

Peyto Exploration & Development Corp.

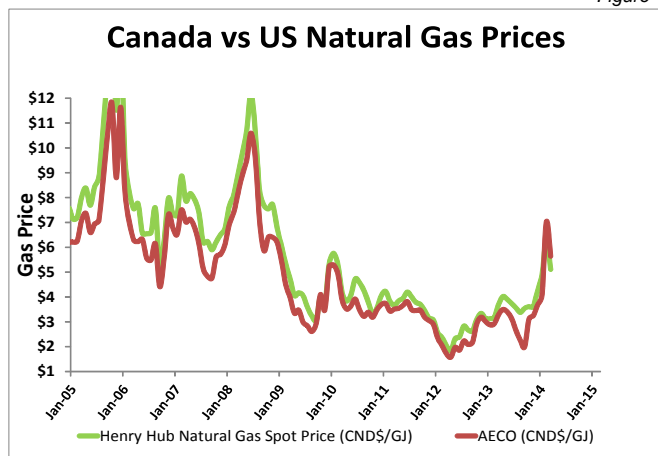
President's Monthly Report

April 2014

From the desk of Darren Gee, President & CEO

Winter looks like it is finally coming to a close and with it all the pressure on natural gas prices. Alberta day prices are back down to the \$4 levels, more in line with the next 12 months of future strip. That's still a great price relative to what we've seen over the past few years. US prices (shown as Henry Hub in CND\$) didn't get quite as high as Canadian prices, but then, we had colder weather. Henry Hub is back into the \$4 range now too. For a moment there, both of us had visions of '05-'08 - boy were those lofty days.

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	Oct	Nov	Dec	Q4	2013	Jan	Feb
ONR Acq./other acq.			205	-21	184	0	0	0				0	0.0		
Land & Seismic	3	1	2	6	12	2	6	3	1	1	0	2	11.9	6	0
Drilling	52	23	59	78	211	76	32	86	22	24	14	60	253.0	24	27
Completions	31	14	35	47	127	41	10	54	15	18	15	47	151.7	11	11
Tie ins	8	5	11	22	46	15	7	14	5	4	3	12	48.2	7	5
Facilities	4	3	6	25	37	36	18	24	19	10	5	34	112.2	18	11
Total	99	46	317	157	618	169	74	181	61	57	36	155	578	65	53

Production*

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

	Q3 12	Q4 12	2012	Q1 13	Q2 13	Q3 13	Oct	Nov	Dec	Q4 13	2013	Jan	Feb	Mar	Q1 14
Sundance	35.7	36.0	35.4	39.7	41.6	41.5	43.7	48.1	50.3	47.4	42.6	48.3	50.1	49.7	49.3
Kakwa	3.6	3.1	3.7	3.3	3.0	2.6	2.6	2.5	2.4	2.5	2.9	2.4	2.5	2.4	2.4
Ansell	2.9	6.8	2.4	8.8	10.7	9.9	11.7	14.6	15.4	13.9	10.8	16.1	15.8	15.3	15.7
Other	3.6	3.6	3.0	3.3	2.9	2.4	2.3	4.0	4.5	3.6	3.1	4.9	4.9	4.6	4.8
Total	45.9	49.5	44.5	55.2	58.2	56.5	60.3	69.2	72.6	67.3	59.3	71.7	73.3	72.0	72.3

* 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.

Funding Sustainability

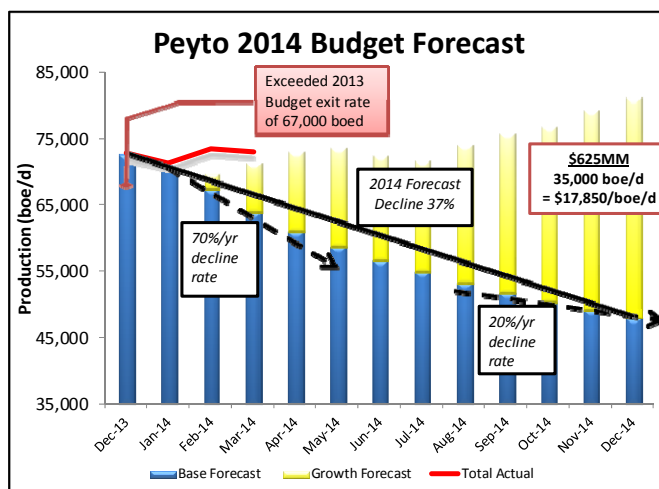
The first day of spring is fast approaching and with it the traditional spring thaw. It is the only time of year that most of the activity grinds to a halt in the Canadian oil patch and usually affords us a rare, albeit brief, look at the behaviour of Western Canadian base production without the noise.

Usually, all of the new production additions that happen throughout the year make it difficult to see the declining nature of older production. But if we're trying to discern the sustainability of current production levels and the potential effect of supply on commodity prices, you need to have a sense of what the underlying "base" production is doing.

Take Peyto for example. We often show our corporate production broken into the base, or the declining wedge, and the incremental additions, that are a result of our capital program. The ratio of total capital spent divided by the annual incremental production additions, we refer to as the capital efficiency or \$/boe/d.

Figure 2 is an example of our forecast for 2014. Our base production (in blue) is expected to decline approximately 37% over the year. But of course, as is the nature of tight reservoirs, that decline is not linear. It's much steeper in the early days (~70%/yr) than in the latter days of the year (~20%/yr).

Figure 2



The wedge of new production we're about to build is expected to cost approximately \$625 million for 35,000 boe/d or a capital efficiency of \$17,850 per boe/d, however, it's both the steepness of the base decline, combined with how efficiently capital can build new production, that really drives sustainability of the top line production number.

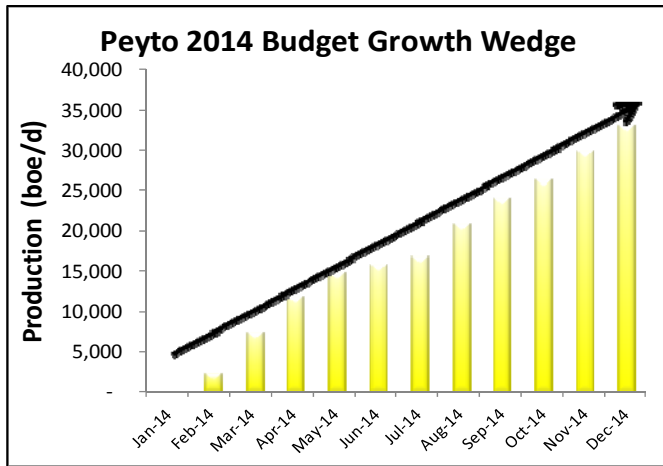
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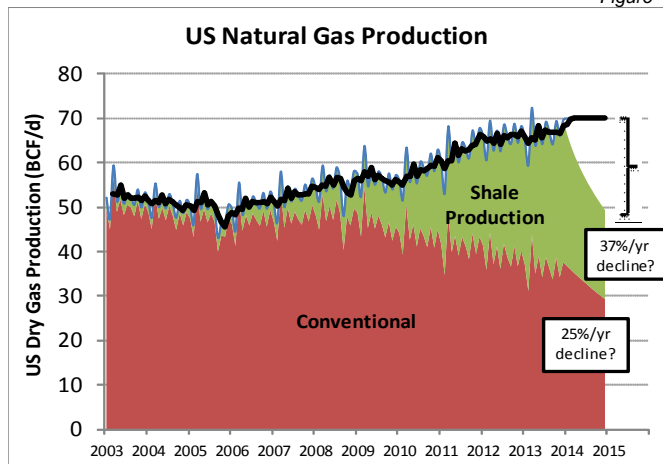
From this graph we get a visual of why production additions in the first half of the year have much less dramatic impact on top line production, than they do in the latter half of the year, even though the pace of additions might be quite linear. Figure 3 shows just our cumulative forecast additions for the year.

Figure 3



So, if that's the nature of Peyto's production base and growth wedge, what's it look like for, say, all of the US, where rising shale gas should have much of the same characteristics as our tight sandstone reservoirs?

Figure 4



Source: EIA

In Figure 4, I've assumed that US conventional production has a 25%/yr exponential decline and all the shale production in the US has the exact same decline profile as Peyto's base, or 37%/year. A reasonable guess for illustration I think. If that was the case, there would need to be some 21 BCF/d built in 2014 just to hold the top line production at that 70 BCF/d level.

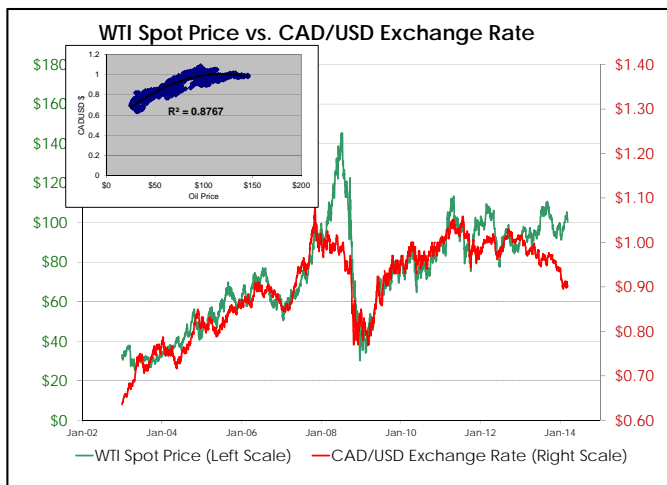
So then the next question is, what would it take to do that? The funds flowing from 70 BCF/d, if we assume an average operating margin of 55% (revenue after all cash costs), would be around \$2.60/mcf on a 2014 NYMEX price of \$4.60/MMBTU. So 70 BCF/d would generate some \$66 Billion. Yet to build a wedge of new production in order to replace declines, we need around 21 BCF/d. So that would be a capital efficiency of \$3,140 per mcf/d or \$18,900 per boe/d.

For sustainability of supply at these levels and these prices, the entire US gas industry would have to be as efficient at adding new production as Peyto is. Somehow, I don't think that's possible, since we are by far the lowest cost producer in the Canadian space.

It is probably more accurate to assume something twice that cost, in which case, replacing declines will likely cost some \$60 Billion more than the industry is even making. And that is a far cry from sustainably funding a 70 BCF/d level.

Activity Levels and Commodity Prices

Figure 5



Source: Bank of Canada, EIA

Currency exchange rates are important to Canadian producers since most of our excess oil and gas production is sold to the US. Most of the time, our Canadian dollar correlates extremely well with oil prices, which is why ours is often referred to as a "Petrocurrency" (see Figure 5). Lately, however, that correlation looks broken. Some economists claim it is because of a selloff in CND bonds as money returns to a strengthening US economy. Whatever it is, this is good news for Canadian producers. High oil and gas prices combined with low exchange rates mean higher realized Canadian prices.