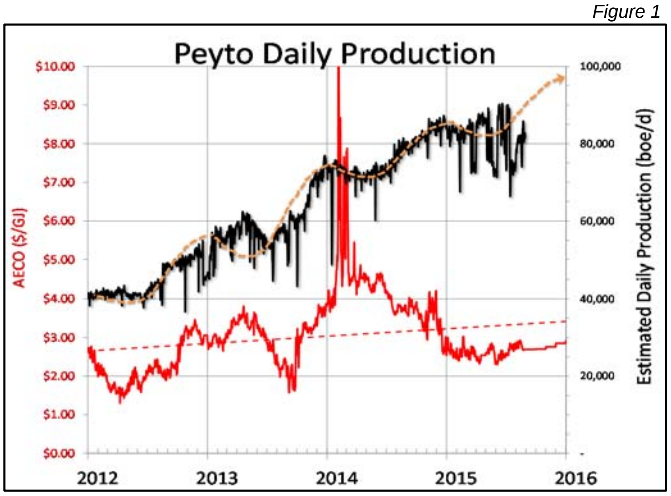
Peyto Exploration & Development Corp.
President's Monthly Report

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

As expected August was a rough month for production. Both turnarounds and transportation restrictions holding over 10,000 boe/d off line. In contrast to oil, natural gas prices have remained relatively stable this year, around the $2.75/GJ range, which is helpful when thinking about our budgets for the upcoming year.

Figure 1



Source: Peyto

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*

*2014/15 Capital Summary (millions$ CND)**

	Q1	Q2	Q3	Q4	2014	Q1	Apr	May	Jun	Q2	Jul
Acq.	0	0	0	0	0.3	3	0	0	0	0	0
Land & Seismic	7	8	0	6	21.3	4	1	0	1	1	0
Drilling	80	68	83	81	310.8	70	19	16	25	59	31
Completions	36	48	46	54	183.1	43	11	8	14	33	15
Tie ins	16	10	11	14	51.3	7	3	3	5	11	4
Facilities	40	16	40	26	122.2	12	2	2	9	12	7
Total	**179**	**151**	**180**	**180**	**690**	**138**	**35**	**28**	**54**	**117**	**57**

Production*

*2014/15 Production ('000 boe/d)**

	Q1 14	Q2 14	Q3 14	Q4 14	2014	Q1 15	Apr	May	June	Q2 15	Jul	Aug
Sundance	49.4	51.7	57.2	59.4	54.4	56.5	57.9	54.5	58.9	57.1	56.7	57.4
Ansell	15.7	14.2	14.3	16.5	15.2	16.8	17.1	14.6	14.5	15.4	12.3	12.8
Brazeau	1.6	1.3	1.2	3.2	1.8	4.3	6.9	6.3	6.1	6.4	5.4	7.0
Kakwa	2.4	2.4	2.4	2.3	2.4	2.2	2.2	2.2	2.0	2.1	2.1	2.1
Other	3.2	2.5	2.4	2.0	2.5	1.7	1.8	1.0	2.0	1.6	1.5	1.8
Total	**72.3**	**72.1**	**77.5**	**83.3**	**76.3**	**81.6**	**85.9**	**78.6**	**83.5**	**82.6**	**78.0**	**81.1**

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.

Dividend Sustainability

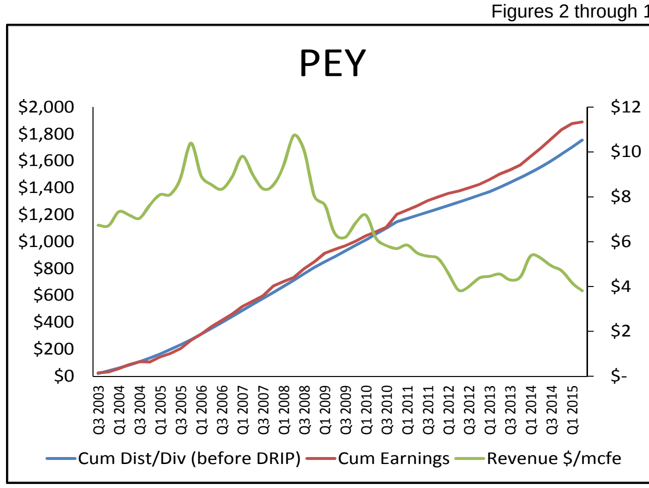
Another round of dividend cuts (and eliminations) in the industry has brought investor attention back to the topic of yield sustainability. This is a topic I've written about several times in the past (Oct 2014, July 2012, Oct 2008, etc.) In those reports I pointed out that one cannot expect dividends to be sustainable over the long term in the absence of earnings or profits. By their very definition, "dividends are a sum of money paid to shareholders of a corporation *out of earnings*." So when commodity prices drop to the point where there are no earnings, dividends start to be paid out of debt or equity. Both of which become very expensive, especially if equity markets have followed the drop in commodity prices (as they recently have).

As a result, dividends get cut and re-investment programs (DRIPs) get cancelled to protect balance sheets and stop the bleed of new equity diluting out shareholders.

Perhaps even more shocking than the action taken by these corporations to protect their balance sheets is the ***re***action by investors to the cuts. I mean, what did they expect? All you have to do is look at the cumulative earnings of a corporation relative to its cumulative dividend payments to see what's going to happen. There are many reasons why companies pay dividends to investors and only one of those reasons is to share in the profits. Sometimes it's to try and get investors to pay more for their shares so they can issue less equity, thus lowering their cost of capital. But that doesn't make them sustainable.

Here's a quick look at several of the dividend paying E&Ps (ex-Trusts) in the industry. The red line is cumulative earnings, the blue line is cumulative distributions/dividends (before any DRIP) and green line is realized commodity price ($/mcfe or $/boe):

Figures 2 through 12



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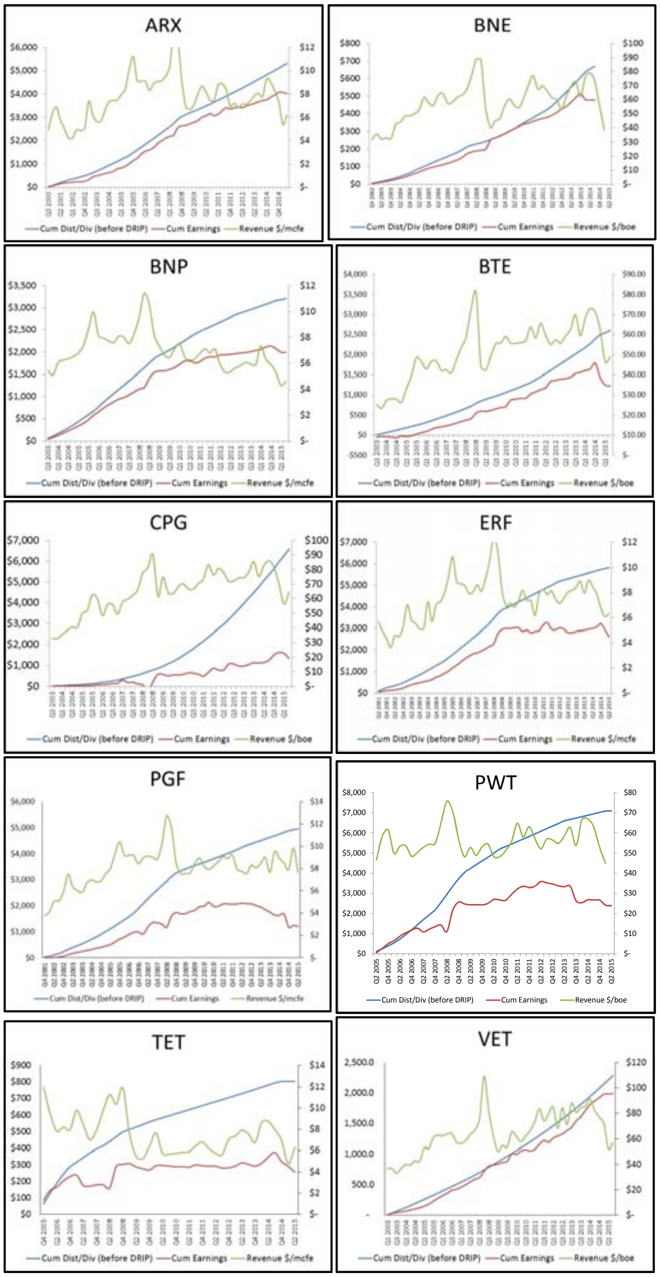
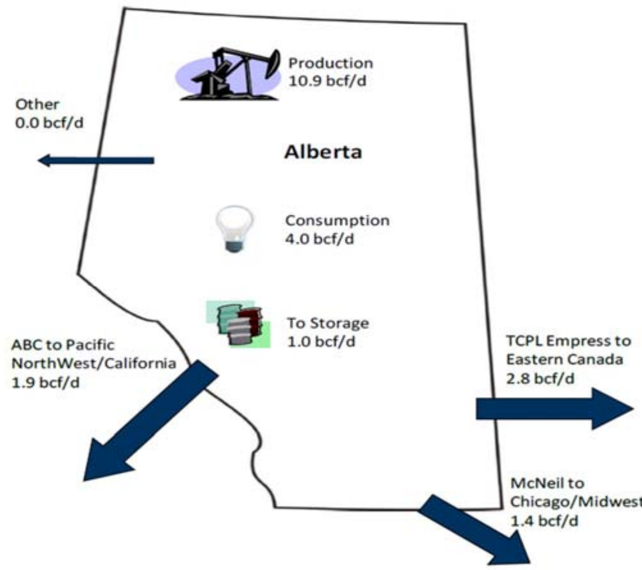


Source: Peyto, Company *Financials*

As you can see, the pace of dividend payout doesn’t always match that of earnings generation (blue line - dividends outpaces red line - earnings). I personally believe that illustrates quite simply when dividends are not sustainable. Sadly, even when there are earnings generated, our governments seem hell bent on taxing them as illustrated in the Alberta Governments recent statement that “those who are profitable should be paying just a little bit more.” Ironically, it’s not the companies that will be paying more, it will be their shareholders (whose dividends could ultimately be cut as after tax earnings fall) that will be doing the “paying.”

Activity Levels and Commodity Prices

Figure 13



Source: RBC, TransCanada, data as of April 10, 2015

The potential overhang of increased US NE gas volumes continues to weigh on AECO prices, especially since we are long gas in Alberta. Last check, Alberta produced around 6 BCF/d more than it consumed (see Figure 13). Logically, the focus has been on getting more egress built and diversifying markets for our exports. But what if we decided to put more of that excess to our own use and generate all our electricity with natural gas? It would achieve gains on a number of fronts; reduced greenhouse gas emissions from coal fired power, increased natural gas price from increased demand which would drive higher royalties and revenues for the province, increased drilling activity from the industry and economic benefit for the local economy. It’s an idea that even our NDP government could easily get their head around.

Currently, coal produces over 40% of the electricity in Alberta, while the combined cycle and cogeneration (using natural gas) contribute another 40%. If we were to replace all the coal fired power plants in the province with the most efficient cogeneration facilities, we would not only significantly lower our GHG emissions, but we would consume approximately 1.0 BCF/d more of our domestic natural gas production. In the short term, this would relieve pressure on increasing export markets and building new export pipelines. Not a bad alternative to *just* increasing exports.