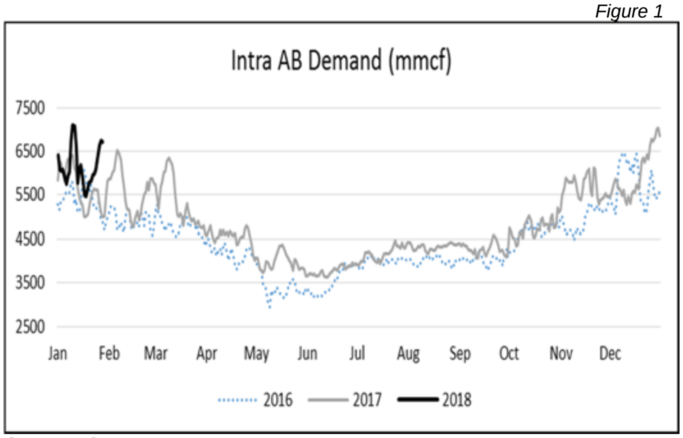
Peyto Exploration & Development Corp.
President's Monthly Report

February 2018 | From the desk of Darren Gee, President & CEO

Brrr. This has already been a long, cold winter (as many predicted) and we're barely into February. In the US, there have been record draws from storage and out here in Alberta, intra-Alberta demand has been high (Figure 1), which is a good thing, considering we have too much supply that is being prevented from reaching the rest of the North American market. Alberta has new industrial demand planned, including power generation and petrochemical use, oil sands demand, and residential demand that will all help to reduce the volumes that need to leave the basin and since many require the same length of commitment as new pipeline contracts, they are all vying for the same supply.

Figure 1



Source: TCPL

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*

2016/17 Capital Summary (millions$ CND)*

	Q1 16	Q2 16	Q3 16	Q4 16	2016	Q1 17	Q2 17	Q3 17	Oct	Nov	Dec	Q4 17	2017
Acq.	28	0	5	1	34	4	0	0	0	0	0	0	4
Land & Seismic	4	1	1	4	9	9	2	1	0	4	0	4	17
Drilling	63	30	64	63	219	67	48	73	25	29	15	69	256
Completions	33	8	27	37	105	36	21	34	17	14	12	42	134
Tie ins	12	3	13	14	42	13	9	15	6	5	5	16	53
Facilities	37	9	4	11	60	25	17	11	2	1	1	4	57
Total	**176**	**50**	**114**	**130**	**469**	**154**	**98**	**135**	**50**	**53**	**32**	**134**	**521**

Production*

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

	2015	Q1 16	Q2 16	Q3 16	Q4 16	2016	Q1 17	Q2 17	Q3 17	Oct	Nov	Dec	Q4 17	2017	Jan
Sundance	59	61	54	58	59	58	59	56	55	58	59	59	58	57	57
Ansell	17	25	20	21	22	22	21	20	22	21	22	22	21	21	21
Brazeau	7	12	11	14	17	14	18	19	21	23	27	27	25	21	27
Kakwa	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2
Other	2	2	1	1	1	1	1	1	2	3	3	3	3	2	3
Total	**86**	**101**	**88**	**96**	**102**	**97**	**101**	**98**	**102**	**106**	**112**	**111**	**110**	**103**	**110**

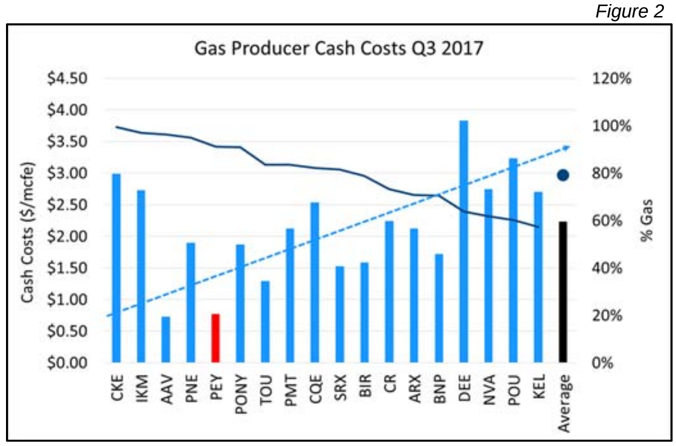
*This estimate is based on real field data, not a ***forecast, and actual numbers will vary from the estimate due to accruals and adjustments. Such variance may be material. Tables may not add due to rounding.***

Expanding the Moat

It's interesting that when commodity prices turn the wrong direction, most companies in our industry try to fix their profit margin by focusing on the revenue line of the income statement. At Peyto, we have a longstanding strategy of focusing on the other side of the ledger, that being costs. We have always believed that costs are the only thing that's truly in our control. Sure, we could be like everyone else and when gas prices go south we could chase liquids, but we also know that the cost of liquid production is much higher than gas. So you might be able to fool the market into thinking you can have your cake and eat it too with low gas costs and high liquids revenues, but sooner or later the truth will become evident.

Instead, we focus on expanding that "moat" around our business by reducing costs to a level far below the industry in order to insulate ourselves from low commodity prices. For instance, when you compare our cash costs to the average of some other gas producers, we lead by a wide margin at less than 1/3 of the average (Figure 2).

Figure 2



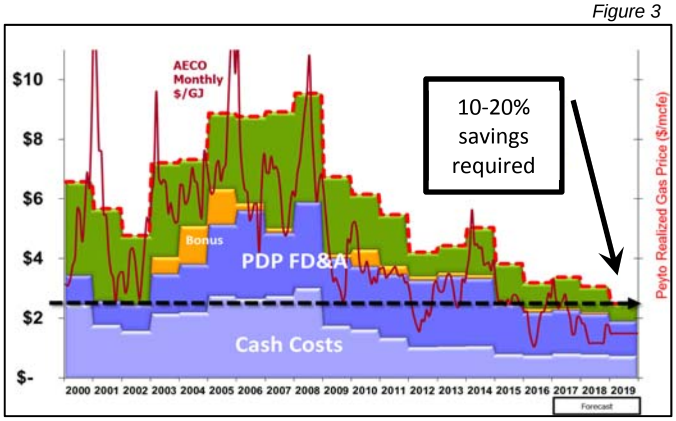
Source: GMP First Energy

So with AECO gas prices at historic lows, the question becomes, who has the cost structure to ride out this temporary low gas price storm? Clearly Peyto does. With cash costs in the order of \$0.75-\$0.80/mcfe and capital costs of less than \$1.45 our total supply cost is currently around \$2.20/mcfe. The revenue we obtain from \$1.50/GJ gas and adjusted for heat content and NGLs will yield us around \$2.50/mcfe. This doesn't give us our historical 30+% margin though, which is why we have decided to cut back our capital program and renew our focus on reducing costs until it does (including a dividend cut and debt repayment to reduce interest expense). That includes both the cost to develop new reserves and costs to produce and sell them. As always, our focus is on building and producing our resource for far less than what we sell it for and generating a healthy margin of profit (see Figure 3).

Suite 300, 600 – 3rd Avenue SW
Calgary, AB T2P 0G5
Fax: 403 451 4100

TSX Symbol: PEY
E-mail: info@peyto.com

Figure 3



Source: Peyto

Since we can't control what we sell it for, we better control what it costs us. So that is what we're going to do. And if gas prices get stronger, then we'll just have more profit to enjoy. And if they get weaker, then we'll have even more insulation from it. Where are we going to find this 10-20% savings on costs you ask? Where we always have, in every facet of our operations. That's why we've always wanted to be in control – in control of our capital programs, in control of the production operations, and in control of our midstream infrastructure. And even though we only have a small team, still just over 50 staff in Calgary, with 1/3 the capital program, we'll have more time to find those savings. After a 20 year track record of industry leading costs, I'm confident we can shave off a little more.

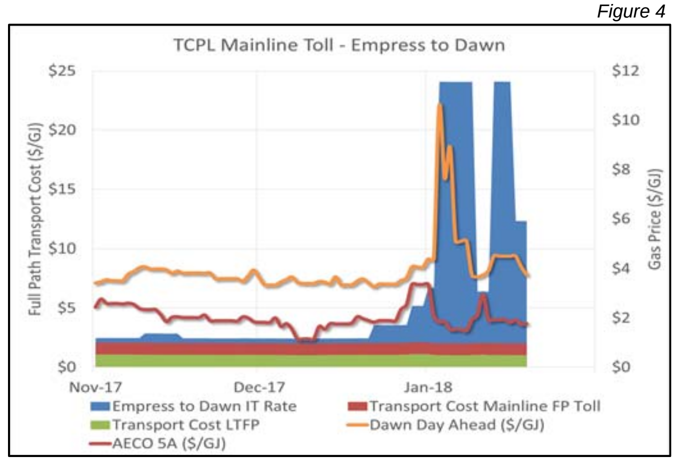
We can also optimize the revenue line too. And we will, with more Cardium drilling and Cheap Cut facility installations we can produce and strip more liquids, in the process boosting our revenue and, more importantly, the value of our resource. Ours has, and always will be, a returns driven strategy, focused solely on the pursuit of profit.

Activity Levels and Commodity Prices

AECO is a problem. We have trapped gas in Western Canada which is driving down the local price to a level below the industry's supply cost. The usual explanation is that we have too much supply and not enough pipelines to get that supply to market. But that's not the whole story. In reality, it's the ***cost*** to get that gas to market that is too high because we have too few pipeline companies competing to move gas to US markets. Producers have done a great job reducing the cost of supply but pipeline companies haven't done their part. They are not incented to build more pipelines just to lower the price to get it there. For them, higher volume at lower tolls is the same as lower volume at higher tolls. What we really need is more pipeline companies competing for the business. That will ultimately result in higher volume at lower tolls which will allow more gas to get to market, relieving the bottleneck and resulting in a higher local price supporting higher supply levels.

If you don't agree that it's the high cost to get to market that is controlling the price, look at Figure 4. In January, when demand in Ontario was high due to cold weather, Ontario gas prices (Dawn) spiked as high as $10/GJ. But Alberta/BC couldn't participate in all that demand because the interruptible toll on the mainline for that period was increased from just over $2/GJ to over $24/GJ, or a 1200% increase! The consumers in Ontario paid way too much for gas, while the royalty owners in Alberta collected very little, all because the National Energy Board allows this type of variable pricing to occur. (It makes one question why we have a national regulator in the first place if not to protect the interest of Canadians). It's clear that the solution is a true free market for gas transportation, not the oligopoly we have today with their ability to charge what they like.

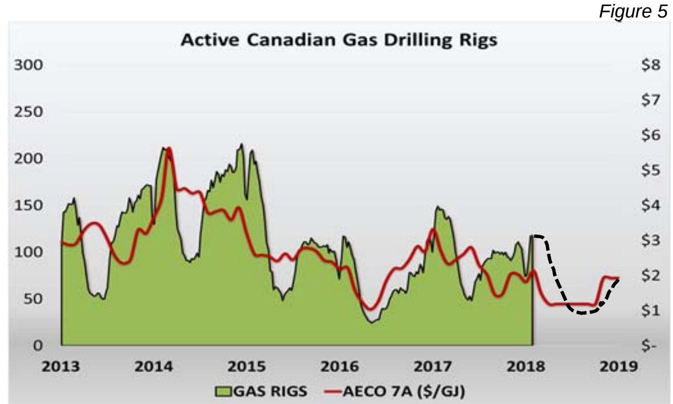
Figure 4



Source: TD, TCPL

Relative to where gas prices are, and are going, the Canadian gas rig count remains rather robust at 100 rigs. Likely this is a bit skewed by winter drilling programs and liquids rich gas drilling. I'd expect that come spring if gas prices stays as currently forecast the gas rig count will start to fall and so will production, just like it did in 2016 (Figure 5).

Figure 5



Source: Baker Hughes, NGX

Forward Looking Statements

Certain information set forth in this monthly report, including management's expectation of future natural gas prices and the reasons therefore and management's estimate of monthly capital spending, field estimate of production, production decline rates and forecast 2018 netback, contains forward-looking statements. By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond Peyto's control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Peyto's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits that Peyto will derive there from. The forward-looking statements contained in this monthly report are made as of the date of this monthly report. Except as required by applicable securities law, we assume no obligation to update publicly or otherwise revise any forward-looking statements or the foregoing risks and assumptions affecting such forward-looking statements, whether as a result of new information, future events or otherwise.

All references are to Canadian dollars unless otherwise indicated. Natural gas liquids and oil volumes are recorded in barrels of oil (bbl) and are converted to a thousand cubic feet equivalent (mcfe) using a ratio of six (6) thousand cubic feet to one (1) barrel of oil (bbl). Natural gas volumes recorded in thousand cubic feet (mcf) are converted to barrels of oil equivalent (boe) using the ratio of six (6) thousand cubic feet to one (1) barrel of oil (bbl). Boe may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf:1 bbl is based in an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. In addition, given that the value ratio based on the current price of oil as compared with natural gas is significantly different from the energy equivalent of six to one, utilizing a boe conversion ratio of 6 mcf:1 bbl may be misleading as an indication of value.

Certain measures in this monthly report do not have any standardized meaning as prescribed by International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. These measures may not be comparable to similar measures presented by other issuers. Non-IFRS measures are commonly used in the oil and gas industry and by Peyto to provide potential investors with additional information regarding Peyto's liquidity and its ability to generate funds to conduct its business. Non-IFRS measures used herein include netback and funds from operations.

Netbacks are a non-IFRS measure that represents the profit margin associated with the production and sale of petroleum and natural gas. Netbacks are per unit of production measures used to assess Peyto's performance and efficiency. The primary factors that produce Peyto's strong netbacks and high margins are a low cost structure and the high heat content of its natural gas that results in higher commodity prices. Funds from operations is a non-IFRS measure which represents cash flows from operating activities before changes in non-cash operating working capital and provision for future performance based compensation. Management considers funds from operations and per share calculations of funds from operations to be key measures as they demonstrate Peyto's ability to generate the cash necessary to pay dividends, repay debt and make capital investments. Management believes that by excluding the temporary impact of changes in non-cash operating working capital, funds from operations provides a useful measure of Peyto's ability to generate cash that is not subject to short-term movements in operating working capital. The most directly comparable IFRS measure is cash flows from operating activities.