

# Peyto Exploration & Development Corp.

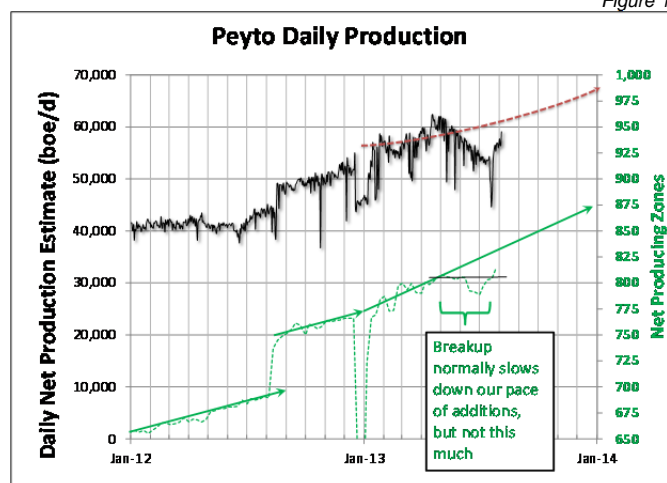
## President's Monthly Report

August 2013

From the desk of Darren Gee, President & CEO

If June was a bad weather month, July was even worse. More very wet surface conditions delayed us at every turn from executing our completion and drilling program, while problems with our dehydration at Oldman interrupted some of the wells that we did have on production (1,000 boe/d). Thankfully, we have persevered and are finally getting to the backlog of completions and tie-ins, which, in turn, is getting production back on track with our growth plans. Figure 1 illustrates the daily production estimates along with the net zones on production. You can see the abnormal 2.5 month period this summer when no new producing zones were added (and its effect on capital investment/total production!).

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)\*

	2011	Q1	Q2	Q3	Q4	2012	Q1	Apr	May	Jun	Q2
ONR Acq./other acq.				205	-21	184	0				0
Land & Seismic	28	3	1	2	6	12	2	3	2	1	6
Drilling	178	52	23	59	78	211	76	9	3	20	32
Completions	104	31	14	35	47	127	41	9	0	1	10
Tie ins	32	8	5	11	22	46	33	2	1	4	7
Facilities	40	4	3	6	25	37	17	6	6	6	18
<b>Total</b>	<b>379</b>	<b>99</b>	<b>46</b>	<b>317</b>	<b>157</b>	<b>618</b>	<b>169</b>	<b>29</b>	<b>13</b>	<b>32</b>	<b>73</b>

### Production\*

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

	Q1 12	Q2 12	Q3 12	Q4 12	2012	Q1 13	Apr	May	June	Q2 13	Jul
Sundance	35.4	34.3	35.7	36.0	35.4	39.7	43.2	41.7	40.0	41.6	38.1
Kakwa	3.8	4.2	3.6	3.1	3.7	3.3	3.2	2.9	2.9	3.0	2.7
Ansell	-	-	2.9	6.8	2.4	8.8	10.2	11.3	10.5	10.7	10.3
Other	2.0	2.8	3.6	3.6	3.0	3.3	3.4	2.8	2.6	2.9	2.4
<b>Total</b>	<b>41.2</b>	<b>41.3</b>	<b>45.9</b>	<b>49.5</b>	<b>44.5</b>	<b>55.2</b>	<b>60.0</b>	<b>58.7</b>	<b>56.0</b>	<b>58.2</b>	<b>53.5</b>

\* 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.

### Más gas por favor?

The 2013 Calgary Stampede saw just shy of 1.2 million visitors, similar to 2011 and 2010 (2012 was the 100<sup>th</sup> anniversary, so it was more), which was an amazing result considering the flooded grounds 2 weeks prior. Among those visiting, were portfolio managers from across the globe, using the event as an added excuse to come hear about the many energy companies headquartered here in Calgary.

During the week, I presented at several conferences and attended many other functions, one of which afforded me a rare opportunity to dine with famed Texan and Octogenarian, Henry Groppe. Henry is a seasoned veteran of the oil and gas industry, and through his firm of Groppe, Long & Littell, provides long-term forecasts for oil, natural gas, NGLs and refined products which are used by companies, financial institutions and governments around the world. They've been at it for more than 50 years.

Not only did he regale us with stories of his relationships with the likes of T. Boone Pickens and George Bush, he also offered his views on North American oil and gas prices, which was obviously closer to my particular interests.

First off, he's a long term, natural gas price bull (we got along right away) and a rather large skeptic of claims that the US has, effectively, an unlimited supply of natural gas reserves that can be cheaply developed. He believes, based on his firm's detailed modelling, that not only are all conventional sources of US natural gas in steep decline (Gulf of Mexico, Tight gas, Coal Bed Methane, etc.), the shale plays with their high decline rates will also soon, in aggregate, begin to decline. Mostly because a \$4 gas price does not justify the activity required to develop enough production to offset the declines.

Interestingly, he also argues that US demand for natural gas has peaked and will begin to decline. This is due to more efficient use of natural gas and efficient electricity generation going forward. I'm not sure I agree with him on this part.

So in combination, he is forecasting US domestic supply will overtake US domestic demand by around 2016 but that it will only stay like that for a few years before declining supplies will drop below declining demand again and the US will be back in an undersupplied situation. This happens around the same time as LNG exports in both Canada and the US come online. This is when he is forecasting natural gas prices really take off, effectively catching up to world oil prices (less the appropriate liquifaction and transportation costs) but most definitely a price in the double digits!

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

August 2013

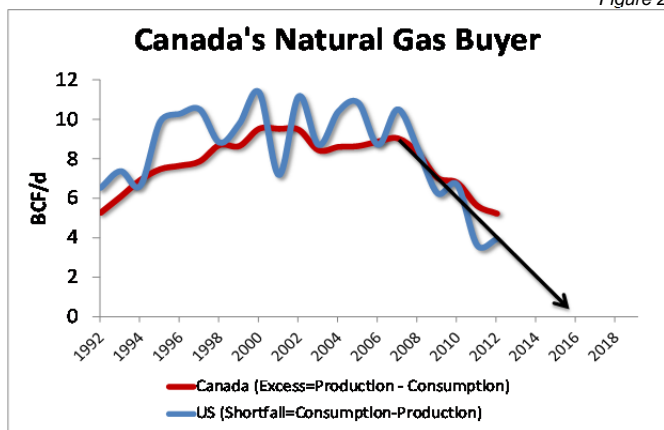
From the desk of Darren Gee, President & CEO

He paints an interesting view of the future. Basically suggesting that natural gas prices will not be demand driven but supply (price) driven. That US consumption will decline from here but that the globalization of gas, via LNG exports, will close the price gap between US gas prices and Brent oil prices.

So where does that leave Canadian gas? Although he admits he doesn't model Canada with nearly the same precision that they model the US, he is forecasting Canadian exports to the US to continue to shrink, as US supply fills US demand.

That isn't news to me. As I've shown in the past (and in Figure 2) when we look at US imports and our exports, that volume is quickly heading south.

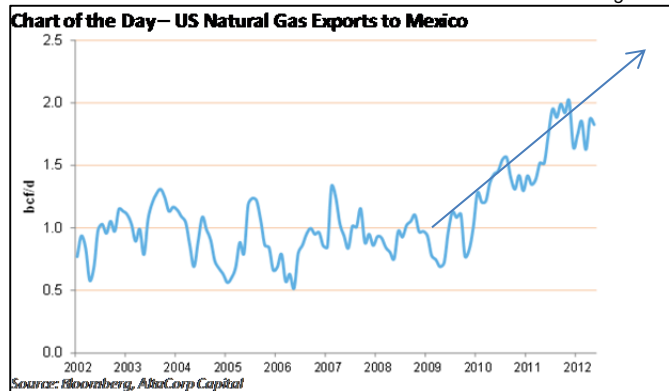
Figure 2



Source: EIA, Peyto

Or perhaps our Canadian gas might just flow "through" the US, on it's way to Mexico. If the US becomes self sufficient in natural gas, and Canada has too much, but Mexico not enough – then maybe it makes sense that our excess feeds Mexico's shortfall? It's already pipeline connected and Mexican imports have been rising steadily of late (Figure 3).

Figure 3



By 2016, there could be a market for 2.5-3.0 BCF/d of Canadian natural gas. With our current excess of 5 BCF/d shrinking fast, we might just have that amount by then. So maybe the options for excess Canadian gas are not just limited to LNG exports and increased domestic demand.

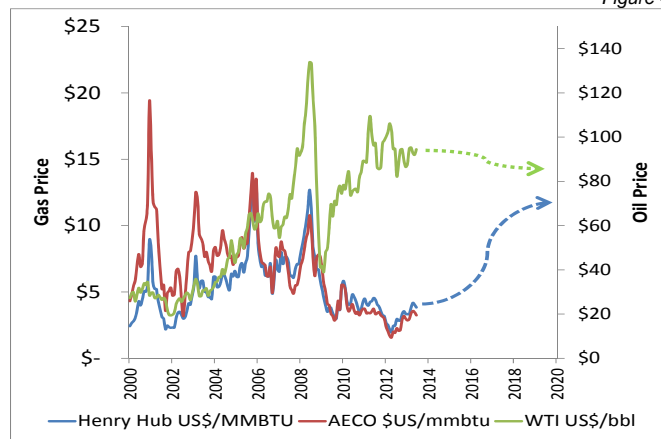
While I mostly agree with Henry on his assessment of the supply side for North American natural gas, I disagree with his assessment of demand. The price may indeed stay in that \$4 range for the next few years (advantage Peyto), but I think that low prices will drive continued demand growth. And since natural gas is the cleaner environmental alternative to coal or oil, that demand growth will be permanent. Sign me up for a new 2014 CNG powered Ford F150!!

## Activity Update and Commodity Prices

This latest issue with the AECO gas price is a frustrating one. It's caused by Eastern buyers who are rejecting Western gas because of high interruptible tolls charged by TCPL. TCPL is doing so to encourage those buyers to sign up for long term transport on their Mainline. I suspect the buyers believe they have such a luxury to reject Western gas, and instead either deplete their storage (rather than fill it at this time of year), or use available supplies coming from Eastern US shale gas. This results in the backing up of Western Canadian gas and the filling of our storage rather fast, thus pushing AECO prices down. We probably shouldn't be surprised. As natural gas becomes more of a continental and global commodity, there will be all kinds of volatility in prices by an even greater host of factors. Being the low cost producer is the only protection.

What needs to be kept in mind, and something that Henry Groppe is forecasting, is the amount gas prices have to increase to close the heating value gap with oil. If his prediction on timing is right, we're more than half way there.

Figure 4



Source: EIA, Peyto