



**RELIABLE**

**STRATEGIC**

**RESPONSIBLE**

**GROWTH**

## About Pembina

The Pembina Pipeline Income Fund was established in 1997 when it acquired all of the notes and shares of Pembina Pipeline Corporation. Pembina gathers approximately half of Western Canada's conventional crude oil and natural gas liquids production, has a substantial presence in Alberta's oil sands sector and has developed significant midstream operations, which leverage its expansive energy infrastructure business. Pembina's premium assets generate consistent and sustainable monthly cash distributions to investors and provide reliable, responsible and competitive services to its customers. Pembina's trust units (PIF.UN) and convertible debentures (PIF.DB.B) are traded on the TSX.

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### Forward-Looking Statements and Information

The information contained in this Annual Report contains certain forward-looking statements and information that are based on the Fund's current expectations, estimates, projections and assumptions in light of its experience and its perception of historical trends. Actual results may differ materially from those expressed or implied by these forward-looking statements. For more information about these risks, please see page 41.

## Financial Highlights

(at December 31)	2008	2007	2006	2005	2004
Revenues <sup>(1)</sup> (millions of dollars)	<b>453.9</b>	389.7	335.8	290.5	279.1
Net operating income <sup>(2)</sup> (millions of dollars)	<b>303.0</b>	260.1	215.2	187.8	174.1
Net earnings (millions of dollars)	<b>161.8</b>	142.3	88.9	70.4	60.4
Distributable cash <sup>(2)</sup> (millions of dollars)	<b>207.2</b>	188.9	148.2	123.4	110.5
Distributed cash <sup>(2)</sup> (millions of dollars)	<b>198.8</b>	178.9	142.3	113.5	106.2
Distributed cash per Trust Unit <sup>(2)</sup> (dollars)	<b>1.49</b>	1.37	1.17	1.05	1.05
Net earnings per Trust Unit (dollars)	<b>1.21</b>	1.09	0.73	0.65	0.60
Trust Units outstanding (weighted average in millions)	<b>133.4</b>	130.5	122.1	108.1	101.1
Average daily trading volume (thousands of units per day)	<b>216.2</b>	213.3	257.9	227.0	196.0
Total enterprise value <sup>(2)</sup> (billions of dollars)	<b>3.0</b>	3.2	2.7	2.5	2.1
Total debt to enterprise value	<b>32.1%</b>	26.3%	23.7%	27.3%	34.2%
Throughput volumes <sup>(3)</sup> (thousands of barrels per day)					
Total Conventional Pipelines	<b>439.2</b>	447.1	448.5	435.4	435.0
Oil Sands and Heavy Oil (contracted capacity)	<b>775.0</b>	525.0	389.0	389.0	303.7
Total	<b>1,214.2</b>	972.1	837.5	824.4	738.7

<sup>(1)</sup> Net of product purchases.

<sup>(2)</sup> Refer to "Non-GAAP Measures" on page 11.

<sup>(3)</sup> Actual throughput reported for conventional pipelines and contracted capacity for oil sands.



### RELIABLE

Pembina is a reliable energy transportation and service provider, a trusted member of the communities where we operate, and a dependable investment of choice for our Unitholders.



### STRATEGIC

Pembina's integrated businesses support and enhance each other. Quality assets, combined with prudent financial management, form the foundation of our business plan.



### RESPONSIBLE GROWTH

Pembina believes in staged, carefully managed growth that meets the expectations of all stakeholders.

## What We Do



### CONVENTIONAL PIPELINES

Pembina's eight operated and one non-operated crude oil and natural gas liquids ("NGL") pipelines are part of our 8,000 km network that extends across much of Alberta and British Columbia. In 2008, the conventional systems transported approximately 439,000 bbls/d of crude oil and natural gas liquids. This represents approximately half of Western Canada's conventional crude oil production and approximately 20 percent of NGLs produced.



### MIDSTREAM & MARKETING

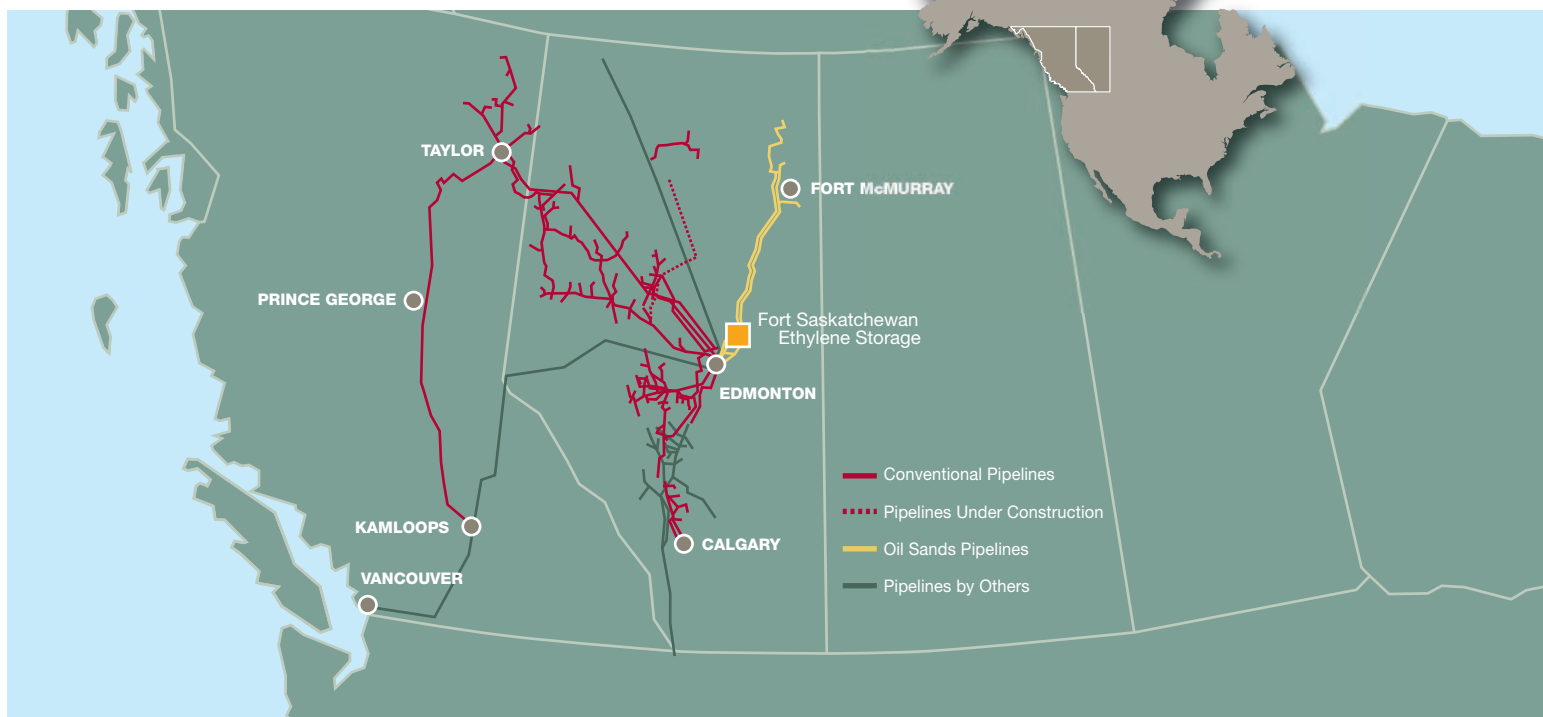
This business consists of Pembina's 50 percent non-operated interest in the Fort Saskatchewan Ethylene Storage Facility and the wholly-owned network of terminals, storage facilities and hub services across our conventional pipeline system. Like all of Pembina's businesses, Midstream & Marketing generates revenue by providing quality products and services.



### OIL SANDS AND HEAVY OIL INFRASTRUCTURE

Pembina's role in transporting heavy oil from Alberta's oil sands region has increased significantly in recent years. Since 2001, Pembina has provided dedicated service to Syncrude Canada Ltd., the operator of the largest oil sands crude oil production facility in the world. A 56-km pipeline completed in 2006 provides diluent for customers located near Cheecham, Alberta, while the Horizon Pipeline, completed in 2008, provides exclusive service to Canadian Natural Resources Ltd.'s oil sands project near Fort McMurray, Alberta.

## Where We Operate



# STRONG RESULTS

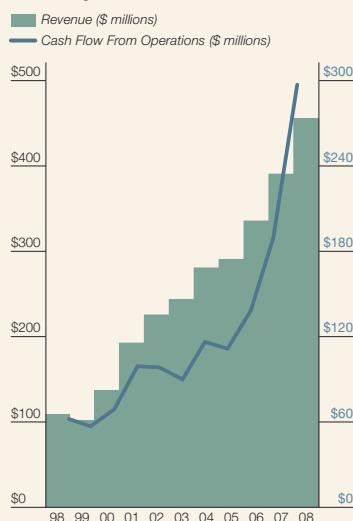
In 2008, all three of Pembina’s business segments contributed to strong results, generating an aggregate of \$453.9 million in revenue and \$219.9 million in cash flow from operations, a 16 percent increase over the comparable periods of the prior year. Over the five year period ending December 31, 2008, Pembina has delivered PER UNIT growth as follows:

**↑ 42%**  
Cash Flow from Operations

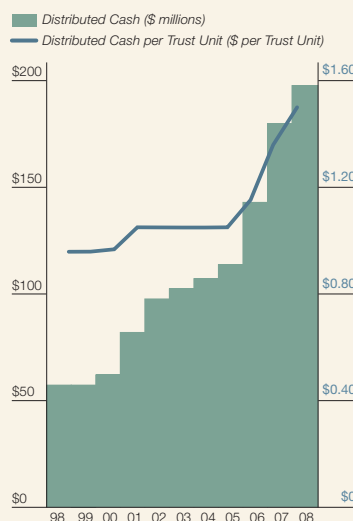
**↑ 42%**  
Distributed Cash

**↑ 103%**  
Net Earnings

**Revenue and Cash Flow From Operations**

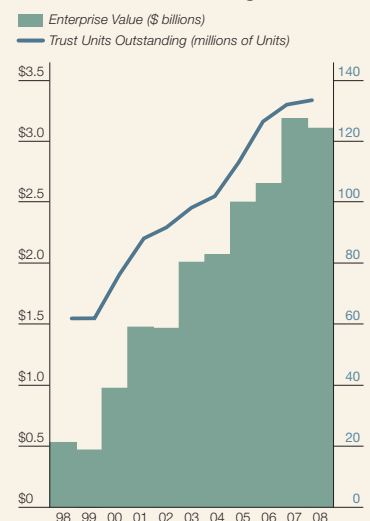


**Distributed Cash**



Refer to "Non-GAAP Measures" on page 11.

**Enterprise Value and Trust Units Outstanding**



Refer to "Non-GAAP Measures" on page 11.

## Delivering Value

“Pembina’s strategy has consistently delivered value to Unitholders.”

### 2008 Operating Highlights

	Conventional Pipelines		Midstream & Marketing		Oil Sands & Heavy Oil <sup>(4)</sup>		Total	
	2008	2007	2008	2007	2008	2007	2008	2007
Average throughput (thousands of barrels per day)	<b>439.2</b>	447.1			<b>775.0</b>	525.0	<b>1,214.2</b>	972.1
Revenue <sup>(1)</sup> (\$ millions)	<b>263.4</b>	249.1	<b>105.1</b>	79.0	<b>85.4</b>	61.7	<b>453.9</b>	389.8
Operating expense (\$ millions)	<b>113.2</b>	97.3	<b>9.0</b>	8.6	<b>28.7</b>	23.7	<b>150.9</b>	129.6
Net operating income <sup>(2)</sup> (\$ millions)	<b>150.2</b>	151.8	<b>96.1</b>	70.4	<b>56.7</b>	38.0	<b>303.0</b>	260.2
Average revenue <sup>(3)</sup> (\$/bbl)	<b>1.55</b>	1.43			<b>0.79</b>	0.54	<b>1.25</b>	1.08

<sup>(1)</sup> Net of product purchases.

<sup>(2)</sup> Refer to “Non-GAAP Measures” on page 11.

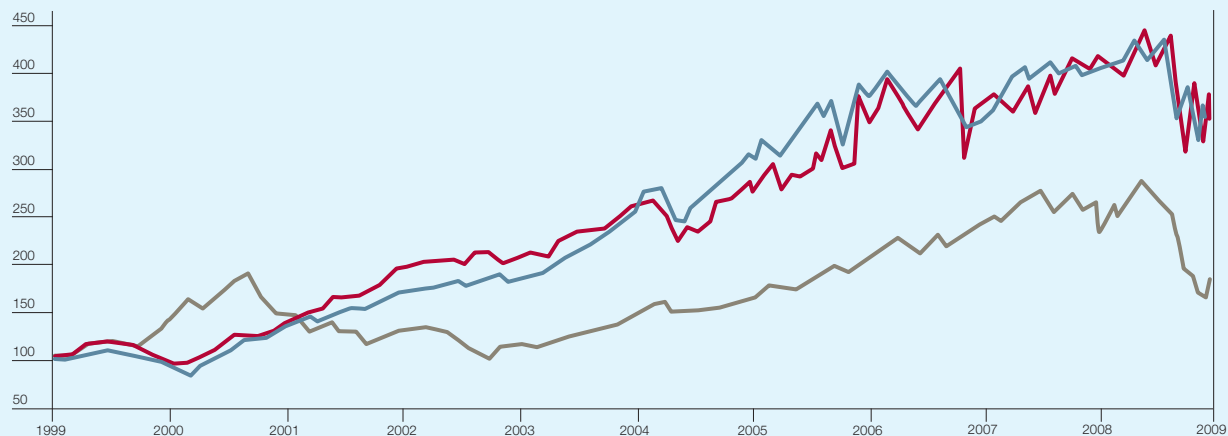
<sup>(3)</sup> Midstream & Marketing revenue is excluded in total average revenue calculation.

<sup>(4)</sup> Revenue is contract-based and independent of utilization rates, therefore volumes reported are contracted capacity.

### Comparative Total Returns

Relative performance (100 = January 1, 1999)

— Pembina — Scotia Utilities/Infrastructure Trust Index<sup>(1)</sup> — S&P/TSX Index



<sup>(1)</sup> Source: Scotia Capital Utilities and Infrastructure Trust Index and Bloomberg. Distributions are reinvested in their respective securities.

## Accomplishments and Priorities

# STRATEGY IN ACTION

### Building for continued success

**Pembina's business strategy is comprised of five key elements, structured to produce results that generate value for our Unitholders:**

- **Generate value by partnering with high quality customers** to provide the superior products and services they require to be successful.
- **Build business flexibility**, allowing Pembina to diversify its assets and respond to market conditions to help enhance profitability.
- **Maintain a strong balance sheet** through the application of prudent financial management to all business decisions.
- **Implement staged, carefully managed growth** in a safe and environmentally responsible way.
- **Develop businesses** which lend themselves to future economic expansion and vertical integration.

### Accomplishments in 2008

- **Expanded current operations** – Completed the Horizon Pipeline, Pembina's largest pipeline project to date and increased Pembina's contracted oil sands transportation capacity by 250,000 bbls/d to 775,000 bbls/d.
- **Planned for new growth** – Signed long-term transportation service agreements for the proposed Nipisi and Mitsue Pipeline projects and created a new Major Projects Group to specialize in large-scale expansion initiatives.
- **Built organizational capacity** – Created the position of Chief Operating Officer to oversee operational excellence and restructured to provide more focused leadership to the business units.
- **Generated wealth** – Increased distributions to Unitholders by 8.3 percent to \$1.56 per unit per year.

### Plans for 2009

- **Responsible growth** – Integrate input from stakeholders into our project plans and advance the development of the Nipisi and Mitsue Pipelines to help ensure they are in service by Pembina's expected completion date in mid-2011, and readily expandable beyond 2011.
- **Ready for conversion** – Begin the work required to ensure a smooth transition from an income trust fund to a corporation, which Pembina expects to implement in the latter half of 2010.
- **Strengthen business processes** – Implement leading edge business systems, processes, and management training programs to improve the efficiency of our financial and management systems; save both time and money and strengthen governance controls.
- **Investigate new business opportunities** – Pursue opportunities to partner with customers on enhanced oil recovery from mature fields using CO<sub>2</sub> flooding as well as new crude oil and diluent transportation and storage options. Develop incremental revenue generating opportunities and further diversify our midstream business.

## Message to Unitholders

### Fellow Unitholders

#### 2008: A Year of Accomplishment

This was a year of significant accomplishment for Pembina. All three of our business units – Conventional Pipelines, Oil Sands & Heavy Oil Infrastructure and Midstream & Marketing – continued to grow and prosper. Corporate-wide, we enjoyed record cash flow of \$219.9 million, our net operating income increased by 16 percent to \$303.0 million, and cash distributions to Unitholders reached the highest level in the company's history.

Of particular note was the completion, in July, of the fully contracted Horizon Pipeline, which provides exclusive service to Canadian Natural Resources Ltd.'s ("CNRL") Horizon Oil Sands Project near Fort McMurray, Alberta. Pembina projects that the Horizon Pipeline will contribute incremental net operating income of a minimum of \$45 million per year over the 25-year life of the contract under which it is operated. The project builds on our experience operating and expanding the Syncrude Pipeline (formerly the Alberta Oil Sands Pipeline, or AOSPL), which provides dedicated service to the largest oil sands crude oil production facility in the world, operated by Syncrude Canada Ltd.

Since acquiring the Syncrude Pipeline in 2001, Pembina has invested more than \$600 million to expand and enhance our service base in the Athabasca oil sands region. We now have 775,000 barrels per day (bbls/d) of fully contracted transportation capacity in three distinct pipelines serving this market. We expect our market share to grow as we continue to pursue future business opportunities.

This past year saw another milestone in Pembina's next major expansion project – the Nipisi heavy oil pipeline and the Mitsue condensate pipeline. In August, Pembina signed long-term transportation service agreements with the founding customers of these pipeline systems, CNRL and EnCana Corporation. Total capital cost for the two pipelines is estimated to be \$400 million and, pending regulatory approval, Pembina expects the facilities to be in service by mid-2011. Based on Pembina's internal projections, these two pipelines are estimated to contribute approximately \$45 million in initial net operating income per annum once operations commence.

During 2008, Pembina's Board of Directors communicated its plan to convert Pembina from an income trust to a corporate entity, most likely in the latter part of 2010. We expect this move to be well received by our business partners, customers and in the communities where we operate, as it reflects our confidence in our financial strength and business plan, which we believe will allow us to achieve both our operational and growth goals.

**It's easy to judge a company by how it performs in good times. But the real test is how that same company fares in challenging times.** I'm proud to say that, in the case of Pembina, our strong business fundamentals enabled us to achieve many successes in 2008. Our longstanding emphasis on reliable operations, a proven business strategy and a responsible plan for growth provide a strong foundation for the future.

These principles are reflected in our growth plans for 2009 and beyond, and are further reinforced by Pembina's commitment, based on the Fund's current assumptions, expectations, estimates and projections, to maintain our 2008 level of cash distributions (\$1.56 per unit per year) over the next five years. Our aim: to provide investors with a reliable stream of cash flow, even in uncertain times.



Today's economy may pose challenges, but it also presents opportunities. Compared to recent years, we can expect construction costs to be more competitive and labour shortages to ease. Armed with a healthy balance sheet, Pembina is in a strong position to take advantage of these trends and forge ahead with a strategic growth plan aimed at realizing the full value of our asset base and talented workforce.

As in the past, success will not just be about what we do, but how we do it. That means setting for ourselves the very highest standards of safety, reliability, community engagement and environmental responsibility – and then continuing to deliver on our commitments.

### **A Reliable Performer**

For more than half a century, Pembina has earned a reputation as a reliable energy services provider and responsible corporate citizen. We are known as a trusted member of the communities where we operate and for dealing with stakeholders in an open and respectful manner. We are also recognized in the marketplace for reliably generating value for our investors in varying market conditions.

Pembina is renowned for providing safe, reliable transportation services to Western Canada's energy industry. We are strongly committed to ensuring the integrity of our pipelines. We do this by purchasing high quality materials, installing state-of-the-art pipeline safety technology and monitoring our systems 24 hours a day, 365 days per year. Our employees and contractors all have a safety-first mindset.

Pembina realizes that how we manage our existing operations influences the level of confidence stakeholders have in our ability to grow our company in a responsible manner. That's why, in November, Pembina appointed Michael (Mick) Dilger to the newly created position of Chief Operating Officer. Mick, who served as Vice President, Business Development since 2005, fully understands our existing operations and is now charged with maintaining excellence across our businesses.

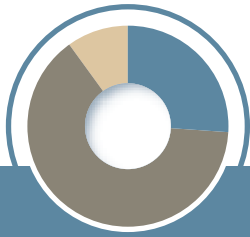
“Our longstanding emphasis on reliable operations, a proven business strategy and a responsible plan for growth provide a strong foundation for the future.”

## **RELIABLE RETURNS\***

In 2006, the Government of Canada introduced legislation designed to change the taxation of certain specified investment flow-through entities (“SIFTs”), more commonly referred to as income trusts. In response to this change, after detailed consideration of the various options available to the Fund, Pembina's Board of Directors has determined conversion from an income trust to a corporate entity, prior to January 1, 2011, when the new tax legislation will take effect, will best serve the interest of Pembina's owners.

The Board concluded that Pembina's proven business strategy and potential for future growth will more than offset the increased tax burden of converting to a corporation through 2013. In addition, based on the Fund's current assumptions, expectations, estimates and projections, the Board anticipates being able to maintain our 2008 level of cash distributions to equity holders (\$1.56 per unit per year) over the next five years.

\* Based on the Fund's current assumptions, expectations, estimates and projections. Actual results may differ materially from those expressed or implied. For more information please see “Forward-Looking Statements and Information” on page 41.

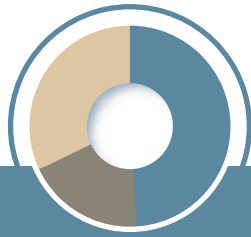


**2008  
Throughput Composition**

(Average barrels per day)

● Conventional	317,699
● Oil Sands <sup>(1)</sup>	775,000
● Natural Gas Liquids	121,547
<b>Total</b>	<b>1,214,246</b>

<sup>(1)</sup> Contracted capacity.



**2008  
Net Operating Income**

(\$ millions)

● Conventional	150.2
● Oil Sands	56.7
● Midstream	96.1
<b>Total</b>	<b>\$303.0</b>

Refer to "Non-GAAP Measures" on page 11.

“Corporate-wide, in 2008, we enjoyed record cash flow of \$219.9 million, our net operating income increased by 16 percent to \$303.0 million, and cash distributions to Unitholders reached the highest level in the company’s history.”

### A Proven Business Strategy

Since becoming a public company in 1997, Pembina has made significant investments in acquisitions and expansions. We have more than doubled the length of our conventional pipeline network, steadily expanded our capacity to transport oil sands production, and developed our midstream and marketing business to increase the range of services we offer our customers.

The continued goal of this diversification strategy is to build a corporate entity that is self-sustaining – where each of our businesses supports and enhances the other, and where there is sufficient flexibility to respond to and prosper in changing market conditions.

We have invested in high quality assets that are strategically located, and have structured our energy infrastructure business to serve the needs of Western Canadian hydrocarbon producers. We provide our customers with safe, reliable, cost effective and market-responsive services and have expanded our operations and services in a staged, carefully managed way. We aim to leverage our core capabilities, capture the full profit potential of our assets, and prudently manage our capital resources.

This strategy has delivered superior results. Since 1997, Pembina’s total enterprise value has increased six-fold to more than \$3 billion at the end of 2008. Over that same period, we distributed over \$1.2 billion to our Unitholders.

In 2008, Pembina management took important steps to build on this successful business strategy. A corporate reorganization ensured each of our three businesses now have defined leaders to oversee commercial and operational performance and identify opportunities for growth and development. This new corporate structure is intended to result in improved customer service, more focused in-house expertise and enhanced competitiveness and profitability.

### Pursuing Responsible Growth

Pembina has experienced significant growth over the past decade. And in the years ahead, we expect to pursue further strategic opportunities. Growth brings opportunity, but also great responsibility. At Pembina, we believe in staged, carefully managed growth that respects the interests and concerns of all stakeholders. That's why we put such a strong emphasis on community consultation and environmental stewardship.

These priorities are reflected in the two major expansion projects we are currently pursuing. Taken together, the proposed Nipisi and Mitsue Pipelines would see our transportation capacity increase by 100,000 bbls/d of heavy oil and by 22,000 bbls/d of condensate (a light petroleum product used to dilute heavy oil). Pembina intends to contribute significant existing under-utilized infrastructure to this project, materially reducing the operating and environmental footprint of this expansion.

Pembina will work closely with the people and communities affected by these proposed projects to ensure our facilities are designed, constructed and operated in an environmentally and socially responsible manner. This will include ongoing consultation and dialogue with our Aboriginal neighbours, landowners, regulators and other stakeholders.

In 2008, Pembina established a Major Projects Group that is committed to ensuring our significant growth projects are delivered safely, responsibly, on time and on budget.

### A Team Approach

The success of any company comes down to the quality of the employees and management it attracts. I'm proud to say that Pembina continues to hire and retain the best and the brightest this industry has to offer. Their talent, hard work and dedication have made Pembina a reliable performer, a strategic industry player and an agent of responsible growth.

Our corporate team was recently strengthened with the promotions of: Barbara Jack, Vice President, Human Resources; Robert Jones, Vice President, Midstream & Marketing; and Sam Stephenson, Vice President, Engineering and Operations, Conventional Pipelines. I would also like to recognize Bruce Harris, the outgoing Vice President, Engineering and Operations, who retired in December after 27 years of dedicated service and significant contribution to Pembina's record of achievement.

“Growth brings opportunity, but also great responsibility. At Pembina, we believe in staged, carefully managed growth that respects the interests and concerns of all stakeholders.”

On December 17, 2008, we welcomed Leslie O'Donoghue and Doug Haughey to our Board of Directors. Leslie, with her expertise in governance, and Doug, with his years of experience in the energy sector, will play significant roles in overseeing Pembina's next generation of success.

I would also like to thank our Board of Directors for their sound stewardship and support. The Board sets the tone from the top, insisting on the highest standards of corporate governance and acting as the ultimate guardian of our investors' interests.

Finally, I want to thank you, Pembina's Unitholders, for your confidence and support. Together, I know we will continue to build an organization of which we can all be proud.



**Robert B. Michaleski**  
President and Chief Executive Officer  
Pembina Pipeline Corporation

March 4, 2009

# Management's Discussion and Analysis



The following discussion and analysis of the financial results of Pembina Pipeline Income Fund ("Pembina" or the "Fund") dated March 4, 2009 is supplementary to, and should be read in conjunction with, the Audited Consolidated Financial Statements for the years ended December 31, 2008 and 2007. This MD&A has been reviewed and approved by both the Audit Committee and the Board of Directors. All amounts are stated in Canadian dollars unless otherwise specified.

## 2008 Highlights and Selected Information<sup>(1)(2)</sup>

Years ended December 31

(in millions of dollars, except per Trust Unit amounts where noted)

	2008	2007	2006
Revenue <sup>(3)</sup>	<b>\$ 453.9</b>	\$ 389.7	\$ 335.8
Operating expenses	<b>150.9</b>	129.6	120.6
Net operating income <sup>(2)</sup>	<b>303.0</b>	260.1	215.2
Interest on long-term debt	<b>39.4</b>	29.5	24.9
Interest on convertible debentures	<b>3.4</b>	4.8	7.7
Net earnings before taxes	<b>172.9</b>	119.8	64.6
Net earnings	<b>161.8</b>	142.3	88.9
Net earnings per Trust Unit – basic	<b>1.21</b>	1.09	0.73
Net earnings per Trust Unit – diluted	<b>1.19</b>	1.06	0.73
EBITDA <sup>(2)</sup>	<b>287.9</b>	220.5	184.2
Cash flow from operations	<b>219.9</b>	189.5	143.9
Distributable cash <sup>(2)</sup>	<b>207.2</b>	188.9	148.2
Distributed cash <sup>(2)</sup>	<b>198.8</b>	178.9	142.3
Distributed cash per Trust Unit <sup>(2)</sup>	<b>1.49</b>	1.37	1.17
Trust Units outstanding (weighted average, thousands of Units)	<b>133,380</b>	130,513	122,094
Trust Units outstanding (end of year, thousands of Units)	<b>134,703</b>	132,542	126,218
Total enterprise value <sup>(2)</sup>	<b>3,021.4</b>	3,179.2	2,655.1
Capital expenditures	<b>223.0</b>	300.3	168.9
Total assets	<b>2,118.2</b>	1,966.8	1,676.2
Total long-term financial liabilities	<b>1,069.7</b>	976.3	752.6

<sup>(1)</sup> Pembina Pipeline Income Fund distributes cash generated by the pipeline operations of Pembina Pipeline Corporation and other operating subsidiaries.

<sup>(2)</sup> Refer to "Non-GAAP Measures" on page 11.

<sup>(3)</sup> Net of product purchases of \$220.9 million in 2008; \$115.1 million in 2007; \$5.1 million in 2006.

**Forward-looking Statements and Information**

The information contained in this Management's Discussion and Analysis ("MD&A") contains certain forward-looking statements and information that are based on the Fund's current expectations, estimates, projections and assumptions in light of its experience and its perception of historical trends. Actual results may differ materially from those expressed or implied by these forward-looking statements. For more information, refer to "Forward-Looking Statements and Information" on page 41.

**Non-GAAP Measures**

The financial statements of the Fund are presented in Canadian dollars and in compliance with Canadian generally accepted accounting principles ("GAAP"). Throughout this MD&A, the Fund and Pembina Pipeline Corporation (or just the "Fund") have used the following terms that are not defined by GAAP:

**DISTRIBUTABLE CASH**

The amount of cash that is available for distribution before retaining a portion as reserve to absorb the impact of material one-time events and to reduce bank indebtedness. Not all available cash is distributed to Unitholders.

**DISTRIBUTED CASH**

The amount of cash that has been or is to be available for distribution to the Unitholders. Distributed cash is calculated pursuant to the terms of the Declaration of Trust.

**DISTRIBUTED CASH PER TRUST UNIT**

Calculated on a weighted average basis using basic and diluted units outstanding during the year.

**EARNINGS BEFORE INTEREST, TAXES, DEPRECIATION AND AMORTIZATION ("EBITDA")**

Net income plus depreciation and amortization, financing charges and income taxes.

**ENTERPRISE VALUE**

Calculation based on the market values of Trust Units and the convertible debentures (refer to Note 8 to the accompanying Financial Statements) at December 31, 2008 plus senior debt.

**NET OPERATING INCOME**

Revenues less operating expenses.

Management believes that in addition to net earnings, the above noted items are useful measures. They provide an indication of the results generated by the Fund's business activities prior to consideration of how the activities were financed or how the results are taxed. Investors should be cautioned however that distributable cash, distributed cash, EBITDA, enterprise value and net operating income should not be construed as alternatives to net earnings, cash flow from operating activities or other measures of financial results determined in accordance with GAAP as indicators of the Fund's performance. Furthermore, these measures may not be comparable to similar measures presented by other issuers.

**Materiality**

For the purposes of the MD&A and the financial statements and for the purposes of general disclosure to the investment community, Pembina considers an item or event to be material if the omission or misstatement of an item of information or event, or an aggregate of such items or events, would influence or change a decision to buy, sell or hold the Fund's securities. In order to determine what information would be considered as material, Pembina's review includes, but is not limited to, determination as to the effect on income and operating costs, future impact to operations and overall returns to Pembina. Outside legal counsel is also consulted with respect to the required disclosure applicable to certain matters.

## Overview

### Reliable, Strategic, Responsible Growth

Pembina's principal objectives are to provide a long-term stable stream of distributions to Unitholders and to enhance and preserve the long-term value of the Fund. The business strategy Pembina follows to achieve these objectives has five key elements:

- Generate value by partnering with high quality customers to provide the superior products and services they require to be successful.
- Build business flexibility, allowing Pembina to diversify its assets and respond to market conditions to help enhance profitability.
- Maintain a strong balance sheet through the application of prudent financial management to all business decisions.
- Implement staged, carefully managed growth in a safe and environmentally responsible way.
- Develop businesses which lend themselves to future economic expansion and vertical integration.

Pembina believes the most prudent manner to achieve this objective is to maintain and to develop assets around Pembina's hydrocarbon-liquids services business within Western Canada. Pembina plans to further develop this business through the continuous improvement and ongoing expansion of Pembina's asset base and the acquisition of quality energy infrastructure assets. Pembina regards quality assets as assets that are imbued with inherent competitive advantages, that have cash flows that can be predicted with a reasonable degree of certainty, and either service or are in close proximity to long-life, economic hydrocarbon reserves.

Pembina's business is structured in three key segments: **Conventional Pipelines, Oil Sands & Heavy Oil Infrastructure** and **Midstream & Marketing**.

The primary objectives for Pembina's conventional pipeline assets located in Alberta and British Columbia ("BC") are safe, reliable operations and the maintenance of competitive operating margin contributions, while pursuing opportunities for increased throughput and revenue enhancement. Operating margins are maintained through incremental volume capture and system expansion, revenue management and operating cost discipline. Pembina strives to attract new business to its conventional pipeline systems by offering cost-effective, competitively-positioned and reliable transportation services.

Pembina has successfully leveraged its uniquely positioned infrastructure and operating knowledge in the oil sands and intends to continue to pursue future opportunities in this key sector. Pembina's existing Oil Sands & Heavy Oil Infrastructure assets, and those currently under development, are characterized by fully contracted service and long-term returns which are designed to provide a secure stream of stable cash flow. Operating income contribution from this business is related to invested capital and is not sensitive to fluctuations in costs or capacity utilization. The life of these assets is effectively tied to the life of the oil sands and heavy oil reserves to which they provide service; reserve lives which Pembina believes can span in excess of 50 years. Due to the long-term and stable nature of these assets, the further expansion of Pembina's business interests in this sector is a priority.

Pembina's Midstream & Marketing business consists of its 50 percent non-operated interest in the Fort Saskatchewan Ethylene Storage Facility and the network of terminals, storage facilities and hub services across Pembina's conventional pipeline system. This business unit has rapidly expanded and diversified in recent years and now generates approximately one-third of Pembina's net operating income. By understanding the value chains for crude oil and NGLs, Pembina has developed additional revenue sources associated with its existing energy infrastructure assets. Pembina anticipates that the further expansion of midstream services should diversify sources of revenue, making revenue more sustainable and consistent, which is of significant benefit to both pipeline customers and Unitholders. This strategy serves to both expand the quality and range of services offered to customers and to extend the economic life of Pembina's conventional asset base.

### **Financial Management**

Pembina maintains a conservative capital structure that allows it to finance its day-to-day cash requirements through its operations, without requiring external sources of capital. Pembina funds its operating commitments, short-term capital spending as well as its distributions to Unitholders through internally-generated cash flow, while new borrowing and equity issuances are typically reserved for the support of specific growth projects. Long-term debt is comprised of bank credit facilities, senior secured and unsecured notes, and convertible debentures, all of which are denominated in Canadian Dollars.

### **Corporate Governance**

Pembina is committed to maintaining a high standard of corporate governance and ethical practices, both within the corporate boardroom and throughout its operations. Pembina's corporate governance practices are designed with a view to:

- ensure the business and affairs of the Fund and its subsidiaries are effectively managed in the best interests of the Unitholders;
- enhance and preserve the long-term value of the Fund and cash distributions to Unitholders;
- ensure Pembina meets its obligations to all regulatory bodies, business partners, customers, stakeholders and Unitholders on an on-going basis; and
- ensure Pembina operates in a reliable and safe manner.

Pembina's Code of Ethics, which is available on the Fund's website at [www.pembina.com](http://www.pembina.com) and on the Fund's SEDAR profile at [www.sedar.com](http://www.sedar.com), outlines Pembina's vision, strategy and commitment to fair and ethical practices. The Code of Ethics establishes a high standard governing the activities of Pembina's employees, executive and Board members, including expectations for maintaining personal privacy, the protection of confidential information and ensuring a safe, healthy and respectful workplace. Beyond this, Pembina maintains a culture of strong corporate governance and ensures it is in compliance with all existing rules and regulations of the governing bodies under which it operates. These corporate governance practices are not limited to internally focused activities. Pembina places a great deal of importance on community involvement and maintaining good relationships with all stakeholders.

### **Reporting and Disclosure Controls and Procedures**

As part of the requirements mandated by the Canadian securities regulatory authorities under Multilateral Instrument 52-109 "Certification of Disclosure in Issuer's Annual and Interim Filings", Pembina's Chief Executive Officer and the Chief Financial Officer have evaluated the Fund's reporting and disclosure controls and procedures as of December 31, 2008. It was concluded that the disclosure controls and procedures are effective in ensuring that the information disclosed in the financial statements, the annual information form and other filings to the Canadian securities regulatory authorities are accurate and complete and filed within the mandated timelines. These reporting and disclosure controls provide reasonable assurance that the information that Pembina is required to disclose is appropriately accumulated and communicated to Pembina's management in a timely manner.

The certifying officers are also responsible for establishing and maintaining internal controls related to financial reporting. These controls are designed to provide reasonable assurance regarding the reliability of Pembina's financial reporting and compliance with Canadian GAAP in Pembina's consolidated financial statements. The Fund has designed and evaluated the effectiveness of such controls, concludes that these controls are effective, and confirms that there have been no changes during the year that have materially affected the Fund's internal controls over financial reporting.

## Operating Results

### Results From Operations

(in millions of dollars, except where noted)	2008		2007	
	Revenues	Net operating income <sup>(1)</sup>	Revenues	Net operating income <sup>(1)</sup>
Conventional Pipelines	\$ 263.4	\$ 150.2	\$ 249.1	\$ 151.8
Oil Sands & Heavy Oil Infrastructure	85.4	56.7	61.7	38.0
Midstream & Marketing Business <sup>(2)</sup>	105.1	96.1	78.9	70.3
<b>Total</b>	<b>\$ 453.9</b>	<b>\$ 303.0</b>	<b>\$ 389.7</b>	<b>\$ 260.1</b>

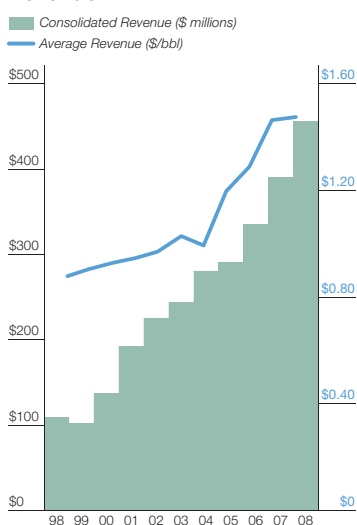
<sup>(1)</sup> Refer to "Non-GAAP Measures" on page 11.

<sup>(2)</sup> Midstream & Marketing revenue is net of \$220.9 million in product purchase expense for 2008 (2007: \$115.1 million).

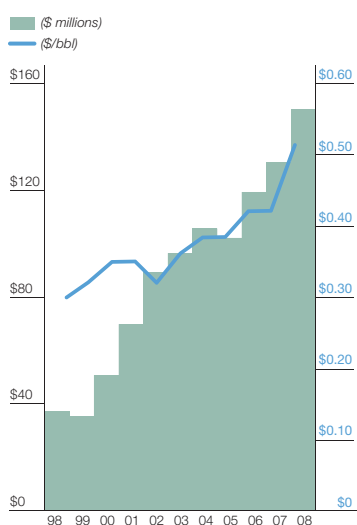
All three of Pembina's businesses contributed to strong results in 2008, generating aggregate consolidated revenue of \$453.9 million, a 16.5 percent increase from 2007 revenue of \$389.7 million. The Conventional Pipelines business generated revenue of \$263.4 million in 2008, an increase of \$14.3 million or 5.7 percent compared to revenue of \$249.1 million in 2007. Revenue contributed by Oil Sands & Heavy Oil Infrastructure operations was 38.4 percent higher in 2008 at \$85.4 million, compared to revenue of \$61.7 million in 2007. Pembina's Midstream & Marketing business contributed revenue of \$105.1 million, an increase of \$26.2 million, or 33.2 percent, from 2007 revenue of \$78.9 million.

Aggregate net operating income in 2008 was \$303.0 million, a 16.5 percent or \$42.9 million increase from 2007 net operating income of \$260.1 million. Higher revenues of \$64.2 million are offset by a \$21.3 million or 16.4 percent increase in operating expense from \$129.6 million in 2007 to \$150.9 million in 2008. Higher operating expenses were due to increased labour costs, property taxes, maintenance spending and power costs.

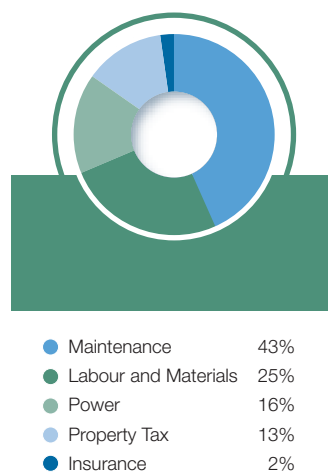
#### Consolidated Revenue



#### Operating Costs



#### Composition of 2008 Operating Costs





## Conventional Pipelines

(in millions of dollars, except where noted)	2008		2007	
	Alberta	BC <sup>(1)</sup>	Alberta	BC <sup>(1)</sup>
Average throughput (mbbls/d)	<b>416.6</b>	<b>22.6</b>	422.7	24.4
Revenue	<b>\$ 224.3</b>	<b>\$ 39.1</b>	\$ 216.4	\$ 32.7
Operating expenses	<b>95.5</b>	<b>17.7</b>	79.7	17.6
Net operating income <sup>(2)</sup>	<b>128.8</b>	<b>21.4</b>	136.7	15.1
Capital expenditures	<b>43.7</b>	<b>5.7</b>	72.1	5.0
Operating expenses (\$/bbl)	<b>0.63</b>	<b>0.99</b>	0.52	0.89
Average revenue (\$/bbl)	<b>1.47</b>	<b>2.17</b>	1.40	1.66

<sup>(1)</sup> Represents volume transported on the Western system only. BC volume transported east is included in Alberta pipelines total. Revenue, operating expenses and net operating income include both Western and BC gathering system results.

<sup>(2)</sup> Refer to "Non-GAAP Measures" on page 11.

### Alberta Pipelines

Throughput on the Alberta conventional pipeline systems averaged 416,600 bbls/d in 2008, compared to the 2007 average throughput of 422,700 bbls/d. This decrease in annual throughput volume is a result of natural decline, various outages (including the two month outage on the Cremona pipeline system, described below), and a reduction in natural gas liquids receipts from several connected gas plants.

The Alberta conventional pipelines generated revenue of \$224.3 million in 2008, up from \$216.4 million in 2007. This increase in revenue is partially attributable to increased receipts on the Drayton Valley and Swan Hills pipeline systems. Average revenue per barrel on the Alberta pipeline systems of \$1.47 in 2008 was up 7 cents per barrel compared to the average of \$1.40 in 2007. Higher per barrel revenue on the Alberta pipeline systems was partially attributable to increased receipts from new connections, the effort in attracting volumes by our Midstream business, and higher tariffs resulting from an increase in operating expenses.

Net operating income on the Alberta conventional pipelines was impacted by one time costs of approximately \$5 million associated with clean-up activities related to a prior period spill on Pembina's Drayton Valley system near Lodgepole, Alberta, and a pipeline interruption on Pembina's Cremona system near the Red Deer River, which occurred on June 15, 2008.

Operating expenses for the Alberta conventional pipelines were \$95.5 million in 2008, up \$15.8 million from \$79.7 million in 2007. This increase is primarily attributable to increases in integrity related maintenance spending, the clean-up activities for the above mentioned historical spill and pipeline interruption, as well as labour and property taxes. Power continues to comprise a significant component of these costs, constituting over 9.0 percent of total operating costs for the Alberta conventional pipelines. As part of Pembina's risk management program, the non-transmission portion of costs of Pembina's estimated annual power requirements for substantially all its Alberta conventional pipelines have been fixed in a power rate swap transaction, as described below, and this substantial benefit has been passed on to Pembina's customers.

Pembina has hedged 16 mega watts per hour to December 31, 2010, with EPCOR Power L.P. (rated A (low) by DBRS and BBB+ by S&P as of December 31, 2008) to help mitigate its exposure to power cost fluctuations. As a result of this hedge, power cost savings were \$6.1 million in 2008 compared with savings of \$2.9 million in 2007. These power cost savings are passed through to customers. Since 2002, the hedge has provided a savings of \$21.3 million. The fixed unit costs for 2008 under this hedging arrangement were below the market cost of electric power during the year, and the mark-to-market value of the power rate swap at December 31, 2008, resulted in an unrealized gain of \$9.1 million.

Pembina maintains a conservative but positive outlook on 2009 operating results for the Alberta conventional pipelines. Pembina expects that a number of new connections and facility upgrades under development, along with incremental volume capture and system expansion, revenue management and operating cost discipline, may counter the expected effect that reduced commodity prices may have on drilling activity in Western Canada.

### **BC Pipelines**

Volumes transported on the BC gathering systems averaged 26,500 bbls/d in 2008, compared to the 2007 average of 29,700 bbls/d. The year-over-year decrease in volumes is primarily due to natural declines. Volumes transported on the Western system in 2008 were 22,600 bbls/d, down from the 24,400 bbls/d in 2007. This decrease is primarily due to outages at various refineries during the summer.

Revenue generated by the BC gathering systems and the Western system (collectively called the "BC Pipelines") was \$39.1 million in 2008, a 19.6 percent increase from 2007 revenue of \$32.7 million. This increase in revenue on the BC Pipelines was mainly due to increases on the Western system of \$6.5 million. Revenue on the provincially regulated BC Pipelines is mostly based on recovery of operating costs and a return on capital invested, and is independent of throughput.

In 2008, Pembina reached negotiated settlements with customers of its Western system and implemented a new service designed to retain deliveries to Kamloops and offer long-term incentives to shippers aimed at maximizing the utilization of the Western system. These agreements are in effect until February 29, 2012.

Operating expenses on the BC Pipelines totaled \$17.7 million in 2008, approximately the same as amount expended in 2007. In 2004, Pembina expanded its maintenance, inspection and integrity program on the BC Pipelines, with special focus on the Western system. Over the length of the program, the BC Pipelines and related facilities have undergone major upgrading, inspections and repair programs. A total of \$3.8 million was expended during 2008 in respect of this continued integrity program.

## Oil Sands & Heavy Oil Infrastructure

(in millions of dollars, except where noted)

	2008	2007
Contracted capacity <sup>(1)</sup> (mbbls/d)	<b>775.0</b>	525.0
Revenue	<b>\$ 85.4</b>	\$ 61.7
Operating expenses	<b>28.7</b>	23.7
Net operating income <sup>(2)</sup>	<b>56.7</b>	38.0
Capital expenditures	<b>131.6</b>	212.7
Operating expenses <sup>(3)</sup> (\$/bbl)	<b>0.27</b>	0.21
Average revenue <sup>(3)</sup> (\$/bbl)	<b>0.79</b>	0.54

<sup>(1)</sup> Oil sands revenue is contract-based and independent of utilization rates, therefore oil sands volumes reported represent contracted capacity. Actual average throughput was 294.8 mbbls/d in 2008 and 310.8 mbbls/d in 2007.

<sup>(2)</sup> Refer to "Non-GAAP Measures" on page 11.

<sup>(3)</sup> Calculation uses actual average throughput.

Pembina has 775,000 bbls/d of fully contracted synthetic crude oil transportation capacity over three distinct pipeline systems serving customers in the Athabasca oil sands region: the Syncrude Pipeline which provides dedicated service to Syncrude, the world's largest crude oil producer from oil sands; the Cheecham Lateral Pipeline which delivers synthetic crude oil from the Syncrude Pipeline to a facility near Cheecham, Alberta; and, the recently completed Horizon Pipeline which provides dedicated service to Canadian Natural Resources Ltd.'s ("CNRL") Horizon Oil Sands Project. Revenue generated by these fully contracted pipelines is independent of throughput and provides for the full recovery of operating expenses.

The Syncrude Pipeline generated revenue of \$64.6 million during 2008, 13.1 percent higher than 2007 due to higher operating expenses, which flowed through to shippers on this system. This pipeline, which has a transportation capacity of 389,000 bbls/d and is fully contracted to the Syncrude owners, transported an average of 294,800 bbls/d during 2008, 5.1 percent lower than 2007. Prior to the scheduled in-service date for the Horizon Pipeline, Pembina purged and sold 385,000 barrels of excess linefill on the 22" Syncrude Pipeline for total estimated proceeds of \$54.8 million and a gain on the sale of \$42.9 million. The after tax proceeds from the sale of excess linefill on the Syncrude Pipeline will reduce the Syncrude Pipeline rate base and reduce annual net earnings in respect of the Syncrude Pipeline by approximately \$6.3 million pursuant to Pembina's agreement with the Syncrude shippers.

The Cheecham Lateral Pipeline generated revenue of \$5.7 million and transported an average of 22,629 bbls/d. The Cheecham Lateral Pipeline is fully contracted to shippers with a capacity of 136,000 bbls/d.

The recently completed Horizon Pipeline began generating revenue on November 1, 2008. To year-end 2008, this pipeline contributed \$15.1 million in revenue and \$11.9 million in net operating income. Pembina expects the Horizon Pipeline to generate approximately \$45 million in net operating income to Pembina annually over the length of the contract in its current state, with the possibility of greater contributions should the pipeline be expanded beyond its current operating capacity. CNRL has exclusive use of the Horizon Pipeline and Pembina will have the exclusive right to construct expansions or extensions of the pipeline. The contracted revenue requirement includes a provision for a fixed rate of return on invested capital and the full recovery of operating costs.

Pembina expects a significant increase in revenue from Oil Sands & Heavy Oil Infrastructure operations in 2009 resulting from a full year of revenue contribution from the Horizon Pipeline.

## Midstream & Marketing Business

(in millions of dollars, except where noted)

	2008	2007
Revenue <sup>(1)</sup>	<b>\$ 105.1</b>	\$ 78.9
Operating expenses	<b>9.0</b>	8.6
Net operating income <sup>(2)</sup>	<b>96.1</b>	70.3
Capital expenditures	<b>42.0</b>	10.5

<sup>(1)</sup> Net of \$220.9 million in product purchase expense for 2008 (2007: \$115.1 million).

<sup>(2)</sup> Refer to "Non-GAAP Measures" on page 11.

Pembina's Midstream & Marketing business segment is comprised of its 50 percent non-operated interest in the Fort Saskatchewan Ethylene Storage Facility and its wholly-owned terminalling, storage and hub services operated on several of its conventional pipeline systems.

The Fort Saskatchewan Ethylene Storage Facility generates returns based on a 20-year renewable contract, maturing in June 2023. The contract, with the two principal facility customers, Dow Chemical Canada Inc. and NOVA Chemicals Corporation, provides for full operating cost recovery plus a return on invested capital. Total revenue generated by the Fort Saskatchewan Ethylene Storage Facility in 2008 was \$22.3 million, compared to \$24.4 million in 2007. This decrease is primarily due to lower operating expenses and slightly lower sustaining capital.

The revenue Pembina will receive from the Fort Saskatchewan Ethylene Storage Facility in 2009 is expected to be consistent with 2008 results given the long-term contract on the Fort Saskatchewan Ethylene Storage Facility and the stable nature of the revenue stream generated from Pembina's interest in this facility.

Midstream activities are now present on Pembina's Swan Hills, Cremona, Peace and Drayton Valley pipeline systems. Total net operating income generated by the Midstream business in 2008 was \$96.1 million, up \$25.8 million from 2007. This increase is due to in part to increased activity on single shipper systems, the addition of a full service truck terminal at LaGlace, Alberta, which was put into service in the fourth quarter, and a full year of operations for facilities added in 2007.

Operating expenses for Midstream rose year-over-year due to an increase in the scope of midstream business activities. Pembina expects to see continued growth in terminalling, storage and hub services over the next several years, and currently has a number of projects under development, such as the start-up of a new truck terminal at Buck Creek, Alberta, on the Drayton Valley system, and upgraded truck terminals at Gordondale and Valleyview, Alberta, on the Peace system. Pembina develops Midstream and Marketing projects with a view to add value to and diversify Pembina's traditional business, which has been built around transportation services.

## New Developments and Outlook

Canada's energy industry encountered commodity price volatility of an unprecedented scale in 2008 and into 2009, with crude oil prices ranging from a high of US\$147 per barrel WTI Cushing Spot ("WTI") in July, 2008, to a low of US\$31 per barrel WTI in December, 2008. Pembina's operational and financial results for 2008 demonstrate its continuing ability to produce stable and consistent results, even in challenging economic times. Pembina's business model, which enables a large portion of cash flow to be derived from operating income that is related to invested capital (and not crude oil prices or pipeline capacity utilization), helped mitigate the impact of the market downturn during the latter half of 2008. Pembina believes that its reliable cash flow, limited commodity price exposure and strong credit profile, will enable it to preserve its financial strength into the foreseeable future, despite uncertain market conditions.

In order to maintain financial viability during periods of price volatility that are expected to continue into 2009, Pembina will:

- Continue to emphasize safe and reliable operations of its core businesses, with a view to minimizing operating expenses.
- Maintain prudent financial management and a healthy balance sheet, with a focus on preserving a low debt to cash flow ratio.
- Leverage competitive construction costs and availability of labour to pursue growth projects such as the Nipisi and Mitsue Pipelines.
- Continue its opportunistic approach to expanding and vertically integrating operations and services across all business units.

For 2009, Pembina has identified \$230 million in potential capital projects. This includes \$150 million relating to the continued development of the Nipisi and Mitsue Pipeline projects, most of which is expected to be incurred late in the fourth quarter of 2009, and \$80 million largely for discretionary development and upgrade projects over its pipeline systems. Pembina expects that financing for this spending will be sourced from undrawn and additional credit facilities, cash flow from operations and Pembina's recently reinstated Premium Distribution, Distribution Reinvestment and Optional Unit Purchase Plan ("DRIP") (see Note 12 to the accompanying Financial Statements).

The priority growth projects for Pembina in 2009 will be the Nipisi and Mitsue Pipelines. These projects were initiated in response to industry demand for reliable diluent supply to, and diluted heavy oil take-away capacity from, the Nipisi, Alberta region.

Founding customers, CNRL and EnCana Corporation, have, subject to certain conditions, contracted for dedicated capacity totaling 80 to 90 percent of available capacity on the Nipisi Pipeline and 50 to 55 percent on the Mitsue Pipeline over the contract term. Pembina Marketing Ltd., a subsidiary of Pembina Pipeline Corporation, has contracted for the balance of available capacity on these pipelines and aims to attract and retain third party production. Pembina Midstream & Marketing will also construct a truck terminal and trim blending facility, the Utikuma Terminal, mentioned below, to facilitate area truck receipts in respect of these pipelines.

Pending receipt of required regulatory approval, Pembina expects the 100,000 bbls/d Nipisi Pipeline to require approximately 195-kilometres of new pipeline. This new pipeline, which is being designed to carry heavy oil, is planned to run from the Utikuma Terminal, north of Slave Lake, Alberta, to Pembina's Judy Creek pump station, south of Swan Hills, Alberta. From Judy Creek, the new system will connect to an existing pipeline system to deliver product to the Edmonton, Alberta area.

Pembina expects the 22,000 bbls/d Mitsue Pipeline to require approximately 135-kilometres of new pipeline, and to utilize approximately 120-kilometres of existing pipeline to transport condensate from Pembina's Whitecourt, Alberta, pump station north to the Utikuma Terminal.

Both pipelines are projected to be expandable by approximately 50 percent of their current projected capacities, primarily through the addition of pump stations. Together, Pembina estimates the Nipisi and Mitsue Pipelines will have total capital costs of \$400 million and projected in-service dates of mid-2011.

The agreements governing operations on the Nipisi and Mitsue Pipelines are designed to provide Pembina with a fixed return on invested capital and allow for the full recovery of operating costs over the term of the agreements (please see "Completion of the Nipisi and Mitsue Pipelines" on page 36). Based on Pembina's internal projections, the two pipelines are estimated to contribute approximately \$45 million per annum in initial net operating income once operations commence.

The Nipisi and Mitsue Pipeline projects are expected to deliver significant value to Unitholders by virtue of the utilization of Pembina's existing asset base. The ability to use existing assets reduces Pembina's operating footprint, minimizes impacts on communities, land and environment, and allows Pembina to offer customers dedicated service at attractive commercial terms, with lower project and execution risk.

Pembina commenced public consultation with respect to the Nipisi and Mitsue Pipeline projects in mid-2008 and is seeking feedback on the proposed pipeline routing, traditional land use, environmental impact and other aspects of the projects. Information gathered through this process is being incorporated into project planning. Further, Pembina intends to work with communities potentially impacted by these projects to explore economic opportunities arising from the projects. Pembina anticipates having regulatory approvals in place for the Nipisi and Mitsue Pipeline projects by late 2009, with construction commencing early 2010.

In the Conventional Pipeline business unit, Pembina anticipates that the new connections and upgrades in its 2009 capital spending plan, along with those that have come on-stream in 2008, have the potential to provide year-over-year increases in cash flow contribution to offset the cash flow impact of natural production declines. Pembina continues to explore future opportunities on its conventional pipeline systems. Of particular interest is the potential for several of Pembina's conventional pipeline systems to support enhanced oil recovery projects, such as CO<sub>2</sub> sequestration and transportation.

In 2008, Pembina completed construction of the \$400 million Horizon Pipeline. The Horizon Pipeline is fully contracted to CNRL and is operated under the terms of a 25-year extendible transportation agreement providing Pembina a fixed return on invested capital and full recovery of operating costs. Pembina began earning on the Horizon Pipeline on November 1, 2008, and 2009 will be the first full year of revenue contribution from this pipeline. Pembina projects the Horizon Pipeline will contribute incremental net operating income of a minimum of \$45 million per year over the contract term. Pembina continues to actively explore other oil sands and heavy oil pipeline opportunities and believes its strong foothold, and recent construction experience in the oil sands region, positively positions it to attract new business.

Related to the development of oil sands and heavy oil, Pembina believes it is well positioned to respond to opportunities arising from the contemplated transportation of imported condensate from British Columbia to refineries in the Edmonton, Alberta, area.

Revenue generated by Pembina's Midstream & Marketing business has risen dramatically over the past four years. This increase in 2008 is primarily attributable to an expansion of midstream activities along Pembina's conventional pipelines and full year of operations on facilities added in 2007. Pembina strives to enhance the robustness of this business by further diversifying services; thereby mitigating sensitivity to volatility in commodity prices. In 2009, Pembina plans to add new services, including terminals, storage and hub services on several of Pembina's conventional pipeline systems. In particular, Pembina will focus on the commissioning of facilities at Gordondale and Valleyview, Alberta, on the Peace system, and will complete pipeline hub projects near Edmonton, Alberta, while continuing development work at Heartland, near Fort Saskatchewan, Alberta.

In August 2008, Pembina increased its annual distribution rate by 8.3 percent to \$1.56 per Trust Unit on an annualized basis. Pembina expects that solid results in all areas of its business, together with its reliable cash flow, limited commodity price exposure and strong credit profile, will enable it to maintain this increased level of distribution to Unitholders into the foreseeable future.

In 2006, the Government of Canada introduced legislation designed to change the taxation of certain specified investment flow-through entities ("SIFTs"), more commonly referred to as income trusts. In response to this change, after detailed consideration of the various options available to the Fund, Pembina's Board of Directors has determined conversion from an income trust to a corporate entity, prior to January 1, 2011, when the new tax legislation will take effect, will best serve the interest of Pembina's owners.

The Board concluded that Pembina's proven business strategy and potential for future growth will more than offset the increased tax burden of converting to a corporation through 2013. In addition, the Board anticipates being able to maintain Pembina's 2008 level of cash distributions to equity holders (\$1.56 per unit per year) over the next five years.

Solid, sustainable results generated by all three of Pembina's business units, together with anticipated significant incremental cash flow contribution from the capital projects presently underway, lend confidence in Pembina's ability to maintain the distribution rate through corporate conversion and the onset of taxable status. Further, Pembina believes that the more favourable tax treatment afforded to dividends, as compared to distributions of income, under current Canadian tax law, may result in more attractive after-tax returns for certain taxable Canadian investors, depending on individual circumstances. Pembina believes this level of dividend post conversion can be continued while maintaining a prudent capital structure and continuing to fund its planned growth initiatives. For important information regarding additional assumptions made by Pembina in this regard, and the related risks associated with these assumptions, please see "Forward-Looking Statements and Information" on page 41.

## Expenses

### General and administrative and management fees

General and administrative expenses were \$38.6 million in 2008, representing an increase of \$8.0 million over the \$30.6 million expended in 2007. The most significant components of this increase were salaries, benefits and fees associated with the exploration and implementation of new opportunities and businesses. As Pembina continues to expand its asset base, it faces an increasing number of operational, regulatory and compliance requirements as well as costs associated with the development of future opportunities. These increased demands have required an increase in staff levels in order to ensure sufficient resources are available to execute opportunities and manage day-to-day operations in a reliable and safe manner. Pembina's Calgary based staff grew from 109 people at the end of 2007 to 134 at the end of 2008, an increase of 22.9 percent. Overall, general and administrative expenses represent 12.8 percent of net operating income and 8.5 percent of revenues in 2008, which is consistent with 2007 levels.

Effective June 30, 2006, the Fund acquired all of the outstanding common shares of Pembina Management Inc., the manager of the Fund, from executive officers of its subsidiary, Pembina Pipeline Corporation. Total consideration for the transaction consisted of an initial cash payment of \$6 million and a contingent deferred payment of \$18.5 million, which is expected to be paid in March 2009, that was linked to future growth in distributable cash per Trust Unit of the Fund over the three year period ended December 31, 2008. Please see Note 3 to Pembina's Financial Statements for the year ended December 31, 2008 for more information with respect to the contingent deferred payment.

A copy of the Share Purchase Agreement is available at [www.sedar.com](http://www.sedar.com).

### Depreciation and amortization

Depreciation and amortization expenses increased year-over-year by \$5.6 million from \$66.5 million in 2007 to \$72.1 million in 2008. The increase is a result of two months depreciation commencing on the deemed in-service date of November 1, 2008, on the assets related to the Horizon Pipeline, and a full year depreciation on 2007 additions in 2008. Conventional pipeline assets and facilities are depreciated on a straight line basis over the estimated service life of the assets, which range from 25 to 30 years depending on the pipeline system; or on a declining balance basis at rates ranging from 3 percent to 10 percent per annum. These rates have been established to depreciate original costs over the expected economic or contractual life of the related assets. Oil Sands & Heavy Oil Infrastructure assets are depreciated over the life of the long-term transportation agreements under which these systems are administered. The transportation agreement in respect of the Syncrude Pipeline is currently set to expire at the end of 2035, the transportation agreement in respect of the Cheecham Lateral is currently set to expire at the end of 2032 and the transportation agreement in respect of the Horizon Pipeline is currently set to expire July 1, 2033. The Fort Saskatchewan Ethylene Storage Facility assets are amortized over the 20-year life of the storage agreement, which expires in June, 2023.

### Accretion on asset retirement obligations

Accretion on asset retirement obligations was \$5.0 million in 2008 compared to \$2.7 million in 2007. This increase was due to the increase in the asset retirement obligation (which is evaluated on an annual basis) for estimates related to the ultimate retirement expense of assets and facilities. In 2008, the annual re-evaluation resulted in a 27 percent increase in estimated abandonment and dismantling costs. Accretion on asset retirement obligations is based on estimates of the operating life and the ultimate retirement expense for assets and facilities. The actual results may differ from these estimations. There were no material asset retirements in 2008 or 2007.



**Interest expense and financial instruments**

Net interest expense for 2008 was \$39.4 million compared to \$29.5 million in 2007, a \$9.9 million increase. The increase in interest expense is due to the increase in average debt outstanding throughout the year. Outstanding total debt at the end of 2008 was \$920.3 million, \$133.6 million higher than the 2007 closing balance of \$786.7 million. The increase in debt is mostly due to the financing of development capital expenditures, particularly in relation to the Horizon Pipeline in 2008 of \$117.0 million. In 2008, interest of \$8.0 million relating to development projects was capitalized compared to \$9.9 million in 2007. At year end, Pembina had \$200.0 million in interest rate swaps outstanding on its floating senior debt, with an average rate of 4.5 percent and an average remaining term to expiration of 7 years. The unrealized mark-to-market loss on the interest rate swaps was \$23.0 million as at December 31, 2008. Including the interest swaps, interest rates on \$655.3 million in senior secured and unsecured notes have been fixed, leaving approximately 29 percent of Pembina's outstanding debt exposed to interest rate fluctuations.

**Convertible debentures**

Interest on Pembina's outstanding convertible debentures was \$3.4 million in 2008, compared to \$4.8 million in 2007. The \$1.4 million decrease is due to the conversion of a number of the convertible debentures into Trust Units. In 2008, \$6.8 million in convertible debentures were converted into Trust Units, reducing the total principal amount outstanding, net of issue costs, from \$47.7 million at December 31, 2007 to \$40.9 million at December 31, 2008, represented by the 7.35 percent debentures convertible at \$12.50 per unit, maturing December 31, 2010. Given that the trading price of the Trust Units consistently remains above the conversion price for the debentures, Pembina anticipates that the conversion of the debentures into Trust Units will continue throughout 2009.

**Income taxes**

As the Fund is a unit trust for income tax purposes, the Fund is taxable on the income that is not distributed to Unitholders. Pursuant to its Declaration of Trust, the Fund is required to distribute all of its income to the Unitholders, subject to maintaining sufficient working capital reserves. However, the subsidiaries of the Fund are taxable entities, and any income tax expenses or future income tax liabilities reported in the consolidated financial statements of the Fund are those of the subsidiaries.

As at December 31, 2008, the future income tax liabilities of the subsidiaries totaled \$98.9 million. These liabilities are determined by applying future statutory income tax rates to the differences between the book values and the tax values of the capital assets plus other minor differences between book and tax values. The differences arose either at the time of the initial acquisition of the assets on the establishment of the trust or on subsequent acquisitions. Upon recognition of the future income tax liability, an equivalent amount was allocated to goodwill as the estimated depreciated replacement cost of the acquired assets approximated the value of those assets. The future income tax expense of \$11.1 million in 2008 represents the change between the book value and the tax value of the acquired assets at the future statutory income tax rates plus other minor timing differences.

### Pension liability

The Fund's subsidiary, Pembina Pipeline Corporation, maintains non-contributory defined benefit pension plans together with an unfunded supplemental retirement plan covering 395 employees and 102 retirees. At the end of 2008, the pension plans carried a deficit of \$0.7 million, compared to a deficit of \$3.8 million at the end of 2007. At December 31, 2008, plan obligations amounted to \$61.4 million, compared to plan assets of \$60.7 million. In 2008, the pension plans expense was \$4.3 million, compared to \$4.8 million in 2007. Contributions to the pension plans totaled \$3.8 million in 2008, consistent with 2007 contributions.

The accrued pension plans asset of \$11.7 million represents the net difference between the amounts required to be expensed in the Fund's financial statements and the amount contributed to the pension plans. In 2009, contributions to the pension plan are expected to be \$10 million and pension plans expenses are anticipated to be \$5 million. Management anticipates a long-term return on the pension plans assets of 6.75 percent and an annual increase in compensation of 6 percent, which are consistent with current industry standards.

## Net Earnings

Years ended December 31, 2008 and 2007

(in millions of dollars, except per Trust Unit amounts)

	2008	2007
Revenues <sup>(1)</sup>	<b>\$ 453.9</b>	\$ 389.7
Less: operating expenses	<b>150.9</b>	129.6
Net operating income <sup>(2)</sup>	<b>303.0</b>	260.1
Deduct/(add):		
General and administrative	<b>38.6</b>	30.6
Internalization of management contract	<b>13.8</b>	4.7
Interest on long-term debt	<b>39.4</b>	29.5
Interest on convertible debentures	<b>3.4</b>	4.8
Depreciation and amortization	<b>72.2</b>	66.5
Accretion on asset retirement obligations	<b>5.0</b>	2.6
Future income tax expense (reduction)	<b>11.1</b>	(22.5)
Gain on sale of linefill and other	<b>(42.3)</b>	1.6
Net earnings	<b>\$ 161.8</b>	\$ 142.3
Net earnings per Trust Unit – basic	<b>\$ 1.21</b>	\$ 1.09
Net earnings per Trust Unit – diluted	<b>\$ 1.19</b>	\$ 1.06

<sup>(1)</sup> Net of product purchases of \$220.9 million in 2008; \$115.1 million in 2007.

<sup>(2)</sup> Refer to "Non-GAAP Measures" on page 11.

Pembina's net earnings in 2008 were \$161.8 million, an increase of 13.7 percent or \$19.5 million over net earnings from 2007. This increase is primarily due to an increase of \$64.2 million in total revenue from all three business segments and a gain of \$42.9 million on the sale of excess linefill on the Syncrude pipeline. The increase in net earnings was offset by increases in total expenses of \$54.0 million and an increase in future income tax expense of \$33.6 million. There were also increases in operating expenses, interest expense on long-term debt, depreciation and amortization, accretion, internalization of management fees and general and administrative costs from 2007 to 2008.

## Distributed Cash

Years ended December 31, 2008 and 2007  
(in millions of dollars, except per Trust Unit amounts)

	2008	2007
Cash flow from operations	<b>\$ 219.9</b>	\$ 189.5
Add/(deduct):		
Employee future benefits expense	<b>(4.3)</b>	(4.8)
Employee future benefits contributions	<b>3.8</b>	3.8
Changes in non-cash working capital	<b>(11.4)</b>	2.7
Other	<b>(0.8)</b>	(2.3)
Distributable cash <sup>(1)</sup>	<b>207.2</b>	188.9
Increase in distribution reserve	<b>(8.4)</b>	(10.0)
Distributed cash <sup>(1)</sup>	<b>\$ 198.8</b>	\$ 178.9
Distributable cash <sup>(1)</sup> (before reserve) per Trust Unit	<b>\$ 1.55</b>	\$ 1.45
Distributed cash per Trust Unit <sup>(1)</sup>	<b>\$ 1.49</b>	\$ 1.37
Diluted distributed cash per Trust Unit <sup>(1)</sup>	<b>\$ 1.46</b>	\$ 1.33
Payout ratio	<b>96%</b>	95%

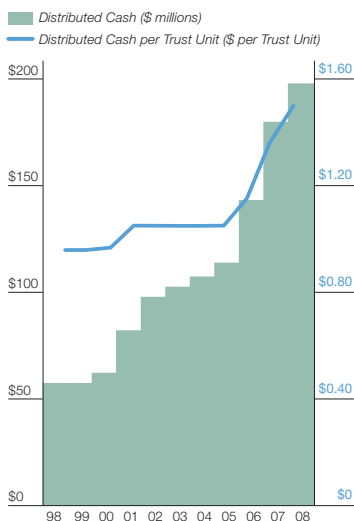
<sup>(1)</sup> Refer to "Non-GAAP Measures" on page 11.

Distributable cash is a non-GAAP measure that the Fund uses to manage its business and to assess future cash requirements that impact the determination of future distributions to Unitholders. The Fund defines distributable cash as cash flow from operations less pension and post retirement benefit expense net of contributions, net changes in non-cash working capital, Trust Unit based compensation expense and financing fees. The impact of these items is excluded in the calculation of distributable cash as it adjusts for timing differences throughout the year.

## 2008 Cash Distributions to Unitholders

Record Date	Payment Date	Taxable Other Income	Non-Taxable Amount	Total
January 31, 2008	February 15, 2008	\$0.09729	\$0.02271	\$0.12
February 29, 2008	March 14, 2008	\$0.09729	\$0.02271	\$0.12
March 31, 2008	April 15, 2008	\$0.09729	\$0.02271	\$0.12
April 30, 2008	May 15, 2008	\$0.09729	\$0.02271	\$0.12
May 31, 2008	June 13, 2008	\$0.09729	\$0.02271	\$0.12
June 30, 2008	July 15, 2008	\$0.09729	\$0.02271	\$0.12
July 31, 2008	August 15, 2008	\$0.09729	\$0.02271	\$0.12
August 31, 2008	September 15, 2008	\$0.10540	\$0.02460	\$0.13
September 30, 2008	October 15, 2008	\$0.10540	\$0.02460	\$0.13
October 31, 2008	November 14, 2008	\$0.10540	\$0.02460	\$0.13
November 30, 2008	December 15, 2008	\$0.10540	\$0.02460	\$0.13
December 31, 2008	January 15, 2009	\$0.10540	\$0.02460	\$0.13
		\$1.20803	\$0.28197	\$1.49

### Distributed Cash



Refer to "Non-GAAP Measures" on page 11.

Of the total distribution of \$1.49 per Trust Unit declared in 2008, \$1.20803 per Trust Unit, or 81.08 percent, is taxable as "other income" and \$0.28197 per Trust Unit, or 18.92 percent, is non-taxable. For the majority of Unitholders, the non-taxable portion is considered a return of capital, which will reduce the cost base of each Trust Unit. Pembina projects that these proportions in 2009 will be approximately 75 percent of the total distribution per Trust Unit being taxable as "other income" and the remaining 25 percent as nontaxable return of capital.

It is the Canada Revenue Agency's administrative position that for Unitholders participating in the regular distribution reinvestment plan, the five percent discount at which additional units are acquired is considered income in the hands of the Unitholder. Further, Pembina expects that the two percent premium earned under the premium distribution component of the DRIP will continue to be taxed as income in the future.

The table below shows the Fund's cash distributions paid relative to cash flow from operations and net earnings for the years indicated. See also "New Developments and Outlook" and "Risk Factors" below for further information regarding the sustainability of cash distributions.

<i>(in millions of dollars, except where noted)</i>	2008	2007	2006	2005
Cash flow from operations	<b>\$ 219.9</b>	\$ 189.5	\$ 143.9	\$ 112.4
Net earnings	<b>161.8</b>	142.3	88.9	70.4
Distributed cash	<b>198.8</b>	178.9	142.3	113.5
Excess (shortfall) of cash flow from operations over distributed cash	<b>21.1</b>	10.6	1.6	(1.1)
Excess (shortfall) of net earnings over distributed cash	<b>(37.0)</b>	(36.6)	(53.4)	(43.1)
Cumulative notional reserve <sup>(1)</sup>	<b>\$ 39.5</b>	\$ 31.0	\$ 21.0	\$ 15.1

<sup>(1)</sup> Refer to "Non-GAAP Measures" on page 11.

The continued growth in distributed cash reflects the growth in both Pembina's asset base and the Unitholder base. Distributed cash rose by \$19.9 million, from \$178.9 million in 2007 to \$198.8 million in 2008, and was funded exclusively from operations. Annual cash distributions per Trust Unit increased from \$1.37 in 2007 to \$1.49 in 2008. Pembina's notional distribution reserve also grew, from \$31.0 million at the end of 2007 to \$39.5 million at the end of 2008. Pembina maintains a notional reserve in order to ensure stability over economic and industry cycles and to absorb the impact of material one-time events. Therefore, not all available cash is distributed to Unitholders but instead, a portion of the Fund's distributable cash is used to reduce bank indebtedness. Historical cash distributions compared to cash flow from operations shows excess cash flow in every period except 2005. The shortfall in 2005 was due to a prepaid pension contribution made by the Fund in the amount of \$13.3 million and due to changes in non-cash working capital. As at December 31, 2005, a cumulative reserve of \$15.1 million remained after funding the shortfall. Cash distributions to Unitholders are greater than net earnings, as the Fund does not consider it necessary to retain depreciation that has been deducted in the determination of net earnings. The earning capacity of the Fund's existing assets will generally not erode and are not expected to be replaced provided they are properly maintained, and such maintenance costs are deducted in the calculation of net earnings. Asset additions typically increase the earning capacity of the Fund and are financed in either the debt or equity markets and are not dependent on cash flow from existing assets.

#### **Non-Resident Unitholders**

Current domestic tax laws require a withholding tax from distribution income to non-residents of Canada at a rate of 25 percent. The withholding rate on income may be reduced pursuant to a bilateral income tax convention between Canada and the country in which the Unitholder is resident. For US residents, the withholding tax is reduced to 15 percent on trust income distributions. Such income is determined in accordance with the laws of Canada. It is important for the Unitholders to contact their brokers or financial institution with regards to the amount of withholding tax that is being deducted, as it is Pembina's understanding that the withholding tax is determined by the financial institution where the units are held. Accordingly, we do not comment on the impact of relevant tax laws in various jurisdictions of residence but advise Unitholders to seek tax advice in this regard.

## Liquidity and Capital Resources

(\$ millions)	2008	2007
Working capital	<b>\$ 4.6</b>	\$ 2.4
Variable rate debt		
Bank debt	<b>390.0</b>	250.0
Senior unsecured notes	<b>75.0</b>	75.0
Variable rate debt swapped to fixed	<b>(200.0)</b>	(60.0)
Total variable rate debt outstanding (average rate of 3.69%)	<b>265.0</b>	265.0
Fixed rate debt		
Senior unsecured notes	<b>375.0</b>	375.0
Senior secured notes	<b>80.3</b>	86.7
Variable rate debt swapped to fixed	<b>200.0</b>	60.0
Total fixed rate debt outstanding (average rate of 5.52%)	<b>655.3</b>	521.7
Convertible debentures	<b>40.9</b>	47.7
Total debt and debentures outstanding	<b>961.2</b>	834.4
Unutilized debt capacity	<b>140.0</b>	280.0

The Fund's cash flow from operations was \$219.9 million in 2008, compared to \$189.5 million in 2007. The increase in cash flow was primarily due to improved margins and the implementation and development of midstream activities on certain sections of the conventional pipeline systems.

Pembina has credit facilities with a syndicate of Canadian banks of \$530 million, of which \$140.0 million was unutilized at year-end. The Fund's credit facilities at the end of 2008 consisted of an unsecured \$500 million revolving credit facility due July, 2012. Pembina also has a \$30 million operating facility in place which matures July, 2009, at which time Pembina expects this operating facility will be renewed for another 365 days. There are no repayments due over the term of either facility. Borrowings bear interest at either prime lending rates or based on bankers acceptances plus applicable margins. The margins are based on the credit rating of the senior unsecured debt of Pembina Pipeline Corporation and range from 0.50 percent to 1.50 percent. Other debt includes \$80.3 million in fixed rate senior secured notes due 2017, \$175 million in fixed rate senior unsecured notes due 2014, \$75 million of floating rate senior unsecured notes due June, 2009, and \$200 million in senior unsecured notes due 2021 (refer to Note 7 to the Financial Statements). Pembina expects to refinance the \$75 million in notes that mature in June, 2009, by either extending with existing lenders or refinancing with an increased bank facility. However, given the current uncertainty in financial markets, Pembina's financing costs in this regard may increase.

At December 31, 2008, Pembina had long-term debt of \$920.3 million compared to \$786.7 million at the end of 2007. Payments of interest and principal on Pembina bank indebtedness and senior notes ranks in priority to monthly cash distributions to be paid to Unitholders.

Management believes that the Fund has sufficient liquidity to meet its daily operational commitments and existing obligations. Principally, all of the Fund's accounts receivable are with customers in the oil and gas industry and under the terms of the Fund's shipping rules and regulations or pursuant to contracts. Balances are payable on the 25th day of the following month. This date coincides with the date on which oil and gas companies receive payment from industry partners and customers. Furthermore, on the conventional pipeline systems, the Fund has the right to take the shipper's oil and NGLs in kind to settle any outstanding receivable balance. Therefore, Pembina considers the risk of non-collection to be low.

The Fund distributes all of its net cash flow, subject to retaining an appropriate distribution reserve, financing requirements, required repayments on debt and, if applicable, funding future removal and site restoration reserves. Aggregate debt (long-term debt plus outstanding debentures) of \$961.2 million at December 31, 2008 resulted in a ratio of total debt to total enterprise value of 32.1 percent. This compares to \$834.4 million and 26.2 percent, respectively, at the end of last year. Management remains satisfied that the leverage currently employed in Pembina's capital structure is sufficient and appropriate given the characteristics and operations of the underlying asset base.

(\$ millions)	2008	2007
Development capital		
Conventional Pipelines	<b>\$ 49.4</b>	\$ 77.1
Oil Sands & Heavy Oil Infrastructure	<b>131.6</b>	212.7
Midstream & Marketing	<b>42.0</b>	10.5
Total development capital	<b>\$ 223.0</b>	\$ 300.3

Development capital expenditures totaled \$223.0 million in 2008, a reduction of \$77.3 million from 2007, primarily due to the completion of construction of the Horizon Pipeline in July, 2008. Capital expenditures for the conventional pipeline systems of \$49.4 million during 2008 includes \$24.0 million for new connections and upgrades, \$10.8 million for the Peace system product segregation facilities and \$9.0 million for linefill on the Bonnie Glen pipeline system. Oil Sands & Heavy Oil Infrastructure spending totaled \$131.6 million, down from 2007 as the Horizon Pipeline came to completion. In 2008, \$123.6 million was spent on the Horizon Pipeline, \$6.8 million was spent on the preliminary design of the Nipisi and Mitsue Pipelines and \$3 million was spent on upgrades to the Syncrude Pipeline. Spending in the Midstream & Marketing business segment of \$42 million was related to expenses of \$22.5 million for Peace facilities and operations equipment, \$6.9 million in expenditures on the Swan Hills system for operations equipment and \$3.3 million on the Drayton Valley system for operations equipment. Current significant capital expenditure commitments include an estimated \$400 million for construction of the Nipisi and Mitsue Pipelines and an additional \$33 million for the Horizon Pipeline to meet future potential increased capacity requirements (refer to "Contractual Obligations" on page 30).

Credit rating agency ratings on Pembina Pipeline Income Fund and Pembina Pipeline Corporation were confirmed by the Dominion Bond Rating Services ("DBRS") in early 2008 with a STA-2 (low) stability rating, 'BBB high' on senior secured debt and 'BBB' on senior unsecured debt. On July 24, 2008, Standard & Poor's (S&P) upgraded its long-term corporate credit and bank loan ratings on Pembina Pipeline Corporation to "BBB+" from "BBB", and its senior secured debt rating on the company to "A-" from "BBB+", on a diverse business risk profile and stable outlook. S&P also rates the Fund and has a current rating of SR-2.

The DBRS stability rating system measures the volatility and sustainability of distributions per Trust Unit on a rating scale STA-1 to STA-7 (STA-1 being the highest rating possible). STA-2 rated funds are considered to have very good distribution per Trust Unit stability and sustainability. The BBB rating is the fourth highest of DBRS' ten rating categories for long-term debt, which range from AAA to D. DBRS uses "high" and "low" designations on ratings from AA to C to indicate the relative standing of securities being rated within a particular rating category. The absence of a "high" or "low" designation indicates that a rating is in the "middle" of the category. The BBB rating indicates that, in DBRS's view, the rated securities are of adequate credit quality. Protection of interest and principal is considered acceptable, but the entity is fairly susceptible to adverse changes in financial and economic conditions, or there may be other adverse conditions present which reduce the strength of the entity and its rated securities.

The S&P rating system rates distributable cash on a scale of SR-1 to SR-7 with SR-2 rated funds considered to have very high stability. Debt securities rated BBB+ exhibit adequate protection parameters. The A rating is the third highest rating, and the BBB rating is the fourth highest rating, of S&P's ten rating categories for long-term debt which range from AAA to D. The ratings from AA to CCC may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories. Issues of debt rated A are judged by S&P to be somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still viewed by S&P to be strong. Issues of debt securities rated BBB are judged by S&P to exhibit adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation. These ratings recognize the Fund's stable assets profile and financial results, as well as the stability and sustainability of the per Trust Unit distribution.

These ratings are not recommendations to purchase, hold or sell the securities in as much as such ratings do not comment as to market price or suitability for a particular investor. There is no assurance that any rating will remain in effect for any given period of time or that any rating will not be revised or withdrawn entirely by a rating agency in the future if in its judgment, circumstances so warrant.

## Contractual Obligations

	Total	Payments Due By Period			
		Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Office and vehicle leases	\$ 16.7	\$ 4.7	\$ 8.1	\$ 3.9	\$
Long-term debt	920.3	81.9	414.0	194.1	230.3
Convertible debentures	40.9		40.9		
Construction commitments	426.2	54.3	355.4	16.5	
Total contractual obligations	\$ 1,404.1	\$ 140.9	\$ 818.4	\$ 214.5	\$ 230.3

Pembina is contractually committed to the construction and the operation of the Nipisi and Mitsue Pipelines. Development of the Nipisi and Mitsue Pipelines is underway with projected costs of \$400 million, with \$6.8 million incurred to date and \$393.2 million expected to be spent in later years. An additional \$33 million in construction costs related to the Horizon Pipeline is also expected to be incurred in later years, to meet potential increased capacity requirements in the future. Pembina anticipates utilizing its undrawn credit facilities, equity raised under the DRIP and potentially accessing the debt and equity market to finance the costs of the Nipisi and Mitsue Pipelines, and other future capital expenditures.



## Critical Accounting Estimates

Management is required to make judgments, assumptions and estimates in the applications of generally accepted accounting principles that have a significant impact on the Fund. Readers are referred to Note 2 of the audited Consolidated Financial Statements as at and for the year ended December 31, 2008, for a description of the Fund's significant accounting policies. The following discussion outlines certain items for which critical estimates must be made in preparing those statements.

### **Depreciation**

Pipeline assets and facilities are generally depreciated using the straight line method over 25 to 30 years or declining balance method at rates ranging from 3 percent to 10 percent per annum. Oil sands pipeline assets are depreciated over the life of the long-term transportation agreement under which the pipeline system is administered. Storage facility assets are amortized over the 20 year life of the storage agreement. These rates have been established to depreciate the original asset and facility costs over the expected economic lives or contractual duration of the related assets. Estimates of the economic life of various pipeline systems have been based on projecting future throughputs using historic oil and gas production decline rates and throughputs. Management has assumed that these historical trends will continue and that the increased tolls required to offset these decline rates will also remain competitive. However, the actual useful life of the assets may differ from management's original estimate due to higher decline rates, non-competitive tolls and customer requirements. A resultant change in depreciation expense would have a corresponding effect on the net earnings of the Fund.

### **Goodwill**

Goodwill, which represents the estimated tax costs related to the difference between the fair value and the tax basis of acquired assets, is assessed by the Fund for impairment at least annually. Management estimates the fair value of these assets by discounting the projected future cash flows generated by these assets using the Fund's weighted average cost of capital. If it is determined that the fair value of the future cash flows is less than the book value of the assets at the time of the assessment, an impairment amount would be determined by deducting the fair value of the cash flows from the book values and applying it against the book balance of goodwill. To date, there has been no impairment of these goodwill values.

### **Asset Retirement Obligations**

Management recognizes the fair value of an estimated asset retirement obligation in the period in which it is incurred, when an estimate can reasonably be made and industry practice or regulation requires removal of the asset upon retirement. The estimated fair value is recorded as a long-term liability with a corresponding increase in the carrying value of the property, plant and equipment. The liability is accumulated over time through charges to period earnings and is reduced by the actual costs incurred upon settlement. Any difference between the actual cost incurred upon settlement and the recorded liability is recognized as a gain or loss in the Fund's earnings.

### **Asset Impairment**

Management regularly reviews property, plant, equipment and other intangibles to determine if circumstances indicate impairment in the carrying value or changes in the estimated useful life of the asset. Impairment is generally considered to have occurred when the fair value of the future cash flows that are to be generated by an asset are less than the carrying value of that asset. If impairment has occurred, an impairment charge to earnings is recognized in the amount that the carrying value of the asset exceeds its fair value. To date, there has been no impairment in the carrying value of Pembina's assets.

### **Pensions and other Post Retirement Benefits**

The Fund accrues for its obligations under its employee pension plans and the related costs, net of pension plan assets. The costs of the pension plans and other retirement benefits is actuarially determined using the projected benefit method based on the length of service and reflects management's best estimate of expected pension plan investment performance, salary escalation and retirement ages of employees. The return on the pension plan assets is based on the fair value of those assets. The obligation is discounted using a market interest rate at the beginning of the year on high quality corporate debt instruments. The pension expense includes the costs of pension benefits earned during the current year, the interest cost on pension obligations, the return on pension plan assets, the amortization of the net transitional obligation, the amortization of adjustments arising from pension plan amendments and the amortization of the excess of the net actuarial gain or loss over 10 percent of the greater of the benefit obligation and the fair value of plan assets. The amortization period covers the expected average remaining service lives of employees covered by the pension plan. The actual costs and projections may differ from management's estimates and any change would have a corresponding effect in the net earnings of the Fund.

## **Changes in Accounting Principles and Practices**

The Canadian Institute of Chartered Accountants ("CICA") issued three new accounting standards; Handbook Section 1535 "Capital Disclosures", Handbook Section 3862 "Financial Instruments – Disclosure" and Handbook Section 3863 "Financial Instruments – Presentation" effective January 1, 2008. The Fund adopted these standards effective January 1, 2008, and as a result has included additional disclosures, both qualitative and quantitative, on financial instruments and on the management of capital in the financial statements and notes.

The CICA Accounting Standards Board confirmed in February, 2008, that Canadian publicly accountable enterprises will adopt International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), effective January 1, 2011, with early adoption starting in 2009. IFRS will require increased financial statement disclosures. Although IFRS uses a conceptual framework similar to Canadian GAAP, differences in accounting policies need to be addressed to assess the impact on the Fund's existing accounting policies, the impact on business processes and the impact on information systems requirements and internal controls.

It is the Fund's intention to prepare its interim and annual consolidated financial statements in accordance with IFRS from the financial year beginning January 1, 2011 (the "Changeover"). Effective from that date, it is also the Fund's intention to adopt IFRS as its primary accounting principles. Consequently, upon the Changeover to IFRS the Fund will reconcile its primary IFRS Financial Statements to Canadian GAAP, representing a change from its current full Canadian GAAP reporting.

The Fund has commenced the process to transition from current Canadian GAAP to IFRS. A steering committee and a working group have been established and an IFRS conversion plan has been created which includes regular progress reporting to Pembina's Audit Committee and the Board of Directors.

The IFRS conversion plan consists of three phases:

- 1. Impact Assessment Phase** – This phase includes an IFRS impact assessment identifying key areas that may be impacted by the transition to IFRS. Areas have been identified and the impact on the Fund's financial reporting, disclosure, systems and processes, business processes and stakeholders has been ranked as Low, Medium or High. This phase is currently being completed; however, continued progress is necessary before the Fund can prudently increase the specificity of the disclosure in respect of this phase.
- 2. Impact Analysis and Evaluation Phase** – In this phase, each key area identified in the Impact Assessment Phase will be analyzed, with priority being placed on areas assessed with higher impact. Analysis will include a review of the accounting policy alternatives, potential business process and information system changes and an initial reconciliation from IFRS to Canadian GAAP equity and income. Training will also commence during this phase. Pembina will commence this phase once the first phase, above, has been completed.
- 3. Implementation and Review Phase** – This phase involves formal authorization processes to approve the recommended accounting policy changes. Training will continue during this phase and an opening IFRS compliant draft balance sheet and financial statement note disclosure will be prepared.

As activities progress, Pembina expects to be able to increase the specificity of its disclosure of the accounting policy differences and their expected impacts.

A business wide information technology implementation has commenced to accommodate IFRS reporting requirements and increase overall business unit reporting effectiveness and analysis. The Fund is accumulating information on IFRS to prepare for the Fund's Changeover to IFRS in 2011.

The IASB work plan currently has projects underway that are expected to result in new pronouncements that continue to evolve IFRS. As a result, IFRS at Changeover is expected to differ from its current state. To minimize the impact on the Fund's reporting at Changeover, it is the Fund's intention to adopt applicable Canadian GAAP accounting policies that also comply with IFRS.

There were no changes in Pembina's other principles or practices that affected the disclosure of or the accounting for its operations for the year ended December 31, 2008.

## Trust Unit Information

(in thousands of dollars, except where noted)

	March 3, 2009 <sup>(1)</sup>	December 31, 2008	December 31, 2007
<b>Trading volume and value</b>			
Total volume (Trust Units)	10,046,125	54,477,506	53,754,138
Average daily volume (Trust Units)	239,193	216,181	213,310
Value traded	\$ 143,172	\$ 884,059	\$ 883,762
Trust Units outstanding (Trust Units)	136,339,431	134,703,067	132,541,536
Trust Unit trading price (\$/Unit)	\$ 13.50	\$ 15.24	\$ 17.54
<b>Market value</b>			
Trust Units	\$ 1,840,577	\$ 2,052,874	\$ 2,324,769
7.35% convertible debentures <sup>(2)</sup>	44,235	48,243	67,770
<b>Market capitalization</b>			
	\$ 1,884,812	\$ 2,101,117	\$ 2,392,539
<b>Senior debt</b>			
	918,607	920,286	786,708
<b>Total enterprise value</b>			
	\$ 2,803,419	\$ 3,021,403	\$ 3,179,247

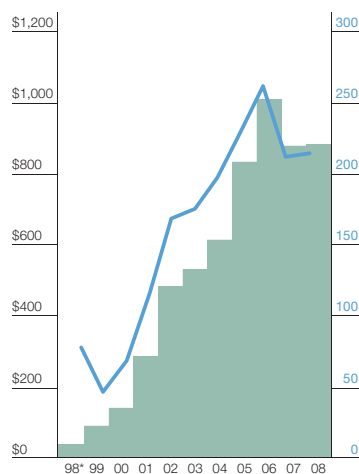
<sup>(1)</sup> Based on 42 trading days from January 1 to March 3, 2009 inclusive.

<sup>(2)</sup> \$42.7 million principal amount of 7.35% convertible debentures outstanding at a market price of \$113.01 at December 31, 2008.

The Fund's Trust Units, along with the 7.35% convertible debentures, are publicly traded on the Toronto Stock Exchange. The total market value of the Fund's outstanding securities was \$3.0 billion at December 31, 2008. Issued and outstanding Trust Units of the Fund rose to 134.7 million by the end of 2008, an increase of 2.2 million from 2007. During 2008, 0.6 million Trust Units were issued through debenture conversions, 1.1 million Trust Units were issued under the DRIP (which is described below) and 0.5 million Trust Units were issued upon the exercise of Trust Unit options by certain officers and other employees of Pembina.

### Liquid Investment

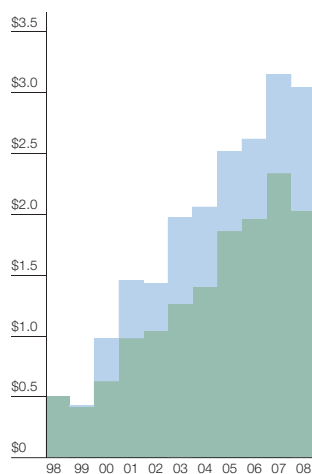
■ Annual Value Traded (\$ millions)  
— Average Daily Volume (Thousands of Units)



\* PIF.UN commenced trading as a fully paid trust unit on October 23, 1998.

### Total Enterprise Value

■ Equity (\$ billions)  
■ Debt (\$ billions)



Refer to "Non-GAAP Measures" on page 11.

Since its launch in 2003, Pembina's DRIP has attracted significant Unitholder interest and has raised \$228.8 million. The plan, which was discontinued as of June 30, 2007, was reinstated effective October 31, 2008. Participation in the DRIP for the most recently completed month (January, 2009) was 83 million Trust Units or \$10.9 million. Pembina expects participation in the DRIP to remain consistent at this rate through the balance of 2009.

Data provided by Pembina's transfer agent indicates that non-resident holdings in the Fund totaled 17 percent at December 31, 2008. This level is within the 49 percent restriction on non-resident ownership in the Fund imposed by Pembina's Declaration of Trust and is consistent with guidelines under the Income Tax Act (Canada).

## Risk Factors

The following is a summary of the primary risk factors identified by management that could potentially have a material impact on the financial results and operations of the Fund. For a full discussion of these and other risk factors affecting the business and operation of the Fund and its operating subsidiaries, readers are referred to the Fund's Annual Information Form, an electronic copy of which is available through the internet on Pembina's website at [www.pembina.com](http://www.pembina.com) or on the Fund's SEDAR profile at [www.sedar.com](http://www.sedar.com).

### Distributions

The Fund has announced its 2009 distribution objective of \$1.56 per Trust Unit. Management believes that continued robust operating results produced by Pembina's conventional pipeline assets, coupled with growth in its oil sands and heavy oil infrastructure and midstream and marketing business segments, will continue to generate significant and sustainable cash flow that will support this level of cash distribution. However, there can be no assurance that this level of distribution will be achieved. The actual amount of distributions paid to Unitholders will depend upon numerous factors including, but not limited to, operating cash flow, general and administrative costs, debt repayment and service costs, taxes, capital expenditures, reclamation reserves, if any, and working capital requirements. Payments by Pembina Pipeline Corporation, the principal operating subsidiary, to the Fund may be delayed or reduced by restrictions imposed by lenders, disruptions in services or the ability of Pembina Pipeline Corporation, under certain circumstances, to delay interest payments on its senior secured notes for up to twelve months.

**Debt Service**

At the end of 2008, Pembina Pipeline Corporation had exposure to floating interest rates on \$265 million in debt. A 0.25 percent change in short-term interest rates would have an annualized impact of \$0.7 million on net cash flows. Variations in interest rates and scheduled principal repayments, if required under the terms of the banking agreements as described in Note 7 to the Fund's 2008 Consolidated Financial Statements, could result in significant changes in the amounts required to be applied to debt service before payment of any amounts by the operating subsidiaries to the Fund. Certain covenants in the agreements with the lenders may also limit payments by the operating subsidiaries to the Fund. Although it is believed that the existing credit facilities are sufficient, there can be no assurance that the amount will be adequate for the financial obligations of Pembina or that additional funds can be obtained. Holders of senior secured notes, with a balance of \$80.3 million, have been provided with security over substantially all of the assets of Pembina Pipeline Corporation. If Pembina Pipeline Corporation becomes unable to pay its debt service charges or otherwise commits an event of default, such as bankruptcy, the lenders will rank senior to the Fund in respect of payments made by the operating subsidiaries on securities or unsecured promissory notes that are held by the Fund. As a result, cash distributions from the Fund to Unitholders would be adversely affected by such circumstances.

**Capital Resources**

The timing and amount of capital expenditures of Pembina, and the ability of Pembina to repay or refinance existing debt as it becomes due, directly affects the amount of cash distributions that are paid by the Fund to Unitholders. Future acquisitions, expansions of Pembina's pipeline systems and midstream operations, other capital expenditures, including the capital expenditures that Pembina has committed to in respect of the proposed Nipisi and Mitsue Pipelines, and the repayment or refinancing of existing debt as it becomes due will be financed from sources such as cash generated from operations, the issuance of additional Trust Units or other securities (including debt securities) of the Fund, and borrowings. Distributions may be reduced, or even eliminated, at times when significant capital or other expenditures are made. There can be no assurance that sufficient capital will be available on terms acceptable to Pembina, or at all, to make additional investments, fund future expansions or make other required capital expenditures. To the extent that external sources of capital, including the issuance of additional Trust Units or other securities or the availability of additional credit facilities, becomes limited or unavailable on favourable terms or at all due to credit market conditions or otherwise, the ability of Pembina to make the necessary capital investments to maintain or expand its operations, to repay outstanding debt and to invest in assets, as the case may be, may be impaired. To the extent Pembina is required to use cash flow to finance capital expenditures or acquisitions or to repay existing debt as it becomes due, the level of cash distributions to Unitholders of the Fund may be reduced.

**Completion of the Nipisi and Mitsue Pipelines**

The Nipisi and Mitsue Pipelines are currently under development by Pembina and Pembina cannot provide any assurances as to the successful completion of these pipelines as such is dependent on numerous factors outside of Pembina's control, including gaining the support and approval of various groups of stakeholders and regulatory boards, as well as managing construction costs. Under the agreements governing the construction and operation of the Nipisi and Mitsue Pipelines, Pembina is obligated to construct the pipelines and Pembina bears the risk for any cost overruns. While Pembina is not currently aware of any significant cost overruns at the date hereof, any such cost overruns in the future could reduce Pembina's expected return on the Nipisi and Mitsue Pipelines and adversely affect Pembina's results of operations which, in turn, could reduce the level of cash distributed to Unitholders. See "Risk Factors – Capital Resources" above.

**Reserve Replacement and Throughput**

Pembina's conventional pipeline tariff revenues are based upon a variety of tolling arrangements, including "ship or pay" contracts, cost of service arrangements and market-based tolls. As a result, certain pipeline tariff revenues are heavily dependent upon throughput levels of crude oil, NGLs and condensate. Future throughput on Pembina's crude oil and NGL pipelines and replacement of oil and gas reserves in the service areas will be dependent upon the success of producers operating in those areas in exploiting their existing reserve bases and exploring for and developing additional reserves. Without reserve additions, or expansion of the service areas, throughput on such pipelines will decline over time as reserves are depleted. As oil and gas reserves are depleted, production costs may increase relative to the value of the remaining reserves in place, causing producers to shut-in production and seek out lower cost alternatives for transportation. Given the current adverse global economic conditions, the demand for and prices of these products have decreased substantially from their historically high levels during the summer of 2008 and the risks to Pembina that producers will not seek reserves additions has heightened. If the level of tariffs collected by Pembina decreases as a result, cash flow available to make cash distributions to Unitholders and to service obligations under the convertible debentures would be adversely affected.

Over the long term, Pembina's business will depend, in part, on the level of demand for crude oil, condensate, NGLs and natural gas in the markets served by the crude oil and NGL pipelines in which Pembina has an interest. As noted above, recent global economic events have had a substantial downward effect on the demand for and prices of such products and Pembina cannot predict the impact of future economic conditions on the energy and petrochemical industries or future demand for and prices of crude oil, condensate, NGLs and natural gas. Future prices of these products are determined by supply and demand factors, including weather and general economic conditions as well as economic, political and other conditions in other oil and natural gas regions, all of which are beyond Pembina's control.

**Environmental Costs and Liabilities**

Pembina is subject to Canadian Federal and Alberta and British Columbia Provincial laws and regulations relating to environmental protection and operational safety. While Pembina believes that the current operation of its pipeline systems is in compliance with all applicable environmental and safety regulations, there can be no assurance that substantial costs or liabilities will not be incurred. Moreover, it is possible that other developments, such as increasingly strict environmental and safety laws, regulation and enforcement or claims for damages to persons or property resulting from Pembina's operations, could result in significant costs and liabilities to Pembina. If Pembina were not able to recover the resulting costs through insurance or tariffs, cash flow available to make cash distributions to Unitholders or to service obligations under the convertible debentures would be adversely affected. While Pembina maintains insurance in respect of damage caused by seepage or pollution in an amount it considers prudent and in accordance with industry standards, certain provisions of this insurance may limit its availability in respect of certain occurrences unless they are discovered within fixed timed periods. These periods can range from 72 hours to seven days. If Pembina is unaware of or is unable to locate a spill within the relevant time period insurance coverage may not be available. However, Pembina believes that it has adequate leak detection systems in place to detect and monitor a significant spill.

**Competition to the Pipeline Operations**

Pembina competes with other pipelines in its service areas, other transporters of crude oil and NGLs, and other midstream businesses. The introduction of competing transportation alternatives into Pembina's service areas could potentially have the impact of limiting Pembina's ability to adjust tolls as it may deem necessary. Additionally, potential pricing differentials on the components of NGLs may result in these components being transported by competing gas pipelines. Pembina believes that it is prepared for and determined to meet these existing and potential competitive pressures.

**Regulation**

Legislation in Alberta and British Columbia exists to ensure that producers have fair and reasonable opportunities to produce, transport, process and market their reserves. In Alberta and British Columbia, the Alberta Energy Resources Conservation Board and the British Columbia Utilities Commission respectively, may, upon application and following a hearing (and in Alberta with the approval of the Lieutenant Governor in council), declare the operator of a pipeline a common carrier of oil or natural gas and must not discriminate between producers who seek access to the pipeline. Producers and shippers may also apply to the regulatory authorities for a review of tariffs if they believe the tariffs are not just and reasonable. Applications by producers to have a pipeline operator declared a common carrier are usually accompanied with an application to have tariffs set by the regulatory authorities. The extent to which regulatory authorities in such instances can override existing transportation or processing contracts has not been fully decided. The potential for direct regulation of tolls, other than for the provincially regulated BC Pipelines, while considered remote, could result in toll levels that are not considered fair and reasonable by Pembina and could impair the economic operation of such regulated pipeline systems.



### **Pipeline Abandonment Costs**

Pembina is responsible for compliance with all applicable laws and regulations regarding the abandonment of its pipeline assets at the end of their economic life, and such abandonment costs may be substantial. The proceeds of the disposition of certain assets associated with Pembina's pipeline systems including, in respect of certain pipeline systems, linefill would be available to offset abandonment costs.

However, it is not possible to definitively predict abandonment costs since they will be a function of regulatory requirements at the time and the value of Pembina's assets, including linefill, may then be more or less than the abandonment costs. Pembina may, in the future, determine it prudent or be required by applicable laws or regulations to establish and fund one or more reclamation funds to provide for payment of future abandonment costs. Such reserves could decrease cash flow available for distribution to Unitholders and to service obligations under the Convertible Debentures.

### **Operational Hazards**

Pembina's operations are subject to the customary hazards of the pipeline transportation business. The operations of Pembina's pipelines could be disrupted by natural disasters or other events beyond Pembina's control. A casualty occurrence could result in the loss of equipment or life as well as injury and property damage. Pembina carries insurance coverage with respect to some, but not all, casualty occurrences in amounts customary for similar business operations, which coverage may not be sufficient to compensate for all casualty occurrences.

### **Structural Integrity of the Storage Facility**

Three of the five ethylene storage caverns are due for regulatory workover including a mechanical integrity test ("MIT") in 2010. Successful completion of the workover and passing of the MIT would allow the caverns to operate for another 10 years, with a mandatory mid-term MIT evaluation required at the end of the fifth year (in 2015). The regulatory workover and MIT of the other two caverns was successfully completed in 2006 and 2007. Pembina and its facility co-owner are currently examining alternative capacity opportunities that are available elsewhere on the jointly-owned property to address a possible situation where one or both of the existing caverns do not pass the MIT. If alternative capacity is not developed, failure of these caverns could result in one or more of them being taken out of service and resulting in a reduction in storage capacity, which could decrease the revenue generated by this facility and the subsequent cash flow available for distribution.

### **Credit Risk**

Pembina is subject to credit risk arising out of both its pipeline and midstream and marketing operations. A majority of Pembina's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risk. Historically, Pembina has collected its accounts receivable in full. On its conventional pipelines, Pembina has the right to take shipper's oil and NGLs in kind to settle any outstanding receivable balance and to offset amounts owing to it for single shipper operations. Pembina also actively reviews credit worthiness of all new shippers on its systems and regularly reviews the credit status of current shippers.

### **Pricing**

Terminalling, storage and hub services are dependent upon the ability of Pembina to take advantage of pricing differentials for various qualitative factors in the hydrocarbon liquids streams. These differentials are based primarily on product density and sulphur content and are subject to normal market forces. Pembina actively monitors market conditions, stream content and quality to mitigate risk should there be a significant change in either price or quality factors.

## Selected Quarterly Information

(in thousands of dollars, except where noted)	2008				2007			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	<b>149,375</b>	<b>201,289</b>	<b>181,484</b>	<b>142,735</b>	133,990	131,477	126,373	112,948
Product purchases	<b>24,025</b>	<b>84,243</b>	<b>76,215</b>	<b>36,451</b>	32,756	32,761	32,947	16,589
Operating expenses	<b>42,428</b>	<b>40,136</b>	<b>33,262</b>	<b>35,095</b>	35,885	31,833	30,718	31,192
EBITDA <sup>(1)</sup>	<b>66,801</b>	<b>85,037</b>	<b>77,074</b>	<b>58,972</b>	53,614	57,901	53,082	55,863
Cash flow from operations	<b>63,505</b>	<b>50,445</b>	<b>46,921</b>	<b>59,034</b>	48,788	51,666	42,180	46,907
Cash flow from operations per Trust Unit (\$ per Unit)	<b>0.47</b>	<b>0.38</b>	<b>0.35</b>	<b>0.44</b>	0.37	0.39	0.32	0.37
Net earnings	<b>38,968</b>	<b>48,131</b>	<b>42,122</b>	<b>32,572</b>	34,981	37,903	35,492	33,929
Net earnings per Trust Unit (\$ per Unit):								
Basic	<b>0.29</b>	<b>0.36</b>	<b>0.32</b>	<b>0.25</b>	0.26	0.29	0.27	0.27
Diluted	<b>0.29</b>	<b>0.35</b>	<b>0.31</b>	<b>0.24</b>	0.26	0.28	0.27	0.26
Distributed cash <sup>(1)</sup>	<b>52,312</b>	<b>50,732</b>	<b>47,922</b>	<b>47,793</b>	47,684	46,198	42,890	42,098
Distributed cash per Trust Unit <sup>(1)</sup>								
Basic	<b>0.3900</b>	<b>0.3800</b>	<b>0.3600</b>	<b>0.3600</b>	0.3600	0.3500	0.3300	0.3300
Diluted	<b>0.3840</b>	<b>0.3729</b>	<b>0.3528</b>	<b>0.3530</b>	0.3521	0.3393	0.3211	0.3219
Trust Units outstanding (thousands):								
Weighted average (basic)	<b>134,133</b>	<b>133,504</b>	<b>133,117</b>	<b>132,758</b>	132,454	131,994	129,966	127,568
Weighted average (diluted)	<b>137,668</b>	<b>137,595</b>	<b>137,564</b>	<b>137,196</b>	137,243	136,850	135,274	135,206
End of period	<b>134,703</b>	<b>133,569</b>	<b>133,278</b>	<b>132,816</b>	132,542	132,065	131,388	128,247

<sup>(1)</sup> Refer to "Non-GAAP Measures" on page 11.

Pembina's stable operations typically produce limited variability in quarterly results. Variations typically result from one-time events and expected seasonal factors which impact pipeline receipts and operating expenses, occurring most frequently during the second quarter of each year. Such events and factors include, but are not limited to, regularly scheduled facilities maintenance, road bans and weather-related impact on receipts and spending patterns.

## Fourth Quarter Results

Net earnings for the fourth quarter were \$39.0 million compared with \$35.0 million in 2007. The \$4.0 million increase in net earnings reflects increased revenues and net operating income in all business segments.

Cash flow from operations for the fourth quarter of 2008 was \$63.5 million, an increase of \$14.7 million from 2007. The increase is primarily due to improved operating income on portions of Pembina's conventional pipeline systems, the contribution of revenue from the Horizon Pipeline, which commenced November 1, 2008, and increased revenues and the growth in all business operations throughout 2008. Cash outflow from financing activities in the fourth quarter of 2008 of \$38.7 million consisted of distributions to Unitholders offset by the reinstatement of the DRIP. Cash used in investing activities decreased from \$80.0 million in 2007 to \$22.4 million in 2008 as a result of the completion of the construction of the Horizon Pipeline.

## Additional Information

Additional information relating to Pembina Pipeline Income Fund, including the Fund's 2008 Annual Information Form and financial statements, can be found at the Fund's website at [www.pembina.com](http://www.pembina.com) and on the Fund's profile on the SEDAR website at [www.sedar.com](http://www.sedar.com).

## Forward-Looking Statements and Information

*In some cases, forward-looking statements and information ("forward-looking statements") can be identified by terminology such as "may", "will", "should", "expects", "projects", "plans", "anticipates", "targets", "believes", "strives", "intends", "estimates", "continue", "designed", "objective", "maintain", "schedule", "endeavor" and similar expressions.*

*In particular, this document contains forward-looking statements, including certain financial outlooks, regarding (i) the possible conversion of Pembina to a corporate form prior to January 1, 2011 and the ability of Pembina to maintain its current level of cash distributions to its equity holders both prior to and for the foreseeable future after conversion (in the form of dividends after conversion); (ii) the future net operating income of Pembina in relation to the Horizon Pipeline; and (iii) the proposed construction of the Nipisi and Mitsue Pipelines. These forward-looking statements are being made by Pembina based on certain assumptions that Pembina has made in respect thereof as at the date of this document. These assumptions include, in respect of the possible corporate conversion of Pembina and future cash distributions or dividends to equity holders, that Pembina's internal cash flow and tax projections are correct; that Pembina can obtain all necessary approvals in respect of the corporate conversion; that favourable growth parameters continue to exist in respect of current and future projects of Pembina (including in respect of the ability to finance such projects on favourable terms); that there will be no changes to current tax laws governing the taxation of specified investment flow-through ("SIFT") entities and the treatment of distributions from such entities; that the draft legislation related to the conversion of SIFT entities into corporations, as introduced on July 14, 2008, will be enacted in the form proposed; and the continued sustainable results of all three of Pembina's business segments. In respect of the forward-looking statements made in relation to the future net operating income of the Horizon Pipeline, Pembina has assumed that future tolls are consistent with internal projections, that counterparties fulfill their contract obligations in a timely manner, that there are no unforeseen events preventing performance of contracts by Pembina, and that there are no unforeseen material costs relating to the pipeline system which are not recoverable from shippers. In respect of the forward-looking statements made in relation to the proposed Nipisi and Mitsue Pipelines, Pembina has assumed that the in-service date for the Nipisi and Mitsue Pipelines will be in mid-2011; that future tolls in respect of the proposed Nipisi and Mitsue Pipelines will be consistent with internal projections; that counterparties will comply with contracts in a timely manner; that there are no unforeseen events preventing the performance of contracts by Pembina; that Pembina is able to obtain financing on favourable terms in respect of the costs associated with the Nipisi and Mitsue Pipelines; that there are no unforeseen construction costs related to the Nipisi and Mitsue Pipelines; and that there are no unforeseen material costs relating to the pipeline systems which are not recoverable from shippers.*

*Further, this MD&A contains forward-looking statements with respect to: future stability and sustainability of cash distributions to Unitholders; ongoing utilization and expansions of and additions to Pembina's asset base; the amount of future liabilities related to environmental incidents; the availability of coverage under Pembina's insurance policies (including in respect of Pembina's business interruption insurance policy); future acquisitions, growth and growth potential in Pembina's conventional pipelines, oil sands & heavy oil infrastructure and midstream & marketing operations; potential revenue and cash flow enhancement; future cash flows; maintenance of operating margins; continued high levels of oil and gas activity and increased oil and gas production in proximity to Pembina's pipelines and other assets (which could be affected by, among other things, possible changes to applicable royalty and tax regimes); additional throughput potential on additional connections and other initiatives on the conventional system; expected project start-up and construction dates; future distributions, payout ratios and taxation of distributions; future financing capability and sources; negative credit rating adjustments; the expansion of midstream services; and the future tax treatment of the Fund and income trusts.*

*None of the forward-looking statements described above are guarantees of future performance and they are all subject to a number of known and unknown risks and uncertainties, including but not limited to: the impact of competitive entities and pricing, approvals by industry partners, reliance on key alliances and agreements, default by counterparties to agreements which Pembina has entered into in respect of its business, the strength and operations of the oil and natural gas production industry and related commodity prices, the regulatory environment and decisions and the inability to obtain required regulatory approvals (including in respect of the Nipisi and Mitsue pipelines), tax laws and treatment, fluctuations in operating results, the ability of Pembina to raise sufficient capital (or to raise capital on favourable terms) to complete future projects and satisfy future commitments (including in respect of the proposed construction of the Nipisi and Mitsue pipelines and related facilities and the repayment of debt as it becomes due), construction costs of the Nipisi and Mitsue Pipelines, construction delays and labour and material shortages, continued adverse general economic and market conditions and further changes thereto in Canada, North America and elsewhere, including changes in interest rates or foreign currency exchange rates, and certain other risks detailed from time to time in the Fund's public disclosure documents. The Fund believes the expectations reflected in these forward-looking statements are reasonable as of the date hereof but no assurance can be given that these expectations will prove to be correct. Undue reliance should not be placed on these forward-looking statements as both known and unknown risks and uncertainties, including those business risks stated above, may cause actual performance and financial results in future periods to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements. Accordingly, readers are cautioned that events or circumstances could cause results to differ materially from those predicted. Such forward-looking statements are expressly qualified by the above statements. The Fund does not undertake any obligation to publicly update or revise any forward-looking statements contained herein, except as required by applicable laws.*

*Management of the Fund approved the financial outlook contained herein as of the date of this document. The purpose of the financial outlook contained herein is to give the reader an indication of the value to Pembina of its future business opportunities, growth projects as well as the potential effects to Unitholders of a possible conversion of Pembina to a corporate form. Readers should be aware that the information contained in the financial outlook contained herein may not be appropriate for other purposes.*

## Management's Responsibility

The consolidated financial statements of Pembina Pipeline Income Fund (the "Fund") are the responsibility of Pembina's management. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles, using management's best estimates and judgments, where appropriate.

Management is responsible for the reliability and integrity of the financial statements, the notes to the financial statements, and other financial information contained in this report. In the preparation of these financial statements, estimates are sometimes necessary because a precise determination of certain assets and liabilities is dependent on future events. Management believes such estimates have been based on careful judgments and have been properly reflected in the accompanying financial statements.

Management maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that accounting systems provide timely, accurate and reliable financial information.

The Board of Directors of Pembina Pipeline Corporation (the "Board") is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board is assisted in exercising their responsibilities through the Audit Committee, which is composed of three non-management directors. The Audit Committee meets periodically with management and the auditors to satisfy itself that management's responsibilities are properly discharged, to review the financial statements and to recommend approval of the financial statements to the Board.

KPMG LLP, the independent auditors, have audited the Fund's financial statements in accordance with Canadian generally accepted auditing standards and their report follows. The independent auditors have full and unrestricted access to the Audit Committee to discuss their audit and their related findings.



**Robert B. Michaleski**  
*President and Chief Executive Officer*  
*Pembina Pipeline Corporation*



**Peter D. Robertson**  
*Vice President Finance and Chief Financial Officer*  
*Pembina Pipeline Corporation*

March 4, 2009

## Auditors' Report to Unitholders

We have audited the consolidated balance sheets of Pembina Pipeline Income Fund as at December 31, 2008 and 2007 and the consolidated statements of earnings and deficit, comprehensive income (loss) and cash flows for years then ended. These consolidated financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 Fund 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.

The logo for KPMG LLP, featuring the letters 'KPMG' in a bold, sans-serif font, followed by 'LLP' in a smaller, similar font. A horizontal line is drawn below the text, starting from the left and extending to the right, ending under the 'P'.

*Chartered Accountants  
Calgary, Canada*

*March 4, 2009*

## Consolidated Balance Sheets

<i>December 31, 2008 and 2007 (In thousands of dollars)</i>	<b>2008</b>	2007
<b>Assets</b>		
Current assets:		
Cash	<b>\$ 13,638</b>	\$ 16,736
Accounts receivable and other	<b>65,140</b>	56,177
	<b>78,778</b>	72,913
Property, plant and equipment <i>(note 5)</i>	<b>1,685,394</b>	1,524,887
Goodwill and other <i>(note 6)</i>	<b>354,037</b>	358,212
Derivative financial instruments <i>(note 2 and note 16)</i>		10,796
	<b>\$ 2,118,209</b>	\$ 1,966,808
<b>Liabilities and Unitholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	<b>\$ 65,913</b>	\$ 59,485
Distributions payable to Unitholders	<b>17,511</b>	15,905
Current portion of long-term debt <i>(note 7)</i>	<b>81,904</b>	6,422
	<b>165,328</b>	81,812
Long-term debt <i>(note 7)</i>	<b>831,797</b>	772,364
Convertible debentures <i>(note 8)</i>	<b>40,865</b>	47,702
Derivative financial instruments <i>(note 2 and note 16)</i>	<b>13,962</b>	
Asset retirement obligations <i>(note 10)</i>	<b>84,158</b>	62,236
Future income taxes <i>(note 11)</i>	<b>98,869</b>	93,957
	<b>1,234,979</b>	1,058,071
Unitholders' equity:		
Trust Units <i>(note 12)</i>	<b>1,350,694</b>	1,320,692
Deficit	<b>(456,856)</b>	(419,890)
Accumulated other comprehensive income (loss) <i>(note 2)</i>	<b>(10,608)</b>	7,935
	<b>883,230</b>	908,737
Commitments <i>(note 18)</i>		
	<b>\$ 2,118,209</b>	\$ 1,966,808

On behalf of the Board of Pembina Pipeline Corporation:



**Lorne B. Gordon**  
Director



**Robert F. Taylor**  
Director

See accompanying notes.

## Consolidated Statements of Earnings and Deficit

Years Ended December 31, 2008 and 2007

(In thousands of dollars, except per Trust Unit amounts)

	2008	2007
Revenues:		
Conventional Pipelines	<b>\$ 263,409</b>	\$ 249,056
Oil Sands & Heavy Oil infrastructure	<b>85,425</b>	61,714
Midstream & Marketing business	<b>326,049</b>	194,018
	<b>674,883</b>	504,788
Expenses:		
Operations	<b>150,921</b>	129,628
Product purchases	<b>220,934</b>	115,053
General and administrative	<b>38,632</b>	30,643
Depreciation and amortization (note 5, 6)	<b>72,148</b>	66,450
Accretion on asset retirement obligations (note 10)	<b>5,022</b>	2,665
Internalization of management contract (note 3)	<b>13,800</b>	4,700
Gain on sale of linefill and other	<b>(42,310)</b>	1,639
	<b>459,147</b>	350,778
Earnings before interest and taxes	<b>215,736</b>	154,010
Interest on long-term debt (note 7)	<b>(39,430)</b>	(29,456)
Interest on convertible debentures (note 8)	<b>(3,386)</b>	(4,769)
Earnings before taxes	<b>172,920</b>	119,785
Income tax expense (reduction) (note 11)	<b>11,127</b>	(22,520)
Net earnings	<b>161,793</b>	142,305
Deficit, beginning of year	<b>(419,890)</b>	(383,325)
Distributed cash	<b>(198,759)</b>	(178,870)
Deficit, end of year	<b>\$ (456,856)</b>	\$ (419,890)
Earnings per Trust Unit – basic (note 14)	<b>\$ 1.21</b>	\$ 1.09
Earnings per Trust Unit – diluted (note 14)	<b>\$ 1.19</b>	\$ 1.06

See accompanying notes.

## Consolidated Statement of Comprehensive Income (Loss)

<i>Years Ended December 31, 2008 and 2007 (In thousands of dollars)</i>	<b>2008</b>	2007
Net earnings for the year	<b>\$ 161,793</b>	\$ 142,305
Other comprehensive income:		
Change in unrealized gain (loss) on derivative instruments designated as cash flow hedges, net of tax of \$6.2 million	<b>(18,543)</b>	2,887
Total comprehensive income	<b>\$ 143,250</b>	\$ 145,192
Accumulated other comprehensive income (loss) <i>(note 2)</i> :		
Opening balance, net of tax of \$2.9 million	<b>\$ 7,935</b>	\$ 5,048
Change in unrealized gain (loss) on derivative instruments designated as cash flow hedges, net of tax of \$6.2 million	<b>\$ (18,543)</b>	2,887
Accumulated other comprehensive income (loss)	<b>\$ (10,608)</b>	\$ 7,935

See accompanying notes.



## Consolidated Statements of Cash Flow

<i>Years Ended December 31, 2008 and 2007 (In thousands of dollars)</i>	<b>2008</b>	2007
Cash provided by (used in):		
Operating activities:		
Net earnings	<b>\$ 161,793</b>	\$ 142,305
Items not involving cash:		
Depreciation and amortization	<b>72,148</b>	66,450
Accretion on asset retirement obligations	<b>5,022</b>	2,665
Future income tax expense (reduction)	<b>11,127</b>	(22,520)
Gain on sale of linefill	<b>(42,896)</b>	
Employee future benefits expense (note 9)	<b>4,288</b>	4,777
Trust Unit based compensation expense	<b>766</b>	1,232
Other		1,099
Employee future benefits contributions (note 9)	<b>(3,759)</b>	(3,759)
Changes in non-cash working capital (note 15)	<b>11,416</b>	(2,709)
Cash flow from operations	<b>219,905</b>	189,540
Financing activities:		
Bank borrowings	<b>141,337</b>	239,113
Repayment of senior secured notes	<b>(6,422)</b>	(5,973)
Issue of Trust Units on exercise of options (note 12)	<b>7,536</b>	7,372
Issue of Trust Units under Distribution Reinvestment Plan (note 12)	<b>14,863</b>	47,170
Distributions to Unitholders – current year	<b>(181,248)</b>	(162,965)
Distributions to Unitholders – prior year	<b>(15,905)</b>	(12,622)
	<b>(39,839)</b>	112,095
Investing activities:		
Capital expenditures	<b>(223,976)</b>	(300,312)
Proceeds on sale of linefill	<b>54,764</b>	
Changes in non-cash working capital (note 15)	<b>(13,952)</b>	13,552
	<b>(183,164)</b>	(286,760)
Change in cash	<b>(3,098)</b>	14,875
Cash, beginning of year	<b>16,736</b>	1,861
Cash, end of year	<b>\$ 13,638</b>	\$ 16,736
Other cash disclosures:		
Interest on long-term debt paid	<b>\$ (44,481)</b>	\$ (40,929)
Interest on convertible debentures paid	<b>\$ (3,273)</b>	\$ (4,412)
Interest capitalized	<b>\$ (8,039)</b>	\$ (9,895)

See accompanying notes.

# Notes to Consolidated Financial Statements



*Years ended December 31, 2008 and 2007 (Tabular amounts stated in thousands of dollars, except per Trust Unit amounts)*

**NOTE 1. Structure of The Fund:**

Pembina Pipeline Income Fund (the “Fund”) is an open-ended, single purpose trust formed under the laws of the Province of Alberta pursuant to a declaration of trust. The Fund commenced operations in October 1997 when it acquired all of the shares and unsecured promissory notes of Pembina Pipeline Corporation (“Pembina”) which owns or has interests in pipelines and related facilities to deliver crude oil, condensates and natural gas liquids in Alberta and British Columbia, and other energy related infrastructure.

The Fund makes monthly distributions of its distributable cash to Unitholders of record on the last day of each calendar month. The amount of the distributions per Trust Unit are equal to the pro-rata share of interest income (and in certain circumstances repayment of principal) on the Pembina notes and dividends (and in certain circumstances repayment of capital) on the Pembina shares less expenses of the Fund and cash redemptions of Trust Units.

Pursuant to the Fund’s distribution policy, it will pay interest, principal, dividends and capital, subject to retaining an appropriate distribution reserve, satisfying its financing covenants, making loan repayments, and funding future removal and site restoration expenditures. Pembina’s routine operations are expected to be funded from available cash while ongoing development, expansions and acquisitions of pipeline and other assets and related facilities are expected to be funded primarily through borrowings or issuance of additional Trust Units.

**NOTE 2. Significant Accounting Policies:**

The preparation of these consolidated financial statements requires the use of estimates and assumptions which have been made using careful judgment. In the opinion of management, these consolidated financial statements have been properly prepared within reasonable limits of materiality and within the framework of Canadian generally accepted accounting principles for non rate-regulated entities. Certain of the prior year’s comparative figures have been reclassified to conform with the current year’s presentation.

#### INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Canadian Institute of Chartered Accountants (“CICA”) Accounting Standards Board (AcSB) confirmed in February 2008, that Canadian publicly accountable enterprises will adopt International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), effective January 1, 2011, with early adoption starting in 2009. IFRS will require increased financial statement disclosures. Although IFRS uses a conceptual framework similar to Canadian GAAP, differences in accounting policies need to be addressed to assess the impact on the Fund’s existing accounting policies, the impact on business processes and the impact on information systems requirements and internal controls.

As required, it is the Fund’s intention to prepare its interim and annual consolidated financial statements in accordance with IFRS from the financial year beginning January 1, 2011 (the “Changeover”). Effective from that date, it is also the Fund’s intention to adopt IFRS as its primary accounting principles. Consequently, upon the changeover to IFRS, the Fund will reconcile its primary IFRS Financial Statements to Canadian GAAP, representing a change from its current full Canadian GAAP reporting.

The Fund has commenced the process to transition from current Canadian GAAP to IFRS. A steering committee and a working group have been established and an IFRS conversion plan has been created which includes regular progress reporting to Pembina’s Audit Committee and the Board of Directors.

The IFRS conversion plan consists of three phases:

- 1. Impact Assessment Phase** – This phase includes an IFRS impact assessment identifying key areas that may be impacted by the transition to IFRS. Areas have been identified and the impact on the Fund’s financial reporting, disclosure, systems and processes, business processes and stakeholders has been ranked as Low, Medium or High. This phase is currently being completed; however, continued progress is necessary before the Fund can prudently increase the specificity of the disclosure in respect of this phase.
- 2. Impact Analysis and Evaluation Phase** – In this phase, each key area identified in the Impact Assessment Phase will be analyzed, with priority being placed on areas assessed with higher impact. Analysis will include a review of the accounting policy alternatives, potential business process and information system changes and an initial reconciliation from IFRS to Canadian GAAP equity and income. Training will also commence during this phase. Pembina will commence this phase once the first phase, above, has been completed.
- 3. Implementation and Review Phase** – This phase involves formal authorization processes to approve the recommended accounting policy changes. Training will continue during this phase and an opening IFRS compliant draft balance sheet and financial statement note disclosure will be prepared.

As activities progress, Pembina expects to be able to increase the specificity of its disclosure of the accounting policy differences and their expected impacts.

A business wide information technology implementation has commenced to accommodate IFRS reporting requirements and increase overall business unit reporting effectiveness and analysis. The Fund is accumulating information on IFRS to prepare for the Fund’s Changeover to IFRS in 2011.

The IASB work plan currently has projects underway that are expected to result in new pronouncements that continue to evolve IFRS. As a result, IFRS as at Changeover is expected to differ from its current state. To minimize the impact on the Fund’s reporting at Changeover, it is the Fund’s intention to adopt applicable Canadian GAAP accounting policies that also comply with IFRS.

**REGULATION**

The pipeline systems in Alberta and British Columbia are subject to the respective provincial utilities board authority over matters such as construction, rates and rate setting agreements with customers. Pipelines crossing provincial borders are also subject to the authority of the National Energy Board. The Alberta pipelines generally operate under market tolling arrangements and the utilities board will not review rates unless it receives a complaint. Rates on the BC Pipelines require provincial utility board approval and certain period costs are deferred and recovered in tolls over a five year period as directed by the regulator.

**PRINCIPLES OF CONSOLIDATION**

These consolidated financial statements include the accounts of the Fund, its wholly owned subsidiary companies and partnerships, and its proportionate share of the accounts of joint ventures and partnerships. The Fund does not utilize off balance sheet arrangements with unconsolidated entities.

**CASH AND CASH EQUIVALENTS**

Short term investments with original maturities of ninety days or less are considered to be cash equivalents and are recorded at cost which approximates market value.

**PROPERTY, PLANT AND EQUIPMENT**

Development capital expenditures are capitalized at cost. Maintenance and repair costs are expensed as incurred. Interest is capitalized during the construction phase of large expansions.

Pipeline assets and facilities are generally depreciated using the straight line method over 25 to 30 years or declining balance method at rates ranging from 3 percent to 10 percent per annum. Oilsands and storage assets and facilities are depreciated using the straight line method at annual rates ranging from 3 percent to 5 percent. These rates are established to depreciate original costs over the economic lives or contractual duration of the related assets.

**GOODWILL**

In February, 2008, the CICA issued Section 3064 *Goodwill and Intangible Assets* ("Section 3064"), which replaces Section 3062, *Goodwill and Other Intangible Assets*, and Section 3450 *Research and Development Costs*. The purpose of this section is to provide more specific guidance on the recognition of internally developed intangible assets and requires that research and development expenditures be evaluated against the same criteria as expenditures for intangible assets.

Goodwill represents the excess, if any, of the consideration paid over the fair value of identifiable assets and liabilities acquired in a business combination, and often arises as a result of the recognition of a future income tax liability related to the difference between the fair value and the tax base of acquired assets. Goodwill is not amortized but, at a minimum, is subject to an annual impairment test and an impairment loss is recognized when the carrying amount of goodwill exceeds its fair value. The measurement methodology used to evaluate whether there is a permanent impairment in the value of goodwill is based on discounted cash flows.

Section 3064 increases harmonization of Canadian standards with IFRS and applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. The Fund's results of operations and financial position are not expected to be materially affected by the new recommendations.

**OTHER INTANGIBLES**

Other intangibles acquired individually or as part of a group of assets are recognized and measured at cost. Other intangibles are amortized using the straight line method over the 20 year contractual duration of the related asset.

**IMPAIRMENT OF LONG-LIVED ASSETS**

Management reviews property, plant and equipment and other intangibles to determine if circumstances indicate impairment in the carrying value or changes in the estimated useful life of the asset. If impairment has occurred, an impairment charge to earnings is recognized for the amount the carrying value of the asset exceeds its estimated fair value based on discounted future cash flows.

**EMPLOYEE PENSION PLANS**

A subsidiary of the Fund maintains non-contributory defined benefit pension plans covering its employees along with an unfunded supplemental retirement plan for those employees affected by the Canada Revenue Agency maximum pension limits. The cost of pension benefits earned by employees in the defined benefit plans are charged to earnings as services are rendered using the projected benefit method pro-rated on service. The cost of the defined benefit plans reflects management's estimate of the rate of return on pension plan assets, salary escalations, mortality and other factors affecting the payments of future benefits. Adjustments arising out of plan amendments, changes in assumptions and experience gains and losses are normally amortized, using the corridor method, over the expected remaining average service life of the employee group. Under the corridor method, amortization is recorded only if the accumulated net actuarial gains or losses exceed 10 percent of the greater of the accrued benefit obligation and the value of the plan assets. The market value of assets is used for all calculations.

**ASSET RETIREMENT OBLIGATIONS**

The fair value of the estimated asset retirement obligations are recognized in the period in which they are incurred, when an estimate can reasonably be made and industry practice or regulation requires removal of the asset upon retirement. The fair value is recorded as a long-term liability with a corresponding increase in the carrying value of the property, plant and equipment. The liability is accumulated over time through charges to earnings and is reduced by the actual costs incurred upon settlement. Any difference between the actual costs incurred upon settlement and the recorded liability is recognized as a gain or loss in earnings.

**INCOME TAXES**

Income taxes, based on current legislation, are recorded on the liability method of accounting as the subsidiaries are projected to be taxable in the future. Income tax obligations relating to distributions from the Fund are the obligations of the Unitholders. Accordingly, no provision for income taxes on the earnings of the Fund have been made.

Future income tax liabilities of subsidiaries are recognized on acquisitions and reflect the difference between the book value and tax value of capital assets at future statutory income tax rates. On recognition, an equivalent amount is allocated to property, plant and equipment or, if the consideration paid approximates the estimated depreciated replacement cost, then the allocation is to goodwill. The future income tax expense represents the change in these amounts and other timing differences during the year.

Bill C-52 relating to trust tax has no additional impact on the future income tax liability. The Fund has no timing differences other than those of its subsidiaries that are fully reflected in the future income tax liability and, as the tax basis of the Fund's investment in its subsidiaries far exceeds the cost basis, it is not appropriate to record the benefit of a future tax asset of this nature.

**REVENUE RECOGNITION**

Pipeline transportation revenues are recorded when the services have been provided. For rate or contractually regulated pipeline operations, revenue is recognized in a manner that is consistent with the underlying rate design as mandated by agreement or regulatory authority.

Certain pipelines have been designated single-shipper lines where producers must either sell their product at the inlet point or sell their product at the inlet point and repurchase it at the delivery point for the inlet price paid plus an agreed-upon differential on a pre-arranged basis. The buy/sell transactions are recorded when the services have been provided and recognized on a net basis in the statement of earnings. Product purchases for terminalling, storage and hub services are recognized on a gross basis in the statement of earnings. Product sales are recognized when the product is delivered to a customer.

Storage revenue is recognized when the service is provided consistent with the rate contracted with the customer.

**UNIT BASED COMPENSATION**

The Fund uses the fair value method to account for the compensation cost of options granted pursuant to the unit option plan described in Note 13. Under the fair value method, the options are measured at fair value at the grant date and the cost is recognized in earnings over the vesting period. Consideration paid on exercise of the options is credited to Unitholders' equity.

The Fund has a restricted Trust Unit plan as described in Note 13. As participants in this plan are entitled to a cash payment on a fixed vesting date, the Fund is using the intrinsic value method to account for the compensation cost of this plan. Changes in intrinsic value result in a change in the measurement of compensation cost. As awards vest at the end of the vesting period, compensation cost is recognized as incurred.

**COMPREHENSIVE INCOME**

CICA Handbook Section 1530 introduced comprehensive income, which consists of net income and other comprehensive income such as revenues, expenses, gains and losses that, in accordance with GAAP, are recognized in comprehensive income but not in net earnings. The Fund's consolidated financial statements include a Consolidated Statement of Comprehensive Income (Loss). Within the Consolidated Statement of Comprehensive Income (Loss), the Fund has included an accumulated comprehensive income continuity which shows the cumulative changes in other comprehensive income and the period end balance is presented as a separate category in Unitholders' equity. The other comprehensive income is comprised of the unrealized gains or losses on derivative financial instruments designated as cash flow hedges.

The rules require the recording of hedging derivatives at fair value. The unrealized gains and losses in the fair value of cash flow hedging instruments are recorded in other comprehensive income, net of tax, until recognized in earnings. The fair value of the cash flow hedges are recorded on the Balance Sheet as assets with changes in the fair value reflected in accumulated comprehensive income in Unitholders' equity with no impact on net earnings for the period. Gains and losses on derivatives that are not designated as cash flow hedges and any gains and losses after the termination of hedging relationships are charged to earnings as they arise.

**FINANCIAL INSTRUMENTS**

The Fund has interest rate swaps and a power swap hedge that are both designated as cash flow hedges. These cash flow hedges are used to manage the potential increase or decrease in interest expense on floating rate debt instruments and the price of non-transmission power charges. The fair value of these cash flow hedges are recorded on the Balance Sheet with changes in the fair value reflected in accumulated comprehensive income.

Effective January 1, 2008, the Fund adopted the new recommendations of the CICA Handbook Section 3862, *Financial Instruments – Disclosures* (“Section 3862”) and Handbook Section 3863, *Financial Instruments – Presentation* (“Section 3863”) which increases harmonization with IFRS. Section 3862 requires entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments on the entity’s financial position and its performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. Section 3863 established standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equities, the classification of related interest, dividends, losses and gains, and circumstances in which financial assets and financial liabilities are offset. The adoption of these standards did not have any impact on the classification and valuation of the Fund’s financial instruments. The Fund has included disclosures recommended by these new standards in Note 16 of the financial statements.

#### **RISK MANAGEMENT**

The Fund uses derivative financial instruments to manage exposure to interest rates, power costs and crude oil or natural gas liquids. The Fund does not trade financial instruments or use them for speculative purposes.

The Fund formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions for all financial instruments designated as cash flow hedges. The Fund also assesses, both at inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

#### **CAPITAL MANAGEMENT**

Effective January 1, 2008, the Fund adopted the new recommendation of CICA Handbook Section 1535, *Capital Disclosures* (“Section 1535”). Section 1535 increases harmonization with IFRS by establishing standards for disclosing information about an entity’s capital and how it is managed. It requires the disclosure of information about; the entity’s objectives, policies and processes for managing capital, qualitative information about what the entity regards as capital, whether the entity has complied with any capital requirements, and if it has not complied, the consequences of such non-compliance. The Fund has included disclosures recommended by Section 1535 in Note 17 of the financial statements.

#### **NOTE 3. Internalization of Management Contract:**

Effective June 30, 2006, the Fund acquired all of the outstanding common shares of Pembina Management Inc., the manager of the Fund. Total consideration for the transaction consisted of an initial cash payment of \$6 million and a contingent deferred payment to be made in 2009 that was linked to growth in distributable cash per Trust Unit of the Fund in the period from January 1, 2006 to December 31, 2008.

The cumulative distributable cash was \$4.73 per Trust Unit and resulted in a base purchase price of \$13.5 million, or 850,662 notional Trust Units based on the weighted-average trading price of the Trust Units for the 20 trading days prior to June 30, 2006 of \$15.87 (the “closing price”). The purchase price was also adjusted by the distributions paid on the notional Trust Units and the change in the value of the Fund’s Trust Units from the closing price, after giving consideration to the estimated impact of the specified investment flow-through entities (“SIFT”) tax and market conditions, resulting in an estimated deferred payment of \$18.5 million that is payable in March, 2009.

**NOTE 4. Business Segments:**

The Fund conducts its operations through three operating segments: Conventional Pipelines, Oil Sands and Heavy Oil Infrastructure and Midstream and Marketing business.

Conventional Pipelines consists of the tariff based operations of pipelines and related facilities to deliver crude oil, condensates and natural gas liquids in Alberta and British Columbia.

Oil Sands & Heavy Oil infrastructure consists of the Syncrude system, the Cheecham Lateral and the Horizon Pipeline, which was completed on July 1, 2008. This operating segment consists of pipelines and related facilities to deliver synthetic crude oil produced from oil sands under long-term cost-of-service arrangements.

Midstream & Marketing business consists of the Fund's direct and indirect interest in a storage operation and direct interests in terminalling, storage and hub services under a mixture of short, medium and long-term contractual arrangements.

The financial results of the business segments are as follows:

<i>(in thousands of dollars)</i>	Conventional Pipelines <sup>(1)</sup>	Oil Sands & Heavy Oil Infrastructure <sup>(2)</sup>	Midstream & Marketing Business <sup>(3)</sup>	Corporate	Total
<b>2008</b>					
Revenues:					
Pipeline transportation	\$ 263,409	\$ 85,425	\$	\$	\$ 348,834
Terminalling, storage and hub services			326,049		326,049
Revenue before expenses	263,409	85,425	326,049		674,883
Expenses:					
Operations	113,195	28,746	8,980		150,921
Product purchases			220,934		220,934
General and administrative <sup>(3)</sup>		1,347		37,285	38,632
Depreciation and amortization	47,293	13,545	10,368	942	72,148
Accretion on asset retirement obligations	4,376	646			5,022
Internalization of management contract				13,800	13,800
Gain on sale of linefill and other <sup>(2)</sup>		(42,897)		587	(42,310)
	164,864	1,387	240,282	52,614	459,147
Earnings (loss) before interest and taxes	\$ 98,545	\$ 84,038	\$ 85,767	\$ (52,614)	\$ 215,736
Property, plant and equipment	\$ 796,884	\$ 706,449	\$ 175,388	\$ 6,673	\$ 1,685,394
Goodwill and other	\$ 206,045	\$ 28,300	\$ 119,692	\$	\$ 354,037

<sup>(1)</sup> Less than 8 percent of conventional pipeline revenues are under regulated tolling arrangements.

<sup>(2)</sup> Included in Oil Sands & Heavy Oil Infrastructure segment is a gain on sale of Syncrude linefill of \$42.9 million. This represents the purging and sale of 385,000 barrels of excess linefill for total proceeds of \$54.8 million.

<sup>(3)</sup> General and administrative expenses for Midstream & Marketing are included in operating expenses.



<i>(in thousands of dollars)</i>	Conventional Pipelines <sup>(1)</sup>	Oil Sands & Heavy Oil Infrastructure <sup>(2)</sup>	Midstream & Marketing Business <sup>(3)</sup>	Corporate	Total
2007					
Revenues:					
Pipeline transportation	\$ 249,056	\$ 61,714	\$	\$	\$ 310,770
Terminalling, storage and hub services			194,018		194,018
Revenue before expenses	249,056	61,714	194,018		504,788
Expenses:					
Operations	97,289	23,720	8,619		129,628
Product purchases			115,053		115,053
General and administrative <sup>(3)</sup>		1,306		29,337	30,643
Depreciation and amortization	45,046	11,970	8,983	451	66,450
Accretion on asset retirement obligations	2,521	144			2,665
Internalization of management contract				4,700	4,700
Other				1,639	1,639
	144,856	37,140	132,655	36,127	350,778
Earnings before interest and taxes	\$ 104,200	\$ 24,574	\$ 61,363	\$ (36,127)	\$ 154,010
Property, plant and equipment	\$ 795,792	\$ 592,441	\$ 131,169	\$ 5,485	\$ 1,524,887
Goodwill and other	\$ 206,574	\$ 28,300	\$ 123,338	\$	\$ 358,212

<sup>(1)</sup> Less than 6 percent of conventional pipeline revenues are under regulated tolling arrangements.

<sup>(2)</sup> Included in property, plant and equipment are assets under construction for the Horizon Pipeline of \$264.8 million.

<sup>(3)</sup> General and administrative expenses for midstream are included in operating expenses.

A summary of the Fund's interest in the Fort Saskatchewan Ethylene Storage Partnership as at December 31, 2008, is as follows:

	2008	2007
Current assets	<b>\$ 1,813</b>	\$ 2,034
Working capital	<b>1,813</b>	2,034
Property, plant and equipment	<b>86,586</b>	91,508
Goodwill and other intangibles	<b>119,692</b>	123,338
Future income taxes	<b>(48,206)</b>	(50,874)
Investment in partnership	<b>\$ 159,885</b>	\$ 166,006
Revenues	<b>\$ 22,334</b>	\$ 24,372
Expenses	<b>4,609</b>	5,606
Net earnings	<b>8,682</b>	9,783
Cash flow from operations	<b>\$ 17,725</b>	\$ 18,766

**NOTE 5. Property, Plant and Equipment:**

	2008 Cost	2007 Cost	2008 Accumulated Depreciation	2007 Accumulated Depreciation	2008 Net	2007 Net
Conventional Pipelines <sup>(1)</sup>	\$ 1,390,278	\$ 1,345,870	\$ (593,394)	\$ (550,078)	\$ 796,884	\$ 795,792
Oil Sands & Heavy Oil infrastructure	772,847	645,294	(66,398)	(52,853)	706,449	592,441
Midstream & Marketing business	210,940	156,023	(35,552)	(24,854)	175,388	131,169
Corporate	12,148	10,018	(5,475)	(4,533)	6,673	5,485
	<b>\$ 2,386,213</b>	<b>\$ 2,157,205</b>	<b>\$ (700,819)</b>	<b>\$ (632,318)</b>	<b>\$ 1,685,394</b>	<b>\$ 1,524,887</b>

<sup>(1)</sup> Includes \$7 million of deferred integrity costs on the Western system amortized over five years at the direction of the regulator (2007: \$7 million).

Depreciation and amortization expense in 2008 was \$72.1 million (2007: \$66.5 million).

**NOTE 6. Goodwill and Other:**

	Cost	Accumulated Depreciation	2008 Net	2007 Net
Goodwill	\$ 287,670	\$	\$ 287,670	\$ 287,670
Other intangibles	75,000	(20,308)	54,692	58,338
Pension asset (note 9)	11,675		11,675	12,204
	<b>\$ 374,345</b>	<b>\$ (20,308)</b>	<b>\$ 354,037</b>	<b>\$ 358,212</b>

In 2008, amortization of deferred charges (classified with long-term debt) of \$1.1 million (2007: \$1.1 million) is included in interest on long-term debt expense with no amortization included in depreciation and amortization expense.

**NOTE 7. Long-Term Debt:**

	Available facilities at December 31, 2008	2008	2007
Bank loans:			
Operating facility	\$ 30,000	\$	\$
Revolving credit facility	500,000	390,000	250,000
Senior unsecured notes – Series A	175,000	175,000	175,000
Senior unsecured notes – Series B	75,000	75,000	75,000
Senior unsecured notes – Series C	200,000	200,000	200,000
Senior secured notes	80,286	80,286	86,708
	\$ 1,060,286	920,286	786,708
Less current portion		(81,904)	(6,422)
Less deferred charges		(6,585)	(7,922)
<b>Balance December 31</b>		<b>\$ 831,797</b>	<b>\$ 772,364</b>

The bank facilities are syndicated facilities established with Canadian chartered banks. On July 24, 2007, the revolving credit facilities of Pembina Pipeline Corporation, the principal operating subsidiary of the Fund, were renewed for a period of five years to July 24, 2012. The \$30 million operating facility matures July 24, 2009, at which time it is expected to be renewed for another 365 days. There are no repayments due over the term. Borrowings bear interest at either prime lending rates or based on banker's acceptance rates plus applicable margins. The margins are based on the credit rating of the senior unsecured debt of Pembina Pipeline Corporation and range from 0.50 percent to 1.50 percent.

Series A senior unsecured notes bear interest at 5.99 percent payable semi-annually and are due June 15, 2014. Series B senior unsecured notes bear interest at the three month banker's acceptance rate plus 90 basis points payable quarterly in arrears and are due on June 22, 2009. Series C senior unsecured notes bear interest at 5.58 percent payable semi-annually and are due September 30, 2021. These notes are subject to the maintenance of certain financial ratios.

The \$80.3 million senior secured notes are due 2017 and bear interest at 7.38 percent per annum, compounded semi-annually and payable monthly in arrears. Blended monthly payments of principal and interest of approximately \$1 million are payable on the first day of each month through August, 2017. These notes are subject to the maintenance of certain financial ratios, and are secured by a floating charge debenture on the assets of the Fund and its subsidiaries, guarantees of the subsidiaries and a pledge of the subsidiaries' shares.

The Fund has \$200 million in interest rate swaps outstanding on the floating senior debt, with an average rate of 4.5 percent and an average remaining term to expiration of 7 years. The Fund receives a floating rate and pays a fixed rate. The unrealized mark to market loss on the interest rate swap was \$23.0 million as at December 31, 2008.

Scheduled payments of principal on the notes in the next five years are as follows (the renewed credit facilities have no repayments due over the term):

Year	Notes
2009	81,904
2010	7,423
2011	7,981
2012	8,581
2013	9,226
	<b>\$ 115,115</b>

**NOTE 8. Convertible Debentures:**

	7.50%	7.35%	Total
Balance, January 1, 2007	\$ 15,133	\$ 61,679	<b>\$ 76,812</b>
Conversions	(15,133)	(13,977)	<b>(29,110)</b>
Balance, December 31, 2007		47,702	<b>47,702</b>
Conversions		(6,837)	<b>(6,837)</b>
<b>Balance, December 31, 2008</b>	<b>\$</b>	<b>\$ 40,865</b>	<b>\$ 40,865</b>

The 7.5% convertible unsecured subordinated debentures matured on June 30, 2007.

The 7.35% convertible unsecured subordinated debentures mature on December 31, 2010, with interest payable semi-annually in arrears on June 30 and December 31. The debentures may be converted at the option of the holder at a conversion price of \$12.50 per Trust Unit at any time prior to maturity and may be redeemed by the Fund. The Fund may, at its option after June 30, 2006, elect to redeem the debentures by issuing Trust Units. The Fund can elect to pay interest on the debentures by issuing Trust Units.

The Fund did not allocate a portion of the convertible debentures to equity as the calculation of the equity component was not significant when such an allocation was based on an approximate interest rate that would have been applicable to the issuance of similar debt without the conversion features at the time the debentures were issued.

**NOTE 9. Employee Future Benefits:**

A subsidiary of the Fund maintains non-contributory defined benefit pension plans covering its employees: a funded registered plan for all employees and an unfunded supplemental retirement plan for those employees affected by the Canada Revenue Agency maximum pension limits. Benefits under the plans are based on the length of service and the final average best three years of earnings of the employee. Benefits paid out of the plans are not indexed.

The subsidiary funds these plans in accordance with government regulations by contributing to trust funds administered by an independent trustee. The funds are invested primarily in equities and bonds.

The Fund measures its accrued benefit obligation and the fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation is as at December 31, 2006.

Plan contributions totaled \$3.8 million in 2008 (2007: \$3.8 million).

Information about the defined benefit plan is as follows:

	2008	2007
Accrued benefit obligation		
Accrued benefit obligation, beginning of year	\$ 76,503	\$ 78,282
Current service cost	4,069	4,391
Interest cost	4,406	4,169
Benefits paid	(3,016)	(3,785)
Actuarial gain	(20,603)	(6,554)
Accrued benefit obligation, end of year	\$ 61,359	\$ 76,503
Plan assets		
Fair value of plan assets, beginning of year	\$ 72,725	\$ 72,209
Actual return on plan assets	(12,786)	542
Employer contributions	3,759	3,759
Benefits paid	(3,016)	(3,785)
Fair value of plan assets, end of year	\$ 60,682	\$ 72,725
Funded status		
Deficit	\$ (677)	\$ (3,778)
Unamortized net actuarial loss	14,350	18,265
Unamortized transitional asset	(1,998)	(2,283)
Accrued benefit asset	\$ 11,675	\$ 12,204

Plan assets consist of:

Asset category	Percentage of plan assets	
Equity securities	59%	65%
Debt securities	38%	35%
Cash	3%	0%
Total	100%	100%

Less than 0.1 percent of the plan assets are invested in securities of the Fund.

The net benefit plan expense is as follows:

	2008	2007
Current service cost	<b>\$ 4,069</b>	\$ 4,391
Interest cost	<b>4,406</b>	4,169
Actual return on plan assets	<b>12,786</b>	(542)
Actuarial gain on accrued benefit obligation	<b>(20,603)</b>	(6,554)
Cost arising in the period	<b>658</b>	1,464
Differences between costs arising in the period and costs recognized in the period in respect of:		
Return on plan assets	<b>(17,702)</b>	(4,290)
Actuarial losses	<b>21,617</b>	7,888
Transitional asset	<b>(285)</b>	(285)
Net benefit plan expense	<b>\$ 4,288</b>	\$ 4,777

Assumptions for the expense and accrued benefit obligation are as follows:

	2008	2007
Assumptions for expense		
Discount rate	<b>5.6%</b>	5.2%
Expected long-term rate of return on plan assets	<b>6.75%</b>	6.75%
Rate of compensation increase	<b>6.25%</b>	6.5%
Assumptions for accrued benefit obligation		
Discount rate	<b>7.5%</b>	5.6%
Rate of compensation increase	<b>6.00%</b>	6.5%

The Fund has a non-pension post employment benefit plan which has an unfunded benefit obligation of \$0.9 million (2007: \$0.9 million). In 2008, there was a plan net income of \$0.1 million (2007 plan net expense of: \$0.3 million).

**NOTE 10. Asset Retirement Obligations:**

The Fund has estimated the net present value of its total asset retirement obligations based on a total future liability (adjusted for 5 percent inflation per annum) of \$525 million (2007: \$347 million). The obligations are expected to be paid over the next 50 years with substantially all being paid after 30 years. The Fund used credit adjusted risk free rates ranging from 5.85 to 6.15 percent to calculate the present value of the asset retirement obligations.

The property, plant and equipment of the Fund consists primarily of underground pipelines, above ground equipment facilities and storage assets. No amount has been recorded relating to the removal of the underground pipelines or the storage assets as the potential obligations relating to these assets cannot be reasonably estimated due to the indeterminate timing or scope of the asset retirement. As the timing and scope of retirement become determinable for these assets, the fair value of the liability and the cost of retirement will be recorded.

	2008	2007
Obligations, beginning of year	<b>\$ 62,236</b>	\$ 29,889
Change in obligation estimate	<b>16,900</b>	29,682
Accretion expense	<b>5,022</b>	2,665
Obligations, end of year	<b>\$ 84,158</b>	\$ 62,236

**NOTE 11. Income Taxes:**

The components of the subsidiaries' future income tax liability are as follows:

	2008	2007
Difference between book values and tax values of:		
Property, plant and equipment	<b>\$ 100,200</b>	\$ 91,699
Intangibles	<b>10,565</b>	11,413
Taxable limited partnership income deferral	<b>71,896</b>	46,197
Benefit of loss carry-forwards	<b>(62,922)</b>	(43,954)
Asset retirement obligation	<b>(21,040)</b>	(15,559)
Deferred revenue		(1,106)
Financial instruments designated as hedges	<b>(3,355)</b>	2,861
Other	<b>3,525</b>	2,406
	<b>\$ 98,869</b>	\$ 93,957

The provision for income taxes in the financial statements differs from the result which would have been obtained by applying the combined federal and provincial tax rate to the Fund's earnings before taxes. This difference results from the following items:

	2008	2007
Earnings before taxes	<b>\$ 172,920</b>	\$ 119,785
Combined statutory rate	<b>29.50%</b>	32.12%
Income taxes at the statutory rate	<b>51,011</b>	38,475
Increase (decrease) resulting from:		
Interest deductions of subsidiaries arising from intercorporate debt	<b>(48,787)</b>	(51,931)
Tax rate changes on future income tax balances	<b>(591)</b>	(4,439)
Interest on convertible debentures	<b>999</b>	1,532
Non-deductible items	<b>(1,857)</b>	1,635
Other	<b>10,352</b>	(7,792)
Income taxes	<b>\$ 11,127</b>	\$ (22,520)

On October 31, 2006, the Federal Government announced a proposed trust taxation of 31.5 percent, subsequently reduced to 29 percent, of distributions which may be effective January 1, 2011, that may impact the Fund's current and future income taxes. The enactment of Bill C-52 relating to trust tax has no additional impact on the future income tax liability. The Fund has no timing differences other than those of its subsidiaries that are fully reflected in the future income tax liability of \$98.9 million and as the tax basis of the Fund's investment in its subsidiaries far exceeds the cost basis, it is not appropriate to record the benefit of a future tax asset of this nature.

**NOTE 12. Trust Units:**

The Fund is authorized to create and issue an unlimited number of Trust Units.

	Trust Units	Amount
Balance, January 1, 2007	126,217,888	\$ 1,235,809
Exercise of Trust Unit options	564,399	7,371
Debenture conversions	2,644,451	29,110
Distribution Reinvestment Plan	3,114,798	47,170
Contributed surplus		1,232
Balance, December 31, 2007	132,541,536	1,320,692
Exercise of Trust Unit options	517,310	7,536
Debenture conversions	571,360	6,837
Distribution Reinvestment Plan	1,072,861	14,863
Contributed Surplus <i>(note 13)</i>		766
<b>Balance, December 31, 2008</b>	<b>134,703,067</b>	<b>\$ 1,350,694</b>

Trust Units are redeemable at any time at the option of the holder. The redemption price is equal to the lesser of 95 percent of the average market price of the Trust Units during a 10 day period commencing immediately after the redemption date and the closing market price on the redemption date. The total amount payable by the Fund in respect of redemptions in any calendar month shall not exceed \$250,000. To the extent that a Unitholder is not entitled to receive cash upon the redemption of the Trust Units, the redemption price shall be satisfied by way of the Fund distributing a pro-rata number of Pembina notes, shares or securities of other businesses, if any, acquired from time to time.

A Unitholders' rights plan was approved by the Unitholders on May 1, 2008, for a further three year period. If a bid to acquire control of the Fund is made, the plan is designed to give the Board of Directors time to consider alternatives to allow Unitholders to receive full and fair value for their Trust Units. In the event that a bid, other than a permitted bid, is made, Unitholders become entitled to exercise rights to acquire Trust Units of the Fund at 50 percent of market value.

The Fund has adopted a DRIP. This Plan allows participants an opportunity, under the distribution reinvestment component of the plan, to reinvest distributions into Trust Units at a five percent discount to a weighted average market price or, alternatively, under the premium distribution component of the Plan, to realize two percent more cash on their distributions. Eligible Unitholders can also make optional Trust Unit purchases at the weighted average market price. On June 30, 2007, the Fund prorated its DRIP to zero as its bank facilities offered a lower cost of financing for the Fund compared to equity investment. As at October 31, 2008, the Fund reinstated the DRIP program to raise more capital for future development projects.

**NOTE 13. Unit-Based Compensation:**

The Fund has an option plan under which directors, officers and employees are eligible to receive options. The number of Trust Units reserved for issuance at December 31, 2008, is 6,375,415 representing 3,448,496 options issued and exercisable, 424,614 options issued and exercisable on or after their vesting date of December 31, 2009, and 2,502,305 options are reserved for future grants.

In 2008, the directors approved new grants totaling 601,500 options which were granted to certain employees (excluding officers) at exercise prices of \$17.08, \$16.46, \$18.06 and \$16.78, one-third of which vested immediately, one-third of which will vest on the first anniversary date of the grant, and one-third of which will vest on the second anniversary date of the grant. These options expire seven calendar years after their grant date.

The following tables summarize information about the outstanding options at December 31, 2008 and 2007:

	Number of options	Weighted average exercise price
Outstanding and exercisable, January 1, 2007	4,339,614	\$ 14.17
Granted	317,500	15.72
Exercised	(564,399)	13.42
Expired	(136,706)	14.73
Outstanding and exercisable, December 31, 2007	3,956,009	14.12
Granted	601,500	17.10
Exercised	(517,310)	14.16
Expired	(167,089)	15.94
<b>Outstanding and exercisable, December 31, 2008</b>	<b>3,873,110</b>	<b>\$ 14.76</b>

Exercise Price	Number outstanding at December 31, 2008	Options exercisable	Weighted average remaining life (years)
\$10.56	270,700	270,700	0.91
\$13.85	278,091	278,091	3.32
\$14.74	2,562,814	2,562,814	4.92
\$15.57	212,502	141,668	5.49
\$16.73	36,667	24,445	5.75
\$17.08	47,834	15,945	6.00
\$16.46	127,000	42,333	6.28
\$18.06	160,834	53,611	6.50
\$16.78	176,668	58,889	6.75
<b>\$10.56 to \$18.06</b>	<b>3,873,110</b>	<b>3,448,496</b>	<b>5.72</b>

The fair value of each unit option is estimated on the date of grant using the Black-Scholes option pricing model. The weighted average fair values of the options granted during the year and the weighted average assumptions used in their determination are as follows:

	2008	2007
Annual distribution yield	<b>8.9%</b>	8.7%
Risk free interest rate	<b>3.25%</b>	4.5%
Expected life	<b>5 Years</b>	5 years
Expected volatility	<b>24%</b>	30%
Weighted average fair value per option	<b>\$ 0.95</b>	\$ 1.89

The Fund expensed \$0.8 million net of cancellations for the year ended December 31, 2008, which was recorded in contributed surplus (2007: \$1.2 million).



A long-term incentive plan was established in 2005. Under this unit-based compensation plan, awards of restricted units are made to qualifying employees and directors. The plan results in participants receiving cash compensation based on the value of underlying notional Trust Units granted under the plan. The units vest in equal annual amounts over a three year period and the cash payments are based on a trading value of the Trust Units plus notional accrued distributions and performance of the Fund. The details of the various grants are included in the following table:

	Total Grant	Outstanding at December 31, 2008	Vested at December, 31, 2008
2005	55,844		
2006	145,771		86,985
2007	238,214	175,198	174,937
<b>2008</b>	<b>227,626</b>	<b>281,974</b>	<b>140,986</b>

Based on the ninety-day weighted average trading price of the Trust Units prior to December 31, 2008, the estimated intrinsic value of the restricted Trust Units vested to December 31, 2008, totaled \$6.0 million (2007: \$4.6 million). The Fund has recorded compensation expense of \$6.4 million in 2008 (2007: \$4.6 million) relating to vested awards.

**NOTE 14. Earnings Per Trust Unit:**

The following table summarizes the computation of net earnings per Trust Unit:

	2008	2007
Net earnings		
Numerator for basic earnings per Trust Unit	<b>\$ 161,793</b>	\$ 142,305
Numerator for diluted earnings per Trust Unit	<b>\$ 164,180</b>	\$ 145,542
Denominator:		
Weighted average denominator for basic Trust Units	<b>133,380</b>	130,513
Dilutive instruments:		
Debentures	<b>3,838</b>	6,211
Employee options	<b>430</b>	642
Denominator for diluted earnings per Trust Unit	<b>137,648</b>	137,366
Basic earnings per Trust Unit	<b>\$ 1.21</b>	\$ 1.09
Diluted earnings per Trust Unit	<b>\$ 1.19</b>	\$ 1.06

**NOTE 15. Change In Non-Cash Working Capital:**

	2008	2007
Accounts receivable	<b>\$ (8,963)</b>	\$ (11,231)
Accounts payable and accrued liabilities	<b>6,427</b>	22,074
	<b>\$ (2,536)</b>	\$ 10,843
Operations	<b>\$ 11,416</b>	\$ (2,709)
Investments	<b>\$ (13,952)</b>	\$ 13,552

**NOTE 16. Financial Risk Management and Financial Instruments:****FINANCIAL RISK**

The Fund has exposure to credit risk, liquidity risk and market risk. The Fund's Board of Directors has the overall responsibility for the oversight of these risks and reviews the Fund's policies on an ongoing basis to ensure that these risks are appropriately managed. The Fund's Audit Committee oversees how management monitors compliance with the Fund's risk management policies and procedures and reviews the adequacy of this risk framework in relation to the risks faced by the Fund. The Fund's Risk Management Function assists in managing these risks. The Fund's primary risk management objective is to protect earnings and cash flow and ultimately Unitholder distributions.

**CREDIT RISK**

Credit risk is the risk of financial loss to the Fund if a customer, partner or counterparty to a financial instrument fails to meet its contractual obligations and arises primarily from the Fund's cash and cash equivalents and receivables and from counterparties on its power cost swaps. The carrying amount of the financial assets and liabilities and the fair value of the long-term debt, convertible debentures and swaps represents the maximum credit exposure to the Fund.

The Fund manages credit risk for its cash and cash equivalents by maintaining bank accounts with Schedule 1 banks. The Fund has minimal credit risk related to its receivables as a majority of these amounts are with large customers in the oil and gas industry and are subject to the terms of the Fund's shipping rules and regulations or pursuant to contracts. Balances are payable on the 25th day of the following month. This date coincides with the date on which oil and gas companies receive payment from industry partners and customers. Historically, Pembina has collected its receivables in full with an excess of 90 percent collected on the due date. Pembina also maintains lien rights on the oil and NGLs that are in the Fund's custody during the transportation of such products on the pipeline as well as the right to offset for single shipper operations. Therefore, the risk of non-collection is considered to be low and no allowance for doubtful accounts has been made.

Additionally, credit risk is mitigated through established credit management techniques, including conducting financial and other assessments for all new shippers on its systems and regular reviews of the credit status of current shippers to establish and monitor the counterparty's creditworthiness, to set exposure limits and to obtain financial assurances such as letters of credit and guarantees when warranted. The Fund's review includes external ratings for customers, where available, and in other cases, detailed financial assessments and reviews which generates a credit rating based on financial ratios. Purchase limits are established for each customer representing the maximum open amount without requiring approval from the Risk Management Committee. These limits are reviewed on an ongoing basis as deemed required.

The Fund minimizes credit risk on its derivative financial instruments (power and commodity swaps) by entering into risk management transactions only with entities that have investment grade credit ratings.

**LIQUIDITY RISK**

Liquidity risk is the risk that the Fund will not be able to meet its financial obligations as they come due. The Fund's approach to managing liquidity risk is to ensure that funds and credit facilities are available to meet its short term obligations. Management monitors daily cash positions and performs cash forecasts weekly to determine cash requirements. On a monthly basis, Management typically forecasts cash flows for a period of 12 months to identify financing requirements. These financing requirements are then addressed through a combination of credit facilities and through access to capital markets if required.

<i>(in thousands of dollars)</i>	Outstanding Balances Due By Period					
	Carrying Amount	6 months or less	6 – 12 months	1 – 2 years	2 – 5 years	> 5 years
Accounts payable and accrued liabilities	\$ 65,913	\$ 64,425	\$ 1,488	\$	\$	\$
Distributions payable to Unitholders	17,511	17,511				
Long-term debt (excluding financing fees) <sup>(1)</sup>	920,286	78,390	3,515	15,404	592,726	230,251
Convertible debentures	40,865			40,865		
	\$ 1,044,575	\$ 160,326	\$ 5,003	\$ 56,269	\$ 592,726	\$ 230,251

<sup>(1)</sup> \$75 million of floating rate senior unsecured notes are due June, 2009. The \$390 million drawn on the revolving credit facilities is due in July, 2012, and the \$175 million in fixed rate senior unsecured notes are due in June 2014 (2 – 5 years period). The \$80.3 million balance in fixed rate senior secured notes are due in August, 2017, and the \$200 million in fixed rate senior unsecured notes is due September, 2021 (> 5 years period).

**MARKET RISK**

Market risk is the risk that the changes in market prices, such as interest rates, foreign exchange rates, and commodity prices affect the Fund's earnings and the value of financial instruments it holds.

The Fund uses derivative financial instruments to manage exposure to power costs, interest rates and crude oil and natural gas liquid prices. The Fund does not trade financial instruments or use them for speculative purposes.

Contracts used to manage market risk generally consist of swap contracts. These contracts consist of interest rate swaps and power swap hedges designated as cash flow hedges. These cash flow hedges are used to manage the potential increase or decrease in the price of non-transmission power charges and interest expense on floating rate debt instruments. The \$60 million interest rate swap matured on June 9, 2008. The Fund entered into new interest rate swaps of \$200 million during the second half of the year.

The Fund, from time to time, enters into commodity swap hedges but the swaps have an insignificant value and are recorded in current period earnings.

The Fund's credit facilities, as at December 31, 2008, consisted of an unsecured \$500 million revolving credit facility and a \$30 million operating line of credit. Pembina had \$390 million drawn leaving \$140 million of undrawn capacity. At December 31, 2008, the Fund was exposed to changes in interest rates on \$265.0 million of bank borrowings.

## LIQUIDITY AND CAPITAL RESOURCES

<i>(in thousands of dollars)</i>	<b>December 31 2008</b>	December 31 2007
Variable rate debt		
Bank debt	<b>\$ 390,000</b>	\$ 250,000
Senior unsecured notes	<b>75,000</b>	75,000
Variable rate debt swapped to fixed	<b>(200,000)</b>	(60,000)
Total variable rate debt outstanding (average rate of 3.69%)	<b>265,000</b>	265,000
Fixed rate debt		
Senior unsecured notes	<b>375,000</b>	375,000
Senior secured notes	<b>80,286</b>	86,708
Variable rate debt swapped to fixed	<b>200,000</b>	60,000
Total fixed rate debt outstanding (average rate of 5.52%)	<b>655,286</b>	521,708
Convertible debentures	<b>40,865</b>	47,702
Total debt and debentures outstanding	<b>961,151</b>	834,410
Unutilized debt capacity	<b>140,000</b>	280,000

The Fund has fixed the interest rate on \$200.0 million of variable rate bank borrowings through interest rate swaps. The interest rate swaps had a fair value of \$23.0 million unrealized loss as at December 31, 2008, and are for terms of 5 to 10 years.

Including the interest swaps, interest rates on \$655.3 million in senior secured and unsecured notes have been fixed, leaving roughly 29 percent of Pembina's outstanding debt exposed to interest rate fluctuations.

The Fund is also exposed to changes in the cost of power. At December 31, 2008, the Fund has fixed the price of non-transmission power charges by way of price swap contracts which expire in 2010. The fair value of these contracts at December 31, 2008, was an unrealized gain of \$9.1 million. The power swap hedges the first 16 MW of power consumption each day on the conventional pipeline systems. Power costs on our oil sands and heavy oil systems are not hedged and as revenue on these pipelines is contracted to recover operating costs, Pembina's net operating income from oil sands and heavy oil is not impacted by fluctuations in power costs. Assuming a portion of the power was not hedged, every \$5 change in the Alberta pool price will increase operating expenses by approximately \$0.7 million.

Terminalling, storage and hub services are dependent upon the ability of Pembina to take advantage of pricing differentials for various qualitative factors in the crude oil and NGL streams. These differentials are based primarily on product density and sulphur content and are subject to normal market forces. Pembina actively monitors the market conditions and the stream content and quality to ensure that it is not subject to undue risk or exposure should there be significant change in either price or quality factors.

The Fund documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions for all financial instruments designated as cash flow hedges. The Fund also assesses, both at inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Pembina does not have any material currency risk as most transactions are in Canadian dollars.

#### FAIR VALUES

The Fund classifies its financial instruments as follows: cash is designated as “held for trading” and is measured at carrying value which approximates fair value due to the short term nature of these instruments. Accounts receivable and other are designated as “loans and receivables” and are measured at amortized cost. The derivative financial instruments are designated as cash flow hedges and are measured at fair value using market rates (values disclosed above). Accounts payable and accrued liabilities, distributions payable, long-term debt and convertible debentures are designated as “other liabilities” and recorded at amortized cost. The fair values for the long-term debt are determined by discounting the future contractual cash flows under the note agreements at discount rates which represent borrowing rates available for loans with similar terms and conditions. The fair value of debentures are determined based on available market information. There are no material differences in the carrying amounts of the financial instruments reported on the balance sheet compared to the estimated fair values except as follows:

	December 31, 2008		December 31, 2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<i>(in thousands of dollars)</i>				
Long-term debt				
Senior secured notes	<b>\$ 80,286</b>	<b>\$ 76,941</b>	\$ 86,708	\$ 93,659
Senior unsecured notes	<b>\$ 450,000</b>	<b>\$ 424,208</b>	\$ 450,000	\$ 441,893
Convertible debenture	<b>\$ 40,865</b>	<b>\$ 48,243</b>	\$ 47,702	\$ 67,770

The Fund classifies transaction costs (deferred financing fees) related to long-term debt with “long-term debt” on the balance sheet. These costs amount to \$6.6 million as at December 31, 2008.

**NOTE 17. Capital Risk Management:**

The Fund's objective when managing capital is to safeguard the Fund's ability to continue as a going concern so that it can continue to provide a stable stream of distributions to Unitholders that is sustainable over the long-term. The Fund distributes all of its net cash flow, subject to retaining an appropriate distribution reserve, financing, making repayments on debt and, if applicable, funding future removal and site restoration reserves.

The Fund manages its capital structure and makes adjustments to it in light of changes in economic conditions and risk characteristics of its underlying asset base and based on requirements arising from significant capital development activities. The Fund, upon approval from its Board of Directors, will balance its overall capital structure through new Trust Unit or debt issuances as required. Additionally, the Fund has resumed its DRIP to raise new equity.

The Fund maintains a conservative capital structure that allows it to finance its day-to-day cash requirements through its operations, without requiring external sources of capital. The Fund funds its operating commitments, short-term capital spending as well as its distributions to Unitholders through this cash flow, while new borrowing and equity issuances are reserved for the support of specific significant development activities. The capital structure of the Fund consists of Trust Units, deficit and accumulated other comprehensive income. Long-term debt is comprised of bank credit facilities, senior secured and unsecured notes and convertible debentures. The Fund monitors its ratio of total debt (as shown on the balance sheet) to total enterprise value (market value of trust units and debentures) quarterly and remains satisfied that the leverage currently employed in the Fund's capital structure is sufficient and appropriate given the characteristics and operations of the underlying asset base.

The Fund is not subject to externally imposed capital requirements and the Fund's overall strategy with respect to capital risk management remains unchanged from the year ended December 31, 2008.

Note 12 of these financial statements demonstrates the change in Trust Units for the year ended December 31, 2008.

**NOTE 18. Commitments:**

The Fund is committed to annual payments as follows:

Contractual Obligations	Total	Payments Due By Period			
		Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Office and vehicle leases	<b>16,745</b>	4,748	8,104	3,893	–

The Fund has entered into pipeline agreements that will require future capital expenditures. The remaining cost of construction of additional pipelines to provide the contracted transportation capacity is estimated to cost \$426.7 million.

## Supplementary Information (unaudited)

### Consolidated Balance Sheets

Years ended December 31, 2008, 2007, 2006, 2005, and 2004

(in thousands of dollars)

	2008	2007	2006	2005	2004
<b>Assets</b>					
Current assets:					
Cash	\$ 13,638	\$ 16,736	\$ 1,861	\$	\$
Accounts receivable and other	65,140	56,177	44,947	31,012	26,432
	<b>78,778</b>	72,913	46,808	31,012	26,432
Property, plant and equipment	<b>1,685,394</b>	1,524,887	1,257,729	1,161,691	1,160,613
Goodwill and other	<b>354,037</b>	358,212	371,667	366,416	361,855
Derivative financial instruments		10,796			
	<b>\$ 2,118,209</b>	\$ 1,966,808	\$ 1,676,204	\$ 1,559,119	\$ 1,548,900
<b>Liabilities and Unitholders' Equity</b>					
Current liabilities:					
Bank indebtedness	\$	\$	\$	\$ 7,311	\$ 2,971
Accounts payable and accrued liabilities	65,913	59,485	37,411	18,489	12,792
Distributions payable to Unitholders	17,511	15,905	12,622	9,966	9,007
Current portion of long-term debt	81,904	6,422	5,973	7,968	3,522
Current portion of convertible debentures			15,133	8,000	
	<b>165,328</b>	81,812	71,139	51,734	28,292
Long-term debt	<b>831,797</b>	772,364	547,396	456,094	430,866
Convertible debentures	<b>40,865</b>	47,702	61,679	150,040	251,663
Derivative financial instruments	<b>13,962</b>				
Asset retirement obligations	<b>84,158</b>	62,236	29,889	19,716	15,729
Future income taxes	<b>98,869</b>	93,957	113,617	137,923	167,300
	<b>1,234,979</b>	1,058,071	823,720	815,507	893,850
Unitholders' equity					
Trust Units	<b>1,350,694</b>	1,320,692	1,235,809	1,073,537	941,902
Deficit	<b>(456,856)</b>	(419,890)	(383,325)	(329,925)	(286,852)
Accumulated other comprehensive income (loss) – cash flow hedges	<b>(10,608)</b>	7,935			
	<b>883,230</b>	908,737	852,484	743,612	655,050
	<b>\$ 2,118,209</b>	\$ 1,966,808	\$ 1,676,204	\$ 1,559,119	\$ 1,548,900

Supplementary Information *(unaudited)*

## Consolidated Statements of Earnings and Deficit

*Years ended December 31, 2008, 2007, 2006, 2005, and 2004**(in thousands of dollars except per Trust Unit amounts)*

	2008	2007	2006	2005	2004
Revenues:					
Conventional Pipelines	<b>\$ 263,409</b>	\$ 249,056	\$ 222,957	\$ 204,331	\$ 201,734
Oil Sands & Heavy Oil Infrastructure	<b>85,425</b>	61,714	62,120	55,472	54,104
Midstream & Marketing Business	<b>326,049</b>	194,018	55,801	30,719	23,285
	<b>674,883</b>	504,788	340,878	290,522	279,123
Expenses:					
Operations	<b>150,921</b>	129,628	120,605	102,736	105,028
Product purchases	<b>220,934</b>	115,053	5,060		
General and administrative	<b>38,632</b>	30,643	24,013	17,091	15,017
Management fee			1,027	1,165	1,076
Depreciation and amortization	<b>72,148</b>	66,450	85,619	85,270	83,695
Accretion on asset retirement obligations	<b>5,022</b>	2,665	1,395	1,015	952
Internalization of management contract	<b>13,800</b>	4,700	6,000		
Gain on sale of linefill and other	<b>(42,310)</b>	1,639			
	<b>459,147</b>	350,778	243,719	207,277	205,768
Earnings before interest and taxes	<b>215,736</b>	154,010	97,159	83,245	73,355
Interest on long-term debt	<b>(39,430)</b>	(29,456)	(24,880)	(23,877)	(24,131)
Interest on convertible debentures	<b>(3,386)</b>	(4,769)	(7,700)	(16,599)	(19,890)
Earnings before taxes	<b>172,920</b>	119,785	64,579	42,769	29,334
Income tax expense (reduction)	<b>11,127</b>	(22,520)	(24,306)	(27,640)	(31,089)
Net earnings	<b>161,793</b>	142,305	88,885	70,409	60,423
Deficit, beginning of year	<b>(419,890)</b>	(383,325)	(329,925)	(286,852)	(241,083)
Distributed cash	<b>(198,759)</b>	(178,870)	(142,285)	(113,482)	(106,192)
Deficit, end of year	<b>\$ (456,856)</b>	\$ (419,890)	\$ (383,325)	\$ (329,925)	\$ (286,852)
Earnings per Trust Unit – basic	<b>\$ 1.21</b>	\$ 1.09	\$ 0.73	\$ 0.65	\$ 0.60
Earnings per Trust Unit – diluted	<b>\$ 1.19</b>	\$ 1.06	\$ 0.73	\$ 0.65	\$ 0.60



Supplementary Information *(unaudited)*

## Consolidated Statements of Cash Flows

*Years ended December 31, 2008, 2007, 2006, 2005, and 2004**(in thousands of dollars)*

	2008	2007	2006	2005	2004
Cash provided by (used in):					
Operating activities:					
Net earnings	<b>\$ 161,793</b>	\$ 142,305	\$ 88,885	\$ 70,409	\$ 60,423
Items not involving cash:					
Depreciation and amortization	<b>72,148</b>	66,450	85,619	85,270	83,695
Accretion on asset retirement obligations	<b>5,022</b>	2,665	1,395	1,015	952
Future income tax expense (reduction)	<b>11,127</b>	(22,520)	(24,306)	(29,377)	(33,300)
Gain on sale of linefill	<b>(42,896)</b>				
Employee future benefits expense	<b>4,288</b>	4,777	4,620	3,383	3,609
Trust Unit based compensation expense	<b>766</b>	1,232	1,135		
Other		1,099	363	362	584
Employee future benefits contributions	<b>(3,759)</b>	(3,759)	(9,000)	(13,349)	(4,436)
Changes in non-cash working capital	<b>11,416</b>	(2,709)	(4,851)	(5,353)	6,054
Cash flow from operations	<b>219,905</b>	189,540	143,860	112,360	117,581
Financing activities:					
Bank borrowings	<b>141,337</b>	239,113	59,862	31,438	18,277
Issue of unsecured senior notes, net of issue costs			194,842		247,125
Repayment of long-term debt			(165,000)		(250,000)
Repayment of senior secured notes	<b>(6,422)</b>	(5,973)	(5,555)	(1,764)	
Issue of Trust Units on exercise of options	<b>7,536</b>	7,372	3,271	6,762	3,030
Issue of Trust Units under Distribution Reinvestment Plan	<b>14,863</b>	47,170	76,639	31,250	29,750
Distributions to Unitholders:					
– current year	<b>(181,248)</b>	(162,965)	(129,664)	(103,516)	(97,185)
– prior year	<b>(15,905)</b>	(12,622)	(9,966)	(9,007)	(8,642)
	<b>(39,839)</b>	112,095	24,429	(44,837)	(57,645)
Investing activities:					
Capital expenditures	<b>(223,976)</b>	(300,312)	(168,955)	(79,457)	(58,007)
Proceeds on sale of linefill	<b>54,764</b>				
Changes in non-cash working capital	<b>(13,952)</b>	13,552	9,838	7,594	(8,166)
	<b>(183,164)</b>	(286,760)	(159,117)	(71,863)	(66,173)
Change in cash	<b>(3,098)</b>	14,875	9,172	(4,340)	(6,237)
Cash (bank indebtedness), beginning of year	<b>16,736</b>	1,861	(7,311)	(2,971)	3,266
Cash (bank indebtedness), end of year	<b>\$ 13,638</b>	\$ 16,736	\$ 1,861	\$ (7,311)	\$ (2,971)

Supplementary Information *(unaudited)*

## Five Year Operating Statistics

<i>Years ended December 31, 2008, 2007, 2006, 2005, and 2004</i>	<b>2008</b>	2007	2006	2005	2004
<b>Average annual throughput</b> <i>(in thousands of barrels per day)</i>					
Alberta					
Conventional crude oil	<b>246.8</b>	242.7	235.1	213.5	213.6
Condensate	<b>48.3</b>	49.4	50.3	53.2	54.0
Natural gas liquids	<b>121.5</b>	130.6	140.4	144.9	141.9
Total Alberta pipeline systems	<b>416.6</b>	422.7	425.8	411.6	409.5
British Columbia (BC) <sup>(1)</sup>					
Conventional crude oil	<b>22.6</b>	24.4	22.7	23.8	25.5
Oil Sands & Heavy Oil Infrastructure <sup>(2)</sup>					
Synthetic crude oil	<b>775.0</b>	525.0	389.0	389.0	303.7
Total Pembina					
Conventional crude oil	<b>269.4</b>	267.1	257.8	237.3	239.1
Synthetic crude oil <sup>(2)</sup>	<b>775.0</b>	525.0	389.0	389.0	303.7
Condensate	<b>48.3</b>	49.4	50.3	53.2	54.0
Natural gas liquids	<b>121.5</b>	130.6	140.4	144.9	141.9
<b>Total average throughput</b>	<b>1,214.2</b>	972.1	837.5	824.4	738.7
<b>Throughput composition</b> <i>(% of total)</i>					
Conventional crude oil	<b>22.2%</b>	27.5%	30.8%	28.8%	32.4%
Synthetic crude oil	<b>63.8%</b>	54.0%	46.4%	47.2%	41.1%
Condensate and natural gas liquids	<b>14.0%</b>	18.5%	22.8%	24.0%	26.5%
<b>Pipeline Revenue</b> <i>(in millions of dollars)</i>					
Alberta	<b>\$ 224.3</b>	\$ 216.4	\$ 195.2	\$ 179.0	\$ 173.4
BC	<b>39.1</b>	32.7	27.8	25.3	28.3
Oil Sands & Heavy Oil	<b>85.4</b>	61.7	62.1	55.5	54.1
Pipeline revenue	<b>348.8</b>	310.8	285.1	259.8	255.8
<b>Midstream revenue</b>	<b>105.1</b>	79.0	50.7	30.7	23.3
<b>Total revenue</b>	<b>\$ 453.9</b>	\$ 389.8	\$ 335.8	\$ 290.5	\$ 279.1
<b>Average revenue</b> <i>(dollars per barrel)</i> <i>(excluding oil sands and midstream results)</i>	<b>\$ 1.55</b>	\$ 1.43	\$ 1.27	\$ 1.20	\$ 1.18

<sup>(1)</sup> BC volume is Western system throughput only.

<sup>(2)</sup> Oil Sands pipelines results are shown as contracted capacity as revenue is independent of throughput. Actual throughputs were 294.8 mbbbls/d for 2008, 310.8 mbbbls/d for 2007, 263.5 mbbbls/d for 2006, 218.7 mbbbls/d for 2005, and 243.6 mbbbls/d for 2004.

Supplementary Information *(unaudited)*

## Quarterly Financial Statistics

<i>(in thousands, except per Trust Unit amounts)</i>	2008				Year ended Dec. 31/08	Year ended Dec. 31/07
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter		
Operating revenue	\$ 106,284	\$ 105,269	\$ 117,046	\$ 125,350	<b>\$ 453,949</b>	\$ 389,735
Operating expense	35,095	33,262	40,136	42,428	<b>150,921</b>	129,628
General and administrative	9,372	9,705	9,623	9,932	<b>38,632</b>	30,643
Depreciation and amortization	17,126	17,469	17,981	19,572	<b>72,148</b>	66,450
Accretion on asset retirement obligations	944	1,566	1,256	1,256	<b>5,022</b>	2,665
Internalization of management contract	1,859	4,479	2,504	4,958	<b>13,800</b>	4,700
Gain on sale of linefill	42	(20,817)	(21,510)	(25)	<b>(42,310)</b>	1,639
Earnings before interest and taxes	41,846	59,605	67,056	47,229	<b>215,736</b>	154,010
Interest on long-term debt	8,240	8,248	11,498	11,444	<b>39,430</b>	29,456
Interest on convertible debentures	898	872	828	788	<b>3,386</b>	4,769
Income tax expense (reduction)	136	8,363	6,599	(3,971)	<b>11,127</b>	(22,520)
<b>Net Earnings</b>	<b>32,572</b>	<b>42,122</b>	<b>48,131</b>	<b>38,968</b>	<b>161,793</b>	142,305
Add/(Deduct):						
Depreciation and amortization	17,126	17,469	17,981	19,572	<b>72,148</b>	66,450
Accretion on asset retirement obligations	944	1,566	1,256	1,256	<b>5,022</b>	2,665
Future income tax reduction	136	8,363	6,599	(3,971)	<b>11,127</b>	(22,520)
Gain on sale of linefill		(21,308)	(21,588)		<b>(42,896)</b>	
Increase in distribution reserve	(2,985)	(290)	(1,647)	(3,513)	<b>(8,435)</b>	(10,030)
<b>Distributed Cash<sup>(1)</sup></b>	<b>\$ 47,793</b>	<b>\$ 47,922</b>	<b>\$ 50,732</b>	<b>\$ 52,312</b>	<b>\$ 198,759</b>	\$ 178,870
Trust Units outstanding <i>(weighted average in thousands)</i>	132,758	133,117	133,504	134,133	<b>133,380</b>	130,513
Distributed cash per Trust Unit	\$ 0.36	\$ 0.36	\$ 0.38	\$ 0.39	<b>\$ 1.49</b>	\$ 1.3700
– taxable “income from a trust”	\$ 0.29187	\$ 0.29187	\$ 0.30809	\$ 0.31619	<b>\$ 1.20803</b>	\$ 1.18026
– non-taxable “capital distribution from a trust”	\$ 0.06813	\$ 0.06813	\$ 0.07191	\$ 0.07381	<b>\$ 0.28197</b>	\$ 0.18974

<sup>(1)</sup> Pembina Pipeline Income Fund distributes cash generated by the pipeline operations of Pembina Pipeline Corporation and other operating subsidiaries.

Supplementary Information *(unaudited)*

## Quarterly Segmented Information

<i>(in millions)</i>	2008				Year ended Dec. 31/08	Year ended Dec. 31/07
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter		
<b>Operating Revenue</b>						
Conventional Pipelines	\$ 67.1	\$ 63.0	\$ 67.7	\$ 65.6	<b>\$ 263.4</b>	\$ 249.1
Oil Sands & Heavy Oil Infrastructure	15.6	14.7	21.1	34.0	<b>85.4</b>	61.7
Midstream & Marketing Business	23.6	27.6	28.3	25.6	<b>105.1</b>	79.0
<b>Total</b>	<b>\$ 106.3</b>	<b>\$ 105.3</b>	<b>\$ 117.1</b>	<b>\$ 125.2</b>	<b>\$ 453.9</b>	<b>\$ 389.8</b>
<b>Operating Expense</b>						
Conventional Pipelines	\$ 27.3	\$ 25.3	\$ 29.7	\$ 30.9	<b>\$ 113.2</b>	\$ 97.3
Oil Sands & Heavy Oil Infrastructure	6.0	5.8	8.3	8.6	<b>28.7</b>	23.7
Midstream & Marketing Business	1.8	2.2	2.2	2.8	<b>9.0</b>	8.6
<b>Total</b>	<b>\$ 35.1</b>	<b>\$ 33.3</b>	<b>\$ 40.2</b>	<b>\$ 42.3</b>	<b>\$ 150.9</b>	<b>\$ 129.6</b>
<b>Net Operating Income</b>						
Conventional Pipelines	\$ 39.8	\$ 37.7	\$ 38.0	\$ 34.7	<b>\$ 150.2</b>	\$ 151.8
Oil Sands & Heavy Oil Infrastructure	9.6	8.9	12.8	25.4	<b>56.7</b>	38.0
Midstream & Marketing Business	21.8	25.4	26.1	22.8	<b>96.1</b>	70.4
<b>Total</b>	<b>\$ 71.2</b>	<b>\$ 72.0</b>	<b>\$ 76.9</b>	<b>\$ 82.9</b>	<b>\$ 303.0</b>	<b>\$ 260.2</b>

Supplementary Information *(unaudited)*

## Quarterly Operating Statistics

	2008				Year ended Dec. 31/08	Year ended Dec. 31/07
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter		
<b>Pipeline Throughput – by pipeline system</b>						
<i>(thousands of barrels per day)</i>						
Alberta	435.3	412.2	408.4	410.8	<b>416.6</b>	422.7
BC	23.7	21.2	22.2	23.3	<b>22.6</b>	24.4
Oil Sands & Heavy Oil Infrastructure <sup>(1)</sup>	525.0	525.0	775.0	775.0	<b>775.0</b>	525.0
Total pipeline throughput	984.0	958.4	1,205.6	1,209.2	<b>1,214.2</b>	972.1
<b>Average revenue (\$ per barrel)</b>						
<i>Revenue (\$ per barrel) (excluding storage revenue)</i>						
Alberta	1.44	1.46	1.53	1.44	<b>1.47</b>	1.40
BC	2.08	1.91	2.25	2.46	<b>2.17</b>	1.66
Oil Sands & Heavy Oil Infrastructure <sup>(1)</sup>	0.63	0.60	0.74	1.13	<b>0.79</b>	0.54
System-wide average	1.20	1.17	1.26	1.38	<b>1.25</b>	1.08
System-wide average <i>(excluding Oil Sands)</i>	1.51	1.51	1.61	1.55	<b>1.55</b>	1.43
<b>Operating Expense (\$ per barrel)</b>						
Alberta	0.59	0.58	0.69	0.65	<b>0.63</b>	0.52
BC	0.83	0.86	0.85	1.40	<b>0.99</b>	0.89
Oil Sands & Heavy Oil Infrastructure <sup>(1)</sup>	0.24	0.24	0.29	0.29	<b>0.27</b>	0.21

<sup>(1)</sup> Results for oil sands pipelines show contracted capacity rather than actual throughput. Revenue per barrel and operating expense per barrel calculations are based on actual throughputs of 272.3 mbbls/d for Q1 2008, 269.6 mbbls/d for Q2 2008, 310.9 mbbls/d for Q3 2008, 325.8 mbbls/d for Q4 2008, and 310.8 mbbls/d for year ended December 31, 2007.

Supplementary Information *(unaudited)*Trust Unit Trading Activity <sup>(1)</sup>

<i>(in millions)</i>	2008				Year ended	Year ended
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Dec. 31/08	Dec. 31/07
Unit trading price (\$ per Trust Unit)						
– high	\$ 18.00	\$ 18.79	\$ 18.45	\$ 17.10	<b>\$ 18.79</b>	\$ 17.99
– low	\$ 15.45	\$ 16.18	\$ 15.28	\$ 11.97	<b>\$ 11.97</b>	\$ 15.03
– close <i>(at end of period)</i>	\$ 16.30	\$ 17.91	\$ 16.11	\$ 15.24	<b>\$ 15.24</b>	\$ 17.54
Volume traded <i>(number of Trust Units)</i>	13,328,306	11,406,786	12,034,092	17,708,322	<b>54,477,506</b>	53,754,138
Value traded <i>(dollars)</i>	225,135,837	199,403,542	200,241,059	259,278,381	<b>884,058,820</b>	883,762,403
Trust Units outstanding <i>(end of period)</i>	132,815,734	133,278,126	133,568,526	134,703,067	<b>134,703,067</b>	132,541,536
Trust Units outstanding <i>(weighted average)</i>	132,757,571	133,117,365	133,503,861	134,133,242	<b>133,380,417</b>	130,513,020

<sup>(1)</sup> Pembina Pipeline Income Fund Trust Units trade on the Toronto Stock Exchange under the symbol PIF.UN.

Supplementary Information *(unaudited)*Historic Unitholder Distributions and Tax Treatment<sup>(1)</sup>

<i>(\$ per Trust Unit)</i>	1997	1998	1999	2000	2001	2002
Total annual distribution declared						
<i>(\$ per Trust Unit)</i>	0.140000	0.950000	0.950000	0.960000	1.050000	1.050000
Taxable "other income"	0.099200	0.618900	0.783000	0.770208	0.900768	0.893160
Non-taxable "return of capital"	0.040800	0.331100	0.167000	0.189792	0.149232	0.156840
Cost base – beginning of period	10.000000	9.959200	9.628100	9.461100	9.271308	9.122076
Less: return of capital	0.040800	0.331100	0.167000	0.189792	0.149232	0.156840
Cost base – end of period	9.959200	9.628100	9.461100	9.271308	9.122076	8.965236
	2003	2004	2005	2006	2007	<b>2008</b>
Total annual distribution declared						
<i>(\$ per Trust Unit)</i>	1.050000	1.050000	1.050000	1.165000	1.370000	<b>1.490000</b>
Taxable "other income"	0.970680	1.037880	0.888480	0.894341	1.180260	<b>1.208030</b>
Non-taxable "return of capital"	0.079320	0.012120	0.161520	0.270658	0.189740	<b>0.281970</b>
Cost base – beginning of period	8.965236	8.885916	8.873796	8.712276	8.441618	<b>8.251878</b>
Less: return of capital	0.079320	0.012120	0.161520	0.270658	0.189740	<b>0.281970</b>
Cost base – end of period	8.885916	8.873796	8.712276	8.441618	8.251878	<b>7.969908</b>

<sup>(1)</sup> Cost base for units held from inception (October 1997).

## Key Personnel

### SENIOR MANAGEMENT TEAM

**Robert B. Michaleski**

*President and Chief Executive Officer*

**Michael H. Dilger**

*Chief Operating Officer*

**Peter D. Robertson**

*Vice President and Chief Financial Officer*

**D. James Watkinson**

*Vice President, General Counsel and Secretary*

**Glenys E. Hermanutz**

*Vice President, Corporate Affairs*

**Sam Stephenson**

*Vice President, Engineering & Operations,  
Conventional Pipelines*

**Barbara S. Jack**

*Vice President, Human Resources*

**Robert M. Jones**

*Vice President, Midstream & Marketing*

### BOARD OF DIRECTORS

**Lorne B. Gordon**<sup>(1)(4)</sup>

*Chairman  
Calgary, Alberta  
Corporate Director*

**Robert B. Michaleski**

*Calgary, Alberta  
President and Chief Executive Officer  
Pembina Pipeline Corporation*

**David. A Bissett**<sup>(2)(3)</sup>

*Calgary, Alberta  
Corporate Director*

**Allan L. Edgeworth**<sup>(3)(4)</sup>

*Calgary, Alberta  
Corporate Director*

**Myron F. Kanik**<sup>(2)(4)</sup>

*Calgary, Alberta  
Corporate Director*

**Robert F. Taylor**<sup>(1)(4)</sup>

*Calgary, Alberta  
Corporate Director*

**Randall J. Findlay**<sup>(2)</sup>

*Calgary, Alberta  
Corporate Director*

**Leslie A. O'Donoghue**<sup>(3)</sup>

*Calgary, Alberta  
Corporate Director*

**Douglas J. Haughey**<sup>(1)</sup>

*Calgary, Alberta  
Corporate Director*

<sup>(1)</sup> Audit Committee Members

<sup>(2)</sup> Human Resources and Compensation Committee Members

<sup>(3)</sup> Health, Safety and Environment Committee Members

<sup>(4)</sup> Governance Committee



# Corporate Information

## HEAD OFFICE

**Pembina Pipeline Corporation**  
Suite 2000, 700 – 9th Avenue S.W.  
P.O. Box 1948  
Calgary, Alberta T2P 2M7

## AUDITORS

**KPMG LLP**  
Chartered Accountants  
Calgary, Alberta

## TRUSTEE AND REGISTRAR AND TRANSFER AGENT

**Computershare Trust Company of Canada**  
Suite 600, 530 – 8th Avenue S.W.  
Calgary, Alberta T2P 3S8  
Shareholder Communications  
1-800-564-6253

## STOCK EXCHANGE

**Pembina Pipeline Income Fund**  
Trust Units are listed on the Toronto Stock Exchange under the symbol PIF.UN  
7.35% Convertible Debentures  
Symbol: PIF.DB.B

## CREDIT AGENCY RATINGS

**Pembina Pipeline Income Fund**  
DBRS Stability Rating STA-2 (low)  
S&P Stability Rating SR-2

**Pembina Pipeline Corporation**  
DBRS senior secured debt rating 'BBB high'  
DBRS senior unsecured debt rating 'BBB'  
S&P's credit profile rating 'BBB'  
S&P's senior secured debt rating 'A-'  
S&P's senior unsecured debt rating 'BBB plus'

## INVESTOR INQUIRIES CONTACT

Phone (403) 231-7500  
Fax (403) 237-0254  
Toll Free (403) 1-888-428-3222  
Email investor-relations@pembina.com  
Website www.pembina.com

*The following documents are available at Pembina's website:*

- Annual and Quarterly Reports
- Unit Trading Information
- Tax Information
- Press Releases
- Investor Presentations
- Distribution Information

## ANNUAL GENERAL MEETING

Unitholders are invited to attend Pembina's annual meeting on April 30, 2009 at 2:00 pm. The meeting will be held in the Grand Lecture Theatre, The Metropolitan Centre, 333 – 4th Avenue S.W., Calgary, Alberta.

## PREMIUM DISTRIBUTION, DISTRIBUTION REINVESTMENT AND OPTIONAL UNIT PURCHASE PLAN

Pembina offers a Premium Distribution, Distribution Reinvestment and Optional Unit Purchase Plan to eligible Unitholders of the Pembina Pipeline Income Fund.

*The Plan allows participants an opportunity to:*

- Reinvest distributions into Trust Units at a five percent discount to a weighted average market price, under the distribution reinvestment component of the Plan; or
- Realize two percent more cash on their distributions, under the premium distribution component of the Plan
- Eligible Unitholders may also make optional Trust Unit purchases at the weighted average market price.

A brochure, detailing administration of the Plan and eligibility and enrolment information, is available on-line on Pembina's website located at [www.pembina.com](http://www.pembina.com), or call **1-888-428-3222** to receive a copy by mail. Unitholders wishing to enroll in the Plan are asked to contact their broker, financial advisor or financial institution.

## ABBREVIATIONS

mbbls/d thousands of barrels per day  
NGLs natural gas liquids  
\$/bbl dollars per barrel of pipeline throughput  
cents/bbl cents per barrel of pipeline throughput

**Pembina Pipeline Income Fund**  
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[www.pembina.com](http://www.pembina.com)

