

Peyto Exploration & Development Corp.

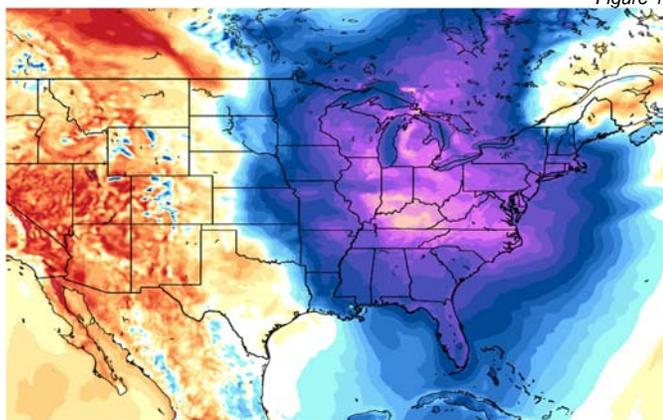
President's Monthly Report

March 2015

From the desk of Darren Gee, President & CEO

As with the last couple of winters, this winter was slow to get going but has been picking up an icy headwind. The map below has been rather consistent for the last several weeks with much colder than normal weather on the east half of North America (as shareholders in Toronto and NY can attest) and hot, drought in the West. This would normally result in much higher natural gas consumption, driving prices up. The consumption is definitely there, but the price has been going the other way as continuously growing supply has dominated headlines. Perhaps we should be banking it, if this **global cooling** trend is any indication, we may need all that gas supply in future years.

Figure 1



Source: Washington Post

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*

2013/14 Capital Summary (millions\$ CND)*

	2013	Jan	Feb	Mar	Q1	Q2	Q3	Oct	Nov	Dec	Q4	2014	Jan
Land & Seismic	11.9	6	0	1	7	8	0	4	1	1	6	21.3	3
Drilling	253.0	24	27	30	80	68	83	28	29	24	81	310.8	26
Completions	151.7	11	11	14	36	48	46	20	16	17	54	183.1	16
Tie ins	48.2	7	5	5	16	10	11	7	5	3	14	51.3	2
Facilities	112.2	18	11	12	40	16	40	14	6	5	26	122.2	5
Total	578	65	53	62	179	151	180	73	56	50	180	690	52

Production*

2013/14 Production ('000 boe/d)*

	2013	Q1 14	Q2 14	Q3 13	Oct	Nov	Dec	Q4 13	2014	Jan	Feb
Sundance	42.6	49.4	51.7	57.2	59.3	59.6	59.2	59.4	54.4	57.8	56.5
Ansell	10.8	15.7	14.2	14.3	16.1	16.3	17.0	16.5	15.2	17.2	16.7
Brazeau		1.6	1.3	1.2	1.8	3.4	4.4	3.2	1.8	3.9	4.4
Kakwa	2.9	2.4	2.4	2.4	2.4	2.2	2.2	2.3	2.4	2.2	2.1
Other	3.1	3.2	2.5	2.4	2.1	2.0	1.9	2.0	2.5	1.9	1.9
Total	59.3	72.3	72.1	77.5	81.7	83.5	84.7	83.3	76.3	83.0	81.6

* 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.

Forecast vs Actual

Normally this is the time of year when we look at our reserves report card for the past year and assess if we did a good job (or not) investing capital in our drilling projects. At the end of the day, we put \$690 million of investor's capital to work into wells, lands, seismic, facilities, etc. That's the most ever. So what did we get for that?

We start by looking at the value of all the wells we drilled with that capital. It's easy enough for the independent engineers to do, they just isolate the 2014 new drills and run a consolidated economic forecast of those reserves. The effective date of that evaluation is Dec. 31, 2014. Then we compare that value to how much capital we're "out of pocket" at that same date. The out-of-pocket or net capital being the total capital spent, less the net operating income ("NOI") generated in the year, for those 2014 wells.

The consolidated forecast of the 123 wells we drilled in 2014 is shown in the table below at various discount rates (ie. the net present value of all future income from those wells, brought back into today's dollars at different discount rates as a way of risking those future incomes).

Table 1

\$MM	2014 Total Capital	2014 Net Op. Income	Net Capital	PDP+PA NPV		
				0%	10%	26%
2014 new drills	(690)	191	(499)	1,472	781	499

Source: Peyto

So, subtracting the \$191 million of NOI from the \$690 million of capital spent, gets us the \$499 million of net capital we still need to recover. According to the independent engineers these wells will recover \$1.47 billion over their life, \$1.0 billion discounted at 5%, \$781 million discounted at 10% or exactly \$499 million discounted at 26%, which implies an Internal Rate of Return (IRR) of 26% on that capital investment.

That's pretty good. And not surprising, it's very similar to the last couple of years, as we had expected when we decided to invest the capital. But of course, this full cycle returns analysis is founded on a forecast of production, reserves, operating costs, royalties, and last of all, commodity prices. All things that could potentially change.

We're pretty confident on the production forecasts and reserves. We have a lot of analog data from other producing wells in these zones to base it on. And we assume the Crown won't be changing the royalties. And because Peyto operates these wells and controls where they are processed, we're pretty confident in the operating costs we will have. But the commodity prices could change a lot.

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So perhaps rather than looking forward at what might or should happen, what if instead we looked back, at what did happen? How would that validate what we're assuming, in terms of the returns we think we're generating?

By now, the wells we drilled in, say 2010, would have reached payout and some of their total return should have been generated. What if we compare the future analysis of return we did back then to the cumulative lease ops of today? Would the returns be the same? Better? Worse? Are we just fooling ourselves in think we're getting this great return on our capital?

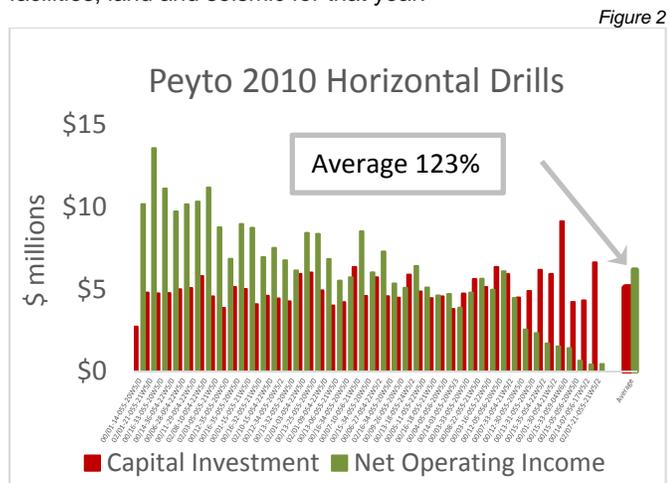
Back at the end of 2010, we concluded that we should be generating a 33% return on our \$261MM of capital investment, at then current commodity price forecasts.

Table 2

\$MM	2010 Total Capital	2010 Net Op. Income	Net Capital	PDP+PA		
				NPV 0%	NPV 10%	NPV 33%
2010 new drills	(261)	63	(201)	955	394	201

Source: Peyto

Digging up the lease ops on those 52 new 2010 drills and comparing that to the capital associated with those wells is shown in Figure 2. In most cases the wells have recovered their capital and some form of return. On average 120% of the well capital has been recovered, implying we've also paid for all the facilities, land and seismic for that year.

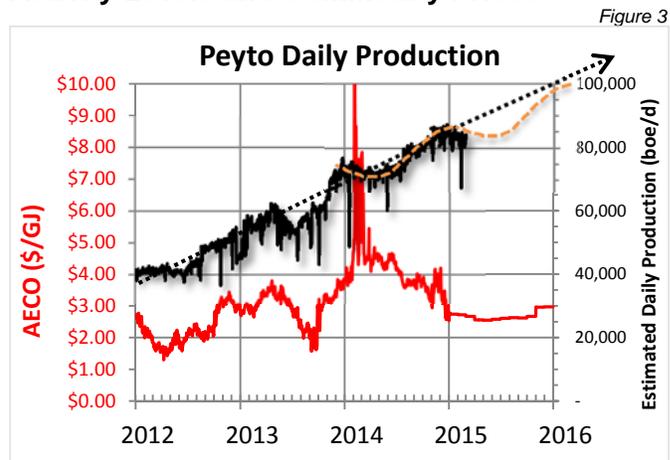


Source: Peyto

That's pretty good, and of course, we're not done yet. These 52 wells are still producing some 3,000 boe/d today, generating positive income. They are *forecast* (with current prices) to recover another \$400 million in net operating income in the future. So that makes us feel pretty good about ultimately getting most of that 33% return we were supposed to get.

To me, this type of look back is important confirmation. Too often in our industry the focus is on just getting the capital back and redeploying it, regardless of whether any return is ever generated. Personally, I'm more interested in the return **on** capital as opposed to just return **of** capital. Taking your money and then just giving it back to you is easy. The hard part is giving you back significantly more.

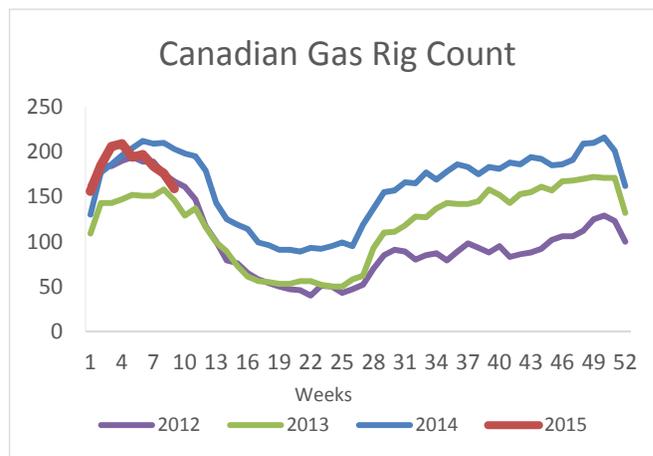
Activity Levels and Commodity Prices



Source: Peyto, GasAlberta.com

The 2015 future strip for AECO natural gas price is hovering around \$2.75/GJ, somewhere between the 2012 price of \$2.26/GJ and the 2013 price of \$3.01/GJ. Thankfully, we have a business that works just fine at these levels as history has proven. Not many other gas producers apparently do, as evidenced by the rapidly falling gas rig count in Canada (Figure 4). Another 2012 or 2013 result would be fine by me, like good wine those were good vintages of Peyto.

Figure 4



Source: Baker Hughes