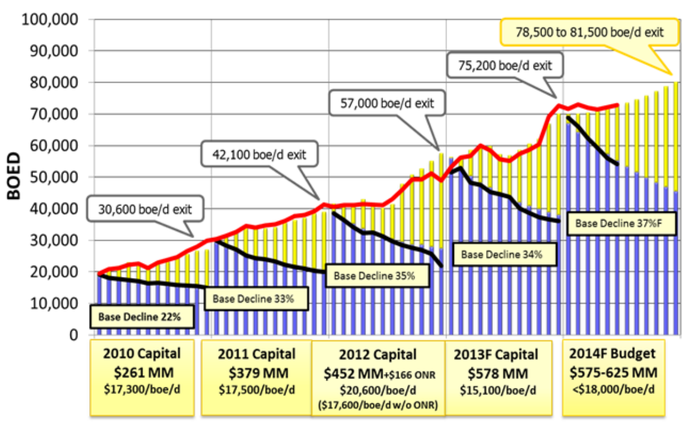
Peyto Exploration & Development Corp.
President's Monthly Report

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

On Friday July 4, "The Greatest Outdoor Show On Earth!" – The Calgary Stampede kicks off here in town. In addition to hundreds of thousands of tourists that will visit the grounds, there are investors from around the globe here to see what our oil and gas industry has to offer. As a general comment, I would say our industry is feeling more robust this year compared to the past few. Both oil and natural gas prices are strong and there are numerous opportunities in Western Canada to put capital to work. At Peyto, our profitable growth is on track (Figure 1) with 9 rigs drilling in our core Deep Basin areas.

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*

*2013/14 Capital Summary (millions$ CND)**

	2012	Q1	Q2	Q3	Q4	2013	Jan	Feb	Mar	Q1	Apr	May
ONR Acq./other acq.	184	0	0	0	0	0.0				0		
Land & Seismic	12	2	6	3	2	11.9	6	0	1	7	1	0
Drilling	211	76	32	86	60	253.0	24	27	30	80	22	22
Completions	127	41	10	54	47	151.7	11	11	14	36	16	14
Tie ins	46	15	7	14	12	48.2	7	5	5	16	4	3
Facilities	37	36	18	24	34	112.2	18	11	12	40	6	4
Total	**618**	**169**	**74**	**181**	**155**	**578**	**65**	**53**	**62**	**179**	**49**	**43**

Production*

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

	Q1 13	Q2 13	Q3 13	Q4 13	2013	Jan	Feb	Mar	Q1 14	Apr	May	June	Q2 14
Sundance	39.7	41.6	41.5	47.4	42.6	48.3	50.1	49.7	49.3	50.4	51.0	52.4	51.3
Kakwa	3.3	3.0	2.6	2.5	2.9	2.4	2.5	2.4	2.4	2.5	2.4	2.4	2.4
Ansell	8.8	10.7	9.9	13.9	10.8	16.1	15.8	15.3	15.7	14.3	14.8	14.0	14.4
Other	3.3	2.9	2.4	3.6	3.1	4.9	4.9	4.6	4.8	4.2	3.9	4.0	4.0
Total	**55.2**	**58.2**	**56.5**	**67.3**	**59.3**	**71.7**	**73.3**	**72.0**	**72.3**	**71.4**	**72.1**	**72.8**	**72.1**

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.

Ramblings of a Cynic

Call me a raving cynic, but one of the main reasons I believe we are oversupplied with natural gas in North America is because we have, as a producing industry, too much access to an abundance of cheap capital. When you combine that cheap capital with a technology that allows for rapid production development (ie. Hz multi-stage frac), you can oversupply the natural gas market in a hurry. This oversupply is magnified when those supplying the capital aren't demanding any return on it.

You would think that a situation like that wouldn't persist for long, as investors see that, despite the rapid growth, there are no profits being generated with *their* capital and therefore no real returns for them. But this oversupplied situation has persisted for several years now and doesn't show any signs of letting up.

I have used my monthly reports as a platform to discuss, ad nauseam, why we at Peyto believe profitability is more important than growth. And that growth without profitability is meaningless. But the message seems to fall on deaf ears. The market continues to focus on and reward those companies that put up the growth, regardless of any demonstrated profitability.

Perhaps it's hard for investors to measure real, profitable growth? Gawd knows, IFRS (International Financial Reporting Standards) hasn't helped the situation. Now, with companies able to use a large portion of undeveloped reserves in their determination of depletion, real cash earnings have become much harder to discern. That's because the largest deduction from cashflow to get to earnings is depletion, or the cost to replace producing reserves. And with most company's 1P and 2P reserves so heavily weighted with undeveloped reserves, their forecast cost to replace the producing reserves is much less of a real number, with a lot of estimating and very little risking of future results (especially capital costs).

That's why I've gone to replacing depletion in my measure of "profit" with Proved Developed Producing Finding, Development & Acquisition cost (PDP FD&A). At least this metric is an actual dollar spent divided by a producing reserve number. Which means far less unknowns, especially with respect to what wells cost, because the capital has been spent and the result is known. And sure, you have to look at that number over time because sometimes there is capital invested today (facilities, land, etc.) for tomorrow's reserves. But at least you know what's been spent and where.

I guess the tough part for an investor is that most companies don't report their PDP FD&A number in their annual disclosure. So you have to do it yourself or rely on

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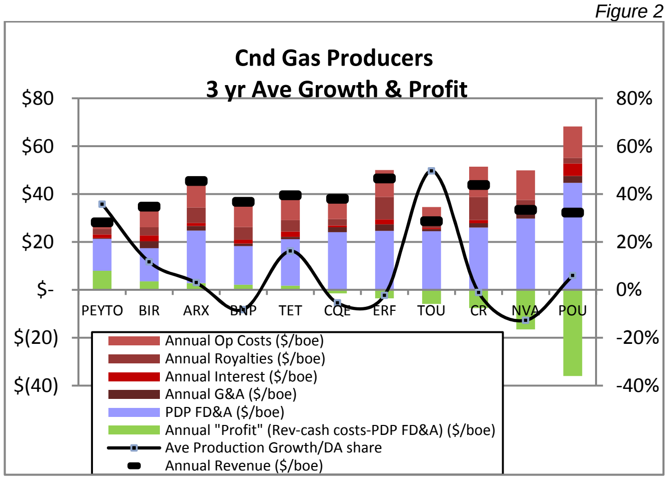
independent research to find it. For instance, First Energy Capital's research includes PDP FD&A in their analysis.

If we look across the gas producers group in Canada for this profitability, we see it's pretty hard to come by - and doesn't necessarily correlate to growth. Figures 2&3 show the average of PDP FD&A, Cash Costs and what's left over from revenue as "profit", in comparison to production per debt adjusted share growth, over the last 3 years. As you can see, some producers can generate profit and some can generate growth, but rarely can they do both, especially over the the longer term.

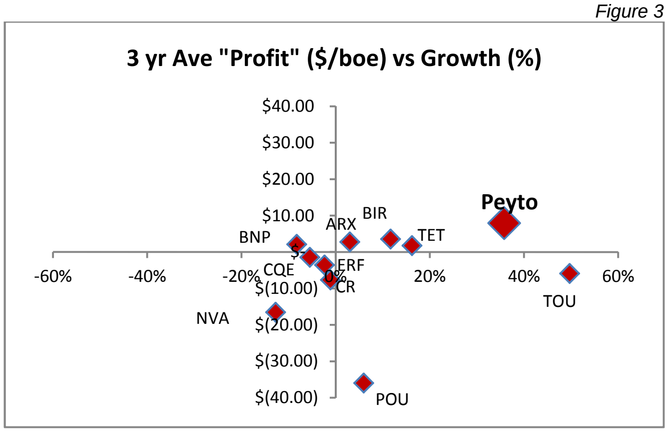
Figure 2



Source: Peyto, FirstEnergy Capital

Extending this analysis to US shale plays and US producers in those plays, the results are very similar, as I've shown in past reports (Nov 2013).

Figure 3



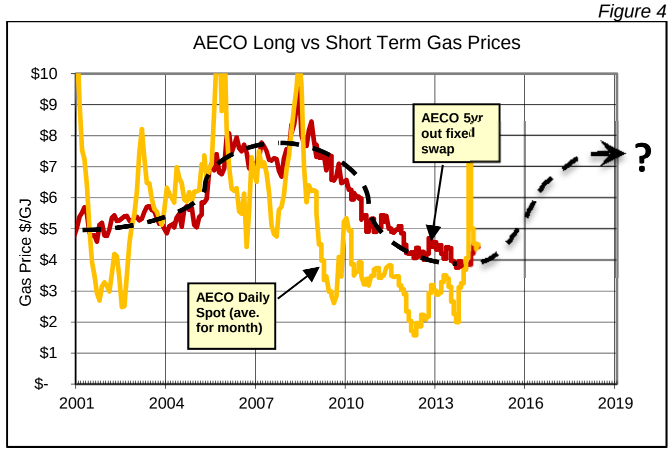
Source: Peyto, FirstEnergy Capital

It appears to me that growth seems to be easier to generate than profitability. Or maybe, because it's rewarded more readily, that's what producers tend to focus on. Perhaps, it should be profitability that is rewarded before growth. If it was, you might also see more independent research with greater focus on who's making money versus who's growing.

Because at the end of the day, all that growth really gets you is bigger. And generally, bigger is not more efficient nor is it more profitable. It's usually less. What investor wants that?

Activity Levels and Commodity Prices

Figure 4



Source: Peyto

I find it very interesting that for the first time in six years we are seeing the short term price of natural gas in Alberta above the long term price (see Figure 4). It could be that we are finally starting to climb back out of this part of the price cycle, much like we did back in 2003.

Of course, there have been many changes in the natural gas world over the last decade (technology, shale gas, LNG), but could it be that the length of the long dated price cycle is around ten years? Looking out to the future, there are many reasons we could see natural gas prices climbing over the next 5 years, all of them with respect to increasing demand:

- Increased, permanent displacement of North American coal by natural gas for power generation.
- Increased use of natural gas as fuel in oil sands recovery.
- Exports of North American natural gas to the rest of the world.
- Possible displacement of oil and other transportation fuels with natural gas.

Still, I would expect that we should have several years left to benefit from Peyto's counter-cyclical strategy and build out our asset base at the most optimal time in the cycle.