting these inflows were cash outflows of \$259 (2006 - \$470) for the repayment of long-term debt and capital lease obligations. At November 12, 2007, the Trust had 31,654,917 Trust Units and 2,761,406 Trust Unit options outstanding.

Contractual obligations In the normal course of business, the Trust incurs contractual obligations and those obligations are disclosed in the Trust's MD&A for the year ended December 31, 2006. As at September 30, 2007 the Trust's commitment to purchase property and equipment is approximately \$5,981. The Trust expects to draw upon approximately \$1,000 of its non-reducing revolving term loan facility in 2007 Q4 to finance a portion of the commitment related to the construction of a new repair facility in Nisku, Alberta. The remaining commitments are expected to be financed from cash flows from operations.

CONTROLS AND PROCEDURES

Management is responsible for establishing and maintaining adequate disclosure controls and internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external reporting purposes in accordance with GAAP. Internal control over financial reporting may not prevent or detect fraud or misstatements because of limitations inherent in any system of internal control. There were no significant changes in the design or effectiveness of the Trust's disclosure controls or internal controls over financial reporting in Q3 2007.

CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2007, The Trust adopted the Canadian Institute of Chartered Accountants ("CICA") section 3855, "Financial Instruments - Recognition and Measurement", section 3865, "Hedges", and section 1530, "Comprehensive Income". These standards have been adopted prospectively. For the nine months ended September 30, 2007, the adoption of these standards did not have an effect on the Trust's consolidated financial statements. A general summary of these accounting standards was included in the Trust's 2006 annual MD&A.

BUSINESS RISKS

The MD&A for the year ended December 31, 2006, which is included in the Trust's 2006 Annual Report, includes an overview on business risks associated with the Trust and its operating entities. Those business risks remain in effect as at September 30, 2007.

DISTRIBUTIONS

The Administrator of the Trust reviews the level and nature of distributions (cash, in-kind or a combination of cash and in-kind) on an ongoing 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. Despite the seasonality of the Trust's business, it is the Trust's policy to pay consistent distributions throughout the year. The Trust's operations in western Canada are subject to seasonality as activity levels in the oilfield services industry are generally lower during "spring breakup" which normally commences in late March and continues through to May (mainly in the 2nd quarter of the fiscal year). The net result of the Trust's policy to pay consistent distributions throughout the year despite the seasonality of its operations is that in Q2 cash distributions declared may exceed net income, cash flow from operating activities and/or Distributable Cash for the quarter.

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

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



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

	2007 Q3	2007 Q3 YTD	Fiscal year	
			2006	2005
Cash flow from operating activities	\$ 3,156	\$ 27,228	\$ 39,929	\$ 21,609
Net income for the period	\$ 7,126	\$ 14,498	\$ 35,348	\$ 21,807
Distributable Cash	\$10,747	\$ 26,950	\$ 45,972	\$ 27,551
Cash distributions declared	\$ 6,626	\$ 19,756	\$ 24,681	\$ 11,162
Excess (short-fall) of cash flow from operating activities over cash distributions declared	\$ (3,470)	\$ 7,472	\$ 15,248	\$ 10,447
Excess (short-fall) of net income over cash distributions declared	\$ 500	\$ (5,258)	\$ 10,667	\$ 10,645
Excess of Distributable Cash over cash distributions declared	\$ 4,121	\$ 7,194	\$ 21,291	\$ 16,389

Due to the seasonality of the Trust's business it normally has a cash inflow from working capital related to operating activities during Q2 and when activities levels increase after spring breakup there is a cash outflow related to working capital from operating activities during Q3. Changes in non-cash operating working capital are financed by the Trust using its bank indebtedness/line of credit facility. Due to the seasonality of the Trust's western Canadian business it is management's belief that quarter-to-quarter comparisons of cash flow from operating activities to cash distributions declared cannot be looked at in isolation and therefore year-to-date comparisons and/or trailing four quarters comparisons need to be considered. Management looks beyond quarter-to-quarter fluctuations in working capital when providing recommendations to the board of trustees regarding monthly distributions. As a result, management believes that adjusting for changes in non-cash operating working capital when calculating Distributable Cash is appropriate. For the nine months ended September 30, 2007 and the September 30, 2007 trialing four quarters cash flow from operating activities exceeded cash distributions declared.

Net income includes significant non-cash changes which for the three months ended September 30, 2007 were \$4,861 and for the nine months ended September 30, 2007 were \$14,062 that do not impact cash flow. Included in these non-cash charges is a provision for depreciation that is not a reasonable proxy for the cost of maintaining existing levels of service (i.e. Maintenance Capital Expenditures). Therefore, in certain periods net income may exceed cash distributions declared. Management does not consider the excess of cash distributions declared over net income for the nine months ended September 30, 2007 to be an economic return of capital. Instead the excess is considered a function of the timing of cash flows versus accounting income.

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

Distributable Cash for the three and nine months ended September 30, 2007 and 2006 is calculated as follows:

	Three months ended		Nine months ended	
	September 30		September 30	
	2007	2006	2007	2006
Cash flow from operating activities	\$ 3,156	\$ 4,144	\$ 27,228	\$ 25,926
Add: - changes in non-cash operating working capital	7,858	10,177	175	9,363
Less: - required principal repayments on long-term debt and capital lease obligations	(67)	(62)	(242)	(399)
- Maintenance Capital Expenditures	(200)	(48)	(211)	(207)
Distributable Cash	\$10,747	\$14,211	\$ 26,950	\$ 34,683
Cash distributions declared	\$ 6,626	\$ 6,150	\$ 19,756	\$ 16,655
Payout ratio	62%	43%	73%	48%

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), Maintenance Capital Expenditures are currently minimal. Current Maintenance Capital Expenditure levels may not be indicative of future Maintenance Capital Expenditure levels.



EBITDA:

EBITDA is calculated as follows:

	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
EBITDA as reported	\$13,775	\$16,010	\$33,024	\$39,747
Deduct: - depreciation and amortization	3,110	2,849	8,809	7,755
- interest – long-term debt and capital lease obligations	269	236	792	672
- non-cash compensation expense	323	254	1,205	1,214
- provision for taxes	2,947	1,275	7,720	2,885
Net income for the period	\$ 7,126	\$11,396	\$14,498	\$27,221

GOVERNANCE

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

OUTLOOK

The Trust has benefited significantly from its geographic diversification. The U.S. and southeast Saskatchewan markets have both remained very active for directional drilling. In the U.S. directional drilling operations continue to grow and further growth is expected. Recently the Trust commenced providing directional drilling services in the state of Michigan. The company will continue to add to its service lines into this region. The southeast Saskatchewan market is oil based and activity levels in this area have remained strong due to the strength in the price of oil. Industry analysts continue to forecast strong oil prices into 2008.

One major area of uncertainty in the market place is related to the price of natural gas. The price of natural gas is affecting the cash flows of the operators that Cathedral works for. To date it has affected Canadian operators more than those in the U.S. The turn around in natural gas pricing will hopefully be answered with a strong winter heating season and the resulting draws of natural gas from storage.

The Government of Alberta's recent announcement related to changes in the royalty regime will also have an impact on the drilling and service industry in Alberta. The magnitude of the potential impact will depend on the final form of the enacted rules and its impact on our customers, and therefore, at this point in time, we can not reasonably estimate the effect on our operations.

Operationally the trust continues to grow. The directional drilling businesses of the Trust will add 5 Electro-Magnetic ("EM") MWD systems in 2007 Q4 and they will be the Trust's new 2nd generation system. The 2nd generation EM-MWD system will include bi-directional (talk down) communication. The new generation will allow surface control of the tool to change data rates, power levels and data formats. The result will be increased efficiency and power management, which by default, will allow greater depth capability.

The Trust's wireline and production testing divisions have been affected by the decline in drilling activity in western Canada and a rebound in their revenue generation ability will be tied to natural gas prices. The Trust now operates two wireline units in the U.S. and further units will be added based upon market demand. On the production testing side of the Trust's business, in 2007 Q4 we will complete our upgrade of low pressure testing units with high pressure units and we will continue to expand into the high-end testing market including critical sour service work.

The Trust expects to exit 2007 with 78 MWD systems, 27 wireline units and 19 production testing units.

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



SUMMARY OF QUARTERLY RESULTS

Three month period ended (\$ in 000's except per Trust Unit amounts)	Sep 2007	Jun 2007	Mar 2007	Dec 2006	Sep 2006	Jun 2006	Mar 2006	Dec 2005
Revenues	\$ 38,355	\$24,985	\$42,712	\$35,327	\$38,041	\$26,204	\$38,682	\$32,101
EBITDA	13,775	4,837	14,412	13,046	16,010	8,370	15,367	12,090
Net income (loss)	7,126	(2,415)	9,787	8,127	11,396	4,963	10,862	7,762
Net income (loss) per Trust Unit – basic	0.23	(0.08)	0.32	0.26	0.37	0.16	0.36	0.26
Net Income (loss) per Trust Unit – diluted	0.22	(0.08)	0.31	0.26	0.36	0.16	0.35	0.25
Cash distributions declared per Trust Unit	0.21	0.21	0.21	0.26	0.20	0.185	0.16	0.1375

CONSOLIDATED BALANCE SHEETS

\$ in 000's

	September 30 2007 (unaudited)	December 31 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 645	\$ 1,554
Accounts receivable	38,639	37,693
Inventory	3,542	3,050
Prepaid expenses and deposits	1,003	892
	43,829	43,189
Property and equipment	66,498	61,488
Intangibles	626	736
Goodwill	19,775	19,775
Other assets	-	33
	\$ 130,728	\$ 125,221
LIABILITIES AND UNITHOLDERS' EQUITY		
Current liabilities:		
Bank Indebtedness	\$ 10,005	\$ 6,460
Accounts payable and accrued liabilities	15,374	16,446
Distribution payable to Unitholders	2,214	3,717
Taxes payable	1,017	1,232
Current portion of capital lease obligations	198	212
Current portion of long-term debt	80	71
	28,888	28,138
Capital lease obligations	301	452
Long-term debt	17,170	15,100
Future income taxes (note 4)	9,357	5,308
	55,716	48,998
Unitholders' equity (note 5):		
Unitholders' capital	48,005	44,667
Contributed surplus	1,871	1,162
Retained earnings	25,136	30,394
	75,012	76,223
	\$ 130,728	\$ 125,221



CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

\$ in 000's except per Trust Unit amounts
(unaudited)

	Three months ended		Nine months ended	
	September 30		September 30	
	2007	2006	2007	2006
Revenues	\$ 38,355	\$ 38,041	\$ 106,052	\$ 102,927
Expenses :				
Operating	18,598	17,035	53,770	48,055
General and administrative	6,533	5,607	19,547	16,180
Depreciation and amortization	3,110	2,849	8,809	7,755
Interest – long-term debt and capital lease obligations	269	236	792	672
Interest – other	120	150	282	358
Foreign exchange loss (gain)	302	(1)	586	57
Non-cash compensation expense	323	254	1,205	1,214
	29,255	26,130	84,991	74,291
	9,100	11,911	21,061	28,636
Gain on disposal of property and equipment	973	760	1,157	1,470
Income before taxes	10,073	12,671	22,218	30,106
Taxes:				
Current	1,426	702	3,476	2,283
Future (note 4)	1,521	573	4,244	602
	2,947	1,275	7,720	2,885
Net income for the period	7,126	11,396	14,498	27,221
Retained earnings, beginning of period	24,636	27,085	30,394	21,765
Less: Distributions declared	(6,626)	(6,150)	(19,756)	(16,655)
Retained earnings, end of period	\$ 25,136	\$ 32,331	\$ 25,136	\$ 32,331
Net income per Trust Unit:				
Basic	\$ 0.23	\$ 0.37	\$ 0.46	\$ 0.89
Diluted	\$ 0.22	\$ 0.36	\$ 0.46	\$ 0.86

CONSOLIDATED STATEMENTS OF CASH FLOWS

\$ in 000's
(unaudited)

	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
Cash provided by (used in):				
Operating activities:				
Net income for the period	\$ 7,126	\$ 11,396	\$ 14,498	\$ 27,221
Items not involving cash:				
Depreciation and amortization	3,110	2,849	8,809	7,755
Future taxes (note 4)	1,521	573	4,244	602
Unrealized foreign exchange gain	(93)	9	(196)	(33)
Non-cash compensation expense	323	254	1,205	1,214
Gain on disposal of property and equipment	(973)	(760)	(1,157)	(1,470)
	11,014	14,321	27,403	35,289
Changes in non-cash operating working capital	(7,858)	(10,177)	(175)	(9,363)
	3,156	4,144	27,228	25,926
Investing activities:				
Property and equipment additions	(4,364)	(6,950)	(14,652)	(21,988)
Proceeds on disposal of property and equipment	1,586	1,153	2,100	2,372
Change in other assets	110	-	-	-
Changes in non-cash investing working capital	(4,240)	(265)	(2,702)	(1,287)
	(6,908)	(6,062)	(15,254)	(20,903)
Financing activities:				
Distributions paid to Unitholders	(6,616)	(5,990)	(21,258)	(16,004)
Advances under long-term debt	2,000	3,000	2,173	3,000
Repayment of long-term debt	(20)	(55)	(93)	(237)
Repayment of capital lease obligations	(47)	(78)	(166)	(233)
Proceeds on exercise of Trust Unit options	524	321	2,916	2,715
Increase in bank indebtedness	7,775	3,350	3,545	4,460
	3,616	548	(12,883)	(6,299)
Change in cash and cash equivalents	(136)	(1,370)	(909)	(1,276)
Cash and cash equivalents, beginning of period	781	2,185	1,554	2,091
Cash and cash equivalents, end of period	\$ 645	\$ 815	\$ 645	\$ 815

SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Three and nine months ended September 30, 2007 and 2006

(\$ in 000's except per Trust Unit amounts)
(unaudited)

1. Significant accounting policies:

These unaudited interim consolidated financial statements for the period ended September 30, 2007 do not include all disclosures required in the annual financial statements and should be read in conjunction with the annual consolidated financial statements and notes thereto for the year ended December 31, 2006 included in the Trust's 2006 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, 2006 except for the new accounting policies described in note 2.

2. New accounting policies:

Effective January 1, 2007, The Trust adopted the Canadian Institute of Chartered Accountants ("CICA") section 3855, "Financial Instruments – Recognition and Measurement", section 3865, "Hedges", and section 1530, "Comprehensive Income". These standards have been adopted prospectively. For the three and nine months ended September 30, 2007, the adoption of these standards did not have an effect on the Trust's consolidated financial statements.



3. 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. 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.

4. Taxes:

In 2007 Q2 tax legislation included in Bill C-52, the Budget Implementation Act, 2007 (the "Bill"), was substantively enacted and this will result in the taxation of existing income and royalty trusts, other than real estate investment trusts, at effective rates similar to Canadian corporations. Substantive enactment of the Bill resulted in the recognition of future income tax amounts based on estimated net taxable temporary differences which are expected to reverse after 2010 and for which no tax has previously been recorded in the Trust's financial statements. Accordingly, a future income tax expense and a net future income tax liability of \$3,560 has been recognized in accounts for the nine months ended September 30, 2007.

5. Unitholders' equity:

(a) Issued Unitholders capital:

	Three months ended September 30, 2007		Nine months ended September 30, 2007	
	Number of Trust Units	Amount	Number of Trust Units	Amount
Balance, beginning of period	31,484,547	\$ 47,326	30,970,979	\$ 44,667
Issued on exercise of options	140,704	524	654,272	2,916
Contributed surplus on options exercised	-	155	-	422
Balance, end of period	31,625,251	\$ 48,005	31,625,251	\$ 48,005

(b) Contributed surplus:

	Three months ended September 30, 2007	Nine months ended September 30, 2007
Balance, beginning of period	\$ 1,728	\$ 1,162
Non-cash compensation expense related to Trust Unit option plan	298	1,131
Less: contributed surplus on options exercised	(155)	(422)
Balance, end of period	\$ 1,871	\$ 1,871

(c) Trust Unit options:

	Three months ended September 30, 2007	Nine months ended September 30, 2007
Outstanding, beginning of period	2,421,976	2,869,544
Issued	536,600	614,600
Forfeited	(23,800)	(35,800)
Exercised	(140,704)	(654,272)
Outstanding, end of period	2,794,072	2,794,072

(d) Trust Unit options:

During the nine months ended September 30, 2007, 614,600 Trust Unit options were granted. The following table sets out the assumptions used in applying the Black-Scholes model:

	Date of Issue	
	Mar 9, 2007	Sep 10, 2007
Expected distribution yield	8.05%	10.24%
Risk-free interest rate	3.94%	4.28%
Expected volatility	37%	34%
Expected life (in years)	3.5	3.5
Fair value per option	\$ 1.77	\$ 1.07
Exercise price	\$ 10.44	\$ 8.20



5. Unitholders' equity (continued):

(e) Retained earnings:

Retained earnings is comprised of the following items:

	September 30 2007	December 31 2006
Accumulated income	\$ 98,995	\$ 84,497
Less: accumulated distributions	(73,859)	(54,103)
	<u>\$ 25,136</u>	<u>\$ 30,394</u>

6. Segmented information:

The Trust, through its directly and indirectly wholly-owned entities, Cathedral Energy Services Ltd. and Cathedral Energy Services Limited Partnership, is engaged in the business of providing selected oilfield services to oil and natural gas exploration entities 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 geographic segment are as follows:

Revenues	Three months ended September 30		Nine months ended September 30	
	2007	2006	2007	2006
Canada	\$ 27,996	\$ 31,272	\$ 75,330	\$ 80,796
United States	10,359	6,769	30,722	22,131
	<u>\$ 38,355</u>	<u>\$ 38,041</u>	<u>\$ 106,052</u>	<u>\$ 102,927</u>

	September 30 2007	December 31 2006
Property and equipment, intangibles and goodwill		
Canada	\$ 72,477	\$ 71,100
United States	14,422	10,899
	<u>\$ 86,899</u>	<u>\$ 81,999</u>

During the three months ended September 30, 2007 one customer accounted for 17% of consolidated revenues (2006 – no customers accounted for greater than 10%). During the nine months ended September 30, 2007, one customer accounted for 23% (2006 – one customer at 13%) of consolidated revenues.

7. Commitments:

In the normal course of business, the Trust incurs contractual obligations and those obligations are disclosed in the Trust's annual financial statements for the year ended December 31, 2006. As at September 30, 2007, the Trust's commitment to purchase property and equipment is approximately \$5,981.

*Cathedral Energy Services Income Trust is a limited purpose trust which 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 companies in western Canada and the Rocky Mountain region of the United States and currently provides 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, complete slickline services and casing integrity inspection logging; and **Xtreme Wireline** which provides slickline services. Cathedral strives to provide its clients with value added technologies and solutions to meet their drilling and production testing 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.*

