PEYTO Energy Trust

President's Monthly Report

September 2007 — From the desk of Darren Gee, President & CEO

Summer holidays are over, the kids are back at school and at Peyto our operations are running smoothly. The weather in northern Alberta for the month of August was a bit wet, hampering access slightly, but has not materially affected the pace of our activity. Drilling projects that began in June, after breakup, have begun to reach the tie in stage and newly developed production and reserves for 2007 are growing. Despite the National Oceanic and Atmospheric Administration's (NOAA) forecast for an above average hurricane season, there have been little disturbances to the gas production in the greater Gulf of Mexico area. As a result gas storage volumes are high and natural gas prices are low. All of these factors are, of course, having a more dramatic affect on short term gas prices than long term.

As in the past, this report includes an estimate of monthly capital spending, as well as our field estimate of production for the most recent month (see Capital Investment and Production tables below).

Capital Investment

*2007 Capital Summary (millions$ CND)**

	Q1	Apr	May	Jun	Q2	July	Aug	Sept	Q3	2007 YTD
Land & Seismic	1	0	1	0	1	0				1
Drilling	16	0	0	6	6	7				29
Completions	10	1	0	3	4	5				18
Tie ins	3	1	0	0	1	2				6
Facilities	1	0	0	0	0	0				1
Other	0	0	0	0	0	0				0
Total	**30**	**2**	**1**	**9**	**13**	**14**				**56**

**This is an estimate based on real field data, not a forecast, and the actual numbers will vary from the estimate due to accruals and adjustments. Such variance may be material.*

Production

*2007 Production ('000 boe/d)**

	Apr	May	June	Q2	Jul	Aug	Sept	Q3
Sundance	16.9	16.3	15.8	16.3	15.6	16.1		
Kakwa	2.3	2.2	2.1	2.2	2.1	2.1		
Other	2.2	2.1	2.0	2.1	1.6	1.9		
Total	**21.3**	**20.5**	**19.9**	**20.5**	**19.3**	**20.1**	**-**	**-**

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Death by Taxes

Like most Canadians I personally think we pay far too much tax, or perhaps it is what is taxed that rubs me wrong. I would be ok with funding the government by taxing my consumption. At least I have a choice to consume or not. But taxing my efforts just seems counter productive. The same applies to taxing corporations. Corporations are not individuals that use public services, so why tax their efforts and discourage them from being profitable?

In the petroleum industry, at least, there are programs to offset the burden of corporate taxes and to recognize and promote industry investment which enhances energy security and economic growth. These programs have evolved over time to ensure that the producing industry is taxed on the basis of profits rather than revenues, or successes rather than efforts.

In the calculation of income tax payable for producing companies, the appropriate income tax rates are applied to the taxable net income, after all allowable expenses have been deducted from gross revenue. Included in those deductions are operating and overhead costs, royalties, interest on debt, capital cost allowance (UCC), and intangible costs. The intangible costs are certain of the capital costs which are written off in the year of expenditure or at a specified rate over a number of years and include COGPE (Canadian Oil and Gas Property Expense), CDE (Canadian Development Expense) and CEE (Canadian Exploration Expense). The intangible costs and the undepreciated capital cost can be carried forward indefinitely.

The intangible costs are written off according to the following rates:

1. Canadian Exploration Expense (CEE) includes the costs to drill and evaluate exploratory wells. Geological and geophysical expenses are also included in this category so seismic costs, for instance, would be captured here. These expenses may be written off at a rate of 100% in the year in which they were incurred or they may be carried forward.
2. Canadian Development Expense (CDE) includes the costs to drill and evaluate development wells. These expenses may be written off at a rate of 30% per annum of the diminishing balance.
3. Canadian Oil and Gas Property Expense (COGPE) includes all costs for the purchasing of any producing oil and gas reserves and unproven P&NG properties including the bonus paid for mineral leases. These expenses may be written off at a rate of 10% per annum of the diminishing balance.

Therefore, it is apparent that an organic business model, such as Peyto's, as opposed to an acquiring business model, will generate more effective tax pools. With more capital allocated to CEE and CDE, more yearly write-offs are generated.

When Peyto began as a Junior E&P company, capital spending far exceeded the cashflow and subsequent taxable

income each year. As cashflow increased due to discovery and development of new reserves, more and more capital spending was required to generate pools to shelter the ever increasing taxable income. This is typical of the traditional E&P model, up to the point where the cashflow outstrips the number of good capital investment opportunities, whereupon the taxable income begins to exceed the tax pool shelter, rendering the company taxable (see Figure 1).

Peyto Exploration and Development Corp

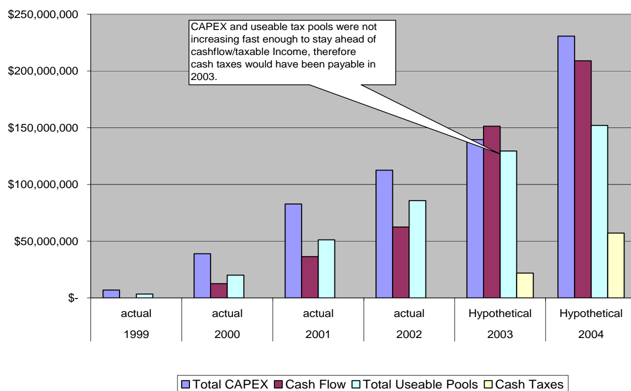


Figure 1

It was at this point in 2003 that Peyto chose to convert to the FTE (flow through entity) model which transfers a portion of the taxable income to the unitholder who enjoys a lower tax rate than the corporation. This point comes much faster in an acquiring business model as the pools generated from acquisition (COGPE) can only be written down at 10%/year. Conversely, the less successful the company is with their capital investment program, the longer they remain non-taxable as they generate tax pools with no corresponding revenue from their unsuccessful investments. Although, this is generally how the E&P sector works for corporations and trusts, most companies are far more complicated.

For Peyto, the conversion was driven by the desire to let the unitholders (shareholders) decide how to minimize their tax burden and eliminate any double taxation.

For a long lasting, sustainable business, even structured as a FTE, and engaged in the more tax efficient organic exploration and development activity, sooner or later there will be corporate taxability. Growing capital programs typically become less efficient and there just aren't enough profitable drilling opportunities in which to invest. In the past this phenomenon has been the "Achilles Heel" of the Canadian oil and gas sector; the pressure to re-invest rather than pay taxes. Our experience has shown us that when corporations begin focusing on minimizing taxes, they end up destroying more wealth than they ultimately save in taxes. That is one of the key benefits of the FTE model, a choice to return funds to the unitholder rather than re-invest inefficiently.

It is unfortunate that civil servants in Ottawa fail to recognize this fact. It is also unfortunate that more than one oil and gas company has "died" attempting to remain non-taxable.

Commodity Prices and Activity Levels

Gas prices continue to soften as storage fills. Contrasted, are oil prices that remain strong, causing heat equivalent prices to diverge yet again (see figure 2).

Commodity Price History

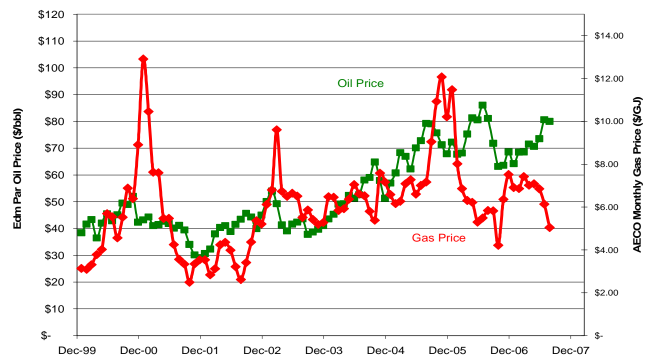
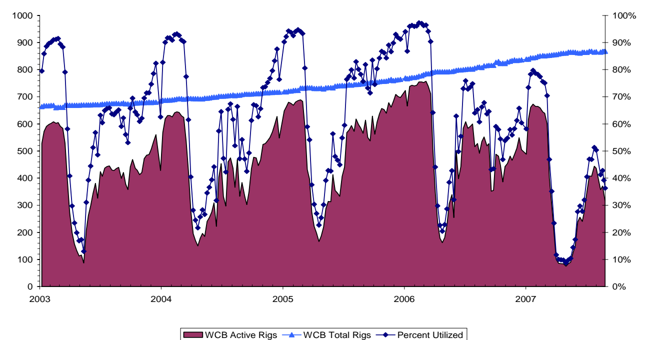


Figure 2

One would think that sooner or later natural gas will become so cheap by comparison to oil as to drive additional fuel switching (this next round requiring capital investment) and result in increasing gas demand. It is only a matter of time, I believe.

On the drilling front, activity in Western Canada remains very low with rig utilization around the 40% mark. Onshore US, however, rig activity remains at record levels, indifferent, it seems, to the price of natural gas. For now, we will have to take advantage of what service cost savings we can, and continue to "grind away" those costs to improve our returns.

Western Canada Drilling Rig Utilization



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