Peyto Exploration & Development Corp.
President's Monthly Report

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

The third quarter numbers are out and I believe Peyto has officially become the lowest cost producer in North America, surpassing Ultra Petroleum, in terms of total cash costs *(in truth, I think we passed them in Q1 but I wanted to be sure)*. Not including the capital to build new production, but including the royalties (production taxes), operating costs (lease operating expenses), transportation, gathering, interest and G&A, Peyto's total cash costs were a mere $1.24/mcfe in Q3, as compared to Ultra's $1.37/mcfe (see Table 1). That's less than $7.50/boe for all costs. What surprises me is that if these are the types of costs required to make gas production profitable, as Peyto and Ultra have shown, then how is it we have such an overabundance of natural gas production in North America? Because these cash costs are not the norm. In Canada, producers with 60% or greater gas weighting have an average cash cost of $2.80/mcfe.

Total Cash Costs ($/mcfe)	2008	2009	2010	Q1 '11	Q2 '11	Q3 '11
Peyto	$3.01	$1.75	$1.64	$1.36	$1.39	$1.24
Ultra	$1.88	$1.43	$1.49	$1.42	$1.48	$1.37

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

*2011 Capital Summary (millions$ CND)**

	2010	Q1 '11	Q2 '11	July	Aug	Sept	Q3 '11	Oct	Nov	Dec	Q4	2011
Land & Seismic	18.5	6	1	1	7	6	14	7				
Drilling	140.5	51	32	17	14	15	46	15				
Completions	65.3	33	18	8	10	8	26	11				
Tie ins	30.3	7	5	4	3	4	10	4				
Facilities	19	8	16	4	6	6	16	1				
Drilling Credit Used	-7.6	0	-3	0	0	0	0	0				
Total	**262**	**104**	**69**	**33**	**40**	**39**	**112**	**37**				

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)**

	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Jul	Aug	Sept	Q3 11	Oct	Nov	Dec	Q4 11
Sundance	15.9	16.5	18.5	20.1	24.6	28.0	30.2	31.2	32.1	33.8	32.3	34.5	34.9		
Kakwa	2.4	2.8	2.7	2.6	2.6	2.6	3.2	2.9	3.1	3.1	3.0	3.1	3.2		
Other	1.1	1.3	1.1	1.0	1.1	1.1	1.1	1.1	1.0	1.0	1.0	1.0	1.4		
Total	**19.4**	**20.6**	**22.3**	**23.8**	**28.2**	**31.7**	**34.4**	**35.1**	**36.2**	**37.9**	**36.4**	**38.6**	**39.5**		

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Gas to Ass Ratio

One of the things that surprises potential investors when I tell them about Peyto for the first time is how few employees we have. They are confused by how we can possibly run a $3 billion dollar market cap company with just *35 employees*. Especially considering that we are a very active operator. We operate vitrually 100% of our 40,000 boe/d and our 5, 100% owned and operated gas plants. We've also coordinated and managed the investment of over $2.1 billion in capital projects over the last dozen years which included the drilling, completion and equiping of over 800 gas wells, the installation of close to 1,000 km of pipelines, and the building of our five gas plants with over 320 MMcf/d of processing capacity.

When you compare the number of head office employees Peyto has per barrel or mcf equivalent of production, we definitely stand out. As Michael Watford of Ultra Petroleum allegedly puts it, a very high "gas per ass" ratio (Figure 1).

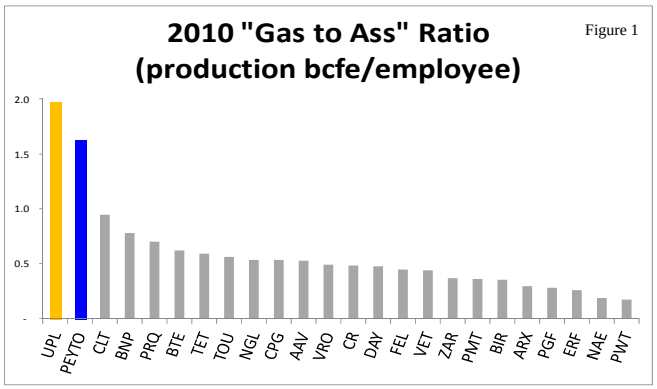

Figure 1

**Source: Company AIF and Financials*

Sure we have many contractors and service providers who "get 'er done" in the field. From those that operate our wells and gas plants on a day to day basis, to those that only work on a project by project, as needed, basis. Many of these have been loyal Peyto service providers for many years and make up part of our extended Peyto Team. We couldn't have accomplished what we have without them. But that isn't any different to how most of our peers operate.

So how do we stay so lean? Perhaps it is principally driven by our strategy of profitable growth. Which inherently implies keeping costs low (a.k.a. the profitability part). When you compare Peyto to the rest of our industry, G&A costs per boe stand out as much as our gas/ass ratio does, which makes logical sense, since G&A for a large part relates to the number of asses you have. Now, some would argue that our G&A doesn't include our cash bonuses paid at year end which are primarily derived from stock appreciation. But then, neither does someone elses G&A who has stock options (*a topic for another time*). So I think it's still a good apples to apples comparison. Figure 2 shows the G&A per boe for the same group of companies.

But that still doesn't answer how to we get so much done with so few people.

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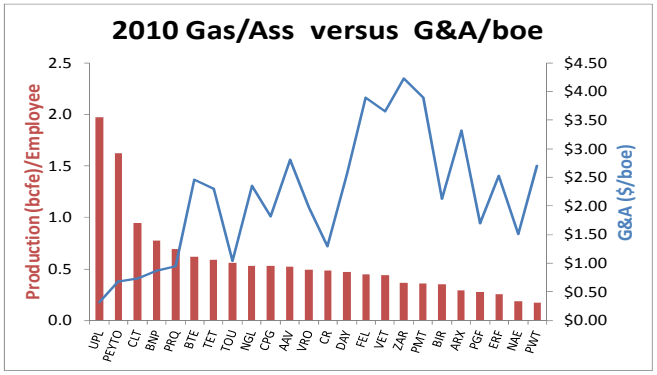
Figure 2



Source: Company AIF and Financials

One of the reasons we're so efficient with people is the high level of ownership and control. At Peyto we operate over 99% of our production. So we only spend our time looking after our own production. Unlike most of our industry that shares the job of operating, which really implies a person at each company looking after the same producing boe. And since everything we produce from today, we went out and found and developed, we don't have to spend a lot of time maintaining it.

Think of it like a new house. If you were there for the building of your house at every step, you know what's in the walls, where the plumbing goes, and the heating and the electrical. So when there is a problem, you know exactly where it originates and how to fix it quickly (and cheaply). However, if you bought your house, you don't know where any of that is, so you spend a lot of time and money hiring different contractors to find the problem and fix it. In many ways, operating producing wells isn't much different than that. Plus, our "house" is relatively new, built to today's stringent codes, so its less likely to require overhaul, renovation or major upkeep. All of those things require time and people.

It is a bit of double edged sword though, with the downside being very little reduncancy and the risk of losing key people. Using a hockey analogy, with a very short bench, it requires you to constantly keep a close eye on your farm team for new recruits that can be quickly inserted into the lineup.

For now though, I'm happy to give Mike a run for his money in the Gas per Ass category. In fact, I think by the end of 2011, we might just overtake them.

Activity Update and Commodity Prices

There was an interesting article in the news last month that flew under the radar. A press release by Mitsubishi corp. regarding two natural gas fired power plants that were approved to be installed in California. Total power capacity of 1,000 MW with the first one to be operational July 2012. These two plants are supported by 10 year power contracts. http://www.mitsubishicorp.com/jp/en/pr/archive/2011/html/0000013039.html

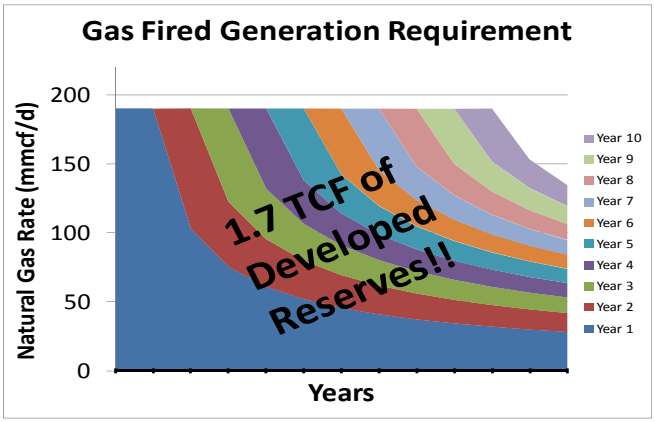
What makes them interesting to me is how quickly they are being built and their size. 1,000 MW or 1 GW of power generation is apparently equivalent to a small nuclear power plant. Good luck getting one of those built these days, and especially in such a short time.

These combined plants are not overly large considering California has some 66 GW of power generation capacity, but then again, California leads the US in natural gas fired power. But I think it speaks to the ease and speed at which natural gas demand can be created.

From a consumption perspective I'm told that a typical simple cycle plant heat rate would run around 10 GJ/MWh and would operate in base load at around 80%. So if we wanted to calculate how much gas this type of plant might consume, we'd multiply: 1,000MWh*10GJ/MWh*80% = 8,000 GJ/hr or 192,000 GJ/d.

Most gas in the North American distribution system contains a heat content of around 38 GJ/e3m3, which divided into the 192,000 GJ/d equates to about 5,100 e3m3/d of natural gas consumption or approximately 180 mmcf/d. Considering that Peyto produces some 215 mmcf/d of sales gas, that's almost equivalent to us. Multiply that daily consumption by a 10 year contract and you're talking about almost 0.7 TCF of developed reserves. The rub, of course, with this number is that the 180 mmcf/d has to be steady for 10 years. Which means the resource behind it must be much larger. If we assume typical tight or shale gas declines with super harmonic profiles, that reserve number would need to be greater than 1.7 TCF (See figure 3 to illustrate what I mean). All of a sudden these two little power plants look a lot bigger!

Figure 3



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