

## Management's discussion and analysis

This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the audited consolidated financial statements of Peyto Energy Trust (the "Trust" or "Peyto") for the years ended December 31, 2008 and 2007. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

The Trust was created by way of a Plan of Arrangement effective July 1, 2003 which reorganized Peyto Exploration & Development Corp. ("PEDC") from a corporate entity into a trust. Accordingly, the consolidated financial statements were reported on a continuity of interests basis. This discussion provides management's analysis of Peyto's historical financial and operating results and provides estimates of Peyto's future financial and operating performance based on information currently available. Actual results will vary from estimates and the variances may be significant. Readers should be aware that historical results are not necessarily indicative of future performance. This MD&A was prepared using information that is current as of March 3, 2009. Additional information about Peyto, including the most recently filed annual information form is available at [www.sedar.com](http://www.sedar.com).

On January 1, 2008, Peyto completed an internal reorganization. As a result of this reorganization, all of the oil and gas assets of Peyto are now held in the Peyto Energy Limited Partnership. Peyto Energy Administration Corp. is the administrator of Peyto and Peyto Operating Trust, and PEDC is the general partner of the Partnership. Certain subsidiaries of Peyto were amalgamated pursuant to the internal reorganization.

Certain information set forth in this Management's Discussion and Analysis, including management's assessment of the Trust's future plans and operations, contains forward-looking statements. By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond these parties' control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Peyto's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits that Peyto will derive there from. Peyto disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Management uses funds from operations to analyze the operating performance of its energy assets. In order to facilitate comparative analysis, funds from operations is defined throughout this report as earnings before performance based compensation, non-cash and non-recurring expenses. Peyto believes that funds from operations is an important parameter to measure the value of an asset when combined with reserve life. Funds from operations is not a measure recognized by GAAP and does not have a standardized meaning prescribed by GAAP. Therefore, funds from operations, as defined by Peyto, may not be comparable to similar measures presented by other issuers, and investors are cautioned that funds from operations should not be construed as an alternative to net earnings, cash flow from operating activities or other measures of financial performance calculated in accordance with GAAP. Funds from operations cannot be assured and future distributions may vary.

Peyto's foreign ownership level stands at approximately 40% as at January 31, 2009, below the level that would jeopardize Peyto's status as a mutual fund trust under current or proposed legislation.

All references are to Canadian dollars unless otherwise indicated. Natural gas volumes recorded in thousand cubic feet (mcf) are converted to barrels of oil equivalent (boe) using the ratio of six (6) thousand cubic feet to one (1) barrel of oil (bbl).

### **Alberta's New Royalty Framework**

On April 10, 2008, the Alberta Government announced revisions to the New Royalty Framework ("Framework" or "NRF"). The NRF took effect on January 1, 2009. The basis for royalty payments under the new system are as follows:

- Royalty percentages are now dependent upon both well productivity and commodity price
- Gas royalty rates will have a minimum of 5% and a maximum of 50%
- Oil royalty rates will have a minimum of 0% and a maximum of 50%
- In general, under commodity prices of the past few years, well royalty percentages will be higher under this new regime, particularly for higher productivity wells
- Royalty holiday programs have been either eliminated or reduced significantly.

Subsequent to legislation of the NRF, the Alberta Government introduced the Transitional Royalty Plan (“TRP”) in response to the anticipated decrease in Alberta development activity resulting from the economic downturn and declining commodity prices. The TRP offers an alternative for new wells drilled on or after November 19, 2008 that meet certain depth criteria. The TRP is in place for a period of five years to December 31, 2013. All wells will convert to the NRF on January 1, 2014. Operators will elect which royalty regime they wish to adopt for each well drilled. The TRP royalties can be beneficial for certain well depths and production rates. Peyto does not anticipate any material benefit from the TRP in 2009. In general, Peyto expects to see more volatility in royalty rates as a result of the NRF.

The Alberta government announced a “Three Point Incentive Program” to stimulate new and continued economic activity. The key aspects of the program are a drilling depth based credit earned for wells drilled over the next year and applicable against existing corporate royalties as well as a flat 5% royalty rate for a one year period for each new well drilled. Peyto will evaluate the impact of this program but, at first glance, anticipates these combined credits will effectively reduce well costs for the next year by 20% thereby offsetting the low near term commodity price outlook.

#### **Federal Government’s Trust Tax Legislation**

On June 12, 2007, Bill C-52 (the “SIFT Rules”) enacted the October 31, 2006 proposal to impose a new tax on distributions from flow-through entities, including publicly traded income trusts. Under the SIFT Rules, existing income trusts will be subject to the new measures commencing in their 2011 taxation year, following a four-year grace period. In simplified terms, under the proposed tax plan, income distributions will first be taxed at the trust level at a special rate estimated to be the Federal Corporate rate and applicable provincial corporate rate. Income distributions to unitholders will then be treated as dividends from a Canadian corporation. Individual unitholders will be eligible for the dividend tax credit. Tax-deferred accounts (RRSPs, RRIFs and Pension Plans) will continue to pay no tax on distributions but will not be eligible to use the dividend tax credit. Non-resident unitholders will be taxed on distributions at the non-resident withholding tax rate for dividends. The net impact on individual Canadian taxable investors is expected to be minimal because they can take advantage of the dividend tax credit. However, as a result of the tax at the trust level, distributions to tax-deferred accounts and non-residents will be reduced. On the basis of proposed legislation it is anticipated that the tax will be 26.5%.

On July 14, 2008, the Department of Finance released proposed amendments (the "Conversion Rules") to the Income Tax Act (Canada) to facilitate the conversion of existing income trusts into corporations. In general, the proposed amendments will permit a conversion to be tax deferred for both the unitholders and the income trust. However, the Conversion Rules provide alternative approaches to completing a tax deferred conversion. The Department of Finance requested comments on the Conversion Rules by September 15, 2008 and it is anticipated that there will be further amendments to the Conversion Rules. Management and the Board of Directors continue to review the impact of the Trust tax on our business strategy and while there has not been a decision as to Peyto's future direction, at this time we are of the opinion that the conversion from a trust into a corporation may be the most logical and tax efficient alternative for unitholders. At the present time, Peyto believes that if structural or other similar changes are not made, the relative after-tax distribution amount in 2011 to taxable Canadian investors will remain approximately the same, however, will decline for both tax-deferred Canadian investors (RRSPs, RRIFs, pension plans, etc.) and foreign investors.

## **Climate Change Programs**

Peyto looks to both Alberta provincial authorities and to Canada's federal authorities for direction regarding environmental and climate change legislation.

In January 2008 the Alberta Government released Alberta's new Climate Change Strategy. The new strategy focuses on implementing carbon capture and storage, conserving and using energy efficiently, and greening energy production. The provincial vision is significant reductions in emissions for both the mid-term (2014) and long term (2050). To date, the only tangible legislation set forth pertains to large emitting facilities (over 100,000 tonnes per year) and excludes any of Peyto current facilities. The goal of that legislation is to reduce emissions by 20 Mt by 2010, by 50 Mt by 2020, and 200 Mt by 2050. No other new provincial legislation has been developed at this time.

At the federal level, the April 2007 Regulatory Framework for Air Emissions laid out the broad vision for reduction of industrial emissions of both greenhouse gases and air pollutants. This plan calls for greenhouse gas emissions to be reduced by 20 per cent below 2006 levels by 2020. All covered industrial sectors are required to reduce emissions by 18% below 2006 levels by 2010, with a 2% continuous improvement every year after. On March 10, 2008 the federal government announced further details of the April 2007 regulatory framework. The March 10 framework elaborates on fixed process emissions, new facility regulations, cleaner fuel standards, carbon capture and storage, and compliance mechanisms (Canada's domestic offset system, Clean Development Mechanism, Credit for Early Action Program, Technology Fund). The emission intensity targets remain the same as previously laid out in the April 2007 framework.

Currently the framework is being translated into actual regulations. The final regulations are expected to be approved and published in Canada Gazette, Part II in Fall 2009, with greenhouse gas provisions of the regulations coming into force on January 1, 2010.

As mentioned in the October 2006 Notice of Intent to develop and Implement Regulations and Other Measures to Reduce Emissions, the government still intends to transition from energy-intensity targets to fixed emission caps in the 2020-2025 period.

Peyto will monitor the progress of the pending Federal regulations and expects clarity by the end of this year to determine what actions will be required and what impacts will occur from those regulations.

## **United States Proposed Changes to Qualifying Dividends**

A bill was introduced into United States Congress on March 23, 2007 that could deny qualified dividend income treatment to the distributions made by the Trust to its U.S. unitholders. The bill is in the first step of the legislative process and it is uncertain whether it will eventually be passed into law in its current form. If the bill is passed in its current form, distributions received by U.S. unitholders would no longer qualify for the 15% qualified dividend tax rate.

## **OVERVIEW**

Peyto is a Canadian energy trust involved in the development and production of natural gas in Alberta's deep basin. As at December 31, 2008, the total Proved plus Probable reserves were 998.3 billion cubic feet equivalent (166.4 million barrels of oil equivalent) with a reserve life of 23 years as evaluated by the independent petroleum engineers. Production is weighted approximately 85% natural gas and 15% natural gas liquids and oil.

The Peyto model is designed with the objective to deliver growth in its assets, production and income, all on a per unit basis. The model is built around three key principles:

- Use technical expertise to achieve the best return on capital employed, through the development of internally generated drilling projects.
- Maintain a payout ratio designed to efficiently fund a growing inventory of drilling projects.
- Build an asset base which is made up of high quality long life natural gas reserves.

Operating results over the last ten years indicate that these principles have been successfully implemented. This business model makes Peyto a unique energy trust.

## ANNUAL FINANCIAL INFORMATION

The following is a summary of selected financial information of the Trust for the periods indicated. Reference should be made to the audited consolidated financial statements of the Trust, which are available at [www.sedar.com](http://www.sedar.com).

Year Ended December 31	2008	2007	2006
(\$000 except per unit amounts)			
Total revenue (before royalties)	<b>418,886</b>	404,033	439,008
Funds from operations	<b>286,907</b>	279,624	305,845
Per unit – basic and diluted	<b>2.71</b>	2.65	2.93
Earnings	<b>179,397</b>	208,884	195,228
Per unit – basic and diluted	<b>1.69</b>	1.98	1.86
Total assets	<b>1,280,246</b>	1,192,232	1,136,700
Total long-term debt	<b>500,000</b>	430,000	420,000
Cash distributions per unit	<b>1.76</b>	1.68	1.66

## QUARTERLY FINANCIAL INFORMATION

(\$000 except per unit amounts)	2008				2007			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Total revenue (net of royalties)	<b>79,612</b>	86,607	87,682	85,164	82,307	75,589	83,017	92,499
Funds from operations	<b>67,354</b>	74,485	74,113	70,955	68,976	62,938	69,345	78,364
Per unit – basic and diluted	<b>0.64</b>	0.70	0.70	0.67	0.65	0.60	0.66	0.74
Earnings	<b>50,711</b>	64,834	31,412	32,440	73,289	39,886	38,825	56,883
Per unit – basic and diluted	<b>0.48</b>	0.61	0.30	0.31	0.69	0.37	0.37	0.54
Distributions	<b>47,664</b>	47,664	46,605	44,798	44,399	44,399	44,399	44,350
Per unit – basic and diluted	<b>0.45</b>	0.45	0.44	0.42	0.42	0.42	0.42	0.42

## RESULTS OF OPERATIONS

### Production

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2008	2007	2008	2007
Natural gas (mmcf/d)	<b>101,907</b>	104,749	<b>100,384</b>	102,418
Oil & natural gas liquids (bbl/d)	<b>3,207</b>	3,675	<b>3,265</b>	3,599
Barrels of oil equivalent (boe/d)	<b>20,191</b>	21,134	<b>19,996</b>	20,669
Thousand cubic feet equivalent (mcf/d)	<b>121,146</b>	126,801	<b>119,975</b>	124,011

Natural gas production averaged 101.9 mmcf/d in the fourth quarter of 2008, 3% lower than the 104.7 mmcf/d reported for the same period in 2007. Oil and natural gas liquids production averaged 3,207 bbl/d, a decrease of 13% from 3,675 bbl/d reported in the prior year. Production for the year decreased 3% from 124,011 mcf/d to 119,985 mcf/d (20,669 boe/d to 19,996 boe/d). The production decreases are attributable to natural production declines.

### Commodity Prices

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2008	2007	2008	2007
Natural gas (\$/mcf)	<b>7.30</b>	6.57	<b>8.87</b>	7.24
Hedging – gas (\$/mcf)	<b>0.69</b>	1.10	<b>(0.23)</b>	1.18
Natural gas – after hedging (\$/mcf)	<b>7.99</b>	7.67	<b>8.64</b>	8.42
Oil and natural gas liquids(\$/bbl)	<b>49.16</b>	76.67	<b>85.52</b>	66.68
Hedging – oil (\$/bbl)	-	(1.44)	<b>(0.74)</b>	1.20
Oil and natural gas liquids – after hedging (\$/bbl)	<b>49.16</b>	75.23	<b>84.78</b>	67.88
Total Hedging (\$/boe)	<b>3.49</b>	5.19	<b>(1.25)</b>	6.08
Total Hedging (\$/mcf)	<b>0.58</b>	0.86	<b>(0.21)</b>	1.01

Peyto's natural gas price before hedging averaged \$7.30/mcf during the fourth quarter of 2008, an increase of 11% from \$6.57/mcf reported for the equivalent period in 2007. Oil and natural gas liquids prices averaged \$49.16/bbl down 36% from \$76.67/bbl a year earlier. Average natural gas prices for the year were up 23% at \$8.87/mcf while oil and natural gas liquids prices were up 28% at \$85.52/bbl compared to 2007. Hedging activity for fiscal 2008 decreased Peyto's price achieved by \$0.21/mcf or \$1.25/boe. Natural gas prices rose sharply through the first seven months of 2008 and have fallen steadily since peaking in July.

## Revenue

(\$000)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2008	2007	2008	2007
Natural gas	68,396	63,374	325,840	270,602
Oil and natural gas liquids	14,501	25,923	102,206	87,594
Hedging gain (loss)	6,480	10,090	(9,161)	45,837
Total revenue	89,377	99,387	418,885	404,033

For the three months ended December 31, 2008, gross revenue decreased 10% to \$89.4 million from \$99.4 million for the same period in 2007. The decrease in revenue for the quarter was a result of decreased production volumes and decreased natural gas liquids prices as detailed in the following table:

	Three Months ended Dec 31			Twelve Months ended Dec. 31		
	2008	2007	\$million	2008	2007	\$million
Total Revenue, Dec 31, 2007			99.4			404.0
Revenue change due to:						
<b>Natural gas</b>						
Volume (mmcf)	9,375	9,637	(2.0)	36,740	37,382	(5.4)
Price (\$/mcf)	7.99	7.67	3.0	8.64	8.42	8.1
<b>Oil &amp; NGL</b>						
Volume (m bbl)	295	338	(3.3)	1,195	1,314	(8.0)
Price (\$/bbl)	49.16	75.23	(7.7)	84.78	67.88	20.2
Total Revenue, Dec 31, 2008			89.4			418.9

## Royalties

Royalties are paid to the owners of the mineral rights with whom leases are held, including the provincial government of Alberta. Alberta gas crown royalties are invoiced on the Crown's share of production based on a monthly established Alberta Reference Price. The Alberta Reference Price is a monthly weighted average price of gas consumed in Alberta and gas exported from Alberta reduced for transportation and marketing allowances.

(\$000 except per unit amounts)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2008	2007	2008	2007
Royalties,	9,765	17,080	79,821	70,621
% of sales before hedging	12	19	19	20
% of sales after hedging	11	17	19	17
\$/boe	5.26	8.78	10.91	9.36
\$/mcf	0.88	1.46	1.82	1.56

For the fourth quarter of 2008, royalties averaged \$0.88/mcfe (\$5.26/boe) or approximately 11% of Peyto's total petroleum and natural gas sales. Royalties for the year were 19% of sales in 2008 compared to 17% in 2007. The royalty rate expressed as a percentage of sales will fluctuate from period to period due to the fact that the Alberta Reference Price can differ significantly from the commodity prices obtained by the Trust and that hedging gains and losses are not subject to royalties. As average per well production rates decline, the associated effective Crown Royalty rate will decrease. Fourth quarter 2008 royalties were reduced by the recovery of Deep Gas Royalty Holiday claims. The Deep Gas Royalty Holiday program ended December 31, 2008. In its 10 year history, Peyto has invested over \$1.5 billion in capital projects and has found and developed gas reserves that have paid over \$475 million in royalties to Albertans.

## Operating Costs & Transportation

The Trust's operating expenses include all costs with respect to day-to-day well and facility operations. Processing and gathering income related to joint venture and third party gas reduces operating expenses.

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2008	2007	2008	2007
Operating costs (\$000)				
Field expenses	<b>7,789</b>	7,136	<b>30,391</b>	28,433
Processing and gathering income	<b>(2,950)</b>	(2,753)	<b>(11,349)</b>	(9,074)
Total operating costs	<b>4,839</b>	4,383	<b>19,042</b>	19,359
\$/boe	<b>2.60</b>	2.25	<b>2.60</b>	2.57
\$/mcf	<b>0.43</b>	0.38	<b>0.44</b>	0.43
Transportation	<b>1,158</b>	1,052	<b>4,604</b>	4,296
\$/boe	<b>0.62</b>	0.54	<b>0.63</b>	0.57
\$/mcf	<b>0.10</b>	0.09	<b>0.10</b>	0.09

Operating costs were \$4.8 million in the fourth quarter of 2008 compared to \$4.4 million during the same period a year earlier. Processing and gathering income has increased as third party volumes have increased significantly. Transportation expense increased due to an increase in pipeline tariffs effective January 1, 2008. On a unit-of-production basis, operating costs averaged \$0.43/mcf (\$2.60/boe) in the fourth quarter of 2008 compared to \$0.38/mcf (\$2.25/boe) for the fourth quarter of 2007. Operating costs for the year averaged \$0.44/mcf (\$2.60/boe) in 2008 compared to \$0.43/mcf (\$2.57/boe) in 2007.

### Netbacks

Operating netbacks represent the profit margin associated with the production and sale of petroleum and natural gas. The primary factors that produce Peyto's strong netbacks are a low cost structure and the high heat content of its natural gas that results in higher commodity prices.

(\$/mcf)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2008	2007	2008	2007
Gross Sale Price	<b>7.44</b>	7.66	<b>9.75</b>	7.93
Hedging gain (loss)	<b>0.58</b>	0.86	<b>(0.21)</b>	1.01
Net Sale Price	<b>8.02</b>	8.52	<b>9.54</b>	8.92
Less:				
Royalties	<b>0.88</b>	1.46	<b>1.82</b>	1.56
Operating costs	<b>0.43</b>	0.38	<b>0.44</b>	0.43
Transportation	<b>0.10</b>	0.09	<b>0.10</b>	0.09
Field netback	<b>6.61</b>	6.59	<b>7.18</b>	6.84
General and administrative	<b>0.11</b>	0.15	<b>0.15</b>	0.16
Interest on long-term debt	<b>0.45</b>	0.53	<b>0.50</b>	0.51
Cash netback	<b>6.05</b>	5.91	<b>6.53</b>	6.17
Cash netback (\$/boe)	<b>36.26</b>	35.49	<b>39.20</b>	37.07

### General and Administrative Expenses

(\$000 except per unit amounts)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2008	2007	2008	2007
G&A expenses	<b>2,274</b>	2,648	<b>10,227</b>	10,242
Overhead recoveries	<b>(1,033)</b>	(950)	<b>(3,572)</b>	(3,117)
Net G&A expenses	<b>1,241</b>	1,698	<b>6,655</b>	7,125
\$/boe	<b>0.67</b>	0.87	<b>0.91</b>	0.94
\$/mcf	<b>0.11</b>	0.15	<b>0.15</b>	0.16

General and administrative expenses before overhead recoveries remained relatively constant in the fourth quarter of 2008, as compared to the same period in 2007. Net of overhead recoveries associated with the capital expenditures program, general and administrative costs decreased to \$0.11/mcf (\$0.67/boe) in the fourth quarter of 2008, from \$0.15/mcf (\$0.87/boe) in the fourth quarter of 2007. Fourth quarter 2008 capital overhead recoveries were 8.7% higher than fourth quarter 2007 recoveries and were 14.6% higher on an annual basis. General and administrative expenses for 2008 averaged \$0.15/mcf (\$0.91/boe) in 2008 compared to \$0.16/mcf (\$0.94/boe) in 2007.

## Interest Expense

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2008	2007	2008	2007
Interest expense (\$000)	5,020	6,198	21,857	23,007
\$/boe	2.70	3.19	2.99	3.05
\$/mcfe	0.45	0.53	0.50	0.51
Average interest rate	4.0%	6.0%	4.8%	5.7%

2008 interest expense was \$21.9 million or \$0.50/mcfe (\$2.99/boe) compared to \$23.0 million or \$0.51/mcfe (\$3.05/boe) a year earlier. Although interest rates have continued to be favorable, they have been increasingly volatile due to the global economic crisis. Interest rates are not expected to increase substantially in the short-term, however the stamping fee component of interest expense is expected to rise.

## Depletion, Depreciation and Accretion

The 2008 provision for depletion, depreciation and accretion totaled \$75.7 million as compared to \$75.8 million in 2007. On a unit-of-production basis, depletion, depreciation and accretion costs averaged \$1.72/mcfe (\$10.34/boe) as compared to \$1.67/mcfe (\$10.05/boe) in 2007. Increases or decreases in the depletion rate on a unit-of-production basis are influenced by the reserves added through Peyto's drilling program.

## Income Taxes

The 2008 provision for future income tax expense was \$32.1 million (2007 – recovery of \$12.5 million). Increases in capital spending and distributions shorten the period over which timing differences between the accounting and tax basis of assets reverse. As a result, higher reversals occur in the years subject to a zero% tax rate rather than in years subject to the SIFT tax rate, reducing the tax rate applied to the timing differences in calculating future income taxes by approximately 7%. This resulted in a reduction of the future income tax liability and corresponding future tax recovery. Peyto's trust structure is unique and was designed to provide for discretion at the operating trust level to distribute taxable income to the Trust. Resource pools are generated from the capital program, which are available to offset current and future income tax liabilities. Unitholders benefit as the Trust may use these resource pools to increase the tax free return of capital component of the cash distributions. As a result of the internal reorganization that took place January 1, 2008, the tax rate applied to differences between the accounting basis and tax basis of the Trust's assets increased by approximately 3% (the difference between future corporate income tax rates and future tax rates applicable to trusts). At December 31, 2008 the Trust has tax pools of approximately \$653.8 million (December 31, 2007 - \$660.1 million) available for deduction against future income.

Canada Revenue Agency ("CRA") has conducted an audit of restructuring costs claimed as a result of the trust conversion in 2003 that has resulted in the reclassification of \$41.0 million dollars in employment related costs as eligible capital. In October, 2008, the Trust has received a notice of reassessment from the CRA and paid an amount of \$7.3 million related to this audit. Based upon consultation with legal counsel, management's view is that CRA's position has no merit. A notice of objection has been filed and a notice of appeal will be filed shortly.

## MARKETING

### Commodity Price Risk Management

Effective January 1, 2007, the Trust adopted the Canadian Institute of Chartered Accountants ("CICA") Section 3855, "Financial Instruments - Recognition and Measurement," Section 3865, "Hedges," Section 1530, "Comprehensive Income" and Section 3861, "Financial Instruments – Disclosure and Presentation." The Trust has adopted these standards retroactively without restatement and the comparative interim consolidated financial statements have not been restated. Transition amounts have been recorded in retained earnings or accumulated other comprehensive income. See Note 2 to the Consolidated Financial Statements.

The Trust is a party to certain derivative financial instruments, including fixed price contracts. The Trust enters into these forward contracts with well established counter-parties for the purpose of protecting a portion of its future revenues from the volatility of oil and natural gas prices. During 2008, a hedging loss of \$9.2 million was recorded as compared to a hedging gain of \$45.8 million in 2007. A summary of contracts outstanding in respect of the hedging activities are as follows:

<b>Natural Gas Period Hedged</b>	<b>Type</b>	<b>Daily Volume</b>	<b>Price (CAD)</b>
April 1, 2008 to March 31, 2009	Fixed price	5,000 GJ	\$7.05/GJ
April 1, 2008 to March 31, 2009	Fixed price	5,000 GJ	\$6.82/GJ
Nov 1, 2008 to March 31, 2009	Fixed price	5,000 GJ	\$7.25/GJ
Nov 1, 2008 to March 31, 2009	Fixed price	5,000 GJ	\$7.50/GJ
Nov 1, 2008 to March 31, 2009	Fixed price	5,000 GJ	\$7.60/GJ
Nov 1, 2008 to March 31, 2009	Fixed price	5,000 GJ	\$8.00/GJ
Nov 1, 2008 to March 31, 2009	Fixed price	5,000 GJ	\$8.25/GJ
Nov 1, 2008 to March 31, 2009	Fixed price	5,000 GJ	\$8.40/GJ
Nov 1, 2008 to March 31, 2009	Fixed price	5,000 GJ	\$8.65/GJ
Nov 1, 2008 to March 31, 2009	Fixed price	5,000 GJ	\$9.00/GJ
Nov 1, 2008 to March 31, 2009	Fixed price	5,000 GJ	\$9.70/GJ
April 1, 2009 to October 31, 2009	Fixed price	5,000 GJ	\$7.85/GJ
April 1, 2009 to October 31, 2009	Fixed price	5,000 GJ	\$8.12/GJ
April 1, 2009 to October 31, 2009	Fixed price	5,000 GJ	\$8.95/GJ
April 1, 2009 to October 31, 2009	Fixed price	5,000 GJ	\$9.30/GJ
April 1, 2009 to October 31, 2009	Fixed price	5,000 GJ	\$10.20/GJ
April 1, 2009 to October 31, 2009	Fixed Price	5,000 GJ	\$7.50/GJ
April 1, 2009 to March 31, 2010	Fixed Price	5,000 GJ	\$7.65/GJ
April 1, 2009 to March 31, 2010	Fixed Price	5,000 GJ	\$6.90/GJ
November 1, 2009 to March 31, 2010	Fixed Price	5,000 GJ	\$8.35/GJ
November 1, 2009 to March 31, 2010	Fixed Price	5,000 GJ	\$8.39/GJ
November 1, 2010 to March 31, 2011	Fixed Price	5,000 GJ	\$8.91/GJ
November 1, 2010 to March 31, 2011	Fixed Price	5,000 GJ	\$9.15/GJ

As at December 31, 2008, the Trust had committed to the future sale of 16,215,000 gigajoules (GJ) of natural gas at an average price of \$8.36 per GJ or \$9.78 per mcf based on the historical heating value of Peyto's natural gas. Had these contracts been closed on December 31, 2008, the Trust would have realized a gain in the amount of \$30.2 million.

#### Commodity Price Sensitivity

Peyto's earnings are largely determined by commodity prices for crude oil and natural gas including the US/Canadian dollar exchange rate. Volatility in these oil and gas prices can cause fluctuations in Peyto's earnings over which the Trust has no control. Low operating costs and long reserve life reduce Peyto's sensitivity to changes in commodity prices.

#### Currency Risk Management

The Trust is exposed to fluctuations in the Canadian/US dollar exchange ratio since the natural gas and oil sales are effectively priced in US dollars and converted to Canadian dollars. In the short term, this risk is mitigated indirectly as a result of a commodity hedging strategy that is conducted in Canadian currency. Over the long term, the Canadian dollar tends to rise as oil prices rise. There is a similar correlation between oil and gas prices. Currently Peyto has not entered into any agreements to further manage this specific risk.

#### Interest Rate Risk Management

The Trust is exposed to interest rate risk in relation to interest expense on its revolving demand facility. Currently there are no agreements to manage this risk. At December 31, 2008, the increase or decrease in earnings for each 100 bps (1%) change in interest rate paid on the outstanding revolving demand loan amounts to approximately \$4.5 million per annum. Average debt outstanding for 2008 was \$454.7 million.

### LIQUIDITY AND CAPITAL RESOURCES

#### Funds from Operations

(\$000 except per unit amounts)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2008	2007	2008	2007
Net earnings	50,711	73,289	179,397	208,884
Items not requiring cash:				
Provision for (recovery of) performance based compensation	(5,036)	(371)	(269)	269

Future income tax expense	1,778	(30,226)	32,111	(12,453)
Depletion, depreciation & accretion	19,901	19,151	75,668	75,791
Non-recurring items:				
Market and reserve value performance based compensation	-	7,133	-	7,133
Funds from operations	67,354	68,976	286,907	279,624
Funds from operations per unit	0.64	0.65	2.71	2.65

For the quarter ended December 31, 2008, funds from operations totaled \$67.4 million or \$0.64 per unit, as compared to \$69.0 million, or \$0.65 per unit during the same period in 2007. Peyto's policy is to balance distributions to unitholders and funding for a capital program with cashflow and available bank lines. Earnings and cash flow are highly sensitive to changes in commodity prices, exchange rates and other factors that are beyond Peyto's control. Current volatility in commodity prices creates uncertainty as to the funds from operations and capital expenditure budget. Accordingly, results are assessed throughout the year and operational plans revised as necessary to reflect the most current information.

Revenues will be impacted by drilling success and production volumes as well as external factors such as the market prices for natural gas and crude oil and the exchange rate of the Canadian dollar relative to the US dollar.

### Bank Debt

The Trust has an extendible revolving term credit facility with a syndicate of financial institutions in the amount of \$550 million including a \$530 million revolving facility and a \$20 million operating facility. Available borrowings are limited by a borrowing base, which is based on the value of petroleum and natural gas assets as determined by the lenders. The loan is reviewed annually and may be extended at the option of the lender for an additional 364 day period. If not extended, the revolving facility will automatically convert to a one year and one day non-revolving term loan. The loan has therefore been classified as long-term on the balance sheet. The average borrowing rate for 2008 was 4.8% (2006 – 5.7%). The Trust is in compliance with all terms and conditions of its credit facility.

At December 31, 2008, \$500 million was drawn under the facility. Working capital liquidity is maintained by drawing from and repaying the unutilized credit facility as needed. At December 31, 2008, the working capital surplus was \$32.1 million (including a non-cash current asset of \$27.8 million for unrealized mark to market future hedging gains).

Peyto believes that funds generated from operations, together with borrowings under the credit facility and proceeds from equity issued will be sufficient to finance current operations and the planned capital expenditure program. The total amount of capital invested in 2009 will be driven by the number and quality of projects generated. Capital will only be invested if it meets the long term objectives of the Trust. The majority of the capital program will involve drilling, completion and tie-in of low risk development gas wells. Peyto has the flexibility to match planned capital expenditures to actual cash flow.

As a result of the weakened global economic situation, the Trust may have restricted access to capital and increased borrowing costs. Although the Trust's business and asset base have not changed, the lending capacity of all financial institutions has been diminished and risk premiums have increased. These issues may impact the Trust as it reviews financing alternatives for the 2009 capital program and manages future cash flow.

### Capital

On March 17, 2008 the Trust completed a private placement of 207,830 trust units to employees and consultants for net proceeds of \$3.9 million (\$18.92 per unit). These trust units were issued on March 17, 2008. On December 31, 2008, 105,920,194 trust units were outstanding (December 31, 2007 – 105,712,364).

Authorized: Unlimited number of voting trust units  
Issued and Outstanding:

<b>Trust Units (no par value) (\$000)</b>	<b>Number of Units</b>	<b>Amount</b>
<b>Balance, December 31, 2006</b>	<b>105,251,394</b>	<b>398,434</b>
Trust units issued by private placement	460,970	7,867
<b>Balance, December 31, 2007</b>	<b>105,712,364</b>	<b>406,301</b>
Trust units issued by private placement	207,830	3,932
<b>Balance, December 31, 2008</b>	<b>105,920,194</b>	<b>410,233</b>

### Performance Based Compensation

The Trust awards performance based compensation to employees and key consultants annually. The performance based compensation is comprised of market and reserve value based components.

The reserve value based component is 4% of the incremental increase in value, if any, as adjusted to reflect changes in debt, equity and distributions, of proved producing reserves calculated using a constant price at December 31 of the current year and a discount rate of 8%. This methodology can generate interim results which vary significantly from the final compensation paid. No provision for compensation expense was recorded for the year ended December 31, 2008.

<b>(\$millions except unit values)</b>	<b>2008</b>	<b>2007</b>	<b>Change</b>
Net present value of proved producing reserves @ 8% based on constant Paddock Lindstrom 2009 price forecast	<b>1,648.0</b>	1,858.8	
Net debt before performance based compensation	<b>(492.6)</b>	(457.4)	
2008 distributions	-	(186.7)	
Net value	<b>1,155.4</b>	1,214.7	<b>(59.3)</b>
Equity adjustment factor*			100%
Equity adjusted increase in value			<b>(59.3)</b>
<b>2008 reserve value based compensation @ 4%</b>			<b>-</b>

\*Equity adjustment factor is calculated as the percent increase in value per unit divided by the total percent increase in value

Under the market based component, rights with a three year vesting period are allocated to employees and key consultants. The number of rights outstanding at any time is not to exceed 6% of the total number of trust units outstanding. At December 31 of each year, all vested rights are automatically cancelled and, if applicable, paid out in cash. Compensation is calculated as the number of vested rights multiplied by the total of the market appreciation (over the price at the date of grant) and associated distributions of a trust unit for that period. For rights vesting in 2008, a tax factor of 1.333 was applied to determine the amount to be paid. Commencing for rights vesting in 2009, no tax factor will be applied to determine the amount paid.

Based on the five day weighted average trading price of the trust units for the year ended December 31, 2008, compensation costs related to 1.2 million vested rights (1% of the total number of trust units outstanding), at an average grant price of \$24.94, average cumulative distributions of \$5.10 and the five day weighted average closing price of \$9.53, is \$nil. The Trust records a non-cash provision for future compensation expense over the life of the rights. The cumulative provision is \$nil.

The total amount expensed under these plans was as follows:

<b>(\$000)</b>	<b>2008</b>	<b>2007</b>
Market based compensation	-	13
Reserve value based compensation	-	7,120
<b>Total</b>	<b>-</b>	<b>7,133</b>

Liability for future market based compensation as at December 31, 2008 related to 3.1 million non-vested rights with an average grant price of \$17.04 were \$nil (2007 - 3.0 million non-vested rights with an average grant price of \$21.04 were \$0.3 million).

### Capital Expenditures

Net capital expenditures for the fourth quarter of 2008 totaled \$22.5 million. Exploration and development related activity represented \$17.6 million or 78% of the total, while expenditures on facilities, gathering systems and equipment totaled \$4.9 million or 22% of the total. The following table summarizes capital expenditures for the year.

(\$000)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2008	2007	2008	2007
Land	730	-	2,106	984
Seismic	1,036	464	3,300	1,799
Drilling – Exploratory & Development	15,786	29,734	114,302	96,908
Production Equipment, Facilities & Pipelines	4,915	5,326	19,583	21,834
Office Equipment	-	22	33	46
<b>Total Capital Expenditures</b>	<b>22,467</b>	<b>35,546</b>	<b>139,324</b>	<b>121,571</b>

### Cash Distributions

(\$000)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2008	2007	2008	2007
Funds from operations (\$000)	67,354	68,976	286,907	279,624
Total distributions (\$000)	47,664	44,399	186,731	177,548
Total distributions per unit (\$)	0.45	0.42	1.76	1.68
Payout ratio (%)	71	64	65	63

Peyto's policy is to balance distributions to unitholders and funding for a capital program with cashflow and available bank lines. The Board of Directors is prepared to adjust the payout levels to achieve the desired distributions while maintaining an appropriate capital structure. For Canadian income tax purposes distributions made are considered a combination of income and return of capital. The portion that is return of capital reduces the adjusted cost base of the units. As a result of the volatility in commodity prices and in order to maintain financial flexibility in light of the on-going global economic and financial crisis, the Trust announced a decrease in distributions to \$0.12 per unit subsequent to year end.

### Accumulated Earnings and Distributions

(\$000)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2008	2007	2008	2007
Opening accumulated earnings	868,724	666,749	740,038	531,154
Net earnings for the period	50,711	73,289	179,397	208,884
Total accumulated earnings	919,435	740,038	919,435	740,038
Total accumulated distributions	(809,197)	(622,466)	(809,197)	(622,466)
Accumulated earnings per Balance Sheet	110,238	117,572	110,238	117,572

Since inception, Peyto has accumulated earnings of \$919.4 million and distributed \$809.2 million to unitholders.

### Contractual Obligations and Commitments

The Trust is committed to payments under operating leases for office space as follows:

(\$000)	\$
2009	1,097
2010	1,097
2011	822
	<b>3,016</b>

From time to time, Peyto is the subject of litigation arising out of its day-to-day operations. While Peyto assesses the merits of each lawsuit and defends itself accordingly, Peyto may be required to incur significant expenses or devote significant resources to defending itself against such litigation. Such claims are not currently expected to have a material impact on Peyto's financial position or results of operations.

### RELATED PARTY TRANSACTIONS

An officer of the Trust is a partner of a law firm that provides legal services to the Trust. The fees charged are based on standard rates and time spent on matters pertaining to the Trust and its subsidiaries. For the year ended December 31, 2008, legal fees totaled \$0.4 million.

## INCOME TAXES

The following sets out a general discussion of the Canadian and US tax consequences of holding Peyto units as capital property. The summary is not exhaustive in nature and is not intended to provide legal or tax advice. Unitholders or potential Unitholders should consult their own legal or tax advisors as to their particular tax consequences.

### Canadian Taxpayers

The Trust qualifies as a mutual fund trust under the *Income Tax Act* (Canada) and, accordingly, Trust units are qualified investments for RRSPs, RRIFs, RESPs, TFSAs and DPSPs. Each year, the Trust is required to file an income tax return and any taxable income of the Trust is allocated to unitholders.

Unitholders are required to include in computing income their pro-rata share of any taxable income earned by the Trust in that year. An investor's adjusted cost base (ACB) in a trust unit equals the purchase price of the unit less any non-taxable cash distributions received from the date of acquisition. To the extent the unitholders' ACB is reduced below zero, such amount will be deemed to be a capital gain to the unitholder and the unitholders' ACB will be brought to nil.

For 2008, the Trust paid distributions to the unitholders in the amount of \$186.7 million (2007 - \$177.5 million) in accordance with the following schedule:

<b>Production Period</b>	<b>Record Date</b>	<b>Distribution Date</b>	<b>Per Unit</b>
Special Distribution	January 1, 2008	January 15, 2008	\$0.0035
January 2008	January 31, 2008	February 15, 2008	\$0.14
February 2008	February 29, 2008	March 14, 2008	\$0.14
March 2008	March 31, 2008	April 15, 2008	\$0.14
April 2008	April 30, 2008	May 15, 2008	\$0.14
May 2008	May 31, 2008	June 13, 2008	\$0.15
June 2008	June 30, 2008	July 15, 2008	\$0.15
July 2008	July 31, 2008	August 15, 2008	\$0.15
August 2008	August 31, 2008	September 15, 2008	\$0.15
September 2008	September 30, 2008	October 15, 2007	\$0.15
October 2008	October 31, 2008	November 14, 2008	\$0.15
November 2008	November 30, 2008	December 15, 2008	\$0.15
December 2008	December 31, 2008	January 15, 2008	\$0.15

### US Taxpayers

US unitholders who receive cash distributions are subject to a 15% Canadian withholding tax, applied to the taxable portion of the distributions as computed under Canadian tax law. US taxpayers may be eligible for a foreign tax credit with respect to Canadian withholding taxes paid.

The taxable portion of the cash distributions, if any, is determined by the Trust in relation to its current and accumulated earnings and profit using US tax principles. The taxable portion so determined, is considered to be a dividend for US tax purposes.

The non-taxable portion of the cash distributions is a return of the cost (or other basis). The cost (or other basis) is reduced by this amount for computing any gain or loss from disposition. However, if the full amount of the cost (or other basis) has been recovered, any further non-taxable distributions should be reported as a gain.

A bill was introduced into United States Congress on March 23, 2007 that could deny qualified dividend income treatment to the distributions made by the Trust to its U.S. unitholders. The bill is in the first step of the legislative process and it is uncertain whether it will eventually be passed into law in its current form. If the bill is passed in its current form, distributions received by U.S. unitholders would no longer qualify for the 15 per cent qualified dividend tax rate.

US unitholders are advised to seek legal or tax advice from their professional advisors.

## **RISK MANAGEMENT**

Investors who purchase units are participating in the net funds from operations from a portfolio of western Canadian crude oil and natural gas producing properties. As such, the funds from operations paid to investors and the value of the units are subject to numerous risks inherent in the oil and natural gas industry.

Expected funds from operations depends largely on the volume of petroleum and natural gas production and the price received for such production, along with the associated costs. The price received for oil depends on a number of factors, including West Texas Intermediate oil prices, Canadian/US currency exchange rates, quality differentials and Edmonton par oil prices. The price received for natural gas production is primarily dependent on current Alberta market prices. Peyto's marketing strategy is designed to smooth out short term fluctuations in the price of natural gas through future sales. It is meant to be methodical and consistent and to avoid speculation.

Although Peyto's focus is on internally generated drilling programs, any acquisition of oil and natural gas assets depends on an assessment of value at the time of acquisition. Incorrect assessments of value can adversely affect distributions to unitholders and the value of the units. Peyto employs experienced staff and performs appropriate levels of due diligence on the analysis of acquisition targets, including a detailed examination of reserve reports; if appropriate, re-engineering of reserves for a large portion of the properties to ensure the results are consistent; site examinations of facilities for environmental liabilities; detailed examination of balance sheet accounts; review of contracts; review of prior year tax returns and modeling of the acquisition to attempt to ensure accretive results to the unitholders.

Inherent in development of the existing oil and gas reserves are the risks, among others, of drilling dry holes, encountering production or drilling difficulties or experiencing high decline rates in producing wells. To minimize these risks, Peyto employs experienced staff to evaluate and operate wells and utilize appropriate technology in operations. In addition, prudent work practices and procedures, safety programs and risk management principles, including insurance coverage protect the Trust against certain potential losses.

The value of Peyto's units is based on among other things, the underlying value of the oil and natural gas reserves. Geological and operational risks can affect the quantity and quality of reserves and the cost of ultimately recovering those reserves. Lower oil and gas prices increase the risk of write-downs on oil and gas property investments. In order to mitigate this risk, proven and probable oil and gas reserves are evaluated each year by a firm of independent reservoir engineers. The reserves committee of the Board of Directors reviews and approves the reserve report.

Access to markets may be restricted at times by pipeline or processing capacity. These risks are minimized by controlling as much of the processing and transportation activities as possible and ensuring transportation and processing contracts are in place with reliable cost efficient counter-parties.

The petroleum and natural gas industry is subject to extensive controls, regulatory policies and income and resource taxes imposed by various levels of government. These regulations, controls and taxation policies are amended from time to time. Peyto has no control over the level of government intervention or taxation in the petroleum and natural gas industry. The Trust operates in such a manner to ensure, to the best of its knowledge that it is in compliance with all applicable regulations and are able to respond to changes as they occur.

The petroleum and natural gas industry is subject to both environmental regulations and an increased environmental awareness. Peyto has reviewed its environmental risks and is, to the best of its knowledge, in compliance with the appropriate environmental legislation and have determined that there is no current material impact on operations.

Peyto is subject to financial market risk. In order to maintain substantial rates of growth, the Trust must continue reinvesting in, drilling for or acquiring petroleum and natural gas. The capital expenditure program is funded primarily through funds from operations, debt and, if appropriate, equity.

## **CONTROLS AND PROCEDURES**

### **Disclosure Controls and Procedures**

The Trust's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, disclosure controls and procedures to provide reasonable assurance that: (i) material

information relating to the Trust is made known to the Trust's Chief Executive Officer and Chief Financial Officer by others, particularly during the period in which the annual and interim filings are being prepared; and (ii) information required to be disclosed by the Trust in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time period specified in securities legislation. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Trust's disclosure controls and procedures at the financial year end of the Trust and have concluded that the Trust's disclosure controls and procedures are effective at the financial year end of the Trust for the foregoing purposes.

#### **Internal Control over Financial Reporting**

The Trust's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, internal control over financial reporting to provide reasonable assurance regarding the reliability of the Trust's financial reporting and the preparation of financial statements for external purposes in accordance with the Canadian GAAP. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Trust's internal control over financial reporting at the financial year end of the Trust and concluded that the Trust's internal control over financial reporting is effective, at the financial year end of the Trust, for the foregoing purpose.

The Trust is required to disclose herein any change in the Trust's internal control over financial reporting that occurred during the period beginning on October 1, 2008 and ended on December 31, 2008 that has materially affected, or is reasonably likely to materially affect, the Trust's internal control over financial reporting. No material changes in the Trust's internal control over financial reporting were identified during such period that has materially affected, or are reasonably likely to materially affect, the Trust's internal control over financial reporting.

It should be noted that a control system, including the Trust's disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

### **CRITICAL ACCOUNTING ESTIMATES**

#### **Reserve Estimates**

Estimates of oil and natural gas reserves, by necessity, are projections based on geologic and engineering data, and there are uncertainties inherent to the interpretation of such data as well as the projection of future rates of production and the timing of development expenditures. Reserve engineering is an analytical process of estimating underground accumulations of oil and natural gas that can be difficult to measure. The accuracy of any reserve estimate is a function of the quality of available data, engineering and geological interpretation and judgment. Estimates of economically recoverable oil and natural gas reserves and future net cash flows necessarily depend upon a number of variable factors and assumptions, such as historical production from the area compared with production from other producing areas, the assumed effects of regulations by governmental agencies and assumptions governing future oil and natural gas prices, future royalties and operating costs, development costs and workover and remedial costs, all of which may in fact vary considerably from actual results. For these reasons, estimates of the economically recoverable quantities of oil and natural gas attributable to any particular group of properties, classifications of such reserves based on risk recovery, and estimates of the future net cash flows expected there from may vary substantially. Any significant variance in the assumptions could materially affect the estimated quantity and value of the reserves, which could affect the carrying value of the Trust's oil and natural gas properties and the rate of depletion of the oil and natural gas properties as well as the calculation of the reserve value based compensation. Actual production, revenues and expenditures with respect to the Trust's reserves will likely vary from estimates, and such variances may be material.

The Trust's estimated quantities of proved and probable reserves at December 31, 2008 were audited by independent petroleum engineers Paddock Lindstrom & Associates Ltd. Paddock has been evaluating reserves in this area and for Peyto for 10 consecutive years.

#### **Depletion and Depreciation Estimate**

The full cost method of accounting for petroleum and natural gas operations is followed whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized. Such costs include land acquisition costs, geological and geophysical costs, carrying charges on non-producing properties, costs of

drilling both productive and non-productive wells and overhead charges directly related to acquisition, exploration and development activities.

All costs of exploring for and developing petroleum and natural gas reserves, together with the costs of production equipment, are depleted and depreciated on the unit-of-production method based on estimated gross proven reserves. Petroleum and natural gas reserves and production are converted into equivalent units based upon estimated relative energy content (6 mcf to 1 barrel of oil).

Costs of acquiring unproved properties are initially excluded from depletion calculations. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion calculations.

#### **Full Cost Accounting Ceiling Test**

The carrying value of property, plant and equipment is reviewed at least annually for impairment. Impairment occurs when the carrying value of the assets is not recoverable by the future undiscounted cash flows. The ceiling test is based on estimates of proved reserves, production rates, estimated future petroleum and natural gas prices and costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material. Any impairment would be charged as additional depletion and depreciation expense.

#### **Asset Retirement Obligation**

The asset retirement obligation is estimated based on existing laws, contracts or other policies. The fair value of the obligation is based on estimated future costs for abandonment and reclamation discounted at a credit adjusted risk free rate. The liability is adjusted each reporting period to reflect the passage of time and for revisions to the estimated future cash flows, with the accretion charged to earnings. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material.

#### **Future Market Performance Based Compensation**

The provision for future market based compensation is estimated based on current market conditions, distribution history and on the assumption that all outstanding rights will be paid out according to the vesting schedule. The conditions at the time of vesting could vary significantly from the current conditions and may have a material effect on the calculation.

#### **Reserve Value Performance Based Compensation**

The reserve value based compensation is calculated using the year end independent reserves evaluation which was completed in January 2008. A quarterly provision for the reserve value based compensation is calculated using estimated proved producing reserve additions adjusted for changes in debt, equity and distributions. Actual proved producing reserves additions and forecasted commodity prices could vary significantly from those estimated and may have a material effect on the calculation.

#### **Income Taxes**

The determination of the Trust's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded.

#### **Financial Instrument Disclosures**

As of January 1, 2008, the Trust adopted CICA Handbook Sections, Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation" which replaced Section 3861. These standards require disclosure of the significance of financial instruments to an entity's financial statements, the risks associated with the financial instruments, and how those risks are managed. The presentation standard essentially carries forward the current presentation requirements. Refer to Note 10 to the Consolidated Financial Statements for the additional disclosures under section 3862.

#### **Capital Disclosures**

As of January 1, 2008, the Trust adopted CICA handbook Section 1535 "Capital Disclosures", which requires entities to disclose their objectives, policies and processes for management of capital, and in addition, whether the entity has complied with any externally imposed capital requirements. Refer to Note 11 to the Consolidated Financial Statements.

**Accounting Changes**

Voluntary changes in accounting policy are made only if they result in financial statements which provide more reliable and relevant information. Accounting policy changes are applied retrospectively unless it is impractical to determine the period or cumulative impact of the change. Corrections of prior period errors are applied retrospectively and changes in accounting estimates are applied prospectively by including these changes in earnings. When the Trust has not applied a new primary source of GAAP that has been issued, but is not effective, the Trust will disclose the fact along with information relevant to assessing the possible impact that application of the new primary source of GAAP will have on the financial statements in the period of initial application.

**Adoption of IFRS**

In January 2006, the CICA Accounting Standards Board (“ASCB”) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards (“IFRS”) by 2011. On February 13, 2008, The ASCB confirmed that the use of IFRS will be required in 2011 for publicly accountable profit-orientated enterprises. The Trust continues to assess the impact of the convergence of Canadian GAAP and IFRS. At this time, the Trust has appointed internal staff along with sponsorship from the senior leadership team to review the impact of converting to IFRS on the accounting policies, information and computer systems, internal and disclosure controls, financial reporting in addition to the changes in the Trust’s financial statements.

**Goodwill and Intangible Assets**

As of January 1, 2009, the Trust will be required to adopt new CICA Handbook Section 3064 “Goodwill and Intangible Assets” which replaces Section 3062 “Goodwill and Other Intangible Assets” and Section 3450 “Research and Development Costs.” Various changes have been made to other standards to be consistent with the new Section 3064, which establishes standards for the recognition, measurement, presentation and disclosure of goodwill and of intangible assets. Standards concerning goodwill are unchanged from the standards in the previous Section 3062. The Trust is assessing the impact of this new standard on its consolidated financial statements, however, the adoption is not expected to have a material impact on its consolidated financial statements.

**ADDITIONAL INFORMATION**

Additional information relating to Peyto Energy Trust can be found on SEDAR at [www.sedar.com](http://www.sedar.com) and [www.peyto.com](http://www.peyto.com).

## Quarterly information

	2008				2007
	Q4	Q3	Q2	Q1	Q4
<b>Operations</b>					
Production					
Natural gas (mcf/d)	<b>101,907</b>	100,324	97,819	101,468	104,749
Oil & NGLs (bbl/d)	<b>3,207</b>	3,199	3,226	3,430	3,675
Barrels of oil equivalent (boe/d @ 6:1)	<b>20,191</b>	19,920	19,530	20,342	21,134
Thousand cubic feet equivalent (mcf/d @ 6:1)	<b>121,146</b>	119,520	117,177	122,050	126,801
Average product prices					
Natural gas (\$/mcf)	<b>7.99</b>	8.81	9.32	8.49	7.67
Oil & natural gas liquids (\$/bbl)	<b>49.16</b>	99.28	107.45	83.45	75.23
\$/MCFE					
Average sale price (\$/mcf)	<b>8.02</b>	10.05	10.75	9.40	8.52
Average royalties paid (\$/mcf)	<b>0.88</b>	2.18	2.52	1.73	1.46
Average operating expenses (\$/mcf)	<b>0.43</b>	0.42	0.43	0.45	0.38
Average transportation costs (\$/mcf)	<b>0.10</b>	0.10	0.11	0.10	0.09
Field netback (\$/mcf)	<b>6.61</b>	7.35	7.69	7.12	6.59
General & administrative expense (\$/mcf)	<b>0.11</b>	0.12	0.18	0.20	0.15
Interest expense (\$/mcf)	<b>0.45</b>	0.46	0.56	0.53	0.53
Cash netback (\$/mcf)	<b>6.05</b>	6.77	6.95	6.39	5.91
<b>Financial (\$000 except per unit)</b>					
Revenue	<b>89,377</b>	110,537	114,543	104,428	99,387
Royalties	<b>9,765</b>	23,930	26,861	19,264	17,080
Funds from operations	<b>67,354</b>	74,485	74,113	70,955	68,976
Funds from operations per unit	<b>0.64</b>	0.70	0.70	0.67	0.65
Total distributions	<b>47,664</b>	47,664	46,605	44,798	44,399
Total distributions per unit	<b>0.45</b>	0.45	0.44	0.42	0.42
Payout ratio	<b>71%</b>	64%	63%	63%	64%
Earnings	<b>50,711</b>	64,834	31,412	32,440	73,289
Earnings per diluted unit	<b>0.48</b>	0.61	0.30	0.31	0.69
Capital expenditures	<b>22,467</b>	62,271	21,528	33,058	35,546
Weighted average trust units outstanding	<b>105,920,194</b>	105,920,194	105,920,194	105,744,338	105,712,364