Peyto Announces Strategic Three Year Plan

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CALGARY, Jan. 16, 2019 - Peyto Exploration & Development Corp. ("Peyto” or the “Company") announces a three year strategic plan to address the natural gas price crisis currently affecting the entire Alberta natural gas market and Canadian natural gas producers. The Board of Directors of Peyto has approved a plan to enhance shareholder value by; investing in several strategic longer-term initiatives, protecting the Company’s balance sheet through the near term natural gas price weakness, continued market diversification initiatives including additional vertical integration efforts, and by expanding into new venture opportunities.

The Alberta natural gas price (AECO) has experienced unprecedented volatility over the past year and a half, driven primarily by a lack of excess capacity in the Nova Gas Transmission (NGTL) system and inadequate seasonal access to storage reservoirs. Despite growing Alberta demand, additional supply of gas in the Western Canadian Sedimentary Basin (WCSB) remains restricted from accessing other North American markets resulting in large discounts to the realized price. This is further exacerbated by a similar situation with heavy oil which has caused increased discounts to condensate (diluent) and other natural gas liquids prices associated with liquid-rich gas production. This is a temporary situation that should be resolved over the next three years as TC Energy, formerly TransCanada Corporation, invests over $9 billion to expand the NGTL system and increases its ability to move gas volumes from within the basin to export pipelines, specifically at the eastern Alberta border. Beyond that timeline, LNG export projects off both the west and east coasts of Canada will have continued to move forward, enabling Western Canadian natural gas resources to ultimately access world markets. As a result, future natural gas price realizations in Alberta are expected to improve significantly over the next several years. In order to maximize the returns for shareholders from Peyto’s resource development opportunities, the business planning cycle needs to extend to a 3 to 5 year time horizon with the judicious timing of future capital investments made to coincide with this commodity price improvement.

Operational Update

Peyto’s fourth quarter drilling activity, which represented almost half of the total 2018 capital investments resulted in production growth from approximately 83,000 boe/d in October to exit the year at 94,000 boe/d. Importantly, condensate and natural gas liquids production grew from a low of approximately 8,000 bbl/d to exit the year at a record 12,000 bbl/d, a 50% increase. This increase was primarily driven by activity in Peyto’s Deep Basin Cardium play, with average liquid yields of 60 bbl/mmcf to as high as 130 bbl/mmcf, and where an innovative completion design has improved both productivity and reserve recovery thereby increasing the rate of return on investment in this play.

Peyto drilled a total of 70 gross (67.25 net) wells in 2018 which added approximately 23,000 boe/d of new production at the lowest cost in the Company’s history. Included in this drilling activity was 48 gross Cardium wells (45.65 net) and one Montney exploratory well. Completion of the Montney well is planned for Q2 2019 in order to eliminate certain completion costs relating to frac water heating and after additional offsetting information becomes available.

Three Year Development Plan

Peyto’s preliminary 2019 capital budget announced Nov 7, 2018, ranging from $250-$300 million, has been reduced to $150 to $200 million. As always, investment will be directed toward the highest return opportunities within Peyto’s inventory of drilling locations, with continued focus on the most liquids rich portions of the Company’s Deep Basin assets. The Company will reassess the program mid-year for potential expansion as commodity prices continue to evolve over the balance of the winter and in response to potential Alberta Government actions. This capital program involves drilling approximately 50 gross Cardium wells (greater than 90% working interest), as well as continuing to advance its Swanson Gas Plant deep-cut process addition and Montney exploration play. The program is expected to build approximately 17,000 boe/d of new production, approximately 25% of which will be natural gas liquids, at a cost of $10,000/boe/d to $11,000/boe/d. This new production is expected to help offset the Company’s forecast 25% base decline.

In 2020 and 2021 Peyto plans to ramp-up capital investment with capital programs of approximately $270 and $320 million at a cost similar to 2019. These programs are expected to offset forecast base declines of 21% and 25%, respectively, with production exiting 2021 at close to 100,000 boe/d, including 18,000 bbl/d of condensate and NGLs.

Strategic Long Term Initiatives

Peyto has a substantial, integrated midstream asset base that was originally built exclusively for Company and joint interest production. Up until now, available processing capacity has not been offered to industry on a fee for service use. Going forward, and while excess capacity exists, Peyto will be actively marketing midstream processing opportunities for its excess capacity in order to maximize the return from these infrastructure investments.

Peyto has recently signed a definitive agreement to purchase certain mineral rights in the Sundance area that encompass a depleted, high permeability reservoir suitable for a proprietary natural gas storage scheme. The pool originally contained an estimated 110 BCF of gas in place and Peyto expects to establish a working range of 60 to 80 BCF of storage capability. Not unlike TransCanada’s “Big Eddy” Edson Gas Storage facility, Peyto envisions the “Big Sunny” storage facility will enable the Company to inject gas in summer months when prices are lower and produce those reserves in winter months when prices are higher. As an example, there is currently greater than a 40% forecast improvement in AECO prices from summer 2019 to winter 2019/20.

Peyto added substantial new drilling inventory during the year through the addition of both Cardium and Montney lands. A total of 47 sections (60% working interest) of Cardium lands were added that are expected to yield more than 120 gross locations, as well as 50 sections (100% working interest) of Montney lands in a new exploratory area. In the next few years, Peyto expects that industry land expiries, particularly in the Montney, will present significant opportunity for the Company to continue to amass an increasing inventory of undeveloped drilling locations that can be developed as pricing recovers.

Balance Sheet Protection

During 2018, Peyto generated cashflow in excess of both capital investments and dividends to shareholders. This free cashflow was used to reduce indebtedness and strengthen Peyto’s balance sheet. As announced on January 3, 2019, Peyto has also continued to protect its balance sheet from rising interest rates with the closing of another private placement of senior unsecured notes. On that date, Peyto issued CND$100 million of senior unsecured notes which bear a coupon rate of 4.39% and mature on January 3, 2026. Proceeds from the notes were used to repay the $100 million of senior notes of Peyto which matured on January 3, 2019. The issuance of the senior notes maintained Peyto's aggregate borrowing capacity at $1.92 billion.

Starting with the January dividend, for shareholders of record on January 31, 2019 and to be paid on February 15, 2019, the monthly dividend will be temporarily reduced from the current $0.06/share to $0.02/share. While this dividend level is expected to be below the earnings forecast for 2019, the Board of Directors feels that greater shareholder returns can be generated by investing in strategic longer term initiatives at this time. The strategy at Peyto continues to focus on a total shareholder return model that at times includes substantial reinvestment in the business and at other times includes profit sharing with shareholders through dividend payments.

The combination of a reduced capital program and temporary dividend reduction will allow Peyto to continue to materially reduce indebtedness. This will ultimately allow for an even greater investment in opportunities in the future that are expected to achieve above average returns for shareholders.

Market Diversification Efforts

As announced in early 2018, Peyto has adopted a market diversification strategy which is designed, over time, to expose 40% of its natural gas sales to AECO based pricing, link 40% to US pricing and sell 20% directly to intra-Alberta industrial markets. As before, Peyto will continue to hedge future prices to smooth out the volatility in both Alberta and US natural gas markets.

Peyto has made significant strides advancing this strategy. For the forecast 2019 natural gas production volume, 8% is currently exposed to the Dawn market, 24% to the Henry Hub market, and the remaining 68% to the AECO market. In each of these markets, 13%, 62% and 73% respectively, or 65% of aggregate volume, has already been pre-sold to achieve price certainty. For 2020 and 2021 respectively, 46% and 45% of forecast volumes have been exposed to markets outside of the AECO market.

As previously announced, Peyto has entered into a gas supply agreement with a gas-fired power generation company with an expected first delivery in 2022. The current contracted supply is approximately 52 mmcf/d, which at the 2018 average power pool price would yield Peyto a $3.00/mcf price relative to the average 2018 AECO daily price of $1.64/mcf. Peyto is committed to be an important part of Alberta’s clean energy future and is determined to further increase this intra-Alberta supply commitment through either an enlargement of this project or through other like projects.

Peyto’s future revenue is further diversified by a natural gas liquids stream which includes condensate, pentane, butane and propane that collectively account for approximately 13% of current production growing to 18% over the next three years. These liquids components are expected to represent between 35% and 50% of the total annual revenue and substantially increase dry gas netbacks.

Outlook

Peyto’s asset base encompasses a concentrated collection of lands, resources and infrastructure that continues to deliver an industry leading cost structure and operating margin while offering vertical integration along the value chain. Although accelerated development and growth of this asset is being partially deferred for the short term, over the medium to longer term, as market access is expanded and improved, this asset base will continue to deliver solid returns for shareholders.

The Company’s three year plan, provides for a strategic path forward through a period of significant commodity price volatility and immense opportunity. Peyto will continue to remain poised to capitalize on these opportunities while at the same time will be nimble to changing market dynamics with both the financial and operational flexibility to ramp up activity quickly and take advantage of attractive investment opportunities that may arise. Already Peyto has advanced its Montney exploration initiative, diversified its gas markets, integrated supply with inter-Alberta industrial users, advanced seasonal storage capability and is working to maximize revenues through innovative liquids extraction. While these elements are all individually accretive to shareholder value, collectively they enhance the intrinsic value of Peyto’s entire asset base in the greater Edson area and enable shareholder returns to be further compounded over time.

In the near term, shareholders can remain confident that a continued attention to financial flexibility and a disciplined, returns focused approach to all future capital investments will preserve and enhance total shareholder value.

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Certain information set forth in this document, including management's assessment of Peyto’s future plans and operations, capital expenditures and capital efficiencies, contains forward-looking statements. By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond Peyto’s control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on *forward-looking statements. Peyto's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits Peyto will derive there from. In addition, Peyto is providing future oriented financial information set out in this press release for the purposes of providing clarity with respect to Peyto’s strategic direction and readers are cautioned that this information may not be appropriate for any other purpose. Other than is required pursuant to applicable securities law, Peyto does not undertake to update forward looking statements at any particular time, except as required by applicable laws. To provide a single unit of production for analytical purposes, natural gas production and reserves volumes are converted mathematically to equivalent barrels of oil (BOE). Peyto uses the industry-accepted standard conversion of six thousand cubic feet of natural gas to one barrel of oil (6 Mcf = 1 bbl). The 6:1 BOE ratio is based on an energy equivalency conversion method primarily applicable at the burner tip. It does not represent a value equivalency at the wellhead and is not based on current prices. While the BOE ratio is useful for comparative measures and observing trends, it does not accurately reflect individual product values and might be misleading, particularly if used in isolation. As well, given that the value ratio, based on the current price of crude oil to natural gas, is significantly different from the 6:1 energy equivalency ratio, using a 6:1 conversion ratio may be misleading as an indication of value.*

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