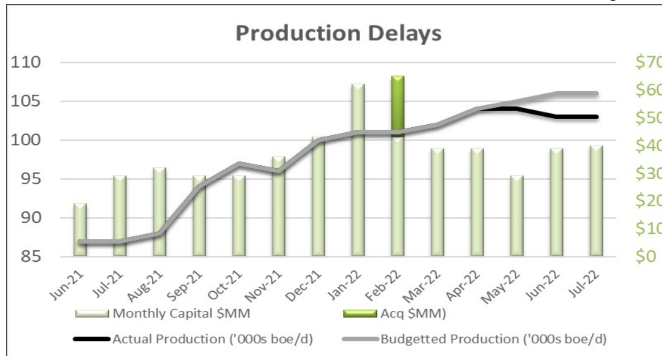
# Peyto Exploration & Development Corp.
# President's Monthly Report

August 2022 — From the desk of Darren Gee, Chief Executive Officer

It's been a challenging couple of months. We should be dancing in the streets right now with record natural gas prices but instead we're a bit frustrated. And it has nothing to do with the PTSD everyone has after two years of pandemic. First the rains in June slowed down our tie in activity connecting new wells. And now we've got unanticipated bottlenecks in select parts of our gathering system that are preventing us from realizing the incremental net production from new drilling. The new wells are looking great in isolation, don't get me wrong. But we are fighting to see total production up in some areas as our gathering system is overwhelmed, particularly in the greater Brazeau area. In the grand scheme of things, this is not a new problem – debottlenecking our gathering system. We've had to do this lots in the past when we're growing. But in the short term its frustrating none the less, particularly with $9 gas. We'll fix that and get caught back up soon.

*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).

***Capital Summary (millions$ CND)****

| | 2020 | Q1 21 | Q2 21 | Q3 21 | Q4 21 | 2021 | Jan | Feb | Mar | Q1 22 | Apr | May | Jun | Q2 22 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Acq/Disp | 3 | 36 | 0 | 0 | 1 | 36 | 0 | 22 | 0 | 22 | 0 | 0 | 0 | 0 |
| Land & Seismic | 8 | 1 | 1 | 2 | 4 | 8 | 0 | 1 | 0 | 1 | 7 | 1 | 1 | 8 |
| Drilling | 105 | 34 | 28 | 43 | 54 | 159 | 18 | 19 | 16 | 52 | 14 | 13 | 18 | 45 |
| Completions | 70 | 18 | 15 | 26 | 27 | 87 | 9 | 13 | 11 | 33 | 6 | 8 | 12 | 25 |
| Tie ins | 23 | 5 | 4 | 7 | 9 | 25 | 3 | 3 | 4 | 10 | 4 | 3 | 3 | 10 |
| Facilities | 26 | 16 | 8 | 12 | 14 | 50 | 32 | 8 | 7 | 47 | 9 | 6 | 6 | 21 |
| **Total** | **236** | **109** | **57** | **90** | **109** | **365** | **62** | **65** | **39** | **166** | **39** | **29** | **40** | **108** |

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

| | Q1 20 | Q2 20 | Q3 20 | Q4 20 | 2020 | Q1 21 | Q2 21 | Q3 21 | Q4 21 | 2021 | Q1 22 | Apr | May | Jun | Q2 22 | Jul |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Sundance | 49 | 47 | 47 | 49 | **48** | 48 | 50 | 49 | 56 | **51** | 57 | 55 | 53 | 55 | 54 | 55 |
| Ansell | 14 | 14 | 13 | 16 | **14** | 17 | 15 | 15 | 16 | **16** | 16 | 16 | 16 | 15 | 15 | 14 |
| Brazeau | 12 | 14 | 15 | 16 | **14** | 17 | 18 | 18 | 16 | **17** | 18 | 22 | 25 | 24 | 23 | 24 |
| Kakwa | 2 | 2 | 2 | 2 | **2** | 2 | 2 | 2 | 2 | **2** | 2 | 2 | 2 | 2 | 2 | 2 |
| Other | 2 | 2 | 1 | 1 | **2** | 4 | 5 | 5 | 7 | **5** | 9 | 10 | 9 | 8 | 9 | 9 |
| **Total** | **79** | **78** | **78** | **84** | **80** | **88** | **89** | **89** | **97** | **91** | **101** | **104** | **104** | **103** | **104** | **104** |
| Liquids % | 15% | 14% | 14% | 13% | 14% | 14% | 14% | 12% | 11% | 13% | 11% | 12% | 13% | 13% | 13% | 13% |

***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.***

## Return On or Of Capital

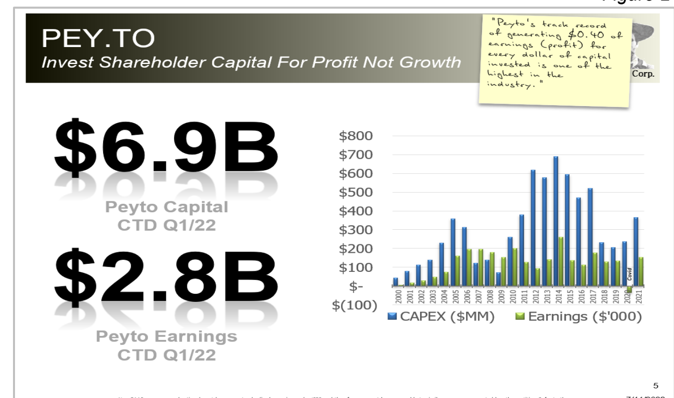
The Calgary Stampede came and went in July with several industry conferences taking place in Calgary. All the talk was about how energy companies were maximizing their return "***of***" capital to shareholders. But I think there must be some confusion there. I mean, who wants to just have their capital given back to them? And I don't think our industry is going anywhere anytime soon, so you don't need to be quickly getting back what you put in. What we should all be talking about, and striving for, is return ***"on"*** capital.

In its simplest terms, return ***on*** capital is the money you make divided by the money you used. And so, to increase the return, you either need to increase the money you make (profit) or decrease the money you use (debt and equity), or both. Which is why all the talk is really about commodity prices driving up the profits, and debt repayment and share buybacks reducing the money being used.

At Peyto, our core focus has always been to maximize the return ***on*** our shareholders' capital (it is theirs after all). Given our expertise in drilling wells and developing reserves, the best way we can do that is to maximize the profit we generate on every dollar of shareholder capital we deploy. That profit is measured by corporate earnings. The only problem with using earnings is that with all the gyrations in commodity prices, if you don't practice hedge accounting, it's hard to see exactly what your earnings are. That's because the unrealized mark to market valuation of a company's hedge book either reduces or inflates earnings, sometimes significantly.

At Peyto, we are one of the rare companies that have always practiced hedge accounting. Which means our earnings are truly reflective of our cash profits. And there has been a lot over the 23 years – some $2.8 billion in earnings, or $0.40 of profit for every dollar of capital invested (Figure 2). It's probably the one thing I'm most proud of during my 21+ years here, for it's very rare in this industry.

*Figure 2*




*Source: Peyto Financials*

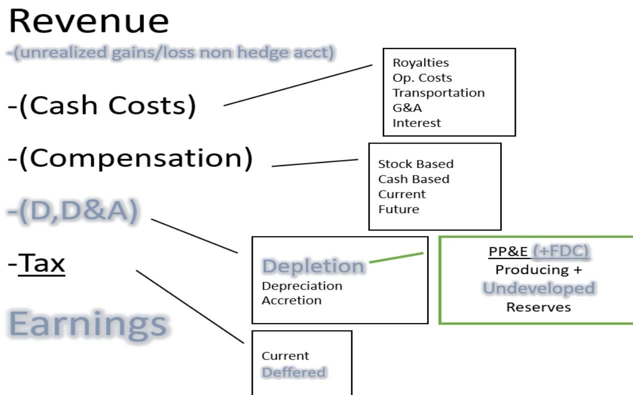


Suite 300, 600 – 3rd Avenue SW
Calgary, AB T2P 0G5
Fax: 403 451 4100
TSX Symbol: PEY
E-mail: info@peyto.com

Perhaps that is now changing, as more and more companies in our industry focus on spending less to chase growth and instead trying to make more return off these higher commodity prices. We too are currently following that same path (spend less, make more). And in doing so we hope to see a significant increase in the rate of earnings generation going forward (Figure 4), mostly as a result of significant margin expansion.

For a quick refresh, lets consider how earnings are calculated for an oil and gas company like Peyto (Figure 3). Quite simply, we take the realized revenue (we do hedge accounting so no unrealized gains are included), deduct the cash costs (including corporate costs of G&A and interest, and other compensation expense), and that gives us the cashflow. Then we deduct the DD&A, which is mostly dominated by depletion. Depletion (on a unit of production basis) for an oil and gas company is determined by looking at the undepreciated capital remaining (actual capital invested) divided by the remaining producing reserves (actual reserves found and developed), plus an estimate of future development capital divided by the undeveloped reserves. Unfortunately, these future numbers are mostly an educated guess *(yes, I know, they are determined by independent reservoir engineers using all the best information at the time).* And for some companies with a lot of future and no past, their entire depletion calculation is mostly a guess. For us at Peyto, it's about 50% of each (actual/future) that we make sure is reasonable (track record on Pg5 of reserves release). Then we take off any current or deferred tax, and we arrive at earnings or profit.

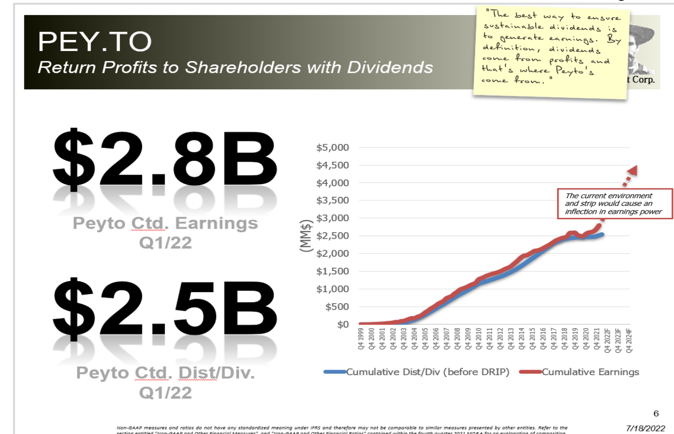
*Figure 3*




I suppose the reason so many don't focus on earnings is that some of these numbers are rather "fuzzy" (for some companies) and that makes the earnings/profit estimates fuzzy. But the margin expansion Peyto's expecting to see, from a significant increase in revenue (driven by higher commodity prices as a result of restricted production growth) combined with a smaller increase in costs, both cash costs (Opex, G&A, Interest, Transport, *but not royalties as they scale up*) and actual capital to develop new reserves, is going to be significant.

As I mentioned last month, higher commodity prices are not necessarily driving higher production, but they are driving higher profits. And that is what we're striving for because higher profit (return ***on*** capital) is what drives higher dividends paid to shareholders. Which, as a big shareholder, I like.

*Figure 4*



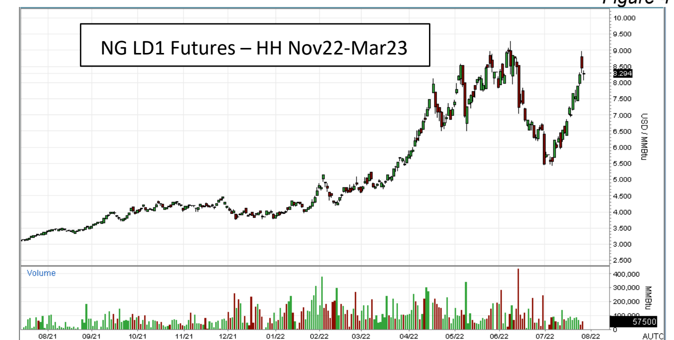

*Source: Peyto Financials*

Milton Freedman would argue that the sole responsibility of business is to generate profit for shareholders. I'm not sure that's the only responsibility, but it should definitely be top of the list. And since oil and gas in North America is an industry made up of companies owned by private shareholders, the goal of the industry should be to make a profit, while at the same time providing a good product (responsibly developed, affordable energy) that appears to be in ever increasing demand.

### Activity Levels and Commodity Prices

The futures curve for NYMEX gas has rallied back to almost the early June levels that established the high water mark (June 7, 2022 was the high). This is despite the 2 BCF/d LNG export outage at Freeport. Heat in the US in eating into that extra 2 BCF/d that's remaining in North America, so not much is going into storage.

*Figure 4*




*Source: ICE*

## 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 netbacks, 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.*