2016 Q2 INTERIM REPORT

FINANCIAL HIGHLIGHTS

Dollars in 000's except per share amounts

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Revenues	$ 15,587	$ 29,679	$ 36,682	$ 79,756
Adjusted gross margin % (1)	13%	11%	19%	17%
Adjusted EBITDAS (1)	$ (1,638)	$ (1,237)	$ (162)	$ 4,549
Diluted per share	$ (0.05)	$ (0.03)	$ -	$ 0.13
As % of revenues	-11%	-4%	0%	6%
Funds from (used in) operations (1)	$ (1,798)	$ (853)	$ (1,631)	$ 3,112
Diluted per share	$ (0.05)	$ (0.02)	$ (0.04)	$ 0.09
Earnings (loss) before income taxes	$ (10,222)	$ (6,342)	$ (1,051)	$ (7,137)
Basic per share	$ (0.28)	$ (0.17)	$ (0.03)	$ (0.20)
Diluted per share	$ (0.28)	$ (0.17)	$ (0.03)	$ (0.20)
Gain on disposal of foreign subsidiary	$ -	$ -	$ 10,865	$ -
Provision for settlement	$ (3,796)	$ -	$ (3,796)	$ -
Write-down of deferred taxes related to CRA settlement	$ -	$ (10,768)	$ -	$ (10,768)
Net earnings (loss)	$ (6,916)	$ (15,266)	$ 2,767	$ (15,990)
Basic per share	$ (0.19)	$ (0.42)	$ 0.08	$ (0.44)
Diluted per share	$ (0.19)	$ (0.42)	$ 0.08	$ (0.44)
Dividends declared per share	$ -	$ 0.04	$ -	$ 0.08
Property and equipment additions - cash basis	$ 70	$ 1,845	$ 338	$ 6,148
Weighted average shares outstanding				
Basic (000s)	36,295	36,295	36,295	36,295
Diluted (000s)	36,295	36,295	36,295	36,295

	June 30 2016	December 31 2015
Working capital	$ 17,210	$ 13,550
Total assets	$ 137,002	$ 155,610
Loans and borrowings excluding current portion	$ 25,298	$ 30,477
Shareholders' equity	$ 97,724	$ 96,607

(1) Refer to "NON-GAAP MEASUREMENTS"

MANAGEMENT'S DISCUSSION & ANALYSIS

This Management's Discussion & Analysis ("MD&A") for the three and six months ended June 30, 2016 should be read in conjunction with the annual audited consolidated financial statements and notes thereto for the year ended December 31, 2015, as well as the MD&A in the 2015 Annual Report of Cathedral Energy Services Ltd. (the "Company" or "Cathedral"). This MD&A has been prepared as of August 9, 2016. Dollar amounts are in '000's except for day rates and per share amounts.

2016 Q2 KEY TAKEAWAYS

Negotiated a settlement of our collective action wage and hour lawsuits in the United States ("U.S.");

Adjusted gross margin improved to 13% in 2016 Q2 from 11% in 2015 Q2;

Loans and borrowings were reduced by $5,317 compared to December 31, 2015 including a reduction of the revolving term loan of $5,000 to $25,000;

Revenues and profitability were significantly affected by reduced industry activity and pricing pressures resulting from continued decline in commodity prices in early 2016;

Revenues of $15,587 in 2016 Q2 compared to $29,679 in 2015 Q2, a 47% decline and Adjusted EBITDAS loss of $(1,638) in 2016 Q2 compared to $(1,237) loss in 2015 Q2; and

Management continues to focus on initiatives to manage costs, improve margins, improve revenue through enhanced focus on our sales and marketing capabilities and manage Cathedral's financial obligations and liquidity.

OUTLOOK

2016 Q2 continued to be challenging for the oilfield services sector, particularly for those companies tied to drilling and well completion activity. The impact of commodity price declines in the first quarter further impacted activity levels in Q2 due to exploration and production companies continuing to cut their drilling and completions budgets.

The U.S. rig count declined 42% from January 1, 2016 to a low of 404 active rigs in May – down from an average rig count of 807 for the second half of 2015. Canada suffered similar activity declines which were further exacerbated by energy companies curtailing activities due to an early and extended spring breakup. In Canada there was an average of 48 rigs operating in 2016 Q2 compared to 98 rigs in the comparable quarter in 2015. The bright light in the first half of 2016 is that our market share continued to increase in the U.S. as measured by the number of rigs we provided services on and in July our U.S. directional drilling job count continued to increase.

Optimism for the sector started to improve in June as WTI prices moved into the $45/bbl U.S. dollars ("USD") to $50/bbl USD range. Supporting our previous assertion that WTI pricing needs to be in the $50/bbl USD range for activity levels to improve we saw a significant pickup in our sales prospects in June and July through requests for proposals and customer indications for work in the second half of the year. However, it is not clear how the recent WTI price retreat into the $40/bbl USD range will impact this, however, we suspect the prior customer enthusiasm may wane in the short term as a consequence.

A key accomplishment in the quarter was negotiating a settlement of our collective action wage and hour lawsuits in the U.S. (see "Provision for settlement" under "Results of Operations"). We employed an innovative approach to dealing with this challenge and the outcome is something we believe is manageable within our current financial constraints. It was also important to deal with this liability as it was creating significant uncertainty in the market and consuming a large amount of management's time and energy.

Although the industry, analysts and other commentators continue to believe prospects will improve and signs of this are being demonstrated, our banking syndicate has taken a more conservative view. As such, the syndicate is requiring we further reduce our credit facility to $30 million by December 31, 2016 and to $25 million by March 31, 2017. As at the date hereof, our total drawn facility was $27.3 million and we had cash balances of $2.2 million. The bank has indicated they want to see Cathedral's debt levels come within more typical industry averages based on cash flow the business has been able to generate in this current environment. In this context, management and the board are investigating alternatives to achieve the banks objectives and maximize shareholder value. These alternatives may include alternative forms of financing and looking at potential corporate partnerships and transactions.

We still view Cathedral's business prospects very favorably. We continue to focus on ways to better manage our business in this environment and are actively implementing initiatives to make our business stronger.

DIVIDENDS

In 2015 Q4, the Board of Directors made the decision to suspend the payment of Cathedral's quarterly dividend until industry conditions improve. This decision was based on the reductions in commodity prices and uncertainties around expected drilling and completion activity in 2016. Additionally, this allows the Company to preserve cash, to manage liquidity, invest selectively in capital asset additions and pursue operational initiatives to better position the Company for economic turn-around. The Board of Directors will review dividend distributions on a quarterly basis giving consideration to current performance, historical and future trends in the business, the expected sustainability of those trends as well as required long-term debt repayments, maintenance capital expenditures required to sustain performance. It is the long-term intent of the Company to pay quarterly dividends to shareholders.

2016 CAPITAL PROGRAM

During the six months ended June 30, 2016 Company invested $338 (2015 - $6,148) in property and equipment. The following table details the current period's net property and equipment additions:

		Six months ended June 30, 2016
Property and equipment additions:		
Growth capital [1]	$	122
Maintenance capital [1]		28
Replacement capital [1]		188
Infrastructure capital [1]		-
Total cash additions		338
Less: proceeds on disposal of property and equipment		(2,030)
Net property and equipment additions [1]	$	(1,692)

(1) See "NON-GAAP MEASUREMENTS"

Cathedral's 2016 capital budget remains at $1,000 with $200 for growth capital and $800 for replacement or maintenance capital. The growth additions are primarily for MWD system enhancements and maintenance capital is primarily to replace items which have been lost-in-hole or are required to maintain existing capacity levels. Proceeds from disposal of property and equipment are primarily related to equipment lost-in-hole. The capital budget will be reviewed quarterly.

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

	June 30 2016	December 31 2015	June 30 2015
Directional Drilling - MWD systems	140	140	140
Flow back and Production Testing ("F&PT") units	66	66	66

RESULTS OF OPERATIONS – THREE MONTHS ENDED JUNE 30

	Three months ended June 30, 2016			Three months ended June 30, 2015		
Revenues	Directional drilling	Flow back and production testing	Total	Directional drilling	Flow back and production testing	Total
Canada	$ 3,286	$ 913	$ 4,199	$ 6,629	$ 2,936	$ 9,565
United States	11,339	49	11,388	15,290	4,824	20,114
Total	$ 14,625	$ 962	$ 15,587	$ 21,919	$ 7,760	$ 29,679

Revenues 2016 Q2 revenues were $15,587 which represented a decrease of 14,093 or 48% from 2015 Q2 revenues of $29,679. All divisions experienced revenue decreases compared to 2015 Q2 due to reduced activity levels resulting from customer reactions to decreases in commodity prices and day rate decreases primarily related to competitive pressure and pricing concessions requested by customers due to market conditions.

Canadian Directional Drilling revenues (excluding motor rental revenues) decreased to $1,799 in 2016 Q2 from $5,413 in 2015 Q2; a 67% decrease. This decrease was the result of: i) a 51% decrease in activity days to 271 in 2016 Q2 from 552 in 2015 Q2; and ii) a 32% decrease in the average day rate to $6,638 in 2016 Q2 from $9,806 in 2015 Q2.

The decrease in activity days was mainly due to overall reductions in activity levels in Canada as well as certain Cathedral customers reducing their drilling programs and others who stopped drilling during the period. The average active land rig count for Canada was down 53% in 2016 Q2 compared to 2015 Q2 and was down 68% from 2016 Q1. The decrease in day rates was in part due to type of work performed, but mainly due to decreases in day rates charged to customers which were a result of competitive pressure and pricing concessions provided to customers to secure work.

Partially offsetting these declines was an increase of $271 on the rental of motors, particularly Cathedral's CLAW™ motor. Motor rental revenues for 2016 Q2 were $1,487 (2015 Q2 - $1,216).

U.S. Directional Drilling revenues (excluding motor rental revenues) decreased to $10,431 in 2016 Q2 from $15,075 in 2015 Q2; a 31% decrease. This decrease was the result of: i) a 27% decrease in activity days to 984 in 2016 Q2 from 1,349 in 2015 Q2; and ii) a 5% decrease in the average day rate to $10,601 in 2016 Q2 from $11,175 in 2015 Q2 (when converted to Canadian dollars). All U.S. districts experienced a decrease in activity levels. The average active land rig count for U.S. was down 53% in 2016 Q2 compared to 2015 Q2 and was down 25% from 2016 Q1. Rates in USD fell to $8,228 USD in 2016 Q2 from $9,095 USD in 2015 Q2, a 10% decline. U.S. day rate decreases were partially tempered by the U.S. division providing footage drilling services to certain clients which can result in higher relative day rates. U.S. motor rental revenues for 2016 Q2 were $908 compared to $215 in 2015 Q2.

Canadian F&PT revenues decreased to $913 in 2016 Q2 from $2,936 in 2015 Q2; a 69% decrease. The decrease was due to the reduction in activity levels due to the industry downturn as well as a 27% decline in pricing. Wells completed in Canada fell approximately 43% in 2016 Q2 compared to 2015 Q2.

U.S. F&PT revenues decreased to $49 in 2016 Q2 from $4,824 in 2015 Q2, a 99% decrease. In Q1 2016, the company made the decision to scale down the operations of its U.S. F&PT division to reflect current industry activity levels and mitigate losses. Business development activities have continued in order to enable the business to secure work where it makes economic sense. As industry activity levels improve, management's intention is to further ramp up operations commensurately.

Gross margin and adjusted gross margin Gross margin for 2016 Q2 was negative (14%) compared to negative (6%) in 2015 Q2. Adjusted gross margin (see Non-GAAP Measurements) for 2016 Q2 was $1,980 or 13% compared to $3,355 or 11% for 2015 Q2.

The Company has implemented a number of cost reductions throughout 2015 and 2016 including reducing wages for field, support and office staff, implementing work force reductions and reducing other direct cost items. Even with lower revenue day rates in many divisions the adjusted gross margin improved due to reduced field labour costs, however, these reductions were offset by higher repairs on percentage of revenue basis.

Additionally, there was a reduction in the fixed component of cost of sales of 36% compared with 2015 Q2 amount. However, on a percentage of revenue basis, these costs were greater in 2016 Q2 increasing 5% over 2015 Q2.

Depreciation allocated to cost of sales decreased to $4,195 in 2016 Q2 from $5,134 in 2015 Q2. Depreciation included in cost of sales as a percentage of revenue was 27% for 2016 Q2 and 17% in 2015 Q2.

Selling, general and administrative expenses ("SG&A") SG&A expenses were $3,947 in 2016 Q2; a decrease of $777 compared with $4,724 in 2015 Q2. As a percentage of revenue, SG&A was 25% in 2016 Q2 and 16% in 2015 Q2.

Excluding the non-cash items of depreciation and share-based compensation, SG&A was $3,881 in 2016 Q2 compared to $4,639 in 2015 Q2, a decrease of $758 or 16%. SG&A decreased primarily due to work force reductions, wage rollbacks and reductions in variable compensation. SG&A wage rollbacks were implemented February 1, 2015 at a range of 5% to 15% and a further 5% to 9% on January 1, 2016. There have been additional reductions to staffing levels in 2015 and 2016. Staffing costs included in SG&A include executive, sales, accounting, human resources, payroll, safety, technology support and related support staff. As well there were year-over-year reductions in virtually every other SG&A item due to efforts to reduce expenditures.

Gain on disposal of equipment During 2016 Q2, the Company had a gain on disposal of equipment of $194 compared to $135 in 2015 Q2. These gains mainly relate to equipment lost-in-hole. Proceeds from clients on lost-in-hole equipment are based on amounts specified in service agreements and in most cases these proceeds exceed the net book value of the equipment and result in a gain. 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 a foreign exchange loss of $(55) in 2016 Q2 compared to a gain of $543 in 2015 Q2 due to the fluctuations in the Canadian dollar relative to the U.S. dollar. 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 2016 Q2 foreign currency gains are unrealized losses of $27 (2015 Q2 – gain of $647) related to intercompany balances.

Finance costs Finance costs consist of interest expenses on operating loans, loans and borrowings and bank charges of $411 for 2016 Q2 versus $446 for 2015 Q2. The decrease in finance costs relate to a decreased utilization of the Company's credit facility.

Provision for settlement Subsequent to June 30, 2016, the Company entered into a Settlement Agreement and Release (the "Settlement Agreement") in respect of two wage and hour lawsuits (the "Collective Actions") that were filed against Company's wholly-owned subsidiary, Cathedral Energy Services Inc. ("INC"). The first collective action lawsuit, Wallace vs. Cathedral Energy Services Inc. ("Wallace"), was filed on November 6, 2014, in the United States District Court for the Southern District of Texas, Houston Division (the "Houston Court") alleging that INC employed or contracted Measurement While Drilling ("MWD") and Directional Drilling ("DD") operators were entitled to recover unpaid overtime wages under the Fair Labor Standards Act ("FLSA"). The second collective action lawsuit, Price vs. Cathedral Energy Services Inc., was filed on April 9, 2015, in the United States District Court District of Colorado, Denver Division (and subsequently transferred to Houston Court) alleging that the Company incorrectly calculated the overtime pay for certain hourly paid operators in violation of the FLSA. Legal actions involving similar alleged FLSA violations have been filed in the United States against a number of other oilfield service companies. Cathedral has denied the allegations, and vigorously defended the litigation leading up to entering into the Settlement Agreement.

The Settlement Agreement provides a mechanism for finally resolving and releasing the claims for all INC employed and contracted MWD and DD operators. Under the terms of the Settlement Agreement, the parties will establish a settlement fund of up to $3,400 USD. The final determination of the settlement fund amount will be based on the number of claimants that participate in the settlement and Cathedral estimates the final settlement amount will be in the $2,900 USD range. The settlement fund payments will be paid quarterly by the Corporation over a three-year period with the final payment due on or before September 2019. The quarterly payments may be accelerated in the event Cathedral meets certain financial targets over the payment period and can be deferred if a scheduled payment would put Cathedral in violation of its credit facility covenants subject to not more than three payments being deferred.

All claims in both Collective actions have been settled and the Houston Court, approved the settlement of the Wallace claim on August 8, 2016. Any settlement fund payments made by Cathedral are subject to the approval of Cathedral's banking syndicate.

Income tax For 2016 Q2, the Company had an income tax recovery of $3,306 compared to expense of $(8,924) in 2015 Q2. Excluding the non-cash gain on disposal of foreign subsidiary and adjustment to prior years' tax provisions, the effective tax rate was 31% for 2016 Q2 and 29% for 2015 Q2. Income tax expense is booked based upon expected annualized effective rates.

Included in the 2015 Q2 amount is a charge to earnings of $10,768 related to a write-off of a portion of the tax attributes obtained as part of the December 18, 2009 conversion from an income trust to a corporation ("Conversion"). Cathedral elected to enter into the agreement with Canada Revenue Agency ("CRA") as a highly satisfactory solution to avoid potential costly and time consuming legal proceedings and allow management to focus its efforts on business operations and enhancing shareholder value. The CRA agreement did not give rise to any cash outlay by Cathedral for prior taxation years. Cathedral continues to have access to a portion of the tax attributes obtained as part of the Conversion to offset federal and provincial taxes in subsequent taxation years.

RESULTS OF OPERATIONS – SIX MONTHS ENDED JUNE 30

	Six months ended June 30, 2016			Six months ended June 30, 2015		
Revenues	Directional drilling	Flow back and production testing	Total	Directional drilling	Flow back and production testing	Total
Canada	$ 8,949	$ 2,777	$ 11,726	$ 21,673	$ 7,934	$ 29,607
United States	24,421	535	24,956	37,043	13,106	50,149
Total	$ 33,370	$ 3,312	$ 36,682	$ 58,716	$ 21,040	$ 79,756

Revenues 2016 revenues were $36,682 which represented a decrease of $43,074 or 54% from 2015 revenues of $79,756. All divisions experienced revenue decreases compared to 2015 due to reduced activity levels resulting from customer reactions to decreases in commodity prices and day rate decreases primarily related to competitive pressure and pricing concessions requested by customers due to market conditions.

Canadian Directional Drilling revenues (excluding motor rental revenues) decreased to $5,153 in 2016 from $20,205 in 2015; a 74% decrease. This decrease was the result of: i) a 63% decrease in activity days to 772 in 2016 from 2,059 in 2015; and ii) a 32% decrease in the average day rate to $6,675 in 2016 from $9,813 in 2015.

The decrease in activity days was mainly due to overall reductions in activity levels in Canada as well as certain of Cathedral's customers reducing their drilling programs and some who stopped drilling during the period. The average active land rig count for Canada was down 50% in 2016 compared to 2015. The decrease in day rates was in part due to type of work performed, but mainly due to decreases in day rates charged to customers which were a result of competitive pressure and pricing concessions provided to customers to secure work.

Partially offsetting these declines was an increase of $2,328 on the rental of motors, particularly Cathedral's CLAW™ motor. Motor rental revenues for 2016 were $3,796 (2015 - $1,468).

U.S. Directional Drilling revenues (excluding motor rental revenues) decreased to $22,408 in 2016 from $36,545 in 2015; a 39% decrease. This decrease was the result of: i) a 38% decrease in activity days to 1,963 in 2016 from 3,180 in 2015; and ii) a 1% decrease in the average day rate to $11,415 in 2016 from $11,492 in 2015 (when converted to Canadian dollars). All U.S. districts experienced a decrease in activity levels. The average active land rig count for U.S. was down 56% in 2016 compared to 2015. Rates in USD fell to $8,566 USD in 2016 from $9,320 USD in 2015, an 8% decline. U.S. day rate decreases were partially tempered by the U.S. division providing footage drilling services to certain clients which can result in higher relative day rates. U.S. motor rental revenues for 2016 were $2,013 compared to $498 in 2015.

Canadian F&PT revenues decreased to $2,777 in 2016 from $7,934 in 2015; a 65% decrease. The decrease was due to the reduction in activity levels due to the industry downturn as well as a 30% decline in pricing. Wells completed in Canada fell approximately 58% in 2016 compared to 2015.

U.S. F&PT revenues decreased to $535 in 2016 Q2 from $13,106 in 2015 Q2, a 96% decrease. In Q1 2016, the company made the decision to scale down the operations of its U.S. F&PT division to reflect current industry activity levels and mitigate losses. Business development activities have continued in order to enable the business to secure work where it makes economic sense. As industry activity levels improve, management's intention is to further ramp up operations commensurately.

Gross margin and adjusted gross margin Gross margin for 2016 was negative (4%) compared to 4% in 2015. Adjusted gross margin (see Non-GAAP Measurements) for 2016 was $6,885 or 19% compared to $13,475 or 17% for 2015.

The Company has implemented a number of cost reductions throughout 2015 and 2016 including reducing wages for field, support and office staff, implementing work force reductions and reducing other direct cost items. Even with lower revenue day rates in many divisions the adjusted gross margin improved due to reduced field labour costs, however, these reductions were offset by higher repairs on percentage of revenue basis.

Additionally, there was a reduction in the fixed component of cost of sales of 32% compared with 2015 amount. However, on a percentage of revenue basis, these costs were greater in 2016 increasing 8% over 2015.

Depreciation allocated to cost of sales decreased to $8,428 in 2016 from $10,225 in 2015. Depreciation included in cost of sales as a percentage of revenue was 23% for 2016 and 13% in 2015.

Selling, general and administrative expenses ("SG&A") SG&A expenses were $8,885 in 2016; a decrease of $1,432 compared with $10,317 in 2015. As a percentage of revenue, SG&A was 24% in 2016 and 13% in 2015.

Excluding the non-cash items of depreciation and share-based compensation, SG&A was $8,735 in 2016 compared to $10,161 in 2015, a decrease of $1,426 or 14%. SG&A decreased primarily due to work force reductions, wage rollbacks and reductions in variable compensation. SG&A wage rollbacks were implemented February 1, 2015 at a range of 5% to 15% and a further 5% to 9% on January 1, 2016. There have been additional reductions to staffing levels in 2015 and 2016. Staffing costs included in SG&A include executive, sales, accounting, human resources, payroll, safety, technology support and related support staff. As well there were year-over-year reductions in virtually every other SG&A item due to efforts to reduce expenditures.

Gain on disposal of equipment During 2016, the Company had a gain on disposal of equipment of $1,086 compared to $1,304 in 2015. These gains mainly relate to equipment lost-in-hole. Proceeds from clients on lost-in-hole equipment are based on amounts specified in service agreements and in most cases these proceeds exceed the net book value of the equipment and result in a gain. The timing of lost-in-hole recoveries is not in the control of the Company and therefore can fluctuate significantly from quarter-to-quarter. In 2015 Q1, the Company completed the sale and leaseback of its Oklahoma City operating facility. This resulted in a gain on sale of land and buildings of $456.

Foreign exchange loss The Company had a foreign exchange gain of $2,299 in 2016 compared to a loss of $(883) in 2015 due to the fluctuations in the Canadian dollar relative to the U.S. dollar. 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 2016 foreign currency gains are unrealized gains of $2,340 (2015 – loss of $629) related to intercompany balances.

Finance costs Finance costs consist of interest expenses on operating loans, loans and borrowings and bank charges of $798 for 2016 versus $913 for 2015. The decrease in finance costs relate to a decreased utilization of the Company's credit facility.

Provision for settlement Subsequent to June 30, 2016, the Company entered into a Settlement Agreement and Release (the "Settlement Agreement") in respect of two wage and hour lawsuits (the "Collective Actions") that were filed against Company's wholly-owned subsidiary, Cathedral Energy Services Inc. ("INC"). The first collective action lawsuit, Wallace vs. Cathedral Energy Services Inc. ("Wallace"), was filed on November 6, 2014, in the United States District Court for the Southern District of Texas, Houston Division (the "Houston Court") alleging that INC employed or contracted Measurement While Drilling ("MWD") and Directional Drilling ("DD") operators were entitled to recover unpaid overtime wages under the Fair Labor Standards Act ("FLSA"). The second collective action lawsuit, Price vs. Cathedral Energy Services Inc., was filed on April 9, 2015, in the United States District Court District of Colorado, Denver Division (and subsequently transferred to Houston Court) alleging that the Company incorrectly calculated the overtime pay for certain hourly paid operators in violation of the FLSA. Legal actions involving similar alleged FLSA violations have been filed in the United States against a number of other oilfield service companies. Cathedral has denied the allegations, and vigorously defended the litigation leading up to entering into the Settlement Agreement.

The Settlement Agreement provides a mechanism for finally resolving and releasing the claims for all INC employed and contracted MWD and DD operators. Under the terms of the Settlement Agreement, the parties will establish a settlement fund of up to $3,400 USD. The final determination of the settlement fund amount will be based on the number of claimants that participate in the settlement and Cathedral estimates the final settlement amount will be in the $2,900 USD range. The settlement fund payments will be paid quarterly by the Corporation over a three-year period with the final payment due on or before September 2019. The quarterly payments may be accelerated in the event Cathedral meets certain financial targets over the payment period and can be deferred if a scheduled payment would put Cathedral in violation of its credit facility covenants subject to not more than three payments being deferred.

All claims in both Collective actions have been settled and the Houston Court, approved the settlement of the Wallace claim on August 8, 2016. Any settlement fund payments made by Cathedral are subject to the approval of Cathedral's banking syndicate.

Gain on disposal of foreign subsidiary During 2016 Q1, the Company completed the sale of its wholly-owned Barbados subsidiary, Directional Plus International Inc. ("DPI"), for net proceeds of $nil which resulted in a non-cash gain on sale of $10,865. DPI held the Company's investment in Venezuela and this sale completes Cathedral's exit from carrying on a business in Venezuela.

Income tax For 2016, the Company had an income tax recovery of $3,818 compared to expense of $(8,853) in 2015. Excluding the non-cash gain on disposal of foreign subsidiary and adjustments to prior years' tax provisions, the effective tax rate was 37% for 2016 and 25% for 2015. Income tax expense is booked based upon expected annualized effective rates.

Included in the 2015 Q2 amount is a charge to earnings of $10,768 related to a write-off of a portion of the tax attributes obtained as part of the December 18, 2009 conversion from an income trust to a corporation ("Conversion"). Cathedral elected to enter into the agreement with Canada Revenue Agency ("CRA") as a highly satisfactory solution to avoid potential costly and time consuming legal proceedings and allow management to focus its efforts on business operations and enhancing shareholder value. The CRA agreement did not give rise to any cash outlay by Cathedral for prior taxation years. Cathedral continues to have access to a portion of the tax attributes obtained as part of the Conversion to offset federal and provincial taxes in subsequent taxation years.

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 six months ended June 30, 2016, the Company had funds from continuing operations (see Non-GAAP Measurements) of $(1,950) (2015 - $3,112). The decrease in funds from continuing operations is due to lower activity levels and reductions in day rates. In 2016 the Company reduced its bank loans by $5,317 which included a reduction in the revolving term loan of $5,000. Cash balances as at June 30, 2016 were $2,244.

Working capital At June 30, 2016 the Company had working capital of $17,210 (December 31, 2015 - $13,550) and a working capital ratio of 2.5 to 1 (December 31, 2015 – 1.5 to 1). The increase in working capital level was primarily due to the sale of DPI which had the effect of reducing certain payables recorded.

Credit facility The Company has a 3 year committed revolving credit facility (the "Facility") that expires in August 2017. The Facility is secured by a general security agreement over all present and future personal property.

The Facility was amended on June 12, 2015 (the "First Amendment"); in January 2016, the Company negotiated further amendments to the Facility ("Second Amendment") and further amendments occurred in June 2016 ("Third Amendment").

The Second and Third Amendments have less restrictive financial covenants than the prior Facility terms. The Third Amendment provides for credit availability of $35,000, representing a $25,000 decrease from the First Amendment. The First Amendment increased the accordion feature to $35,000 and this was unchanged in the Second and Third Amendments. The Second and Third Amendments mature in August, 2017, consistent with the duration of the original Facility. The Amendments have certain restrictions, including, but not limited to; paying dividends, utilization of the accordion feature, enhanced lender financial reporting and a cap on any litigation settlement payments without lender approval.

Effective 2015 Q4 the Company includes lost-in-hole equipment proceeds in the definition of EBITDA per credit agreement.

During the waiver period associated with the Third Amendment there is a minimum cumulative EBITDA per credit agreement for the two quarters ending June 30, 2016 of $100. The applicable cumulative EBITDA per credit agreement for the lending agreement in 2016 Q1 and Q2 was $230 compared with the required minimum EBITDA of $100. As such, the Company currently is in compliance with each of the financial covenants under the Third Amendment.

On August 9, 2016, the Company completed negotiations on the Fourth Amending Agreement. The Fourth Amendment provides for credit availability of $33,000, further reducing to $30,000 by December 31, 2016 and $25,000 by March 31, 2017. The Fourth Amendment matures in August, 2017, consistent with the duration of the original Facility.

The financial covenants associated with the Amendments are as follows:

Quarter ending:	Maximum Funded Debt to EBITDA per credit agreement Ratio	Minimum Debt Service Ratio
June 30, 2016	Waived	Waived
September 30, 2016	Waived	Waived
December 31, 2016	Waived	Waived
March 31, 2017	Waived	Waived
June 30, 2017	Waived	Waived
September 30, 2017 and thereafter	3.00	1.75

Under the Fourth Amendment the working capital covenant in the Facility was also waived.

The Fourth Amendment has the following required minimum cumulative EBITDA per the credit agreement:

Three months ended September 30, 2016	$1,100
Six months ended December 31, 2016	$2,500
Nine months ended March 31, 2017	$4,900
Twelve months ended June 30, 2017	$5,000

Under the Fourth Amendment the lending syndicate has required the Company provide its plan by September 15, 2016 to get Cathedral's Facility within more typical industry covenant levels based on cash flow the business is able to generate in this current environment. This plan will be considered in the context of extending the maturity of the Company's current Facility beyond August 2017 or entering into a new credit Facility agreement with a term extending beyond August 2017. There is no guarantee the lending syndicate will either extend the existing Facility beyond August 2017 or enter into a new Facility with a later maturity date. As such the entire Facility may be come due and payable within 12 months of August 2016. The Company will continue to work with the existing lenders or seek other alternatives in respect of the maturity of its existing Facility.

After the amendments discussed above, the Facility bears interest at the bank's prime rate plus 0.50% to 5.00% or bankers' acceptance rate plus 1.75% to 6.25% with interest payable monthly. Interest rate spreads for the Facility depend on the level of funded debt to the 12 month trailing EBITDA. The Facility provides a means to lock in a portion of the debt at interest rates through bankers' acceptance ("BA") based on the interest rate spread on the date the BA was entered into. The Company has historically maximized the use of this option thereby lowering its interest costs, however, the ability to achieve these lower rates will be impacted in the future based on current rates which increase based on the Company's funded debt to EBITDA per credit agreement.

Based on current available information, Cathedral expects to comply with all covenants for the next twelve months.

The Company's financial ratios in the 2016 Q2 waiver period were:

Ratio	June 30, 2016 value
Debt service ratio	2.49:1
Funded debt to EBITDA per credit agreement	6.44:1
Working capital ratio	2:49:1
Cumulative minimum EBITDA	$230

In light of the current volatility in oil and gas prices and uncertainty regarding the timing for recovery in such prices, management's ability to forecast activity levels is challenging. As a consequence the Company could breach the covenants included in the Fourth Amendment in 2016 and 2017. An actual breach would constitute an event of default under the Facility, which provides the lenders several alternatives including a waiver of the breach, an amendment to the Facility to reset the covenant or, in the unlikely event, a requirement to repay the borrowings.

In the event the Company believes it could be in breach of its loan covenants it will first enter into discussions on amendments to the financial covenants in the Facility to avoid such a breach.

The following table outlines the current credit Facility:

		June 30 2016		December 31 2015
Total credit facility	$	35,000	$	60,000
Drawings on credit facility:				
Operating loan		785		2,484
Revolving term loan		25,000		30,000
Letters of credit		1,503		1,554
Total drawn facility	$	27,288	$	34,038
Undrawn portion of credit facility	$	7,712	$	25,962
Net debt (see NON-GAAP MEASUREMENTS):				
Loans and borrowings, net of current portion	$	25,298	$	30,477
Working capital:				
Current assets	$	28,783	$	41,575
Current liabilities		(11,573)		(28,025)
Working capital	$	17,210	$	13,550
Net debt	$	8,088	$	16,927

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, 2015. As at June 30, 2016, the Company had a commitment to purchase approximately $nil of equipment.

Contingency On October 29, 2014 Cathedral received a letter from one of its U.S. clients ("the Complainant") alleging a down-hole drilling incident which impacted two of their wells in December 2013. The Complainant had indicated potential damages of $3,000 USD and in 2015 Q3 increased this indication to $3,700 USD. Cathedral does not carry insurance for this type of incident. In January 2016, the Complainant filed a formal complaint in Pennsylvania court initiating a formal legal process related to their claim. On June 17, 2016, the Complainant initiated the "Discovery/Interrogatory" process (which is a normal part of the litigation process) where they are requesting Cathedral provide certain information and documents related to the case. Cathedral is currently preparing responses to these interrogatories and has filed a list of interrogatories for the Complainant. On July 12, 2016, Cathedral, with its legal counsel, filed a formal response to the complaint. Due to the uncertainty around what amount, if any, and the means of settlement, the Company has made no provision in the financial statements for this incident.

Share capital At August 9, 2016, the Company has 36,295,380 common shares and 1,589,499 options outstanding with a weighted average exercise price of $2.28.

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 June 30, 2016 that have materially affected, or are reasonably likely to materially affect, Cathedral's ICFR.

RISK FACTORS

The MD&A for the year ended December 31, 2015, which is included in the Company's 2015 Annual Report, includes an overview on risk factors associated with the Company and its operating entities. Those risk factors remain in effect as at June 30, 2016.

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

There were no other new or amended standards issued during the six months ended June 30, 2016 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, 2015.

SUMMARY OF QUARTERLY RESULTS

Three month periods ended	Jun 2016	Mar 2016	Dec 2015	Sep 2015	Jun 2015	Mar 2015	Dec 2014	Sep 2014
Revenues	$ 15,587	$ 21,095	$ 24,949	$ 31,374	$ 29,679	$ 50,077	$ 73,242	$ 77,376
Adjusted EBITDAS [(1)]	$ (1,638)	$ 1,476	$ (169)	$ 3,013	$ (1,237)	$ 5,786	$ 9,408	$ 14,347
Adjusted EBITDAS [(1)] per share - diluted	$ (0.05)	$ 0.04	$ (0.00)	$ 0.08	$ (0.03)	$ 0.16	$ 0.26	$ 0.40
Net earnings (loss)	$ (6,916)	$ 9,683	$ (16,348)	$ (3,004)	$ (15,266)	$ (724)	$ 1,776	$ 5,805
Net earnings (loss) per share - basic and diluted	$ (0.19)	$ 0.27	$ (0.45)	$ (0.08)	$ (0.42)	$ (0.02)	$ 0.05	$ 0.16
Dividends declared per share	$ -	$ -	$ -	$ 0.04	$ 0.04	$ 0.04	$ 0.0825	$ 0.0825

(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: WTI pricing needs to be in the $50 USD range for activity levels to improve; it is not clear how the recent WTI price retreat into the $40 USD bbl range will impact sales prospects; customer enthusiasm may wane in the short term as a consequence of recent WTI price retreat; we still view our business prospects very favorably; projected capital expenditures and commitments and the financing thereof; anticipate that we will not reinstate dividend payments until industry conditions and operating cash flow improves; the Company could breach the covenants included in the Amended Credit Facility; Cathedral expects to comply with all covenants during 2016; and long-term intent of the Company to pay quarterly dividends to shareholders.

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 and reliance on major customers;
- risks associated with technology development and intellectual property rights;
- the ability of Cathedral to maintain safety performance;
- the ability of Cathedral to obtain timely financing on acceptable terms;
- the ability to obtain sufficient insurance coverage to mitigate operational risks;
- currency exchange and interest rates;
- risks associated with foreign operations;
- risks associated with acquisitions and business development efforts;
- environmental risks;
- the number of claimants that participate in the FLSA settlement;
- changes under governmental regulatory regimes and tax, environmental and other laws in Canada and U.S.; and
- competitive risks.

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

Cathedral uses certain performance measures throughout this document that are not defined under GAAP. Management believes that these measures provide supplemental financial information that is useful in the evaluation of Cathedral's operations and are commonly used by other oil and gas service companies. Investors should be cautioned, however, that these measures should not be construed as alternatives to measures determined in accordance with GAAP as an indicator of Cathedral's performance. Cathedral's method of calculating these measures may differ from that of other organizations, and accordingly, may not be comparable.

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) "Adjusted EBITDAS" - defined as earnings before finance costs, unrealized foreign exchange on intercompany balances, taxes, non-recurring gains and losses on disposal of property and equipment (see non-GAAP measurement), depreciation, non-recurring expenses (including severance), write-down of inventory, gain on disposal of foreign subsidiary, provision for settlement and share-based compensation; 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) "EBITDA per credit agreement" – defined in the Company's credit agreement as Adjusted EBITDAS less gains on disposal of equipment not previously excluded, less any unusual or non-recurring cash expenses approved by the Lenders (excluding non-recurring compensation previously deducted from Adjusted EBITDAS" and plus lost-in-hole equipment proceeds. EBITDA per credit agreement is used in calculation of banking covenants;

v) "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);

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

vii) “Maintenance equipment additions” or “Maintenance capital” – is capital spending incurred in order to refurbish or replace previously acquired other than “replacement equipment additions” described below. 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;

viii) “Replacement 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 equipment additions is considered important as such additions are financed by way of proceeds on disposal of equipment (see discussion within the MD&A on “gain on disposal of equipment);

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

xi) “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 June 30		Six months ended June 30	
	2016	2015	2016	2015
Gross margin	$ (2,207)	$ (1,798)	$ (1,545)	$ 3,216
Add non-cash items included in cost of sales:				
Depreciation	4,195	5,134	8,428	10,225
Share-based compensation	(8)	19	2	34
Adjusted gross margin	$ 1,980	$ 3,355	$ 6,885	$ 13,475
Adjusted gross margin %	13%	11%	19%	17%

Adjusted EBITDAS

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Earnings (loss) before income taxes	$ (10,222)	$ (6,342)	$ (1,051)	$ (7,137)
Add:				
Depreciation included in cost of sales	4,195	5,134	8,428	10,225
Depreciation included in selling, general and administrative expenses	34	44	68	88
Share-based compensation included in cost of sales	(8)	19	2	34
Share-based compensation included in selling, general and administrative expenses	32	41	82	68
Finance costs	411	446	798	913
EBITDAS	(5,558)	(658)	8,327	4,191
Unrealized foreign exchange (gain) loss on intercompany balances	24	(647)	(2,340)	629
Non-recurring expenses	100	16	643	185
Non-recurring gain on disposal of land and building	-	52	-	(456)
Write-down of inventory	-	-	277	-
Provision for settlement	3,796	-	3,796	-
Gain on disposal of foreign subsidiary	-	-	(10,865)	-
Adjusted EBITDAS	$ (1,638)	$ (1,237)	$ (162)	$ 4,549

Funds from operations

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Cash flow from operating activities	$ 2,942	$ 497	$ 7,098	$ 22,429
Add (deduct):				
Changes in non-cash operating working capital	(4,615)	(2,143)	(8,850)	(20,954)
Income taxes paid	(259)	258	(139)	1,585
Current tax recovery (expense)	134	535	260	52
Funds from operations	$ (1,798)	$ (853)	$ (1,631)	$ 3,112

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

June 30, 2016 and December 31, 2015
Dollars in '000s
(unaudited)

	June 30 2016	December 31 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 2,244	$ 1,426
Trade receivables	13,191	23,107
Current taxes recoverable	2,891	2,962
Prepaid expenses	1,474	1,988
Inventories	8,983	12,092
Total current assets	28,783	41,575
Equipment (note 4)	100,001	108,918
Intangible assets	2,008	2,006
Deferred tax assets	6,210	3,111
Total non-current assets	108,219	114,035
Total assets	$ 137,002	$ 155,610
Liabilities and Shareholders' Equity		
Current liabilities:		
Operating loan	$ 785	$ 2,484
Trade and other payables	8,978	20,198
Loans and borrowings (note 5)	388	686
Provision for settlement, current (note 6)	1,422	-
Deferred revenue	-	4,657
Total current liabilities	11,573	28,025
Loans and borrowings (note 5)	25,298	30,477
Provision for settlement, long-term (note 6)	2,407	-
Deferred tax liabilities	-	501
Total non-current liabilities	27,705	30,978
Total liabilities	39,278	59,003
Shareholders' equity:		
Share capital (note 7)	74,481	74,481
Contributed surplus	9,554	9,470
Accumulated other comprehensive income	9,843	11,577
Retained earnings	3,846	1,079
Total shareholders' equity	97,724	96,607
Total liabilities and shareholders' equity	$ 137,002	$ 155,610

See accompanying notes to condensed consolidated interim financial statements.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

Three and six months ended June 30, 2016 and 2015
Dollars in '000s except per share amounts
(unaudited)

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Revenues	$ 15,587	$ 29,679	$ 36,682	$ 79,756
Cost of sales:				
Direct costs	(13,607)	(26,324)	(29,797)	(66,281)
Depreciation	(4,195)	(5,134)	(8,428)	(10,225)
Share-based compensation	8	(19)	(2)	(34)
Total cost of sales	(17,794)	(31,477)	(38,227)	(76,540)
Gross margin	(2,207)	(1,798)	(1,545)	3,216
Selling, general and administrative expenses:				
Direct costs	(3,881)	(4,639)	(8,735)	(10,161)
Depreciation	(34)	(44)	(68)	(88)
Share-based compensation	(32)	(41)	(82)	(68)
Total selling, general and administrative expenses	(3,947)	(4,724)	(8,885)	(10,317)
	(6,154)	(6,522)	(10,430)	(7,101)
Gain on disposal of equipment	194	135	1,086	1,304
Gain (loss) on disposal of land and buildings	-	(52)	-	456
Loss from operating activities	(5,960)	(6,439)	(9,344)	(5,341)
Finance costs	(411)	(446)	(798)	(913)
Foreign exchange gain (loss)	(55)	543	2,299	(883)
Write-dow n of inventory	-	-	(277)	-
Provision for settlement (note 6)	(3,796)	-	(3,796)	-
Gain on disposal of foreign subisidiary (note 8)	-	-	10,865	-
Earnings (loss) before income taxes	(10,222)	(6,342)	(1,051)	(7,137)
Income tax recovery (expense):				
Current	134	535	260	52
Deferred curent year	3,261	1,210	3,647	1,764
Deferred adjustment to prior years (note 9)	(89)	(10,669)	(89)	(10,669)
Total income tax recovery (expense)	3,306	(8,924)	3,818	(8,853)
Net earnings (loss)	(6,916)	(15,266)	2,767	(15,990)
Other comprehensive income (loss):				
Foreign currency translation gain on disposal of foreign subsidiary	-	-	1,348	-
Foreign currency translation differences for foreign operations	123	(742)	(3,082)	3,064
Total comprehensive income (loss)	$ (6,793)	$ (16,008)	$ 1,033	$ (12,926)
Net earnings (loss) per share				
Basic	$ (0.19)	$ (0.42)	$ 0.08	$ (0.44)
Diluted	$ (0.19)	$ (0.42)	$ 0.08	$ (0.44)

See accompanying notes to condensed consolidated interim financial statements.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

Six months ended June 30, 2016 and 2015
Dollars in '000s
(unaudited)

	Share capital	Contributed surplus	Accumulated other comprehensive income	Retained earnings	Total shareholders' equity
Balance at December 31, 2014	**$ 74,481**	**$ 9,261**	**$ 3,850**	**$ 40,776**	**$ 128,368**
Total comprehensive income (loss) for six months ended June 30, 2015	-	-	3,064	(15,990)	(12,926)
Transactions with shareholders, recorded directly in equity contributions by and distributions to shareholders for six months ended June 30, 2015:					
Dividends to equity holders	-	-	-	(2,904)	(2,904)
Share-based compensation	-	102	-	-	102
Total contributions by and distributions to shareholders	-	102	-	(2,904)	(2,802)
Balance at June 30, 2015	**$ 74,481**	**$ 9,363**	**$ 6,914**	**$ 21,882**	**$ 112,640**
Balance at December 31, 2015	**$ 74,481**	**$ 9,470**	**$ 11,577**	**$ 1,079**	**$ 96,607**
Total comprehensive income (loss) for six months ended June 30, 2016	-	-	(3,082)	2,767	(315)
Accumulated other comprehensive income recognized in income on sale of subsidiary	-	-	1,348	-	1,348
Transactions with shareholders, recorded directly in equity contributions by and distributions to shareholders for six months ended June 30, 2016:					
Share-based compensation	-	84	-	-	84
Total contributions by and distributions to shareholders	-	84	-	-	84
Balance at June 30, 2016	**$ 74,481**	**$ 9,554**	**$ 9,843**	**$ 3,846**	**$ 97,724**

See accompanying notes to condensed consolidated interim financial statements.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

Three and six months ended June 30, 2016 and 2015
Dollars in ‘000s
(unaudited)

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Cash provided by (used in):				
Operating activities:				
Net earnings (loss)	$ (6,916)	$ (15,266)	$ 2,767	$ (15,990)
Items not involving cash:				
Depreciation	4,229	5,178	8,496	10,313
Total income tax (recovery) expense	(3,306)	8,924	(3,818)	8,853
Unrealized foreign exchange loss on intercompany balances	24	(647)	(2,340)	629
Finance costs	411	446	798	913
Share-based compensation	24	60	84	102
Gain on disposal of equipment	(194)	(135)	(1,086)	(1,304)
Gain on disposal of land and building	-	52	-	(456)
Write-dow n of inventory	-	-	277	-
Provision for settlement (note 6)	3,796	-	3,796	-
Gain on disposal of foreign subsidiary (note 7)	-	-	(10,865)	-
Cash flow from operations	(1,932)	(1,388)	(1,891)	3,060
Changes in non-cash operating w orking capital	4,615	2,143	8,850	20,954
Income taxes recovered (paid)	259	(258)	139	(1,585)
Cash flow from operating activities	2,942	497	7,098	22,429
Investing activities:				
Equipment additions	(70)	(1,845)	(338)	(6,148)
Intangible asset additions	(50)	(39)	(95)	(189)
Proceeds on disposal of equipment	506	479	1,711	2,151
Proceeds on disposal of land and buildings	-	-	-	6,174
Changes in non-cash investing w orking capital	(635)	(498)	11	(93)
Cash flow from (used for) investing activities	(249)	(1,903)	1,289	1,895
Financing activities:				
Change in operating loan	380	881	(1,708)	(155)
Repayments on loans and borrow ings	(2,714)	(3,160)	(5,317)	(23,340)
Interest paid	(320)	(774)	(454)	(1,129)
Dividends paid	-	(1,452)	-	(4,446)
Cash flow from (used for) financing activities	(2,654)	(4,505)	(7,479)	(29,070)
Effect of exchange rate on changes in cash and cash equivalents	5	(99)	(90)	348
Change in cash and cash equivalents	44	(6,010)	818	(4,398)
Cash and cash equivalents, beginning of period	2,200	6,721	1,426	5,109
Cash and cash equivalents, end of period	$ 2,244	$ 711	$ 2,244	$ 711

See accompanying notes to condensed consolidated interim financial statements.

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Three and six months ended June 30, 2016 and 2015
Dollars in '000s except per share amounts
(unaudited)

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 June 30, 2016 comprise the Company and its 100% owned subsidiary, Cathedral Energy Services Inc. ("INC"), (together referred to as "Cathedral"). INC is incorporated in the United States of America ("U.S.") and its functional currency is U.S. dollars ("USD").

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 the U.S.

During 2016 Q1, the Company disposed of its 100% interest in Directional Plus International Inc. ("DPI"). See note 7 for further details.

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, 2015, which are included in the Company's 2015 Annual Report.

The unaudited condensed consolidated interim financial statements were authorized for issue by the Board of Directors on August 9, 2016.

(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, 2015. The accounting policies have been applied consistently by the Company.

Future Accounting Pronouncements
There were no other new or amended standards issued during the period ended June 30, 2016 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, 2015.

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 decrease 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. Equipment

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

	Six months ended June 30	
	2016	2015
Directional Drilling equipment	$ 338	$ 3,780
Flow back and Production Testing equipment	-	1,345
Land and buildings	-	613
Automotive equipment	-	181
Office and computer equipment	-	229
Equipment additions	$ 338	$ 6,148

5. Loans and borrowings

		June 30 2016		December 31 2015
Current liabilities:				
Current portion of finance lease liabilities	$	388	$	686
Non-current liabilities:				
Finance lease liabilities	$	298	$	477
Secured revolving term loan		25,000		30,000
Total	$	25,298	$	30,477

Terms and debt repayment schedule

The Company has a 3 year committed revolving credit facility (the "Facility") that expires in August 2017. The Facility is secured by a general security agreement over all present and future personal property.

The Facility was amended on June 12, 2015 (the "First Amendment"); in January 2016, the Company negotiated further amendments to the Facility ("Second Amendment") and further amendments occurred in June 2016 ("Third Amendment").

The Second and Third Amendments have less restrictive financial covenants than the prior Facility terms. The Third Amendment provides for credit availability of $35,000, representing a $25,000 decrease from the First Amendment. The First Amendment increased the accordion feature to $35,000 and this was unchanged in the Second and Third Amendments. The Second and Third Amendments mature in August, 2017, consistent with the duration of the original Facility. The Amendments have certain restrictions, including, but not limited to; paying dividends, utilization of the accordion feature, enhanced lender financial reporting and a cap on any litigation settlement payments without lender approval.

Effective 2015 Q4 the Company includes lost-in-hole equipment proceeds in the definition of EBITDA per credit agreement.

During the waiver period associated with the Third Amendment there is a minimum cumulative EBITDA per credit agreement for the two quarters ending June 30, 2016 of $100. The applicable cumulative EBITDA per credit agreement for the lending agreement in 2016 Q1 and Q2 was $230 compared with the required minimum EBITDA of $100. As such, the Company currently is in compliance with each of the financial covenants under the Third Amendment.

On August 9, 2016, the Company completed negotiations on the Fourth Amending Agreement. The Fourth Amendment provides for credit availability of $33,000, further reducing to $30,000 by December 31, 2016 and $25,000 by March 31, 2017. The Fourth Amendment matures in August, 2017, consistent with the duration of the original Facility.

The financial covenants associated with the Amendments are as follows:

Quarter ending:	Maximum Funded Debt to EBITDA per credit agreement Ratio	Minimum Debt Service Ratio
June 30, 2016	Waived	Waived
September 30, 2016	Waived	Waived
December 31, 2016	Waived	Waived
March 31, 2017	Waived	Waived
June 30, 2017	Waived	Waived
September 30, 2017 and thereafter	3.00	1.75

Under the Fourth Amendment the working capital covenant in the Facility was also waived.

The Fourth Amendment has the following required minimum cumulative EBITDA per the credit agreement:

Three months ended September 30, 2016	$1,100
Six months ended December 31, 2016	$2,500
Nine months ended March 31, 2017	$4,900
Twelve months ended June 30, 2017	$5,000

Under the Fourth Amendment the lending syndicate has required the Company provide a plan by September 15, 2016 to get Cathedral's Facility within more typical industry covenant levels based on cash flow the business is able to generate in this current environment. This plan will be considered in the context of extending the maturity of the Company's current Facility beyond August 2017 or entering into a new credit Facility agreement with a term extending beyond August 2017. There is no guarantee the lending syndicate will either extend the existing Facility beyond August 2017 or enter into a new Facility with a later maturity date. As such the entire Facility may be come due and payable within 12 months of August 2016. The Company will continue to work with the existing lenders or seek other alternatives in respect of the maturity of its existing Facility.

After the amendments discussed above, the Facility bears interest at the bank's prime rate plus 0.50% to 5.00% or bankers' acceptance rate plus 1.75% to 6.25% with interest payable monthly. Interest rate spreads for the Facility depend on the level of funded debt to the 12 month trailing EBITDA. The Facility provides a means to lock in a portion of the debt at interest rates through bankers' acceptance ("BA") based on the interest rate spread on the date the BA was entered into. The Company has historically maximized the use of this option thereby lowering its interest costs, however, the ability to achieve these lower rates will be impacted in the future based on current rates which increase based on the Company's funded debt to EBITDA per credit agreement.

Based on current available information, Cathedral expects to comply with all covenants for the next twelve months.

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

The Company's financial ratios in the 2016 Q2 waiver period were:

Ratio	June 30, 2016 value
Debt service ratio	2.49:1
Funded debt to EBITDA per credit agreement	6.44:1
Working capital ratio	2:49:1
Cumulative minimum EBITDA	$230

In light of the current volatility in oil and gas prices and uncertainty regarding the timing for recovery in such prices, management's ability to forecast activity levels is challenging. As a consequence the Company could breach the covenants included in the Fourth Amendment in 2016 and 2017. An actual breach would constitute an event of default under the Facility, which provides the lenders several alternatives including a waiver of the breach, an amendment to the Facility to reset the covenant or, in the unlikely event, a requirement to repay the borrowings.

In the event the Company believes it could be in breach of its loan covenants it will first enter into discussions on amendments to the financial covenants in the Facility to avoid such a breach.

The Company's loans and borrowings to total capitalization and EBITDA per credit agreement (as defined in the credit agreement) ratios at the end of the reporting period were as follows:

		June 30 2016		December 31 2015
Loans and borrow ings, current portion	$	388	$	686
Loans and borrow ings, long-term portion		25,298		30,477
Loans and borrow ings, including current portion	$	25,686	$	31,163
Shareholders' equity	$	97,724	$	96,607
Less Accumulated other comprehensive income ("AOCI")		(9,843)		(11,577)
Shareholders' equity excluding AOCI		87,881		85,030
Loans and borrow ings, including current portion		25,686		31,163
Total capitalization	$	113,567	$	116,193
Loans and borrow ings, including current portion to total capitalization		0.23		0.27
Loans and borrow ings, including current portion	$	25,686	$	31,163
Operating loans		785		2,484
Less cash balances		(2,401)		(2,085)
Letter of credit		1,503		1,554
Funded debt per lending agreement	$	25,573	$	33,116

		Three months ended June 30 2016		Year ended December 31 2015
Earnings (loss) before income taxes	$	(10,222)	$	(32,087)
Add (deduct):				
Depreciation included in cost of sales		4,195		20,566
Depreciation included in selling, general and administrative expenses		34		179
Share-based compensation included in cost of sales		(8)		59
Share-based compensation included in selling, general and administrative expenses		32		150
Finance costs		411		1,664
Unrealized foreign exchange gain on intercompany balances		24		4,191
Gain on sale of land and buildings		-		(456)
Non-recurring expenses		100		766
Write-dow n of goodw ill		-		5,848
Write-dow n of equipment		-		3,189
Write-dow n of inventory		-		3,736
Provision for settlement		3,796		
Gain on disposal of foreign subsidiary		-		-
Adjusted EBITDAS as per MD&A		(1,638)		7,805
Gain on disposal of equipment		(194)		(3,363)
Proceeds from disposal of equipment		283		3,803
EBITDA per credit agreement for the period		(1,549)		8,245
EBITDA per credit agreement from prior 3 trailing quarters		5,521		N/A
Trailing tw elve months EBITDA per credit agreement	$	3,972	$	8,245
Funded debt to EBITDA		6.44		4.02

6. Provision for settlement

Subsequent to June 30, 2016, the Company entered into a Settlement Agreement and Release (the "Settlement Agreement") in respect of two wage and hour lawsuits (the "Collective Actions") that were filed against Company's wholly-owned subsidiary, Cathedral Energy Services Inc. ("INC"). The first collective action lawsuit, Wallace vs. Cathedral Energy Services Inc. ("Wallace"), was filed on November 6, 2014, in the United States District

Court for the Southern District of Texas, Houston Division (the "Houston Court") alleging that INC employed or contracted Measurement While Drilling ("MWD") and Directional Drilling ("DD") operators were entitled to recover unpaid overtime wages under the Fair Labor Standards Act ("FLSA"). The second collective action lawsuit, Price vs. Cathedral Energy Services Inc., was filed on April 9, 2015, in the United States District Court District of Colorado, Denver Division (and subsequently transferred to Houston Court) alleging that the Company incorrectly calculated the overtime pay for certain hourly paid operators in violation of the FLSA. Legal actions involving similar alleged FLSA violations have been filed in the United States against a number of other oilfield service companies. Cathedral has denied the allegations, and vigorously defended the litigation leading up to entering into the Settlement Agreement.

The Settlement Agreement provides a mechanism for finally resolving and releasing the claims for all INC employed and contracted MWD and DD operators. Under the terms of the Settlement Agreement, the parties will establish a settlement fund of up to $3,400 USD. The final determination of the settlement fund amount will be based on the number of claimants that participate in the settlement and Cathedral estimates the final settlement amount will be in the $2,900 USD range. The settlement fund payments will be paid quarterly by the Corporation over a three-year period with the final payment due on or before September 2019. The quarterly payments may be accelerated in the event Cathedral meets certain financial targets over the payment period and can be deferred if a scheduled payment would put Cathedral in violation of its credit facility covenants subject to not more than three payments being deferred.

All claims in both Collective actions have been settled and the Houston Court, approved the settlement of the Wallace claim on August 8, 2016. Any settlement fund payments made by Cathedral are subject to the approval of Cathedral's banking syndicate.

7. Share capital

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

Common shares issued:

	Six months ended June 30, 2016		Year ended December 31, 2015	
	Number	Amount	Number	Amount
Issued, beginning and end of period	36,295,380	$ 74,481	36,295,380	$ 74,481

Issuance of common shares

There were no shares issued in the period.

Basic earnings per share

The calculation of basic earnings per share for the three and six months ended June 30, 2016 was based on the profit (loss) attributable to common shareholders of $(6,916) and $2,767 (2015 – $(15,266) and $(15,990)) and a weighted average number of common shares outstanding of 36,295,380 and 36,295,380 (2015 – 36,295,380 and 36,295,380); calculated as follows:

Weighted average number of ordinary shares

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Issued, beginning of period	36,295,380	36,295,380	36,295,380	36,295,380
Effect of share options exercised	-	-	-	-
Weighted average number of common shares at end of period	36,295,380	36,295,380	36,295,380	36,295,380

Diluted earnings per share

As the Company was in a loss position for the three months ended June 30, 2016 and 2015 and for the six months ended June 30, 2015 there was no calculation of diluted earnings per share.

The calculation of diluted earnings per share for the six months ended June 30, 2016 was based on profit attributable to common shareholders of $2,767 and a weighted average number of common shares outstanding after adjustment for the effects of all dilutive potential common shares of 36,295,380 calculated as follows (all other periods were in loss position so no diluted calculation):

Weighted average number of common shares (diluted)

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Weighted average number of common shares (basic)	36,295,380	36,295,380	36,295,380	36,295,380
Effect of share options on issue	-	-	-	-
Weighted average number of common shares (diluted) at end of period	36,295,380	36,295,380	36,295,380	36,295,380

At June 30, 2016, 1,594,499 options (2015 – 1,195,863 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.

During the six months ended June 30, 2016, the Company granted no share options.

8. Gain on disposal of foreign subsidiary

During 2016 Q1, the Company completed the sale of its DPI foreign subsidiary for net proceeds of $nil plus assumption of obligations of DPI which resulted in a non-cash gain on sale of $10,865. DPI held the Company's investment in Venezuela and this sale completes Cathedral's exit from carrying on a business in Venezuela.

9. Deferred tax provision

Included in the 2015 Q2 deferred tax expense is a charge to earnings of $10,768 related to a write-off of a portion of the tax attributes obtained as part of the December 18, 2009 conversion from an income trust to a corporation ("Conversion"). Cathedral elected to enter into the agreement with Canada Revenue Agency ("CRA") as a highly satisfactory solution to avoid potential costly and time consuming legal proceedings and allow management to focus its efforts on business operations and enhancing shareholder value. The CRA agreement did not give rise to any cash outlay by Cathedral for prior taxation years. Cathedral continues to have access to a portion of the tax attributes obtained as part of the Conversion to offset federal and provincial taxes in subsequent taxation years

10. 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, 2015. As at June 30, 2016, the Company's commitment to purchase equipment is approximately $nil.

The Company has issued three standby letters of credit, two of which relate to property leases and renew annually to landlords. The first letter of credit is $700 for the first ten years of the lease and then reduces to $500 for the last five years of the lease. The second letter of credit is for $542 USD and increases annually based upon annual changes in rent. The final letter of credit is for $75 USD issued in relation to U.S. workers' compensation coverage.

11. Contingency

On October 29, 2014 Cathedral received a letter from one of its U.S. clients ("the Complainant") alleging a down-hole drilling incident which impacted two of their wells in December 2013. The Complainant had indicated potential damages of $3,000 USD and in 2015 Q3 increased this indication to $3,700 USD. Cathedral does not carry insurance for this type of incident. In January 2016, the Complainant filed a formal complaint in Pennsylvania court initiating a formal legal process related to their claim. On June 17, 2016, the Complainant initiated the "Discovery/Interrogatory" process (which is a normal part of the litigation process) where they are requesting Cathedral provide certain information and documents related to the case. Cathedral is currently preparing responses to these interrogatories and has filed a list of interrogatories for the Complainant. On July 12, 2016, Cathedral, with its legal counsel, filed a formal response to the complaint. Due to the uncertainty around what amount, if any, and the means of settlement, the Company has made no provision in the financial statements for this incident.