

# Peyto Exploration & Development Corp.

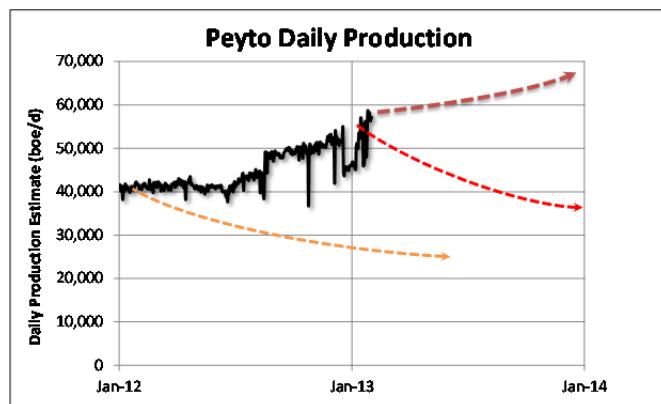
## President's Monthly Report

February 2013

From the desk of Darren Gee, President & CEO

Our winter drilling program is going full steam ahead with 9 drilling rigs spitting out about 12 wells a month. Considering that the average well puts out 600 boe/d over the first 30 days, it means we're building over 7,000 boe/d/month of productive capability. Of course, declines cut that by more than half by the end of the first year, but that still means we're building up to 30,000 boe/d by the end of 2013 if we can get at least 10 months of solid activity at this level.

The startup challenges at our Oldman deep cut facility seem to be behind us and we are now able to realize the full extent of the enhanced liquids extraction and the production capability that was waiting behind pipe. Even though both Dec and Jan monthly production was behind our budget, daily production has recently been touching 59,000 boe/d.



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 Capital Summary (millions\$ CND)\*

	2010	2011	Q1	Q2	Jul	Aug	Sep	Q3	Oct	Nov	Dec	Q4	2012
ONR Acq./other acq.					205		205		-21	-21	184		
Land & Seismic	19	28	3	1	0	1	1	2	4	0	2	6	12
Drilling	141	178	52	23	19	17	23	59	26	30	23	78	212
Completions	65	104	31	14	9	14	12	35	11	15	21	47	127
Tie ins	30	32	8	5	3	4	4	11	8	5	9	22	46
Facilities	19	40	4	3	1	2	2	6	2	3	20	25	37
Total	262	379	99	46	33	243	41	317	50	53	54	157	619

### Production\*

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

	Q4 11	2011	Q1 12	Q2 12	Q3 12	Oct	Nov	Dec	Q4 12	2012	Jan
Sundance	35.1	31.3	35.4	34.3	35.7	36.6	37.5	34.0	36.0	35.4	36.4
Kakwa	3.4	3.1	3.8	4.2	3.6	3.2	3.2	2.9	3.1	3.7	3.2
Ansell	-	-	-	2.9	5.9	6.5	8.1	6.8	2.4	9.2	
Other	1.3	1.1	2.0	2.8	3.6	3.4	3.8	3.5	3.6	3.0	3.2
Total	39.8	35.5	41.2	41.3	45.9	49.1	51.0	48.5	49.5	44.5	52.0

\*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.

### Fuel for our future

The oil and gas industry runs on oil, mainly, or diesel fuel derived therefrom.

Drilling rigs burn diesel fuel (about 5,000 litres per day in winter when they have boilers generating heat for the rig). As do the many big trucks that move the rigs from place to place and supply them with pipe, mud chemicals, drill bits and an assortment of other services and materials.

Frac pumpers burn diesel. So do the sand haulers, water haulers, water heaters, and trucks that haul the tanks from site to site. Service rigs, snubbing units and wireline trucks all burn diesel.

The cats, and backhoes, and directional drilling rigs that lay the pipelines all run on diesel fuel. As do the trucks that carry all that pipe from manufacturer to distributor to locations in the field.

And of course, there is all the people. Generally, all the oilfield personnel ride in diesel powered pickups from Dodge Rams to Chevy HDs to Ford 150s, 250s and 350s. Personal preference is, of course, fiercely defended.

So the old saying "it takes money, to make money" could just as easily be converted to "it takes oil, to find oil." But what about when you're finding and developing natural gas?

When oil and natural gas prices are relatively similar, then it doesn't matter that it takes oil to find natural gas. But when oil is worth a lot more, it isn't so efficient. From a self sufficiency standpoint, you'd prefer to use natural gas to find and develop natural gas. At Peyto, that's exactly what we've started to do.



The price advantage makes a compelling argument. Bulk diesel in the Alberta oil patch sells for around \$1.00/litre

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(\$3.80/US gal), while natural gas on an energy equivalent basis sells for around \$0.10/litre (\$0.38/US gal) or \$3/Mcf. Considering all the places we could try to replace diesel fuel with CNG, the savings could really start to add up.

At our Oldman Gas plant last November we installed a compressed natural gas (CNG) fueling station to begin this process of replacing diesel in our operations (see picture above). The site is basically a small compressor station with storage tanks and a gas dispenser. It allows our operators to begin switching their work trucks over to natural gas or dual fuel systems. It also allows one of our drilling rig providers, CanElson, to deploy their CanGas system and replace about 2/3 of the daily diesel their rigs consume with our natural gas. Other drilling rigs can also swap out diesel boilers for natural gas fired boilers.

On completions, we can use CNG to fuel frac water heating systems. And maybe, now that the CNG is available close by, we can get the frac pumbers to switch over.

And it's not just diesel that we can replace with natural gas. It's coal too. Most of the electrical power we consume at our gas plants is generated from Alberta's coal fired power plants. But the cost of each kilowatt, when you consider the line losses to get it to us, is more than the cost to generate that same amount of electricity with natural gas. So we're installing generators at our gas plants to switch over. All in an effort to lower operating costs and become more self sufficient.

The savings can really start to add up. Table 1 outlines the various places we can save using natural gas and the annual prize available.

Table 1

\$1.6 MM Peyto CNG Fueling Station			
(\$MM)	Cost of Diesel/yr	Cost of Nat Gas/yr	Savings
Operator Trucks (45)	\$0.800	\$0.065	\$0.735
Frac Fluid Heating (90 fracs/yr)	\$1.000	\$0.100	\$0.900
Drilling Rig Power (8 rigs)	\$2.900	\$0.300	\$2.600
Drilling Rig Boilers (8 rigs, 120 days/yr)	<u>\$1.100</u>	<u>\$0.100</u>	<u>\$1.000</u>
	\$5.800	\$0.565	<b>\$5.235</b>

As you can see, the prize is significant, over \$5 million annually. But of course, it is an exchange of capital (\$1.6 MM investment) for operating cost savings. Or, in the case of drilling rigs and frac fluid, a small capital investment today to save much more capital over the long run. In other words, it's the **return** on the investment of capital that we're more concerned with.

For instance, as demonstrated in Table 2, installing power generation units at our Oldman gas plant that burn natural gas will cost \$1.5MM, but provides annual savings of up to \$380,000/yr in electrical power costs, which in turn delivers a 25% IRR on the capital investment.

Table 2

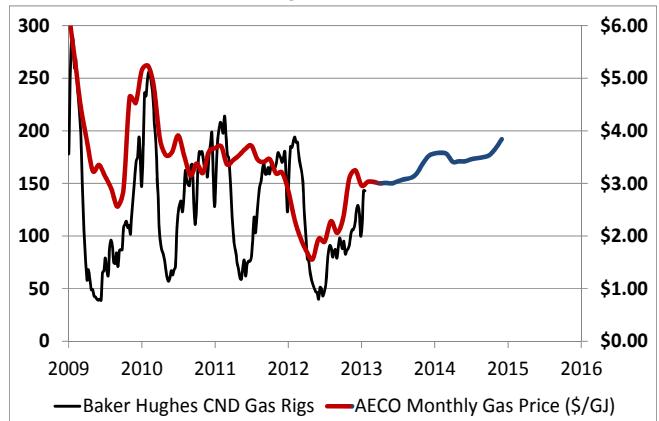
<b>\$1.5MM Peyto Oldman Generator Install</b>	
Generator natural gas consumption	8.2 MMBTU/hr
Natural gas price	<u>\$3.15/MMBTU</u> \$25.80/hr
Equivalent power draw	770 kW-hr
Power price	<u>\$0.09/kW-hr</u> \$69.30/hr
Annual Savings (8760 hrs/yr)	<b>\$ 381,060</b>

So by using natural gas to fuel our business of finding and producing natural gas, we achieve self sufficiency and we generate a return on the capital invested in those conversion projects for our shareholders.

Now that's what I call a win-win.

### Activity Update and Commodity Prices

Although natural gas prices are still above \$3/GJ, natural gas drilling activity in Western Canada hasn't returned to previous levels. This is most likely due to constrained capital programs from lower oil and natural gas liquids prices.



Rumor has it, however, that several big NOC/IOC firms will begin large scale drilling programs in NE BC later this year, to begin developing out some of the resource needed for the west coast LNG export projects. This will likely put upward pressure on available rigs, crews and services. It's probably best we get after our drilling program earlier in the year rather than later if that's the case.