

PEYTO Energy Trust

President's Monthly Report

October 2008

From the desk of Darren Gee, President & CEO

Smart minds think alike. A small, private Calgary-based company, called Kitimat LNG, just announced they plan on building a LNG export facility (rather than an import facility) on the west coast of British Columbia for export to Asia and Europe. A few more of those and perhaps we'll have a competing market for our "made in Alberta" natural gas reserves. At least it would help eliminate some of the large spread between European and NYMEX future natural gas price, which currently sits as high as \$10/mmbtu.

South of the border, Chesapeake Energy (a very large, 2.3 bcf/d natural gas producer) recently announced that both rising costs and lower natural gas prices have squeezed their returns, so they are cutting back on capital spending. In my August report, I talked about the challenge this would place on growing US shale gas production if others follow suit. The result should be less supply and ultimately higher natural gas prices.

Both of these news items are moves in the right direction if we want the longer term price of natural gas to start climbing again, but considering the current economic crisis, it may take a while.

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

2008 Capital Summary (millions \$ CDN)*

	Jan	Feb	Mar	Q1	Apr	May	Jun	Q2	July	Aug	Sept	Q3
Land & Seismic	0	0	0	1	0	0	1	2	1	1		
Drilling	6	5	6	17	1	1	8	10	10	11		
Completions	2	3	4	9	2	0	5	7	7	6		
Tie ins	1	2	3	5	1	0	2	3	2	2		
Facilities	0	0	0	0	0	0	0	0	0	0		
Other	0	0	0	0	0	0	0	0	0	0		
Total	10	10	13	33	3	2	16	21	20	20		

*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

2008 Production ('000 boe/d)*

	Q1 08	Apr	May	June	Q2 08	Jul	Aug	Sept	Q3 08
Sundance	16.4	16.3	16.0	15.6	16.0	16.1	16.5	16.6	16.4
Kakwa	2.6	2.5	2.3	2.2	2.3	2.4	2.2	2.4	2.3
Other	1.4	1.4	1.2	1.2	1.3	1.2	1.2	1.3	1.2
Total	20.4	20.2	19.5	19.0	19.6	19.7	19.9	20.3	19.9

*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.

The Real Yield

With all of the turmoil in the US financial market these days and the spill over into the Canadian and European markets, investors are looking for a place to hide. Some are also

looking at this as a time to buy, since many stocks are significantly discounted relative to their NAV. But where to look? One place is in the income trust space which currently offers some very attractive yields.

Yield is a term that is tossed around in finance circles but often it means different things to different people in different situations. There is nominal yield, current yield, yield to maturity, yield to call, real yield, dividend yield and the list goes on. With respect to income trusts, like Peyto, the yield is called a distribution yield and is simply the ratio of the yearly distribution divided by the share price.

For instance, if Peyto is distributing \$1.80/unit/year (\$0.15/unit/month) and if a unit of Peyto is trading at \$16, then the yield is \$1.80/\$16.00 or 11.25% (let's call it a "unit price derived yield"). Inversely, if you paid \$16 for a unit of Peyto and received \$1.80/year in distribution, it would take you 8.9 years to get your money back. This concept of yield is confusing for some investors because they attempt to compare it to the yield to maturity or yield to call of a bond, which is really more of a measure of total return, ie. 10% yield on a \$10 bond is \$1, in addition to the \$10 of capital.

Where the unit price derived or distribution yield can be misleading is in the lack of reference to the underlying asset value that supports the distribution payment (unlike the \$10 bond which is actually worth \$10). For example, if an energy trust offers a distribution yield of 10% or \$1.00/year for a unit price of \$10, it implies that there would be at least 10 years of distributable value in the asset base of the trust. But what if the trust only has 5 years of distributable value in its asset base? Should it still be called a 10% yield?

2007 Distribution Life, Proved Developed Producing NPV

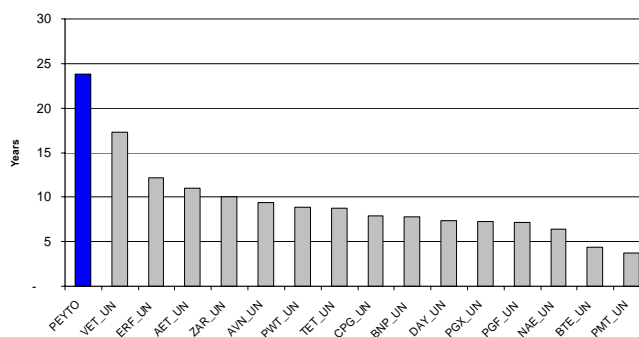


Figure 1

In our corporate presentation we include a graph (Figure 1) that is an industry comparison of an asset derived distribution life. This is basically the Net Present Value (debt adjusted) of the proven producing assets divided by the annual distribution. To put it another way; how many years a trust could pay out their current distribution before the value

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of the asset base is depleted. Going one step further, one can calculate a before tax rate of return on an initial unit price purchase, using a schedule of future distribution payments based on the trusts asset value.

Table 1 shows a schedule of future distribution payments for several energy trusts as illustration.

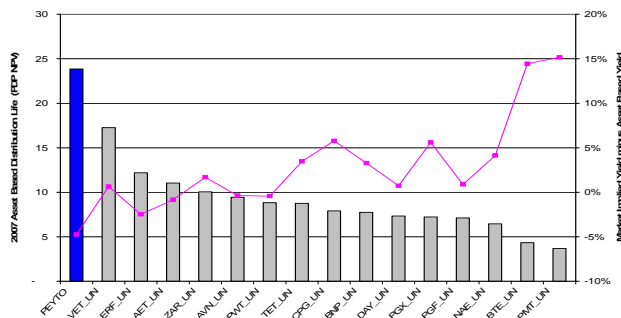
Table 1

	PEYTO	ERF	PWT	PGX	CPG	PMT	BTE
2007 PDP NPV(0) DA/unit	\$ 40.07	\$ 61.40	\$ 36.00	\$ 8.66	\$ 19.01	\$ 4.42	\$ 9.25
Annual Distribution \$/unit	\$ 1.80	\$ 5.04	\$ 4.08	\$ 1.20	\$ 2.76	\$ 1.20	\$ 3.00
Asset Based Dist. Life (yrs)	22.3	12.2	8.8	7.2	6.9	3.7	3.1
Current Unit Price	\$ 16.00	\$ 40.00	\$ 27.00	\$ 13.00	\$ 35.00	\$ 8.00	\$ 28.00
Annual Distribution \$/unit	\$ 1.80	\$ 5.04	\$ 4.08	\$ 1.20	\$ 2.76	\$ 1.20	\$ 3.00
Distribution Yield	11%	13%	15%	9%	8%	15%	11%
Current Unit Price	\$ (16.00)	\$ (40.00)	\$ (27.00)	\$ (13.00)	\$ (35.00)	\$ (8.00)	\$ (28.00)
Distribution Pmt Year 1	\$ 1.80	\$ 5.04	\$ 4.08	\$ 1.20	\$ 2.76	\$ 1.20	\$ 3.00
2	\$ 1.80	\$ 5.04	\$ 4.08	\$ 1.20	\$ 2.76	\$ 1.20	\$ 3.00
3	\$ 1.80	\$ 5.04	\$ 4.08	\$ 1.20	\$ 2.76	\$ 1.20	\$ 3.00
4	\$ 1.80	\$ 5.04	\$ 4.08	\$ 1.20	\$ 2.76	\$ 0.82	\$ 0.25
5	\$ 1.80	\$ 5.04	\$ 4.08	\$ 1.20	\$ 2.76		
6	\$ 1.80	\$ 5.04	\$ 4.08	\$ 1.20	\$ 2.76		
7	\$ 1.80	\$ 5.04	\$ 4.08	\$ 1.20	\$ 2.45		
8	\$ 1.80	\$ 5.04	\$ 4.08	\$ 0.26			
9	\$ 1.80	\$ 5.04	\$ 3.36				
10	\$ 1.80	\$ 5.04					
11	\$ 1.80	\$ 5.04					
12	\$ 1.80	\$ 5.04					
13	\$ 1.80	\$ 0.92					
14	\$ 1.80						
15	\$ 1.80						
16	\$ 1.80						
17	\$ 1.80						
18	\$ 1.80						
19	\$ 1.80						
20	\$ 1.80						
21	\$ 1.80						
22	\$ 1.80						
23	\$ 0.47						
IRR	11%	9%	8%	-11%	-17%	-31%	-56%

Here is where the distribution yield becomes misleading. Although coincidentally, the IRR and distribution yield for Peyto are the same at 11%, this is not always the case. The distribution yield (annual distribution over unit price) has little relation to the rate of return that is achieved with distribution payments derived from underlying asset value.

This begs the question: if the current unit price is suggesting there are more years of distribution to be paid out than the assets would afford, where is that distribution going to come from?

Figure 2



The difference between the two distribution life calculations; unit price derived and asset based, could be interpreted as a premium (Figure 2) afforded to those trusts that have demonstrated an ability to add new reserves and extend their distribution life. One would think that premium, would be consistent with those that had the longer asset based distribution life to begin with. In fact, almost the opposite seems to be true. The yield premium appears to be offered to the trusts with the shortest asset based distribution life.

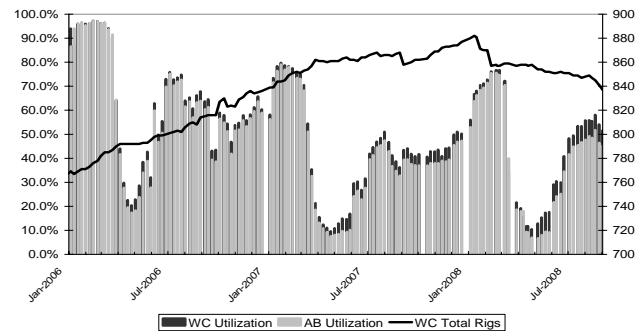
Is that because the trusts with the shorter distribution life are paying it back faster and if so, then the premium is offered for the time value of money? If that were the case then it should be captured in the rate of return calculation which honors that future payment schedule.

What this rate of return exercise demonstrates is that a unit price derived yield can be very misleading if not supported by real asset value.

Activity Levels and Commodity Prices

Western Canadian drilling activity has stalled out since both natural gas and oil prices have pulled back. In Alberta, the new royalty regime has forced over 100 drilling rigs (15% of fleet) to relocate.

Western Canadian Drilling Rig Utilization



Meanwhile natural gas futures prices have dropped back inline with previous seasons.

Natural Gas Seasonal Price

