

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⁽¹⁾⁽²⁾

Years ended December 31

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

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

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

⁽²⁾ Refer to "Non-GAAP Measures" on page 11.

⁽³⁾ 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 and on the Fund's SEDAR profile at 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 ⁽¹⁾ | Revenues | Net operating income ⁽¹⁾ |
| 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 ⁽²⁾ | 105.1 | 96.1 | 78.9 | 70.3 |
| Total | \$ 453.9 | \$ 303.0 | \$ 389.7 | \$ 260.1 |

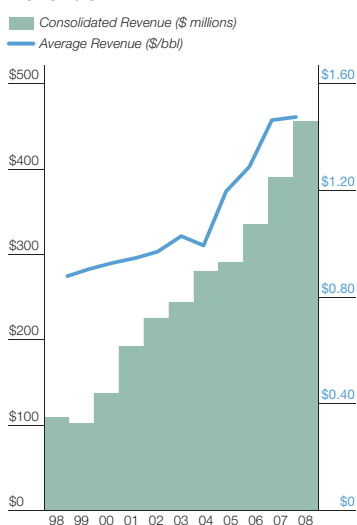
⁽¹⁾ Refer to "Non-GAAP Measures" on page 11.

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

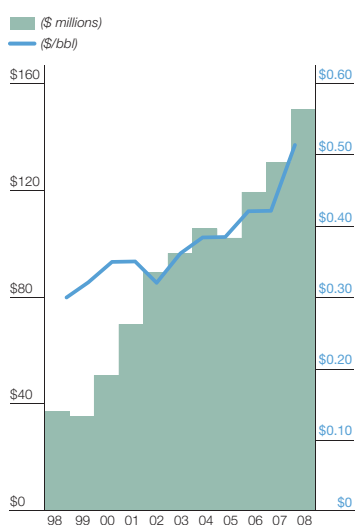
All three of Pembina's businesses contributed to strong results in 2008, generating aggregate consolidated revenue of \$453.9 million, a 16.5 percent increase from 2007 revenue of \$389.7 million. The Conventional Pipelines business generated revenue of \$263.4 million in 2008, an increase of \$14.3 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.

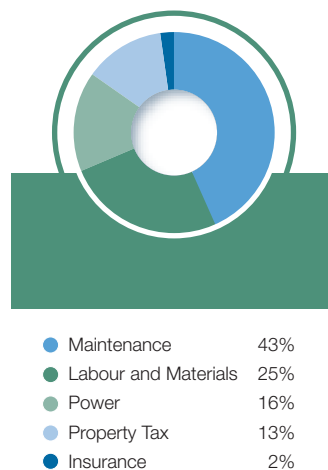
Consolidated Revenue



Operating Costs



Composition of 2008 Operating Costs



Conventional Pipelines

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

⁽¹⁾ 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.

⁽²⁾ 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 ⁽¹⁾ (mmbbls/d) | 775.0 | 525.0 |
| Revenue | \$ 85.4 | \$ 61.7 |
| Operating expenses | 28.7 | 23.7 |
| Net operating income ⁽²⁾ | 56.7 | 38.0 |
| Capital expenditures | 131.6 | 212.7 |
| Operating expenses ⁽³⁾ (\$/bbl) | 0.27 | 0.21 |
| Average revenue ⁽³⁾ (\$/bbl) | 0.79 | 0.54 |

⁽¹⁾ 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 mmbbls/d in 2008 and 310.8 mmbbls/d in 2007.

⁽²⁾ Refer to "Non-GAAP Measures" on page 11.

⁽³⁾ 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 ⁽¹⁾ | \$ 105.1 | \$ 78.9 |
| Operating expenses | 9.0 | 8.6 |
| Net operating income ⁽²⁾ | 96.1 | 70.3 |
| Capital expenditures | 42.0 | 10.5 |

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

⁽²⁾ 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 CO₂ 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.

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

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

⁽²⁾ 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 | \$ 219.9 | \$ 189.5 |
| Add/(deduct): | | |
| Employee future benefits expense | (4.3) | (4.8) |
| Employee future benefits contributions | 3.8 | 3.8 |
| Changes in non-cash working capital | (11.4) | 2.7 |
| Other | (0.8) | (2.3) |
| Distributable cash ⁽¹⁾ | 207.2 | 188.9 |
| Increase in distribution reserve | (8.4) | (10.0) |
| Distributed cash ⁽¹⁾ | \$ 198.8 | \$ 178.9 |
| Distributable cash ⁽¹⁾ (before reserve) per Trust Unit | \$ 1.55 | \$ 1.45 |
| Distributed cash per Trust Unit ⁽¹⁾ | \$ 1.49 | \$ 1.37 |
| Diluted distributed cash per Trust Unit ⁽¹⁾ | \$ 1.46 | \$ 1.33 |
| Payout ratio | 96% | 95% |

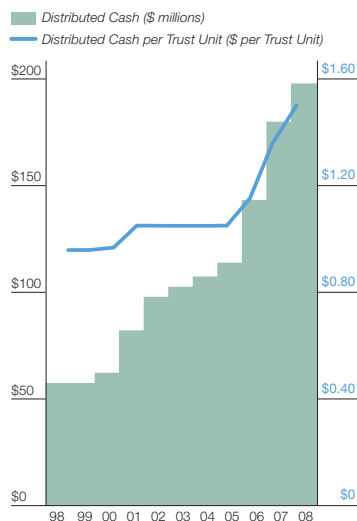
⁽¹⁾ Refer to "Non-GAAP Measures" on page 11.

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 | \$ 219.9 | \$ 189.5 | \$ 143.9 | \$ 112.4 |
| Net earnings | 161.8 | 142.3 | 88.9 | 70.4 |
| Distributed cash | 198.8 | 178.9 | 142.3 | 113.5 |
| Excess (shortfall) of cash flow from operations over distributed cash | 21.1 | 10.6 | 1.6 | (1.1) |
| Excess (shortfall) of net earnings over distributed cash | (37.0) | (36.6) | (53.4) | (43.1) |
| Cumulative notional reserve ⁽¹⁾ | \$ 39.5 | \$ 31.0 | \$ 21.0 | \$ 15.1 |

⁽¹⁾ 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 | \$ 4.6 | \$ 2.4 |
| Variable rate debt | | |
| Bank debt | 390.0 | 250.0 |
| Senior unsecured notes | 75.0 | 75.0 |
| Variable rate debt swapped to fixed | (200.0) | (60.0) |
| Total variable rate debt outstanding (average rate of 3.69%) | 265.0 | 265.0 |
| Fixed rate debt | | |
| Senior unsecured notes | 375.0 | 375.0 |
| Senior secured notes | 80.3 | 86.7 |
| Variable rate debt swapped to fixed | 200.0 | 60.0 |
| Total fixed rate debt outstanding (average rate of 5.52%) | 655.3 | 521.7 |
| Convertible debentures | 40.9 | 47.7 |
| Total debt and debentures outstanding | 961.2 | 834.4 |
| Unutilized debt capacity | 140.0 | 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 | \$ 49.4 | \$ 77.1 |
| Oil Sands & Heavy Oil Infrastructure | 131.6 | 212.7 |
| Midstream & Marketing | 42.0 | 10.5 |
| Total development capital | \$ 223.0 | \$ 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 ⁽¹⁾ | December 31, 2008 | December 31, 2007 |
|---------------------------------------------|------------------------------|-------------------|-------------------|
| Trading volume and value | | | |
| 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 |
| Market value | | | |
| Trust Units | \$ 1,840,577 | \$ 2,052,874 | \$ 2,324,769 |
| 7.35% convertible debentures ⁽²⁾ | 44,235 | 48,243 | 67,770 |
| Market capitalization | | | |
| | \$ 1,884,812 | \$ 2,101,117 | \$ 2,392,539 |
| Senior debt | | | |
| | 918,607 | 920,286 | 786,708 |
| Total enterprise value | | | |
| | \$ 2,803,419 | \$ 3,021,403 | \$ 3,179,247 |

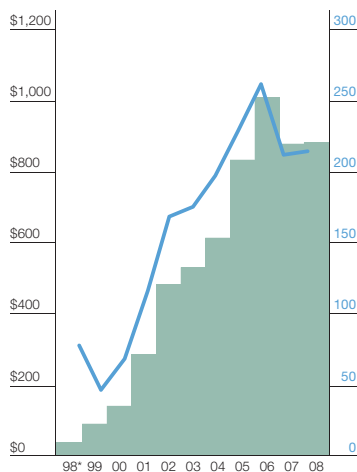
⁽¹⁾ Based on 42 trading days from January 1 to March 3, 2009 inclusive.

⁽²⁾ \$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

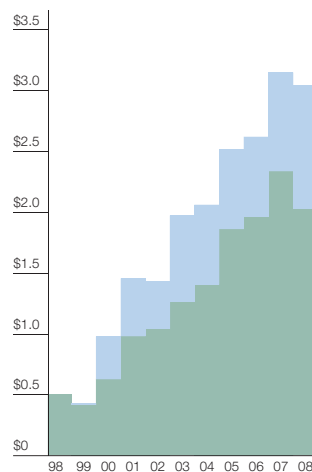
■ Annual Value Traded (\$ millions)
— Average Daily Volume (Thousands of Units)



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

⁽¹⁾ 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 and on the Fund's profile on the SEDAR website at 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.