PEYTO Energy Trust

President's Monthly Report

May 2010 — From the desk of Darren Gee, President & CEO

Spring breakup is in full swing right now with all field operations shut down. The last wells of the winter drilling season have now been completed and are on-stream. So far, the results look very encouraging but as expected, we have seen some variability.

As the frost is coming out, the ground is firming up. So too are gas prices as the US gas-directed rig count has quit climbing and revised EIA numbers for domestic US production show less production capacity is available. That means a tighter supply-demand picture going forward, especially considering the North American economy continues to improve. I guess that is what gives analysts like eighty some year old Henry Groppe the confidence to make a bold prediction that gas will be $8 by the end of summer. But higher gas prices will surely bring more activity and higher costs. Right now the price is keeping costs down and activity light. In other words, it's a great time to be building gas production and reserves when others are not. For now, that's exactly the path we're steaming ahead on.

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

*2009/2010 Capital Summary (millions$ CND)**

	Q1	Q2	Q3	Oct	Nov	Dec	Q4	2009	Jan	Feb	Mar	Q1
Land & Seismic	0	0	4	0	1	1	2	6	0	0	0	0
Drilling	7	3	18	3	6	8	17	44	10	9	12	31
Completions	4	0	8	4	2	4	11	23	4	7	6	16
Tie ins	2	0	3	3	2	1	5	10	4	2	3	8
Facilities	1	1	0	0	0	0	0	2	1	0	1	2
Drilling Credit Used	0	0	-3	-1	-1	-2	-2.6	-6	-1	-1	-1	-3
Sub Total	**13**	**5**	**29**	**10**	**9**	**12**	**32**	**78**	**18**	**17**	**20**	54
Rem. Drilling Credit								-5	-3	-1	-1	**-5**
Total								**73**	**15**	**16**	**19**	**49**

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

*2010 Production ('000 boe/d)**

	Jan	Feb	Mar	Q1 10	Apr	May	Jun	Q2 09
Sundance	15.9	16.5	17.1	16.5	18.3			
Kakwa	2.5	2.9	3.0	2.8	2.9			
Other	1.2	1.4	1.3	1.3	1.1			
Total	**19.5**	**20.8**	**21.4**	**20.6**	**22.3**	**-**	**-**	**-**

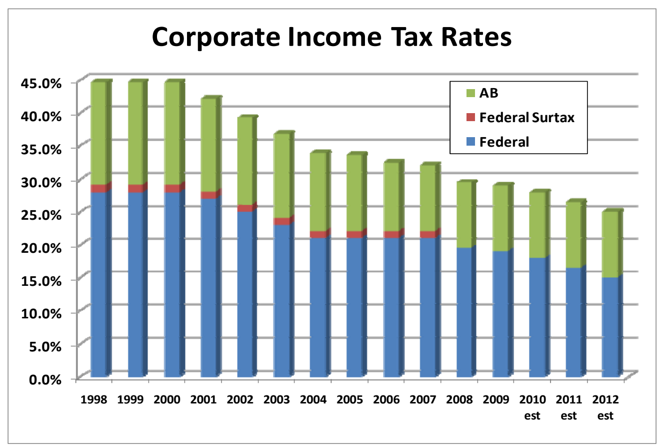
This is an estimate based on real field data, not a forecast, and the actual numbers will vary from the estimate due to accruals and adjustments. Such variance may be material. Tables may not add due to rounding.

Tax Talk

Okay, I'm an engineer, not an accountant. Nor am I a tax expert, so that probably doesn't make me particularly qualified to talk about taxes. In fact, let me reiterate that investors should consult their individual tax advisor with respect to tax issues because everyone is different. That said, it is tax season and with the upcoming trust to corporate conversion that Peyto is envisioning for the end of 2010, I thought I might discuss the tax implications with respect to Peyto and its unitholders.

From the Business Side

First, corporation versus trust. As most unitholders are probably aware, the trust structure allows for the distribution of before tax cashflow from Peyto into the hands of its unitholders. The unitholders then bear the burden of tax on that income at their individual rates. The basic tax advantage of the trust structure was that the collective individual tax rates would be less than the corporate rate and therefore more efficient. But much has changed over the last ten years with respect to corporate tax rates that makes the trust structure less efficient. The following graph shows the corporate income tax rates for an Alberta corporation over the last dozen years or so.



As shown above, since the time of Peyto's conversion into a trust (2003), corporate tax rates have fallen from a combined 36.75% to 28% (they are expected to fall even further to 25% by 2012). However, if the collective tax rate of the trust unitholders receiving distributions in those respective years was less than the corporate rate, then the trust structure was better – more tax efficient. But what this also shows is that being a corporation in the year 2011 and beyond is better than it was back in the year 2000, at least as far as income tax goes. What's further implied, is that if being a high dividend paying corporation was less sustainable in the past, because of high tax rates, then it should be more sustainable in the future due to much lower tax rates. With maximum personal income tax rates as high as 50% in some provinces, having the income taxed in the organization might be more efficient than in the hands of the unitholders. It really depends on who and where the unitholders are.

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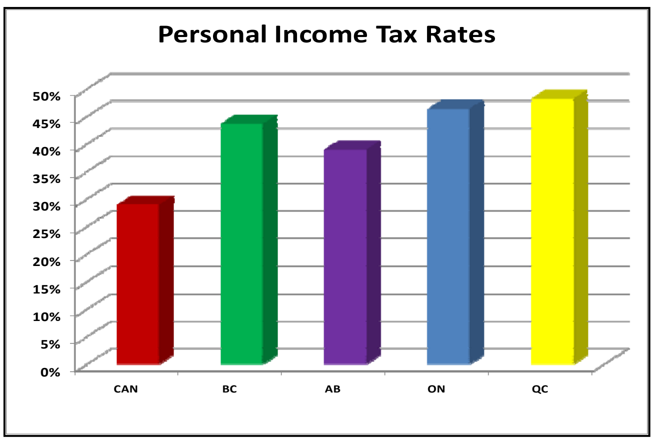
For most trusts, determining who and where your unitholders are is harder than you might think. And because we are publicly traded, it’s changing every day. What we really only see from the various analysis available, is that most of the units are held by the Clearing and Depository Service (CDS), which effectively means they are held by brokerage firms on behalf of their clients. But we have no firm idea as to what province that might be in, or even if they are in Canada and further, whether those distributions are subject to tax today and at what level.

Okay. So a Canadian or Alberta based corporation is enjoying lower and lower taxes. And the trust unitholders are spread all over the map with various tax rates on their personal incomes. It’s getting harder and harder then, to determine who pays less tax on the income, the corporation or the collective trust unitholders.

From the Personal Side

So what about the trust or me the unitholder of the trust (which according to the tax man is more or less the same thing – except you never want taxable income in a trust, very punitive, you always flow it out or shelter it)? Canadian trust investors, unfortunately, are not nearly as lucky as the corporations they might work for. The following graph shows the personal income tax rates for a Canadian in the various provinces (at the highest tax bracket). These rates haven’t really changed in the past ten years with the average Canadian paying ≈40%+ for combined federal (red) and provincial tax. Pretty high compared to a lot of other places.



Source: CRA

Well, if straight income in the hands of the Canadian unitholder isn’t treated so kindly, what about dividends? The following table shows the dividend tax rates (after the impact of dividend tax credits) for those Canadians receiving a dividend from an Alberta corporation as compared to a distribution from a Trust.

Post-Budget 2008 SIFT and Corp. Taxation

	2010		2011		2012	
	All Trusts	AB Corp.	AB Trust	AB Corp.	AB Trust	AB Corp.
Business Income	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00
Tax Payable	0.00	-28.00	-26.50	-26.50	-25.00	-25.00
Distributable Income	$100.00	$72.00	$73.50	$73.50	$75.00	$75.00
Tax Characterization	Income	Dividend	Dividend	Dividend	Dividend	Dividend
Tax Payable by Investor						
QU Individual[1,2]	$48.22	$22.09	$23.41	$23.41	$24.61	$24.61
ON Individual[1,3]	$46.41	$17.03	$18.62	$18.62	$20.06	$20.06
AB Individual[1,4]	$39.00	$11.60	$13.68	$13.68	$15.65	$15.65
Tax Exempt Entity	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Non-resident Investor[5]	$15.00	$10.80	$11.03	$11.03	$11.25	$11.25
Net Proceeds to Investors						
QU Individual	$51.78	$49.91	$50.09	$50.09	$50.39	$50.39
ON Individual	$53.59	$54.97	$54.88	$54.88	$54.94	$54.94
AB Individual	$61.00	$60.40	$59.82	$59.82	$59.35	$59.35
Tax Exempt Entity	$100.00	$72.00	$73.50	$73.50	$75.00	$75.00
Non-resident Investor	$85.00	$61.20	$62.47	$62.47	$63.75	$63.75

So the bottom line is that 2011 income from “Peyto the corporation” flowing dividends to Alberta shareholders, for example, could pay a maximum of 40%; combined corporate (26.5%) and personal (13.7% - 18.6% on the remainder) tax. That same income flowing from Peyto Energy Trust to Alberta unitholders in the form of distributions would pay a maximum of 39% in 2010- combined corporate (0%) and personal (39%) tax, or exactly the same 40% in 2011. So dividends are not quite as good, especially when you consider that even though the corporate rate will drop another 3% in the next two years, the dividend rate will climb by up to 5%.

The conclusion seems to be that using the corporate dividend paying model may not be quite as good as the trust structure; however, decreasing corporate tax rates are making it more competitive than it would otherwise have been. Unfortunately, there really isn’t a lot of choice. Trust distributions are going to be treated exactly like dividends come 2011 anyway. In many ways, the old fashioned growth corporation where all of the income is reinvested, little corporate tax is ever paid and shareholders only pay half of their personal income tax rate on capital gains, is now the most tax efficient. But there are problems there too. No capital discipline, for one, and it forces you to divest your holdings to realize your profits which doesn’t provide for any kind of steady “income stream.” The ongoing challenge is still balancing tax efficiency with capital reinvestment efficiency. Fortunately for Peyto, the substance of our business and our activity doesn’t change even if our structure does.

Activity Levels and Commodity Prices

The EIA announced a correction to US domestic natural gas production that was far less than most were expecting, which didn’t do much for the price. I agree with Goldman Sach’s sentiment that either more demand or less supply still exists because the “balancing term” is still too great. As they put it, *“the revisions were not large enough to move the balancing item back in line with the historical norm. The disconnect remains, suggesting there might be further downward revisions to supply or upward revisions to demand to come.”* We’ll wait to see.