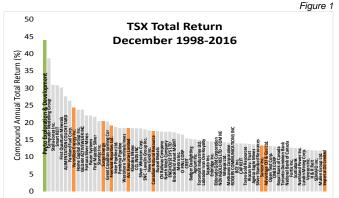
## Peyto Exploration & Development Corp. President's Monthly Report

#### February 2017

As responsible stewards of shareholder capital, we at Peyto believe that openly discussing with investors the risks that are currently prevalent in our industry and the plans Peyto has to mitigate those risks and to protect investors, their capital and their returns, is critically important. At a time when commodity prices may have shown a spark of excitement, and most of our peer group have abandoned the shackles of profitability in favor of chasing dramatic growth, this focus on risks appears to some as rather "depressing". But there is nothing depressing about smart, calculated, and careful business tactics. A business truly focused on maximizing returns can never be too careful with respect to its shareholders' capital. This type of approach to business is one of the reasons Peyto has delivered the highest total return of any public company traded on the TSX over the same 18 year period, oil and gas, or otherwise.



Source:BMO

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)\* 01 15 15 03 15 04 15 Acq. Land & Seismic 1 3 0 9 Drilling 70 88 71 63 26 24 13 219 59 287 30 63 64 13 10 Completions 43 33 44 54 173 33 8 27 14 37 105 Tie ins 15 16 12 5 6 14 42 11 49 13 4 Faciliti Total 38 130

#### Production\*

2015/16 Production ('000 boe/d)*												
	Q1 15	Q2 15	Q3 15	Q4 15	2015	Q1 16	Q2 16	Q3 16	Q4 16	2016	Jan	
Sundance	57	57	58	63	59	61	54	58	59	58	59	
Ansell	17	15	13	21	17	25	20	21	22	22	21	
Brazeau	4	6	7	9	7	12	11	14	17	14	19	
Kakwa	2	2	2	2	2	2	2	2	2	2	2	
Other	2	2	2	2	2	2	1	1	1	1	2	
Total	82	83	81	97	86	101	88	96	102	97	102	
Deferral							17	6				
	* 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 rounding.

Suite 300, 600 – 3<sup>rd</sup> Avenue SW Calgary, AB T2P 0G5 Fax: 403 451 4100 From the desk of Darren Gee, President & CEO

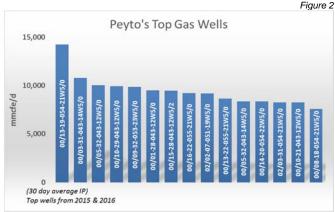
#### **Big Wells Are All Relative**

The end of the month always brings with it a host of research reports summarizing the top wells in the various provinces based on initial productivity. What I continually find disturbing is that the information presented is both incomplete and misleading for investors because these reports almost always fail to include any sort of data regarding cost and risk so that you can put all of this productivity into perspective.

For the data to be relevant to investors, it needs to include more than just production performance. Considerations like repeatability, predictability, operational risk, half and full cycle costs, and ultimately profitability are all left to the reader's imagination. The reader's understanding or assumptions of these various factors determines if the so-called "big wells" are impressive or irrelevant or just plain specious.

At Peyto our goal has always been to maximize the profit on invested capital. And that strategy doesn't involve spending a lot of risky capital to drill a well merely for high initial productivity and a top well award. We'd much rather drill several low risk wells for far less capital to achieve a superior and predictable return.

Don't get me wrong, we too have some big wells we could advertise. Figure 2 is our top 15 wells over the last couple years ranked by IP30. But it doesn't mean anything. What if all those wells cost \$10 million each, like they do in many plays in Alberta? Does that still make them big wells?





You must also consider that the Top Wells Report is of a select few wells. It doesn't represent the average well result and it doesn't contemplate the risks of failure when trying to repeat that top result. Even if that top well can achieve a superior return, the failures trying to reproduce it destroy the value it may have created several times over. This is the primary reason field-level, half-cycle, type economics never seem to materialize at the corporate level over a larger capital program.

TSX Symbol: PEY

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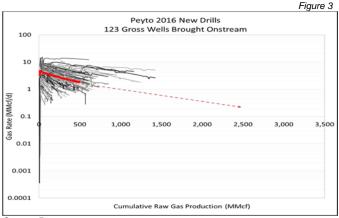
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The extreme pitfall, of course, is when you extrapolate these top-well, type economics over a larger un-risked total inventory, you arrive at a fictitious total NAV that will never agree with reported financial performance.

Contrast that with what we at Peyto can really do with \$10 million. In 2016, our *average* well, including both big successes, average wells and operational failures, cost \$3.0 million to drill, complete, equip and tie in (half cycle, like those \$10MM wells). So we can drill 3.3 wells for \$10 million. And according to figure 3 below, our average IP30 and EUR for 2016 are around 4.0 mmcf/d and 3.1 BCFe. So by comparison, our \$10 million well equivalent has an IP30 of 13 mmcf/d and an EUR of 10 BCFe. More importantly, combined with Peyto's industry leading cash costs, this capital is achieving an average IRR of approx. 25-30%, full cycle.



Source: Peyto

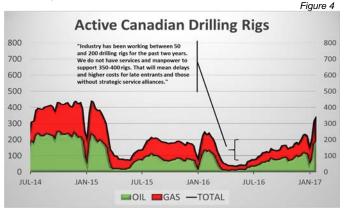
Some might argue that if it takes three wells to make one big well, and develop the same amount of resource, that's not as good. On the contrary, by attempting longer laterals, and more and bigger fracs it introduces more operational risk, more chance of failure, more cost runaways, more frac interference, etc. Besides, at the end of the day the goal is to generate the maximum profit (earnings) from every well drilled. If you generate no earnings, it's pretty hard to argue you generate any profit from your so-called big wells. So perhaps the best way to measure any well is to look at the earnings they generate over time. Which also means that a large inventory of wells that generate no earnings, isn't much of an inventory at all.

## **Activity Levels and Commodity Prices**

The number of active Canadian drilling rigs has sky rocketed lately, up to 350 from a low of just 36 last spring (figure 4). Unfortunately, support services like cementing and fracturing, which had been right-sized to an active rig fleet between 50 and 200 over the past two years, can't possibly keep up. This

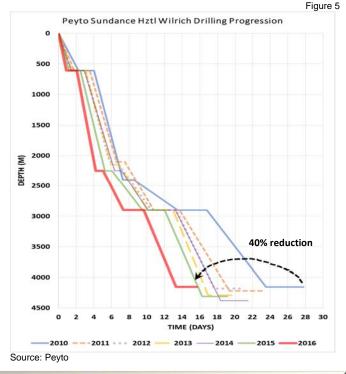
### From the desk of Darren Gee, President & CEO

has the potential to cause significant service cost inflation for those that do not have either fixed contracts or historical strategic alliances with their service providers. Thankfully, Peyto was a very active driller during the lows of the last couple years and established those alliances and contracts which will help mitigate this risk for the near future.



Source: Baker Hughes

We will be watching closely, however, to ensure we are not losing some of the operational gains we've made over the last 5 years with respect to drilling times. As you can see in Figure 5, we've shaved 40% off the drilling times from 2010 to 2016 and we want to hang on to those efficiencies and cost reductions.



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