Peyto Exploration & Development Corp.
President's Monthly Report

March 2011 — From the desk of Darren Gee, President & CEO

Warren Buffet's annual letter to shareholders is out this week and as always it's a fascinating read. He has an amazing ability to combine the sophisticated analysis that comes from successfully allocating billions of dollars of capital with commentary and metaphors that are straight off an Omaha, Nebraska front porch. In doing so, he presents the business of Berkshire in a relatively simple way that is easy to understand. I particularly liked his intrinsic value discussion where he describes the three pillars of Berkshire; their investments, their earnings and their future. Their future, or what he describes as the "what-they-will-do-with-the-money" factor, is the most intangible but possibly the greatest part of their value.

I think Peyto could be described the same way. We have our investments, or the assets we've built, our earnings or the annual cashflow and profits we're reaping from those investments, and the intellectual potential of our team, or his "what-they-will-do-with-the-money" factor. Take away the first two and, like Berkshire, our potential is still great.

As in the past, this report includes an estimate of monthly capital spending, as well as our field estimate of production for the most recent month (see Capital Investment and Production tables below).

Capital Investment

*2010/11 Capital Summary (millions$ CND)**

	Q1 '10	Q2 '10	Q3 '10	Oct	Nov	Dec	Q4	2010	Jan	Feb	Mar	Q1 '11
Land & Seismic	0	0	5	1	0	12	13	18.5	-1			
Drilling	31	18	34	19	23	15	57	140.5	15			
Completions	16	10	13	4	10	12	26	65.3	12			
Tie ins	8	4	10	3	3	3	9	30.3	2			
Facilities	2	6	5	2	2	2	6	19	3			
Drilling Credit Used	-3	-2	-4	-1	-1	2	0	-7.6	0			
Sub Total	55	37	63	28	37	45.0	111	266	29			
Rem. Drilling Credit	-5	0	2	0	0	0	-1	-4.1	0			
Total	50	37	64	28	37	45	110	262	29			

**This is an estimate based on real field data, not a forecast, and the actual numbers will vary from the estimate due to accruals and adjustments. Such variance may be material. Tables may not add due to rounding.*

Production

*2010/11 Production ('000 boe/d)**

	Q1 10	Q2 10	Q3 10	Oct	Nov	Dec	Q4 10	Jan	Feb	Mar	Q1 11
Sundance	16.5	18.5	20.1	22.9	24.4	26.4	24.6	27.1	28.1		
Kakwa	2.8	2.7	2.6	2.5	2.6	2.6	2.6	2.5	2.5		
Other	1.3	1.1	1.0	1.0	1.0	1.2	1.1	1.1	1.1		
Total	20.6	22.3	23.8	26.4	28.0	30.2	28.2	30.7	31.7		

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Comparable Evaluation Metrics

I was recently reviewing my City of Calgary property taxes. Like almost everyone else with a house in North America I was both curious and dismayed to see what the municipality thought my residence was now worth. But in the back of my mind I'm consoling myself, thinking "that can't really be what it's now worth." The true test, of course, is what similar houses around mine are selling for. And in many ways, that's the true test of any valuation. What it will sell for. Sure, I can look at replacement costs, or what it rents out for in the short term, but those are still not as good as what my neighbor's house just sold for.

The same goes for oil and gas assets. We can look at what we are currently selling reserves for on a daily basis as a valuation method. And we can look at what it costs to build new reserves as a way of measuring what they should be worth in the future. But the real measure of what those assets are worth today, is what someone will pay for them today.

Take Peyto's reserves for instance. We just announced our annual independent evaluation that shows we have 1.1 TCFe of Total Proved reserves. Total Proved reserves or 1P reserves being a pretty common measure used around the globe for quality, in the ground reserves. Total Proved includes both a developed component, Proved Producing or Proved Developed Non Producing, and an undeveloped component called Proved Undeveloped. But Proved reserves in general are deemed to have a fairly high degree of confidence (90%) of being recovered, or developed and recovered.

The reserve evaluators forecast the cashflows that will come from the Total Proved reserves and then bring them back into today's dollars by discounting the future cash streams at various discount rates. They have also estimated when, and how much, capital (FDC - Future Development Capital) needs to be invested to develop the undeveloped portion of reserves.

In Peyto's case, the Total Proved reserves and Present Values (in millions) are broken down as follows:

Peyto (as at Dec 31, 2010)	BCFe	FDC	PV5	PV10
Proved Producing	664	$ -	$ 2,363	$ 1,582
Proved Developed Non-Producing	13	$ -	$ 37	$ 18
Proved Undeveloped	401	$ 741	$ 1,004	$ 532
Total Proved	1,078	$ 741	$ 3,404	$ 2,132

So 1.1 TCFe (trillion cubic feet equivalent) is estimated to be worth somewhere between $2 and $3.4 billion, depending on the discount applied to future cashflow streams. Or somewhere between $2/mcfe and $3.15/mcfe.

How does that compare to the evaluation methods described earlier? Well, if we look at what Peyto is selling each day at current prices, the cashflow netback is around $3.65/mcfe (2010 unhedged before bonuses).

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Or, the cost to build it this past year was around $2.35/mcfe and the cost over the last few years was $2.42/mcfe.

Or, we can look at what the neighbors are selling for. There have been a couple big transactions recently where the Total Proved natural gas reserves were close to Peyto's total or greater. Encana sold off 1.0 TCFe of proved reserves in Cutbank Ridge to PetroChina for $5.4 Billion and Chesapeake Energy sold 2.4 TCFe of proved reserves in Fayetteville to BHP Billiton for $4.75 Billion.

So let's compare those metrics to Peyto's 1.1 TCFe of Proved reserves. The following table summarizes that comparison.

Seller Buyer	Encana PetroChina	Chesapeake BHP	Peyto PV(~3%)
Reserves			
Total Proved	1.0	2.4	1.1
Production (mmcfe/d)	255	415	195
NGL Yield (bbl/mmcf) estimate	<5	0	27
R/P ratio (RLI)	11	16	15
Estimated Undeveloped Lands (ac)	320,000	290,000	165,000
Facilities (mmcfe/d)	350	pipe only	250
Price ($millions)	**$ 5,400**	**$ 4,750**	**≈$4,250**
$/Proved Reserves ($/mcfe)	$ 5.40	$ 1.98	$ 3.86
$/Production ($/mcfe/d)	$ 2.12	$ 1.14	$ 2.18
$/Lands ($/ac)	$ 16,875	$ 16,379	$ 25,758

Proved reserves seem to be selling for somewhere between $2-$5/mcfe which is a pretty big spread. Likely the percentage of reserves that are developed plays a big role in the valuation, as future capital required to convert undeveloped reserves to developed reserves has to be deducted from the value.

As well, liquid yield will play a big factor with NGLs worth three times more than gas (when converted at 6:1). And of course, processing costs, whether owned and controlled or subject to 3rd party fees, will have a significant impact on value.

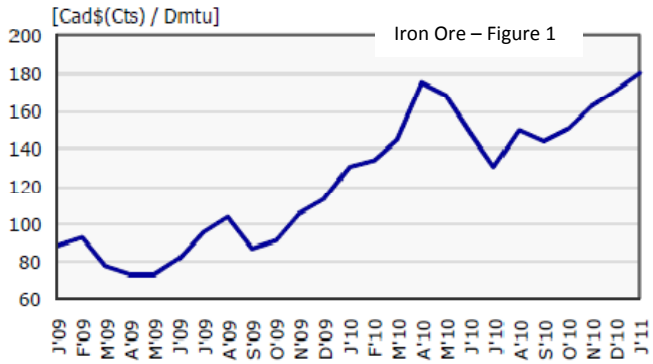
Another fly in the ointment might be changes in royalties upon payout. Many land deals are done that have a trigger when the capital is paid out, whereby overriding royalty or freehold payments can change. This isn't reflected in current production, but should be in the value of company interest reserves.

Lastly, the cost of capital of the buyer can play a big role in the valuation of an asset. From the above comparison, it would appear Asian buyers have a very low cost of capital and are therefore are valuing future cashflows at very low discount rates.

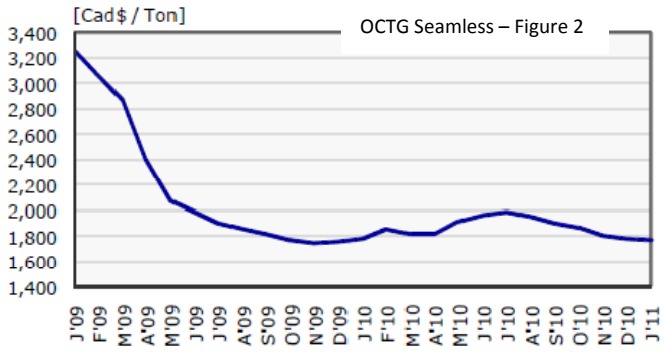
All these factors considered, one would think Peyto's reserves would fetch something closer to the Encana end of the range. But until we decide to sell them, we'll never really know for sure.

Activity Levels and Commodity Prices

Steel prices are on the move again. Driven by Chinese demand increases. Iron Ore, shown below (Figure 1) has been rising steadily (source:Tenaris).



This hasn't affected oilfield steel yet, pricipally casing, but we are likely to see it eventually (Figure 2).



The resurgence of oil sands projects and $100 oil doesn't help that pressure either. As any farmer will remind you, "make hay while the sun shines" because we know that sun isn't going to last forever. So for now, we better get busy drilling gas wells before the price of raw material rises. If the forward strip of natural gas prices is any indication of what we're going to receive, it's not going to justify an increase in the cost to build new production.