# PEYTO Energy Trust

## President's Monthly Report

January 2008 From the desk of Darren Gee, President & CEO

Happy New Year and welcome to 2008! In many ways I'm glad to put 2007 behind us. It was a tumultuous year to say the least. Overhang of the federal government proposal to tax trust distributions at source come 2011, a more punitive provincial royalty framework for Alberta and the impact of increased North American LNG imports on natural gas prices, all contributed to a challenging year for gas trusts. That said, it was a very successful year for Peyto and it is not surprising that Peyto's units performed better than any other gas trust, considering our low cost advantage and sustainability (save one, TAQA's takeover offer for Primewest shot them up 25%).

This past year was a turning point for Peyto. Our production turned around and started growing again. The cost of services has stopped rising and started to fall. Our cost efficiency looks to be markedly improved and we will be reporting those results soon. At the same time, competition for opportunities in Alberta's deep basin has lessened significantly, due to soft natural gas prices, relative to oil, and Alberta's new royalty rates, relative to the rest of the world. This past year wasn't easy though, and many thanks to the Peyto team for all their hard work in making it successful.

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 | Q2 | July | Aug | Sept | Q3 | Oct | Nov | Dec | 2007 YTD |
|---|---|---|---|---|---|---|---|---|---|---|
| Land & Seismic | 1 | 1 | 0 | 0 | 1 | 1 | 0 | 0 | | 2 |
| Drilling | 16 | 6 | 7 | 6 | 6 | 20 | 8 | 7 | | 58 |
| Completions | 10 | 4 | 5 | 3 | 4 | 11 | 3 | 5 | | 33 |
| Tie ins | 3 | 1 | 2 | 3 | 5 | 10 | 1 | 1 | | 17 |
| Facilities | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | | 2 |
| Other | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | | 0 |
| **Total** | **30** | **13** | **14** | **13** | **16** | **43** | **13** | **14** | **0** | **112** |

***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)**

| | Q1 | Q2 | Q3 | Oct | Nov | Dec | Q4 | 2007 |
|---|---|---|---|---|---|---|---|---|
| Sundance | 16.9 | 16.3 | 16.0 | 16.7 | 16.7 | 16.9 | 16.8 | 16.5 |
| Kakwa | 2.2 | 2.2 | 2.0 | 2.9 | 2.9 | 2.5 | 2.7 | 2.3 |
| Other | 2.3 | 2.1 | 1.8 | 1.5 | 1.4 | 1.3 | 1.4 | 1.9 |
| **Total** | **21.4** | **20.5** | **19.8** | **21.0** | **21.0** | **20.7** | **20.9** | 20.7 |

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### What's to become of the Trusts?

The surprising sale of Focus Energy Trust to Enerplus Resources Trust that was announced late in 2007 had many industry players questioning the ability of any gas trust to be really sustainable, particularly on an after tax basis. In cases where trusts have been built by expensive acquisitions, especially when devoid of tax pools, it is almost impossible, even for the best of management teams, to create a truly sustainable enterprise. Many gas trusts have now been acquired or reconfigured (Focus, Primewest, Shiningbank and Fairborne) while others have had to significantly cut their distributions to stay afloat (Trilogy, Progress, Paramount, Daylight and Advantage).

In many of my reports throughout 2007, I've commented on the uniqueness of Peyto and how we continue to build our business by investing in grass roots drilling ideas that are repeatable, predictable and offer handsome rates of return on capital invested. As I discussed in my September 2007 report, organic exploration and development drilling activity also takes advantage of the most tax efficient way of investing in oil and gas. Of course, the challenge for any energy company is to continue to come up with good drilling ideas year in and year out.

The creation of the Peyto Energy Limited Partnership, as part of our recent internal restructuring, allows us to take advantage of those exploration and development tax pools that have been created in Peyto Operating Trust and use them against income generated in Peyto Exploration and Development Corp. The new partnership gives us a more flexible and efficient structure until 2011.

As we move towards 2011 and the ensuing tax on distributions, several strategies have started to emerge. It has been suggested by some that sustainability can only be achieved by getting significantly bigger. Merging several trusts together, for instance will somehow "create" a more sustainable enterprise. The PennWest-Canetic merger argues this point. I, frankly, just don't see it. After opening too many faulty toys this Christmas that were mass manufactured, I am reminded that sometimes quality is better than quantity. Bigger is not necessarily better. More is not more efficient, it is only more.

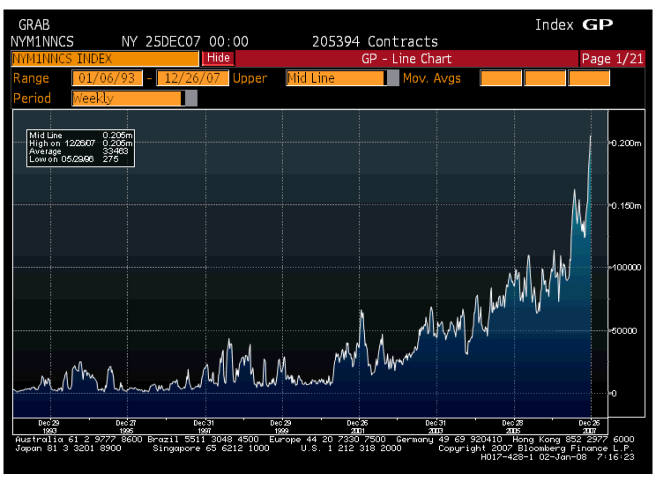
Others argue that with current commodity prices, an energy company should have oil reserves in its portfolio. Well, we know that buying oil reserves won't work, and finding the last of the conventional oil in Western Canada has very little potential for repeatability. There is a reason that oil is $100 per barrel. Of course, there are more significant reserves of heavy oil and tar sands, possibly, but as the environmental pressures mount, these are less attractive. I was astounded that the provincial government, whose mandate included a strong environmental stance, would propose a new royalty framework that caters to the least environmentally friendly hydrocarbon fuel while at the same time discouraging the development of high productivity, conventional, low footprint hydrocarbon reserves. Go figure?!

I continue to believe that the right combination of long life, quality gas assets, coupled with a balanced distribution model and the successful execution of a strong business strategy, is the only way to achieve true ongoing sustainability, even after taxes.

Long life reserves will ultimately yield a very shallow production decline. As long as the cost to replace that decline is only a fraction of the total produced income, a steady flow of funds to unitholders and high Canadian taxes can be afforded. There should even be some left over for growth.

**Commodity Prices and Activity Levels**

I was recently forwarded a Bloomberg graph showing the volume of shorts on North American natural gas lately. That is, the value of trades that have forward sold gas with the expectation that the price will drop and you will be able to buy that same volume of natural gas in the future at a lower price to cover the sale. What it indicates is the general sentiment that gas prices will fall going forward. This is opposite of what the forward strip price for natural gas is showing which indicates higher prices going forward.




What's more, LNG has been selling in spot Asian markets for record prices, upwards of $18/mmbtu. Of course, this might be driven up by the increased Japanese demand due to a downed nuclear power station. Or perhaps there is fear that both India and China won't be leaving any available for the rest of the world.

There seems to be two distinct schools of thought on the future of natural gas prices. Although long term I'm an optimist and side with the bulls, we're still forward selling for the short term to secure prices that compare very favorably to our historical average.

As far as operations go, Peyto is contributing its share of 2 rigs to the active 490 or so in western Canada. At 55% utilization this is still a far cry from historical levels. Alberta's rig utilization continues to show the industry's sentiment towards the new royalty framework.