

Peyto Exploration & Development Corp.

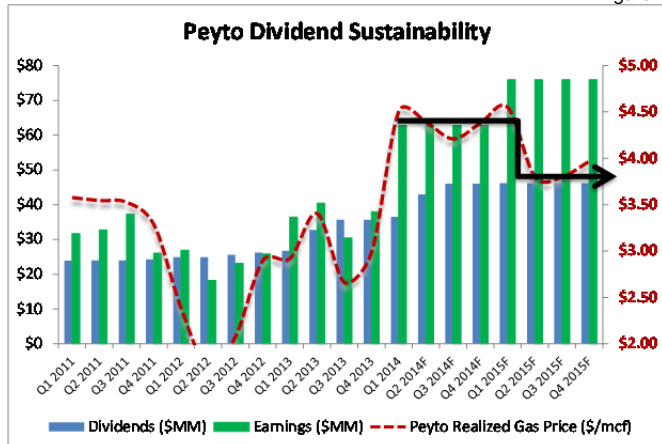
President's Monthly Report

June 2014

From the desk of Darren Gee, President & CEO

I'm hearing that many investors were surprised by our recent dividend bump. That surprises me. Sure, the current natural gas prices are in the \$4/GJ range, giving us realized prices in the \$5/mcf range and a boost in earnings but that's not what we used in determining the increase. We assumed next year's prices in the \$3s in determining what level of sustainable dividend we could pay out of earnings today (see our forecast using the strip in Figure 1).

Figure 1



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*

2012/13 Capital Summary (millions\$ CND)*

	Q1	Q2	Q3	Q4	2012	Q1	Q2	Q3	Q4	2013	Jan	Feb	Mar	Q1	Apr
ONR Acq./other acq.			205	-21	184	0	0	0	0	0.0					0
Land & Seismic	3	1	2	6	12	2	6	3	2	11.9	6	0	1	7	1
Drilling	52	23	59	78	211	76	32	86	60	253.0	24	27	30	80	22
Completions	31	14	35	47	127	41	10	54	47	151.7	11	11	14	36	16
Tie ins	8	5	11	22	46	15	7	14	12	48.2	7	5	5	16	4
Facilities	4	3	6	25	37	36	18	24	34	112.2	18	11	12	40	6
Total	99	46	317	157	618	169	74	181	155	578	65	53	62	179	49

Production*

2012/13/14 Production ('000 boe/d)*

	Q3 12	Q4 12	2012	Q1 13	Q2 13	Q3 13	Q4 13	2013	Jan	Feb	Mar	Q1 14	Apr	May
Sundance	35.7	36.0	35.4	39.7	41.6	41.5	47.4	42.6	48.3	50.1	49.7	49.3	50.4	51.0
Kakwa	3.6	3.1	3.7	3.3	3.0	2.6	2.5	2.9	2.4	2.5	2.4	2.4	2.5	2.4
Ansell	2.9	6.8	2.4	8.8	10.7	9.9	13.9	10.8	16.1	15.8	15.3	15.7	14.3	14.8
Other	3.6	3.6	3.0	3.3	2.9	2.4	3.6	3.1	4.9	4.9	4.6	4.8	4.2	3.9
Total	45.9	49.5	44.5	55.2	58.2	56.5	67.3	59.3	71.7	73.3	72.0	72.3	71.4	72.1

* 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.

Travels with a Trader

I just got back from a west coast marketing tour with an institutional trader and we were discussing how new technology, like that of high frequency trading algorithms, is messing up his ability to do his job effectively and that it hasn't really improved the liquidity situation like it was supposed to.

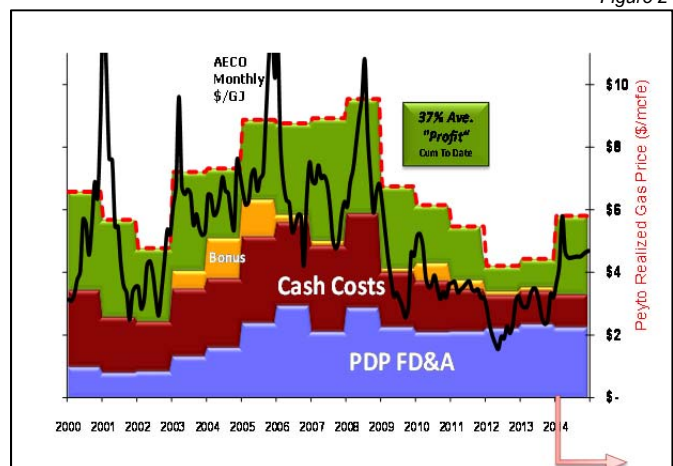
It got me thinking about the impact of new technology, especially the technology that we use in the oil and gas business today, that of horizontal multi-stage fractured well designs, and whether or not it has really improved how we do our business.

If you asked most people, they would tell you that the horizontal well technology has lowered supply costs thereby causing supply to increase and the price of the commodity to fall. And that's why natural gas prices in North America are so low. But I'm not sure I necessarily agree with that sentiment. When I look at Peyto's business and our supply costs, it doesn't seem to support that statement.

Instead, I would conclude that the advantage of this new technology is not to lower absolute supply cost but to unlock additional resources and accelerate capital investment. This is perhaps why those companies most successful with the technology are the ones who have been able to increase their capital programs, have the most and cheapest access to capital and have the expertise to execute larger scale operations.

Let's look at supply costs for starters. I would define **total** supply cost as all the costs to find and develop new producing reserves and all the costs to produce and sell them, including corporate costs like G&A and interest. Peyto's costs over the last 15 years are in the following graph.

Figure 2



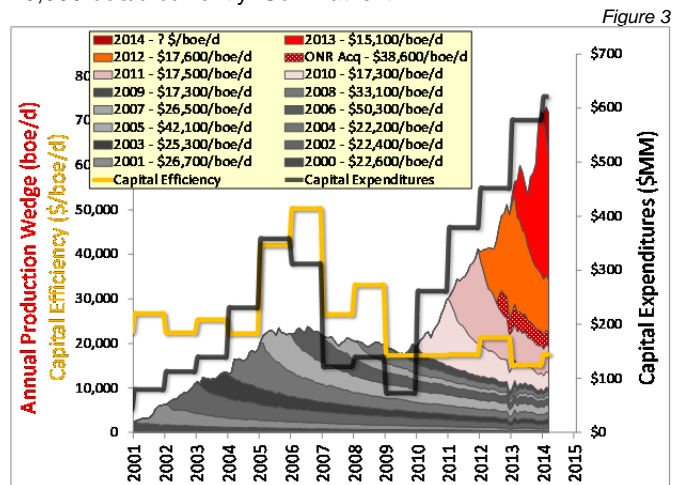
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As you can see, our total costs are not lower today, or over the last several years, than they were before we started to use the "new technology." In fact, if anything, our costs to find and develop new reserves, or our PDP FD&A, are more expensive today than they were back in the 2002 era of vertical wells (\$2/mcfe vs \$1/mcfe). Our cash costs, or our producing costs, are cheaper than they were (\$1/mcfe vs \$2/mcfe), mostly because of lower royalties, due to lower gas prices, lower opex due to fuller facilities and lower interest rates. The combination of the two costs, however, is more or less the same when you look at a period like 2002, which had the same natural gas prices, and compare it to the last couple of years.

So is the total supply cost lower? Not for Peyto it isn't. So if supply cost hasn't changed, then what has? Looking at Figure 2, something must have changed to allow Peyto to grow its production from 17,000 boe/d in the fall of 2009 to over 70,000 boe/d currently. So what is it?



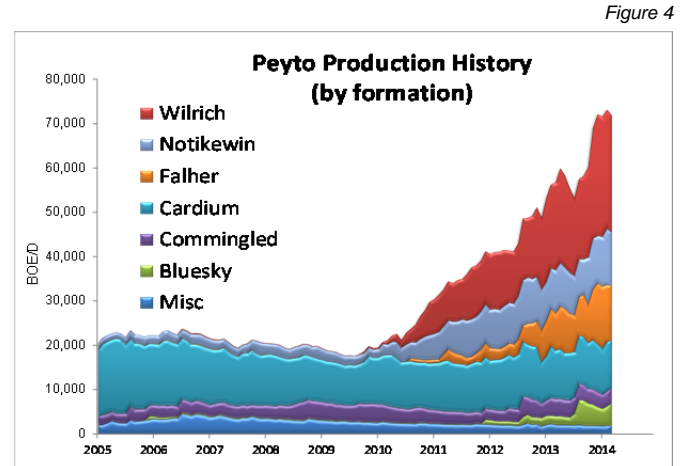
For one, capital investments are way up (black line). And who would have predicted a small team of less than 50 employees could deploy over \$600MM just as effectively as \$300MM ten years ago? That's because we're not drilling more wells. They just cost more, produce more and capture more reserves.

At the same time we're building more initial production for every dollar we're spending. Capital efficiency is better from the \$25-30,000/boe/d level in the 2002 era, to sub \$20,000/boe/d now (yellow line).

Like I said, we've accelerated capital spending, efficiently executed all those operations and grown dramatically, primarily using the cheapest capital we can find, ie. Cashflow.

When you look at what zones are driving that growth, like the Notikewin, Falher and Wilrich, they are not the same ones we

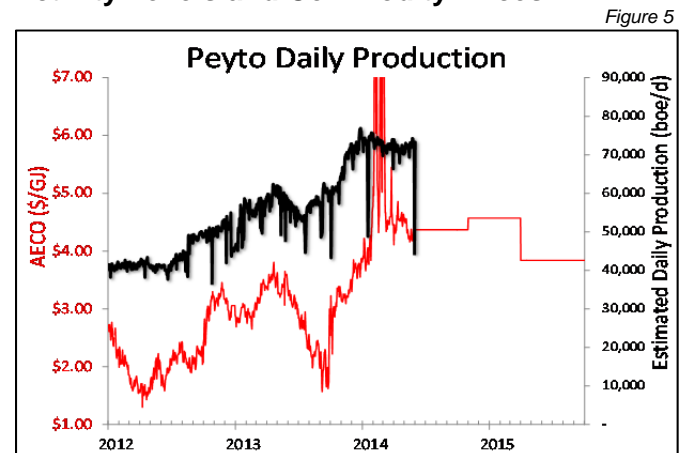
were developing a decade ago (see Figure 3). The technology has definitely allowed us to unlock even lower quality reservoirs and even more reserves than we could before.



All of these dynamics are interesting results from the new technology. But the most important question is still, does the technology make us more profit?

Based on the return analysis that we always do to justify investing shareholder's money, it appears we are making the same amount of return, just on a larger amount of capital. And that's a definite improvement.

Activity Levels and Commodity Prices



Despite our continued struggles with reliable power to our gas plants, our daily volumes are starting to grow, reflecting our continued operations through breakup. At the same time, AECO daily prices are drifting lower, pressured by the softening of the futures strip despite the fundamental storage issues.