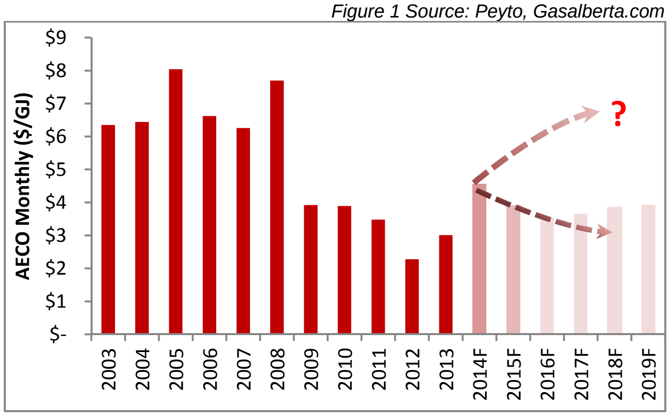
Peyto Exploration & Development Corp.
President's Monthly Report

March 2014 | From the desk of Darren Gee, President & CEO

They say predictability breeds boredom and volatility breeds opportunity. The problem is I like predictable, and boring, especially when it comes to making money. Over the last several years, we've had predictably low natural gas prices and in that environment we've been able to make consistent and successful investments in the development of natural gas. Now, with the winter we're having and the gas demand we are seeing, there is new uncertainty about where gas prices are going. The current strip for natural gas is calling for a near term rise, but then reverts back to low gas prices as the market appears unwilling to accept this new price level for the long term. Only, I'm not so sure. Call me an old codger but it feels like the winds of change.

Figure 1 Source: Peyto, Gasalberta.com



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*

*2012/13 Capital Summary (millions$ CND)**

	Q1	Q2	Q3	Q4	2012	Q1	Q2	Q3	Oct	Nov	Dec	Q4	2013	Jan
ONR Acq./other acq.			205	-21	184	0	0	0				0	0.0	
Land & Seismic	3	1	2	6	12	2	6	3	1	1	0	2	11.9	6
Drilling	52	23	59	78	211	76	32	86	22	24	14	60	253.0	24
Completions	31	14	35	47	127	41	10	54	15	18	15	47	151.7	11
Tie ins	8	5	11	22	46	15	7	14	5	4	3	12	48.2	7
Facilities	4	3	6	25	37	36	18	24	19	10	5	34	112.2	18
Total	**99**	**46**	**317**	**157**	**618**	**169**	**74**	**181**	**61**	**57**	**36**	**155**	**578**	**65**

Production*

*2012/13/14 Production ('000 boe/d)**

	Q3 12	Q4 12	2012	Q1 13	Q2 13	Q3 13	Oct	Nov	Dec	Q4 13	2013	Jan	Feb
Sundance	35.7	36.0	**35.4**	39.7	41.6	41.5	43.7	48.1	50.3	47.4	**42.6**	48.3	50.1
Kakwa	3.6	3.1	**3.7**	3.3	3.0	2.6	2.6	2.5	2.4	2.5	**2.9**	2.4	2.5
Ansell	2.9	6.8	**2.4**	8.8	10.7	9.9	11.7	14.6	15.4	13.9	**10.8**	16.1	15.8
Other	3.6	3.6	**3.0**	3.3	2.9	2.4	2.3	4.0	4.5	3.6	**3.1**	4.9	4.9
Total	**45.9**	**49.5**	**44.5**	**55.2**	**58.2**	**56.5**	**60.3**	**69.2**	**72.6**	**67.3**	**59.3**	**71.7**	**73.3**

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.

Reserves Report Card

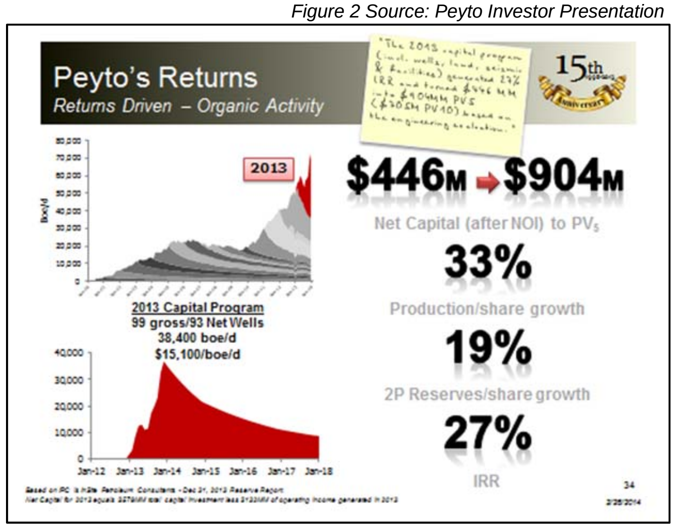
The reserves report card on our 2013 capital program is in and it confirms we had another successful year for Peyto. Just like in high school, though, every year seems to be a little tougher, which means we have to be a little bit better, study a little bit harder, in order to get the same grade.

Unlike most of the kids in our class that are quick to toss you their reserves report card and dash for their rooms hoping you won't notice, we want to sit down and go through it with you so you can understand what it means. Because at this level, the science and the math are not always so straightforward.

For starters, we invested a lot of shareholder's capital last year. The most ever into well related operations and new facilities. So it's important that shareholders (of which I am a large one) know what they got for all that capital. Of course, not all the investments panned out as we had planned. Operational problems meant some came in over budget. Some came in under budget too, as we drew from our experience in order to get things done faster and cheaper than budgeted. But in aggregate we were very satisfied with the overall results.

For the $578 million of total capital that was invested, Peyto drilled 99 gross wells, whose production peaked at the end of the year at 38,400 boe/d. The ratio of capital to production, or what I often refer to as capital efficiency, was $15,100/boe/d. While that is our best ever ratio, we did add a lot of new production in the last two months that grew production well beyond our 71,000 boe/d exit target to 75,000 boe/d, making for an even better year-end ratio. This ratio doesn't tell us much about profitability though, so we need to look deeper.

Figure 2 Source: Peyto Investor Presentation



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Averaged over the year, that 38,400 boe/d exit was actually closer to 16,000 boe/d and generated some $132 million in operating income during the year. By the end of the year then, we were out of pocket around $446 million.

The independent engineers assessed those wells and are predicting they will recover another $1.32 billion over their remaining lives. If we bring that back into today's dollars, at a 5% discount rate or cost of capital, it's worth $904 million. At 10% discount rate, $705 million. Or at a 27% discount rate, exactly $446 million, implying a 27% internal rate of return. Not too bad and very comparable with the last couple of years.

That's the bottoms up analysis, looking at just the wells that make up the 99. But we have to be bit careful just looking at it that way. Sure, our Science and Math marks were very good in isolation, but what about the other grades? How does the entire report card look and what was the total GPA? There are other things beyond the 99 wells that can increase (or decrease) the value of the whole. Things like hedging, liquid recoveries, op cost initiatives, transportation increases, facility investments and many more.

So a top down approach that isolates the value change from year to year and compares that to the capital expenditure is also helpful. First, if we can eliminate value change due to commodity price changes then we can isolate the value the Peyto Team affected. So last year's reserve report, run at this year's prices gives us a starting point. Then when we compare the debt adjusted values of the producing reserves, year over year, at various discount rates, so we can see how that stacks up with the bottoms up analysis (see table 1).

Table 1

Producing Reserves, debt adjusted BT NPV @ discount	**5%**	**10%**	**20%**
Price Adjusted Dec 31, 2012	$2,477	$1,516	$727
Dec 31, 2013	$2,891	$1,779	$843
difference	$414	$263	$116
Add back 2013 NOI	$474	$474	$474
Value Created	$888	$737	$590

Doing it this way shows a slightly lower return than that associated with just the 99 wells above, 21% versus the 27% IRR. A change in liquid recoveries, hedges that are now out of the money and increases in transportation costs are the primary reasons for the difference. And those aren't necessarily associated with the 99 new drills. Overall though, there was still significant total value created with the annual capital program, which is the question we're really trying to answer.

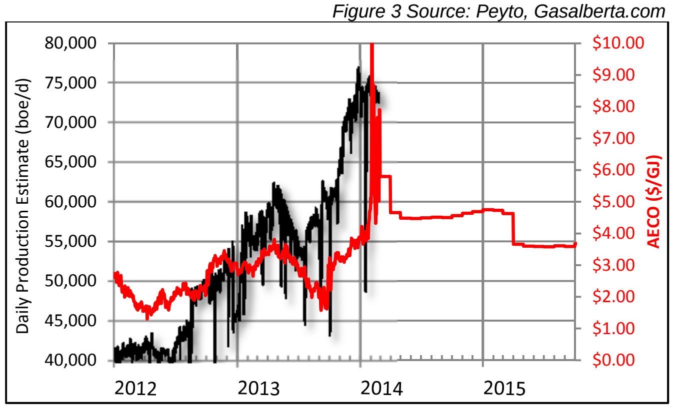
That question is an important one. Should shareholders allow management to continue to invest their capital? If the management team cannot demonstrate why they should, then that capital should not be approved for reinvestment. And a handful of big wells, with impressive economics, doesn't mean that the entire report card is good.

In canvassing the industry, I find very few companies (besides Peyto) that endeavour to answer that question for their shareholders. Most assume they are entitled to continue spending shareholder money even if they have been destroying value. Kinda like parents who are okay with a child graduating to the next grade even with a failing report card. Sooner or later it all catches up.

Activity Levels and Commodity Prices

Figure 2 shows Peyto's daily production estimates with the historical AECO daily gas price and current futures prices. It is amazing how quickly prices have shot up relative to last fall but also how the forward curve steps down in the spring of 2015. The belief that low storage levels will be rectified by increased volumes, or constructive weather, continues to weigh on the price in the outer years.

Figure 3 Source: Peyto, Gasalberta.com



For now, at least, rig activity has not responded to this recent run up in gas prices. Good thing. I don't want the competition.

Figure 4 Source: Altacorp