

# Peyto Exploration & Development Corp.

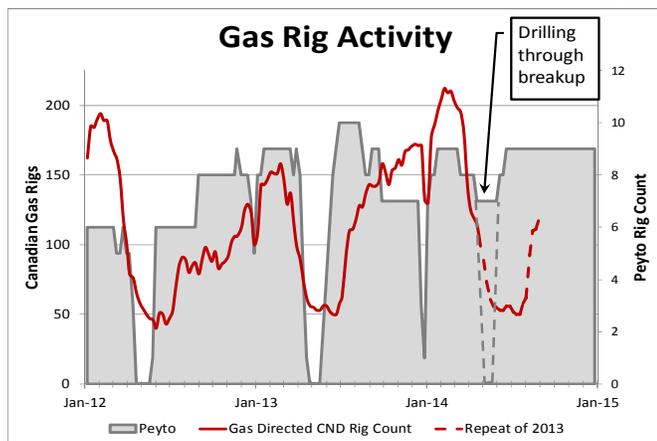
## President's Monthly Report

May 2014

From the desk of Darren Gee, President & CEO

I'm optimistic that spring has finally sprung (considering this past winter, that's cautiously optimistic). Along with spring, breakup has officially started in Western Canada as evidenced by the drop in the gas directed drilling rig count (Figure 1). Peyto's drilling activity, however, is still going strong, as we endeavor to invest more of our capital earlier in the year, just in case higher natural gas prices cause inflation in service costs. Even if we can't get the completions and tie-ins done until after, drilling through breakup makes sense as drilling costs alone typically represent 45% of our capital program.

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	Q4	2013	Jan	Feb	Mar	Q1
ONR Acq./other acq.				205	-21	184	0	0	0	0.0				0
Land & Seismic	3	1	2	6	12	2	6	3	2	11.9	6	0	1	7
Drilling	52	23	59	78	211	76	32	86	60	253.0	24	27	30	80
Completions	31	14	35	47	127	41	10	54	47	151.7	11	11	14	36
Tie ins	8	5	11	22	46	15	7	14	12	48.2	7	5	5	16
Facilities	4	3	6	25	37	36	18	24	34	112.2	18	11	12	40
<b>Total</b>	<b>99</b>	<b>46</b>	<b>317</b>	<b>157</b>	<b>618</b>	<b>169</b>	<b>74</b>	<b>181</b>	<b>155</b>	<b>578</b>	<b>65</b>	<b>53</b>	<b>62</b>	<b>179</b>

### Production\*

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

	Q3 12	Q4 12	2012	Q1 13	Q2 13	Q3 13	Q4 13	2013	Jan	Feb	Mar	Q1 14	Apr
Sundance	35.7	36.0	35.4	39.7	41.6	41.5	47.4	42.6	48.3	50.1	49.7	49.3	50.4
Kakwa	3.6	3.1	3.7	3.3	3.0	2.6	2.5	2.9	2.4	2.5	2.4	2.4	2.5
Ansell	2.9	6.8	2.4	8.8	10.7	9.9	13.9	10.8	16.1	15.8	15.3	15.7	14.3
Other	3.6	3.6	3.0	3.3	2.9	2.4	3.6	3.1	4.9	4.9	4.6	4.8	4.2
<b>Total</b>	<b>45.9</b>	<b>49.5</b>	<b>44.5</b>	<b>55.2</b>	<b>58.2</b>	<b>56.5</b>	<b>67.3</b>	<b>59.3</b>	<b>71.7</b>	<b>73.3</b>	<b>72.0</b>	<b>72.3</b>	<b>71.4</b>

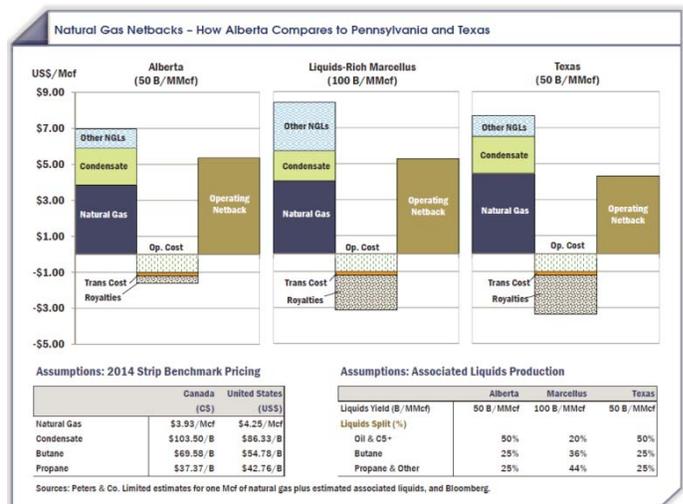
\*This is an estimate based on real field data, not a forecast, and the actual numbers will vary from the estimate due to accruals and adjustments. Such variance may be material. Tables may not add due to rounding.

### Competitive Fiscal Regimes

Lately there has been a lot of debate about the ability for Western Canadian natural gas reserves to compete in the North American market. Especially when you consider that their geographical location currently puts them at a disadvantage – or to use the familiar phrase “at the end of the pipe”. It is an important topic, because as we all know, the energy industry is the primary economic engine of the Western Canadian provinces and natural gas is a large part of that engine.

There have been many, including myself, who have shown that the petroleum fiscal regimes in the Western Canadian provinces are more attractive than in other basins in North America which levels the playing field for gas plays from an economic standpoint. The following netback analysis by Peter's & Co. (Figure 2), for instance, shows that Alberta competes with both the Marcellus and Texas, primarily due to lower royalties.

Figure 2



This is because Alberta has a royalty regime (and incentives) that scales up (and down) with commodity prices, so that in lower natural gas price environments, companies pay fewer royalties, maintaining their competitive position. Looking at Peyto's royalty payments over the last few years shows this system at work (see Figure 3). Lower gas prices have indeed equated to lower royalty rates.

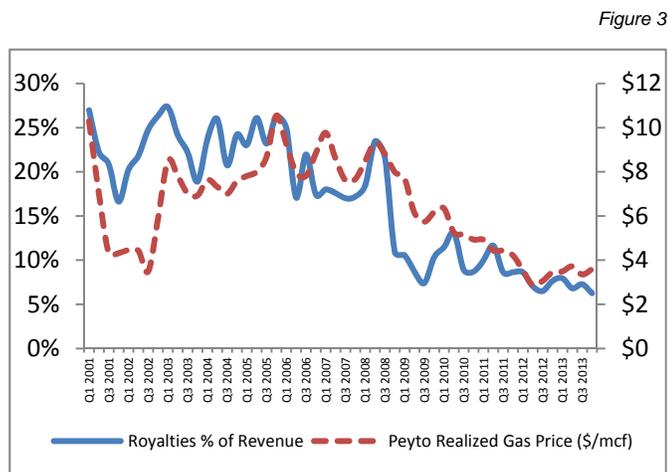
The only problem with this system, however, is that it assumes that when royalty payments go down, making Alberta, for instance, more competitive, that other costs don't increase to compensate. But we know that government funding is reliant on royalty payments and that hasn't gone down. So with lower royalties, has something else gone up?

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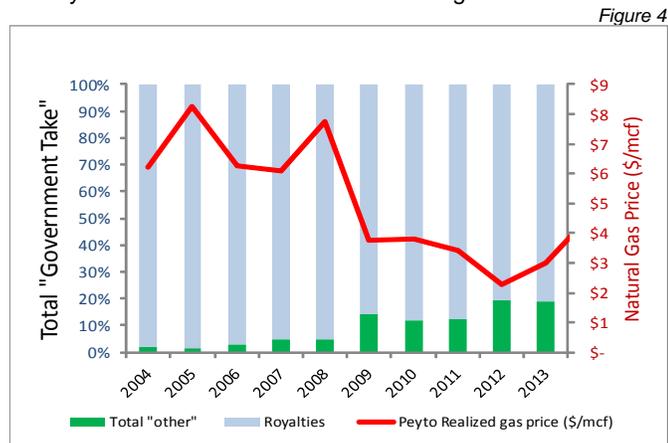
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I thought it might be interesting to look at all the other taxes, fees and levies we are charged to see if the various governments are really collecting less, which is truly allowing us to be more competitive in the North American market, or maybe collecting the same, just in different form.

Looking specifically at Peyto's operating costs and what we pay for ERCB/AER fees, municipal property taxes, municipal activity fees, etc. compared to royalties; we see that the reduced royalty benefit is not quite as good as we think (Figure 4). Yes, there are much lower royalties when gas prices are low but that savings is partially offset by increased taxes and fees in other parts of our business. The total "government take" is not as tied to commodity prices as one initially thinks with closer to 20% now being fixed fees.



Considering that the margins that enable the average Canadian gas producer to be competitive in a North American marketplace are already thin, increases in other forms of take, which are not tied to the commodity price, may be enough to

tip the scales in favor of other jurisdictions, like the Marcellus or Eagleford. It's something that Canadian governments at all levels, Federal, Provincial and Municipal, need to keep in mind. Perhaps not such a big deal for Peyto who enjoys a significant cost advantage over the industry, but it could be a deal breaker for those that don't.

### Activity Levels and Commodity Prices

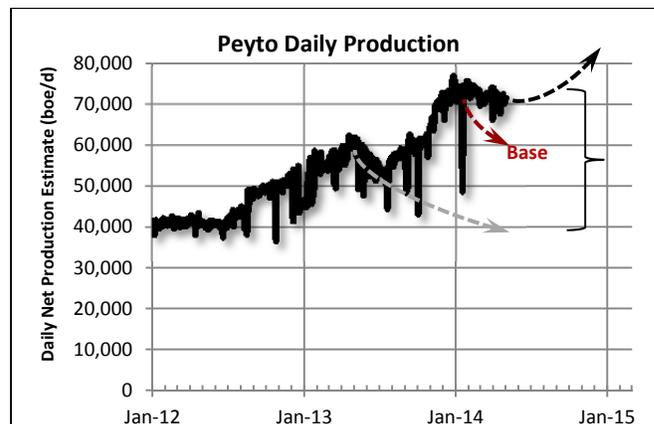


Figure 5

Despite the appearance that our total production has remained relatively flat for the first part of the year, Peyto has been actively adding new production. It's just that the base production decline rate at this time of year is at its highest. Already to the end of April we've built some 15,000 boe/d of new production. Looking at the trailing 12 months of activity (March-March), and the new additions that have been added over that time, 34,300 boe/d of new production has been added for \$588 million of capital investment. That's a ratio of \$17,140 per boe/d, which is in line with the past several years (see Figure 5). While we strive to improve this capital efficiency number, especially in the face of upward service cost pressures expected in the latter part of the year, it's still one of the best, if not the very best, in the industry (Figure 6).

Figure 6

