



**CONSOLIDATED FINANCIAL STATEMENTS  
AS AT DECEMBER 31, 2008 AND 2007  
AND FOR THE YEARS THEN ENDED**



## MANAGEMENT'S REPORT

The accompanying consolidated financial statements of Trilogy Energy Trust ("Trilogy") are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and include certain estimates that reflect management's best judgments. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. The relevant financial information contained elsewhere in this annual report is consistent with the consolidated financial statements.

Management has the overall responsibility for internal controls and maintains a system of internal controls that provides reasonable assurance that all transactions are accurately recorded, that the financial statements realistically report Trilogy's operating and financial results and that Trilogy's assets are safeguarded.

The Board of Directors has approved the information contained in the consolidated financial statements. The Board of Directors fulfills its responsibility regarding the consolidated financial statements through its Audit Committee, which is comprised of independent directors. The Audit Committee meets at least quarterly with management and the external auditors to ensure that management's responsibilities are properly discharged and to review the consolidated financial statements. The Audit Committee reports its findings to the Board of Directors for consideration when approving the annual consolidated financial statements for issuance to the Unitholders. The Audit Committee also considers, for review by the Board of Directors and approval by the Unitholders, the engagement or re-appointment of external auditors.

PricewaterhouseCoopers LLP, an independent firm of chartered accountants, was appointed by a vote of Unitholders at Trilogy's last annual meeting to audit the consolidated financial statements and provide an independent opinion. PricewaterhouseCoopers LLP have full and free access to the Audit Committee and management.

*/s/ J.H.T. Riddell*

**J. H. T. Riddell**

President and Chief Executive Officer

*/s/ M.G. Kohut*

**M. G. Kohut**

Chief Financial Officer

March 3, 2009

## **AUDITORS' REPORT**

March 3, 2009

### **To the Unitholders of Trilogy Energy Trust**

We have audited the consolidated balance sheets of **Trilogy Energy Trust** as at December 31, 2008 and 2007 and the consolidated statements of earnings (loss) and other comprehensive income, unitholders' equity, and cash flows for each of the years in the two year period ended December 31, 2008. 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 each of the years in the two year period ended December 31, 2008 in accordance with Canadian generally accepted accounting principles.

*/s/ PricewaterhouseCoopers LLP*  
**Chartered Accountants**

**TRILOGY ENERGY TRUST**  
**Consolidated Balance Sheets**

(In thousand dollars)

	As at December 31,	
	2008	2007
<b>ASSETS</b>		
<b>Current Assets</b>		
Accounts receivable <i>(notes 11, 12 and 14)</i>	\$ 55,149	\$ 51,603
Financial instruments <i>(notes 11 and 12)</i>	22,187	—
Prepaid expenses	826	656
	<b>78,162</b>	52,259
<b>Property, plant and equipment</b> <i>(note 5)</i>	<b>728,207</b>	721,756
<b>Future income taxes</b> <i>(note 16)</i>	<b>10,749</b>	13,705
<b>Goodwill</b>	<b>140,471</b>	140,471
	<b>\$ 957,589</b>	<b>\$ 928,191</b>
<b>LIABILITIES AND UNITHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities <i>(notes 11, 12 and 14)</i>	\$ 61,138	\$ 59,500
Distributions payable <i>(notes 9, 11, 12 and 14)</i>	9,600	6,623
Financial instruments <i>(notes 11 and 12)</i>	—	6,963
Unit-based compensation liability <i>(note 10)</i>	—	3,092
	<b>70,738</b>	76,178
<b>Long-term debt</b> <i>(notes 6, 11 and 12)</i>	<b>307,405</b>	326,496
<b>Asset retirement obligations</b> <i>(note 7)</i>	<b>75,213</b>	60,752
<b>Future income taxes</b> <i>(note 16)</i>	<b>88,136</b>	82,760
	<b>470,754</b>	470,008
<b>Unitholders' equity</b>		
Unitholders' capital <i>(note 8)</i>	714,950	704,100
Contributed surplus <i>(note 10)</i>	8,977	5,558
Accumulated deficit after distributions	(307,830)	(327,653)
	<b>416,097</b>	382,005
	<b>\$ 957,589</b>	<b>\$ 928,191</b>

**Commitments and contingencies** *(notes 6, 11 and 15)*

See accompanying notes to consolidated financial statements.

On behalf of the Board

*/s/ R.M. MacDonald*  
**R. M. MacDonald**  
 Director

*/s/M.H. Dilger*  
**M. H. Dilger**  
 Director

# TRILOGY ENERGY TRUST

## Consolidated Statements of Earnings (Loss) and Other Comprehensive Income

(In thousand dollars except as otherwise indicated)

	Years Ended December 31,	
	2008	2007
<b>Revenue</b>		
Petroleum and natural gas sales	\$ 465,297	\$ 395,387
Realized gain on financial instruments <i>(notes 11 and 12)</i>	16,020	12,179
Unrealized gain (loss) on financial instruments <i>(notes 11 and 12)</i>	29,150	(25,387)
Royalties	(92,372)	(78,080)
Other income	7,664	195
	<b>425,759</b>	<b>304,294</b>
<b>Expenses</b>		
Operating	88,879	94,560
Transportation	14,139	15,554
General and administrative <i>(notes 10 and 14)</i>	18,848	12,219
Exploration expenditures	10,615	10,918
Loss (gain) on disposition of property, plant and equipment	(441)	1,223
Accretion on asset retirement obligations <i>(note 7)</i>	5,372	4,591
Depletion and depreciation <i>(note 5)</i>	141,660	123,705
Interest and financing charges	15,003	22,219
	<b>294,075</b>	<b>284,989</b>
<b>Earnings before taxes</b>	<b>131,684</b>	<b>19,305</b>
<b>Future income taxes</b> <i>(note 16)</i>	<b>8,331</b>	<b>69,055</b>
<b>Net earnings (loss) / Total comprehensive income (loss)</b>	<b>\$ 123,353</b>	<b>\$ (49,750)</b>
<b>Earnings (loss) per Trust Unit</b> (in full amounts)		
— Basic	\$ 1.29	\$ (0.54)
— Diluted	\$ 1.28	\$ (0.53)
<b>Weighted average Trust Units outstanding</b> (in thousands)		
— Basic	95,715	92,832
— Diluted	96,089	93,050

See accompanying notes to consolidated financial statements.

## TRILOGY ENERGY TRUST

### Consolidated Statements of Unitholders' Equity

(In thousand dollars except Trust Unit information)

	Year Ended December 31, 2008				
	Outstanding Trust Units	Paid-in Capital	Accumulated Deficit	Contributed Surplus	Unitholders' Equity
Opening balance	94,608,704	\$ 704,100	\$ (327,653)	\$ 5,558	\$ 382,005
Net earnings for the year	—	—	123,353	—	123,353
Distribution reinvestment plan <i>(notes 8 and 9)</i>	6,159,521	46,597	—	—	46,597
Distributions declared <i>(note 9)</i>	—	—	(103,530)	—	(103,530)
Normal course issuer bid <i>(note 8)</i>	(4,771,579)	(35,747)	—	762	(34,985)
Unit/stock option recognition <i>(note 10)</i>	—	—	—	2,657	2,657
Closing balance	95,996,646	\$ 714,950	\$ (307,830)	\$ 8,977	\$ 416,097

	Year Ended December 31, 2007				
	Outstanding Trust Units	Paid-in Capital	Accumulated Deficit	Contributed Surplus	Unitholders' Equity
Opening balance	92,566,681	\$ 689,816	\$ (172,062)	\$ 3,100	\$ 520,854
Net loss for the year	—	—	(49,750)	—	(49,750)
Distribution reinvestment plan <i>(notes 8 and 9)</i>	2,042,023	14,284	—	—	14,284
Distributions declared <i>(note 9)</i>	—	—	(105,841)	—	(105,841)
Unit/stock option recognition <i>(note 10)</i>	—	—	—	2,458	2,458
Closing balance	94,608,704	\$ 704,100	\$ (327,653)	\$ 5,558	\$ 382,005

See accompanying notes to consolidated financial statements.

**TRILOGY ENERGY TRUST**  
**Consolidated Statements of Cash Flows**  
(In thousand dollars)

	Years Ended December 31	
	2008	2007
<b>Operating activities</b>		
Net earnings (loss)	\$ 123,353	\$ (49,750)
Add (deduct) non-cash and other items:		
Depletion and depreciation	141,660	123,705
Loss (gain) on disposition of property, plant and equipment	(441)	1,223
Exploration expenditures	10,615	9,903
Asset retirement obligation expenditures <i>(note 7)</i>	(5,441)	(1,266)
Accretion on asset retirement obligations <i>(note 7)</i>	5,372	4,591
Future income tax expense <i>(note 16)</i>	8,331	69,055
Non-cash general and administrative recovery	(433)	(92)
Unrealized loss (gain) on financial instruments <i>(note 12)</i>	(29,150)	25,387
Net changes in operating working capital	(10,346)	13,597
<b>Cash flow from operating activities</b>	<b>243,520</b>	<b>196,353</b>
<b>Financing activities</b>		
Credit facilities – draws	505,530	377,309
Credit facilities – repayments	(524,398)	(465,039)
Distributions to unitholders <i>(note 9)</i>	(53,956)	(99,745)
Purchase and cancellation of Trust Units under normal course issuer bid	(34,985)	—
<b>Cash flow provided by (used in) financing activities</b>	<b>(107,809)</b>	<b>(187,475)</b>
<b>Investing activities</b>		
Property, plant and equipment expenditures	(123,721)	(101,960)
Property acquisitions	(20,594)	—
Proceeds on disposition of property, plant and equipment	561	100,702
Change in investing working capital	8,043	(7,620)
<b>Cash flow used in investing activities</b>	<b>(135,711)</b>	<b>(8,878)</b>
<b>Change in cash / cash, end of year</b>	<b>\$ —</b>	<b>\$ —</b>
<b>Cash interest and financing charges paid</b>	<b>\$ 15,226</b>	<b>\$ 20,837</b>

See accompanying notes to consolidated financial statements.

# TRILOGY ENERGY TRUST

## Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

### 1. GENERAL

Trilogy Energy Trust ("Trilogy" or the "Trust") is an open-ended unincorporated investment trust governed by the laws of the Province of Alberta and created pursuant to its Trust Indenture dated February 25, 2005, as amended and restated from time to time. The Trust is managed by Trilogy Energy Ltd., the administrator of the Trust. The beneficiaries of the Trust are the holders of Trust Units (the "Unitholders").

The consolidated financial statements of Trilogy have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are expressed in Canadian Dollars.

### 2. CURRENT ECONOMIC CONDITIONS

The economic recession that commenced in the United States (U.S.) has significantly impacted the global economy. In Canada, the effects of the economic downturn have been felt as evidenced by the loss of investors' confidence, limited access to capital, tight credit controls, an increased unemployment rate and declining commodity prices, among other factors. Canada's Federal government has implemented certain measures designed to help stimulate the economy, including a significant reduction in interest rates.

The significant decline in energy commodity prices has impacted Trilogy's operations, resulting in reductions to cash flow, distributions to unitholders and forecast capital spending, and heightened risks on financial instruments.

It is uncertain how long these current economic conditions will exist or what the future impact on Trilogy will be. These financial statements do not include any adjustments that may be required should Trilogy be adversely impacted by a worsening economic condition in the foreseeable future.

### 3. ACCOUNTING CHANGES

#### Change in Accounting Policies

On January 1, 2008, Trilogy adopted the recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook Sections 3862 (*Financial Instruments – Disclosures*), 3863 (*Financial Instruments – Presentation*) and 1535 (*Capital Disclosures*). The adoption of these new accounting standards did not impact the amounts reported in the Trust's financial statements but it required the Trust to provide additional disclosures relating to financial instruments (note 11) and the Trust's management of capital (note 13).

## TRILOGY ENERGY TRUST

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

#### Future Accounting Changes

On March 11, 2008, the Accounting Standards Board of Canada confirmed that effective January 1, 2011, International Financial Reporting Standards ("IFRS") will become Canadian GAAP for publicly accountable enterprises. The impact of this change to Trilogy's future consolidated financial statements is not yet reasonably determinable and estimable at this time.

In conjunction with the transition to IFRS, the CICA issued several new standards that harmonize Canadian GAAP to IFRS, including Handbook Section 3064 (*Goodwill and Intangible Assets*). CICA HB 3064 replaces CICA HB 3062 and establishes new standards for the recognition, measurement and disclosure of goodwill and intangible assets. CICA HB 3064's provisions relating to the definition and initial recognition of intangible assets are equivalent to the corresponding provisions of International Accounting Standards ("IAS") 38, *Intangible Assets*. A number of CICA handbooks and EIC Abstracts were amended and/or replaced as a consequence of this new standard. CICA HB 3064 is effective January 1, 2009 for Trilogy but did not impact its financial statements.

#### 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### Consolidation

These consolidated financial statements include the accounts of the Trust and its wholly-owned subsidiaries. The Trust obtains all of the economic benefits of the operations of its operating subsidiaries.

##### Property, Plant and Equipment

The Trust follows the successful efforts method of accounting for petroleum and natural gas operations. Under this method, acquisition costs of oil and gas properties and the costs of drilling and equipping development wells and successful exploratory wells are capitalized. Exploration expenses, including geological and geophysical costs, lease rentals on properties and exploratory dry hole costs, are charged to earnings as incurred. The net costs of abandoned exploratory wells and surrendered leases are charged to earnings in the year of abandonment or surrender. Gains or losses are recognized on the disposition of property, plant and equipment.

Other property, plant and equipment are recorded at cost.

The net amount at which petroleum and natural gas costs on a property or project are carried is subject to an annual cost recovery test or as economic events dictate. An impairment loss is recognized when the carrying amount of the asset is less than the sum of the expected cash flows on an undiscounted basis. The amount of the impairment loss is then calculated as the difference between the carrying amount and the fair value of the asset. Fair value is calculated as the present value of estimated future cash flows.

##### Depletion and Depreciation

Capitalized costs of proved oil and gas properties are depleted using the unit-of-production method. For purposes of these calculations, production and reserves of natural gas are converted to barrels on an energy equivalent basis. Successful exploratory wells and development costs are

## **TRILOGY ENERGY TRUST**

### **Notes to Consolidated Financial Statements**

**December 31, 2008 and 2007**

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

depleted over proved developed reserves while acquired resource properties with proved reserves are depleted over proved reserves. Acquisition costs of probable reserves are not depleted or amortized while under active evaluation for commercial reserves.

Depreciation of production equipment, gas plants and gathering systems is calculated using the straight-line method over their estimated useful life of 12 years. Depreciation of other property, plant and equipment is provided on a straight-line basis over the assets' estimated useful lives varying from three to 10 years.

#### **Joint Operations**

Certain exploration, development and production activities are conducted jointly with others. These financial statements reflect only the Trust's proportionate interest in such activities.

#### **Asset Retirement Obligations**

The fair value of an asset retirement obligation is recognized in the period in which it is incurred or when a reasonable estimate of the fair value can be made. The asset retirement costs equal to the fair value of the retirement obligations are capitalized as part of the cost of the related long-lived asset and allocated to earnings on a basis consistent with depreciation and depletion. The liability associated with the asset retirement costs which is recorded initially at its present value is subsequently adjusted for the passage of time which is recognized as accretion expense in the statement of earnings. The liability is also adjusted due to revisions in either the timing or the amount of the original estimated cash flows associated with the liability. Actual costs incurred upon settlement of the asset retirement obligations reduce the asset retirement liability to the extent of the liability recorded. Differences between the actual costs incurred upon settlement of the asset retirement obligations and the liability recorded are recognized in earnings in the period in which the settlement occurs.

#### **Goodwill**

Goodwill, which represents the excess of the purchase price over the fair value of net assets acquired, is not amortized and is assessed for impairment at least annually. Impairment is assessed by comparison of the fair value of the reporting unit, as to which goodwill is attributable, to the carrying value of the reporting unit's net assets, including goodwill. If the carrying value of the reporting unit's net assets exceeds the fair value of the reporting unit, the excess of the carrying value of goodwill over its fair value is the impairment amount, and is charged to earnings in the period the impairment is identified.

When a portion of a reporting unit that constitutes a business is disposed of, the goodwill associated with such business is reversed and included in the carrying amount of the disposed business in determining the gain or loss on disposal.

#### **Revenue Recognition**

Revenues associated with the sale of natural gas, crude oil, and natural gas liquids are recognized when title passes to the customer in accordance with the terms of the sales contracts. Revenues from oil and natural gas production from properties in which there is an interest with other producers are recognized on a net working interest basis.

## **TRILOGY ENERGY TRUST**

### **Notes to Consolidated Financial Statements**

**December 31, 2008 and 2007**

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

#### **Derivative Financial Instruments**

Trilogy recognizes a financial asset or liability when it becomes a party to the contractual provisions of a financial instrument. Financial assets and financial liabilities are initially measured at fair value. After initial recognition, financial assets and liabilities held for trading are measured at fair value with the unrealized gains and losses recorded in income, loans and receivables are carried at amortized cost, while all other financial liabilities are subsequently measured at amortized cost using the effective interest method. Transaction costs on financial instruments are included in the fair value assessment of each financial asset and financial liability. Trilogy does not designate derivative instruments as hedges and does not have available-for-sale financial assets or held-to-maturity investments.

#### **Income Taxes**

Trilogy follows the liability method of accounting for income taxes. Under this method, future income taxes are recognized for the effect of any difference between the carrying amount of an asset or liability reported in the financial statements and its respective tax basis, using substantively enacted income tax rates. Future income tax balances are adjusted to reflect changes in substantively enacted income tax rates, with adjustments being recognized in net earnings in the period in which the change occurs.

#### **Unit-based Compensation**

The Trust accounts for its unit option plan using the 'fair value method'. Fair values of options are determined using the Binomial model at the grant date and are amortized as compensation cost over the life of the option with a credit to contributed surplus.

Non-reciprocal awards of stock options to Trust employees made by a significant unitholder are fair valued using the Black Scholes model and are amortized to compensation expense over their contractual life of two to four years, with a credit to contributed surplus.

The Trust measured compensation cost under the unit appreciation plan (that terminated on December 15, 2008) as the amount by which the quoted market value of Trust Units covered by the grants exceeded the exercise price and adjusted by unit distributions. Compensation cost under the unit appreciation plan was recognized over the appreciation units' vesting period.

#### **Foreign Currency Translation**

Transactions denominated in U.S. Dollars are translated to Canadian Dollars at the exchange rate on the transaction date. U.S. Dollar denominated monetary assets and liabilities are translated to Canadian Dollar at exchange rates in effect on the balance sheet date. The resulting exchange rate differentials arising from these items are included in net earnings.

#### **Per Trust Unit Information**

The Trust uses the treasury stock method whereby only "in the money" dilutive instruments impact the dilution calculations.

## TRILOGY ENERGY TRUST

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

#### Measurement Uncertainty

The timely preparation of these consolidated financial statements in conformity with Canadian generally accepted accounting principles requires that management make estimates and assumptions and use judgment that affect the reported amounts of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. Actual results could materially differ from these estimates.

The amounts recorded for depletion and depreciation, purchase accounting, asset retirement obligations and related accretion, future income taxes and amortization of fair value of options are based on estimates of reserves, future costs, petroleum and natural gas prices and other relevant assumptions. By their nature, these estimates and those related to the discounted cash flow used to assess impairment are subject to measurement uncertainty, and the impact on the financial statements of future periods could be material.

#### 5. PROPERTY, PLANT AND EQUIPMENT

	2008			2007		
	Cost	Accumulated Depletion and Depreciation	Net Book Value	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties	1,477,303	(754,669)	722,634	1,334,534	(619,817)	714,717
Other	9,038	(3,465)	5,573	8,959	(1,920)	7,039
	<b>1,486,341</b>	<b>(758,134)</b>	<b>728,207</b>	<b>1,343,493</b>	<b>(621,737)</b>	<b>721,756</b>

Capital costs associated with non-producing petroleum and natural gas properties totaling approximately \$112.5 million as at December 31, 2008 (2007 - \$125.6 million) were not subject to depletion. No interest costs were capitalized for the years ended December 31, 2008 and 2007.

The costs of exploratory dry holes and uneconomic wells, amounting to \$9.6 million for the year ended December 31, 2008 (2007 - \$7.8 million), were written off and included in exploration expenditures. A property impairment loss of \$24.1 million was also recognized for the year ended December 31, 2008 (2007 - \$8.1 million) and was included as part of depletion and depreciation expense. The reduction in the expected recoverable reserves attributable to certain petroleum and natural gas wells and the decline in forecast oil prices used in the estimation of future cash flows resulted in the asset impairment. The fair value of these assets was determined using discounted future cash flows.

## TRILOGY ENERGY TRUST

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

#### 6. LONG-TERM DEBT

	2008	2007
Revolving credit and working capital facility	307,787	326,655
Less unamortized discount	(382)	(159)
Carrying value of long-term debt	307,405	326,496
Weighted average interest rate for the year	4.46%	5.62%

The Trust has a \$343 million revolving credit facility and a \$35 million working capital facility with a syndicate of mostly Canadian banks. Borrowing under the facility bears interest at the lenders' prime rate, bankers' acceptance rate or LIBOR, plus an applicable margin dependent on certain conditions. The facilities are available on a revolving basis for a period of at least 364 days and can be extended a further 364 days upon request. The revolving phase of this credit facility expires on March 27, 2009, if not extended. In the event the revolving period is not extended, the revolving facility would be available for a one year term on a non-revolving basis, at the end of which time amounts drawn down under the facility would be due and payable. The working capital facility would continue on a revolving basis for a one year term. Advances drawn on the Trust's facility are secured by a fixed and floating charge debenture over the assets of the Trust. The \$378 million borrowing base is subject to semi-annual review by the banks.

The Trust has undrawn letters of credit totaling \$9.4 million as at December 31, 2008. These letters of credit reduce the amount available for draw under the Trust's working capital facility.

#### 7. ASSET RETIREMENT OBLIGATIONS

	2008	2007
Asset retirement obligations, beginning of year	60,752	55,994
Liabilities incurred	2,370	946
Revisions in estimate	12,353	5,062
Liabilities settled	(5,441)	(1,266)
Accretion expense	5,372	4,591
Liabilities relating to assets sold	(193)	(4,575)
Asset retirement obligations, end of year	75,213	60,752

The undiscounted asset retirement obligations at December 31, 2008 is estimated to be \$182.6 million (2007 - \$156.4 million). The credit-adjusted risk-free rates used to estimate asset retirement obligation liabilities range from 7.875 to 8.5 percent. These obligations will be settled based on the expected life of the underlying assets, the majority of which are expected to be paid after 10 to 30 years and will be funded from the general resources of the Trust at the time of removal.

## **TRILOGY ENERGY TRUST**

### **Notes to Consolidated Financial Statements**

**December 31, 2008 and 2007**

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

#### **8. UNITHOLDERS' CAPITAL**

##### **Authorized**

The authorized capital of the Trust is comprised of an unlimited number of Trust Units and an unlimited number of Special Voting Rights. Compared to the holders of the Trust Units, holders of Special Voting Rights are not entitled to any distributions of any nature from the Trust nor have any beneficial interest in any property or assets of the Trust on termination or winding-up of the Trust.

##### **Issued and Outstanding**

Trilogy had 95,996,646 Trust Units and 94,608,704 Trust Units outstanding at December 31, 2008 and 2007, respectively. No Special Voting Rights have been issued to date.

For the year ended December 31, 2008, 6,159,521 Trust Units (2007 – 2,042,023 Trust Units) were issued under Trilogy's Distribution Reinvestment Plan ("DRIP") (see note 9).

##### **Redemption Right**

Unitholders may redeem their Trust Units at any time by delivering their Trust Unit Certificates to Trilogy's transfer agent together with a duly completed and properly executed notice. The redemption price per Trust Unit is equal to the lesser of 95 percent 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 were tendered for redemption, and the closing market price on the principal market on which the Trust Units are quoted for trading on the date that the Trust Units were tendered for redemption. Cash payments for Trust Units tendered for redemption are limited, subject to the administrator's sole discretion, to \$50,000 per month with redemption requests in excess of this amount eligible to receive notes from the holding trust or other assets held by the Trust. In addition, cash redemption may not apply if the outstanding Trust Units tendered for redemption are not listed for trading, the normal trading of the Trust Units is suspended or halted on any stock exchange or the redemption of Trust Units will result in the delisting of the Trust Units. In such cases, the fair market value of the Trust Units shall be determined by the administrator and be paid and satisfied by way of asset distribution.

##### **Normal Course Issuer Bid**

Pursuant to a normal course issuer bid program, Trilogy purchased and cancelled 4,771,579 Trust Units through the facilities of the Toronto Stock Exchange in 2008 for a total cost of approximately \$35.0 million.

## TRILOGY ENERGY TRUST

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Tabular amounts expressed in thousand dollars except as otherwise indicated)

#### 9. ACCUMULATED DISTRIBUTIONS

	2008				2007			
	Cash	DRIP	Payable	Total	Cash	DRIP	Payable	Total
Balance, beginning of year	484,399	30,260	6,623	521,282	384,654	15,976	14,811	415,441
Distributions paid and/or reinvested	53,956	46,597	—	100,553	99,745	14,284	—	114,029
Change in year end accrual	—	—	2,977	2,977	—	—	(8,188)	(8,188)
Distributions declared	53,956	46,597	2,977	103,530	99,745	14,284	(8,188)	105,841
Balance, end of year	538,355	76,857	9,600	624,812	484,399	30,260	6,623	521,282

Cumulative distributions amounted to \$1.08 per Trust Unit and \$1.14 per Trust Unit for the year ended December 31, 2008 and 2007, respectively.

The Trust intends to make cash distributions to Unitholders at a level that supports the sustainability of the Trust. Such distributions are at the sole discretion of the Trust and subject to numerous factors including, but not limited to, the financial performance of the Trust, debt covenants and obligations including credit availability, and the working capital and future capital requirements of the Trust.

Trilogy's DRIP program provides eligible Unitholders with the opportunity to reinvest their cash distributions, on each distribution payment date, for additional Trust Units at a price equal to 95 percent of the average market price as defined by the plan.

#### 10. UNIT BASED COMPENSATION

##### Unit Option Plan

The Trust has a long-term incentive plan that allows management to award unit options to eligible directors, officers and employees. Under this plan, holders of vested unit options are able to subscribe for the equivalent number of Trust Units at the exercise price within the contractual period prescribed in the governing option agreement. A continuity of the unit option plan for the years ended December 31, 2008 and 2007 is as follows:

	2008			2007		
	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value per Option	No. of Options	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value per Option	No. of Options
Balance, beginning of year	\$ 11.52	\$ 1.64	4,106,500	\$ 14.42	\$ 1.95	2,261,000
Granted	5.90	0.66	1,131,000	8.06	1.28	1,875,500
Exercised	10.54	1.59	(7,500)	—	—	—
Cancelled	11.61	1.66	(464,500)	13.72	1.92	(30,000)
Balance, end of year	\$ 10.18	\$ 1.41	4,765,500	\$ 11.52	\$ 1.64	4,106,500
Exercisable, end of year	\$ 11.97	\$ 1.65	434,500	\$ 14.72	\$ 1.92	176,500

The Trust recorded a compensation expense of \$2.0 million for the year ended December 31, 2008 (2007 - \$1.3 million) representing the recognition of the grant date fair value of outstanding unit

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options, with a corresponding credit to contributed surplus. The fair value of options granted was determined under the binomial model using the following key assumptions:

	Options Granted in	2008	2007
Risk-free interest rate		2.07% to 3.08%	4.00% to 4.25%
Expected life		4.5 to 5.6 years	4.5 to 5.5 years
Expected volatility		35%	30% to 35%
Expected distributions		9.5% to 23.4%	12% to 13.5%

Additional information about Trilogy's unit options outstanding as at December 31, 2008 is as follows:

Exercise Price Range	Weighted Average Contractual Life Remaining	Outstanding Options		Exercisable Options	
		Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
\$4.85 to \$8.90	4.7	2,144,000	\$ 5.94	141,500	\$ 6.67
\$9.25 to \$12.88	2.7	1,668,500	10.93	175,500	10.96
\$18.03 to \$23.95	2.2	953,000	18.41	117,500	19.88
Total	3.5	4,765,500	\$ 10.18	434,500	\$ 11.97

### Unit Appreciation Rights Plan

In 2005, the Trust offered certain employees, officers and directors a unit appreciation arrangement whereby such employees, officers and directors were granted unit appreciation rights entitling the right holders to receive cash payments calculated as the excess of the market price over the exercise price per unit on the exercise date. The exercise price per unit appreciation right was reduced by the aggregate unit distributions paid or payable on the Trust Units to Unitholders of record from the grant date to the exercise date. The remaining unit appreciation rights were paid as at the expiry date of December 15, 2008. The Unit Option Plan replaced the Unit Appreciation Plan in 2006. There is no current intention to make further grants of unit appreciation rights. A continuity of the unit appreciation rights for the years ended December 31, 2008 and 2007 is as follows:

	2008		2007	
	Exercise Price	No. of Unit Rights	Exercise Price	No. of Unit Rights
Balance, beginning of year	\$ 4.14	1,232,250	\$ 5.28	1,268,250
Exercised	3.35	(1,215,250)	4.43	(30,000)
Cancelled	3.88	(17,000)	4.63	(6,000)
Balance, end of year	—	—	\$ 4.14	1,232,250
Unit rights exercisable, end of year	—	—	\$ 4.14	828,250

A compensation expense of \$2.8 million relating to the unit appreciation plan has been recognized in earnings for the year ended December 31, 2008 (2007 - \$2.4 million recovery) with respect to the unit appreciation plan. Cash paid for the exercise of unit rights amounted to \$5.9 million for the year ended December 30, 2008 (2007 - \$0.1 million).

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#### **Non-reciprocal Awards to Trust Employees**

The Trust also recognized compensation expense of \$0.7 million for the year ended December 31, 2008 (2007 - \$1.2 million) with respect to the non-reciprocal awards of stock options to Trust employees made by Paramount Resources Ltd. ("Paramount"), a related party. This amount was credited to contributed surplus.

### **11. FINANCIAL RISK MANAGEMENT AND OBJECTIVES**

Trilogy's principal financial instruments, other than financial derivatives, are its outstanding amounts drawn from its credit facilities. The credit facilities are the main source of Trilogy's finances after cash flow from operations. Trilogy has other financial assets and liabilities arising directly from its operations and trust activities, including accounts receivable, accounts payable and accrued liabilities, unit-based compensation liability and distributions payable. Trilogy also enters into financial derivative transactions, the purpose of which is to mitigate the impact of market volatility.

The main risks arising from Trilogy's financial instruments are credit risk, liquidity risk, commodity price risk, interest rate risk and foreign exchange risk.

#### **Credit Risk**

Under the Services Agreement described in note 14, Paramount carries out marketing functions on behalf of the Trust. The Trust is exposed to credit risk from financial instruments to the extent of non-performance by third parties. Credit risks associated with the possible non-performance by financial instrument counterparties are minimized by entering into contracts with only highly rated counterparties. Third party credit risk is mitigated with credit approvals, limits on exposures to any one counterparty, and monitoring procedures.

Trilogy's production is sold to a variety of purchasers under normal industry sale and payment terms. Accounts receivable are from customers and joint venture partners in the Canadian petroleum and natural gas industry and are subject to normal credit risk. As at December 31, 2008, \$8.2 million or 14.9 percent of the outstanding accounts receivable are outstanding for 90 days or more. Also included in accounts receivable at December 31, 2008 is a \$4.7 million receivable (of which \$3.6 million is outstanding for more than 90 days) from a customer which has filed for protection under the Companies' Creditors Arrangement Act. Trilogy believes it has the ability to set off certain amounts payable to this customer against the outstanding receivable.

#### **Liquidity Risk**

Trilogy's principal sources of liquidity are its cash flow from operations and existing or new credit facilities. Trilogy mitigates liquidity risk by using forward commodity price contracts, maintaining adequate reserves and banking facilities, continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities. Furthermore, Trilogy may adjust the levels of distribution to Unitholders and capital spending to maintain its liquidity (see notes 2, 12 and 13).

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A contractual maturity analysis for Trilogy's financial liabilities as at December 31, 2008 is as follows:

	Within 1 Year	After 1 Year	Total
Accounts payable and accrued liabilities	61,138	—	61,138
Distributions payable	9,600	—	9,600
Long-term debt and estimated interest <sup>(1)</sup>	13,345	311,219	324,564
<b>Total</b>	<b>84,083</b>	<b>311,219</b>	<b>395,302</b>

<sup>(1)</sup> Estimated interest for future periods was calculated using the weighted average interest rate for the year ended December 31, 2008 applied to the debt principal balance outstanding as at that date. Principal repayment is assumed one year after the expiry of the current revolving phase of the credit facility.

### Commodity Price Risk

Inherent to Trilogy's business of producing petroleum and natural gas is the commodity price risk where fluctuations in the market price of oil and natural gas could significantly impact the Trust's ability to generate cash flow from operations. Given that numerous items, including but not limited to, the amounts of distributions to Unitholders, capital expenditures and debt repayments or draw-downs, are dependent upon the level of cash flow generated from operations, fluctuations in petroleum and natural gas prices (in addition to normal operational and external risks) impact Trilogy's liquidity.

To protect cash flow against commodity price volatility, Trilogy uses from time to time forward commodity price contracts that require financial settlement between counterparties. This financial instruments program is generally for periods of up to one year and would not exceed 50 percent of Trilogy's annual production (see note 12 for details of outstanding financial instruments as at December 31, 2008).

### Interest Rate Risk

As described in note 6, Trilogy's credit facilities are subject to floating interest rates at the lenders' prime rate, bankers' acceptance rate or LIBOR, plus an applicable margin. The interest rate margin is determined by the lenders based on their periodic review of the Trust's results and is generally dependent upon Trilogy's debt to cash flow ratio, which may also be impacted by commodity price risk.

Draw-downs from Trilogy's credit facilities are generally in the form of bankers' acceptances with fixed terms ranging from 10 to 180 days which are then rolled-over if not repaid on their due dates. Trilogy may enter into interest rate swap contracts to mitigate the impact of interest rate fluctuations. There are no interest rate swap contracts outstanding as at December 31, 2008.

### Foreign Exchange Risk

Foreign exchange rate exposure may impact the Trust mainly due to the outstanding U.S. Dollar denominated financial instrument contracts mentioned in note 12, in addition to normal conversions of U.S. Dollar denominated revenues into Canadian Dollars. Approximately 15 percent of Trilogy's petroleum and natural gas sales for the year ended December 31, 2008 was denominated in U.S. Dollars. Trilogy may enter into foreign currency contracts to mitigate the impact of foreign exchange rate exposure. There are no outstanding fixed forward currency contracts as at December 31, 2008.

# TRILOGY ENERGY TRUST

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### Market Risk Sensitivity Analysis

A sensitivity analysis showing how net earnings for the year ended December 31, 2008 would have been affected by changes in commodity prices, and interest and exchange rates is set out below.

<b>Risk Variations</b>	<b>Estimated Effect on Net Earnings<sup>(1)</sup></b>
Natural gas price change of \$0.10/Mcf	2,195
Oil and natural gas liquids price change of U.S.\$1.00/Bbl	917
U.S. Dollar to Canadian Dollar exchange rate fluctuation of \$0.01	694
Average interest rate change of 1 percent	3,170

<sup>(1)</sup> The effect of each risk variation is mutually exclusive.

In deriving the above analysis, specific exposures to each risk were quantified based on the risk variations described. The historical information for the year ended December 31, 2008, which were used as key inputs in the sensitivity analysis above, are as follows:

Average production:	
Natural gas	97 MMcf/d
Crude oil and natural gas liquids	4,422 Bbl/d
Average royalty as a percentage of sales	20 percent
Average exchange rate (U.S.\$/Cdn\$)	Cdn\$1.07/U.S.\$1.00
Income tax	Nil
Forward pricing of outstanding financial contracts	As at December 31, 2008

## 12. FINANCIAL INSTRUMENTS

### Carrying Values

Set out below are the carrying amounts by category of Trilogy's financial assets and liabilities that are reflected in the financial statements.

	<b>2008</b>	<b>2007</b>
<b>Financial assets</b>		
Receivables <sup>(1)</sup>	55,149	51,603
Financial instruments held-for-trading <sup>(3)</sup>	22,187	—
<b>Financial liabilities</b>		
Non-trading liabilities <sup>(1) (2)</sup>	(70,738)	(69,215)
Financial instruments held-for-trading <sup>(3)</sup>	—	(6,963)
Indebtedness <sup>(4)</sup>	(307,405)	(326,496)

<sup>(1)</sup> Carried at cost which approximates the fair value of the assets or liabilities due to the short-term nature of the accounts.

<sup>(2)</sup> Consists of accounts payable and accrued liabilities, distributions payable and unit-based compensation liability for 2007.

<sup>(3)</sup> Carried at the estimated fair value of the related financial instruments based on third party quotations. See Forward Contracts below.

<sup>(4)</sup> Carried at amortized cost.

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#### Forward Contracts

At December 31, 2008, the Trust had the following outstanding financial forward commodity sales contracts:

Description	Quantity	Price	Remaining Term
<i>Purchase Contract</i>			
NYMEX Fixed Price	10,000 MMBtu/d	U.S.\$6.63/MMBtu	January 2009 – March 2009
<i>Sales Contracts</i>			
NYMEX Fixed Price	10,000 MMBtu/d	U.S.\$9.94/MMBtu	January 2009 – March 2009
NYMEX Collar	10,000 MMBtu/d	Floor – U.S.\$9.50 Ceiling – U.S.\$13.00	April 2009 – October 2009
AECO Fixed Price	30,000 GJ/d	\$9.50/GJ	January 2009 – March 2009

The Trust classified these financial instruments as held-for-trading and therefore has recognized the fair value of such financial instruments on the balance sheet. The estimated fair values of these financial instruments are based on quoted prices or, in their absence, third-party market indicators and forecasts.

The changes in the fair value associated with the above financial contracts are recorded as an unrealized gain or loss on financial instruments in the statement of earnings. Gains or losses arising from monthly settlements with counterparties are recognized as a realized gain or loss in the statement of earnings.

### 13. CAPITAL DISCLOSURE

The Trust's capital structure currently consists of (a) revolving long-term debt pursuant to a credit facility, (b) working capital facility pursuant to a credit facility, (c) letters of credit issued as financial security to third parties, and (d) unitholders' equity.

The objectives in managing the capital structure are to:

- utilize an appropriate amount of leverage to maximize return on unitholders' equity; and
- provide for borrowing capacity and financial flexibility to maintain the petroleum and natural gas reserve base by replacing production at competitive finding and development costs.

Management and the Board of Directors review and assess the Trust's capital structure and distribution policy at each regularly scheduled board meeting and at other meetings called for that purpose. The financial strategy may be adjusted based on the current outlook of the underlying business, the capital required to fund the reserves program and the state of the debt and equity capital markets. In order to maintain or adjust the capital structure, the Trust may (1) issue new Trust Units, (2) issue new debt securities, (3) amend, revise, renew or extend the terms of the existing long-term debt and working capital facilities, (4) enter into new agreements establishing new credit facilities, (5) adjust the amount of distributions to unitholders, (6) adjust capital spending, and/or (7)

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sell non-core and/or non-strategic assets. As discussed in note 2, Trilogy has already made certain changes in response to the current economic conditions.

A comparison of Trilogy's debt structure against the committed amount on existing credit facilities at the balance sheet dates is as follows:

	2008	2007
Committed amount that can be drawn from credit facilities	378,000	370,000
Outstanding undrawn letters of credit	(9,373)	(8,232)
<b>Amount that can be drawn after letters of credit</b>	<b>368,627</b>	<b>361,768</b>
Long-term debt	(307,405)	(326,496)
Net current assets (liabilities)	7,424	(23,919)
Net debt <sup>(1)</sup>	(299,981)	(350,415)
Mark-to-market valuation of financial instruments	(22,187)	6,963
<b>Adjusted net debt<sup>(1)</sup></b>	<b>(322,168)</b>	<b>(343,452)</b>
Remaining available credit	46,459	18,316

<sup>(1)</sup> Net debt and adjusted net debt as calculated above are not standard terms/measures used by others.

The decrease in adjusted net debt from \$343.5 million at December 31, 2007 to \$322.2 million at December 31, 2008 is attributable primarily to higher cash flow from operations and Trilogy's DRIP, partially offset by an asset acquisition and the purchase of Trilogy's Trust Units through its normal course issuer bid program.

#### 14. RELATED PARTY TRANSACTIONS

Trilogy had the following transactions with Paramount, a Unitholder of the Trust.

- Pursuant to a Services Agreement dated April 1, 2005, a Paramount subsidiary provides administrative and operating services to the Trust and its subsidiaries to assist a Trust subsidiary in carrying out its duties and obligations as general partner of Trilogy's main operating entity and as the administrator of the Trust and its holding trust. Under this agreement, Paramount is reimbursed at cost for all expenses it incurs in providing the services to the Trust and its subsidiaries. The agreement is in effect until March 31, 2009 however may be terminated by either party with at least six months written notice. It is anticipated that the Services Agreement will be extended until March 31, 2010. The amount of expenses billed and accrued as management fees under this agreement was \$0.3 million for the year ended December 31, 2008 (2007 - \$0.8 million). This amount is included as part of the general and administrative expenses in the Trust's consolidated statement of earnings.
- The Trust and Paramount also had transactions with each other arising from the normal course of business. These transactions were recorded at exchange amounts.

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The amounts due from (to) Paramount as at the balance sheet dates are as follows:

Presented in the Balance Sheet as	2008			2007		
	Normal Business	Services Agreement	Trust Distribution	Normal Business	Services Agreement	Trust Distribution
Accounts receivable	222	—	—	441	—	—
Accounts payable and accrued liabilities	(159)	(120)	—	(3,220)	(60)	—
Distributions payable	—	—	(2,234)	—	—	(1,168)

## 15. OFF BALANCE SHEET COMMITMENTS

In addition to items disclosed elsewhere in these financial statements, Trilogy had the following off balance sheet commitments as at December 31, 2008:

(In million dollars)	2009	2010	2011	2012	2013 and after	Total
Pipeline transportation <sup>(1)</sup>	11,203	10,944	10,676	9,991	27,766	70,580
Office premises operating lease <sup>(2)</sup>	2,185	2,783	3,228	3,228	14,526	25,950
Vehicle and other operating leases	978	978	—	—	—	1,956
Total	14,366	14,705	13,904	13,219	42,292	98,486

<sup>(1)</sup> Before Trilogy's undrawn letters of credit (see note 6) issued to cover some pipeline transportation commitments.

<sup>(2)</sup> Net of committed rental reimbursements through sub-lease arrangements.

## 16. INCOME TAXES

In 2007, Bill C-52 Budget Implementation Act, 2007 was enacted by the Canadian federal government. This Bill contains legislation to tax publicly traded trusts in Canada. As a result, income tax will be applied to distributions from Canadian public income trusts. The new tax is not expected to apply to the Trust until 2011 given a transition period that applies to publicly traded trusts in existence prior to November 1, 2006. As a result of the enactment of this legislation, the Trust recorded a net future income tax liability of \$77.4 million as at December 31, 2008 (2007 - \$69.1 million). The future income tax adjustment represents management's estimate of the differences between the book and tax basis of trust entity assets and liabilities ("temporary differences") anticipated to exist in 2011 under current legislation, tax-effected at 29.5 per cent, which is the rate that is currently anticipated to be applicable beginning 2011, and 28 percent thereafter. It also includes the differences between current book and tax basis of Trilogy corporate entities, tax effected at 25 percent.

The following table reconciles the income tax expense calculated using the statutory tax rates to the income tax expense per the statement of earnings (loss):

	2008	2007
Expected income tax expense at statutory tax rate of 39 percent	51,357	7,529
Allocation of earnings to the Trust Unitholders	(42,324)	(8,488)
Non-deductible expenses	1,083	959
Change in estimate of future reversals of temporary differences	(1,785)	—
Future income taxes recognized as a result of new legislation	—	69,055
Income tax expense per statement of earnings (loss)	8,331	69,055

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The nature and tax effect of temporary differences and unused carryforwards that give rise to future income tax assets and liabilities as at December 31, 2008 and 2007 are as follows:

Description of Temporary Differences and Carryforwards	2008	2007
Property, plant and equipment	(101,150)	(90,436)
Asset retirement obligation	20,536	16,096
Loss carryforwards and other	3,227	5,285
Net future income tax liability	(77,387)	(69,055)

Future changes in tax rates and technical interpretations of the new legislation could materially affect management's estimate of the Trust's future income tax liability. The amount and timing of reversals of temporary differences will be dependent upon, among other things, the Trust's future operating results, acquisitions and dispositions of assets and liabilities, and its distribution policy. A change in the assumptions on the preceding items could materially affect the Trust's estimated future income tax liability.

#### 17. SUBSEQUENT EVENTS

Holders of 59,151,849 Trust Units have reinvested their December distributions totaling \$5.9 million through Trilogy's DRIP resulting in the issuance of additional 1,023,618 Trust Units on January 15, 2009.

On January 20, 2009, Trilogy announced its cash distribution for January 2009 at \$0.05 per Trust Unit. The distribution was paid on February 17, 2009 to Unitholders of record on February 2, 2009. Holders of 60,143,617 Trust Units have reinvested their January distributions totaling \$3.0 million through Trilogy's DRIP resulting in the issuance of an additional 616,946 Trust Units on February 17, 2009.

On February 17, 2009, Trilogy also announced that its cash distribution for February 2009 will be \$0.05 per Trust Unit. The distribution is payable on March 16, 2009 to Unitholders of record on March 2, 2009.