

To the Unitholders of:  
Peyto Energy Trust:

## Auditors' Report

We have audited the consolidated balance sheets of Peyto Energy Trust (the "Trust") as at December 31, 2008 and 2007 and the consolidated statements of earnings, comprehensive income, accumulated earnings and accumulated other comprehensive income and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta  
February 20, 2009



Chartered Accountants

# Peyto Energy Trust

## Consolidated Balance Sheets

(\$000)

	December 31, 2008	December 31, 2007
<b>Assets</b>		
<b>Current</b>		
Cash	-	20,547
Accounts receivable (Note 5)	65,662	47,728
Financial derivative instruments (Note 15)	27,788	7,405
Prepaid expenses and deposits	3,367	5,020
	<b>96,817</b>	<b>80,700</b>
Financial derivative instruments (Note 15)	2,458	-
Prepaid capital	3,069	-
Property, plant and equipment (Note 6)	1,177,902	1,111,532
	<b>1,183,429</b>	<b>1,111,532</b>
	<b>1,280,246</b>	<b>1,192,232</b>
<b>Liabilities and Unitholders' Equity</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	48,854	85,923
Cash distributions payable (Note 10)	15,888	14,800
Provision for future performance based compensation (Note 13)	-	16
Future income taxes (Note 14)	-	2,285
	<b>64,742</b>	<b>103,024</b>
Long-term debt (Note 7)	500,000	430,000
Provision for future performance based compensation (Note 13)	-	253
Asset retirement obligations (Note 8)	9,479	6,766
Future income taxes (Note 14)	155,308	123,197
	<b>664,787</b>	<b>560,216</b>
<b>Unitholders' equity</b>		
Unitholders' capital (Note 9)	410,233	406,301
Accumulated earnings (Note 10)	110,238	117,572
Accumulated other comprehensive income	30,246	5,119
	<b>550,717</b>	<b>528,992</b>
	<b>1,280,246</b>	<b>1,192,232</b>

See accompanying notes

On behalf of the Board:



(signed) "Michael MacBean"  
Director



(signed) "Darren Gee"  
Director

## Peyto Energy Trust

### Consolidated Statements of Earnings

(\$000 except per unit amounts)

For the years ended December 31,

	2008	2007
<b>Revenue</b>		
Oil and gas sales	428,047	358,196
Realized gain (loss) on hedges (Note 15)	(9,161)	45,837
Royalties	(79,821)	(70,621)
Petroleum and natural gas sales, net	339,065	333,411
<b>Expenses</b>		
Operating (Note 11)	19,042	19,359
Transportation	4,604	4,296
General and administrative (Note 12)	6,655	7,125
Performance based compensation (Note 13)	-	7,133
Future performance based compensation (Note 13)	(269)	269
Interest on long term debt	21,857	23,007
Depletion, depreciation and accretion (Notes 6 and 8)	75,668	75,791
Earnings before taxes	127,557	136,980
<b>Taxes</b>		
Future income tax expense (Note 14)	32,111	(12,453)
<b>Net earnings for the year</b>	<b>179,397</b>	<b>208,884</b>
Earnings per unit (Note 9)		
Basic and diluted	1.69	1.98

See accompanying notes

## Peyto Energy Trust

### Consolidated Statements of Comprehensive Income

(\$000)

For the years ended December 31,

	2008	2007
<b>Net earnings for the year</b>	<b>179,397</b>	208,884
<b>Other comprehensive income (loss)</b>		
Change in unrealized gain on hedges (2007 - net of tax of \$2,178)	<b>15,960</b>	4,880
Realized (gain) loss on hedges (2007 - net of tax \$10,356)	<b>9,161</b>	(23,202)
<b>Comprehensive Income</b>	<b>204,524</b>	190,562

*See accompanying notes*

## Peyto Energy Trust

### Consolidated Statements of Accumulated Earnings and Accumulated Other Comprehensive Income

(\$000)

For the years ended December 31,

	2008	2007
Accumulated earnings, beginning of year	117,572	86,236
Net earnings for the year	179,397	208,884
Distributions ( <i>Note 10</i> )	(186,731)	(177,548)
<b>Accumulated earnings, end of year</b>	<b>110,238</b>	<b>117,572</b>
Accumulated other comprehensive income, beginning of year	5,119	-
Adoption of financial instruments, net of tax of \$10,463 ( <i>Note 2 and 15</i> )	-	23,441
Other comprehensive income (loss)	25,127	(18,322)
<b>Accumulated other comprehensive income, end of year</b>	<b>30,246</b>	<b>5,119</b>

*See accompanying notes*

## Peyto Energy Trust

### Consolidated Statements of Cash Flows

(\$000)

For the years ended December 31,

	2008	2007
	\$	\$
<b>Cash provided by (used in)</b>		
<b>Operating Activities</b>		
Net earnings for the year	179,397	208,884
Items not requiring cash:		
Future performance based compensation	(269)	269
Future income tax expense	32,111	(12,453)
Depletion, depreciation and accretion	75,668	75,791
Change in non-cash working capital related to operating activities <i>(Note 17)</i>	(38,786)	16,215
	<b>248,121</b>	<b>288,706</b>
<b>Financing Activities</b>		
Issue of trust units, net of costs	3,932	2,825
Cash distributions paid	(186,731)	(177,548)
Increase in bank debt	70,000	10,000
Change in non-cash working capital related to financing activities <i>(Note 17)</i>	1,088	5,107
	<b>(111,711)</b>	<b>(159,616)</b>
<b>Investing Activities</b>		
Additions to property, plant and equipment	(139,324)	(121,571)
Change in non-cash working capital related to investing activities <i>(Note 17)</i>	(17,633)	2,222
	<b>(156,957)</b>	<b>(119,349)</b>
<b>Net increase (decrease) in cash</b>	<b>(20,547)</b>	<b>9,741</b>
Cash, beginning of year	20,547	10,806
<b>Cash, end of year</b>	<b>-</b>	<b>20,547</b>

*See accompanying notes*

# **Peyto Energy Trust**

## **Notes to Consolidated Financial Statements**

December 31, 2008 and 2007

### **1. Nature of Operations**

Peyto Energy Trust (the “Trust” or “Peyto”) is an unincorporated open-ended limited purpose trust established under the laws of the Province of Alberta. The beneficiaries of the Trust are the holders of the Trust units. The unitholders of the Trust are entitled to receive cash distributions paid by the Trust and are entitled to one vote for each Trust unit held at unitholder meetings.

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 Peyto Energy Limited Partnership (the “Partnership”). Peyto Energy Administration Corp. is the administrator of Peyto and Peyto Operating Trust, and Peyto Exploration and Development Corp. is the general partner of the Partnership. Certain subsidiaries of Peyto were amalgamated pursuant to the internal reorganization.

The Trust units trade on the TSX under the symbol “PEY.UN”. The Trust’s principal business activity is the exploration for, development and production of petroleum and natural gas in western Canada.

### **2. Summary of Significant Accounting Policies**

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of periodic financial statements necessarily involves the use of estimates and approximations. Accordingly, actual results could differ from those estimates. The consolidated financial statements have, in management’s opinion, been properly prepared within reasonable limits of materiality and within the framework of the Trust’s accounting policies summarized below.

These consolidated financial statements include the accounts of Peyto Energy Trust and its wholly owned subsidiaries, Peyto Exploration & Development Corp., Peyto Operating Trust, Peyto Energy Limited Partnership and Peyto Energy Administration Corp.

#### **Joint operations**

The Trust conducts a portion of its petroleum and natural gas exploration, development and production activities jointly with others and, accordingly, these consolidated financial statements reflect only the Trust’s proportionate interest in such activities.

#### **Property, plant and equipment**

The Trust follows the full cost method of accounting for its petroleum and natural gas properties. All costs related to the acquisition, exploration and development of petroleum and natural gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical costs, carrying charges of non-producing properties, costs of drilling both productive and non-productive wells, the cost of petroleum and natural gas production equipment and overhead charges related to exploration and development activities. All other general and administrative costs are expensed as incurred.

The Trust evaluates its petroleum and natural gas assets to determine that the costs are recoverable and do not exceed the fair value of the properties (“ceiling test”). The costs are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves plus the cost of unproved properties, less impairment, exceed the carrying value of the oil and gas assets. If the carrying value of the petroleum and natural gas properties is not determined to be recoverable, an impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves

plus the cost of unproved properties. The discounted cash flows are estimated using the future product prices and costs and are discounted using a risk-free rate.

Proceeds from the disposition of petroleum and natural gas properties are applied against capitalized costs except for dispositions that would change the rate of depletion and depreciation by 20% or more, in which case a gain or loss would be recorded.

All costs of acquisition, exploration and development of petroleum and natural gas reserves (net of salvage value) and estimated costs of future development of proved undeveloped reserves are depleted and depreciated using the unit of production method based on estimated gross proved reserves as determined by independent engineers. For purposes of the depletion and depreciation calculation, relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Costs of unproved properties are initially excluded from petroleum and natural gas properties for the purpose of calculating depletion. When proved reserves are assigned to the property or it is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion. Depreciation of gas plants and related facilities is calculated on a straight-line basis over a 20-year term. Office furniture and equipment are depreciated over their estimated useful lives at declining balance rates between 20% and 30%.

#### **Asset retirement obligations**

The Trust records a liability for the fair value of legal obligations associated with the retirement of long-lived tangible assets in the period in which they are incurred, normally when the asset is purchased or developed. On recognition of the liability there is a corresponding increase in the carrying amount of the related asset known as the asset retirement cost, which is depleted on a unit-of-production basis over the life of the reserves. The liability is adjusted each reporting period to reflect the passage of time, with the accretion charged to earnings, and for revisions to the estimated future cash flows. Actual costs incurred upon settlement of the obligations are charged against the liability.

#### **Hedging**

The Trust uses derivative financial instruments from time to time to hedge its exposure to commodity price fluctuations. The Trust does not enter into derivative financial instruments for trading or speculative purposes. All derivative financial instruments are initiated within the guidelines of the Trust's risk management policy. This includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Trust enters into hedges of its exposure to petroleum and natural gas commodity prices by entering into natural gas fixed price contracts, when it is deemed appropriate. These derivative contracts, accounted for as hedges, are recognized on the balance sheet. Realized gains and losses on these contracts are recognized in petroleum and natural gas revenue and cash flows in the same period in which the revenues associated with the hedged transaction are recognized. Premiums paid or received are deferred and amortized to earnings over the term of the contract. For financial derivative contracts settling in future periods, a financial asset or liability is recognized in the balance sheet and measured at fair value, with changes in fair value recognized in other comprehensive income.

#### **Revenue recognition**

Petroleum and natural gas sales are recognized as revenue when title passes to purchasers, normally at pipeline delivery point for natural gas and at the wellhead for crude oil.

#### **Measurement uncertainty**

The timely preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles requires that Management make estimates and assumptions and use judgment regarding the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

Amounts recorded for depreciation, depletion and amortization, asset retirement costs and obligations and amounts used for ceiling test and impairment calculations are based on estimates of gross proved reserves and future costs required to develop those reserves. By their nature, these estimates of reserves, including the estimates of future prices and costs, and the related future cash flows are subject to measurement uncertainty, and the impact in the consolidated financial statements of future periods could be material.

The amount of compensation expense accrued for future performance-based compensation arrangements are subject to management’s best estimate of whether or not the performance criteria will be met and what the ultimate payout will be.

Tax interpretations, regulations and legislation in the various jurisdictions in which the Trust and its subsidiaries operate are subject to change. As such, income taxes are subject to measurement uncertainty.

**Future income taxes**

The Trust follows the liability method of accounting for income taxes. Under this method, future income taxes are recorded for the effect of any difference between the accounting and income tax basis of an asset or liability, using the substantively enacted income tax rates. Accumulated future income tax balances are adjusted to reflect changes in income tax rates that are substantively enacted with the adjustment being recognized in net earnings in the period that the change occurs.

**Financial Instruments**

All financial instruments must initially be recognized at fair value on the balance sheet. The Trust has classified each financial instrument into the following categories: “held for trading” financial assets and financial liabilities; “loans or receivables”; and “other financial liabilities”. Subsequent measurement of the financial instruments is based on their classification. Unrealized gains and losses on held for trading financial instruments are recognized in earnings. The other categories of financial instruments are recognized at amortized cost using the effective interest rate method. The Trust has made the following classifications:

<b>Financial Assets &amp; Liabilities</b>	<b>Category</b>
Cash	Held for trading
Accounts Receivable	Loans & receivables
Due from Private Placement	Loans & receivables
Accounts Payable and Accrued Liabilities	Other Liabilities
Provision for Future Performance Based Compensation	Other Liabilities
Distributions Payable	Other Liabilities
Long Term Debt	Other Liabilities
Financial Derivative Instruments	Held for trading

**Derivative Instruments and Risk Management**

Derivative instruments are utilized by the Trust to manage market risk against volatility in commodity prices. The Trust’s policy is not to utilize derivative instruments for speculative purposes. The Trust has chosen to designate its existing derivative instruments as cash flow hedges. The Trust assesses, on an ongoing basis, whether the derivatives that are used as cash flow hedges are highly effective in offsetting changes in cash flows of hedged items. All derivative instruments are recorded on the balance sheet at fair value in either accounts receivable or accrued liabilities. The effective portion of the gains and losses is recorded in other comprehensive income until the hedged transaction is recognized in earnings. When the earnings impact of the underlying hedged transaction is recognized in the consolidated statement of earnings, the fair value of the associated cash flow hedge is reclassified from other comprehensive income into earnings. Any hedge ineffectiveness is immediately recognized in earnings. The fair values of forward contracts are based on forward market prices.

**Embedded Derivatives**

An embedded derivative is a component of a contract that causes some of the cash flows of the combined instrument to vary in a way similar to a stand-alone derivative. This causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified variable, such as interest rate, financial instrument price, commodity price, foreign

exchange rate, a credit rating or credit index, or other variables to be treated as a financial derivative. The Trust has no contracts containing embedded derivatives.

### **3. Changes in Accounting Policies**

#### **Financial Instruments - Disclosure and Presentation**

As of January 1, 2008, the Trust adopted Canadian Institute of Chartered Accountants (“CICA”) Handbook Sections, Section 3862 “Financial Instruments – Disclosures” and Section 3863 “Financial Instruments – Presentation” which replaced Section 3861 “Financial Instruments – Disclosure and Presentation”. The standards require disclosure on the significance of financial instruments to an entity’s financial statements, the risks associated with the financial instruments, and how those risks are managed. Specifically, Section 3862 requires disclosure on the significance of financial instruments to the Trust’s financial position. In addition, the guidance outlines revised requirements for the disclosure of qualitative and quantitative information regarding exposure to risks arising from financial instruments. The presentation requirements under Section 3863 are relatively unchanged from Section 3861. Refer to Note 15, “Financial Instruments and Risk Management” 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. These disclosures include a description of the Trust’s objectives, policies and processes for managing capital, the quantitative data relating to what the entity regards as capital, whether the entity has complied with capital requirements, and, if it has not complied, the consequences of such non-compliance. Refer to Note 16, “Capital Disclosures”.

#### **Inventories**

As of January 1, 2008, the Trust adopted the CICA section 3031, “Inventories,” which replaced CICA section 3030 of the same name. The new guidance provides additional measurement and disclosure requirements and requires the Trust to reverse previous impairment write-downs when there is a change in the situation that caused the impairment. The transitional provisions of section 3031 provided entities with the option of applying this guidance retrospectively and restating prior periods in accordance with section 1506, “Accounting Changes” or adjusting opening retained earnings and not restating prior periods. The adoption of this standard did not have an impact on the Trust’s consolidated financial statements.

### **4. Pending Accounting Pronouncements**

#### **International Financial Reporting Standards (“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.

In April 2008, the CICA published the exposure draft “Adopting IFRSs in Canada”. The exposure draft proposes to incorporate IFRSs into the CICA Accounting Handbook effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. At this date, publicly accountable enterprises will be required to prepare financial statements in accordance with IFRSs. The Trust is currently reviewing the standards to determine the potential impact on its consolidated financial statements.

#### **Goodwill and Intangible Assets**

As of January 1, 2009, the Trust will be required to adopt 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 Section 3064, which establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Standards concerning

goodwill are unchanged from the standards in Section 3062. The Trust is assessing the impact of this standard on its consolidated financial statements, however, the adoption is not expected to have a material impact on its consolidated financial statements.

## 5. Accounts Receivable

(\$000)	2008	2007
Accounts receivable – general	58,394	47,728
Accounts receivable – income taxes	7,268	-
	<b>65,662</b>	<b>47,728</b>

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 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.

## 6. Property, Plant and Equipment

(\$000)	2008	2007
Property, plant and equipment	1,551,789	1,410,767
Accumulated depletion and depreciation	(373,887)	(299,235)
	<b>1,177,902</b>	<b>1,111,532</b>

At December 31, 2008 costs of \$36.8 (December 31, 2007 - \$37.8) related to undeveloped land have been excluded from the depletion and depreciation calculation.

The Trust performed a ceiling test calculation at December 31, 2008 resulting in the undiscounted cash flows from proved reserves plus the cost of unproved properties, less impairment, exceeding the carrying value of petroleum and natural gas assets. The impairment test was calculated at December 31, 2008 using the following independent engineering consultant’s forecasted prices:

	2009	2010	2011	2012	2013	Thereafter <sup>(1)</sup>
Edmonton Ref Price (\$CDN/bbl)	70.18	77.21	83.93	90.34	98.65	+2%
CDN/US Exchange rate	0.84	0.86	0.88	0.90	0.90	0.90
AECO (\$CDN/mmbtu)	7.24	7.90	8.26	8.60	9.13	+2%

(1) Percentage change of 2.0% represents the change in future prices each year after 2013 to the end of the reserve life.

## 7. Long-Term Debt

The Trust has a syndicated \$550 million extendible revolving credit facility with a stated term date of April 30, 2009. The facility is made up of a \$20 million working capital sub-tranche and a \$530 million production line. The facilities are available on a revolving basis for a period of at least 364 days and upon the term out date may be extended for a further 364 day period at the request of the Trust, subject to approval by the lenders. In the event that the revolving period is not extended, the facility is available on a non-revolving basis for a one year term, at the end of which time the facility would be due and payable. Outstanding amounts on this facility bear interest at rates determined by the Trust’s debt to cash flow ratio that range from prime plus 0.75% for debt to earnings before interest, taxes, depreciation, depletion and amortization (EBITDA) ratios ranging from less than 1:1 to greater than 2.5:1. A General Security Agreement with a floating charge on land registered in Alberta is held as collateral by the bank. The Trust is in compliance with all debt covenants. The average borrowing rate for 2008 was 4.8% (2007 – 5.7%).

## 8. Asset Retirement Obligations

The total future asset retirement obligations are estimated by Management based on the Trust’s net ownership interest in all wells and facilities, estimated costs to reclaim and abandon the wells and facilities and the estimated timing of the costs to be incurred in future periods. The Trust has

estimated the net present value of its total asset retirement obligations to be \$9.5 million as at December 31, 2008 (2007 - \$6.8 million) based on a total future liability of \$34.2 million (2007 - \$25.9 million). These payments are expected to be made over the next 50 years. The Trust's credit adjusted risk free rate of 7% and an inflation rate of 2% were used to calculate the present value of the asset retirement obligations.

The following table reconciles the change in asset retirement obligations:

(\$000)	2008	2007
<b>Balance, December 31, 2007</b>	<b>6,766</b>	5,767
Increase in liabilities relating to investing activities	<b>1,697</b>	581
Accretion expense	<b>1,016</b>	418
<b>Balance, December 31, 2008</b>	<b>9,479</b>	6,766

## 9. Unitholders' Capital

**Authorized:** Unlimited number of voting trust units

### Issued and Outstanding

Trust Units (no par value) (\$000)	Number of Units	Amount
<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, end of year</b>	<b>105,920,194</b>	<b>410,233</b>

### Per Unit Amounts

Earnings per unit have been calculated based upon the weighted average number of units outstanding during the year of 105,876,470 (2007 - 105,670,476). There are no dilutive instruments outstanding.

### Redemption of Units

The Trust Units are redeemable at any time on demand by the holders thereof. Upon receipt of proper notice to redeem Trust Units by the Trust, the holder thereof shall only be entitled to receive a price per Trust Unit equal to the lesser of:

(a) 90% of the market price of the Trust Units on the principal market on which the Trust Units are quoted for trading during the 10 trading day period commencing immediately after the date on which the Trust Units are tendered to the Trust for redemption; and

(b) the closing market price on the principal market on which the Trust Units are quoted for trading on the date that the Trust Units are so tendered for redemption.

### Comprehensive Income

Comprehensive income consists of net earnings and other comprehensive income ("OCI"). OCI comprises the change in the fair value of the effective portion of the derivatives used as hedging items in a cash flow hedge. "Accumulated other comprehensive income" is a new equity category comprised of the cumulative amounts of OCI.

## 10. Accumulated Cash Distributions

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

Production Period	Record Date	Distribution Date	Per Unit
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

### Accumulated Earnings and Distributions

(\$000)	2008	2007
<b>Accumulated earnings, beginning of year</b>	<b>740,038</b>	531,154
Net earnings for the year	<b>179,397</b>	208,884
Total accumulated earnings	<b>919,435</b>	740,038
Total accumulated distributions	<b>(809,197)</b>	(622,466)
<b>Accumulated earnings, end of year</b>	<b>110,238</b>	117,572

### 11. Operating Expenses

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 natural gas reduces operating expenses.

(\$000)	2008	2007
Field expenses	<b>30,391</b>	28,433
Processing and gathering income	<b>(11,349)</b>	(9,074)
<b>Total Operating expenses</b>	<b>19,042</b>	19,359

### 12. General and Administrative Expenses

General and administrative expenses are reduced by operating and capital overhead recoveries from operated properties.

(\$000)	2008	2007
General and Administrative expenses	<b>10,227</b>	10,242
Overhead recoveries	<b>(3,572)</b>	(3,117)
<b>Net General and administrative expenses</b>	<b>6,655</b>	7,125

### 13. 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 reserves 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%.

(\$millions except unit values)	2008	2007	Change
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 will then be 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. The 2008 market based component was based on 1.2 million vested rights 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 (2007 – 1.2 million rights, average grant price of \$24.16, average cumulative distributions of \$4.73 per unit and five day weighted average closing price of \$16.48).

The total amount expensed under these plans was as follows:

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

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

#### 14. Future Income Taxes

(\$000)	2008	2007
Earnings before income taxes	<b>211,508</b>	196,431
Statutory income tax rate	<b>32.50%</b>	32.12%
Expected income taxes	<b>68,740</b>	63,094
Increase (decrease) in income taxes from:		
Corporate income tax rate change	<b>9,338</b>	(21,357)
Income attributed to the trust	<b>(45,516)</b>	(51,933)
Change in valuation allowance for share issue costs	<b>(480)</b>	(1,000)
Other	<b>29</b>	(1,257)
<b>Future income tax expense</b>	<b>32,111</b>	<b>(12,453)</b>

The net future income tax liability is comprised of:

(\$000)	2008	2007
Financial derivative instruments	-	<b>2,285</b>
<b>Current future income taxes</b>	<b>-</b>	<b>2,285</b>
Differences between tax base and reported amounts for depreciable assets	<b>157,962</b>	<b>124,973</b>
Accrued expenditures	-	<b>(85)</b>
Provision for asset retirement obligation	<b>(2,654)</b>	<b>(1,691)</b>
<b>Future income taxes</b>	<b>155,308</b>	<b>123,197</b>

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. The Trust has approximately \$1.4 million (December 31, 2007 - \$2.0 million) in unrecognized future income tax assets and approximately \$1.4 million in loss carryforwards (December 31, 2007 - \$nil) available to reduce future taxable income.

In 2007, Income Trust tax legislation was passed resulting in a two-tiered tax structure subjecting distributions to the federal corporate income tax rate plus a deemed 13 per cent provincial income tax at the Trust level commencing in 2011. On February 26, 2008 the Federal Government announced as part of the Federal budget that the provincial component of the tax on the Trust is to be calculated based on the general provincial rate in each province in which the Trust has a permanent establishment. This is the same way that a corporation would calculate its provincial tax rate. On February 1, 2009 the Minister of Finance tabled a Notice of Ways and Means which includes the proposed legislation for calculating the provincial tax rate. As the proposed rules were not substantively enacted as of December 31, 2008, the Trust has not reflected a reduced tax rate in the calculation of future income taxes in 2008.

## 15. Financial Instruments and Risk Management

As described in Note 2, on January 1, 2007, the Trust adopted the new CICA requirements relating to financial instruments. The following summarizes the prospective adoption adjustments that were required as at January 1, 2007.

(\$000)	December 31, 2006 (As Reported)	Adoption Adjustment	January 1, 2007 (As Restated)
<b>Consolidated Balance Sheets</b>			
<b>Assets</b>			
Financial derivative asset	-	33,904	33,904
<b>Liabilities and Unitholders' Equity</b>			
Future income taxes	135,650	10,463	146,113
Accumulated other comprehensive income	-	23,441	23,441

### Market Risk

Market risk is the risk that changes in market prices will affect the Trust's net earnings or the value of its financial instruments. Market risk is comprised of commodity price risk and interest rate risk. The objective of market risk management is to manage and control its exposures within acceptable limits, while maximizing returns. The Trust's objectives, processes and policies for managing market risks have not changed from the previous year.

### Commodity Price Risk Management

The Trust is a party to certain derivative financial instruments, including fixed price contracts. The Trust enters into these contracts with well established counterparties for the purpose of protecting a portion of its future earnings and cash flows from operations from the volatility of petroleum and natural gas prices. The Trust believes the derivative financial instruments are effective as hedges, both at inception and over the term of the instrument, as the term and notional amount do not exceed the Trust's firm commitment or forecasted transaction and the underlying basis of the instrument correlates highly with the Trust's exposure. A summary of contracts outstanding in respect of the hedging activities at December 31, 2008 are as follows:

<b>Natural Gas</b>			<b>Price</b>
<b>Period Hedged</b>	<b>Type</b>	<b>Daily Volume</b>	<b>(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
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. If the AECO gas price on December 31, 2008 were to increase by \$1/GJ, the unrealized gain on these closed contracts would change by approximately \$16.2 million. An opposite change in commodity prices rates will result in an opposite impact on net income which would have been reflected in the other comprehensive income of the Trust.

Subsequent to December 31, 2008 the Trust entered into the following contracts:

<b>Natural Gas</b>			<b>Price</b>
<b>Period Hedged</b>	<b>Type</b>	<b>Daily Volume</b>	<b>(CAD)</b>
April 1, 2009 to March 31, 2010	Fixed price	5,000 GJ	\$6.90/GJ

#### **Interest rate risk**

The Trust is exposed to interest rate risk in relation to interest expense on its revolving credit facility. Currently, the Trust has not entered into any agreements to manage this risk. If interest rates applicable to floating rate debt were to have increased by 100 bps (1%) it is estimated that the Trust's net income for the year ended December 31, 2008 would decrease by \$4.5 million. An opposite change in interest rates will result in an opposite impact on net income.

#### **Fair Values of Financial Assets and Liabilities**

The Trust's financial instruments include cash, accounts receivable, financial derivative instruments, current liabilities (excluding future income tax), provision for future performance based compensation and long term debt. At December 31, 2008, the carrying value of cash, accounts receivable, financial derivative instruments, current liabilities (excluding future income tax) and provision for future performance based compensation approximate their fair value due to their short term nature. The carrying value of the long term debt approximates its fair value due to the floating rate of interest charged under the credit facility.

#### **Credit Risk**

A substantial portion of the Trust's accounts receivable is with petroleum and natural gas marketing entities.

Industry standard dictates that commodity sales are settled on the 25<sup>th</sup> day of the month following the month of production. The Trust generally extends unsecured credit to these companies, and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions and may accordingly impact the Trust's overall credit risk. Management believes the risk is mitigated by the size, reputation and diversified nature of the companies to which they extend credit. The Trust has not previously experienced any material credit losses on the collection of accounts receivable. Of the Trust's significant individual accounts receivable at December 31, 2008, approximately 43% was due from three companies (December 31, 2007 – 31%, one company). Of the Trust's revenue for the year ended December 31, 2008, approximately 90% was received from four companies (December 31, 2007 – 57%, two companies). The maximum exposure to credit risk is represented by the carrying amount on the balance sheet. There are no material financial assets that the Trust considers past due and no accounts have been written off.

The Trust may be exposed to certain losses in the event of non-performance by counter-parties to commodity price contracts. The Trust mitigates this risk by entering into transactions with counter-parties that have investment grade credit ratings.

Counterparties to financial instruments expose the Trust to credit losses in the event of non-performance. Counterparties for derivative instrument transactions are limited to high credit quality financial institutions, which are all members of our syndicated credit facility.

The Trust assesses quarterly if there should be any impairment of financial assets. At December 31, 2008, there was no impairment of any of the financial assets of the Trust.

### Liquidity Risk

Liquidity risk includes the risk that, as a result of operational liquidity requirements:

- The Trust will not have sufficient funds to settle a transaction on the due date;
- The Trust will be forced to sell financial assets at a value which is less than what they are worth; or
- The Trust may be unable to settle or recover a financial asset at all.

The Trust's operating cash requirements, including amounts projected to complete our existing capital expenditure program, are continuously monitored and adjusted as input variables change. These variables include, but are not limited to, available bank lines, oil and natural gas production from existing wells, results from new wells drilled, commodity prices, cost overruns on capital projects and changes to government regulations relating to prices, taxes, royalties, land tenure, allowable production and availability of markets. As these variables change, liquidity risks may necessitate the need for the Trust to conduct equity issues or obtain project debt financing. The Trust also mitigates liquidity risk by maintaining an insurance program to minimize exposure to some losses.

The following are the contractual maturities of financial liabilities as at December 31, 2008:

(\$000s)	<1 Year	1-2 Years	2-5 Years	Thereafter
Accounts payable and accrued liabilities				
Distributions payable				
Long-term debt <sup>(1)</sup>				

<sup>(1)</sup>Revolving credit facility renewed annually (see Note 7)

## 16. Capital Disclosures

The Trust's objectives when managing capital are: (i) to maintain a flexible capital structure, which optimizes the cost of capital at acceptable risk; and (ii) to maintain investor, creditor and market confidence to sustain the future development of the business.

The Trust manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of our underlying assets. The Trust considers its capital structure to include unitholders' equity, debt and working capital. To maintain or adjust the capital structure, the Trust may from time to time, issue trust units, raise debt and/or adjust its capital spending to manage its current and projected debt levels. The Trust monitors capital based on the following non-GAAP measures: current and projected debt to earnings before interest, taxes, depreciation, depletion and amortization ("EBITDA") ratios, payout ratios and net debt levels. To facilitate the management of these ratios, the Trust prepares annual budgets, which are updated depending on varying factors such as general market conditions and successful capital deployment. Currently, all ratios are within acceptable parameters. The annual budget is approved by the Board of Directors. The Trust's unitholders' capital is not subject to any external financial covenants.

There were no changes in the Trust's approach to capital management from the previous year.

(\$000s)	December 31, 2008	December 31, 2007
Unitholders' equity	550,717	528,992
Long-term debt	500,000	430,000
Working capital (surplus) deficit <sup>(1)</sup>	(32,075)	22,324
	<b>1,018,642</b>	<b>981,316</b>

<sup>(1)</sup>Current liabilities less current assets (includes unrealized hedging asset of \$27.8 million)

## 17. Supplemental Cash Flow Information

Changes in non-cash working capital balances (\$000)	2008	2007
Accounts receivable	(17,934)	5,690
Due from private placement	-	5,042
Prepaid expenses and deposits	1,653	(2,339)
Prepaid capital	(3,069)	-
Accounts payable and accrued liabilities	(37,069)	15,087
Cash distributions payable	1,088	64
	(55,331)	23,544
Attributable to financing activities	1,088	5,107
Attributable to investing activities	(17,633)	2,222
Attributable to operating activities	(38,786)	16,215
	<b>2008</b>	<b>2007</b>
Cash interest paid during the year	<b>21,857</b>	<b>23,007</b>

## 18. Contingencies and Commitments

Following is a summary of the Trust's commitments related to operating leases as at December 31, 2008. The trust has no other contractual obligations or commitments as at December 31, 2008.

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

### Contingent Liability

From time to time, Peyto is the subject of litigation arising out of its day-to-day operations. Damages claimed pursuant to such litigation, including the litigation discussed below, may be material or may be indeterminate and the outcome of such litigation may materially impact Peyto's financial position or results of operations in the period of settlement. 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. These claims are not currently expected to have a material impact on Peyto's financial position or results of operations.

Peyto has been named in a Statement of Claim issued by Canadian Natural Resources Limited and affiliates ("CNRL"), claiming \$13 million in damages for alleged breaches of duty as operator of jointly owned properties, and an interim and permanent injunction to prevent Peyto from proceeding with the completion of a well on those properties. CNRL alleges that Peyto failed to take proper steps as operator of a joint well (the "Well") on lands that offset 100% Peyto owned lands. Peyto has filed a Statement of Defense defending the allegations set forth in the Statement of Claim. The injunction claimed by CNRL was to prevent Peyto from completing the Well at a target location which had been agreed upon by both parties. Although claimed in the Statement of Claim, CNRL did not apply for an interim injunction, and Peyto completed the Well as planned, but no commercial production was obtained. Affidavits of Records were filed in July, 2006 but CNRL had taken no steps to move the matter forward until February 14, 2007 when it proposed to amend its Statement of Claim to add a subsidiary as an additional Plaintiff and to particularize further its allegations. Accordingly, it remains to be seen whether CNRL will proceed with the action. If the action goes ahead, Peyto intends to defend itself vigorously. Although the outcome of this matter is not determinable at this time, Peyto believes that this claim will not have a material adverse effect on the Trust's financial position or results of operations.

**19. 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 (2007 - \$1.1 million). As at December 31, 2007, an amount due to this firm of \$0.1 million was included in accounts payables (2007 - \$0.8 million)

# **Peyto Exploration & Development Corp. Information**

## **Officers**

Darren Gee  
President and Chief Executive Officer

Glenn Booth  
Vice President, Land

Scott Robinson  
Executive Vice-President and Chief Operating Officer

Stephen Chetner  
Corporate Secretary

Kathy Turgeon  
Vice President, Finance and Chief Financial Officer

## **Directors**

Ian Mottershead, Chairman  
Rick Braund  
Don Gray  
Brian Davis  
Michael MacBean  
Darren Gee  
Gregory Fletcher

## **Auditors**

Deloitte & Touche LLP

## **Solicitors**

Burnet, Duckworth & Palmer LLP

## **Bankers**

Bank of Montreal  
Union Bank of California  
Royal Bank of Canada  
BNP Paribas  
Société Générale  
ATB Financial  
Fortis Capital (Canada) Ltd.

## **Transfer Agent**

Valiant Trust Company

## **Head Office**

2900, 450 – 1<sup>st</sup> Street SW

Calgary, AB

T2P 5H1

Phone: 403.261.6081

Fax: 403.451.4100

Web: [www.peyto.com](http://www.peyto.com)

Stock Listing Symbol: PEY.un  
Toronto Stock Exchange