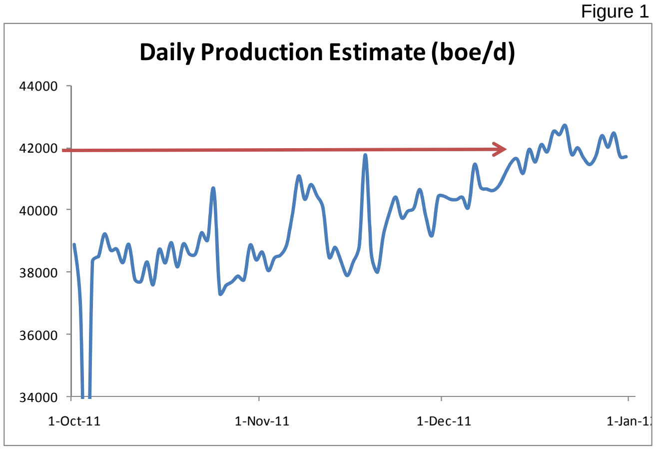
Peyto Exploration & Development Corp.
President's Monthly Report

January 2012 | From the desk of Darren Gee, President & CEO

Well, we made it! Finished off the year with a bang and topped the 42,000 boe/d mark. Congratulations to all the Peyto Team for their hard work. Oh, and a belated Happy New Year to all of you! Estimated daily production for the fourth quarter is shown in Figure 1 below. We may experience a small hiatus in growth over the Christmas/New Year break, but then should see resumption in growth as we get back to work in earnest on next year's program.

Figure 1



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	0			
Drilling	140.5	51	32	17	14	15	46	15	19			
Completions	65.3	33	18	8	10	8	26	11	9			
Tie ins	30.3	7	5	4	3	4	10	4	2			
Facilities	19	8	16	4	6	6	16	1	1			
Drilling Credit Used	-7.6	0	-3	0	0	0	0	0	0			
Total	**262**	**104**	**69**	**33**	**40**	**39**	**112**	**37**	**31**			

****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

*2011 Production ('000 boe/d)**

	Q1 11	Q2 11	Jul	Aug	Sept	Q3 11	Oct	Nov	Dec	Q4 11
Sundance	28.0	30.2	31.2	32.1	33.8	32.3	34.5	34.9	35.9	35.1
Kakwa	2.6	3.2	2.9	3.1	3.1	3.0	3.1	3.2	3.9	3.4
Other	1.1	1.1	1.1	1.0	1.0	1.0	1.0	1.4	1.5	1.3
Total	**31.7**	**34.4**	**35.1**	**36.2**	**37.9**	**36.4**	**38.6**	**39.5**	**41.3**	**39.8**

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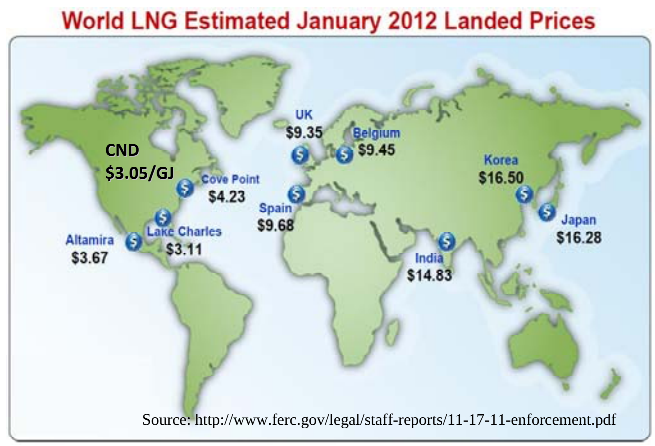
A Little Off the Top

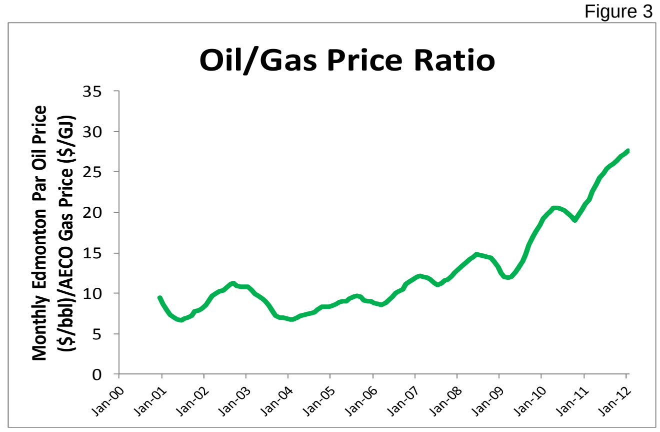
It's a grim reality, but natural gas prices are in the toilet. At least here in North America anyway. Sure, elsewhere in the world they are paying a pretty penny for natural gas (in the form of landed LNG). But here, where we have too much supply, not enough domestic demand, and no export capacity the price of natural gas is just 1/5th that of SE Asia. Figure 2 shows the January 2012 prices around the globe (USD$/MMBTU).

Figure 2



As well, in comparision to oil, North American natural gas prices are only a fraction what they should be. Figure 3 is the oil to natural gas price ratio that, by theoretical heat content, should be 6:1 (ie. 6 mcf of gas is equal to 1 bbl of oil), but has recently risen to as high as 30:1. Which is why, at least here, it is only oil or associated natural gas liquids that are justifying much domestic drilling.

Figure 3



I suppose its fortunate then, that all of Peyto's Deep Basin production is liquids rich so that for the time being, until natural gas prices recover, we continue to generate a healthy amount of revenue from our production stream.

This price difference is the principal driver behind all the talk of deep cut gas processing facilities. For those less familiar, a "deep cut" or "deeper cut" facility is one that extracts more of the heavier hydrocarbons from the gas stream to sell as liquids rather than as additional heat content in gas form.

Using a haircut analogy with respect to this liquids extraction, you can either get a trim, cut it short, or (in my, folically challenged, case) "take it to the wood." For each level of liquids extraction, there are varying cost/price benefit scenarios which, depending on the current and expected future price of natural gas and liquids, helps determine where the optimal returns might be.

For instance, Peyto's Oldman gas plant (in Sundance) has a refrigeration process that currently cools the gas stream to around -35 C which causes some of the Propane (**C3**H8), about half of the Butane/isobutane (**C4**), and most of the Pentanes (**C5**) and Condensates (**C5+**) to condense and drop out of the raw gas stream. This leaves a much less volatile natural gas that you can safely burn in your furnace (without blowing up your house), and allows us to stabilize and sell the liquids for a better price.

Theoretically, we could cool the gas much further ("take it to the wood") in order to knock out all of the heavier hydrocarbons, leaving only pure Methane as gas (**C1**H4). In order to get it all, you would need to cool the gas well below -100 C which typically requires a more sophisticated cryogenic process. These types of plants are both expensive to build and expensive to run, which means you are constantly doing an economic analysis of natural gas prices, liquids prices and operating costs to determine if you should or should not bother extracting the extra liquids.

Our proposed enhanced liquids extraction project at Oldman, for example, is more of a military haircut since we plan on reducing the temperature of the gas stream to around -80C in order to extract all of the propane and all heavier hydrocarbons from the raw gas. Table 1 shows the comparison of liquids extraction at varying temperatures. You can see that by cooling the gas further we can recovery approximately 15 bbl/mmcf more from the raw gas stream. The gas stream, however, shrinks a little more and has less residual heat content, so therefore, garners a slightly lower price.

You can also see that the recovery increase, on a percentage basis, for the different formations is actually more significant for the deeper and leaner streams because they had less of the heavier hydrocarbons to start with.

This extra extraction process does have slightly higher operating costs and comes only after significant capital investment. With an expected payout of under 2 years, the liquid to gas price difference doesn't have to exist for long to justify the project.

Table 1

	Current Refrigeration Process	Future Refrigeration Process	Theoretical Recovery
Process Temperature	-35C	-80C	< -100C
Gas Shrinkage	94.7%	92.6%	85.2%
Gas Heat Content (GJ/e3m3)	40.6	38.5	33.4
Liquid Recovery (bbls/mmcf sales)			
C2 (Ethane)	0.5	0.5	53.4
C3 (Propane)	4.0	15.0	18.2
C4 (Butane/IsoButane	4.4	7.9	8.6
C5+ (Pentanes plus)	12.4	13.4	14.5
Total	21.3	36.8	94.7
Liquid Recovery by Fm. (bbl/mmcf sales)			
Cardium	44	72	138
Notikewin	13	23	73
Falher	18	31	93
Wilrich	6	12	69
Cadomin	9	14	46

What this analysis really illustrates is the potential value in liquids rich natural gas. But we need to remember that there is an optimum point between capital investment and increased operating costs, and the price benefit of these hydrocarbons in liquid form.

Activity Update and Commodity Prices

Henry Hub natural gas prices have averaged just $3.23/MMBTU since the start of November. This is not a price that will sustain much drilling over the winter. Look for rigs and perhaps even production to be shut down which should give us a price boost.

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