Peyto Exploration & Development Corp.
President's Monthly Report

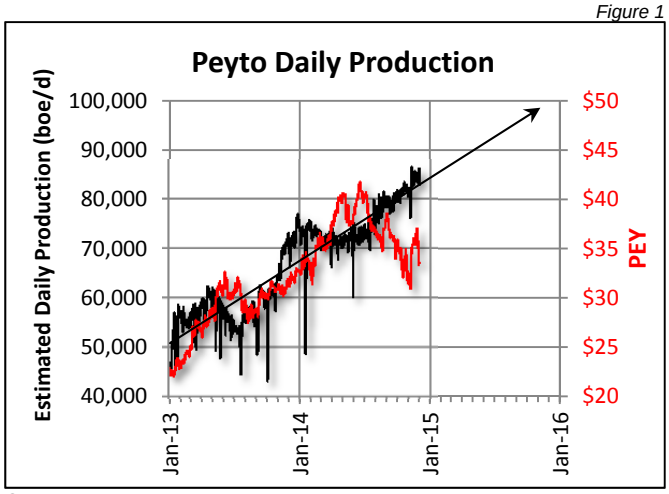
December 2014 — From the desk of Darren Gee, President & CEO

Okay, imagine a thick Scottish accent (Sean Connery style).

"A double in three years, you say?
Seems rather preposterous to me!"

And yet, that seems to be exactly where we are headed - from approximately 50,000 boe/d at the start of 2013, to 100,000 boe/d by the end of 2015. Unbelievable! I just hope the market can keep up with such dramatic and profitable growth. It seemed to be doing alright for the first year and a half (see Figure 1), but lately seems to have forgotten what we're up to here at Peyto. "Ah well, there's always time, I suppose."

Figure 1



Source: Peyto, TMX

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)**

	Q3	Q4	2013	Q1	Apr	May	Jun	Q2	Jul	Aug	Sep	Q3	Oct
Land & Seismic	3	2	11.9	7	1	0	7	8	0	0	0	0	4
Drilling	86	60	253.0	80	22	22	24	68	28	30	24	83	28
Completions	54	47	151.7	36	16	14	18	48	17	14	15	46	20
Tie ins	14	12	48.2	16	4	3	3	10	3	4	4	11	7
Facilities	24	34	112.2	40	6	4	7	16	11	16	13	40	14
Total	**181**	**155**	**578**	**179**	**49**	**43**	**60**	**151**	**60**	**63**	**57**	**180**	**73**

Production*

*2013/14 Production ('000 boe/d)**

	Q4 13	2013	Q1 14	Q2 14	Jul	Aug	Sept	Q3 13	Oct	Nov
Sundance	47.4	**42.6**	49.3	51.6	55.1	58.0	58.3	57.1	59.6	61.0
Kakwa	2.5	**2.9**	2.4	2.4	2.3	2.4	2.4	2.4	2.4	2.4
Ansell	13.9	**10.8**	15.7	14.2	13.2	14.5	15.3	14.3	15.7	16.0
Other	3.6	**3.1**	4.8	3.9	3.5	3.7	4.0	3.7	4.0	4.1
Total	**67.3**	**59.3**	**72.3**	**72.1**	**74.1**	**78.6**	**80.0**	**77.5**	**81.7**	**83.5**

***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.**

The Cost Advantage

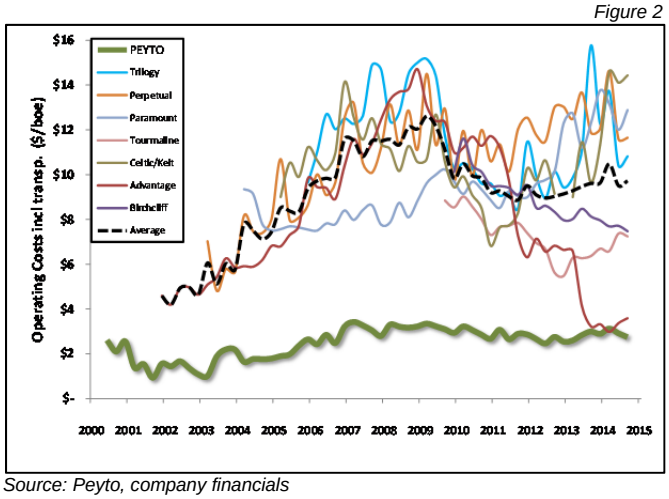
For much of our existence, Peyto has been renowned as the lowest cost producer in Canada. And not just in one particular cost category. Our building costs (FD&A) are consistently some of the lowest each year, and our total cash costs including royalties, op costs, transportation, G&A and interest tend to set the bar for the industry as well.

Some of these cash costs are actually out of our control. Things like royalty and interest rates, for example, are set by someone else, making them harder for us to influence. Of course, we can still choose to develop resources using horizontal wells in deeper parts of the basin that are subject to incentives and lower royalties, and we can decide how much debt we want to use and who to borrow it from, but for the most part we are *subject to* these costs as opposed to *in control* of them.

The two pieces of cash costs we can directly control are operating costs inclusive of transportation and G&A costs. I'll leave the G&A discussion for another time and instead focus this month on op costs.

Operating costs are typically those expenses incurred with respect to the day to day well and facility related operations. And much of what drives operating costs, falls into the WHAT, WHERE, and HOW categories. In other words, they are result of choices a company has made on *what* type of asset they develop, *where* they choose to develop it and *how* they produce it.

Figure 2



Source: Peyto, company financials

Generally speaking, natural gas has lower lifting costs than oil, so one should expect that Peyto, as a pure natural gas (and NGL) producer, would have lower operating costs than an oil company. But Peyto's costs are much lower than even

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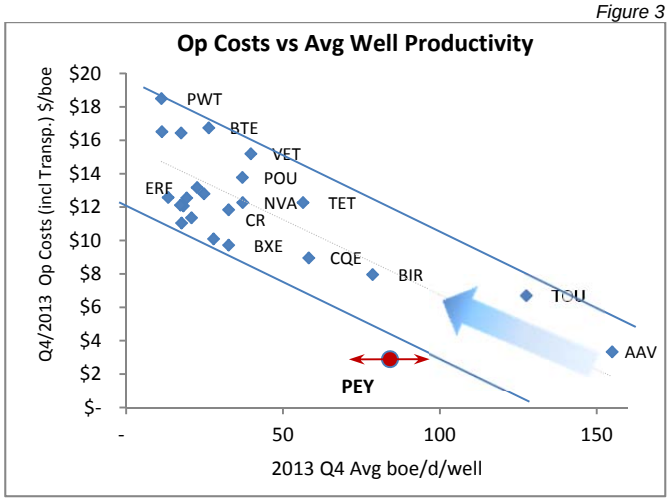
the many gassier producers in the industry and have stayed that way over many years.

In fact, Peyto's costs per unit have stayed the same for the last 8 years, despite some obvious inflation in the industry (see Figure 2).

A lot of this has to do with WHAT we develop - sweet, liquids rich natural gas reservoirs in the Alberta Deep Basin with no mobile water; WHERE we develop – year round, solid ground, in central Alberta with lower transportation costs than northern locations; and HOW we produce – all operated and processed by Peyto at one of our facilities.

But because op costs are reported on a per unit basis, average well productivity actually plays a role. As you would expect, if you can spread fixed costs over a larger production base, per unit costs come down. Figure 3 shows Q4 2013 op costs (including transportation), relative to average per well productivity for various producers in the industry.

Figure 3



Source: Company AIF, Financials

This relationship works both ways. As average production per well declines, per unit operating costs tend to rise. The key is being able to keep them low as this happens.

How you do that is by having as much of your cost base variable as opposed to fixed. This is one of the big reasons why we can keep our costs low despite average well productivity rising or falling over time.

Strategies to accomplish this are numerous and include maximizing utilization of owned processing capacity, minimizing facility downtime, optimizing chemical consumption, utilizing automation where appropriate, minimizing separation and disposal of unwanted components (H_2S, CO_2, water), and on and on. All of which is much easier to accomplish if you are in control of and operating your own production and facilities.

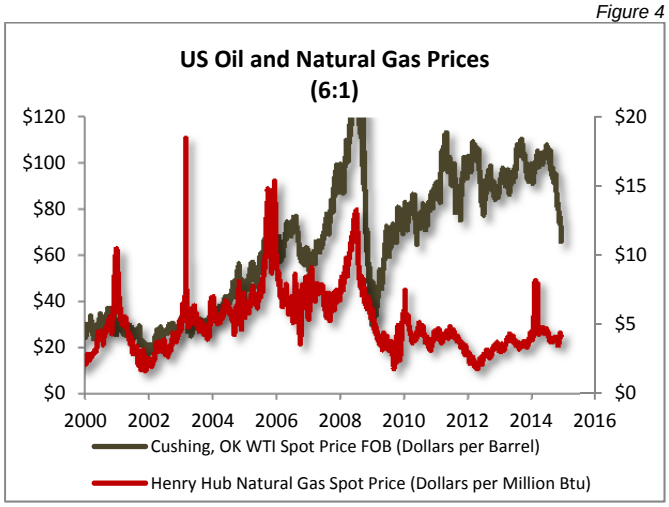
So an enduring op cost advantage, like we have at Peyto, is not something you can buy off a shelf or convert to after the fact. It has to be built. By making the right choices, from the very start, to build it that way.

Activity Levels and Commodity Prices

The volatility in commodity prices over this last couple of months is enough to send even the sanest commodity trader screaming from the room. And it's not that natural gas price hasn't been volatile, but it's the drop in oil prices that is the most interesting. I say interesting because a drop in oil prices, especially when gas prices stay relatively flat, is a huge win for Peyto. Sure we have some natural gas liquids revenue that is tied to oil price, but for the most part we are a gas producer. And when oil prices fall, generally speaking, costs fall too. That's because most everything in the oil and gas services business runs on diesel. Trucks, rigs, pumpers, you name it, they all burn diesel.

As well, high oil prices which gives the ability for the oil producer to "pay more", puts pressure on gas producers that can't. So lower oil prices ends up reducing the competition we see for all sorts of services and materials.

Figure 4



Source: EIA

It's a disadvantage we've been living with for years (Figure 4). The ratio of oil to gas on a heat equivalent basis is around 6:1, not the 25:1 we've had for the last 4 years. I was expecting the North American LNG export initiative and the globalization of natural gas to ultimately be the driver of convergence between the two prices, but I'll take geopolitics in the interim. It's all good from my perspective.