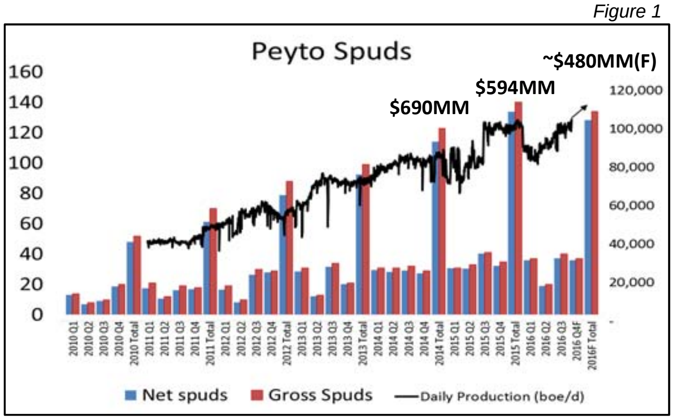
Peyto Exploration & Development Corp.
President's Monthly Report

November 2016 From the desk of Darren Gee, President & CEO

The ghosts and goblins have all had their fun so hopefully that means we are coming to the end of this rather scary 2016 year. Commodity prices have shown some strength this fall and activity levels have even picked up a little. Despite our attempts to be more counter-cyclical to the industry this year, the wet spring and summer have prevented us from drilling more wells this year than last, which breaks a multi-year trend we had going (see Figure 1). We still look to exit with record production though, which means we must be getting more from every well we are drilling. It is interesting how the last 3 years have cost $100MM less each year for almost the same activity.

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) as well as any production deferrals.

Capital Investment*

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

	Q1 15	15	Q3 15	Q4 15	2015	Q1 16	Apr	May	Jun	Q2 16	Jul	Aug	Sep	Q3 16
Acq.	3	0	-6	0	-3	28	0	0	0	0	0	4	1	5
Land & Seismic	4	1	4	2	12	4	1	0	1	1	0	0	1	1
Drilling	70	59	88	71	287	63	8	7	15	30	20	21	23	64
Completions	43	33	44	54	173	33	2	0	5	8	5	11	11	27
Tie ins	7	11	15	16	49	12	0	1	1	3	4	6	3	13
Facilities	12	12	32	20	76	37	3	2	4	9	1	1	1	4
Total	**138**	**117**	**177**	**163**	**594**	**176**	**14**	**10**	**26**	**50**	**30**	**43**	**40**	**114**

Production*

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

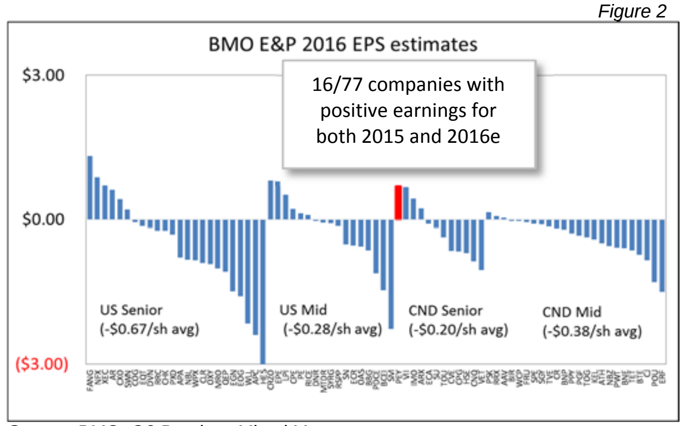
	Q1 15	Q2 15	Q3 15	Q4 15	2015	Q1 16	Q2 16	Jul	Aug	Sept	Q3 16	Oct
Sundance	56.5	57.1	58.2	62.9	**58.7**	60.9	54.3	54.3	59.6	59.3	57.7	60.5
Ansell	16.8	15.4	12.6	21.2	**16.5**	24.6	19.9	20.5	20.5	22.0	21.0	21.9
Brazeau	4.3	6.4	6.8	8.9	**6.6**	12.2	10.7	14.2	12.8	15.7	14.2	16.4
Kakwa	2.2	2.1	1.9	2.1	**2.1**	2.2	2.2	2.1	2.0	2.0	2.0	1.9
Other	1.7	1.6	1.5	1.7	**1.6**	1.7	1.2	1.4	1.5	1.4	1.4	1.3
Total	**81.6**	**82.6**	**81.1**	**96.8**	**85.5**	**101.4**	**88.3**	**92.5**	**96.4**	**100.4**	**96.4**	**102.0**
Deferral							**17.4**	**9.3**	**4.3**	**3.4**	**5.7**	**-**

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.*

Where Have All The Earnings Gone?

I recently read a couple of research pieces previewing industry earnings for the third quarter of this year and I had to laugh. Nowhere in the write-ups were there any actual estimates of earnings. I think it's because, for the majority of E&P companies in both Canada and the US, there aren't any so it doesn't behoove the research analysts to write about it. The reality is that commodity prices are low and many companies can't generate a profit at these levels (see figure 2). What's ironic, however, is that most E&Ps are still claiming that they are highly profitable and still investing capital, as if earnings are not somehow related to profitability.

Figure 2



Source: BMO, Q3 Preview: Mixed Messages

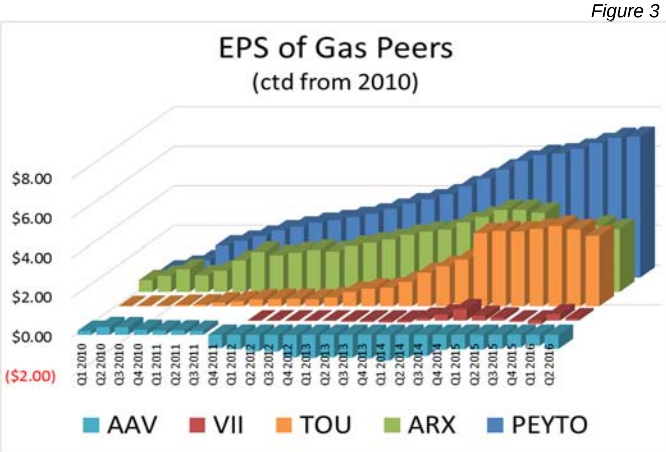
Flipping through corporate investor presentations it's hard not to come to that same conclusion. Each play is described in detail with numerous impressive performance parameters all pointing to incredible profitability. Some might even have independent research showing how their respective play is the lowest cost and most profitable of all the plays ("at the toe of the boot").

So what gives? If the field level economics are so awesome, how is it that so few companies can actually turn that into profit at the corporate level (investor's level)? And even if they can manage to post a quarter of earnings here or there, how is it that so few companies can actually generate consistent earnings year in and year out? Earnings are profits, right?

You'd think this should be of critical importance to investors. Most investors never get to participate in the wells themselves, so they never get to enjoy so-called field level profits. They only get to buy stock in those respective companies, which means they only get to enjoy corporate level profits (if there are any). So the most important question for investors should be "where do ***my*** profits go?" Or are there really just none to begin with?

In Peyto's case, there seems to be a clear path from strong field level returns down to corporate level profits, and vice versa. Looking at our earnings for the past several years compared to our peers (figure 3), we have consistently generated earnings every quarter. This must mean we are making consistently good returns at the field level (which is what our post-mortem full-cycle analysis of the individual well returns also shows).

Figure 3



Source: Peyto, Company Financials

Consistently posting earnings means there is a positive return on the capital being employed (capital employed defined as the sum of all shareholders equity and debt liabilities, which is more or less equal to the remaining undepreciated capital pool). And the difference between returns on capital employed at the corporate level and real rates of return at the field level can only be due to corporate costs like the cost of capital, general and administrative costs, and other compensation costs.

So if there are consistently no earnings, there can be only one of two conclusions. Either there are no real returns at the field level, which is in direct contradiction to all those presentation economics and likely because the real costs are higher and average results poorer, ***or*** the corporate costs are eating up all the profit before it gets to the shareholder. In some cases, it's a combination of both.

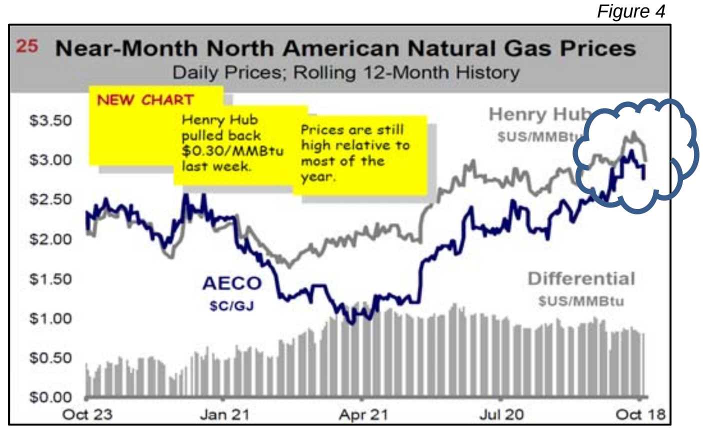
Now granted, the current field level economic predictions in corporate presentations are run with current costs and current commodity forecasts so they are a prediction of future profits. Meanwhile, Return on Capital Employed is the current earnings (profits) from the last several years of capital employed. But it still doesn't change the fact that companies consistently devoid of earnings can't claim to have been profitable. So what makes them think the future is going to be any different?

In the immortal words of Warren Buffett "the rear view mirror is always clearer than the windshield" and I think seeing where you've come from is generally a pretty good proxy of where you're going. And if you look close enough, you can see where all the earnings have really gone.

Activity Levels and Commodity Prices

From what we've heard, some of the TCPL mainline contracts have converted from long haul (gas sourced at Empress, AB) to short haul (gas sourced at Dawn, ON) but there have still been sufficient volumes contracted at Empress through the winter to cause the basis between Henry Hub and AECO to tightened up for the short term. (Figure 4). It's likely that next summer we could be back to the exact same TCPL games so it continues to make sense to protect against that volatility with our hedging strategy.

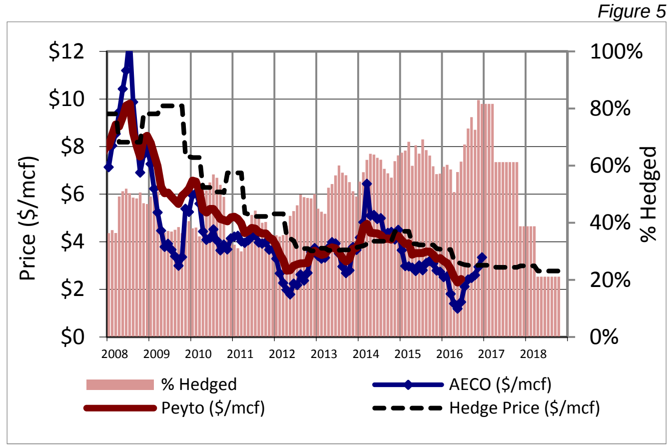
Figure 4



Source: ARC Financial

For now though, at least the spot price is more constructive. Figure 5 shows our current hedge position with good protection for this winter with close to 80% sold. We still have another 20%-25% that needs to be sold for next summer. Then hopefully we can return to a 65% target thereafter assuming TCPL mainline issues are closer to being resolved.

Figure 5



Source: Peyto