

Peyto Exploration & Development Corp.

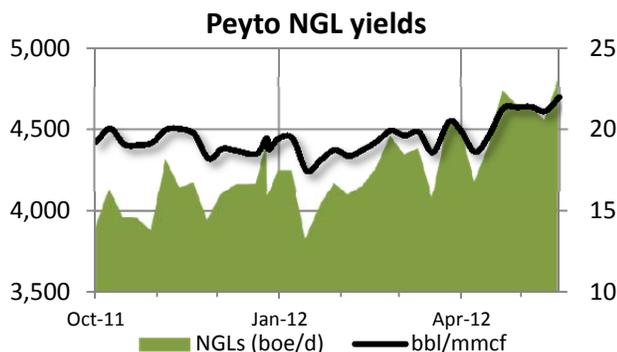
President's Monthly Report

June 2012

From the desk of Darren Gee, President & CEO

Our strategic shift to target more liquids rich natural gas formations and our plan to modify our facilities to extract more Propane and Butane from the gas stream, are beginning to show themselves. By drilling more Cardium and Falher wells in the first quarter, which have higher NGL content, and making a few changes to the operating conditions at our Nosehill gas plant, we've managed to increase our NGL production by close to 600 boe/d, or from a low of 18 bbl/mmcf to over 22 bbl/mmcf (see figure 1). This move should help bolster the revenue stream in the second quarter, at a time when gas prices have bottomed out (see also figure 4). We will continue to make these kinds of improvements in our liquid yield until our Peyto Deep Cut (aka. Cheap Cut) facilities become operational in the fourth quarter which should really help increase our liquids 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

2011/12 Capital Summary (millions\$ CND)*

	Q1	Q2	Q3	Q4	2011	Jan	Feb	Mar	Q1 '12	Apr	May	Jun	Q2 '12
Land & Seismic	6	1	14	7	28	2	0	0	3	1			
Drilling	51	32	46	49	178	20	19	13	52	6			
Completions	33	18	26	28	104	10	11	11	31	4			
Tie ins	7	5	10	10	32	2	4	3	8	2			
Facilities	8	16	16	0	40	1	3	1	4	1			
Drilling Credit Used	0	-3	0	0	-3	0	0	0	0	0			
Total	104	69	112	95	379	35	36	28	99	14			

*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

2011/2012 Production ('000 boe/d)*

	Q1 11	Q2 11	Q3 11	Q4 11	Jan	Feb	Mar	Q1 12	Apr	May	June	Q2 12
Sundance	28.0	30.2	32.3	35.1	35.7	35.7	34.8	35.4	34.6	34.1		
Kakwa	2.6	3.2	3.0	3.4	3.6	3.7	4.0	3.8	4.4	4.1		
Other	1.1	1.1	1.0	1.3	1.7	1.8	2.5	2.0	2.7	2.7		
Total	31.7	34.4	36.4	39.8	41.0	41.2	41.3	41.2	41.7	41.0	-	-

*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.

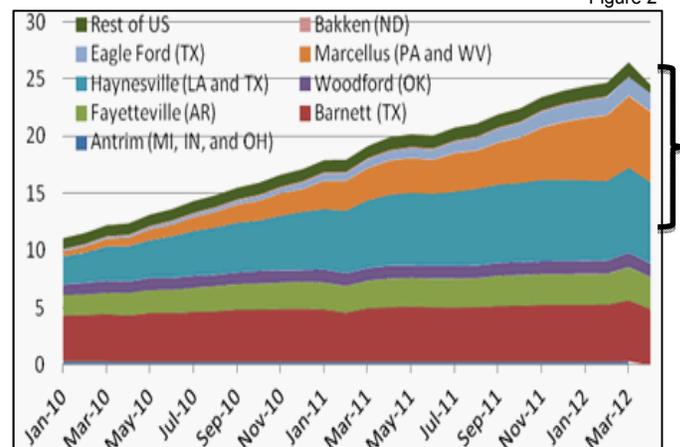
Check Your Brakes, Steep Hill Ahead

I read an article in the WSJ the other day highlighting the switch Waste Management is making with their US garbage truck fleet from diesel to natural gas. T. Boone Pickens would be pleased. The Texas octogenarian might actually get to see the conversion of at least some of the US truck fleet to cleaner burning, cheaper natural gas before his time is up. The economics are a no-brainer, with natural gas prices that are so much cheaper than diesel.

Waste Management isn't the only ones looking at saving some money by using natural gas as a transportation fuel. Even Peyto is getting into the act. With plans to install a natural gas fuelling station at our Oldman plant later this year, we'll be able to offer natural gas for pickup trucks and drilling rigs to our operators and rig contractors in the area. It replaces the high cost of diesel and it's tie to oil prices. Consider that diesel at \$0.90/litre is equivalent to natural gas at over \$25/mcf! And those drilling rigs burn a lot of diesel; somewhere between 3,500 and 5,000 litres a day depending on the time of year. This ultimately translates into cost savings for us while having the added benefit of increasing domestic demand.

The momentum that is building on the natural gas demand front, from transportation, to drilling rigs, to electric generation is heating up, but it is all happening at a time when the supply side is cooling off. Low natural gas prices have driven producers to cut back spending and even shut in high cost production. This is most recently evidenced by the decline in production of the top US shale plays. The first time that's happened for several years.

Figure 2



Source: BMO, Lippman Consulting

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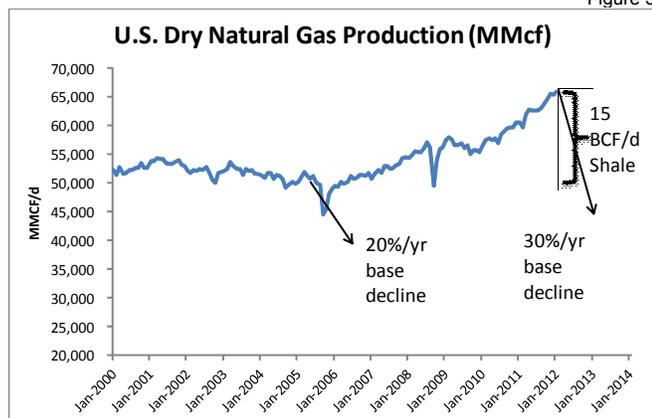
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At Peyto, we know first hand the steep decline that wells of this type experience in the first few years. It's a slippery slope to cut back production additions and stop drilling.

The growth of the shale gas plays have been responsible for virtually all of the incremental US gas production over the last few years (see figure 3). And now, the US basins are no longer declining 20% per year, now they're declining at 30% per year.

Figure 3



That means in order to just offset declines in the US, there now needs to be at least 20 BCF/d of new gas added to the system each and every year (65 BCF/d times 30%/yr decline). But that only keeps up with current, not increasing, demand.

Let's put that another way to illustrate the magnitude of that task. The 20 BCF/d is about the same amount of production coming out of all of the US shale gas plays combined (see figure 2). So that means the industry would need to "re-build" all of the shale plays, each year, just to hold production at this level. A rather significant task, don't you think? And as if this physical task isn't significant enough, especially in light of the drilling rigs migrating away from gas to oil plays, the financial task is no less great. As others (ARC Financial Reports – Nov 2011) have so keenly pointed out, the capital requirement far exceeds the current cash being generated from 65 BCF/d. This means excess capital has to continuously be added to the system, just to hold production at this level.

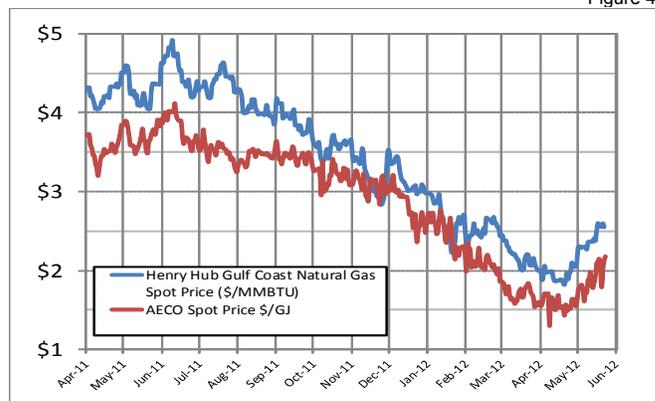
If the glut of natural gas from a warm winter is creating gas prices that are just too attractive, and permanent demand increases are the result, the supply side better be ready to meet those demand challenges. Otherwise declining supplies meeting with increasing demand could cause

natural gas prices to rocket and we'll be riding the runaway lane straight back up.

Activity Update and Commodity Prices

Breakup appears to be over and we are starting to move around in the field with drilling rigs back drilling and frac crews rigging in. Apparently just in time too, as natural gas prices have recovered off their bottom, driven by increased demand on the power generation side. Both Henry Hub (US) and AECO (Canadian) natural gas prices have rebounded from their recent lows as shown in figure 4.

Figure 4



For us, an AECO price of \$2/GJ combined with \$100/bbl oil price actual works. Unfortunately, or fortunately as the case may be, it doesn't work as well for the rest of the Canadian natural gas industry which means there will be continued decline in Western Canadian gas production or the price of natural gas has to move higher still. I suspect a bit of both will happen over the next few months as companies continue to slow down new gas development and keep high cost production shut in. This should translate into increasing pressure on the service costs which will hopefully translate into reduced prices for us.

This also assumes \$100/bbl for oil. Some have suggested there may be some downside risk as far as oil price is concerned. This actually has a silver lining for us as a natural gas producer. As I've alluded to in the past, when oil prices go lower, activity level drops, resulting in lower service costs for us. As well, lower oil price tends to put downward pressure on the CND/US exchange rate, which has the effect of increasing our AECO price (priced off the US NEYMEX).