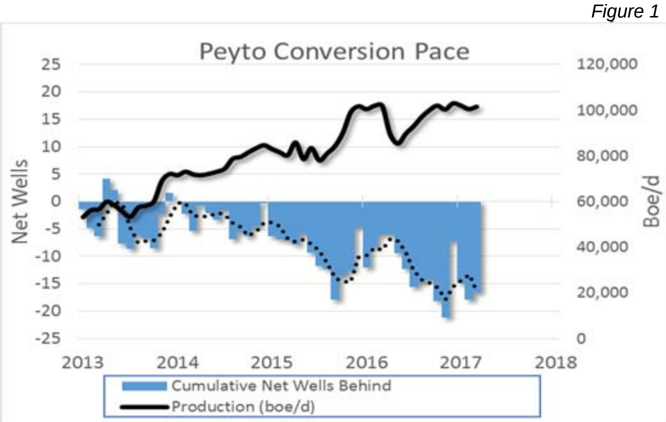
Peyto Exploration & Development Corp.
President's Monthly Report

April 2017   From the desk of Darren Gee, President & CEO

The Canadian rig count in the first quarter was very robust, averaging 295 active rigs. That's an increase of over 70% from Q1 2016. We no longer have the support services (cementing, frac'ing, etc.) for that many rigs so there has been pressure on services to keep up. In response, we at Peyto have slowed parts of our activity so as not to incur any additional costs during this busy period (our continuous focus on returns). As a result, our pace of well connections hasn't kept up with our pace of drilling and we're currently sitting with close to 20 wells yet to come on. At 600 boe/d per well (Avg. 2016 IP30), that's a lot of "behind pipe" gas we need to catch up. Hopefully, with lower activity levels in Q2/Q3, we can get caught up, but it's becoming increasingly more challenging what with pad drilling, step outs into new areas and avoiding service cost pressures (see figure 1).

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*

2016/17 Capital Summary (millions$ CND)*

	Q1 16	Q2 16	Q3 16	Oct	Nov	Dec	Q4 16	2016	Jan	Feb
Acq.	28	0	5	0	0	1	1	34	0	0
Land & Seismic	4	1	1	1	3	0	4	9	8	0
Drilling	63	30	64	26	24	13	63	219	22	25
Completions	33	8	27	10	13	14	37	105	11	13
Tie ins	12	3	13	4	5	6	14	42	3	4
Facilities	37	9	4	2	4	5	11	60	9	5
Total	**176**	**50**	**114**	**43**	**49**	**38**	**130**	**469**	**53**	**47**

Production*

2016/17 Production ('000 boe/d)*

	2015	Q1 16	Q2 16	Q3 16	Oct	Nov	Dec	Q4 16	2016	Jan	Feb	Mar	Q1 17
Sundance	59	61	54	58	61	59	59	59	58	59	59	59	59
Ansell	17	25	20	21	22	21	22	22	22	21	21	22	21
Brazeau	7	12	11	14	16	17	19	17	14	19	18	17	18
Kakwa	2	2	2	2	2	2	2	2	2	2	2	2	2
Other	2	2	1	1	1	2	1	1	1	2	2	1	1
Total	**86**	**101**	**88**	**96**	**102**	**100**	**103**	**102**	**97**	**102**	**100**	**102**	**101**

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

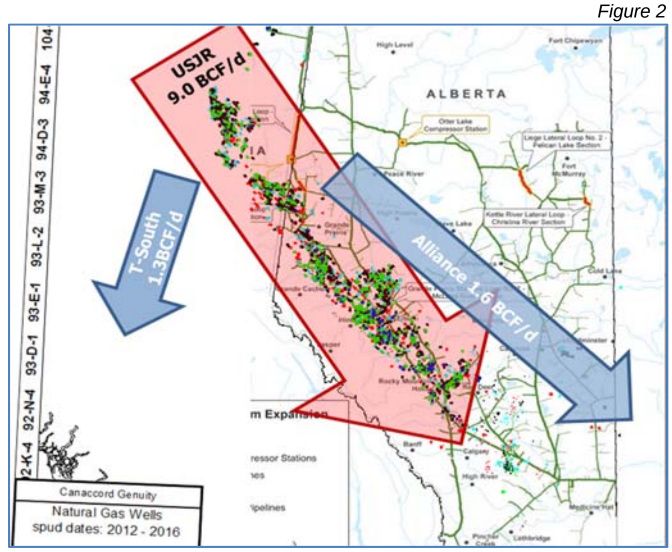
WCSB Can't Grow, So Why Invest?

I've recently returned from Eastern Canada and a visit with investors in Montreal and Toronto. While gone, the Alberta Premier Rachel Notley was having a Twitter fight with Saskatchewan Premier Brad Wall about provincial budgets – to ramp up debt (AB) or practice fiscal responsibility (SK). Wall stated he was not interested in Notley's budget advice since her budget only balances if "oil prices come way back or unicorns prove to be real."

Banking on higher commodity prices (or mythical creatures) to save your bacon has never proved to be a very good strategy in this industry. And it's one the Alberta Government would do well to avoid (as they are effectively the largest oil and gas company in Canada). The problem is, however, growing industry revenues (ergo Government revenues) from growing production isn't a good bet either. Oil sands growth has been capped by gov't emissions limits, prompting many large US players to bail from it, and natural gas growth is now limited by take away capacity. So the big question for the market is - if the basin can't grow, and many investors specifically invest in this industry solely for growth, then why would they invest?

Personally I think the answer is a simple one – for profit. That's always been Peyto's strategy, so it's an easy answer for us to understand but perhaps not so easy for growth investors to get their heads around. It's important to also remember that oil and gas assets, production and reserves, by their very nature constantly deplete. Which means, as an industry, somebody has to replace that depletion. And since we're all not equally efficient and profitable, some companies will get to grow (hopefully profitably) while others will have to shrink. The net effect is the industry will just stay flat but that doesn't mean you have to abandon investing in it altogether.

Figure 2



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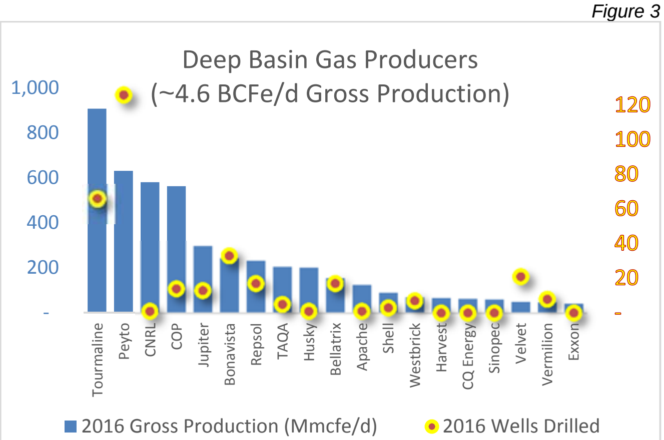
Looking at natural gas take away in Western Canada (figure 2), it looks like we're capped at around 12 BCF/d of take away capacity (1.6 BCF/d on Alliance, 1.3 BCF/d on Spectra and 9 BCF/d on NGTL Upstream James River). The red arrow is where all the drilling has occurred over the last 5 years, in the Deep Basin and Montney, and those pipes out of the basin are all currently full. Production within this part of the basin is also all from tight gas, fracture stimulated reservoirs which means it has a relatively steep decline. If we assumed a 25%/yr decline, that's 3 BCF/d we will have to build in order to keep those pipes full. So whose going do it and can they make any money doing it?

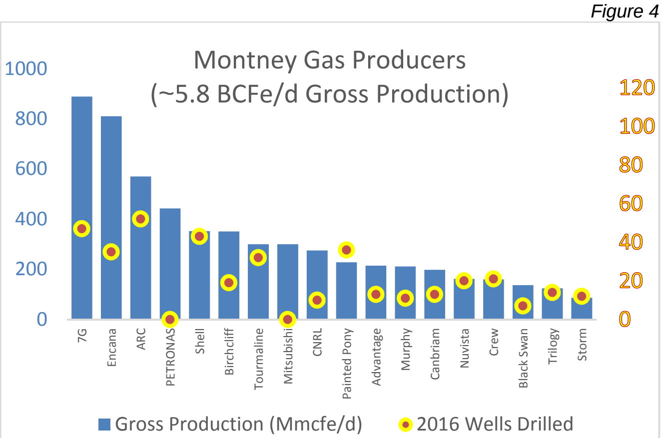
Figure 3



Source: RBC

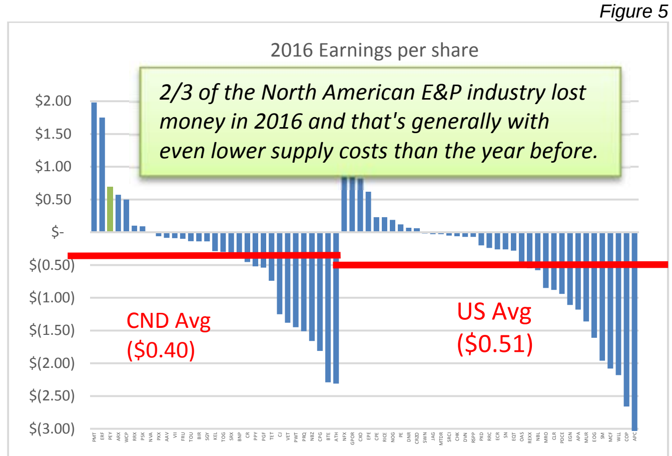
In the Deep Basin last year, there were only a few companies that were actually doing the work to offset the decline (figure 3), the rest were shrinking. We were one of the largest producers and we were the most active driller, along with Tourmaline and Bonavista. But all the rest weren't drilling enough to backfill their declines. In the Montney, the producers and their respective activity was a little more balanced (figure 4).

Figure 4



Source: RBC

Figure 5



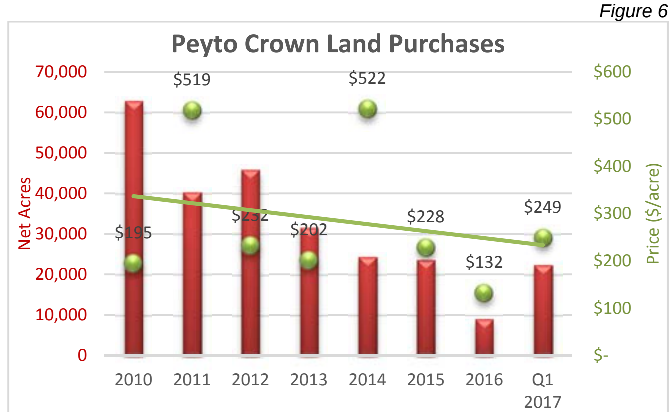
Source: RBC

So if the investment proposition isn't growth but profit, who's making the profit? Looking at earnings (figure 5), there aren't many. Last year only a handful of E&Ps posted earnings, and some of those were gains from asset sales. On average, Canadian companies lost $0.40/share. Our US counterparts were even worse, at an average $0.51/share loss. But for the shrewd investor, there is still the odd company that can post a profit and whose growth can still fit in amongst all the declines. If you're willing to look, Peyto will stand out as one of them.

Activity Levels and Commodity Prices

Land sale activity in both Alberta and BC has been relatively anemic in the last few years. That makes for a lot of opportunity for us. We haven't been sitting around either. So far this year, we've picked up over 35 net sections at public auction and another 14.5 net sections through private purchases. On Crown sales alone we're already ahead of the annual purchases over the last 3 years and at a very reasonable average price of $249/acre (figure 6).

Figure 6



Source: Peyto

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