CATHEDRAL

2014 Q1 INTERIM REPORT

FINANCIAL HIGHLIGHTS

Dollars in 000's except per share amounts

	Three months ended March 31 2014	2013
Revenues	$ 68,020	$ 54,074
Adjusted gross margin % (1)	20.6%	24.7%
EBITDAS (1)	$ 8,581	$ 8,592
Diluted per share	$ 0.24	$ 0.23
EBITDAS (1) as % of revenues	12.6%	15.9%
Funds from operations (1)	$ 8,120	$ 7,507
Diluted per share	$ 0.22	$ 0.20
Net earnings	$ 2,449	$ 2,059
Basic per share	$ 0.07	$ 0.06
Diluted per share	$ 0.07	$ 0.06
Dividends declared per share	$ 0.0825	$ 0.0750
Property and equipment additions (cash)	$ 9,917	$ 6,698
Weighted average shares outstanding		
Basic (000s)	36,186	36,765
Diluted (000s)	36,219	36,826

	March 31 2014	December 31 2013
Working capital	$ 27,518	$ 26,031
Total assets	$ 222,325	$ 205,375
Loans and borrowings excluding current portion	$ 43,608	$ 38,462
Total shareholders' equity	$ 126,689	$ 126,612

(1) Refer to MD&A: see "NON-GAAP MEASUREMENTS"

MANAGEMENT'S DISCUSSION & ANALYSIS

This Management's Discussion & Analysis ("MD&A") for the three months ended March 31, 2014 should be read in conjunction with the annual audited consolidated financial statements and notes thereto for the year ended December 31, 2013, as well as the MD&A in the 2013 Annual Report of Cathedral Energy Services Ltd. ("the Company" / "Cathedral"). This MD&A has been prepared as of May 7, 2014. Dollar amounts are in '000's except for day rates and per share amounts.

2014 Q1 KEY TAKEAWAYS

- 26% increase in consolidated revenues from 2013 Q1 to 2014 Q1;
- Market share gains by Canadian and U.S. directional drilling divisions with the U.S. division achieving record quarterly revenues; and
- 19% increase in net earnings.

OVERVIEW

The Company completed 2014 Q1 with quarterly revenues of $68,020 compared to 2013 Q1 revenues of $54,074. Revenues have increased 26% from 2013. The 2014 Q1 revenues were comprised of 77% (2013 Q1 - 70%) from the directional drilling division and 23% (2013 Q1 - 30%) from the production testing division.

2014 Q1 EBITDAS were $8,581 ($0.24 per share diluted) which represents an $11 decrease from 2013 Q1 EBITDAS of $8,592 ($0.23 per share diluted). For the three months ended March 31, 2014, the Company's net earnings were $2,449 ($0.07 per share diluted) as compared to $2,059 ($0.06 per share diluted) in 2013. The increase in revenues was primarily attributed to recovery of Canadian directional drilling market share, continued growth in U.S. directional drilling on a year-over-year basis and a stronger U.S. dollar.

OUTLOOK

Within the Canadian market, many factors, including improved natural gas prices, unprecedented natural gas storage withdrawals in both Canada and the U.S., a narrowing of the Canadian differentials for both oil and natural gas and a stronger U.S. dollar, have industry analysts expecting improved cash flow for oil and natural gas producers as we progress through 2014. That combined with improved access to equity markets has better positioned producers with balance sheets enabling them to accelerate capital programs. On a longer term basis, there is potential for a significant increase in spending in western Canada as producers realize higher netbacks from a combination of enhanced refining capacity, increased shipment of crude by rail, new and expanded oil pipelines together with development of proposed west coast liquefied natural gas terminals.

Based upon feedback from customers and activity levels as projected by industry analysts, post "spring breakup" we are expecting continued strong activity levels within the Canadian market. Cathedral is active in the key resource plays including the Montney, Bakken, Cardium and Viking plays.

Within the U.S. market industry analysts are expecting a year-over-year increase in capital spending with producers directing capital to oil and liquids targets. U.S. producers are expected to continue to expand the use of horizontal, multi-stage fracturing to complete conventional and unconventional oil and natural gas plays.

2014 Q1 activity for our U.S. directional drilling division was lower than anticipated but as we proceed further into 2014 we are expecting operating levels to increase as additional market share is achieved. Market share gains and margin improvements are expected in all operating areas. Cathedral's current activity is focused in the Permian, Eagle Ford, DJ Basin, Mississippian Lime, San Juan, Utica and Marcellus plays with additional work in Bakken, Woodford Shale, Granite Wash and Piceance Basin plays. Over the past 2 years Cathedral has expanded its U.S. physical and personnel infrastructure and is now expecting to leverage that infrastructure into improved financial results.

Cathedral's "Claw" series of the nDurance mud motor line has been introduced to the market and has been well received. The "Claw" is designed to operate at higher flow rates and has superior torque output than conventional power sections. This motor has significantly increased drilling rate of penetration ("ROP") which leads to reduced drilling time and costs for Cathedral's customers. In addition to including this motor as part of Cathedral's directional drilling service package, due to requests from customers, Cathedral has rented the "Claw" on a standalone basis. Cathedral's 2014 capital program includes further expansion of the fleet of "Claw" motors. At the end of 2014 Q1 Cathedral had 30 "Claw" motors and is building an additional 45 units in 2014 Q2.

For 2014, Cathedral's focus will remain on: i) increasing market share in both operating divisions and geographic areas; ii) enhancing profitability through managing costs; and iii) continued investment in research and development of proprietary technologies.

DIVIDENDS

It is the intent of the Company to pay quarterly dividends to shareholders. The Board of Directors will review the amount of dividends on a quarterly basis with due consideration to current performance, historical and future trends in the business, the expected sustainability of those trends and enacted tax legislation which will affect future taxes payable as well as required long-term debt repayments, maintenance capital expenditures required to sustain performance and future growth capital expenditures. The Directors have approved a 2014 Q2 dividend in the amount of $0.0825 per share which will have a date of record of June 30, 2014 and a payment date of July 15, 2014.

2014 CAPITAL PROGRAM

During 2014 Q1 the Company invested $9,917 (2013 Q1 - $6,698) in property and equipment. The following table details the current period's net property and equipment additions:

	Three months ended March 31, 2014
Property and equipment additions:	
Growth capital [(1)]	$ 5,241
Maintenance capital [(1)]	3,410
Replacement capital [(1)]	436
Infrastructure capital [(1)]	830
Total cash additions	9,917
Less: proceeds on disposal of property and equipment	(1,106)
Net property and equipment additions [(1)]	$ 8,811

(1) See "NON-GAAP MEASUREMENTS"

The major additions for growth capital were $3,693 for additional drilling motors and related equipment for specific job requirements and $1,548 for additional ancillary production testing equipment to reduce future rental costs. Infrastructure capital relates to the construction of a new shop in Oklahoma which is expected to be operational in early 2015.

Cathedral's 2014 capital budget remains at $24,000 which includes $12,000 of growth capital, $8,000 of maintenance capital and $4,000 of infrastructure expenditures.

Cathedral intends to finance its 2014 capital budget from cash flow from operations and, if necessary, its existing credit facility.

The following is a summary of major equipment owned by the Company:

	March 31 2014	December 31 2013	March 31 2013
Directional drilling - MWD systems [(1)]	139	139	136
Production testing units	72	72	69

(1) The Company has 10 Geolink MWD systems that have been excluded from the above figures as they are held for sale.

RESULTS OF OPERATIONS – THREE MONTHS ENDED MARCH 31

Revenues	Three months ended March 31, 2014 Directional drilling	Production testing	Total	Three months ended March 31, 2013 Directional drilling	Production testing	Total
Canada	$ 28,790	$ 8,578	$ 37,368	$ 23,594	$ 7,766	$ 31,360
United States	23,672	6,980	30,652	14,509	8,205	22,714
Total	$ 52,462	$ 15,558	$ 68,020	$ 38,103	$ 15,971	$ 54,074

Revenues 2014 Q1 revenues were $68,020 which represented an increase of $13,946 or 26% from 2013 Q1 revenues of $54,074. All areas, other than U.S. production testing were up on a year-over-year basis.

Canadian directional drilling revenues increased from $23,594 in 2013 Q1 to $28,790 in 2014 Q1; a 22% increase. This increase was the result of: i) a 26% increase in activity days from 2,102 in 2013 Q1 to 2,649 in 2014 Q1; net of ii) a 3% decrease in the average day rate from $11,224 in 2013 Q1 to $10,868 in 2014 Q1. While overall industry activity levels increased marginally, Cathedral's was able to increase its activity levels by 26% due to market share gains. Such market share gains were the result of additional work for existing customers and the addition of new customers.

U.S. directional drilling revenues increased from $14,509 in 2013 Q1 to $23,672 in 2014 Q1; a 63% increase. This increase was the result of: i) a 41% increase in activity days from 1,329 in 2013 Q1 to 1,880 in 2014 Q1; and ii) a 15% increase in the average day rate from $10,917 in 2013 Q1 to $12,591 in 2014 Q1. The increase in U.S. activity days were due to further expansion in the Texas and Oklahoma markets, offset by reduced drilling in the U.S. northeast area within the existing customer base. The increased average day rate was due to a stronger U.S. dollar and higher rates that were achieved in the Rocky Mountain and Texas regions on jobs where the pricing was tied to performance. On a sequential basis, U.S. directional drilling revenues for 2014 Q1 are slightly over 2013 Q4 revenues of $23,536. U.S activity days are down on a sequential basis (2014 Q1 – 1,800 versus 2013 Q4 – 2,027) due to customers deferring the ramp up of their drilling programs.

Canadian production testing revenues increased from $7,766 in 2013 Q1 to $8,578 in 2014 Q1; a 10% increase. The Canadian operating days were up 10% compared to 2013 Q1, while rates were unchanged. 2013 Q1 activity levels were negatively affected by customers deferring work to later periods.

U.S. production testing revenues decreased from $8,205 in 2013 Q1 to $6,980 in 2014 Q1; a 15% decrease. This decrease is attributable a 20% decline in operating days, net of an increase in the average day rate of 7%. The average day rate increase is mainly attributed to a strengthening U.S. dollar. The year-over-year decline in revenue is attributable to a significant customer shifting work to a competitor in early 2013 Q4. There was work for new customers, but they did not make up for the lost customer.

Gross margin and adjusted gross margin The gross margin for 2014 Q1 was 14.0% compared to 15.9% in 2013 Q1. Adjusted gross margin (excludes non-cash expenses) for 2014 Q1 was $14,017 (20.6%) compared to $13,358 (24.7%) for 2013 Q1. The decrease in adjusted gross margin of 4.1% was primarily due to increase in equipment rentals and transportation costs in the U.S. in addition to increased MWD repairs on Canadian drilling operations.

Depreciation allocated to cost of sales decreased from $4,665 in 2013 Q1 to $4,464 in 2014 Q1. Depreciation included in cost of sales as a percentage of revenue was 6.6% for 2014 Q1 and 8.6% in 2013 Q1.

Selling, general and administrative expenses ("SG&A") SG&A expenses were $6,270 in 2014 Q1 which represents an increase of $699 when compared with $5,571 in 2013 Q1. As a percentage of revenue, these costs were 9% in 2014 Q1 and 10% in 2013 Q1. Non-cash expenses (depreciation and share-based compensation) total $143 for 2014 Q1 and $368 for 2013 Q1. Additionally 2013 Q1 SG&A included non-recurring items related to severance costs and a recovery of prior period SG&A related to Venezuelan operations. Excluding these non-cash and non-recurring items SG&A increased $324 ("adjusted SG&A").

Adjusted SG&A increased primarily due to wages, benefits and variable compensation. These increases relate to increased sales commissions, additions to sales staff to accommodate current and future U.S. growth and additions to research and development personnel. Staffing costs included in SG&A relate to executives, sales, accounting, human resources, payroll, safety, research and development and related support staff.

The remaining increase in adjusted SG&A is attributable to i) increased rent due to the sale and leaseback of Alberta properties which closed in 2013 Q3; ii) consulting fees; iii) office, promotion and safety costs associated with expansion within our operating areas; net of iv) reductions in SG&A due to the wind up of activity in Venezuela.

Gain on disposal of property and equipment During 2014 Q1 the Company had a gain on disposal of property and equipment of $734 compared to $505 in 2013 Q1. The Company's 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 Company and therefore can fluctuate significantly from quarter-to-quarter.

Foreign exchange loss The Company had foreign exchange loss of $497 in 2014 Q1 compared to $280 in 2013 Q1 due to the fluctuations in the Canadian dollar compared to U.S. dollars. The Company's foreign operations are denominated in a currency other than the Canadian dollar and therefore, upon consolidation gains and losses due to fluctuations in the foreign currency exchange rates are recorded in other comprehensive income ("OCI") on the balance sheet as a component of equity. However, gains and losses in the Canadian entity on U.S. denominated intercompany balances continue to be recognized in the statement of income. Included in the 2014 Q1 foreign currency loss are unrealized losses of $454 (2013 Q1 - $212) related to intercompany balances.

Finance costs Finance costs consist of interest expenses on operating loans, loans and borrowings and bank charges of $596 for 2014 Q1 versus $480 for 2013 Q1. The increase in finance costs relate mainly to an increased utilization of the Company's operating loan and to a lesser extent increases in interest rates.

Income tax For 2014 Q1, the Company had an income tax expense of $427 compared to $728 in 2013 Q1. The effective tax rate was 15% for 2014 Q1 and 26% for 2013 Q1. Income tax expense is booked based upon expected annualized effective rates.

LIQUIDITY AND CAPITAL RESOURCES

Overview On an annualized basis the Company's principal source of liquidity is cash generated from operations. In addition, the Company has the ability to fund liquidity requirements through its credit facility and the issuance of debt and/or equity. For the three months ended March 31, 2014, the Company had funds from operations of $8,120 (2013 Q1 - $7,507), property and equipment additions of $9,917 (2013 Q1 - $6,698), increase to operating loan of $5,425 (2013 Q1 - $15,796), advances on loans and borrowings of $5,000 (2013 Q1 - $nil) and payment of dividends of $2,984 (2013 Q1 - $2,768).

Working capital At March 31, 2014 the Company had a working capital position of $27,518 (December 31, 2013 - $26,031) and a working capital ratio of 1.54 to 1 (December 31, 2013 – 1.66 to 1).

Credit facility The Company has a $20,000 demand operating line of credit with a major Canadian bank that bears interest, at the Company's option, at the bank's prime rate plus 0.50% to 2.00% or bankers' acceptance rate plus 1.75% to 3.25% with interest payable monthly and is secured as described in note 14 of the audited consolidated financial statements. Interest rates spreads for the credit facility will depend on the level of funded debt to EBITDA (earnings before interest on long-term debt, taxes, depreciation, amortization and non-cash compensation expense – as defined in the credit agreement).

The Company also has a secured revolving term loan with a major Canadian bank at an authorized amount of $55,000, bearing interest at the bank's prime rate plus 0.50% to 2.00% or bankers' acceptance rate plus 1.75% to 3.25%, without repayment terms, maturing June 30, 2014 subject to an annual extension upon agreement between the borrower and the bank for a further one-year period. Interest rates spreads for the credit facility will depend on the level of funded debt to EBITDA (earnings before interest on long-term debt, taxes, depreciation, amortization and non-cash compensation expense – as defined in the credit agreement). Prior to maturity the borrower may convert its revolving term loan to a non-revolving term loan repayable monthly over 36 months with interest only for the first 12 months. The Company's credit facility includes a $35,000 accordion feature which is subject to approval of the Company's bank.

The credit facility is secured by a general security agreement over all present and future personal property and is subject to certain covenants regarding the payment of dividends and the maintenance of certain financial ratios. As at December 31, 2013, the Company is in compliance with all covenants under its credit facility.

The following table outlines the current credit facility:

	March 31 2014	December 31 2013
Available credit facility	$ 75,000	$ 75,000
Drawings on credit facility:		
Operating loan	15,506	10,119
Revolving term loan	42,000	37,000
Letter of credit	700	700
Total drawn facility	$ 58,206	$ 47,819
Borrowing capacity (see NON-GAAP MEASUREMENTS)	$ 16,794	$ 27,181
Net debt (see NON-GAAP MEASUREMENTS):		
Loans and borrowings, net of current portion	$ 43,608	$ 38,462
Working capital:		
Current assets	$ 78,634	$ 65,409
Current liabilities	(51,116)	(39,378)
Working capital	$ 27,518	$ 26,031
Net debt	$ 16,090	$ 12,431

Contractual obligations In the normal course of business, the Company incurs contractual obligations and those obligations are disclosed in the Company's MD&A for the year ended December 31, 2013. As at March 31, 2014, the Company had a commitment to purchase approximately $3,168 of equipment. Cathedral anticipates expending these funds in 2014 Q2 and Q3.

Share capital At May 7, 2014, the Company has 36,252,380 common shares and 1,246,529 share options outstanding with a weighted average exercise price of $7.07.

The Normal Course Issuer Bid was renewed on July 8, 2013 and has an expiry date of July 7, 2014. For the three months ended March 31, 2014, the Company did not repurchase and cancel common shares.

CONTROLS AND PROCEDURES

The Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") are responsible for designing disclosure controls and procedures ("DC&P") and internal controls over financial reporting ('ICFR') as defined in National Instrument 52-109 Certification of Disclosure in Issuer's Annual and Interim Filings ("52-109"), or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Cathedral's DC&P have been designed to provide reasonable assurance that material information relating to Cathedral is made known to the CEO and the CFO by others and that information required to be disclosed by Cathedral in its annual filings, interim filings or other reports filed or submitted by Cathedral under securities legislation is recorded, processed, summarized and reported within the time periods specified in applicable securities legislation.

Because of their inherent limitations, DC&P and ICFR may not prevent or detect all misstatements, errors or fraud. Control systems, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control systems are met.

The CEO and CFO have concluded that there have been no changes in internal controls for the period ended on March 31, 2014 that have materially affected, or are reasonably likely to materially affect, Cathedral's ICFR.

BUSINESS RISKS

The MD&A for the year ended December 31, 2013, which is included in the Company's 2013 Annual Report, includes an overview on business risks associated with the Company and its operating entities. Those business risks remain in effect as at March 31, 2014.

GOVERNANCE

The Audit Committee of the Board of Directors has reviewed this MD&A and the related unaudited condensed consolidated interim 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.

NEW AND FUTURE ACCOUNTING POLICIES

The IASB issued IFRIC 21, “Levies” which has been adopted by the Company on January 1, 2014. The IFRIC clarifies that an entity should recognize a liability for a levy when the activity that triggers payment occurs. The adoption of this interpretation has no impact on the Company's consolidated financial statements.

There were no other new or amended standards issued during the three months ended March 31, 2014 that are applicable to the Company in future periods. A description of standards and interpretations that will be adopted by the Company in future periods can be found in the MD&A for the year ended December 31, 2013.

SUMMARY OF QUARTERLY RESULTS

Three month periods ended	Mar 2014	Dec 2013	Sep 2013	Jun 2013	Mar 2013	Dec 2012	Sep 2012	Jun 2012
Revenues	$ 68,020	$ 65,238	$ 59,734	$ 45,639	$ 54,074	$ 44,836	$ 49,830	$ 40,699
EBITDAS [(1)]	$ 8,581	$ 8,124	$ 10,757	$ 5,342	$ 8,592	$ 8,296	$ 10,538	$ 2,068
EBITDAS [(1)] per share - diluted	$ 0.24	$ 0.22	$ 0.30	$ 0.15	$ 0.23	$ 0.22	$ 0.28	$ 0.05
Net earnings (loss)	$ 2,449	$ (11,248)	$ 7,956	$ (309)	$ 2,059	$ 1,578	$ 3,813	$ (3,222)
Net earnings (loss) per share - basic and diluted	$ 0.07	$ (0.31)	$ 0.22	$ (0.01)	$ 0.06	$ 0.04	$ 0.10	$ (0.09)
Dividends declared per share	$ 0.0825	$ 0.0825	$ 0.0750	$ 0.0750	$ 0.0750	$ 0.0750	$ 0.0750	$ 0.0750

(1) Refer to MD&A: see "NON-GAAP MEASURMENTS"

FORWARD LOOKING STATEMENTS

This MD&A contains certain forward-looking statements and forward-looking information (collectively referred to herein as "forward-looking statements") within the meaning of applicable Canadian securities laws. All statements other than statements of present or historical fact are forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "anticipate", "achieve", "believe", "plan", "intend", "objective", "continuous", "ongoing", "estimate", "outlook", "expect", "may", "will", "project", "should" or similar words suggesting future outcomes. In particular, this MD&A contains forward-looking statements relating to, among other things: activity levels; market share gains and margin improvements in all operating areas; timing of expenditures on purchase commitments; a new shop in Oklahoma to be operational in early 2015; improved cash flow for oil and natural gas producers; oil and natural gas producers accelerate capital programs; potential for a significant increase in spending in western Canada; post “spring breakup” high activity levels within the Canadian market; a year-over-year increase in capital spending in the U.S. market; U.S. producers to continue to expand the use of horizontal, multi-stage fracturing to complete conventional and unconventional oil and natural gas plays; further expansion of the fleet of "Claw" motors; continued investment in research and development of proprietary technologies; and dividends. The Company believes the expectations reflected in such forward-looking statements are reasonable as of the date hereof but no assurance can be given that these expectations will prove to be correct and such forward-looking statements should not be unduly relied upon.

Various material factors and assumptions are typically applied in drawing conclusions or making the forecasts or projections set out in forward-looking statements. Those material factors and assumptions are based on information currently available to the Company, including information obtained from third party industry analysts and other third party sources. In some instances, material assumptions and material factors are presented elsewhere in this MD&A in connection with the forward-looking statements. You are cautioned that the following list of material factors and assumptions is not exhaustive. Specific material factors and assumptions include, but are not limited to:

- the performance of Cathedral's businesses, including current business and economic trends;
- oil and natural gas commodity prices and production levels;
- capital expenditure programs and other expenditures by Cathedral and its customers:
- the ability of Cathedral to retain and hire qualified personnel;
- the ability of Cathedral to obtain parts, consumables, equipment, technology, and supplies in a timely manner to carry out its activities;
- the ability of Cathedral to maintain good working relationships with key suppliers;
- the ability of Cathedral to market its services successfully to existing and new customers;
- the ability of Cathedral to obtain timely financing on acceptable terms;
- currency exchange and interest rates;
- risks associated with foreign operations;
- the ability of Cathedral to realize the benefits of its conversion from an income trust to a corporation;
- risks associated with winding up operations in Venezuela, including the ability to sell Cathedral’s interest in the Venezuela joint venture;
- changes under governmental regulatory regimes and tax, environmental and other laws in Canada, United States ("U.S.") and Venezuela; and
- a stable competitive environment.

Forward-looking statements are not a guarantee of future performance and involve a number of risks and uncertainties some of which are described herein. Such forward-looking statements necessarily involve known and unknown risks and uncertainties, which may cause the Company's actual performance and financial results in future periods to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements. These risks and uncertainties include, but are not limited to, the risks identified in this MD&A and in the Company's Annual Information Form under the heading "Risk Factors". Any forward-looking statements are made as of the date hereof and, except as required by law, the Company assumes no obligation to publicly update or revise such statements to reflect new information, subsequent or otherwise.

All forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement. Further information about the factors affecting forward-looking statements is available in the Company'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 MEASUREMENTS

This MD&A refers to certain non-GAAP measurements that do not have any standardized meaning within IFRS and therefore may not be comparable to similar measures provided by other companies. Management utilizes these non-GAAP measurements to evaluate Cathedral's performance.

The specific measures being referred to include the following:

i) "Adjusted gross margin" - calculated as gross margin plus non-cash items (depreciation and share-based compensation); is considered a primary indicator of operating performance (see tabular calculation);

ii) "Adjusted gross margin %" - calculated as adjusted gross margin divided by revenues; is considered a primary indicator of operating performance (see tabular calculation);

iii) "EBITDAS" - defined as earnings before share of income/loss from associate, finance costs, unrealized foreign exchange on intercompany balances, unrealized foreign exchange due to hyper-inflation accounting, taxes, non-recurring gains and losses on disposal of property and equipment (see non-GAAP measurement), depreciation and share-based compensation plus dividends from associate; is considered an indicator of the Company's ability to generate funds flow from operations prior to consideration of how activities are financed, how the results are taxed and measured and non-cash expenses (see tabular calculation);

iv) "Funds from operations" - calculated as cash provided by operating activities before changes in non-cash working capital and income taxes paid less current tax expense; is considered an indicator of the Company's ability to generate funds flow from operations on an after tax basis but excluding changes in non-cash working capital which is financed using the Company's operating loan (see tabular calculation);

v) “Growth property and equipment additions” or “Growth capital” – is capital spending which is intended to result in incremental revenues. Growth capital is considered to be a key measure as it represents the total expenditures on property and equipment expected to add incremental revenues and funds flow to the Company;

vi) “Maintenance property and equipment additions” or “Maintenance capital” – is capital spending incurred in order to refurbish or replace previously acquired other than “replacement property and equipment additions” (see non-GAAP measurement). Such additions do not provide incremental revenues. Maintenance capital is a key component in understanding the sustainability of the Company’s business as cash resources retained within Cathedral must be sufficient to meet maintenance capital needs to replenish the assets for future cash generation;

vii) “Replacement property and equipment additions” or “Replacement capital” – is capital spending incurred in order to replace equipment that is lost downhole. Cathedral recovers lost-in-hole costs including previously expensed depreciation on the related assets from customers. Such additions do not provide incremental revenues. The identification of replacement property and equipment additions is considered important as such additions are financed by way of proceeds on disposal of property and equipment (see discussion within the MD&A on “gain on disposal of property and equipment);

viii) “Infrastructure property and equipment additions” or “Infrastructure capital” – is capital spending incurred on land, buildings and leasehold improvements. Infrastructure capital is a component in understanding the sustainability of the Company’s business as cash resources retained within Cathedral must be sufficient to meet maintenance capital needs

ix) “Non-recurring gains and losses on disposal of property and equipment” – are disposals of property and equipment that do not occur on a regular or periodic basis. Unlike the lost-in-hole recoveries the proceeds from these gains are not used on equivalent replacement property. These are often on non-field equipment such as land and buildings;

x) “Net property and equipment additions” – is property and equipment additions expenditures less proceeds on the regular disposal of property and equipment (the proceeds on sale of land and buildings have been excluded). Cathedral uses net property and equipment additions to assess net cash flows related to the financing of Cathedral’s property and equipment additions;

xi) “Borrowing capacity” - is total available credit facility less drawings on credit facilities; and

xii) “Net debt” – is loans and borrowing less working capital. Management uses net debt as a metric to shows the Company's overall debt level.

The following tables provide reconciliations from GAAP measurements to non-GAAP measurements referred to in this MD&A:

Adjusted gross margin

	Three months ended March 31 2014	2013
Gross margin	$ 9,505	$ 8,617
Add non-cash items included in cost of sales:		
Depreciation	4,464	4,665
Share-based compensation	48	76
Adjusted gross margin	$ 14,017	$ 13,358
Adjusted gross margin %	20.6%	24.7%

EBITDAS

	Three months ended March 31 2014		2013
Earnings before income taxes	$	2,876	$ 2,787
Add:			
Depreciation included in cost of sales		4,464	4,665
Depreciation included in selling, general and administrative expenses		61	157
Share-based compensation included in cost of sales		48	76
Share-based compensation included in selling, general and administrative expenses		82	211
Unrealized foreign exchange loss on intercompany balances		454	212
Finance costs		596	480
Share of loss from associate		-	4
EBITDAS	$	8,581	$ 8,592

Funds from operations

	Three months ended March 31 2014		2013
Cash flow from operating activities	$	1,594	$ (4,741)
Add (deduct):			
Changes in non-cash operating working capital		6,313	12,641
Income taxes (recovered) paid		(60)	187
Current tax recovery (expense)		273	(580)
Funds from operations	$	8,120	$ 7,507

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

March 31, 2014 and December 31, 2013
Dollars in '000s
(unaudited)

	March 31 2014	December 31 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 738	$ 289
Trade receivables	58,723	46,400
Current taxes recoverable	1,746	1,473
Prepaid expenses	2,616	3,334
Inventories	14,811	13,913
Total current assets	78,634	65,409
Property and equipment (note 4)	127,961	123,487
Intangible assets	1,472	1,474
Deferred tax assets	8,410	9,157
Goodwill	5,848	5,848
Total non-current assets	143,691	139,966
Total assets	$ 222,325	$ 205,375
Liabilities and Shareholders' Equity		
Current liabilities:		
Operating loan	$ 15,506	$ 10,119
Trade and other payables	28,434	22,236
Dividends payable	2,985	2,984
Loans and borrowings (note 6)	744	722
Deferred revenue	3,447	3,317
Total current liabilities	51,116	39,378
Loans and borrowings (note 6)	43,608	38,462
Deferred tax liabilities	912	923
Total non-current liabilities	44,520	39,385
Total liabilities	95,636	78,763
Shareholders' equity:		
Share capital (note 7)	73,974	73,850
Contributed surplus	9,171	9,065
Accumulated other comprehensive income	1,622	1,239
Retained earnings	41,922	42,458
Total shareholders' equity	126,689	126,612
Total liabilities and shareholders' equity	$ 222,325	$ 205,375

See accompanying notes to condensed consolidated interim financial statements.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Three months ended March 31, 2014 and 2013
Dollars in '000s except per share amounts
(unaudited)

	Three months ended March 31 2014	2013
Revenues	$ 68,020	$ 54,074
Cost of sales:		
Direct costs	(54,003)	(40,716)
Depreciation	(4,464)	(4,665)
Share-based compensation	(48)	(76)
Total cost of sales	(58,515)	(45,457)
Gross margin	9,505	8,617
Selling, general and administrative expenses:		
Direct costs	(6,127)	(5,203)
Depreciation	(61)	(157)
Share-based compensation	(82)	(211)
Total selling, general and administrative expenses	(6,270)	(5,571)
	3,235	3,046
Gain on disposal of property and equipment	734	505
Earnings from operating activities	3,969	3,551
Foreign exchange loss	(497)	(280)
Finance costs	(596)	(480)
Share of loss of associate	-	(4)
Earnings before income taxes	2,876	2,787
Income tax recovery (expense):		
Current	273	(580)
Deferred	(700)	(148)
Total income tax expense	(427)	(728)
Net earnings	2,449	2,059
Other comprehensive income:		
Foreign currency translation differences for foreign operations	383	705
Total comprehensive income	$ 2,832	$ 2,764
Net earnings per share		
Basic	$ 0.07	$ 0.06
Diluted	$ 0.07	$ 0.06

See accompanying notes to condensed consolidated interim financial statements.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

Three months ended March 31, 2014 and 2013
Dollars in '000s
(unaudited)

	Share capital	Contributed surplus	Accumulated other comprehensive income (loss)	Retained earnings	Total shareholders' equity
Balance at December 31, 2012	**$ 74,408**	**$ 8,863**	**$ (2,679)**	**$ 57,340**	**$ 137,932**
Total comprehensive income for three months ended March 31, 2013	-	-	705	2,059	2,764
Transactions with shareholders, recorded directly in equity contributions by and distributions to shareholders for three months ended March 31, 2013:					
Dividends to equity holders	-	-	-	(2,724)	(2,724)
Repurchase of common shares	(1,354)	-	-	(1,350)	(2,704)
Share-based compensation	-	287	-	-	287
Share options exercised	30	(5)	-	-	25
Total contributions by and distributions to shareholders	(1,324)	282	-	(4,074)	(5,116)
Balance at March 31, 2013	**$ 73,084**	**$ 9,145**	**$ (1,974)**	**$ 55,325**	**$ 135,580**
Balance at December 31, 2013	**$ 73,850**	**$ 9,065**	**$ 1,239**	**$ 42,458**	**$ 126,612**
Total comprehensive income for three months ended March 31, 2014	-	-	383	2,449	2,832
Transactions with shareholders, recorded directly in equity contributions by and distributions to shareholders for three months ended March 31, 2014:					
Dividends to equity holders	-	-	-	(2,985)	(2,985)
Share-based compensation	-	130	-	-	130
Share options exercised	124	(24)	-	-	100
Total contributions by and distributions to shareholders	124	106	-	(2,985)	(2,755)
Balance at March 31, 2014	**$ 73,974**	**$ 9,171**	**$ 1,622**	**$ 41,922**	**$ 126,689**

See accompanying notes to condensed consolidated interim financial statements.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

Three months ended March 31, 2014 and 2013
Dollars in '000s
(unaudited)

	Three months ended March 31	
	2014	2013
Cash provided by (used in):		
Operating activities:		
Net earnings	$ 2,449	$ 2,059
Items not involving cash:		
Depreciation	4,525	4,822
Total income tax expense	427	728
Unrealized foreign exchange loss on intercompany balances	454	212
Finance costs	596	480
Share-based compensation	130	287
Gain on disposal of property and equipment	(734)	(505)
Share of loss from associate	-	4
Cash flow from continuing operations	7,847	8,087
Changes in non-cash operating working capital	(6,313)	(12,641)
Income taxes paid	60	(187)
Cash flow from (used for) operating activities	1,594	(4,741)
Investing activities:		
Property and equipment additions	(9,917)	(6,698)
Intangible asset additions	(51)	-
Proceeds on disposal of property and equipment	1,106	960
Investment in associate	-	(377)
Changes in non-cash investing working capital	887	(354)
Cash flow used for investing activities	(7,975)	(6,469)
Financing activities:		
Change in operating loan	5,425	15,796
Advances on loans and borrowings	5,000	-
Repayments on loans and borrowings	(167)	(133)
Interest paid	(578)	(579)
Proceeds on exercise of share options	100	25
Repurchase of common shares	-	(2,704)
Dividends paid	(2,984)	(2,768)
Cash flow from financing activities	6,796	9,637
Effect of exchange rate on changes in cash and cash equivalents	34	302
Change in cash and cash equivalents	449	(1,271)
Cash and cash equivalents, beginning of period	289	8,470
Cash and cash equivalents, end of period	$ 738	$ 7,199

See accompanying notes to condensed consolidated interim financial statements.

Dollars in '000s except per share amounts

1. Reporting entity

Cathedral Energy Services Ltd. ("the Company" / "Cathedral") is a company domiciled in Canada. The Company is a publicly-traded company listed on the Toronto Stock Exchange under symbol "CET". The condensed consolidated interim financial statements of the Company as at and for the period ended March 31, 2014 comprise the Company and its subsidiaries (together referred to as "Cathedral") and it's associate as listed below:

Subsidiaries:

	Country of incorporation	Functional Currency	Ownership interest
Cathedral Energy Services Inc. ("INC")	United States	U.S. dollars	100%
Directional Plus International Ltd. ("DPI")	Barbados	U.S. dollars	100%
Directional Plus de Venezuela, C.A. ("DPV")	Venezuela	Venezuelan bolivar	100%

There has been no change in ownership of any subsidiaries in the periods reported on in these financial statements.

Investment in associate:

	Country of incorporation	Functional Currency	Ownership interest
Vencana Servicios Petroleros, S.A. ("Vencana")	Venezuela	Venezuelan bolivar	40%

Vencana Servicios Petroleros, S.A. was incorporated on March 1, 2012.

The Company and INC are primarily involved and engaged in the business of providing selected oilfield services to oil and natural gas companies in western Canada and selected oil and natural gas basins in the United States (U.S."). Cathedral has discontinued operations in Venezuela (see Note 5).

2. Basis of preparation

(a) Statement of compliance

These unaudited condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting* ("IAS 34") ("IFRS" or "GAAP").

Accordingly, certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with IFRS, as issued by the International Accounting Standards Board ("IASB"), have been omitted or condensed. It also requires management to exercise judgment in applying the Company's accounting policies. These unaudited condensed consolidated interim financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2013, which are included in the Company's 2013 Annual Report.

The unaudited condensed consolidated interim financial statements were authorized for issue by the Board of Directors on May 7, 2014.

(b) Basis of measurement

The unaudited condensed consolidated interim financial statements have been prepared on the historical cost basis.

(c) Functional and presentation currency

These unaudited condensed consolidated interim financial statements are presented in Canadian dollars ("CAD"), which is the Company's functional currency. All financial information presented in dollars has been rounded to the nearest thousand except for share and per share amounts.

(d) Significant accounting policies

These unaudited condensed interim consolidated financial statements have been prepared in accordance with IFRS and using the same accounting policies as outlined in note 3 of the consolidated financial statements for the year ended December 31, 2013. The accounting policies have been applied consistently by the Company.

Future Accounting Pronouncements
The IASB issued IFRIC 21, "Levies" which has been adopted by the Company on January 1, 2014. The IFRIC clarifies that an entity should recognize a liability for a levy when the activity that triggers payment occurs. The adoption of this interpretation has no impact on the Company's consolidated financial statements

There were no other new or amended standards issued during the three months ended March 31, 2014 that are applicable to the Company in future periods. A description of standards and interpretations that will be adopted by the Company in future periods can be found in the notes to the consolidated financial statements for the year ended December 31, 2013.

3. Seasonality of operations

A significant portion of the Company'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 mid to late March and continues through to May. Operating activities generally increase in the fall and peak in the winter months from December until mid to late March. Additionally, volatility in the weather and temperatures not only during this period, but year round, can create additional unpredictability in operational results. Activity levels in the oil and natural gas basins in the U.S. are not subject to the seasonality to the same extent that it occurs in the western Canada region.

4. Property and equipment

During the period, the additions to property and equipment by class are as follows:

	Three months ended March 31	
	2014	2013
Directional drilling equipment	$ 7,891	$ 3,958
Production testing equipment	1,855	2,446
Land and buildings	31	84
Automotive equipment	307	429
Office and computer equipment	154	210
Property and equipment additions	$ 10,238	$ 7,127

Included in the above additions are non-cash additions of $321 for the three months ended March 31, 2014 (2013 - $429) related to acquisition of automotive equipment under finance lease liabilities.

5. Investment in associate

The Company has a 40% interest in a joint venture company, Vencana Servicios Petroleros, S.A. ("Vencana") in which the Company has significant influence. The remaining 60% of Vencana is owned by a wholly-owned subsidiary of Petróleos de Venezuela S.A. ("PDVSA"), the state-owned oil and natural gas corporation of the Bolivarian Republic of Venezuela.

During 2014 Q1, Cathedral decided to discontinue operations in Venezuela. Management determined the expected political, financial and operational risks do not warrant continuing to pursue business opportunities in Venezuela. Management has taken action to reduce Venezuela costs and on-going costs associated with the wind down of Venezuela operations are expected to be minimal.

The investment in associate was written down to $nil at December 31, 2013.

6. Loans and borrowings

	March 31 2014	December 31 2013
Current liabilities:		
Current portion of finance lease liabilities	$ 744	$ 722
Non-current liabilities:		
Finance lease liabilities	$ 1,608	$ 1,462
Secured revolving term loan	42,000	37,000
Total	$ 43,608	$ 38,462

Terms and debt repayment schedule

Terms and conditions of outstanding loans were as follows:

The secured revolving term loan with a major Canadian bank at an authorized amount of $55,000 (December 31, 2013 - $55,000), bearing interest at the bank's prime rate plus 0.50 % to 2.00% or bankers' acceptance rate plus 1.75% to 3.25%, without repayment terms, maturing June 30, 2014 subject to an annual extension upon agreement between the borrower and the bank for a further one-year period. Interest rates spreads for the credit facility will depend on the level of funded debt to EBITDA (earnings before interest on long-term debt, taxes, depreciation, amortization and non-cash compensation expense – as defined in the credit agreement). Prior to maturity the borrower may convert its revolving term loan to a non-revolving term loan repayable monthly over 36 months with interest only for the first 12 months.

The credit facility with a major Canadian bank is secured by a general security agreement over all present and future personal property and is subject to certain covenants regarding the payment of dividends and the maintenance of certain financial ratios.

7. Share capital

Authorized: An unlimited number of common shares and an unlimited number of preferred shares (issuable in series).

Common shares issued:

	Three months ended March 31, 2014		Year ended December 31, 2013	
	Number	Amount	Number	Amount
Issued, beginning of period	36,166,380	$ 73,850	36,906,293	$ 74,408
Issued on exercise of options	20,000	100	348,170	1,326
Contributed surplus on options exercised		24		310
Repurchased and cancelled	-	-	(1,088,083)	(2,194)
Issued, end of period	36,186,380	$ 73,974	36,166,380	$ 73,850

Issuance of common shares

20,000 common shares were issued as a result of the exercise of vested options arising from 2010 grants to employees and consultants. Options were exercised at a strike price of $5.00 per option. All issued shares are fully paid.

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

7. Share capital (continued)

Dividends

Cathedral declared a dividend of $2,985 in 2014 Q1 (2013 Q1 - $2,724) or $0.0825 per share (2013 Q1 - $0.075 per share.) After the reporting date the directors approved a dividend of $0.0825 per share with a record date of June 30, 2014 and payable July 15, 2014.

Basic earnings per share

The calculation of basic earnings per share for the three months ended March 31, 2014 was based on the profit (loss) attributable to common shareholders of $2,449 (2013 – $2,059) and a weighted average number of common shares outstanding of 36,185,935 (2013 – 36,765,195); calculated as follows:

Weighted average number of ordinary shares

	Three months ended March 31,	
	2014	2013
Issued, beginning of period	36,166,380	36,906,293
Effect of share options exercised	19,555	1,778
Effect of share repurchases		(142,876)
Weighted average number of common shares at end of period	36,185,935	36,765,195

Diluted earnings per share

The calculation of diluted earnings per share at March 31, 2014 was based on profit attributable to common shareholders of $2,449 (2013 - $2,059) and a weighted average number of common shares outstanding after adjustment for the effects of all dilutive potential common shares of 36,219,407 (2013 - 38,825,808), calculated as follows:

Weighted average number of common shares (diluted)

	Three months ended March 31,	
	2014	2013
Weighted average number of common shares (basic)	36,185,935	36,765,195
Effect of share options on issue	33,472	60,613
Weighted average number of common shares (diluted) at end of period	36,219,407	36,825,808

At March 31, 2014, 1,301,996 options (2013 – 2,902,920 options) were excluded from the diluted weighted average number of common shares calculation as their effect would have been anti-dilutive. The average market value of the Company's common shares for purposes of calculating the dilutive effect of share options was based on quoted market prices for the period during which the options were outstanding.

8. Commitments

In the normal course of business, the Company incurs contractual obligations and those obligations are disclosed in the Company's consolidated financial statements for the year ended December 31, 2013. As at March 31, 2014, the Company's commitment to purchase property and equipment is approximately $3,168. Cathedral anticipates expending these funds in 2014 Q2 and Q3.