# PEYTO

Exploration & Development Corp.

# 1

*Interim Report*
*for the three months ended March 31, 2001*

# Highlights

| **Three Months Ended**<br>**March 31** | **2001** | 2000 | %<br>Change |
|---|---|---|---|
| **Operations** | | | |
| Production | | | |
| Oil & NGLs (bbl/d) | **472** | 91 | *419* |
| Natural gas (mcf/d) | **13,694** | 1,288 | *963* |
| Barrels of oil equivalent (boe/d @ 10:1) | **1,842** | 220 | *737* |
| Average product prices | | | |
| Oil & NGLs ($/bbl) | **39.89** | 37.20 | *7* |
| Natural gas ($/mcf) | **10.30** | 3.51 | *193* |
| Average operating expenses ($/boe) | **2.06** | 6.30 | *(67)* |
| **Financial ($000)** | | | |
| Revenue | **14,386** | 720 | *1,898* |
| Royalties (net of ARTC) | **3,880** | 175 | *2,117* |
| Funds from operations | **9,681** | 227 | *4,164* |
| Net earnings | **4,618** | 62 | *7,348* |
| Capital expenditures | **20,813** | 8,315 | *150* |
| **As at March 31** | | | |
| Working capital deficit | **8,709** | 1,842 | *372* |
| Long term debt | **22,378** | 4,332 | *417* |
| Shareholders' equity | **25,803** | 8,134 | *217* |
| Total assets | **78,886** | 17,150 | *360* |
| Common shares outstanding (000) | **41,646** | 31,451 | *32* |
| Weighted average common shares outstanding (000) | **40,906** | 28,380 | *44* |
| **Per share data ($/share)** | | | |
| Funds from operations | | | |
| Basic | **0.24** | 0.01 | *2,300* |
| Diluted | **0.23** | 0.01 | *2,200* |
| Earnings | | | |
| Basic | **0.11** | 0.00 | *1,000* |
| Diluted | **0.11** | 0.00 | *1,000* |

# Report from the president

PEYTO Exploration & Development Corp. is pleased to present its first quarter financial and operating results for the period ended March 31, 2001.

## Quarterly Review

Production increased 737% to 1,842 boe per day (barrels of oil equivalent with natural gas production converted on a 10:1 basis) from 220 boe per day in the same period in 2000. Peyto produced 13.7 million cubic feet (mmcf) of natural gas and 472 barrels of natural gas liquids per day. Production gains, higher commodity prices and lower operating costs all combined to increase cash flow from operations from $227,341 in 2000 to $9,680,521 in 2001. Earnings increased over the quarter from $61,908 in 2000 to $4,618,069 in the first quarter of 2001. Product prices averaged $10.30 per mcf for gas and $39.89 per barrel for natural gas liquids and oil. Operating costs decreased from $6.30 to $2.06 per barrel of oil equivalent. The field netback realized was up 196% to $61.93 per boe. Capital spending totaled $20,813,000 for the quarter. Production equipment, facility and pipeline expenditures accounted for 34% of the total capital.

Production at the Sundance plant was shut-in for a total of four days to accommodate plant expansion. Peyto drilled or re-entered 11 (7.3 net) gas wells and pipeline connected an additional 21 (13.5 net) operated gas wells to the Sundance gas processing plant during the quarter.

## Activity Update

Gas processing capacity at the Sundance plant will be fully expanded to 48 mmcf of natural gas per day (46 net) by the end of May 2001. An aggressive drilling program is currently underway to ensure the plant is at full capacity before year end. Peyto currently has three drilling rigs operating in the area.

In April 2001 Peyto entered into an agreement for a revolving credit facility to a maximum of $50,000,000.

On May 10, 2001 Peyto received conditional approval for the listing of common shares of the company on the Toronto Stock Exchange.

## Outlook

Successful exploration and development drilling will continue to lead to significant production growth throughout 2001. At this time, Peyto has an inventory of over seventy locations to drill in the Edson area. Shareholders and interested investors are encouraged to visit Peyto's website, www.peyto.com, for more information on the company.

Don T. Gray, P.Eng.
President and Chief Executive Officer
May 17, 2001

# Management's discussion and analysis

Management's discussion and analysis of financial conditions and results of operations should be read in conjunction with the unaudited interim financial statements for the three months ended March 31, 2001 and the audited consolidated financial statements for the year ended December 31, 2000.

Gross revenues for the first quarter of 2001 increased by 1,898 percent to $14.4 million from $0.7 million in 2000. Natural gas revenues rose by 3,075 percent to $12.7 million in 2001 from $0.4 million in 2000. Natural gas production for the quarter increased by 963 percent to 13.7 mmcf per day from 1.3 mmcf per day in 2000. The price for natural gas rose to $10.30 per mcf in 2001 up 193 percent from $3.51 per mcf in 2000. Revenues from oil and natural gas liquids increased by 467 percent in 2001 to $1.7 million from $0.3 million in 2000 primarily as a result of an increase in production of 419 percent to 472 bbl/d in 2001 from 91 bbl/d in 2000. The price received for oil and natural gas liquids was $39.89 per barrel in 2001 an increase of 7 percent from $37.20 per barrel in 2000.

In the first quarter of 2001, royalties, net of Alberta Royalty Tax Credit (ARTC), increased by 2,117 percent to $3.9 million from $0.2 million in 2000 due to higher gross revenues associated with increased production volumes. The average royalty rate, before ARTC, decreased to 27 percent in 2001 from 29 percent in 2000.

Due to increased production volumes, operating costs for the quarter rose to $0.3 million in 2001 from $0.1 million in 2000. On a barrel of oil equivalent basis ("boe", natural gas converted on a 10:1 basis), operating costs declined by 67 percent to $2.06 per boe in 2001 from $6.30 per boe in 2000. The decrease in operating costs was primarily the result of the Peyto operated processing plant which came on production in the second quarter of 2000 thereby eliminating the reliance on third party facilities as well as generating processing income.

Net general and administrative expenses increased by 9 percent to $166,000 in 2001 from $152,000 in 2000. On a boe basis, net general and administrative expenses decreased by 87 percent to $1.00 per boe in 2001 from $7.59 per boe in 2000. This reduction was the result of the increase in production volumes while maintaining the same level of staff.

Financing charges for the first quarter of 2001 were $295,000 up from $40,000 in 2000. The increase was due to higher debt levels associated with Peyto's 2001 capital expenditures totaling $20.8 million compared with $8.3 million for the comparable period in 2000.

Depreciation, depletion and site restoration expenses rose by 1,025% to $1.2 million in 2001 from $0.1 in 2000 as a direct result of Peyto's increased asset base and production volumes. On a per boe basis, the average depreciation, depletion and site restoration rate increased to $7.25 in 2001 from $5.34 in 2000 as a result of significant facilities, processing plant and pipeline expenditures incurred during the first quarter of 2001.

The provision for future income tax increased to $10.7 million in 2001 from $59,000 in 2000. The increase in the tax provision in 2001 is a direct result of the increased profitability in Peyto due to significantly higher production volumes.

First quarter cash flow for 2001 was $9.7 million compared with $0.2 million in 2000. This 4,750% increase was the result of increased production volumes, higher commodity prices and lower operating costs. On a per share basis, 2001 resulted in cash flow of $0.24 per share versus $0.01 per share in 2000. Peyto's field netback for the quarter improved from $20.94 per boe in 2000 to $61.33 per boe in 2001. Net income in 2001 was $4.6 million or $0.11 per share compared with $62,000 in 2000 or $0.00 per share.

At March 31, 2001, long term debt stood at $22.4 million and the Corporation had a working capital deficiency of $8.7 million resulting in a net debt to running cash flow ratio of approximately 0.9:1. Peyto's $20.8 million capital program was funded through cash flow, working capital and long term debt.

# Quarterly information

| | 2001 | 2000 | | | |
|---|---|---|---|---|---|
| | **Q1** | Q4 | Q3 | Q2 | Q1 |
| **Operations** | | | | | |
| Production | | | | | |
| Oil & NGLs (bbl/d) | **472** | 348 | 313 | 236 | 91 |
| Natural gas (mcf/d) | **13,694** | 9,590 | 9,425 | 6,852 | 1,288 |
| Barrels of oil equivalent (boe/d @ 10:1) | **1,842** | 1,307 | 1,256 | 921 | 220 |
| Average product prices | | | | | |
| Oil & NGLs ($/bbl) | **39.89** | 43.92 | 38.83 | 36.46 | 37.20 |
| Natural gas ($/mcf) | **10.30** | 9.16 | 5.55 | 4.87 | 3.51 |
| Average operating expenses ($/boe) | **2.06** | 3.81 | 3.15 | 3.91 | 6.30 |
| Field netback ($/boe) | **61.33** | 56.63 | 35.70 | 32.34 | 20.94 |
| **Financial ($000)** | | | | | |
| Revenue | **14,386** | 9,486 | 5,930 | 3,818 | 720 |
| Royalties (net of ARTC) | **3,880** | 2,219 | 1,442 | 779 | 175 |
| Funds from operations | **9,681** | 5,947 | 3,805 | 2,479 | 227 |
| Net earnings | **4,618** | 2,946 | 1,715 | 1,183 | 62 |
| Capital expenditures | **20,813** | 19,821 | 5,383 | 10,068 | 8,315 |
| Common shares outstanding (000) | **41,646** | 39,799 | 37,699 | 33,199 | 31,451 |
| **Per share data ($/share)** | | | | | |
| Funds from operations | | | | | |
| Basic | **0.24** | 0.17 | 0.11 | 0.08 | 0.01 |
| Diluted | **0.23** | 0.15 | 0.11 | 0.07 | 0.01 |
| Earnings | | | | | |
| Basic | **0.11** | 0.09 | 0.05 | 0.04 | 0.00 |
| Diluted | **0.11** | 0.07 | 0.05 | 0.03 | 0.00 |

# Financial statements

**Balance Sheet**

| As at | March 31 2001 (unaudited) | Dec. 31 2000 (audited) |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash | **$ 120,432** | $ 53,027 |
| Accounts receivable | **10,698,357** | 11,620,928 |
| Prepaids | **304,959** | 247,053 |
| | **11,123,748** | 11,921,008 |
| Property, plant and equipment *(Note 2)* | **71,771,236** | 50,958,564 |
| Accumulated depreciation & depletion | **(4,009,045)** | (2,822,474) |
| | **67,762,191** | 48,136,090 |
| | **$ 78,885,939** | $ 60,057,098 |
| **Liabilities and Shareholders' Equity** | | |
| **Current** | | |
| Accounts payable and accrued liabilities | **$ 19,737,521** | $ 19,477,534 |
| Capital taxes payable | **95,731** | 68,804 |
| | **19,833,252** | 19,546,338 |
| **Long term debt** | **22,378,062** | 13,199,728 |
| **Site restoration provision** | **133,273** | 117,845 |
| **Future income taxes** | **10,738,529** | 6,884,091 |
| **Shareholders' equity** | | |
| Share capital *(Note 3)* | **15,426,703** | 14,551,045 |
| Retained earnings | **10,376,120** | 5,758,051 |
| | **25,802,823** | 20,309,096 |
| | **$ 78,885,939** | $ 60,057,098 |

# Financial statements

**Statements of Earnings and Retained Earnings (Deficit)**
(unaudited)

| **Three Months Ended March 31** | **2001** | 2000 |
|---|---|---|
| **Revenue** | | |
| Oil and gas sales, net | **$ 10,505,548** | $ 545,315 |
| Interest and other income | **3,780** | - |
| | **10,509,328** | 545,315 |
| **Expenses** | | |
| Operating | **341,121** | 126,224 |
| General and administrative | **165,519** | 151,780 |
| Interest | **295,240** | 39,970 |
| Depletion, depreciation and site restoration | **1,201,999** | 106,834 |
| | **2,003,879** | 424,808 |
| Earnings before taxes | **8,505,449** | 120,507 |
| Future income tax expense | **(3,860,453)** | (58,599) |
| Capital tax expense | **(26,927)** | - |
| Earnings for the period | **4,618,069** | 61,908 |
| Retained earnings (deficit), beginning of period | **5,758,051** | (148,162) |
| **Retained earnings (deficit), end of period** | **$ 10,376,120** | $ (86,254) |
| Earnings per share | | |
| Basic | **$0.11** | $0.00 |
| Diluted | **$0.11** | $0.00 |

# Financial statements

**Statements of Cash Flows**
(unaudited)

| **Three Months Ended March 31** | | **2001** | | 2000 |
|---|---|---|---|---|
| **Cash provided by (used in)** | | | | |
| **Operating Activities** | | | | |
| Earnings for the period | **$** | **4,618,069** | $ | 61,908 |
| Items not requiring cash: | | | | |
| Future income taxes | | **3,860,453** | | 58,599 |
| Depletion, depreciation and site restoration | | **1,201,999** | | 106,834 |
| Funds from operations | | **9,680,521** | | 227,341 |
| Change in non-cash working capital from operations | | **2,998,845** | | 93,134 |
| | | **12,679,366** | | 320,475 |
| **Financing Activities** | | | | |
| Issue of common shares, net of costs | | **869,643** | | 50,635 |
| Convertible debenture | | **-** | | 2,700,000 |
| Increase in long term debt | | **9,178,334** | | 1,616,958 |
| | | **10,047,977** | | 4,367,593 |
| **Investing Activities** | | | | |
| Additions to property, plant and equipment | | **(20,812,672)** | | (6,333,570) |
| Change in non-cash working capital related to investing activities | | **(1,847,266)** | | 665,160 |
| Cash acquired in acquisition of Largo Petroleum Inc. | | **-** | | 543,148 |
| | | **(22,659,938)** | | (5,125,262) |
| **Net increase (decrease) in cash** | | **67,405** | | (437,194) |
| Cash, beginning of period | | **53,027** | | 443,725 |
| **Cash, end of period** | **$** | **120,432** | $ | 6,531 |
| Cash flow per share | | | | |
| Basic | | **$0.24** | | $0.01 |
| Diluted | | **$0.23** | | $0.01 |

# Notes to financial statements

1. Accounting Principles

The financial statements of the Company have been prepared by management in accordance with accounting principles generally accepted in Canada. These interim financial statements have been prepared on the same basis as the audited financial statements as at and for the year ended December 31, 2000 with the exception of diluted per share calculations. Management's discussion and analysis of financial conditions and results of operations should be read in conjunction with the unaudited interim financial statements for the three months ended March 31, 2001 and the audited consolidated financial statements for the year ended December 31, 2000. Effective January 1, 2001, the Company adopted the treasury stock method of calculating the dilutive effect of outstanding options to acquire common shares as recommended by the CICA. Comparative figures for 2000 have been restated accordingly.

2. Property, Plant and Equipment

| | **2001**<br>$ | 2000<br>$ |
|---|---|---|
| Property, plant and equipment | **71,571,425** | 50,784,483 |
| Office furniture and equipment | **199,811** | 174,081 |
| | **71,771,236** | 50,958,564 |
| Accumulated depletion and depreciation | **(4,009,045)** | (2,822,474) |
| | **67,762,191** | 48,136,090 |

At March 31, 2001, costs of $8,250,000 (March 31, 2000 - nil) related to undeveloped land have been excluded from the depreciation calculation. No general and administration expenses relating to the Company's exploration, development and acquisition programs were capitalized.

3. Share Capital

**Authorized**

Unlimited number of common voting shares
Unlimited number of preferred shares, issuable in series

**Issued - Common shares**

| | **Number of Shares** | **Amount**<br>$ |
|---|---|---|
| **Balance, December 31, 2000** | 39,799,064 | 14,551,045 |
| Exercise of stock options | 1,847,667 | 883,123 |
| Share issue costs, net of associated tax benefits | — | (7,465) |
| **Balance, March 31, 2001** | 41,646,731 | 15,426,703 |

## Notes to financial statements (continued)

4. Subsequent Events

**Long Term Debt**

In April 2001 Peyto entered into an agreement with the Royal Bank of Canada for a revolving credit facility to a maximum of $50,000,000. Outstanding amounts on this facility bear interest at bank prime and are due on demand. A General Security Agreement with a floating charge on land registered in Alberta is held as collateral by the bank.

**Listing of Common Shares**

On May 10, 2001 Peyto received conditional approval for the listing of common shares of the Company on the Toronto Stock Exchange.

# Corporate information

**Officers**

Don Gray
President and Chief Executive Officer

Roberto Bosdachin
Vice-President, Exploration

Mark Balen
Vice President, Operations

Darren Gee
Vice President, Exploitation

Sandra Brick
Vice President, Finance

Steve Chetner
Corporate Secretary

**Directors**

Rick Braund

Don Gray

Mike Broadfoot

Brian Craig

Jim Riddell

Stephen Chetner

**Auditors**
Ernst & Young LLP

**Solicitors**
Burnet, Duckworth & Palmer

**Bankers**
Royal Bank of Canada

**Transfer Agent**
Computershare Trust Company of Canada

**Head Office**
420, 333 – 5 Avenue SW
Calgary, AB
T2P 3B6

Phone: 403.261.6081
Fax: 403.261.8976
Web: www.peyto.com

Stock Listing Symbol: PEY
Canadian Venture Exchange