PEYTO Energy Trust

President's Monthly Report

May 2008 | From the desk of Darren Gee, President & CEO

Spring breakup has arrived and so our field activities are shut down until the frost comes out of the ground. Once that happens and the roads dry up, we can get back to work in the field. Fortunately, much of our land base is located in year round access areas. We are in the latter stages of finalizing our post-breakup drilling plans and determining the capital requirements. Gas prices are strong, costs are down and we have more clarity about the effects of the new royalty framework, which should combine to make investment decisions easier.

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

2007/08 Capital Summary (millions$ CND)*

	Oct	Nov	Dec	Q4	2007	Jan	Feb	Mar	Q1
Land & Seismic	*0*	*0*	*0*	*0*	*3*	*0*	*0*	*0*	*1*
Drilling	*8*	*7*	*2*	*18*	*60*	*6*	*5*	*6*	*17*
Completions	*3*	*5*	*4*	*12*	*37*	*2*	*3*	*4*	*9*
Tie ins	*1*	*1*	*3*	*5*	*20*	*1*	*2*	*3*	*5*
Facilities	*0*	*0*	*0*	*0*	*2*	*0*	*0*	*0*	*0*
Other	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*
Total	***13***	***14***	***10***	***36***	***122***	***10***	***10***	***13***	***33***

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. Tables may not add due to rounding.

Production

2007/08 Production ('000 boe/d)*

	Jan	Feb	Mar	Q1	Apr	May	June
Sundance	*16.6*	*16.3*	*16.2*	*16.4*	*16.3*		
Kakwa	*2.7*	*2.7*	*2.5*	*2.6*	*2.5*		
Other	*1.3*	*1.4*	*1.4*	*1.4*	*1.4*		
Total	***20.6***	***20.4***	***20.1***	***20.4***	***20.2***	*-*	*-*

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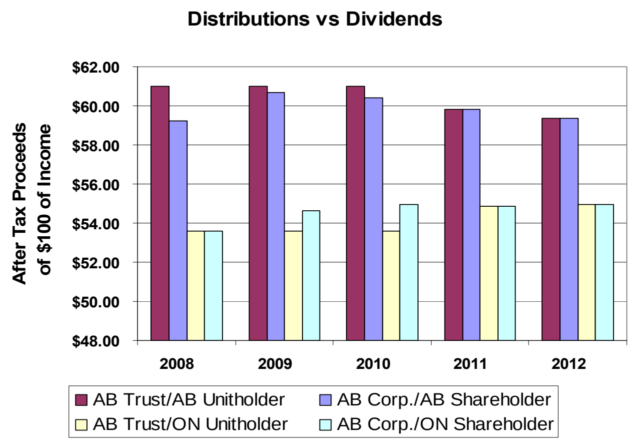
2011 A Corporate Odyssey?

One of our unitholders has asked me to comment on our thoughts about the upcoming federal tax on trust distributions that will come into effect in 2011. While that is still a ways away, and with our government, things will probably change by then, I can at least reiterate what we know, what we don't know and what we guess might happen.

Distributions = Dividends

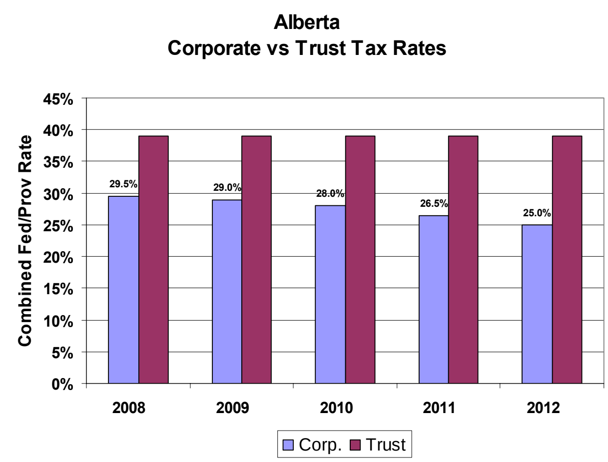
With the mini budget that was announced in the fall of 2007, there were some clarifying details regarding the tax that will be charged on distributions in 2011, before they are paid out to unitholders. Since we are an Alberta business, the combined Fed/Prov. tax rate is expected to be 26.5%. That is the same rate that would be paid if we were a corporation paying out dividends rather than a trust paying out distributions. Since the distributions will be treated as dividends, distributions landing in taxable Canadian accounts would be eligible for the enhanced dividend tax credit. Distributions that land in Canadian tax deferred (retirement) accounts or foreign registered accounts would not be eligible for the credit. For a resident of Alberta or Ontario who is paying tax on their distribution, the comparison is as follows:



The "double taxation" that occurs on tax deferred (retirement) accounts is still a big problem, in my mind, and hopefully we will see the federal government correct it. Distributions received in Alberta are taxed at 26.5% on the way into a RRSP, for example, and are then taxed again, at up to 39%, when they are withdrawn. Dividends are to be treated the same way.

Trusts ≠ Corporations

As for taxes that will be paid on income retained in the organization, it is a different story. Since a trust is effectively an individual, tax rates on income held in the trust are higher than those on income held in a corporation.



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Of course, any exploration and development tax pools that are created from drilling, completions and construction activity will be available to offset income in either type of entity. This leads to the strategy several Energy Trusts have adopted which is to accumulate the pools that are available until 2011, at which time they will be used to shelter both the retained income in the Trust and distributions (by returning only capital) until the pools are depleted. Once depleted, it will be logical for the Trust to convert to a corporation, with no worry about the loss of pools upon conversion. This strategy assumes that current unitholders cannot benefit, from a return of capital before then anyway, which may or may not be the case depending on where the units are held.

That same strategy only provides short term protection for tax deferred unitholders (Pension funds, RRSPs and foreign held units) which will be subject to more tax in 2011. Unfortunately, it will be short lived because once the pools are used up and the Trust converts to a Corporation, it will become taxable.

Another strategy is to pay the tax on the distribution (punitive for the tax deferred unitholders), continue to shelter the retained income in the trust with tax pools (use that income for reserve/production replacement), and continue on as a Trust.

Peyto's Plan - At least today, anyways

I believe that Peyto has a business model that is sustainable on an after tax basis. So long as we can continue to distribute 50-60% of cash flow, we should be able to shelter the remainder with a combination of existing tax pools and new organic activity (drilling, completions, facilities, etc.). If we are *efficient enough*, we should even be able to afford some return of capital to unitholders. Over the last few years 25% of the distributions were classified as return of capital (non-taxable portion). Come 2011, that return of capital should help soften the blow, to tax deferred unitholders, of 26.5% tax on distributions.

Efficient enough means that we are able to sustain our production and reserves with 40-50% of our cash flow. We have successfully demonstrated that over the last three years with average cash flow/boe of $36.80 and average Proved Producing FD&A/boe of $15.16 (41%).

The ongoing challenge will be to balance the right amount of payout with the right amount of re-investment, while at the same time, minimizing the total amount of taxes paid on the total cash flow. This is not always easy, especially in a dramatically changing commodity market.

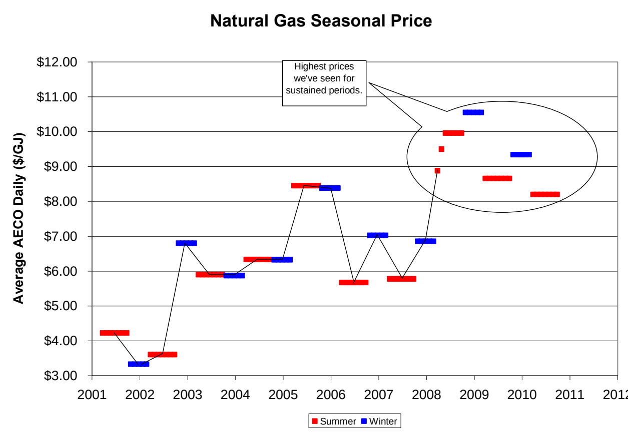
In the past, the oil and gas industry has been guilty of low returns on capital employed (ROCE) by taking too much exploration risk while trying to minimize the taxes paid on cash flow. *"Why not roll the dice on a very risky exploration well, if the funds are just going to be sent to Ottawa anyway (to line the pockets of some ad agency)? We can just write-off the dry hole against our other income!"*

The trust model, if nothing else, has demonstrated to us that by having a choice between re-investment and payout, allows us to be more critical of the re-investment decision, ensuring better capital allocation.

Or, we could choose the alternative. We could burn up all the pools by sheltering all of the income and returning capital rather than income via the distribution. Then, when the pools are depleted, we convert to a corporation - a dividend yielding corporation that offers both income and re-investment. The problem though, is that all the tax pools would be gone, and we would still have a significant cash flow stream subject to income tax, leaving less for either re-investment or dividend.

Of course, all of this is purely speculation on my part, and my training as a Petroleum Engineer hardly makes me an expert in tax planning. In order to even speculate on a potential tax structure, we would require stable tax rules, stable provincial royalties, no new environmental levies, and we would have to be successful at approximately the same rate as we have been for the last nine years. No easy feat. I also wouldn't discount a more novel corporate structure evolving by then. First and most importantly though, we have to focus on what we're doing with the drill bit. That will make or break our success long before bad tax planning will.

Activity Levels and Commodity Prices



Future North American natural gas contracts are offered at some of the highest prices we've ever seen, yet many are suggesting that it is still too low relative to the rest of the world and competing fuels. This makes me very excited about the potential future value of our existing reserves.