CATHEDRAL ENERGY SERVICES LTD.

2009 Annual Report

FIVE YEAR FINANCIAL HISTORY

In '000's of dollars except per share amounts	2009	2008	2007	2006	2005
Revenues	**94,520**	178,928	145,106	138,254	86,002
Gross margin % (1)	**45%**	45%	49%	53%	51%
EBITDAS (1)	**16,652**	50,468	46,731	52,793	31,580
Per share – diluted	**0.48**	1.55	1.47	1.68	1.10
Income before taxes	**2,001**	34,594	31,990	39,679	24,817
Net income	**5,281**	30,139	24,863	35,348	21,807
Basic per share	**0.15**	0.94	0.79	1.16	0.76
Diluted per share	**0.15**	0.93	0.78	1.12	0.76
Cash distributions declared per share	**0.31**	0.84	0.84	0.805	0.385
Property and equipment additions and corporate acquisitions:					
Paid or payable	**8,923**	47,618	19,857	26,436	31,244
Paid or payable in equity	**-**	-	-	1,820	13,712
	8,923	47,618	19,857	28,256	44,956
Weighted outstanding shares					
Basic ('000)	**34,841**	32,215	31,402	30,578	28,711
Diluted ('000)	**34,857**	32,463	31,781	31,423	28,712
Working capital	**22,451**	17,435	16,947	15,051	10,571
Total assets	**173,537**	183,872	131,032	125,221	102,908
Long-term debt excluding current portion	**39,526**	40,233	17,441	15,552	12,797
Shareholders' equity	**97,422**	91,859	79,250	76,223	59,615

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

Table of contents

Annual Meeting:

Shareholders are invited to attend the Annual Meeting which will be held at 3:00 pm on May 13, 2010 in the Royal Meeting Room of the Metropolitan Centre, 333 – 4th Avenue S.W., Calgary, Alberta.

REPORT TO SHAREHOLDERS

When I last reported to Shareholders in March 2009, the oil and gas industry was tightening at an alarming rate. The world economic crisis had taken its toll on the demand for both oil and natural gas, which combined with high storage levels, reduced oil and natural gas commodity prices. This reduction in prices had significantly reduced our customer's cash flow and, consequently, drilling activity across North America declined drastically. Although we believed the long-term fundamentals for the supply and demand for energy to be positive for the oilfield service sector, it was certainly a challenging year. Through this time frame Cathedral moved forward proactively in adjusting our operating cost structure to reflect the reduced activity levels; these adjustments included personnel reductions, wage rollbacks and supplier price reductions. In addition, to maintain a healthy balance sheet in May 2009 we raised $15 million through an equity issuance and reduced both capital expenditures and distributions to Unitholders.

However, Cathedral recognized that despite the downturn in the market, research and development was going to be the cornerstone of its future; the development of new, innovative products was going to expand Cathedral's markets and differentiate us from our competitors. The focus of our efforts has been on the continued improvement in Electro Magnetic ("EM") transmission technology. During 2009, we added human resources to our research and development group and we expect to do the same in 2010. The introduction of our third generation ("G3") Electro-Magnetic Measurement-While-Drilling ("EM-MWD") in late 2008, has allowed Cathedral to operate in environments where previously the downhole formations limited the success of EM data transmission. The G3 tool is now almost exclusively utilized in all of Cathedral's operations. In 2010 Cathedral will commence the manufacture of its next generation EM-MWD tool that includes improved packaging of components within the EM-MWD tool, which will improve the durability in high shock and vibration environments. As well in 2010 Q1, the Cathedral will add "resistivity" to its Logging-While-Drilling ("LWD") capabilities. This technology will primarily be used in expanding Cathedral's international marketing efforts. Cathedral has numerous other development projects in process that are expected to allow us to continue to be a significant player in the directional drilling market.

Over the past 2 years, Cathedral has been involved with field testing of a third party rotary steerable system. The benefit of a rotary steerable system is that it controls the angle and direction of a well bore utilizing continuous rotation which provides for straighter, longer and smoother well profiles. Over the past six months Cathedral has been working on developing an interface that will allow Cathedral's MWD system to operate with the third party rotary steerable system.

Since 2009 Q3, Cathedral has experienced quarter-over-quarter increases in operating activities across all of its service areas in both Canada and the U.S. In the Canadian market, during the past two to three years, there has been a shift towards the redevelopment of older, mature basins and targeting zones both which were previously not viable until the introduction of new completion technologies that employ the use of horizontal, multi-stage fracturing technology. The use of horizontal, multi-stage fracturing technology is beneficial to both the directional drilling and production testing divisions of Cathedral. Based upon customer feedback, we are expecting to see the activity levels remain at the high levels experienced in 2010 Q1 continue through the rest of the year.

In the U.S., we continue to expand our capability in the growing northeast U.S. region (Marcellus) where an operations facility has been opened in Pennsylvania. This facility is expected to be fully operational with motor and MWD re-building capabilities by the end of March 2010. Cathedral currently has a 10 job capacity in the U.S. northeast region. In addition, Cathedral is seeing a significant improvement in drilling activity in the U.S. Rocky Mountain region, which was hit hard by the reduction in drilling activity in early 2009. Cathedral continues to focus on growth of the U.S. production testing market where we have moved a 5th unit into the Rocky Mountain region. As well, Cathedral is currently reviewing opportunities to expand the production testing division into other U.S. markets.

Cathedral continues to advance the operations of its joint venture with a subsidiary of the state owned oil and natural gas producer, Petróleos de Venezuela S.A. ("PDVSA"). The joint venture expects to be providing directional drilling services in Venezuela in 2010.

As we look forward, we are excited about the future prospects for growth.

Sincerely,

Signed: *"Mark L. Bentsen"*
Mark L. Bentsen
President and Chief Executive Officer
Cathedral Energy Services Ltd.
March 3, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") for the year ended December 31, 2009 provides an analysis of the consolidated results of operations, financial position and cash flows of Cathedral Energy Services Ltd. (the "Company" or "Cathedral") and should be read in conjunction with the accompanying audited consolidated financial statements and notes thereto for the year ended December 31, 2009, as well as the Company's 2009 interim MD&A's. This MD&A is intended to assist the reader in the understanding and assessment of significant changes and trends, as well as the risks and uncertainties, related to the results of the operations and financial position of the Company. Dollars are in '000's except for day rates and per share amounts. This MD&A is dated March 3, 2010.

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: access to capital; projected capital expenditures and commitments and the financing thereof; financial results; activity levels; technology advances; 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 the Company's businesses, including current business and economic trends;
- oil and natural gas commodity prices and production levels;
- capital expenditure programs and other expenditures by the Company and its customers;
- the ability of the Company to retain and hire qualified personnel;
- the ability of the Company to obtain parts, consumables, equipment, technology, and supplies in a timely manner to carry out its activities;
- the ability of the Company to maintain good working relationships with key suppliers;
- the ability of the Company to market its services successfully to existing and new customers;
- the ability of the Company to obtain timely financing on acceptable terms;
- currency exchange and interest rates;
- risks associated with foreign operations;
- the ability of the Company to realize the benefit of its conversion from an income trust to a corporation;
- changes under governmental regulatory regimes and tax, environmental and other laws; 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 financial measurements that do not have any standardized meaning within Canadian Generally Accepted Accounting Principles ("GAAP") and therefore may not be comparable to similar measures provided by other companies.

The specific measures being referred to include the following:

i) "Gross margin" - calculated as revenues less operating expenses is considered a primary indicator of operating performance (see tabular calculation under Results of Operations);

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

iii) "EBITDAS" - defined as earnings before interest on long-term debt, taxes, depreciation, amortization, non-cash compensation expense and unrealized foreign exchange gain/loss; this measure 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. The definition of EBITDAS was changed in 2009 Q2 to adjust for unrealized foreign exchange gain/loss. Comparative amounts presented have been restated to the new calculation. (see tabular calculation under EBITDAS);

iv) "Maintenance capital expenditures" – refers to capital expenditures required to maintain existing levels of service but excludes replacement cost of lost-in-hole equipment to the extent the replacement equipment is financed from the proceeds on disposal of the equipment lost-in-hole; and

v) "Funds from operations" - calculated as cash flow from operating activities before changes in non-cash working capital is considered an indicator of the Company's ability to generate funds flow from operations but excluding changes in non-cash working capital which is financed using the Company's bank indebtedness/line of credit facility.

OVERVIEW

Cathedral Energy Services Ltd. (the "Company" or "Cathedral") is incorporated under the Business Corporations Act (Alberta) (the "Act"). The Company was created as a result of the conversion of Cathedral Energy Services Income Trust (the "Trust") to a corporation pursuant to a Plan of Arrangement under the Act, entered into by various entities including the Trust, Cathedral Energy Services Ltd. ("CES") and SemBioSys Genetics Inc. ("SBS") (the "Reorganization").

Upon closing of the Reorganization on December 18, 2009, the Company became the operator of the business of the Trust and its subsidiaries and the existing management and board of directors of CES, plus one director of SBS, became the management and board of directors of the Company. The Reorganization resulted in the Unitholders of the Trust becoming shareholders of the Company with no changes to the underlying business operations. The Company did not acquire any additional business carried on by SBS. The former business of SBS is being carried on by a new entity named SemBioSys Genetics Inc. ("New SBS") which is owned by the former shareholders of SBS.

Prior to the closing of the Reorganization, the consolidated financial statements included the accounts of the Trust, its subsidiaries and partnerships, all of which were wholly owned. Subsequent to the Reorganization, the consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. The Company is considered a continuation of the Trust and these consolidated financial statements follow the continuity of interests method of accounting. Under the continuity of interests method of accounting the transfer of assets, liabilities and equity from the Trust to the Company are recorded at their net book values as at December 18, 2009.

As a result of the application of the continuity of interests method of accounting, certain terms such as shareholders'/unitholders' and share-based/unit-based may be used interchangeably throughout this MD&A.

The Company is publicly traded on the Toronto Stock Exchange under the symbol CET. The Company together with its wholly owned subsidiary, Cathedral Energy Services Inc., is 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. The Company is in the process of establishing operations in Venezuela for providing directional drilling services through its wholly owned subsidiaries Directional Plus International Ltd. and Directional Plus de Venezuela, C.A. The Company strives to provide its clients with value added technologies and solutions to meet their drilling, production testing and wireline requirements.

SELECTED ANNUAL INFORMATION

	2009	Increase (decrease)	2008	Increase (decrease)	2007
Revenues	**$ 94,520**	$ (84,408)	$ 178,928	$ 33,822	$ 145,106
Gross margin % (1)	**45%**	0%	45%	(4)%	49%
EBITDAS (1)	**16,652**	(33,816)	50,468	3,737	46,731
EBITDAS (1) as % of revenue	**18%**	(10)%	28%	(4)%	32%
Income before taxes	**2,001**	(32,593)	34,594	2,604	31,990
Net income	**5,281**	(24,858)	30,139	5,276	24,863
Net income per share - basic	**0.15**	(0.79)	0.94	0.15	0.79
Net income per share - diluted	**0.15**	(0.78)	0.93	0.15	0.78
EBITDAS per share - diluted	**0.48**	(1.09)	1.55	0.10	1.47
Weighted average shares outstanding - basic	**34,841**		32,215		31,402
Weighted average shares outstanding - diluted	**34,857**		32,463		31,781
Funds from operations (1)	**12,268**	28,556	40,824	1,131	39,693
Working capital	**22,451**	5,016	17,435	488	16,947
Total assets	**173,537**	(10,335)	183,872	52,840	131,032
Long-term debt	**39,526**	(707)	40,233	22,792	17,441
Shareholders' equity	**97,422**	5,563	91,859	12,609	79,250

(1) See "NON-GAAP MEASUREMENTS"

MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

2009 COMPARED TO 2008

Overview

The Company completed 2009 with revenues of $94,520 compared to 2008 at $178,928. The 2009 revenues were lead by the Company's directional drilling division which represented 69% (2008 - 76%) of total revenues with the remainder composed of production testing division at 18% (2008 - 10%) and wireline division at 13% (2008 - 14%) of total revenues. The decline in drilling in the oil and gas sector due to low commodity prices and the overall decline in the economy have resulted in a significant decline in revenues as compared to 2008.

2009 EBITDAS was $16,652 ($0.48 per share - diluted) which represents a $33,816 or 67% decrease from $50,468 ($1.55 per share - diluted) in 2008. 2009 EBITDAS is net of one-time charges in the amount of $1,130 of which $453 related to its restructuring of electric line ("E-Line") division and $677 related to the conversion to a corporation.

Revenues and operating expenses

	2009	2008	$ Change	%
Revenues	**$ 94,520**	$ 178,928	$ (84,408)	(47)
Operating expenses	**52,128**	98,614	(46,486)	(47)
Gross margin - $	**$ 42,392**	$ 80,314	$ (37,922)	(47)
Gross margin - %	**45%**	45%	0%	

Revenues	**Year Ended December 31, 2009**				Year Ended December 31, 2008			
	Directional drilling	**Production testing**	**Wireline**	**Total**	Directional drilling	Production testing	Wireline	Total
Canada	**$ 40,596**	**$ 8,806**	**$ 6,524**	**$ 55,926**	$ 71,886	$ 13,348	$ 18,356	$ 103,590
United States	**24,161**	**8,536**	**5,897**	**38,594**	64,113	3,773	7,452	75,338
	$ 64,757	**$ 17,342**	**$ 12,421**	**$ 94,520**	$ 135,999	$ 17,121	$ 25,808	$ 178,928

2009 revenues were $94,520 which represented a decrease of $84,408 or 47% from 2008 revenues of $178,928. The decline is primarily attributed to the decline in oil and natural gas activity in 2009 which has been caused by low commodity prices and the global recession. However, during 2009 commodity prices for both oil and natural gas rose, which resulted in higher activity levels as the year progressed.

The directional drilling division revenues have decreased from $135,999 in 2008 to $64,757 in 2009; a 52% decrease. This decrease is the net result of: i) the 54% decrease in activity days from 14,766 in 2008 to 6,836 in 2009; and ii) the increase in the average day rate from $9,022 in 2008 to $9,275 in 2009, which were caused in large part to the increase in U.S. day rates due to the change in foreign exchange rate for the Canadian dollar relative to the U.S. dollar. Canadian activity days decreased from 7,843 to 4,595 and U.S. activity days decreased from 6,923 to 2,241.

The directional drilling division started the year with 59 Measurement-While-Drilling ("MWD") systems in Canada, 35 in the United States and 4 for international operations. It ended 2009 with 62 MWD systems in Canada, 30 in the United States and 4 for international operations. The Company continuously reviews the demand for its services and shifts equipment among its markets accordingly.

Expansion to the U.S. resulted in increased revenues for the Company's production testing division. The Company's production testing division contributed $17,342 in revenues during 2009 which is a 1% increase over 2008 revenues of $17,121. The division began the year with 21 units in Canada and 8 units in the U.S. and ended with 21 units in Canada and 14 in the U.S.

The wireline division generated revenues of $12,421 for 2009 compared to $25,808 for 2008 which represents a 52% decrease. In mid-June 2009, the Company re-organized its wireline operations to focus its Canadian operations on providing slickline services and to concentrate its electric line ("E-Line") services in the U.S. The division began the year with 23 units in Canada and 5 units in the U.S. It ended 2009 with 14 units in Canada and 10 units in the U.S.

The gross margin for 2009 was 45% unchanged from 45% in 2008. There were no significant changes in direct costs as a percentage of revenue basis from 2008 to 2009. The Company undertook a detailed review of all operating costs and general and administrative expenditures and reduced costs to enhance profitability including layoff of staff and wage rollbacks. Included in operating expenses is $307 of costs associated with the restructuring of the Company's wireline operations.

General and administrative expenses

General and administrative expenses were $26,083 in 2009; a decrease of $4,980 compared with $31,063 in 2008. As a percentage of revenues, general and administrative expenses were 28% in 2009 and 17% in 2008. Recognizing the expected lower activity levels, the Company initiated several measures to improve operating results and further strengthen its balance sheet. As a result, the Company reduced costs to enhance profitability including the elimination of annual bonuses for 2009, laying off of staff and wage rollbacks. Included in the 2009 general and administrative expenses were $146 related to restructuring of the Company's wireline operations. In addition, $677 of fees related to the conversion to a corporation were included in general and administrative expenses for 2009.

Depreciation and amortization

Depreciation for 2009 was $15,343 which compared to $13,416 in 2008. This increase is due to the expansion of the equipment fleet since 2008 Q2. During 2009, approximately $2,809 (2008 - Nil) of property and equipment was temporarily removed from service and therefore no depreciation has been recorded on these assets. As a percentage of revenues, depreciation amounted to 16% for 2009 and 7% for 2008.

Interest expense

Interest expense related to long-term debt increased from $1,158 in 2008 to $1,258 in 2009 due to the combined net effect of: i) an increase in the average level of debt outstanding; and ii) a decrease in the effective interest rate on the related debt. Other interest expense decreased from $422 in 2008 to $290 in 2009 and relates mainly to interest charges on use by the Company of its bank indebtedness/line of credit facility.

Foreign exchange gain/loss

The Company's foreign exchange gain/loss has changed from a $94 loss in 2008 to a gain of $3,340 in 2009 due to the fluctuations in the Canadian dollar in comparison to the U.S. dollar. The Company's U.S. operations are considered to be self-sustaining and therefore 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 operations. Included in the 2009 foreign currency gain are unrealized gains of $3,682 (2008 - $405) related to intercompany balances.

Share-based compensation expense

For 2009, the Company had share-based compensation expense of $1,732 compared to $1,705 for 2008. The value of the options is being amortized against income over the three-year vesting periods. In October 2009, insiders of the Company forfeited all of the outstanding 1,303,334 options, resulting in share based compensation expense of $794 (2008 - nil). On October 13, 2009, non-insider optionees with vested or unvested out-of-the-money options were invited to reduce the exercise price of their share options to $3.81, which equaled the Trust Unit price on the last trading day immediately before the date of the modification. In exchange for this reduction in the exercise price, longer vesting terms were established with due consideration of the original expiry date which did not change. A total of 1,034,003 options were re-priced. The unrecognized compensation costs from the original grant are recognized over the remainder of the original requisite service period and the incremental compensation costs for the modified share options are recognized over the new requisite service period.

Gain on disposal of property and equipment

During 2009 the Company had a gain on disposal of property and equipment of $975 compared to $2,138 in 2008. For 2008, the Company's gains were 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. For 2009, the gains are mainly due to the disposal of E-Line wireline equipment that was not transferred to the United States as part of the re-organization of its wireline operations.

Taxes

For 2009, the Company had a tax recovery of $3,280 compared to tax expense of $4,455 in 2008. A significant portion of the current income taxes for 2008 relates to U.S. operations. As profitability of these operations has fallen dramatically, so has the current income tax expense. Included in the 2009 net tax recovery is $958 net tax expense related to tax on an internal reorganization related to ownership of assets. At the beginning of 2009 Q1 the Company's U.S. subsidiary sold the majority of its operating assets to the Company's Canadian operating entity, as part of an internal reorganization related to ownership of operating assets within the Company. This transaction created a one-time current tax expense in the amount of $4,168 (current taxable income was created mainly due to U.S. recaptured tax depreciation) and a recovery of future taxes in the amount of $3,210; for a net tax cost of $958. Subsequent to this transaction, the Company's U.S. subsidiary leases the majority of its operating equipment from its Canadian parent company. The future tax recovery for 2009 relates to reversal of timing differences on U.S. taxes (see comments above) and the remaining future tax recovery is attributable to adjustments related to the future taxation of SIFT income in Canada (prior to conversion to a corporation) and a tax benefit recognized on the conversion from a trust to a corporation.

Other comprehensive income/loss

The Company incurred a loss of $5,293 compared to a gain of $3,326 in 2008. Other comprehensive income (loss) is comprised entirely of the foreign currency translation of the Company's U.S. self-sustaining subsidiary and reflects the changing value of the Canadian dollar compared to the U.S. dollar. During 2009, the U.S. dollar weakened against the Canadian dollar.

2008 COMPARED TO 2007

Overview

Revenues increased $33,822 or 23% to $178,928 from $145,106 in 2007. Much of the increase was due to the directional drilling business in the U.S. EBITDAS for the year ended December 31, 2008 was $50,468 while the comparative figure for 2007 was $46,731, a combined increase of $3,737 or 8%. The disproportionate increase in EBITDAS (8%) versus the increase in revenues (23%) was due mainly to the increase in operating expenses which has also caused the decline in gross margin percentage. For the year ended December 31, 2008, net income was $30,139 ($0.93 per diluted share) compared to $24,863 ($0.78 per diluted share) for 2007.

Revenues and operating expenses

	2008	2007	$ Change	%
Revenues	**$ 178,928**	$ 145,106	$ 33,822	23
Operating expenses	**98,614**	73,482	25,132	34
Gross margin - $	**$ 80,314**	$ 71,624	$ 8,690	12
Gross margin - %	**45%**	49%	(4%)	

Revenues	**Year Ended December 31, 2008**				Year Ended December 31, 2007			
	Directional drilling	**Production testing**	**Wireline**	**Total**	Directional drilling	Production testing	Wireline	Total
Canada	**$ 71,886**	**$ 13,348**	**$ 18,356**	**$ 103,590**	$ 69,854	$ 12,051	$ 20,892	$ 102,797
United States	**64,113**	**3,773**	**7,452**	**75,338**	41,519	-	790	42,309
	$ 135,999	**$ 17,121**	**$ 25,808**	**$ 178,928**	$ 111,373	$ 12,051	$ 21,682	$ 145,106

2008 revenues were $178,928 and represented an increase of 23% over 2007 revenues. The increase was mainly a result of: i) a 2% increase in the average day rate for directional drilling services to $9,022 per day (2007 - $8,857) and ii) a 20% increase in directional drilling activity days to 14,766 activity days (2007 – 12,274 days).

Canadian directional drilling revenues increased 3% to $71,886 in 2008 from $69,854 in 2007. The Company's 2008 drilling activity days increased to 7,843 days from 7,270 days in 2007, an increase of 8%. At the end of 2008 Q3, the drilling days for the Canadian division had increased by 15% but due to a slowdown in oil and gas activities in 2008 Q4 the annual increase for 2008 was reduced to 8%. The average Canadian day rate decreased by 4%. The Canadian directional drilling division started the year with 55 Measurement-While-Drilling ("MWD") systems and ended the year with 59 MWD systems.

In the U.S., directional drilling revenues increased by 54% to $64,113 from $41,519. The Company's activity days in the U.S. increased from 5,004 days in 2007 to 6,923 days in 2008, an increase of 38%. The average U.S. day rate increased 12% in part due to the strengthening of the U.S. dollar in comparison to Canadian dollar. The number of MWD systems was increased from 23 at the end of 2007 to 35 at the end of 2008.

The wireline division generated revenues of $25,808 for 2008 compared to $21,682 for 2007, a 19% increase. The Canadian division began the year with 25 wireline units, had 1 unit return to service after major repairs and transferred an additional 3 units to the U.S. to end the year at 23 wireline units. In Canada, revenues declined by 12% to $18,356 in 2008 from $20,892 in 2007 due to the transfer of units to the U.S. combined with a decline in activity levels.

Late in 2007 Q2, one wireline unit was transferred from the Canadian operations to form the U.S. wireline division. However, revenue generating operations did not commence until 2007 Q3. The U.S. division ended 2007 with 2 wireline units and ended 2008 with 5 wireline units. As a result of the 2008 expansion and operations for an entire year, the U.S. wireline division generated $7,452 in revenues for 2008; an increase of $6,662 from 2007 of $790.

The Company's production testing division contributed $17,121 in revenues during 2008 representing a 42% increase from 2007 revenues of $12,051. The division added 2 units in Canada to end the year at 21 units, which contributed to the 11% increase in Canadian revenues to $13,348 in 2008 from 2007 of $12,051. The production testing division in Canada was adversely affected by the decline in natural gas drilling in 2008. The Company began production testing operations in the U.S. during 2008 Q3 with 1 production testing unit expanding to 8 units at December 31, 2008. The U.S. division had revenues of $3,773 in 2008.

The gross margin for 2008 was 45%, compared to 49% in 2007. The decrease was attributed to a number of factors, but mainly was the result of an increase in labour costs in all divisions. There was a significant increase in labour costs that began in Q3 of 2007 and continued into 2008 due to the high demand for labour in both Canada and the U.S. for oil and gas field workers. This has caused a 3% decline in the gross margin. Another factor contributing to the decline is an increase in the cost of motor and other equipment repairs in the drilling division.

General and administrative expenses

General and administrative expenses increased from $25,774 in 2007 to $31,063 in 2008, an increase of $5,289. The increase was mainly related to the expansion of operations. As a percentage of revenues, general and administrative expenses were 17% in 2008 and 18% in 2007. Approximately 45% of the overall increase in general and administrative expenses related to the start-up of the U.S. production testing division, operating the U.S. Wireline division for a full year, and the establishment of operations in Venezuela. The remaining increases were due to the expansion of operations in the year as evidenced by the increase in revenues.

Depreciation and amortization

Depreciation for 2008 was $13,416 compared to $12,054 in 2007. This increase was related to the Company's investment in property and equipment including 20 MWD systems, mud motors and drill collars to complement the increase in MWD systems and the purchase of 7 production testing units. As a percentage of revenues, depreciation and amortization amounted to 7% for 2008 and 8% for 2007. Despite the increase in the Company's depreciable asset throughout 2008, depreciation on a year-to-year basis did not increase as much as otherwise anticipated due to the change in the accounting method for foreign currency translation of the Company's U.S. operations.

Interest expense

Interest expense related to long-term debt increased from $1,084 in 2008 to $1,158 in 2008. The main contributing factor to the increase in interest related to long-term debt and capital lease obligations was an increase in the average level of debt outstanding in 2008, net of declines in the prime interest rate during the year. Other interest expense increased from $404 in 2007 to $422 in 2008 and related mainly to interest charges on use by the Company of its bank indebtedness/line of credit facility.

Foreign exchange gain/loss

The Company's foreign exchange gain decreased from $492 in 2007 to $94 in 2008. Effective January 1, 2008, the Company changed the classification of its U.S. operations to self-sustaining (as opposed to integrated) resulting in the financial statements being translated using the current rate method as opposed to the temporal method.

Share-based compensation expense

For 2008, the Company had share-based compensation expense of $1,705 compared to $1,603 for 2007. The Trust Unit options granted are valued using the Black-Scholes option pricing model and such value was amortized against income over their three-year vesting periods.

Gain on disposal of property and equipment

During 2008 the Company had a gain on disposal of property and equipment of $2,138 compared to $1,777 in 2007. The gain on disposal of property and equipment can vary significantly from year-to-year as almost all of the disposals relate to downhole equipment lost-in-hole. The Company recovers lost-in-hole equipment costs including previously expensed depreciation on the related assets.

Taxes

For 2008, the Company had a tax expense of $4,455 (effective tax rate of 12.9%) compared to $7,127 (effective tax rate of 22.3%) in 2007. The 2007 tax provision included a cumulative non-cash adjustment of $2,754 (expense) related to the substantive enactment of the previously announced changes to the taxation of income and royalty trusts, other than real estate investment trusts. Removing the 2007 adjustment noted above the effective tax rate for 2007 was 13.7%. In comparing the adjusted 2007 effective tax rate (13.7%) to the 2008 effective tax rate (12.9%), the decrease was mainly attributable to the net result of the continuing growth in the U.S. operations which were taxed at a higher rate and a reduction to future income tax liability for changes in effected tax rates.

Other comprehensive income

The Company incurred a gain of $3,326 in 2008. Other comprehensive income ("OCI") was comprised entirely of the foreign currency translation of the Company's U.S. self-sustaining subsidiary and reflects the changing value of the Canadian dollar compared to the U.S. dollar. There was no OCI in 2007.

LIQUIDITY AND CAPITAL RESOURCES

The Company's primary source of liquidity is cash generated from operations. The Company also has the ability to fund liquidity requirements through its credit facility and the issuance of debt and/or equity. At December 31, 2009, the Company had a demand operating line of credit with a major Canadian bank in the amount of $20,000 (December 31, 2008 - $20,000) of which $2,181 (December 31, 2008 – $15,406) was drawn. In addition, the Company has a non-reducing revolving term loan facility in the amount of $45,000 (December 31, 2008 - $45,000) of which $39,500 (December 31, 2008 - $40,000) was drawn as at December 31, 2009. In addition, at December 31, 2009, the Company had other long-term debt of $234 (December 31, 2008 - $440). Effective June 30, 2009 the Company renewed its credit facility with a major Canadian bank and the new maturity date is June 30, 2010.

Operating activities

Cash provided by operating activities for 2009 was $18,564 compared to $36,143 in 2008. Funds from operations (see Non-GAAP Measurements) for 2009 were $12,268 compared to $40,824 in 2008. This decrease was caused mainly by a reduction in earnings due to reduced activity levels. The Company has a working capital position at December 31, 2009 at $22,451 compared to $17,435 at December 31, 2008.

Investing activities

Cash used in investing activities for 2009 amounted to $12,020 compared to $40,134 in 2008. During 2009 the Company invested $8,923 (2008 - $47,618) in property and equipment with the main additions being for 8 production testing units. As well in 2009, the Company made cash expenditures related to the Plan of Arrangement in the amount of $3,597.

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

	2009	2008
Directional drilling equipment -		
MWD systems	**96**	98
Drilling mud motors	**468**	496
Production testing units	**35**	29
Wireline units	**24**	28

Proceeds on disposal of property and equipment amounted to $4,219 (2008 - $3,761). For 2008 this amount was mainly related to recovery of downhole equipment costs that were lost-in-hole. For 2009, this amount includes recovery of downhole equipment costs that were lost-in-hole, but is mainly due to the sale of E-Line wireline equipment.

For 2010, the Board of Directors of the Company has approved an updated capital budget of $20,650 including approximately $7,200 for maintenance capital and $3,800 allocated to the new head office and operations centre located in Calgary, which was purchased in 2008. The maintenance capital includes the retro-fit and upgrades to downhole tools. The balance of the 2010 capital program relates mainly to the purchase and integration of resistivity (logging while drilling "LWD") equipment and additional production testing equipment. These capital expenditures are expected to be financed by way of cash flow from operations and the Company's credit facility.

Financing activities

Cash provided by (used in) financing activities for 2009 amounted to ($13,194) compared to $9,618 in 2008. For 2009 the Company repaid other long-term debt in the amount of $5,206 (2008 - $341). During 2009 Q2 the Company issued 3,615,600 Trust Units at $4.15 for proceeds net of issuance costs of $13,820. These proceeds were added to working capital and used to repay $5,000 of the revolving term loan. The Company received $34 (2008 - $4,904) on the exercise of share options. Advances under long-term debt for 2009 were $4,500 (2008 - $23,047) and with respect to bank indebtedness/line of credit there were repayments of $13,225 (2008 – ($9,376)). As at December 31, 2009, the Company was in compliance with all covenants under its credit facility.

Distributions paid in 2009 totaled $13,117 (2008 – $27,368). Cash distributions paid have been financed from cash flow from operations. For 2008, the Company paid monthly cash distributions of $0.07 per Trust Unit. In 2009, this was reduced to $0.04 per Trust Unit in February and as part of the announcement to convert to a growth oriented corporation, the Company ceased paying distributions effective August 2009.

Contractual obligations

In the normal course of business, the Company incurs contractual obligations. The following is a summary of the Company's contractual obligations:

	Total	**2010**	**2011**	**2012**	**2013**	**2014**	**Thereafter**
Property and equipment additions	$ 5,910	$ 5,910	$ -	$ -	$ -	$ -	$ -
Operating lease obligations	12,481	2,876	2,107	1,858	1,719	1,579	2,342
Long-term debt repayments (1)	39,734	208	6,607	13,169	13,167	6,583	-
	$ 58,125	$ 8,994	$ 8,714	$ 15,027	$ 14,886	$ 8,162	$ 2,342

(1) Minimum principal amounts to be paid under long-term debt assumes the Company elects prior to the maturity date of the revolving term loan to repay the loan over 36 months with interest only payable for the first 12 months.

The 2010 contractual obligations are expected to be financed by way of cash flow from operations and the Company's credit facility.

EBITDAS

EBITDAS (refer to Non-GAAP Measurements) is calculated as follows:

	2009	2008
Net income	**$ 5,281**	$ 30,139
Add (deduct):		
Depreciation and amortization	**15,343**	13,416
Interest - long-term debt	**1,258**	1,158
Share-based compensation	**1,732**	1,705
Unrealized foreign exchange gain	**(3,682)**	(405)
Taxes	**(3,280)**	4,455
EBITDAS	$ **16,652**	**$** 50,468

RELATED PARTY TRANSACTIONS

A director of the Company is a partner in a law firm and, through that law firm, is involved in providing and managing the legal services provided to the Company at market rates. The total amount paid for these legal services in 2009 was $635 (2008 - $136).

StoneBridge Merchant Capital Corp. ("StoneBridge") acted as a special advisor to the Company in respect to the Plan of Arrangement and was paid a fee of $572. A director of the Company is an officer of StoneBridge.

DISTRIBUTIONS

Distributions declared for 2009 were $10,836 as compared with $27,432 in 2008. The monthly distribution per Trust Unit was $0.07 for all of 2008. In February 2009, this was reduced to $0.04 per Trust Unit and once the Trust announced its intention to convert to a corporation the distribution was suspended in August 2009. All distributions were paid from income from operations and are not considered a return of capital.

DIVIDENDS

It is the intent of the Company to pay quarterly dividends to shareholders. 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 2010 Q1 dividend in the amount of $0.06 per share which will have a date of record of March 31, 2010 and a payment date of April 15, 2010.

FOURTH QUARTER RESULTS

Revenues and operating expenses

	2009 Q4	2008 Q4	$ Change	%
Revenues	**$ 26,695**	$ 50,506	$ (23,811)	(47)
Operating expenses	**14,391**	29,350	(14,959)	(51)
Gross margin - $	**$ 12,304**	$ 21,156	$ (8,852)	(42)
Gross margin - %	**46%**	42%	4%	

Revenues	**Quarter Ended December 31, 2009**				Quarter Ended December 31, 2008			
	Directional drilling	**Production testing**	**Wireline**	**Total**	Directional drilling	Production testing	Wireline	Total
Canada	**$ 14,595**	**$ 3,276**	**$ 619**	**$ 18,490**	$ 16,551	$ 4,347	$ 4,267	$ 25,165
United States	**4,448**	**2,421**	**1,336**	**8,205**	19,668	2,948	2,725	25,341
	$ 19,043	**$ 5,697**	**$ 1,955**	**$ 26,695**	$ 36,219	$ 7,295	$ 6,992	$ 50,506

Revenues in Q4 have decreased to $26,695 in 2009 from $50,506 in 2008, a decrease of $23,811 or 47%. The declines for all divisions were primarily due to the decline in oil and natural gas activity in 2009 which has been caused by low commodity prices and the global recession.

Directional drilling related revenues decreased $17,176 from $36,219 in 2008 Q4 to $19,043 in 2009 Q4 due to a 39% decrease in activity days (2009 Q4 - 2,200 vs. 2008 Q4 - 3,575) and a 14% decrease in the average day rate (2009 Q4 - $8,517 vs. 2008 Q4 - $9,939). Canadian revenues were down 12% from $16,551 in 2008 Q4 to $14,595 in 2009 Q4. This was the result of a 3% decline in drilling days falling to 1,741 in 2009 Q4 from 1,801 in 2008 Q4 and a 8% decline in the Canadian average day rate. In the U.S., revenues have decreased 77% to $4,448 in 2009 Q4 from $19,668 in 2008 Q4. U.S. drilling days decreased to 460 in 2009 Q4 from 1,774 in 2008 Q4, a decrease of 74%. The average day rate for the U.S. decreased 13%.

Production testing revenues for 2009 Q4 decreased to $5,697 from $7,295 in 2008 Q4; a decrease of 22%. The Canadian division's revenues have decreased 25% to $3,276 in 2009 Q4 from $4,347 in 2008 Q4. The U.S. revenues decreased 18% to $2,421 in 2009 Q4 from $2,948 in 2008 Q4.

Wireline revenues decreased from $6,992 in 2008 Q4 to $1,955 in 2009 Q4. The Canadian wireline division's revenues fell 85% to $619 in 2009 Q4 from $4,267 in 2008 Q4. The U.S. wireline revenues decreased 51% to $1,336 in 2009 Q4 from $2,725 in 2008 Q4.

The consolidated gross margin increased 4% to 46% for 2009 Q4 from 42% in 2008 Q4. The increase in gross margin was primarily due to decreases in labour charges in all divisions due to efforts to control costs and a reduction in the repair costs for the drilling division.

General and administrative charges decreased 20% from $8,098 in 2008 Q4 to $6,474 in 2009 Q4. The decrease was primarily due to decreases in wages and salaries due to staff reductions and salary roll-back plan as well as reductions in numerous expenses as a result of the Company's various cost reduction initiatives. The Company instituted wage rollbacks in May 2009 and the first level of rollbacks was re-instated effective November 1, 2009. As a percentage of revenues, general and administrative expenses were 24% in 2009 Q4 compared to 16% in 2008 Q4.

For 2009 Q4, the Company recorded a tax recovery of $1,140 compared to the 2008 Q4 recovery of $651.

Net income for 2009 Q4 was $2,236 ($0.06 per share - diluted) compared to $9,737 ($0.30 per share - diluted) 2008 Q4.

SUMMARY OF QUARTERLY RESULTS

Three month period ended	Dec 2009	Sep 2009	Jun 2009	Mar 2009	Dec 2008	Sep 2008	Jun 2008	Mar 2008
Revenues	$26,695	$23,544	$12,913	$31,368	$50,506	$52,686	$29,483	$46,253
EBITDAS	5,864	5,724	(1,721)	6,785	13,554	16,887	4,632	15,395
Net income (loss)	2,236	3,125	(1,484)	1,404	9,737	10,296	189	9,917
Net income (loss) per share – basic and diluted	0.06	0.09	(0.04)	0.04	0.30	0.32	0.01	0.31
Cash distributions declared per share	-	0.04	0.12	0.15	0.21	0.21	0.21	0.21

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's consolidated financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and significant accounting policies utilized by the Company are described in notes 1 and 2 to the Company's consolidated financial statements. Management believes the accounting principles selected are appropriate under the circumstances and the Audit Committee of the Company has approved the policies selected.

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

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

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

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

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

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

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

The business and operations of the Company are complex and the Company has executed a number of significant financings, reorganizations, acquisitions and other material transactions over the course of its history. The computation of income taxes payable as a result of these transactions involves many complex factors as well as the Company's interpretation of relevant tax legislation and regulations. The Company's management believes that the provision for income tax is adequate and in accordance with generally accepted accounting principles and applicable legislation and regulations. However, tax filing positions are subject to review by taxation authorities who may successfully challenge the Company's interpretation of the applicable tax legislation and regulations.

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

NEW ACCOUNTING POLICIES

The following summarizes accounting changes that were applied to the Company's consolidated financial statements for the year ended December 31, 2009:

i) The Canadian Institute of Chartered Accountants (the "CICA") issued Section 3064, Goodwill and Intangible Assets, replacing Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs. New Section 3064 addresses when an internally developed intangible asset meets the criteria for recognition as an asset. The CICA also issued amendments to Section 1000, Financial Statement Concepts.

ii) The CICA issued Section 1582, Business Combinations, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements for the acquisition method for business combinations and related disclosures. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company has chosen not to early adopt the new section.

iii) The CICA issued Sections 1601, Consolidated Financial Statements, and Section 1602, Non-controlling Interests, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company has chosen not to early adopt the new sections.

FUTURE ACCOUNTING POLICIES

In February, 2008, the CICA confirmed that the use of International Financial Reporting Standards ("IFRS") will be required in Canada for publicly accountable profit oriented enterprises for fiscal years beginning on or after January 1, 2011. The Company will be required to report using IFRS beginning January 1, 2011.

The Company's IFRS project plan has four phases: education, analysis, design and implementation and testing. The Company is continuing the process of education for all levels of the organization and has completed the analysis phase during which it identified specific significant differences between Canadian GAAP and IFRS. The Company is in the design phase in which it is determining its policies and procedures for IFRS. This phase will be completed and the Company will move into the implementation and testing phase in 2010 Q1 to Q3.

CONTROLS AND PROCEDURES

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

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

Internal controls over financial reporting Management is responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with Canadian GAAP. The CEO and CFO have designed or have caused such internal controls over financial reporting to be designed under their supervision to provide reasonable assurance regarding the reliability of financial reporting and preparation of the Company's financial statements for external purposes in accordance with Canadian GAAP. In addition, the CEO and CFO have evaluated the effectiveness of internal controls over financial reporting and, based upon that evaluation, have concluded that the design and effectiveness of the internal controls over financial reporting were operating effectively as at December 31, 2009 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. There has been no change in the Company's internal controls over financial reporting during the year ended December 31, 2009 that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

RISK FACTORS

Cash dividends to shareholders are dependent on the performance of the Company The Company's ability to make dividend payments to shareholders is dependent upon the operations and business of the Company. There is no assurance regarding the amounts of cash that may be available from the Company's operations and business that could be available to fund future dividends or if dividends will be declared at all. The actual amount of any dividends will depend on a variety of factors, including without limitation, the 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, future growth capital expenditures, effect of acquisitions or dispositions on the Company's business, and other factors that may be beyond the control of the Company or not anticipated by management of the Company. In the event significant cash requirements are necessary for non-dividend purposes or the profitability of the Company declines, there would be a decrease in the amount of cash available for dividends to shareholders and such decrease could be material.

The Company's dividend policy is subject to change at the discretion of its board of directors. In addition, the Company's bank facility covenants include restrictions on the payment of cash dividends if the Company is not in compliance with debt covenants.

Access to capital The credit facilities of the Company contain covenants that require it to meet certain financial tests and that restrict, among other things, the ability of the Company to incur additional debt, dispose of assets or pay dividends in certain circumstances. To the extent the cash flow from operations is not adequate to fund the Company's cash requirements and therefore external financing may be required. Lack of timely access to such additional financing, or which may not be on favorable terms, could limit the future growth of the business of the Company and, potentially have a material adverse effect on the amount of cash available for dividends. To the extent that external sources of capital, including public and private markets, become limited or unavailable, the Company's ability to make the necessary capital investments to maintain or expand its current business and to make necessary principal payments under it credit facility may be impaired.

Forward-looking information may prove inaccurate Numerous statements containing forward-looking information are found in this MD&A/Annual Information Form, documents incorporated by reference herein and other documents forming part of the Company's public disclosure record. Such statements and information are subject to risks and uncertainties and involve certain assumptions, some, but not all, of which are discussed elsewhere in this document. The occurrence or non-occurrence, as the case may be, of any of the events described in such risks could cause actual results to differ materially from those expressed in the forward-looking information.

Third party credit risk relating to completion of the conversion The Company is or may be exposed to third party credit risk relating to any obligations of SBS that are not transferred, or if transferred, from which obligations the Company has not been released. The Company has, through the contractual provisions in the Arrangement Agreement and the indemnity agreement (the "Indemnity Agreement") and divestiture agreement ("Divestiture Agreement") contemplated thereby, attempted to ensure that the liabilities and obligations relating to the business of SBS are transferred to and assumed by New SBS, that the Company is released from any such obligations and, even where such transfer or release is not effective or is not obtained, the Company is indemnified by New SBS for all such obligations. However, in the event New SBS fails or is unable to meet such contractual obligations to the Company and to the extent any applicable insurance coverage is not available, the Company may be liable for such obligations which could have a material adverse effect on the business, financial condition and results of operations of the Company.

Due diligence Although the Company has conducted investigations of, and engaged legal counsel to review, the corporate, legal, financial and business records of SBS and attempted to ensure, through the contractual provisions in the Arrangement Agreement, Indemnity Agreement and Divestiture Agreement, that the liabilities and obligations relating to the business of SBS are transferred to and assumed by New SBS, there may be liabilities or risks that the Company, after reasonable inquiry, may not have uncovered in its due diligence investigations, or that may have an unanticipated material adverse effect on the Company. These liabilities and risks could have, individually or in the aggregate, a material adverse effect on the business, financial condition and results of operations of the Company.

SBS Operational Risks The Company has, through the contractual provisions in the Arrangement Agreement, the Indemnity Agreement and Divestiture Agreement contemplated thereby, attempted to ensure that the liabilities and obligations relating to the business of SBS are transferred to and assumed by New SBS, that the Company is released from any such obligations and, even where such transfer or release is not effective or is not obtained, the Company is indemnified by New SBS for all such obligations. However, in the event New SBS fails or is unable to meet such contractual obligations to the Company, the Company could be exposed to liabilities and risks associated with the operations of SBS, which include, without limitations, risks relating to claims with respect to intellectual property matters, product liability or environmental damages.

Tax related risks associated with the conversion The steps under the Plan of Arrangement pursuant to which the corporate conversion was completed, were structured to be tax-deferred to the entities within the Trust's structure and the Trust's Unitholders based on certain rules under the Income Tax Act (Canada). There is a risk that the tax consequences contemplated by the Trust's entities or the tax consequences of the Plan of Arrangement to the Trust's entities and the Trust's Unitholders may be materially different from the tax consequences anticipated by the Trust in the undertaking the conversion. While the Company is confident in its current position, there is a risk that the Canada Revenue Agency could successfully challenge the tax consequences of the Plan of Arrangement or prior transactions of SBS. Such a challenge could potentially affect the availability or amount of the tax basis or other tax accounts of the Company and/or create taxes payable.

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

Debt service The Company has a secured credit facility with a major Canadian bank in the amount of $65 million ($20 million demand operating loan and a $45 million revolving term loan). Although it is believed that the credit facility is sufficient, there can be no assurance that the amount will be adequate for the financial obligations of the Company. As well, if the Company requires additional financing such financing may not be available or, if available, may not be available on favorable terms. The Company's lender has been provided with security over substantially all of the assets of the Company. The credit facility is subject to an annual renewal and there is no assurance the current lender will renew the existing credit facility. Even if the credit facility is renewed it may only be renewable upon unfavorable terms including, but not limited to, an increase interest rate margin, more stringent debt covenants, reduction in the credit amount available and additional loan fees.

Additional shares If the board of directors of the Company decides to issue additional common shares, preferred shares or securities convertible into common shares, existing shareholders may suffer significant dilution.

Income tax matters The business and operations of the Company are complex and the Company and its predecessors have executed a number of significant financings, reorganizations, acquisitions and other material transactions over the course of its history. The computation of income taxes payable as a result of these transactions involves many complex factors as well as the Company's interpretation of relevant tax legislation and regulations. The Company's management believes that the provision for income tax is adequate and in accordance with generally accepted accounting principles and applicable legislation and regulations. However, tax filing positions are subject to review by taxation authorities who may successfully challenge the Company's interpretation of the applicable tax legislation and regulations.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Crude oil and natural gas prices Demand for the services provided by the Company is directly impacted by the prices that the Company's customers receive for the crude oil and natural gas they produce and the prices received has a direct correlation to the cash flow available to invest in drilling activity and other oilfield services. World crude oil prices and North American natural gas prices are not subject to control by the Company. With that in mind, the Company attempts to partially manage this risk by way of maintaining a low cost structure and a variable cost structure that can be adjusted to reflect activity levels. A significant portion of the Company's fieldwork is performed by sub-contractors which allows us to operate with lower fixed overhead costs in seasonally low activity periods.

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

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

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

Operating risks and insurance The Company has an insurance and risk management plan in place to protect its assets, operations and employees. The Company also has programs in place to address compliance with current safety and regulatory standards. The Company has a safety coordinator responsible for maintaining and developing policies and monitoring operations vis-a-vis those policies. However, the Company's oilfield services are subject to risks inherent in the oil and gas industry, such as equipment defects, malfunctions, failure and natural disasters. These risks could expose the Company to substantial liability for personal injury, loss of life, business interruption, property damage or destruction, pollution and other environmental damages. In addition, the Company's operating activities includes a significant amount of transportation and therefore is subject to the inherent risks including potential liability which could result from, among other things, personal injury, loss of life or property damage derived from motor vehicle accidents. The Company carries insurance to provide protection in the event of destruction or damage to its property and equipment, subject to appropriate deductibles and the availability of coverage. Liability insurance is also maintained at prudent levels to limit exposure to unforeseen incidents. An annual review of insurance coverage is completed to assess the risk of loss and risk mitigation alternatives. Extreme weather conditions, natural occurrences and terrorist activity have strained insurance markets leading to substantial increases in insurance costs and limitations on coverage. It is anticipated that insurance coverage will be maintained in the future, but there can be no assurance that such insurance coverage will be available in the future on commercially reasonable terms or be available on terms as favorable as the Company's current arrangements. The occurrence of a significant event outside of the coverage of the Company's insurance policies could have a material adverse affect on the results of the organization.

Risks of foreign operations The Company is in the process of setting up operations in Venezuela for providing directional drilling services. Working outside of Canada gives rise to the risk of dealing with business and political systems that are different than the Company is accustomed to in Canada. The Company expects to hire employees and consultants who have experience working in the international arena and it is committed to recruiting qualified resident nationals on the staff of its international operations. In addition, the Company is committed to continuing expansion of its North American market to mitigate this risk. These potential risks include: expropriation or nationalization; civil insurrection; labour unrest; strikes and other political risks; fluctuation in foreign currency and exchange control; increases in duties and taxes; and changes in laws and policies governing operations of foreign based companies. At December 31, 2009, the Company's investment in its Venezuela subsidiary is approximately $7,695. During 2010, the Company expects an additional $5,000 of down hole and resistivity tools attributed to the international business segment to be transferred into Venezuela.

Weather and seasonality 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 late March and continues through to May. Operating activities generally increase in the fall and peak in the winter months from December until 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 United States are not subject to the seasonality to the same extent that it occurs in the western Canada region.

Foreign currency exchange rates The Company derives revenues from the United States, which are denominated in the local currency. This causes a degree of foreign currency exchange rate risk which the Company attempts to mitigate by matching local purchases in the same currency. Furthermore, the Company's Canadian operations are subject to foreign currency exchange rate risk in that some purchases for parts, supplies and components in the manufacture of equipment are denominated in U.S. dollars. In addition to foreign currency risk associated with U.S. dollar, the Company is now exposed to foreign currency fluctuations in relation to Venezuelan Bolivar. The Company's foreign currency policy is to monitor foreign current risk exposure in its areas of operations and mitigate that risk where possible by matching foreign currency denominated expense with revenues denominated in foreign currencies. The Company strives to maintain limited amounts of cash and cash equivalents denominated in foreign currency on hand and attempts to further limit its exposure to foreign currency through collecting and paying foreign currency denominated balance in a timely fashion.

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

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

Credit risk All of the Company's accounts receivables are with customers involved in the oil and gas industry, whose revenue may be impacted by fluctuations in commodity prices. Although collection of these receivables could be influenced by economic factors affecting this industry and thereby have a materially adverse effect on operations, management considers risk of significant loss to be minimal at this time.

Reliance on major customers Management of the Company believes it currently has a good mix of customers with only one customer accounting for revenues in excess of 10% (at 28%) of the Company's consolidated revenues for 2009 (2008 – one customer 27%). Mergers and acquisitions activity in the oil and natural gas exploration and production sector can impact demand for our services as customers focus on internal reorganization prior to committing funds to significant oilfield services. In addition, demand for the Company's services could be negatively affected in that post the merger and acquisitions customers may re-direct their work to the Company's competitors.

Environmental risks There is growing concern about the apparent connection between the burning of fossil fuels and climate change. The issue of energy and the environment has created intense public debate in Canada, the U.S. and around the world in recent years that is likely to continue for the foreseeable future and could potentially have a significant impact on all aspects of the economy including the demand for hydrocarbons and resulting in lower demand for the Company's services. There can be no assurance that the provincial, state and local governments or the Federal Governments of Canada and United States and other jurisdictions in which the Company enters into to provide its services will not adopt new environmental regulations, rules or legislation or make modifications to existing regulations, rules or legislation which could increase costs paid by the Company's customers. An increase in environmental related costs could reduce the Company's customers' earnings and/or it could make capital expenditures by the Company's customers uneconomic. The Canadian Federal Government has announced its intention to regulate greenhouse gases ("GHG") and other air pollutants. The Government is currently developing a framework that outlines its clean air and climate change action plan. As this federal program is under development, the Company is unable to predict the total impact of the potential regulations upon its business. It is possible that the Company's customers could face increases in operating costs in order to comply with GHG emissions legislation which could have the effect of curtailing exploration and development by oil and natural gas producers and that in turn, could adversely affect the Company's operations by reducing demand for its services.

Changes to royalty regimes There can be no assurance that the provincial, state and local governments or the Federal Governments of Canada and United States and other jurisdictions in which the Company enters into to provide its services will not adopt a new royalty regime or modify the methodology of royalty calculation which could increase the royalties paid by the Company's customers. An increase in royalties could reduce the Company's customers' earnings and/or it could make capital expenditures by the Company's customers uneconomic. The Alberta Government's new policy with respect to the royalties on oil and gas production in the Province of Alberta became effective January 1, 2009. The new policy increased the royalties charged on oil and gas production using a sliding scale based on the price of the related commodity. Although the Company is not a direct investor in the oil and gas market it does affect the Company's customers' cash flow available to invest in drilling activity and other oilfield services. The new Alberta royalty program has caused producers to re-direct some of their investments to other jurisdictions such as British Columbia and Saskatchewan.

Conflict of interest Certain directors and officers of the Company are also directors and/or officers of other oil and natural gas exploration and/or production entities and oil and natural gas services companies, and conflicts of interest may arise between their duties as officers and directors of the Company and as officers and directors of such other companies. Such conflicts must be disclosed in accordance with, and are subject to such other procedures and remedies as apply under the Alberta Business Corporations Act.

Legal proceedings The Company is involved in litigation from time to time in the ordinary course of business. Although the Company is not currently a party to any material legal proceedings, legal proceedings could be filed against the Company in the future. No assurance can be given as to the final outcome of any legal proceedings or that the ultimate resolution of any legal proceedings will not have a materially adverse effect on the Company.

OFF-BALANCE SHEET ARRANGEMENTS

As at December 31, 2009, the Company has entered into $12,481 of commitments under operating leases for premises and vehicles (refer to note 16 to the consolidated financial statements). The Company has indemnified obligations to its directors and officers. Pursuant to such obligation, the Company indemnifies these individuals, to the extent permitted by law, against any and all claims or losses (including amounts paid in settlement of claims) incurred as a result of their service to the Company. The maximum amount payable under these indemnities cannot be reasonably estimated. The Company expects that it would be covered by insurance for most tort liabilities.

MANAGEMENT'S DISCUSSION AND ANALYSIS

GOVERNANCE

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

SUPPLEMENTARY INFORMATION

At March 3, 2010, the Company had 36,400,061 shares and 3,254,269 options outstanding. In January 2010, the Company granted 102,000 options to non-insiders at an exercise price of $5.00. In addition, 1,441,200 options were granted to insiders at an exercise price $6.01. Additional information regarding the Company, including the Annual Information Form ("AIF"), is available on SEDAR at www.sedar.com.

OUTLOOK

Going into 2010, the market outlook for Cathedral's services is much stronger than experienced in 2009. The rig count in both Canada and the U.S. has experienced significant increases, which in turn has increased the demand for the Company's services. All of the new conventional and unconventional resource plays are utilizing horizontal drilling and multi-frac completion techniques. This change in completion technology has increased the percentage of wells being drilled horizontally into the 60% range.

Since the third quarter 2009, the Company has experienced, on a quarter-over-quarter basis, a sequential improvement in operating activities across all of its service areas in both Canada and the U.S. In Canada, the market has improved as we are seeing old areas being redeveloped (i.e. Cardium) and new zones being discovered (i.e. Duvernay) which are predominately employing the use of horizontal, multi-stage fracturing technology and this work is beneficial to both the directional drilling and production testing divisions of the Company. Based upon customer feedback we are expecting to see increased activity levels in Canada to continue through 2010 Q2 to Q4.

In the U.S., the Company continues its push into the northeast U.S. region (Marcellus) where an operations facility has been opened in Washington, Pennsylvania. This facility is expected to be fully operational with motor re-building capabilities by the end of 2010 Q1. The Company currently has a 10 job capacity in the U.S. northeast region. In addition, the Company is seeing a significant improvement in drilling activity in the U.S. Rocky Mountain region, which was hit hard by the reduction in drilling activity in early 2009. Cathedral continues to focus on growth of the U.S. production testing market where the Company is moving its 15th unit into the Rocky Mountain region before the end of March 2010. As well, Cathedral is currently reviewing opportunities to expand the production testing division into other U.S. markets.

In 2009, the Company recognized that despite the downturn in the market, research and development was going to be the cornerstone of its future; the development of new innovative products was going to expand the Company's markets and differentiate Cathedral from its competitors. In 2010 Q1, the Company will add "resistivity" to its Logging-While-Drilling ("LWD") capabilities. This technology will primarily be used in expanding Cathedral's international marketing efforts. The Company will commence the manufacture of its next generation EM/MWD tool which provides for improved packaging of components within the EM/MWD tool, which will improve the durability in high shock and vibration environments. The Company has numerous other development projects in process that are expected to allow the Company to continue to be a significant player in the directional drilling market.

MANAGEMENT'S REPORT

The consolidated financial statements have been prepared by the management in accordance with Canadian generally accepted accounting principles and, where appropriate, reflect estimates based upon management's judgment. Financial information contained elsewhere in the annual report has been prepared on a consistent basis with that in the consolidated financial statements.

Management is also responsible for a system of internal controls which is designed to provide reasonable assurance that the Company's assets are safeguarded and accounting systems provide timely, accurate financial reports.

The Audit Committee of the Board of Directors has reviewed in detail the consolidated financial statements with management and the external auditor. The Board of Directors has approved the consolidated financial statements on the recommendation of the Audit Committee.

KPMG LLP, an independent firm of chartered accountants, have examined the Company's consolidated financial statements in accordance with Canadian generally accepted auditing standards and provided an independent professional opinion. The auditors have full and unrestricted access to the Audit Committee to discuss their audit and their related findings as to the integrity of the financial reporting process.

Signed: *"Mark L. Bentsen"*
Mark L. Bentsen
President and Chief Executive Officer

Signed: *"P. Scott MacFarlane"*
P. Scott MacFarlane
Chief Financial Officer

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Cathedral Energy Services Ltd. as at December 31, 2009 and 2008 and the consolidated statements of operations and retained earnings, comprehensive income (loss) and accumulated other comprehensive income (loss), and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Signed: "KPMG LLP"
Chartered Accountants
Calgary, Canada
March 3, 2010

CONSOLIDATED BALANCE SHEETS

December 31, 2009 and 2008
Dollars in '000s

	2009	2008
Assets		
Current assets:		
Cash and cash equivalents	**$ 491**	$ 7,551
Accounts receivable	**27,727**	43,629
Income taxes recoverable	**2,550**	688
Inventory	**6,129**	8,963
Prepaid expenses and deposits	**1,629**	1,538
	38,526	62,369
Property and equipment (note 3)	**91,452**	101,287
Future income taxes (note 6)	**23,491**	-
Intangibles, net of accumulated amortization of $637 (2008 - $489)	**293**	441
Goodwill	**19,775**	19,775
	$ 173,537	$ 183,872
Liabilities and Shareholders' Equity		
Current liabilities:		
Bank indebtedness (note 4)	**$ 2,181**	$ 15,406
Accounts payable and accrued liabilities	**13,686**	27,040
Distributions payable to Unitholders	**-**	2,281
Current portion of long-term debt (note 5)	**208**	207
	16,075	44,934
Long-term debt (note 5)	**39,526**	40,233
Future income taxes (note 6)	**-**	6,846
Deferred credit (note 6)	**20,514**	-
	76,115	92,013
Shareholders' equity:		
Share capital (note 7)	**68,995**	-
Unitholders' capital (note 7)	-	54,311
Contributed surplus (note 8)	**4,390**	2,663
Retained earnings	**26,004**	31,559
Accumulated other comprehensive income (loss)	**(1,967)**	3,326
	97,422	91,859
Commitments and contingencies (note 16)		
Subsequent event (note 17)		
	$ 173,537	$ 183,872

See accompanying notes to consolidated financial statements.

Approved by the Directors:

Signed: "Mark L. Bentsen"
Mark L. Bentsen
Director

Signed: "Rod Maxwell"
Rod Maxwell
Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

Years ended December 31, 2009 and 2008
Dollars in '000s except per share amounts

	2009	2008
Revenues	**$ 94,520**	$ 178,928
Expenses:		
Operating	**52,128**	98,614
General and administrative	**26,083**	31,063
Depreciation and amortization	**15,343**	13,416
Share-based compensation	**1,732**	1,705
Interest - long-term debt	**1,258**	1,158
Interest - other	**290**	422
Foreign exchange (gain) loss	**(3,340)**	94
	93,494	146,472
	1,026	32,456
Gain on disposal of property and equipment	**975**	2,138
Income before taxes	**2,001**	34,594
Taxes (note 6):		
Current	**2,151**	6,348
Future (recovery)	**(5,431)**	(1,893)
	(3,280)	4,455
Net income	**5,281**	30,139
Retained earnings, beginning of year	**31,559**	28,852
Less: distributions to Unitholders	**(10,836)**	(27,432)
Retained earnings, end of year	**$ 26,004**	$ 31,559
Net income per share (note 9):		
Basic	**$ 0.15**	$ 0.94
Diluted	**$ 0.15**	$ 0.93

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) AND ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Years ended December 31, 2009 and 2008
Dollars in '000s except per share amounts

	2009	2008
Net income	**$ 5,281**	$ 30,139
Other comprehensive income (loss):		
Unrealized foreign exchange gain (loss) on translation of self-sustaining foreign operations	**(5,293)**	3,326
Comprehensive income (loss)	**$ (12)**	$ 33,465
Accumulated other comprehensive income, beginning of year	**$ 3,326**	$ -
Adjustment for change in foreign currency translation method (note 2)	**-**	(1,894)
Other comprehensive income (loss)	**(5,293)**	5,220
Accumulated other comprehensive income (loss), end of year	**$ (1,967)**	$ 3,326

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2009 and 2008

Dollars in '000s except per share amounts

		2009		2008
Cash provided by (used in):				
Operating activities:				
Net income	**$**	**5,281**	$	30,139
Items not involving cash:				
Depreciation and amortization		**15,343**		13,416
Future income tax recovery		**(5,431)**		(1,893)
Unrealized foreign exchange gain		**(3,682)**		(405)
Share-based compensation		**1,732**		1,705
Gain on disposal of property and equipment		**(975)**		(2,138)
		12,268		40,824
Changes in non-cash operating working capital (note 13)		**6,296**		(4,681)
		18,564		36,143
Investing activities:				
Property and equipment additions		**(8,923)**		(47,618)
Transaction with SemBioSys Genetics Inc. (note 6)		**(3,597)**		-
Proceeds on disposal of property and equipment		**4,219**		3,761
Changes in non-cash investing working capital (note 13)		**(3,719)**		3,723
		(12,020)		(40,134)
Financing activities:				
Advances under long-term debt		**4,500**		23,047
Repayment of long-term debt		**(5,206)**		(341)
Distributions paid to Unitholders		**(13,117)**		(27,368)
Trust Units issued for cash, net of issuance costs (note 7)		**13,820**		-
Proceeds on exercise of Trust Unit options (note 7)		**34**		4,904
Changes in bank indebtedness		**(13,225)**		9,376
		(13,194)		9,618
Effect of exchange rate on changes in cash and cash equivalents		**(410)**		618
Change in cash and cash equivalents		**(7,060)**		6,245
Cash and cash equivalents, beginning of year		**7,551**		1,306
Cash and cash equivalents, end of year	**$**	**491**	$	7,551

See accompanying notes to consolidated financial statements.

Dollars in ‘000s except per share amounts

1. Basis of Presentation

Cathedral Energy Services Ltd. (the “Company”) is incorporated under the Business Corporations Act (Alberta) (the “Act”). The Company was created as a result of the conversion of Cathedral Energy Services Income Trust (the “Trust”) to a corporation pursuant to a Plan of Arrangement under the Act, entered into by various entities including the Trust, Cathedral Energy Services Ltd. (“CES”) and SemBioSys Genetics Inc. (“SBS”) (the ”Reorganization”).

Upon closing of the Reorganization on December 18, 2009, the Company became the operator of the business of the Trust and its subsidiaries and the existing management and board of directors of CES, plus one director of SBS, became the management and board of directors of the Company. The Reorganization resulted in the Unitholders of the Trust becoming shareholders of the Company with no changes to the underlying business operations. The Company did not acquire any additional business carried on by SBS. The former business of SBS is being carried on by a new entity named SemBioSys Genetics Inc. which is owned by the former shareholders of SBS.

Prior to the closing of the Reorganization, the consolidated financial statements included the accounts of the Trust, its subsidiaries and partnerships, all of which were wholly owned. Subsequent to the Reorganization, the consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. The Company is considered a continuation of the Trust and these consolidated financial statements follow the continuity of interest’s method of accounting. Under the continuity of interest’s method of accounting the transfer of assets, liabilities and equity from the Trust to the Company are recorded at their net book values as at December 18, 2009.

As a result of the application of the continuity of interest’s method of accounting, certain terms such as shareholders’/unitholders’ and share-based/unit-based may be used interchangeably throughout these consolidated financial statements.

The Company is publicly traded on the Toronto Stock Exchange under the symbol CET. The Company together with its wholly owned subsidiary, Cathedral Energy Services Inc., is 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. The Company is in the process of establishing operations in Venezuela for providing directional drilling services through its wholly owned subsidiaries Directional Plus International Ltd. and Directional plus de Venezuela, C.A.

2. Significant accounting policies

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

(a) Principles of consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned entities, Cathedral Energy Services Inc., Directional Plus International Ltd. and Directional plus de Venezuela, C.A.

(b) Foreign currency translation

Prior to January 1, 2008, the Company’s U.S. operations were classified as integrated operations and were translated using the temporal method with all translation gains (losses) included in the determination of net income for the current period. Effective January 1, 2008, the Company changed the classification of its U.S. operations to self-sustaining resulting in the consolidated financial statements being translated using the current rate method as opposed to the temporal method. Under the current rate method of translation, revenues and expenses of the subsidiary are translated at the rate in effect at the time of the transactions while assets and liabilities are translated at the current exchange rate in effect at the balance sheet date. Upon consolidation the U.S. operations translation gains and losses due to fluctuations in the foreign currency exchange rates are deferred on the balance sheet as a separate component of Accumulated Other Comprehensive Income (“AOCI”). Accumulated other comprehensive income (loss) forms part of Unitholders’ equity. This change in translation method has been applied prospectively and resulted in a foreign exchange loss of $1,894 being deferred and recorded as AOCI as at January 1, 2008.

The Company’s international operations other than in the U.S. are considered integrated and the Company uses the temporal method of foreign currency translation for these operations.

(c) Inventory

Inventory is comprised of parts to be used in repairing equipment and operating supplies. Inventory is valued at the lower of cost and net realizable value.

(d) Property and equipment

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Significant accounting policies (continued)

(d) Property and equipment (continued)

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

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

(e) Future income taxes

The Company uses the asset and liability method of accounting for future income taxes whereby future income tax assets and liabilities are determined based on temporary differences between the accounting basis and the tax basis of the assets and liabilities, and are measured using substantively enacted tax rates and laws expected to apply when these differences reverse. Tax expense is the sum of the Company's provision for current taxes and the difference between the opening and ending balances of the future income tax assets and liabilities.

(f) Revenue recognition

Revenue is recognized as services are rendered based upon daily, hourly or job rates. Revenue related to the rental of downhole tools is recognized in the period during which the rental hours/days occur.

(g) Per share amounts

Basic net income per share is computed by dividing net income by the weighted average number of shares outstanding for the year. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue shares were exercised or converted to shares. The treasury stock method is used to determine the dilutive effect of options and other dilutive instruments.

(h) Share-based compensation plan

i) Option plan

The Company has an option plan as described in note 7. The related share-based compensation expense is recorded for options issued to employees and non-employees using the fair value method. The fair value of employee options is valued on the date of grant and the resulting fair value is recorded as an expense over the vesting period of the option. The fair value of non-employee options are revalued each reporting date with the change in fair value on the vested options recorded in the income statement, and the change in fair value on unvested options expensed over the remaining vesting period. In determining the fair value of the options granted, the Black-Scholes model is used and assumptions regarding interest rates, underlying volatility of the shares, distribution yield and expected life of the options are made.

ii) Phantom Option plan

The Company had a Phantom Option plan that provided for the granting of stock appreciation rights ("SARs") to key employees. The plan was terminated on October 18, 2009 when the holders forfeited their options (see note 7 f). The SARs provided the holder with the opportunity to earn a cash award equal to the fair market value of the share less the price at which the SAR was issued. Compensation expense was measured based on the market price of the Company's shares at the end of the reporting period.

(i) Cash and cash equivalents

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

(j) Goodwill

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

(k) Intangible assets

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

(l) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

The most significant estimates relate to the depreciation of property and equipment, the cost recovery of property and equipment, goodwill and intangible assets and the determination of share-based compensation. Actual results could differ from those estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Significant accounting policies (continued)

(m) Accounting policy developments in 2009

The following summarizes accounting changes that were applied to the Company's consolidated financial statements for the year ended December 31, 2009:

i) The Canadian Institute of Chartered Accountants (the "CICA") issued Section 3064, Goodwill and Intangible Assets, replacing Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs. New Section 3064 addresses when an internally developed intangible asset meets the criteria for recognition as an asset. The CICA also issued amendments to Section 1000, Financial Statement Concepts.

ii) The CICA issued Section 1582, Business Combinations, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements for the acquisition method for business combinations and related disclosures. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company has chosen not to early adopt the new section.

iii) The CICA issued Sections 1601, Consolidated Financial Statements, and Section 1602, Non-controlling Interests, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company has chosen not to early adopt the new section.

(n) International Financial Reporting Standards

In February, 2008, the CICA confirmed that the use of International Financial Reporting Standards ("IFRS") will be required in Canada for publicly accountable profit oriented enterprises for fiscal years beginning on or after January 1, 2011. The Company will be required to report using IFRS beginning January 1, 2011.

The Company's IFRS project plan has four phases: education, analysis, design and implementation and testing. The Company is continuing the process of education for all levels of the organization and has completed the analysis phase during which it identified specific significant differences between Canadian GAAP and IFRS. The Company is in the design phase in which it is determining its policies and procedures for IFRS. This phase will be completed and the Company will move into the implementation and testing phase in 2010 Q1 to Q3.

3. Property and equipment

2009	Cost	Accumulated depreciation	Net book value
Directional drilling equipment	$ 84,576	$ 36,142	$ 48,434
Production testing equipment	21,928	8,907	13,021
Wireline equipment	23,691	11,614	12,077
Automotive equipment	618	287	331
Office and computer equipment	3,560	1,929	1,631
Leasehold improvements	938	507	431
Deferred development costs	2,677	1,792	885
Buildings	10,953	633	10,320
Land	4,322	-	4,322
	$ 153,263	$ 61,811	$ 91,452

Included in the 2009 property and equipment are assets under capital lease with a cost of $425 and a net book value of $165. During 2009, $2,809 (2008 - Nil) of property and equipment was not depreciated as it was temporarily removed from service.

2008	Cost	Accumulated depreciation	Net book value
Directional drilling equipment	$ 80,410	$ 29,611	$ 50,799
Production testing equipment	19,108	5,403	13,705
Wireline equipment	29,369	11,356	18,013
Automotive equipment	686	206	480
Office and computer equipment	3,532	1,592	1,940
Leasehold improvements	758	344	414
Deferred development costs	2,338	1,456	882
Buildings	11,028	296	10,732
Land	4,322	-	4,322
	$ 151,551	$ 50,264	$ 101,287

Included in the 2008 property and equipment are assets under capital lease with a cost of $425 and a net book value of $207.

4. Bank indebtedness

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 2.00% to 3.50% with interest payable monthly and is secured as described in note 5. 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).

5. Long-term debt

	2009	2008
Bank revolving term loan with a major Canadian bank at an authorized amount of $45,000, bearing interest at the bank's prime rate plus 1.00 % to 2.50% or bankers' acceptance rate plus 2.25% to 3.75%, without repayment terms, maturing June 30, 2010 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	$ 39,500	$ 40,000
Non-interest bearing loans secured by the related automotive equipment with various maturity dates up to 2010	122	218
Capital lease obligations	112	222
	39,734	40,440
Less: current portion of long-term debt	(208)	(207)
	$ 39,526	$ 40,233

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

Minimum principal amounts to be paid under long-term debt (assuming the Company elects prior to the maturity date of the revolving term loan to repay the loan over 36 months with interest only for the first 12 months) during the next five years are approximately as follows:

2010	$ 208
2011	6,607
2012	13,169
2013	13,167
2014	6,583

6. Income taxes

On December 18, 2009, the Company converted from a trust to a corporation by way of a Plan of Arrangement with various entities including the Trust, CES and SBS as described in note 1. SBS had: a) non-capital losses which are available to reduce the future taxable income of the Company in the amount of approximately $33,213; b) research and development expenditures which are available to reduce the future taxable income of the Company in the amount of approximately $41,045 and have an unlimited carry-forward period; and c) investment tax credits which are available to reduce future federal taxes payable of the Company in the amount of $6,747.

A future income tax asset of $24,936 has been recognized with respect to the Plan of Arrangement. As part of the Plan of Arrangement, SBS was paid $3,671 including $2,846 paid in cash and $825 through the issuance of 189,200 common shares of the Company. In addition, advisor and professional fees associated with the transaction in the amount of $751 were capitalized for a total cost of $4,422. The difference between the future income tax asset recognized and the cost of the tax pools has been recorded as a deferred tax credit in the amount of $20,514. SBS also had capital losses of $9,058 which due to their limited use the benefits of these capital losses have not been recognized in these financial statements.

The following table summarizes the temporary differences that give rise to the future income tax asset (liability) as at December 31, 2009 and 2008:

	2009	2008
Property and equipment	$ (3,327)	$ (3,046)
Non capital losses and scientific research and development expenditures carried forward	21,488	-
Investment tax credits	5,043	-
Partnership interests	-	(544)
Deferred partnership income	-	(3,256)
Other	287	-
	$ 23,491	$ (6,846)

6. Income taxes (continued)

The business and operations of the Company are complex and the Company has executed a number of significant financings, reorganizations, acquisitions and other material transactions over the course of its history. The computation of income taxes payable as a result of these transactions involves many complex factors as well as the Company's interpretation of relevant tax legislation and regulations. The Company's management believes that the provision for income tax is adequate and in accordance with generally accepted accounting principles and applicable legislation and regulations. However, tax filing positions are subject to review by taxation authorities who may successfully challenge the Company's interpretation of the applicable tax legislation and regulations.

As at December 31, 2009, the Company has non-capital losses, if not utilized, will expire as follows:

2013	$	942
2014		1,279
2025		4,347
2026		1,523
2027		2,445
2028		11,384
2029		19,549
	$	41,469

As at December 31, 2009, the Company has investment tax credits, if not utilized, will expire as follows:

2017	$	10
2018		48
2019		115
2020		332
2021		260
2022		202
2023		288
2024		1,037
2025		1,036
2026		128
2027		1,575
2028		1,122
2029		594
	$	6,747

Income tax expense for 2009 and 2008 differs from the amount that would be expected by applying the expected statutory income tax rates for the following reasons:

		2009		2008
Effective tax rate		29.3%		29.8%
Income before income taxes	$	2,001	$	34,594
Income allocated to Trust Unitholders		(6,460)		(15,905)
Income (loss) before taxes subject to corporate tax	$	(4,459)	$	18,689
Effective tax rate applied to income subject to corporate tax	$	(1,306)	$	5,569
Adjustment to future taxes for change in effective tax rates		(1,403)		(2,592)
Income taxed in jurisdictions with different tax rates		160		1,228
Non-deductible expenses		528		430
Non-taxable portion of gain on disposal of property and equipment		(326)		(165)
Benefit realized on conversion to corporation		(1,010)		-
Capital taxes		-		12
Other		77		(27)
	$	(3,280)	$	4,455

7. Share Capital

Pursuant to the Plan of Arrangement discussed in note 1, the Company acquired and cancelled all of the issued and outstanding Trust Units on December 18, 2009. Each former Trust Unit holder received one common share of the Company in exchange for one Trust Unit. Shareholders of SBS received 189,200 shares of the Company.

7. Share Capital (continued)

(a) Authorized: An unlimited number of common shares

(b) Trust Units issued

	Number of Trust Units		Amount
Balance, December 31, 2007	31,662,917	$	48,193
Issued on exercise of options	919,105		4,904
Contributed surplus on options exercised (note 8)	-		1,214
Balance, December 31, 2008	32,582,022		54,311
Issued for cash on May 19, 2009	3,615,600		15,005
Less share issuance cost	-		(1,185)
Issued on exercise of options	13,239		34
Contributed surplus on options exercised (note 8)	-		5
Converted into common shares	(36,210,861)		(68,170)
Balance, December 31, 2009	-	$	-

(c) Common shares issued

	Number of shares		Amount
Balance, December 31, 2008	-	$	-
Converted from Trust Units	36,210,861		68,170
Plan of Arrangement (notes 1 and 6)	189,200		825
Balance, December 31, 2009	36,400,061	$	68,995

(d) Options

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

Under the plan, the exercise price of each option at the date of issuance equals the fair market value of the Company's common shares on the day immediately prior to the grant, and has a maximum term till expiry of ten years (also refer to share-based payment modifications in note 7(e)). Options vest over a period of three years from the date of grant as employees, trustees or consultants render continuous service to the Company.

A summary of the status of the Company's equity based compensation plan as at December 31, 2009 and 2008, and changes during the years then ended is presented below:

		2009		2008
	Weighted average number of options	Exercise price	Weighted average number of options	Exercise price
Outstanding, beginning of year	3,053,430	$ 10.27	2,812,937	$ 8.25
Granted	693,066	3.77	1,441,000	11.64
Exercised	(13,239)	2.59	(919,105)	5.34
Forfeited	(1,991,521)	9.95	(281,402)	9.54
Outstanding, end of year	1,741,736	$ 3.67	3,053,430	$ 10.27
Exercisable, end of year	15,667	$ 8.49	1,086,868	$ 9.64

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. Share Capital (continued)

(d) Options (continued)

The range of exercise prices for the options outstanding at December 31, 2009 is as follows:

	Total options outstanding			Exercisable	
Range	Number	Weighted average exercise price	Weighted average remaining life (years)	Number	Weighted average exercise price
$3.35 to $3.68	114,000	$5.59	3.51	-	$ -
$3.81	1,610,069	3.55	3.81	-	-
$4.96 to $11.30	17,667	2.60	8.45	15,667	8.49
$2.59 to $14.74	1,741,736	$3.67	3.84	15,667	$ 8.49

During the year ended December 31, 2009, the Company has recorded share based compensation expense of $1,732 (2008 - $1,672) related to the share option plan.

The following table sets out the assumptions used in applying the Black-Scholes model for options issued in 2009 and 2008 as well as the resulting fair value:

Date of issue	October 13 2009	August 18 2009	July 16 2009
Number of options issued	579,066	54,000	60,000
Exercise price	$ 3.81	$ 3.68	$ 3.35
Fair value per option	$ 1.02	$ 0.98	$ 0.54
Expected dividend / distribution yield	6.30%	6.52%	14.33%
Risk-free interest rate	2.32%	2.49%	2.44%
Expected volatility	52%	52%	52%
Expected life (in years)	3.50	3.50	3.50

Date of issue	September 24 2008	June 3 2008	May 7 2008
Number of options issued	844,000	136,000	461,000
Exercise price	$ 9.65	$ 14.74	$ 14.38
Fair value per option	$ 1.41	$ 2.75	$ 2.63
Expected dividend / distribution yield	8.71%	5.70%	5.84%
Risk-free interest rate	3.34%	3.24%	2.99%
Expected volatility	35%	35%	35%
Expected life (in years)	3.50	3.50	3.50

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

(e) Share-based payment modification

On October 13, 2009, non-insider optionees with vested or unvested out-of-the-money options were invited to reduce the exercise price of their share options to $3.81, which equaled the Trust Unit price on the last trading day immediately before the date of the modification. In exchange for this reduction in the exercise price, longer vesting terms were established with due consideration of the original expiry date which did not change. A total of 1,034,003 options were re-priced. The unrecognized compensation costs from the original grant are recognized over the remainder of the original requisite service period and the incremental compensation costs for the modified share options are recognized over the new requisite service period.

In October 2009, insiders of the Company forfeited all of the outstanding 1,303,334 options, resulting in share based compensation expense of $794 (2008 - nil).

7. **Share Capital (continued)**

(e) Share-based payment modification (continued)

The following sets out the assumptions used in applying the Black-Scholes model for the modified options issued on or about October 13, 2009:

Number of options re-priced	1,034,003
Exercise price	$ 3.81
Weighted average increment fair value per option	$ 0.62
Expected dividend yield	6.30%
Risk-free interest rate	1.3% to 2.3%
Expected volatility	48.5% to 71.9%
Expected life (in years)	1.4 to 5.0

(f) Phantom option plan

The Company had a Phantom Option plan that provided for the granting of stock appreciation rights ("SARs") to key employees. During 2008 120,000 SARs were issued and on October 13, 2009, the holders forfeited all 120,000 SARs outstanding. During the year ended December 31, 2009, nil (2008 - nil) compensation expense related to the SARs was recorded.

8. **Contributed surplus**

Balance, December 31, 2007	$	2,205
Non-cash compensation expense related to option plan (note 7)		1,672
Less: Contributed surplus on options exercised		(1,214)
Balance, December 31, 2008		2,663
Non-cash compensation expense related to option plan (note 7)		1,732
Less: Contributed surplus on options exercised		(5)
Balance, December 31, 2009	$	4,390

9. **Per share amounts**

In calculating the per share amounts, the Company utilizes the treasury method to determine the dilutive effect of options. Under the treasury stock method, only "in the money" dilutive instruments impact the diluted calculations.

At December 31, 2009, the basic weighted average number of shares outstanding was 34,840,714 (2008 - 32,214,502 Trust Units). At December 31, 2009, the diluted number of shares outstanding was 34,856,564 (2008 - 32,462,510 Trust Units), which includes the addition of 15,850 shares (2008 - 222,416 Trust Units) to the basic weighted average number of shares outstanding during the year for the dilutive effect of options.

10. **Management of capital**

The Company views its capital as the combination of long-term debt/capital lease obligations and shareholders' equity excluding accumulated other comprehensive income ("AOCI"). The Company's objectives when managing capital are to maintain a balance between the level of long-term debt/capital lease obligations and shareholders' equity that will allow access to capital markets and long-term debt to fund growth and working capital with due consideration to the cyclical nature of the oilfield services sector. Historically the Company has maintained a conservative ratio of long-term debt/capital lease obligations to long-term debt/capital lease obligations plus shareholders' equity excluding AOCI. As at December 31, 2009 and 2008 this ratio was as follows:

		2009		2008
Long-term debt, net of current portion	$	39,526	$	40,233
Shareholders' equity excluding AOCI		99,389		88,533
Total capitalization	$	138,915	$	128,766
Long-term debt, net of current portion to total capitalization		0.28		0.31

The Company is subject to a leverage test covenant on its credit facility. The management of the Company monitors its credit facility covenants on an on-going basis and is in compliance with the debt covenants as at and for the period ended December 31, 2009.

To assist in the management of its capital the Company prepares annual operating and capital expenditure budgets, which are updated as necessary depending on varying factors including general industry conditions. In order to maintain or adjust the capital structure the Company may, with the approval of its Board of Directors, alter the amount of dividends paid to shareholders, issue new shares, issue new debt, and/or issue new debt to replace existing debt with different characteristics.

The Company's overall strategy with respect to capital management remains unchanged from the year ended December 31, 2008.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Financial instruments

The Company has designated its financial instruments into the following categories applying the indicated measurement methods:

Financial Instrument	Category	Measurement Method
Cash and cash equivalents	Held for trading	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Bank indebtedness/Accounts payable and accrued liabilities/ Distributions payable/ /Long-term debt	Other liabilities	Amortized cost

The Company will assess at each reporting period whether a financial asset, other than those classified as held for trading, is impaired. An impairment loss, if any, is included in net earnings. The Company does not use derivative instruments or hedges. The carrying values of the Company's current assets and current liabilities approximated their fair values as at December 31, 2009 due to the relatively short period to maturity of the instruments. The fair value of long-term debt at December 31, 2009 approximated its carrying value as it bears interest at floating rates.

The Company is exposed to risks of varying degrees of significance which could affect its ability to achieve its strategic objectives for growth and shareholder returns. The principal financial risks to which the Company is exposed are described below.

(a) Credit risk:
Substantially all of the Company's accounts receivable are due from customers in the oil and gas industry and are subject to normal industry credit risks. The carrying value of accounts receivable reflects management's assessment of the associated credit risks. At December 31, 2009 the Company's provision for doubtful accounts is $526 (2008 - $486) and for the year ended had a bad debt expense of $52 (2008 - $16). Included in accounts receivable are amounts of $2,867 (2008 - $4,619) which have been outstanding for greater than 90 days, but which are considered collectable and for which no provision for doubtful accounts has been made.

(b) Liquidity risk:
Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with its financial liabilities. The Company manages liquidity risk through regular monitoring of forecast and actual cash flows, and also the management of its capital structure and financial leverage as outlined in note 10. The Company's credit facility are outlined in notes 4 and 5.

(c) Foreign currency exchange risk:
The Company has an exposure to fluctuations in the Canada/United States foreign currency exchange rate primarily due its operations in the United States. Management attempts to mitigate this exposure by matching local purchases in the same currency. In addition, the Company became exposed to fluctuations in Canadian Dollar versus Venezuelan Bolivars foreign currency exchange rate fluctuations related to funds on deposit in Venezuela. Currently, the Company's net foreign currency exposure risk is not significant enough to warrant an active management program to mitigate the foreign currency exchange exposure.

(d) Interest rate risk:
At December 31, 2009, the Company was exposed to changes in interest rates on its bank indebtedness and most of its long-term debt. A 1% increase in the Company's bank's lending rate would cause interest expense to increase by approximately $417 (2008 - $554) per annum based upon the balance of bank indebtedness and long-term debt with a floating interest rate outstanding as at December 31, 2009.

12. Reorganization costs

To effect the conversion to a corporation, the Company incurred $1,428 of reorganization costs. These costs include fees paid to financial, tax and legal advisors plus regulatory fees and other costs. $677 of these costs have been recognized as general and administrative expenses of the year and the remaining $751 have been recognized as additions to the future tax asset recorded upon the Reorganization.

13. Supplemental cash flow disclosures

		2009		2008
Components of non-cash working capital are as follows:				
Accounts receivable	$	15,020	$	(3,597)
Inventory		2,343		(5,379)
Prepaid expenses and deposits		(151)		(789)
Accounts payable and accrued liabilities		(12,954)		9,836
Taxes payable (recoverable)		(1,681)		(1,029)
		2,577		(958)
Changes in working capital related to investing activities		3,719		(3,723)
Changes in working capital related to operating activities	$	6,296	$	(4,681)
Interest paid	$	1,701	$	1,562
Income taxes paid	$	3,445	$	7,234

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. Segmented information

The Company and its wholly-owned subsidiaries are engaged in the business of providing selected oilfield services to oil and natural gas companies in western Canada, selected basins in the United States and Venezuela, and is viewed as a single operating segment by the chief operating decision maker of the Company for the purpose of resource allocation and assessing performance.

Oilfield services are currently being provided in both Canada and the United States and are expected to occur in Venezuela in 2010. The amounts related to each segment are as follows:

Revenues	2009	2008
Canada	$ 55,926	$ 103,590
United States	38,594	75,338
	$ 94,520	$ 178,928

Revenues by operating division	2009	2008
Directional drilling	$ 64,757	$ 135,999
Production testing	17,342	17,121
Wireline	12,421	25,808
	$ 94,520	$ 178,929

Property and equipment, goodwill and intangibles	2009	2008
Canada	$ 80,188	$ 98,691
United States	23,978	14,974
International	7,354	7,838
	$ 111,520	$ 121,503

During the year ended December 31, 2009, one customer accounted for 28% (2008 – 27%) of consolidated revenues.

15. Related party transactions

A director of the Company is a partner in a law firm and, through that law firm, is involved in providing and managing the legal services provided to the Company at market rates. The total amount paid for these legal services in 2009 was $635 (2008 - $136).

StoneBridge Merchant Capital Corp. ("StoneBridge") acted as a special advisor to the Company in respect to the Plan of Arrangement and was paid a fee of $572. A director of the Company is an officer of StoneBridge. This transaction has been recorded at the exchange amount.

16. Commitments and contingencies

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

2010	$ 2,876
2011	2,107
2012	1,858
2013	1,719
2014	1,579
Thereafter	2,342

(b) Property and equipment additions
At December 31, 2009, the Company has committed to purchase $5,910 (2008 – $4,793) of property, equipment and operating supplies.

(c) Legal and other claims
The Company, in the normal course of operations, will become subject to a variety of legal and other claims against the Company. Management and the Company's legal counsel evaluate all claims on their apparent merits, and accrue management's best estimate of the estimated costs to satisfy such claims. Management believes that the outcome of legal and other claims filed against the Company will not be material.

17. Subsequent event

In January 2010, the Company granted 102,000 options to non-insiders at an exercise price of $5.00. In addition, 1,441,200 options were granted to insiders at an exercise price $6.01.

OFFICERS

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Randy H. Pustanyk, Vice President, Operations

P. Scott MacFarlane, Chief Financial Officer

John Ruzicki, Vice President

David Diachok, Vice President, Sales

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