PEYTO Energy Trust President's Monthly Report

July 2010

We "turned around" our largest gas plant (Oldman) in the Sundance field last week, meaning that it was shut down for its five year scheduled maintenance. In total, 6,000 boe of production was deferred which will have a slight impact on the June production volumes and a very minor impact on Q2 production. But this turnaround, which only lasted 15 hours, was a substantial improvement over the same activity five years ago which took 2.5 days. Innovation and planning helped to achieve this improvement while still meeting the critical objectives. The same observations could be extended to the entire natural gas industry in North America. We are getting more production and making more money from reservoirs previously disregarded as non-commercial because of innovation, technology and project planning. The ingenuity of man is hard at work.

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

2009/2010 Capital Summary (millions\$ CND)*

	2009	Jan	Feb	Mar	Q1	Apr	May	Jun	Q2
Land & Seismic	6	0	0	0	0	0	0		
Drilling	44	10	9	12	31	3	4		
Completions	23	4	7	6	16	6	0		
Tie ins	10	4	2	3	8	1	1		
Facilities	2	1	0	1	2	1	5		
Drilling Credit Used	-6	-1	-1	-1	-3	-1	0		
Sub Total	- 78	18	17	20	55	10	9		
Rem. Drilling Credit	-5	-3	-1	-1	-5	0	0		
Total	73	15	16	19	50	10	9		

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

Production

2010 Production ('000 boe/d)*

	Jan	Feb	Mar	Q1 10	Apr	May	Jun	Q2 09
Sundance	15.9	16.5	17.1	16.5	18.3	18.9	18.2	18.5
Kakwa	2.5	2.9	3.0	2.8	2.9	2.7	2.6	2.7
Other	1.2	1.4	1.3	1.3	1.1	1.1	1.0	1.1
Total	19.5	20.8	21.4	20.6	22.3	22.7	21.8	22.3
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Growth Happens

The same question keeps popping up in investor meetings lately, regarding Peyto's most recent production growth and some industry projections about our future production growth. How are we able to achieve such growth when the last few years have produced none? The answer has to do with capital efficiency. And by *Capital Efficiency* I mean the cost to build a new unit of production, either barrel of oil equivalent (boe) or thousand cubic feet of natural gas equivalent (mcfe) (6 mcfe = 1 boe).

Unfortunately, *Capital Efficiency* is not a very meaningful metric and it must be measured in the context of both time

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From the desk of Darren Gee, President & CEO

and production type. Also, capital efficiency, as we define it, is by no means a measure of profitability because it is a snapshot at one point in time. At Peyto, in an attempt to compare apples to apples, we measure capital efficiency at the end of each calendar year and use it to compare the capital programs year over year. For instance, in 2009 we spent \$73 million to build approximately 4,200 boe/d of new production at capital efficiencies of \$17,300/boe/d. This compares to 2008 where we spent \$139 million to build 4,200 boe/d of production at \$33,000/boe/d (which compares to a more typical acquisition cost between \$60,000 and \$100,000/boe/d).

As I mentioned, this metric only becomes meaningful if we compare the same type of production being built (Deep Basin, liquids rich, sweet, tight gas, Cretaceous reservoirs) and at the same time (end of each year). The following graph shows Peyto's capital efficiency and production additions over the last ten years relative to that year's capital spending.



It's obvious from this graph, that in years when capital efficiency was good, less than \$20,000/boe/d, and capital programs were meaningful, there was growing production. In years when capital efficiency was not good, greater than \$40,000/boe/d, even with large capital programs, production didn't grow.



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However, one additional variable is required to determine capital efficiency - base production decline. This is required so we can see the incremental portion of production that has been built (or might be built in the future). Shown in figure 2 is the waterfall plot that reflects each wedge of production built in that year. Overlain is the aggregate base decline of the previous years of production that the newly built production has to offset. As Peyto's base of production stabilizes, this decline has slowly come down from a high of 32% to close to 20% now.

So there are 3 variables that control future growth potential:

- 1. Base decline
- 2. Size of capital program
- 3. Capital efficiency

Using these variables one can then project how production growth might or might not occur in the future.

For instance, if we were to assume the same base decline as experienced in 2009 of 20%/yr, then exit volumes of 19,500 boe/d (as reported in my Jan 2010 monthly report), might decline to 15,600 boe/d by the end of the year. That would mean 3,900 boe/d would have to be built in 2010 just to hold production flat.

If we also assume that the same capital efficiency of \$17,300/boe/d can be achieved with a capital program of, say \$225 million, then approximately 13,000 boe/d can be added, resulting in 9,100 boe/d of production growth from the 19,500 boe/d. However, if we assumed that capital efficiency of only \$40,000/boe/d was achieved with the \$225 million, then only 5,600 boe/d of can be added, resulting in only 1,700 boe/d of production growth.

A change in base production decline can have a similar effect as a change in capital efficiency. Obviously, offsetting 35%/yr base decline requires more capital before growth can be observed, than offsetting a 20%/yr base decline. That hypothetical math is shown below.

	Example 1	Example 2	Example 3	Example 4	
Base Production					
Start of yr prod.	19,500	19,500	19,500	19,500	boe/d
Base decline/yr	20%	20%	35%	35%	%/yr
End of yr prod.	15,600	15,600	12,675	12,675	boe/d
New Production					
Capex	\$ 225	\$ 225	\$ 225	\$ 225	\$MM
Capital Eff.	17,300	40,000	17,300	40,000	\$/boe/d
New prod added	13,006	5,625	13,006	5,625	boe/d
Total Production					
End of yr total prod.	28,606	21,225	25,681	18,300	boe/d

As I warned earlier, knowing capital efficiency might enable us to predict production growth, but it does nothing to tell us whether capital was invested profitably. For that we need to

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do a completely different analysis regarding full reserve life returns.

Generally speaking, if you focus on returns, and manage to achieve them, more often than not growth also happens. However, if you focus solely on growth and forget about returns, you can sometimes achieve it, while not generating any return at all. Profitless growth. It's worthless, and yet oftentimes is mistakenly rewarded by the market.

Activity Levels and Commodity Prices

The first half of 2010 has definitely been a historic year as far as drilling is concerned. For the first time ever, horizontal wells have outpaced all others in the basin. Figure 3 provided by Peter's&Co. shows that comparison.



This just confirms why certain oilfield services are actually operating at near maximum capacity, while others are still idling. *The times, they are a-changing.*

Natural gas prices seem to have found support at the \$5 NYMEX level, which translates into \$4 AECO when you account for the transportation and \$0.98 CND dollar. The futures strip still projects out between \$5 and \$6 (www.gasalberta.com) which is enough to keep our capital program on track.



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