

Peyto Exploration & Development Corp. President's Monthly Report

December 2013

From the desk of Darren Gee, President & CEO

Drill your way to 100,000 boe/d. I have always thought that would be pretty neat, considering I don't think it's ever been done before in the Canadian Energy Industry. But I really never envisioned we would do it at Peyto. Now though, considering where we were four years ago (20,000 boe/d), where we are today (70,000 boe/d), and where we're headed next year (80,000+ boe/d), it's hard not to look out over the next couple years and think that it's possible. Of course, absolute growth like that wouldn't mean anything if it wasn't profitable. At Peyto, profitable is not something I'm worried about. I know it will be, because for us that's the primary goal, generating returns rather than just generating growth. And while it is generally true that bigger is better, the rule only works to a point. At around 50,000 boe/d and 250 mmoes of Proved reserves you are big enough to obtain maximum efficiency at minimum costs. Generally, as you get bigger beyond that, you risk losing efficiency. At least, when we look out at bigger companies than us, we can't find one that's more efficient. So that rule seems to be the case. Which is why as we move forward, it becomes even more important to be critical of our returns. Being bigger but with lower efficiency just means more work for the same amount of profit – which is something I'm definitely not interested in. So profitability first, then growth – but the first E&P to profitably grow, through the drill bit, from zero to 100,000 boe/d (actually, it needs to be 104,000 boe/d, since we bought 4,000 from ONR)? I kinda like the sound of that.

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	Apr	May	Jun	Q2	Jul	Aug	Sep	Q3	Oct
ONR Acq./other acq.			205	-21	184	0				0				0	
Land & Seismic	3	1	2	6	12	2	3	2	1	6	1	1	1	3	1
Drilling	52	23	59	78	211	76	9	3	20	32	32	30	25	86	22
Completions	31	14	35	47	127	41	9	0	1	10	20	19	15	54	15
Tie ins	8	5	11	22	46	33	2	1	4	7	3	5	6	14	5
Facilities	4	3	6	25	37	17	6	6	6	18	7	9	9	24	19
Total	99	46	317	157	618	169	29	13	32	73	62	63	56	181	61

Production*

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

	Q3 12	Q4 12	2012	Q1 13	Q2 13	Jul	Aug	Sept	Q3 13	Oct	Nov	Dec	Q4 12
Sundance	35.7	36.0	35.4	39.7	41.6	38.1	42.1	44.5	41.5	43.7	48.1		
Kakwa	3.6	3.1	3.7	3.3	3.0	2.7	2.5	2.7	2.6	2.6	2.5		
Ansell	2.9	6.8	2.4	8.8	10.7	10.3	10.5	9.0	9.9	11.7	14.6		
Other	3.6	3.6	3.0	3.3	2.9	2.4	2.5	2.4	2.4	2.3	4.0		
Total	45.9	49.5	44.5	55.2	58.2	53.5	57.6	58.6	56.5	60.3	69.2		

*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.

The Definition of Economic Limit

In a few days we will be closing the issuance of \$120 million of senior unsecured notes with a syndicate of investors who are somewhat new to Peyto. Their newness gave me an opportunity to tell the whole Peyto story right from the start and it reminded me of all the things that make Peyto such a unique company in the Canadian Energy industry. Some of which were likely contributors to Peyto winning Oilweek's Producer of the Year honors.

Figure 1



In explaining to them the nature of the tight gas reservoirs that Peyto develops and produces from, I showed them a typical decline profile of an extremely low permeability reservoir. One that has been stimulated with a large fracture treatment to enhance the near wellbore permeability and productivity, but one where the high initial production rates decline rapidly to a much lower, low declining stable rate. Sometimes this is referred to as the long "tail" on the shape of the decline curve. Figure 1 is an example of that shape.

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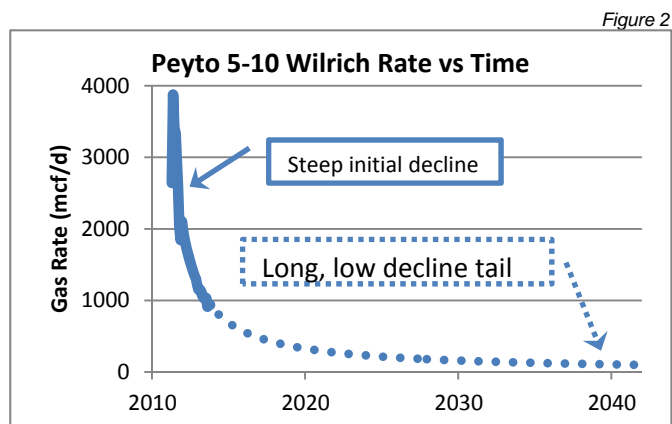
TSX Symbol: PEY

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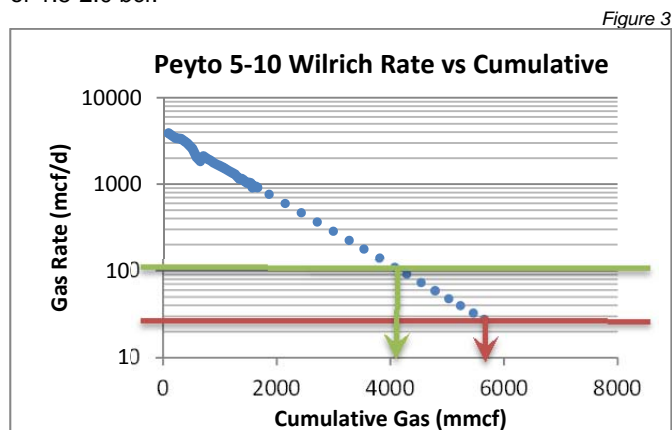
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I also explained that one of the ways a company can extract significantly more value from these types of producing wells is by achieving a very low economic limit. This was a concept that many had not fully considered and was yet another one of the multiple advantages of having a low cost structure.

The concept is a simple one. The lower a well's per unit operating costs are, the lower the production rate at which the revenue continues to exceed the costs and the well remains commercial. This point is called the Economic Limit. Of course, the reverse is also true. The higher the operating costs, the greater the economic limit. In practical terms, for Peyto a well might reach its economic limit at around 25 mcf/d. But that's at *Peyto's operating costs* of \$0.33/mcfe (\$2/boe). Conversely, if a company has \$2.00/mcfe (\$12/boe) operating costs, like many in our industry, then the economic limit might be closer to 100 mcf/d.

If we take the above curve and plot it on log rate vs cumulative production rather than versus time, you can see what a dramatic effect the higher economic limit has on recoverable reserves (Figure 3) decreasing reserves by 30% or 1.5-2.0 bcf.



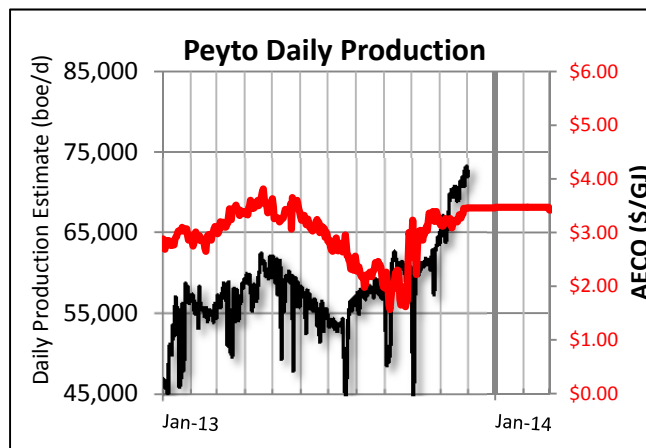
Obviously, as the decline becomes very shallow a significant portion of recoverable reserves becomes quite sensitive to this economic limit. So having an ability to optimize costs, late in a well's life, becomes important in the ultimate volume and value realization.

The economic limit is a pretty basic concept, but one that really drives home the importance of being a low cost producer.

Activity Levels and Commodity Prices

I guess in hindsight we sandbagged our 2013 exit target of 71,000 boe/d in our Q3 release. With all the new production we've recently added and the three new facilities that we had to get running and lined out, you can't really blame us. Things have gone even better than expected in the field though, and with recent production having touched 73,000 boe/d, we've already beat the 71,000 boe/d exit number. I guess maybe we should have set the bar a bit higher.

Figure 4



Winter has arrived this past week, firming up gas prices nicely. At least nicely for us. As I've mentioned before, this \$3.40/GJ gas price is right in our sweet spot. Our Canadian gas industry is trying to put up a good fight too, with the most recent natural gas rig count rising as firm ground allows access to some of the more northern landscapes. The current weather forecast suggests we will be sharing some of this cold weather with those in the east next week.

We have been busy locking this price away for next year. Based on our current budget, we have already sold approximately 40% of our production for next year at \$3.36/GJ, which with heat content and NGLs translates into something closer to \$4.75-\$5/mcfe. Some nice security for our capex program.