Peyto Exploration & Development Corp.
President's Monthly Report

May 2012 — From the desk of Darren Gee, President & CEO

I'm happy to say that the ski season out West has finally come to a close. Good thing too, since the liners in my ski boots are so packed out I'm sloshing around. Tightening down the buckles is the only way to solve the problem and prevent the soft snow from breaking a leg. At Peyto we're also going through our own buckle tightening exercise too. And even for us, as one of the lowest cost natural gas producers in the industry, it's still a necessary exercise with the current natural gas prices where they are. With AECO daily gas price around $1.50/GJ, tightening the buckles is the only thing you can do in the short term to make a difference. Drilling more liquids rich wells and installing deeper cut processing facilities to extract more liquids will eventually help but it all takes time, even for us. Thankfully, we're already starting from a low cost point with additional liquids revenues. If the largest dry gas producer in Canada is a proxy for the industry, you'll see, in the table below, how close the industry is to just covering its dry gas field costs with today's price.

Natural Gas	Encana Q1 2012 Canada	USA
Daily Production Volume mmcf/d (net of royalties)	1,493	1,779
AECO/NYMEX Q1 Monthly Average ($/GJ or $/MMBTU)	$ 2.39	$ 2.74
Unhedged Realized Price ($/mcf)	$ **2.56**	$ **3.00**
Production Costs ($/mcf)	$ **1.64**	$ **1.76**
Prod/Min Taxes	$ 0.01	$ 0.08
Tansport/Processing	$ 0.97	$ 1.07
Operating	$ 0.68	$ 0.61
AECO May 2012 Monthly ($/GJ)	$ 1.47	$ 1.95
Est. Unhedged Realized Price ($/mcf)	$ **1.57**	$ **2.14**

Source: Company financials

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

2011/12 Capital Summary (millions$ CND)*

	2010	Q1	Q2	Q3	Oct	Nov	Dec	Q4	2011	Jan	Feb	Mar	Q1 '12
Land & Seismic	18.5	6	1	14	6	0	1	7	28	2	0	0	3
Drilling	140.5	51	32	46	15	19	15	49	178	20	19	13	52
Completions	65.3	33	18	26	11	9	8	28	104	10	11	11	31
Tie ins	30.3	7	5	10	4	2	5	10	32	2	4	3	8
Facilities	19	8	16	16	0	0	0	0	40	1	3	1	4
Drilling Credit Used	-7.6	0	-3	0	0	0	0	0	-3	0	0	0	0
Total	***262***	***104***	***69***	***112***	***35***	***30***	***29***	***95***	***379***	***35***	***36***	***28***	***99***

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

2011/2012 Production ('000 boe/d)*

	Q1 11	Q2 11	Q3 11	Q4 11	Jan	Feb	Mar	Q1 12	Apr	May	June	Q2 12
Sundance	28.0	30.2	32.3	35.1	35.7	35.7	34.8	35.4	34.6			
Kakwa	2.6	3.2	3.0	3.4	3.6	3.7	4.0	3.8	4.4			
Other	1.1	1.1	1.0	1.3	1.7	1.8	2.5	2.0	2.7			
Total	***31.7***	***34.4***	***36.4***	***39.8***	***41.0***	***41.2***	***41.3***	***41.2***	***41.7***	-	-	-

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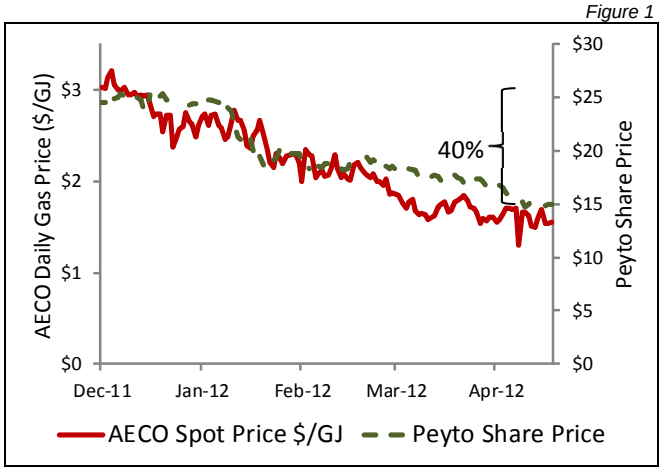
The Value of Time

How much has the recent gas price really affected Peyto's total Net Asset Value? If the market is any indication, it has dropped it by 40%. Which is exactly the same amount the AECO spot gas price has dropped (see correlation in Figure 1). This assumes, of course, that Peyto's market value is a reflection of its net asset value, which is supposed to be the case.

Figure 1



But is that reasonable? Has the total value of our asset base really dropped that much? Even if we assume that gas prices stay depressed for all of 2012 due to the current overhang of storage and it takes until 2013 with reduced rig counts, shut-ins of high cost production, lack of LNG imports (due to prices elsewhere that are 10 times what they are in North America), and it's 2014 before gas prices return to "normal", that still only represents a very small amount of time in the timeline of Peyto's reserve NAV.

And by return to "normal" I mean $3 AECO and $4 NYMEX, since fundamentally nothing has really changed in the gas world. We still have shale gas plays, we still have horizontal multi-stage-fracking drilling technology and we still *don't have* LNG exports. At least, that's my thinking, anyway.

But on the timeline of the independent assesment of Peyto's current and future reserves and cashflows, the next two years is only a small percentage. That's one of the advantages of having such a long reserve life asset (and conversely the disadvantage of having a short reserve life). If we look at the reserve evaluator's forecast of volumes to be recovered from our Proven plus Probable reserves over the next 10 years, we see that 2012 and even 2013 only represent 11% of the total (Figure 2).

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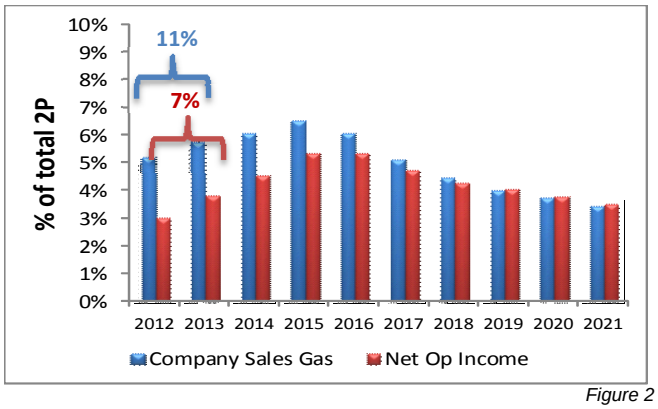
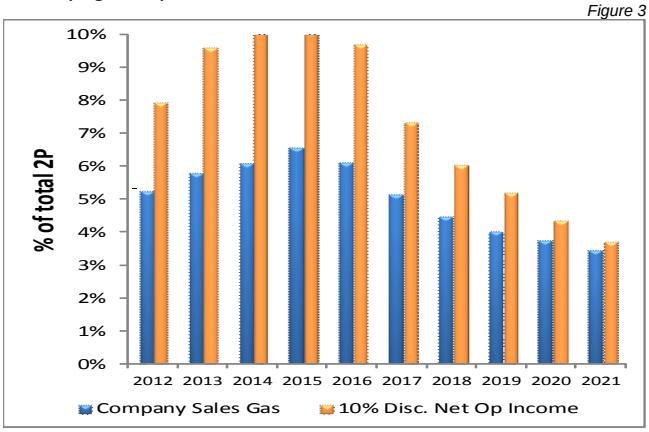


Figure 2

Looking at the forecast of cashflow at the field level (or Net Operating Income "NOI", which is revenue less royalties, opex, and transportation), the answer is similar, only 7% of the total. Of course, I realize the 2011 year end engineering price decks are higher than today's spot prices, but when things return to "normal", ie we return to normal levels of natural gas in storage, those price assumptions become much more reasonable. For instance the 2014 price forecast by Insite called for AECO gas of $3.94/GJ (2% inflation adjusted back to today) and Edm light oil price of $96/bbl. That seems reasonable considering the prices we just came from in 2011 of $3.45/GJ and $95/bbl.

Ah, but you're all saying to yourselves what about the value of ***time*** in this analysis? And rightfully so, cashflow (NOI) this year is worth much more than cashflow ten years from now. That's true, but with interest rates and cost of capital so low, discounting future cashflows should also be at low levels. We believe 5% is the right level, but for this analysis let's be ultra conservative and use 10%. If we discount all future cashflows at 10%, the next couple of years of discounted cashflow still only represent 17% of the total NPV of $3.3 billion (Figure 3).

Figure 3

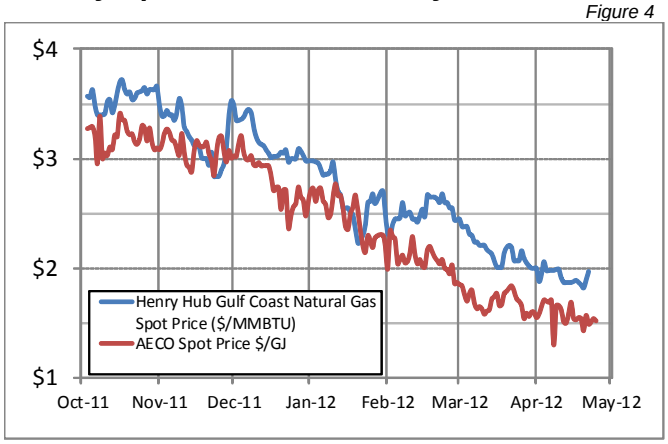


And its not like we're making ***no*** money in the next couple of years. Peyto has ultra low costs, so we still make significant cashflow, even when gas is at $1/GJ (the same cannot be said of higher cost production). So the 17% will likely be something much less. And definitely not the 40% that is currently reflected.

It's understandable that when commodity prices move dramatically, the market can tend to move "en masse" but one needs to remember the inherent benefits of long life and low cost reserves and production. It is one of the main reasons we've spent our entire history focused on only that type of asset base. Because commodity price is the one thing we just can't control in this business.

Activity Update and Commodity Prices

Figure 4



It appears the AECO (CND) and Henry Hub (US) natural gas prices have found a floor, at least for now, at $1.50 and $2 (Figure 4). As I have mentioned before, the real effect of these prices won't be felt until companies see them in their financials, which is 60 days from now. I'm sure the gas traders have realized we've crossed over many companies' field costs and that this gas price will drive substantial shut ins or a "supply response".

As expected the service companies are anticipating a significant slowdown after breakup and are starting to offer "Summer Specials" for those willing to put their capital to work. But only certain services will be so eager to negotiate. Some, that can transition over to the light oil or the oil sands side of the business will likely just move. Truckers, pipe suppliers, welders, etc. will prefer to charge the oil guys the current rate, because they can still afford it, rather than offer discounts to the gassy guys.

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