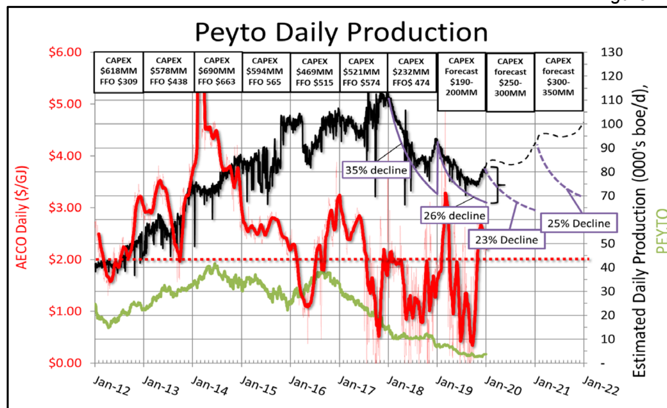
Peyto Exploration & Development Corp.
President's Monthly Report

January 2020 | From the desk of Darren Gee, President & CEO

With our year end exit production hitting 82,000 boe/d we are starting off the new year on the right foot. We've just gone through a rather serious inflection point with respect to production and hopefully natural gas prices too. My new year's wish is that we can put sub-$1 natural gas in the rear view mirror forever and get on with the business of growing WCSB natural gas supplies into the expanding egress and, ultimately, LNG export market. Regardless of federal environmental agendas, we know as an industry that the best thing we can do for the planet is to displace dirty fuels around the world with our cleaner burning, responsibly developed, Canadian natural gas. So let's get to it!

Figure 1



Source: Peyto, Enerdata, TMX

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 Summary (millions$ CND)*

	2017	Q1 18	Q2 18	Q3 18	Q4 18	2018	Q1 19	Q2 19	Jul	Aug	Sep	Q3 19	Oct	Nov
Acq/Disp	4	-4	0	0	2	-2	1	0	0	0	0	0	0	0
Land & Seismic	17	1	1	5	2	8	3	2	0	0	0	1	1	2
Drilling	256	14	7	37	57	116	24	11	5	3	6	14	12	10
Completions	134	17	1	18	36	72	20	14	3	3	3	10	4	9
Tie ins	53	4	1	6	11	21	10	3	1	2	0	3	3	3
Facilities	57	4	5	5	4	18	4	5	4	2	2	8	2	2
Total	**521**	**35**	**15**	**70**	**112**	**232**	**62**	**34**	**14**	**10**	**12**	**37**	**22**	**26**

Production ('000 boe/d)*

	Q1 18	Q2 18	Q3 18	Q4 18	2018	Q1 19	Q2 19	Jul	Aug	Sept	Q3 19	Oct	Nov	Dec	Q4 19	2019
Sundance	56	50	49	50	51	50	49	47	47	47	47	47	48	49	48	49
Ansell	20	18	16	16	18	18	15	14	14	14	14	13	14	16	14	15
Brazeau	24	19	16	15	19	15	13	12	12	12	12	11	11	11	11	13
Kakwa	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2
Other	3	2	2	3	3	3	2	2	2	1	2	2	3	3	3	2
Total	**105**	**92**	**85**	**87**	**92**	**88**	**82**	**78**	**76**	**76**	**77**	**75**	**78**	**81**	**78**	**81**
Deferral		2	0				1	1	2	2	2					
Capability	105	94	86	87	92	88	83	79	78	78	78	75	78	81	78	81
Liquids %	9.5%	10.1%	10.6%	11.5%	10.4%	12.0%	13.5%	13.3%	14.0%	14.5%	13.9%	13.9%	14.7%	15.4%	14.7%	13.5%

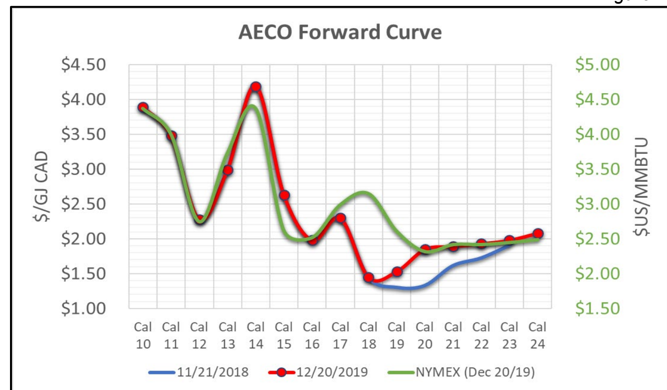
This estimate is based on real field data, not a* ***forecast, and actual numbers will vary from the estimate due to accruals and adjustments. Such variance may be material. Tables may not add due to rounding.*

What's in a Decline?

These days, with a severe lack of capital liquidity in the energy industry, more and more companies are focusing on their cashflow and what they should be doing with it. Obviously, when you have no access to capital in the form of new equity or debt, cashflow is all you have to work with. So the capital allocation decisions with respect to what to do with that cashflow has become of utmost importance. Some companies are choosing to re-invest their cashflow into new capital projects. Others are buying back their own shares. Others still are paying down debt or paying out dividends to shareholders. And there are even a few getting creative and trying to drum up new equity in the market. It will be interesting to see how that goes.

As for Peyto, we've been in a mode of reduced capital investments and reduced dividends, and using our excess free cash instead to pay down debt and strengthen our balance sheet. Over the last two years, capital programs were just over 50% of funds flow. That was last year and the year before. Going forward, however, we're changing gears a bit (see Figure 1). For 2020, the plan is to put more of that cashflow to work drilling wells and building production. We feel comfortable making this change because the economics of go-forward investments look a lot better today, with a much improved forward strip price for AECO natural gas (Figure 2 shows the strip today in red versus a year ago in blue).

Figure 2



Source: EIA, Enerdata

Our projection for growing production even when investing less than cashflow is somewhat unique however. In the past, when we were growing production (Figure 1) we were generally investing more than our Funds from Operations (FFO). For instance, from 2012 to 2017 we generated funds of $3.064 billion while investing $3.470 billion. On average, we invested about 13% more in capex than we generated in FFO. Of course, we also grew quite dramatically from 40,000 boe/d to 110,000 boe/d over that period. But perhaps one of the most important things to note over that period is the change in our

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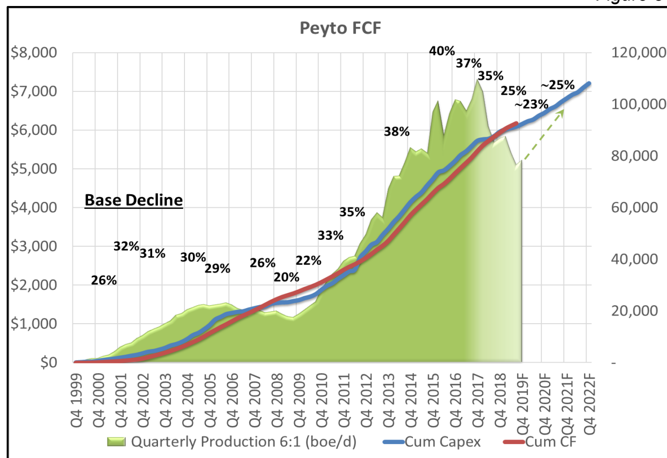
base decline, which increased from around 35% to 40%. That meant that even more of our FFO was needed to be invested each year to offset the decline and less capital contributed to growth.

Fast forward to today, and the base decline has fallen from the 40% level to an expected 23% next year (Figure 3). This is very similar to what happened back from 2006 to 2009. During that period, we did the same thing as we have over the last couple years; we spent far less than our FFO. In fact, over those 4 years we invested just 60% of our FFO through capital programs. And during that time, the base decline fell from 29% to 20%.

Figure 3



Source: Peyto

Then in 2010, we started investing more again. For that year, we invested $264 million in capital while generating $237 million in FFO. And production climbed from 20,000 boe/d to 30,000 boe/d. Then again in 2011, we invested $379 million in capital while generating $315 million in FFO and production climbed from 30,000 boe/d to over 40,000 boe/d. This doubling of production, of course increased the base decline we were offsetting from 20% to 33%.

So here we are today, with again a much lower based decline and looking forward to investing close to our free cashflow (FFO less dividend). This should, just like in 2010, result in growing production for a few years until that base decline climbs.

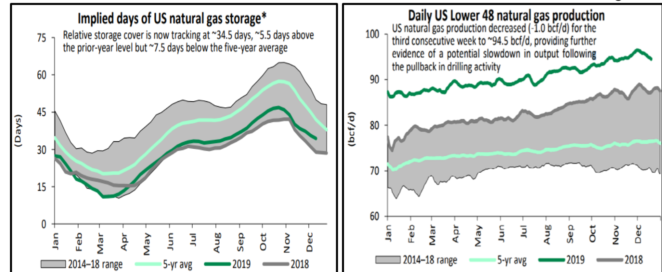
Of course, what's different today is that there is no external capital to invest even more, even if we wanted to. Which means that production cannot grow as dramatically as it did back in 2010, but also that the base decline will not climb as fast as it did back then either.

Ultimately, the capital allocation decisions are based on expected returns, not whether production shrinks, grows or stays flat. So, you might say that rate of return is the real driver behind the declines we're offsetting.

Activity Levels and Commodity Prices

The US natural gas storage situation seems to be tracking the 5-year average but interestingly, the implied days of storage is at very low levels at around 35 days.

Figure 4

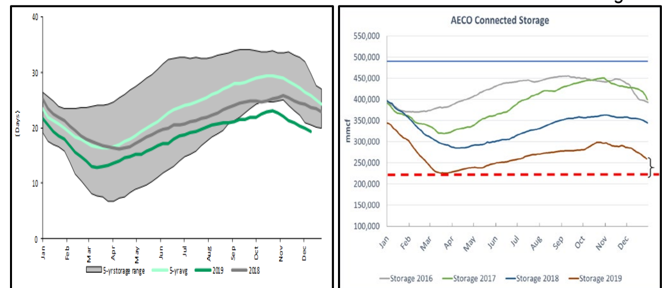


** Based on 30-day trailing US natural gas consumption + Mexico and LNG exports*
Source: Desjardins Capital Markets, Bloomberg, EIA, Genscape, Enerdata

This is because US supply and demand have grown much more than storage capacity. It implies that prices should be more volatile than ever before because we just don't have the time to buffer changing supply/demand dynamics. Now, with supply possibly rolling over and winter demand about to come, there could be some significant price moves in the NYMEX price over the next few months.

Interestingly, in Western Canada things are actually worse than in the US. We have even less implied days of storage, currently sitting at under 20 days. If that continues to track well below the 5-year average and we look to exit winter lower than the 225 BCF of AECO connected storage, then volatility will increase dramatically.

Figure 5



Source: Desjardins Capital Markets, NGTL, Peyto

Right now, the only thing that could potentially change this picture is a surge of new supply (North Montney?) or lack of demand (no winter?). Neither of those are forecast to happen, but I suppose they could. Winter is forecast to hit hard next week and last I heard, the North Montney Mainline was delayed again.

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.