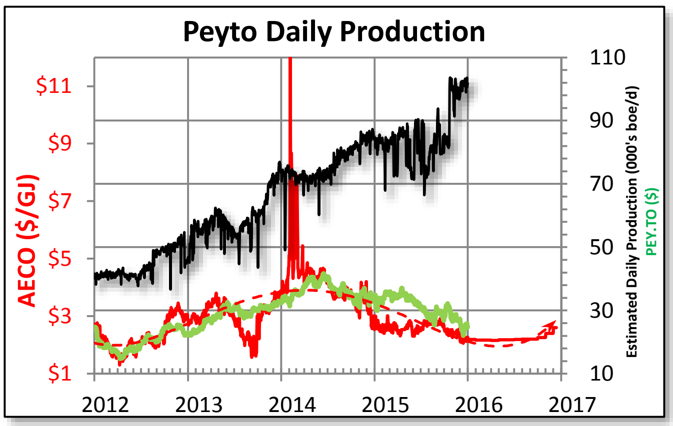
Peyto Exploration & Development Corp.
President's Monthly Report

January 2016 — From the desk of Darren Gee, President & CEO

Well, there goes 2015. Can I say, good riddance? Between low commodity prices, higher taxes, royalty and environmental regulation uncertainty, and transportation restrictions, 2015 had its share of challenges. Peyto persevered though, as we always have, and even managed to exceed our exit target of 100,000 boe/d (see Figure 1) for far less than the original planned capital of $700-$750MM. Good thing because our cash netback of around $18/boe was far less than the $23-24/boe we originally thought we'd have. Still, we put another successful year in the books. On to 2016….

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*

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

	Q1	Q2	Q3	Q4	2014	Q1	Apr	May	Jun	Q2	Jul	Aug	Sep	Q3	Oct	Nov
Acq.	0	0	0	0	0.3	3	0	0	0	0	0	-5	-2	-6	0	0
Land & Seismic	7	8	0	6	21.3	4	1	0	1	1	0	3	1	4	0	2
Drilling	80	68	83	81	310.8	70	19	16	25	59	31	29	28	88	28	27
Completions	36	48	46	54	183.1	43	11	8	14	33	15	15	14	44	23	19
Tie ins	16	10	11	14	51.3	7	3	3	5	11	4	5	6	15	7	6
Facilities	40	16	40	26	122.2	12	2	2	9	12	7	13	12	32	4	5
Total	**179**	**151**	**180**	**180**	**690**	**138**	**35**	**28**	**54**	**117**	**57**	**61**	**59**	**177**	**62**	**58**

Production*

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

	Q3 14	Q4 14	2014	Q1 15	Q2 15	Jul	Aug	Sept	Q3 15	Oct	Nov	Dec	Q4 15	2015
Sundance	57.2	59.4	54.4	56.5	57.1	56.7	57.4	60.7	58.2	62.3	63.2	63.3	62.9	58.7
Ansell	14.3	16.5	15.2	16.8	15.4	12.3	12.8	12.7	12.6	16.4	23.0	24.2	21.2	16.5
Brazeau	1.2	3.2	1.8	4.3	6.4	5.4	7.0	8.1	6.8	8.2	8.5	10.0	8.9	6.6
Kakwa	2.4	2.3	2.4	2.2	2.1	2.1	2.1	1.5	1.9	1.8	2.4	2.1	2.1	2.1
Other	2.4	2.0	2.5	1.7	1.6	1.5	1.8	1.3	1.5	1.4	1.9	1.9	1.7	1.6
Total	**77.5**	**83.3**	**76.3**	**81.6**	**82.6**	**78.0**	**81.1**	**84.3**	**81.1**	**90.1**	**99.0**	**101.5**	**96.8**	**85.5**

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 Stay Flat Case

With commodity prices where they are, many producers in this industry will be struggling just to keep production flat in 2016 with their available cashflow and cash resources (debt, equity, etc.). Peyto on the other hand is taking a very counter cyclical approach and outspending its free cashflow (cashflow minus dividend) in order to deploy more capital at a time when costs are extremely low and returns are ultimately stronger than at other times in the cycle. Many investors are taken aback by this aggressive approach, thinking it risky, but that is because they don't understand how easy a "stay-flat" case for us really is.

The reason the "stay-flat" case is so easily achievable for us is threefold:

1. We have industry leading margins that give us some of the highest cashflow to work with (i.e. low cost producer, also see January 2015 report link).
2. We have industry leading, proven and predictable, full-cycle capital efficiency that allows us to offset our base decline with minimal, low-risk capital investments (i.e. predictable execution).
3. Our dividend is at a manageable level, and over the long run matched to our earnings, leaving us plenty of free cashflow (i.e. sustainable).

So let's run the math and see exactly how that stay flat case works.

If we exit 2015 with production at or greater than 100,000 boe/d, that base production volume is predicted to decline in 2016 at around 35%, leaving us with approximately 65,000 boe/d by the end of the year. Based on the latest service costs and well results, we added new production in 2015 at approximately $12,000/boe/d (what we call "capital efficiency"), so that's a starting point for what it could cost in 2016 to offset that decline. The only difference is that in 2015 we invested approximately 13% of the total capital in new facilities that we won't need in 2016 if production isn't growing. So therefore, the expected cost of new production in 2016, for the stay-flat case, should be 13% less or $10,400/boe/d. If current commodity prices persist and activity levels remain extremely low, we also expect to improve upon service costs, perhaps by another 10%. That would take the 2016 cost to add new production down to $9,400/boe/d. At that level of capital efficiency, it would cost approximately $330 million to replace the 35,000 boe/d of decline. So the next question is, how is that funded?

On the funding side, 100,000 boe/d held flat would generate approximately $550 million of funds from operations if we can achieve a $15/boe netback from current commodity prices. Considering our current dividend is approximately $210 million

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per year that leaves $340 million to cover the capital requirement. That should be enough. So that only leaves one final question. Can we achieve $15/boe cash netback from current commodity prices?

Currently, our production is split around 93% natural gas and 7% natural gas liquids. If we take current strip prices and apply Peyto's historical realizations, we arrive at a blended realized revenue projection for Peyto's production at around $20.00/boe (see table 1).

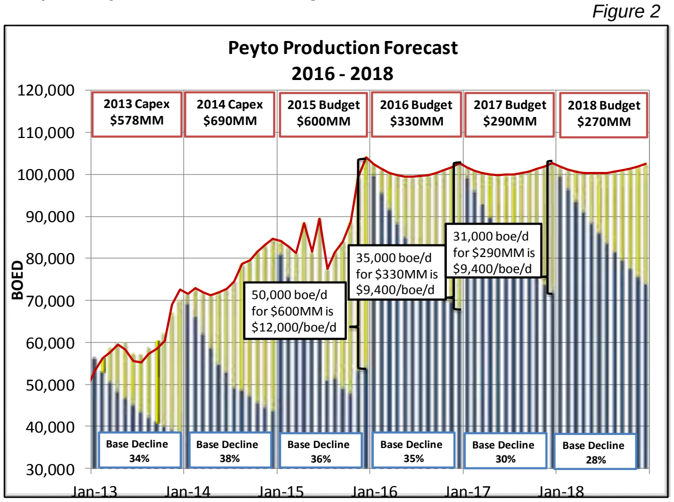
Table 1

	2016 CAD Strip prices ($/GJ, $/bbl)	Peyto's Realizations	Peyto's Prices ($/boe)	Peyto's Production split	Revenue Blend ($/boe)
Unhedged Natural Gas	$ 2.35	115%	$ 16.22	46%	$ 7.46
Hedged Natural Gas	$ 2.96	115%	$ 20.42	47%	$ 9.60
NGLs	$ 56.00	75%	$ 42.00	7%	$ 2.94
Total					$ 20.00

Source: Peyto

Considering that Peyto's cash margins have averaged 79% over the last year, this blended revenue should deliver approximately $15.80/boe of funds from operations. So the answer is yes, we can achieve a $15/boe cash netback from current commodity prices and easily fund a stay flat case. Graphically, that looks like Figure 2.

Figure 2



Source: Peyto

Still, that leaves us with our original question from investors, which is why do more? Why over invest, rather than just invest your free cashflow?

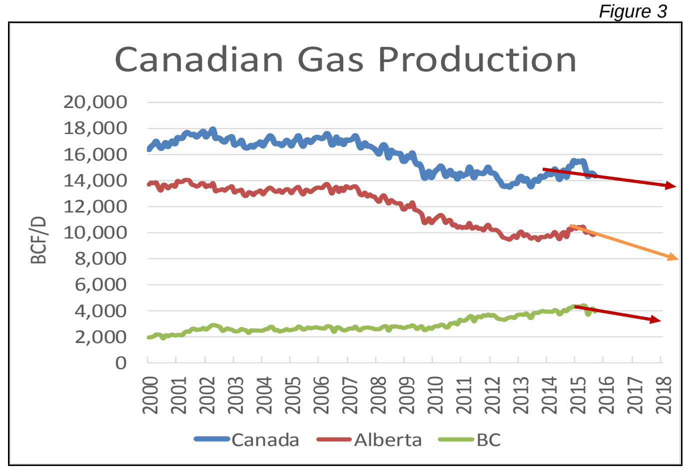
The answer, of course, is that we can still generate a good return on that capital for shareholders. We can use our available cash resources to take advantage of very low supply costs that have resulted from current low levels of activity, which by the way, will not be present when commodity prices go up. Those low supply costs allow us to continue to generate good, full-cycle, risked returns at these commodity prices. And if commodity prices improve, those returns will be even better. This strategy is not something very many companies in our industry can do, but we can, so we should. Because that's really the point of this business of oil and gas. It's not about growing, shrinking or staying flat, it's about generating a profit on capital that is invested. A profit at the shareholder's level, that shareholders can realize. That is the whole point. And we have a growing list of opportunities to do just that.

Activity Levels and Commodity Prices

Oil and gas commodity prices are starting this year where we just left off. Quite simply, the battle for market share continues. For oil, that battlefield is global. OPEC and the Middle East want their market share back, and are prepared to dump supplies on the market to drive down the price in order to get it. They have been doing it for over a year now and appear to be winning. US shale oil production has stalled and Canadian oil sands projects have been shelved. Other parts of the producing world are struggling with the low oil price too.

The battlefield for natural gas is more continental. Basically, it's Canada against the US. Canadian gas production has been losing ground to US shale gas because they are closer to our only market, the US themselves. On a smaller scale, Alberta is losing ground to BC (see Figure 3). The US looks to be first to get LNG exports going in a meaningful way too (oil as well), further expanding their market share.

Figure 3



Source: https://www.neb-one.gc.ca/nrg/sttstc/ntrlgs/stt/mrktblntrlgsprdctn-eng.html

Canada is going to have to get its act together or risk further market share erosion. For right now, that doesn't seem to be a priority for either Canadians or their governments. And why should it, energy is cheap. But when commodity prices turn, as they always do, that loss of market share (and export volume) will become particularly relevant to Canadians and their pocketbooks, and will be an expensive lesson in economics.

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