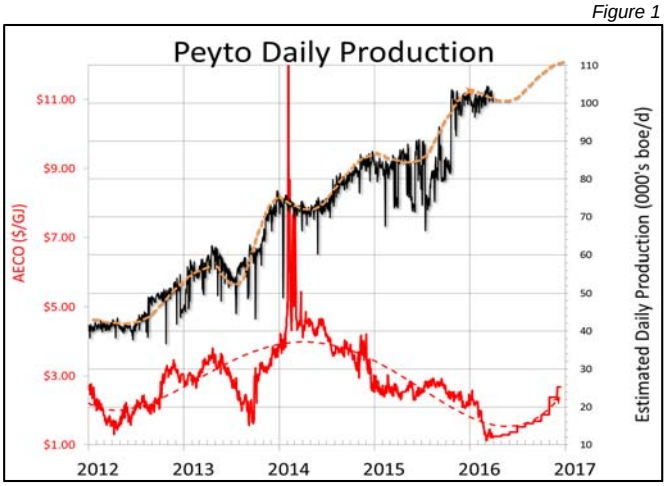
Peyto Exploration & Development Corp.
President's Monthly Report

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

Sooner or later, as an industry, we're going to have to choose which one is more important, higher gas production or higher gas prices. When logic finally prevails, the high op cost production will be first to get shut in. Then the remote production with high transport costs. And eventually the high replacement cost production. Thankfully, Peyto's production should be some of the last, as the lowest cost producer and developer in Canada.

Figure 1



Source: Peyto, GasAlberta

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*

*2015/16 Capital Summary (millions$ CND)**

	2014	Q1	Q2	Q3	Oct	Nov	Dec	Q4	2015	Jan	Feb
Acq.	0.3	3	0	-6	0	0	0	0	-3	0	10
Land & Seismic	21.3	4	1	4	0	2	0	2	12	3	0
Drilling	310.8	70	59	88	28	27	16	71	287	24	23
Completions	183.1	43	33	44	23	19	13	54	173	9	13
Tie ins	51.3	7	11	15	7	6	3	16	49	4	4
Facilities	122.2	12	12	32	4	5	12	20	76	16	13
Total	**690**	**138**	**117**	**177**	**62**	**58**	**44**	**163**	**594**	**56**	**62**

Production*

*2015/16 Production ('000 boe/d)**

	Q1 15	Q2 15	Q3 15	Oct	Nov	Dec	Q4 15	2015	Jan	Feb	Mar	Q1 16
Sundance	56.5	57.1	58.2	62.3	63.2	63.3	62.9	58.7	61.3	61.2	60.1	60.9
Ansell	16.8	15.4	12.6	16.4	23.0	24.2	21.2	16.5	24.1	23.7	25.8	24.6
Brazeau	4.3	6.4	6.8	8.2	8.5	10.0	8.9	6.6	11.3	12.7	12.6	12.2
Kakwa	2.2	2.1	1.9	1.8	2.4	2.1	2.1	2.1	2.1	2.2	2.2	2.2
Other	1.7	1.6	1.5	1.4	1.9	1.9	1.7	1.6	1.7	1.8	1.5	1.7
Total	81.6	82.6	81.1	90.1	99.0	101.5	96.8	85.5	100.5	101.6	102.2	101.4

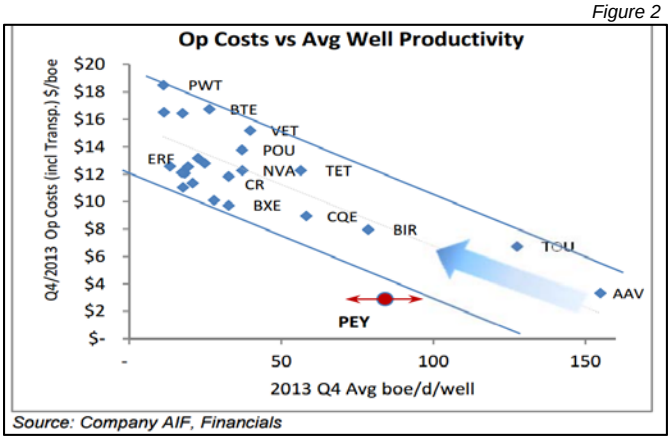
***This is an estimate based on real field data, not a forecast, and the actual numbers will vary from the estimate due to accruals and adjustments. Such variance may be material. Tables may not add due to rounding.**

Costs down or production up?

A while back (December 2014) I wrote a monthly report where I discussed Peyto's operating cost advantage over the industry, how we get such an advantage, and the relationship between costs and production http://www.peyto.com/ia/pmr/20141130PMR.pdf.

I showed the following graph (Figure 2) which illustrated the relationship between operating costs on a per unit basis and average productivity per well. The trend in the industry was clear that as average production per well increased, there was more production to spread fixed costs over, so per unit costs were lower – and vice versa.

Figure 2



Source: Company AIF, Financials

I also suggested that the key to achieving a permanent, low cost advantage was to disconnect costs from well productivity so that as production per well declined, costs would not rise.

Lately, the industry has started to achieve reductions in its operating cost. But it got me wondering, are costs really going down, or is average well productivity just going up? Obviously, if average production is up, per unit costs should come down - again, that relationship between fixed costs and production volume. But they might not stay lower. They're only down because production per well has increased. And as soon as the number of wells and production per well start declining, especially in light of reduced drilling activity, production will drop and costs will just climb back up.

So I looked back through several companies' Annual Information Forms (AIF) to see what the trend looked like. Shown in Figure 3 is that trend from Q4 2013 to Q4 2015. In general, the gas companies shown have been successful lowering per unit costs but often they are also increasing production per well to help do that. This would also suggest that when production rates drop off, costs will start to rise and may not be sustainable into the future. Depending on commodity prices, that's where future production and reserves

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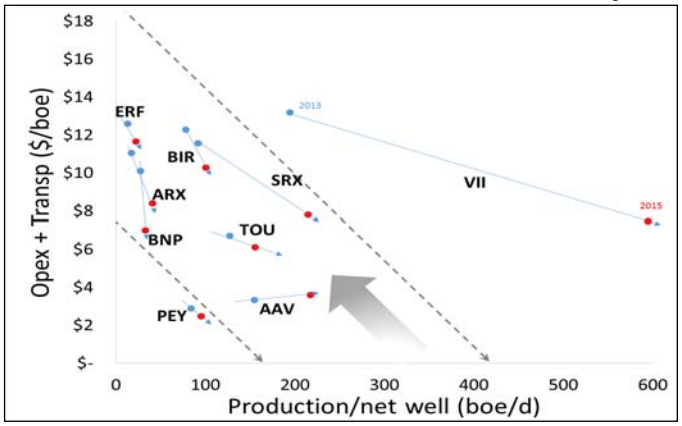
can quickly go from being valuable to valueless if you're not careful.

Figure 3

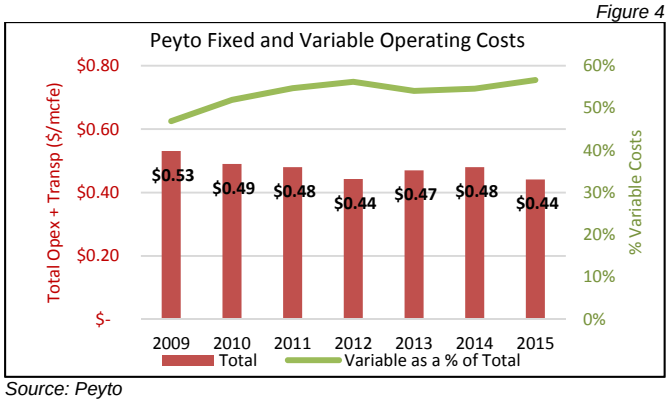


Source: Peyto, Company financials

Don't get me wrong, it's commendable that companies are achieving lower costs. As an industry, we have to drive costs down to stay competitive. But I think we need to keep in mind where that reduction is coming from, especially in light of decreasing activity. What we're really after, is a permanently lower cost structure. Which means detaching fixed costs from production and achieving more variable costs. As I discussed last month, I believe Canadian gas producers have done a better job of reducing costs relative to our US peers because we don't have as much of a fixed cost structure. One of the reasons behind that is that we own more of our processing infrastructure and are in control of those costs.

At Peyto, this operating cost optimization is an ongoing focus. And while we have been able to bring operating costs (incl. transportation) down over the past few years, even from the already low levels of $3/boe or $0.50/mcfe, we've also managed to increase the percentage of costs that are variable versus fixed, while still maintaining control over all production operations (Figure 4).

Figure 4



Source: Peyto

That way, when average production per well does begin to decline, our costs will stay low.

Ultimately, it is this low total cost structure, shown in Figure 5, which really sets us apart from the industry and preserves our margins and profits during commodity downturns.

Figure 5

	100% Deep Basin PEY 2015	80% Marcellus COG 2015 (US$)	65% DB/35% Montney TOU 2015	100% Pinedale UPL 2015 (US$)	100% Montney VII 2015
PD FD&A $/mcfe	($1.64)	($0.86)	($2.29)	($1.42)	($3.56)
Cash Costs $/mcfe	($0.81)	($1.28)	($1.40)	($1.89)	($2.57)
Supply Cost	($2.45)	($2.14)	($3.69)	($3.31)	($6.13)
Sales Price $/mcfe	$3.83	$2.46	$3.87	$3.40	$5.67
Profit/(Loss)	$1.38	$0.32	$0.18	$0.09	($0.46)

*Average Revenue, PD FD&A and cash costs (LOE, Transp., gathering, processing, Royalty or Ad Valorem, G&A and interest) per mcfe from 10k reports.

Source: Peyto, Company financials

Activity Levels and Commodity Prices

Figure 6

Since firm processing in NE BC is approximately $1.25/mcf and combined Spectra T-North and RGT firm transportation service is around $0.40/mcf, many NE BC gas producers are ***losing*** over $0.60/mcf, at current Station 2 prices of sub-$1.00/mcf, before they even get started accounting for royalties, LOE, G&A or interest. Why is there any NE BC gas production right now? Because in their minds the $0.60/mcf loss is less than the $1.65/mcf loss they would incur by shutting in (it's really a $2.60/mcfe loss if you include depletion or replacement of producing reserves, which is likely running north of $2/mcfe). Basically, it's very short term, survival thinking. Painful in the short term, but will ultimately benefit Peyto in the long term as this resource is "thrown away."