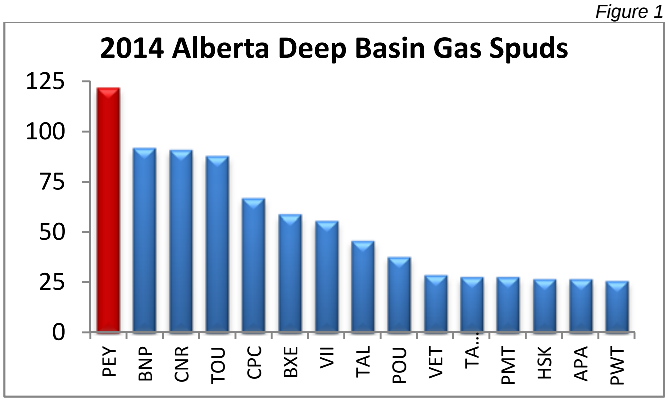
Peyto Exploration & Development Corp.
President's Monthly Report

February 2015 — From the desk of Darren Gee, President & CEO

So much has changed with the oil price lately that most industry participants, from investors to bankers to producers, are frantically analyzing the numbers to figure it all out. Thankfully for us, the drop in oil price was more of a positive than a negative (as I outlined last month), so it leaves me with more time to look at a different set of numbers. Like who drilled the most wells last year! I've always believed that "the true entrepreneur is a doer, not a dreamer," and the following graph of 2014 Deep Basin Spuds is evidence of that. Interestingly, it's not always who you think it is.

Figure 1



Source: Peyto, IHS Accumap

Most of the drilling we've done so far in 2015 is sitting idle waiting to come on. TCPL has restricted our production (see production table below) and many others on the mainline, while they go about proving to the NEB the integrity of two of their smaller pipeline laterals. Their pace is frustratingly slow, but we're hoping the problem is soon rectified.

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)**

	Q1	Q2	Q3	Q4	2013	Q1	Q2	Q3	Oct	Nov	Dec	Q4	2014
Land & Seismic	2	6	3	2	11.9	7	8	0	4	1	1	6	21.3
Drilling	76	32	86	60	253.0	80	68	83	28	29	24	81	310.8
Completions	41	10	54	47	151.7	36	48	46	20	16	17	54	183.1
Tie ins	15	7	14	12	48.2	16	10	11	7	5	3	14	51.3
Facilities	36	18	24	34	112.2	40	16	40	14	6	5	26	122.2
Total	**169**	**74**	**181**	**155**	**578**	**179**	**151**	**180**	**73**	**56**	**50**	**180**	**690**

Production*

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

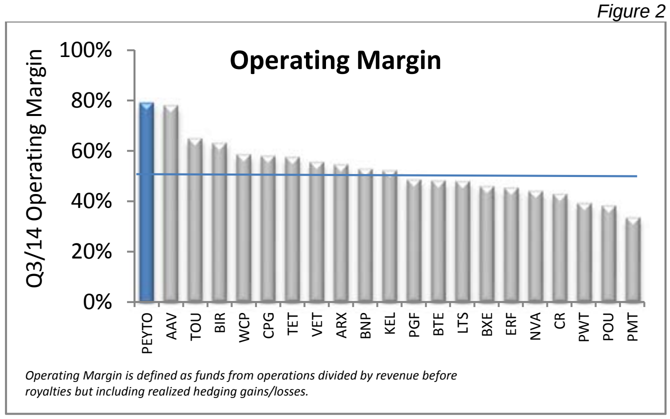
	Q4 13	2013	Q1 14	Q2 14	Q3 14	Oct	Nov	Dec	Q4 14	2014	Jan
Sundance	47.4	**42.6**	49.4	51.7	57.2	59.3	59.6	59.2	59.4	**54.4**	57.8
Ansell	13.9	**10.8**	15.7	14.2	14.3	16.1	16.3	17.0	16.5	**15.2**	17.2
Brazeau			1.6	1.3	1.2	1.8	3.4	4.4	3.2	**1.8**	3.9
Kakwa	2.5	**2.9**	2.4	2.4	2.4	2.4	2.2	2.2	2.3	**2.4**	2.2
Other	3.6	**3.1**	3.2	2.5	2.4	2.1	2.0	1.9	2.0	**2.5**	1.9
Total	**67.3**	**59.3**	**72.3**	**72.1**	**77.5**	**81.7**	**83.5**	**84.7**	**83.3**	**76.3**	**83.0**

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.

Margin Math

My monthly reports in the past have regularly discussed Peyto's low cost advantage – how we get it, how we maintain it, and why it's important. And yet it still seems that, especially in times like now, it's worth repeating the obvious. Low costs equate to high margins. Peyto's costs are the lowest, which is why our margins are the highest (see Figure 2).

Figure 2



Source: Company Financials

High margins, in turn, provide insulation from volatile revenues driven by volatile commodity prices. A simple percentage analysis, like that shown below in Figure 3, shows how the netbacks (or cashflows) of a high cost/low margin business changes with commodity prices versus a low cost/high margin business like Peyto. A 30% drop in commodity prices can cause a 60% drop in the cashflow of the first, versus just a 38% drop in the second.

Figure 3

	Industry Average			Peyto		
	Before	After	Change	Before	After	Change
Revenue	$100	$70	-30%	$100	$70	-30%
Costs	$50	$50		$20	$20	
Profit	$50	$20	**-60%**	$80	$50	**-38%**
Cashflow Margin	50%	29%	-43%	80%	71%	-11%

Okay, so Peyto's low costs mean we're well insulated from commodity price volatility. What does that really mean though? If we slow down and behave in a very defensive manner during periods of low commodity prices, much like everyone else in the industry, having that insulation doesn't really do much for us. Where it becomes a significant advantage, however, is if it allows us to take the opposite tactic. If we aggressively deploy capital in the low commodity environment, much like we've been doing for the last few years, then we are levering off this low cost advantage to improve the returns on that capital. Things will cost less,

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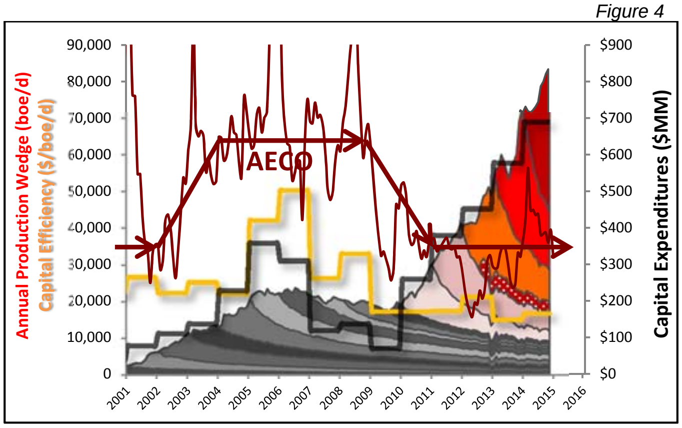
dollars will go further, and the returns we generate on the same kind of well will be even better at a lower capital cost.

That's what having a "returns focused strategy" really means. It means that we deploy capital at times in the cycle when the returns are highest. See Figure 4 as evidence of that counter-cyclical strategy at work. Since 2010, we've been deploying ever larger capital programs (black line), not because the natural gas prices were high (red line), they were actually much lower than before, but because the costs to build new production (yellow line) was the lowest. Which also means our returns were some of the highest.

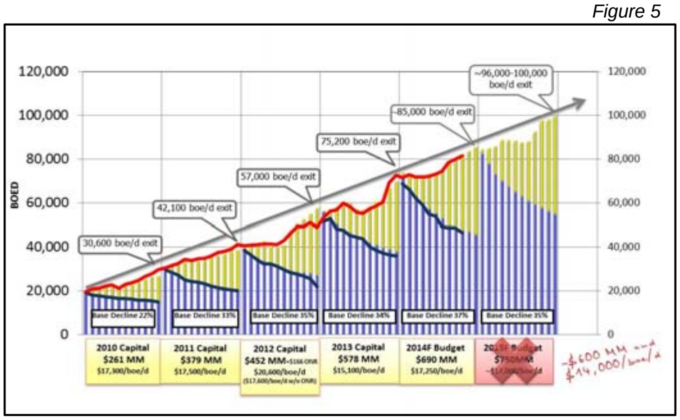
Figure 4



Source: Peyto presentation

Sure, we still have to honor the economic impact of lower commodity prices in the near term. But if the cost savings are greater than what we give up in prices, then the returns should be better. And when you're at the bottom, there is always the chance that commodity prices go up.

Figure 5



Source: Peyto presentation

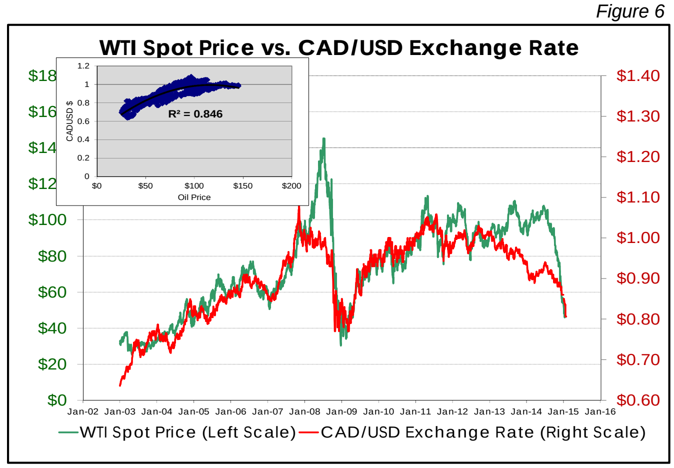
So while most of the industry is running in fear, Peyto is looking to be very opportunistic this year. We want to drill a maximum number of wells at these lower costs, and because we have such high margins, we will have more cash than most with which to do it.

So the plan today is to attempt to drill a record number of wells, delivering a record amount of new production, but with less capital than we previously thought - hopefully, as much as 20% less (Fig. 5). And more for less is never a bad thing.

Activity Levels and Commodity Prices

It appears that after a brief hiatus, our Petro-dollar is back. The recognition that a large portion of the Canadian economy is driven by oil and gas was offered by the Bank of Canada last week with its 25 BPS cut to the prime rate. As a result, the dollar has now returned to its historic correlation with WTI. This is a little bit of good news for Canadian producers who convert US prices into Canadian. Realized Canadian oil and natural gas prices will be stronger as a result of a weaker dollar (see Fig. 6).

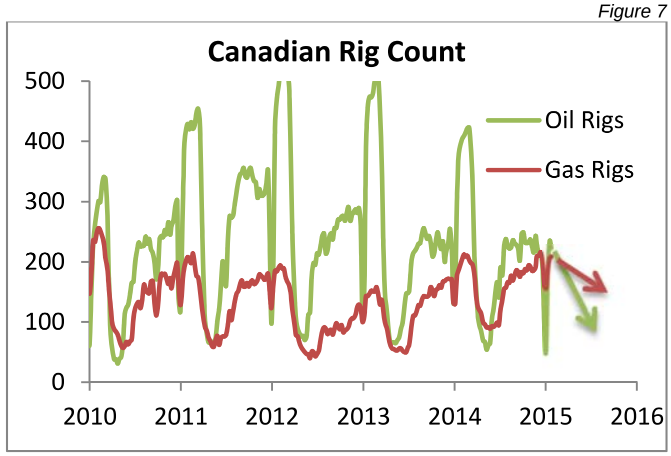
Figure 6



Source: EIA, Bank of Canada

Usually after the Christmas break, the Canadian rig counts shoot up. Not this year. If anything, they're about to plunge. I suspect gas rig counts will taper off almost as much as oil rig counts with all the CAPEX cuts (see Fig. 7).

Figure 7



Source: EIA

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