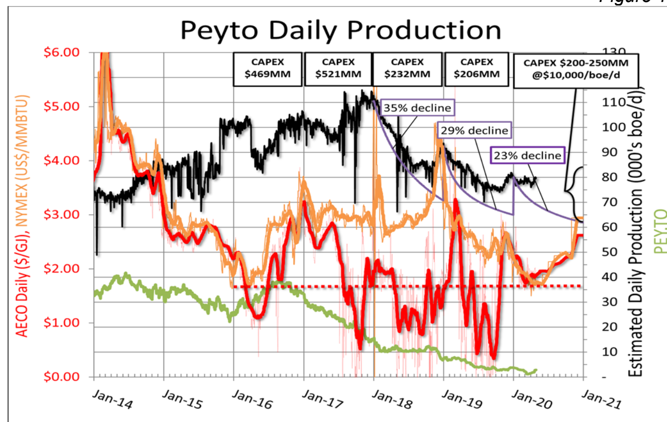
Peyto Exploration & Development Corp.
President's Monthly Report

May 2020 — From the desk of Darren Gee, President & CEO

As the World begins to re-open its economies after attempting to "flatten the curve" and slow down the spread of the COVID-19 pandemic, all eyes are still on the glut of oil and refined fuels that are stockpiled around the globe. In North America, energy markets wait to see if liquid storage capacities will be breached as producers scramble to shut in upstream production. Thankfully, we have so far collected enough storage tanks to house close to 3 weeks of associated condensate production from our Greater Sundance and Brazeau areas, so we should be able to weather the storm without having to shut in our gas production. The market believes, however, there will be significant associated gas shut ins in the industry which is driving up forecast AECO and NYMEX gas prices (Figure 1).

Figure 1



Source: Peyto, TMX, Enerdata

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	Q3 19	Q4 19	2019	Jan	Feb	Mar	Q1 19
Acq/Disp	4	-4	0	0	2	-2	1	0	0	0	1	0	0	0	0
Land & Seismic	17	1	1	5	2	8	3	2	1	2	7	2	2	0	4
Drilling	256	14	7	37	57	116	24	11	14	36	86	16	8	5	28
Completions	134	17	1	18	36	72	20	14	10	21	65	8	7	4	19
Tie ins	53	4	1	6	11	21	10	3	3	9	26	3	2	2	7
Facilities	57	4	5	5	4	18	4	5	8	5	21	7	2	2	10
Total	**521**	**35**	**15**	**70**	**112**	**232**	**62**	**34**	**37**	**73**	**206**	**35**	**21**	**12**	**69**

Production ('000 boe/d)*

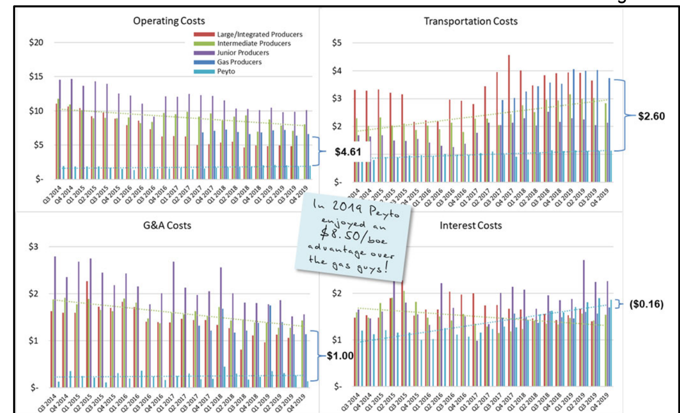
	Q1 18	Q2 18	Q3 18	Q4 18	2018	Q1 19	Q2 19	Q3 19	Q4 19	2019	Jan	Feb	Mar	Q1 20	Apr
Sundance	56	50	49	50	**51**	50	49	47	48	**49**	49	49	49	49	49
Ansell	20	18	16	16	**18**	18	15	14	14	**15**	15	14	14	14	13
Brazeau	24	19	16	15	**19**	15	13	12	11	**13**	11	11	13	12	13
Kakwa	2	2	2	2	**2**	2	2	2	2	**2**	2	2	2	2	2
Other	3	2	2	3	**3**	3	2	2	3	**2**	3	2	1	2	2
Total	**105**	**92**	**85**	**87**	**92**	**88**	**82**	**77**	**78**	**81**	**79**	**78**	**79**	**79**	**79**
Deferral		**2**	**0**				**1**	**2**							
Capability	**105**	**94**	**86**	**87**	**92**	**88**	**83**	**78**	**78**	**81**	**79**	**78**	**79**	**79**	**79**
Liquids %	10%	10%	11%	12%	10%	12%	14%	14%	15%	14%	15%	15%	14%	15%	14%

****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.***

Grinding Away on Operating Costs

Peyto is well known as an industry leader in low cost, high margin operations with some of the lowest, if not the lowest, cash costs. As I've written many times in the past, much of this has to do with our operating cost advantage which is derived from how we operate, where we operate, and what we operate. Running a lean, tight operation, with very high levels of ownership and control, along with facility ownership and a concentrated, sweet production base with no associated water production all contributes to this advantage. Add to that a continuous focus on grinding costs out of our business and that's how we maintain that advantage over the industry.

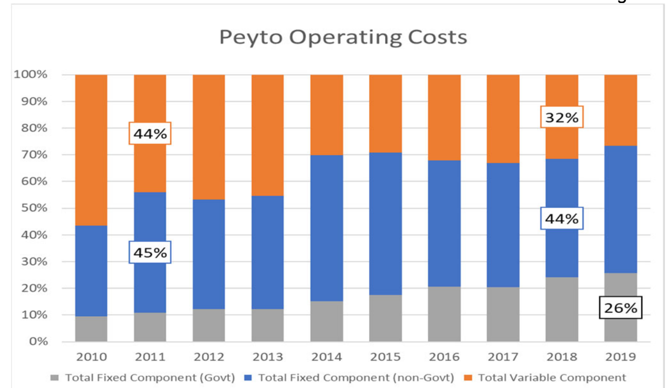
Figure 2



Source: Peter's & Co., Peyto Presentation

As an industry, grinding on operating costs is becoming ever more difficult. That's because there are more and more costs that are outside of our control. These days, there are layers upon layers of government fees and taxes that increase every year and don't scale with either commodity prices or production levels. Every layer of government, from municipal, to provincial to federal are adding fixed costs to the industry's production each year making cost control more difficult.

Figure 3



Source: Peyto

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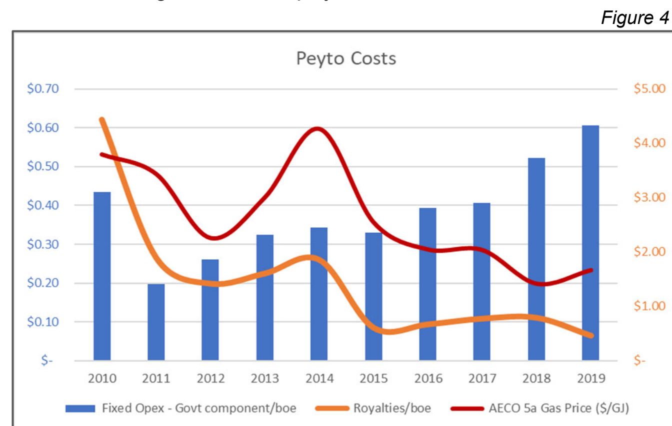
Take a look at Peyto's operating costs (Figure 3) over the last decade. In 2010, we had 60% variable costs and 40% fixed costs, and of that 40% fixed, only 10% were associated with government taxes of various kinds. Things like Yellowhead and Greenview municipal property tax, Alberta Energy Regulator (AER) fees, Orphan well levies, Boiler Vessel fees, Alberta Energy mineral land and surface rentals, Federal Carbon Tax, and on and on. As time has passed all of those fees have continued to increase, some at exorbitant rates.

Today, those government costs make up over one quarter of our total annual operating costs of around $60 million. In other words, what would have been approximately $6 million a year in government charges has exploded to over $15 million a year in just a decade. And remember, those government operating cost charges don't include royalties on production or the portion of government charges associated with our capital program. Levies like the Well Drilling Equipment Tax that we are charged by the local municipalities to move drilling rigs and frac crews in the field are not booked to operating costs but instead are capital expenses. But they are still another layer of costs imposed by the various levels of government.

Unlike Royalties, the biggest problem with these added layers of cost is that they don't scale to productivity or commodity price (Figure 4). The costs are the same (or ever greater every year) regardless of whether the commodity prices are high and companies can afford them, or low and companies can't. Same with productivity. Most of the costs are the same if a well is producing 1,000 boe/d or it's producing 10 boe/d. Obviously, the revenues generated to pay those costs are not the same.

Figure 4

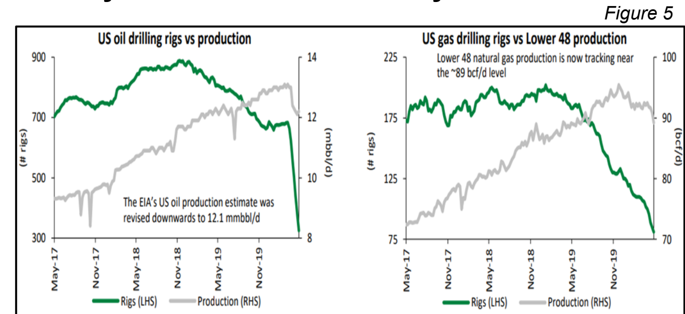


Source: Peyto

As the industry struggles through this incredibly challenging time with gas and now oil prices dipping into negative territory, governments at all levels are going to have to rethink how these various fees and taxes are levied. Some scalability with respect to productivity and commodity price is required, just like when we reworked the royalty take in Alberta. Perhaps its time the industry launched its own "our fair share" review panel to evaulate and review the issue. Without it, more and more industry producers will struggle to reduce costs in order to become competitive again.

Activity Levels and Commodity Prices

Figure 5

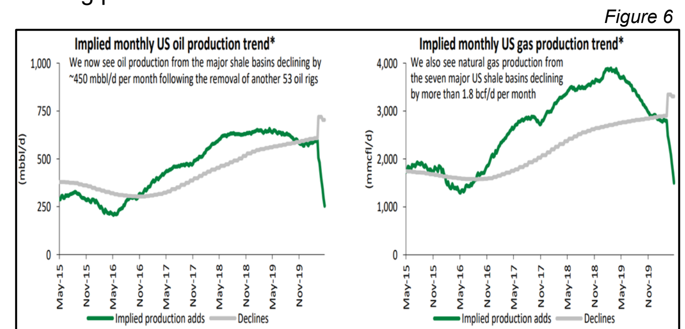


Source: Desjardins

I like these plots from Desjardins. They show how the drop in US drilling activity on both oil and gas plays has resulted in falling production. Clearly, the old adage that "low commodity prices fixes low commodity prices" is alive and well because drilling activity to add replacement production isn't happending when commodity prices are too low. What these plots don't show, however, is that over the last few years, the rate of decline of US oil and gas production has increased significantly. Therefore, the same amount of drilling activity is replacing less and less. This has been offset by increases in drilling rig productivities. In other words, each drilling rig is adding more production per rig than before because it is getting more efficient or the plays are yielding ever better wells.

That's why I like this next pair of graphs even more. In these graphs, rig count is adjusted for productivity and then compared to the base declines so we can see if the activity is enough to grow production or not. Clearly, the current levels of drilling activity in both gas and oil, adjusted for improved rig productivity is nowhere close to offsetting the now steeper declines in the various oil and gas basins in the US. The bottom line is that at current levels of activity, the US oil and gas supply is shrinking, and rapidly. Shrinking supply is ultimately supportive of price, even before we start talking of shutting in existing production.

Figure 6



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.