PEYTO

Exploration & Development Corp.

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Interim Report
for the three and six months ended June 30, 2016

HIGHLIGHTS

	Three Months Ended June 30		%	Six Months Ended June 30		%
	2016	2015	Change	**2016**	2015	Change
Operations						
Production						
Natural gas (mcf/d)	**489,337**	455,443	*7%*	**528,284**	450,148	*17%*
Oil & NGLs (bbl/d)	**6,621**	6,843	*-3%*	**6,815**	7,148	*-5%*
Thousand cubic feet equivalent (mcfe/d @ 1:6)	**529,064**	496,498	*7%*	**569,171**	489,528	*16%*
Barrels of oil equivalent (boe/d @ 6:1)	**88,177**	82,750	*7%*	**94,862**	82,172	*15%*
Production per million common shares (boe/d)*	**545**	523	*4%*	**591**	527	*12%*
Product prices						
Natural gas ($/mcf)	**2.60**	3.50	*-26%*	**2.85**	3.73	*-24%*
Oil & NGLs ($/bbl)	**41.46**	43.54	*-5%*	**37.42**	40.16	*-7%*
Operating expenses ($/mcfe)	**0.26**	0.31	*-16%*	**0.25**	0.31	*-19%*
Transportation ($/mcfe)	**0.17**	0.15	*13%*	**0.16**	0.15	*7%*
Field netback ($/mcfe)	**2.39**	3.22	*-26%*	**2.57**	3.37	*-24%*
General & administrative expenses ($/mcfe)	**0.06**	0.04	*50%*	**0.04**	0.04	-
Interest expense ($/mcfe)	**0.21**	0.19	*11%*	**0.19**	0.20	*-5%*
Financial ($000, except per share*)						
Revenue	**140,891**	172,202	*-18%*	**320,243**	356,014	*-10%*
Royalties	**4,874**	5,875	*-17%*	**11,859**	13,867	*-14%*
Funds from operations	**102,178**	135,195	*-24%*	**242,085**	279,837	*-13%*
Funds from operations per share	**0.63**	0.86	*-27%*	**1.51**	1.80	*-16%*
Total dividends	**53,735**	52,456	*2%*	**106,255**	103,237	*3%*
Total dividends per share	**0.33**	0.33	-	**0.66**	0.66	-
Payout ratio (%)	**53**	39	*36%*	**44**	37	*19%*
Earnings	**9,102**	12,295	*-26%*	**51,045**	56,808	*-10%*
Earnings per diluted share	**0.06**	0.08	*-25%*	**0.32**	0.36	*-11%*
Capital expenditures	**50,634**	116,643	*-57%*	**226,397**	254,720	*-11%*
Weighted average common shares outstanding	**161,845,999**	158,117,853	*2%*	**160,494,262**	155,996,994	*3%*
As at June 30						
End of period shares outstanding (includes shares to be issued				**164,630,168**	158,985,273	*4%*
Net debt				**1,018,796**	934,262	*9%*
Shareholders' equity				**1,656,995**	1,640,616	*1%*
Total assets				**3,389,786**	3,178,991	*7%*

**all per share amounts using weighted average common shares outstanding*

	Three Months Ended June 30		Six Months Ended June 30	
($000 except per share)	**2016**	2015	**2016**	2015
Cash flows from operating activities	**103,123**	134,316	**241,241**	260,450
Change in non-cash working capital	**(9,279)**	(792)	**(10,391)**	14,695
Change in provision for performance based compensation	**8,334**	1,671	**11,235**	4,692
Funds from operations	**102,178**	135,195	**242,085**	279,837
Funds from operations per share	**0.63**	0.86	**1.51**	1.80

(1) Funds from operations - Management uses funds from operations to analyze the operating performance of its energy assets. In order to facilitate comparative analysis, funds from operations is defined throughout this report as earnings before performance based compensation, non-cash and non-recurring expenses. Management believes that funds from operations is an important parameter to measure the value of an asset when combined with reserve life. Funds from operations is not a measure recognized by Canadian generally accepted accounting principles ("GAAP") and does not have a standardized meaning prescribed by GAAP. Therefore, funds from operations, as defined by Peyto, may not be comparable to similar measures presented by other issuers, and investors are cautioned that funds from operations should not be construed as an alternative to net earnings, cash flow from operating activities or other measures of financial performance calculated in accordance with GAAP. Funds from operations cannot be assured and future dvidends may vary.

Report from the president

Peyto Exploration & Development Corp. ("Peyto" or the "Company") is pleased to present its operating and financial results for the second quarter of the 2016 fiscal year. A continued focus on profitability and efficiency resulted in a 73% operating margin (1) and a 7% profit margin (2). Additional highlights included:

- **Production per share up 4%.** Second quarter 2016 production increased 7%, 4% per share, from 497 MMcfe/d (82,750 boe/d) in Q2 2015 to 529 MMcfe/d (88,177 boe/d) in Q2 2016. Approximately 17,400 boe/d of new production (not included in the figure above) was deliberately deferred during the second quarter 2016 due to low commodity prices.

- **Cash costs of $0.80/Mcfe ($0.70/Mcfe or $4.22/boe excluding royalties).** Total cash costs, including $0.10/Mcfe royalties, $0.26/Mcfe operating costs, $0.17/Mcfe transportation, $0.06/Mcfe G&A and $0.21/Mcfe interest expense, were down from $0.82/Mcfe in Q2 2015 despite the deferral of 17,400 boe/d of production. Lower realized commodity prices, partially offset by these lower cash costs, resulted in a cash netback of $2.12/Mcfe ($12.73/boe) or a 73% operating margin.

- **Funds from operations per share of $0.63.** Generated $102 million in Funds from Operations ("FFO") in Q2 2016 down 24% (27% per share) from $135 million in Q2 2015 due to a 23% reduction in realized commodity prices, partially offset by the 7% increase in production volumes.

- **Capital investment of $51 million**. A total of 19 gross wells (18 net) were drilled in the second quarter. New wells brought on production over the last 12 months produced or were capable of 46,700 boe/d at the end of the quarter, which, when combined with a trailing twelve month capital investment of $566 million, equates to an annualized capital efficiency of $12,000/boe/d. This incremental volume includes the new production that was deferred in the quarter.

- **Earnings of $0.06/share, dividends of $0.33/share.** Earnings of $9 million were generated in the quarter while dividends of $53 million were paid to shareholders, representing a before tax payout ratio of 53% of FFO. This quarter represents Peyto's 46th consecutive quarter (11.5 years) of earnings, totaling over $2 billion in cumulative earnings.

Second Quarter 2016 in Review

Peyto continued its track record of positive earnings in the second quarter, despite experiencing the lowest natural gas prices in its almost 18 year history. AECO natural gas prices during April and May averaged just $1.11/GJ, dipping as low as $0.38/GJ on May 9, 2016. The Company quickly adapted to these volatile natural gas prices by deliberately deferring the production from many of the new wells drilled and completed in late 2015 and early 2016 in order to improve the returns that will be generated from those capital investments. Owning and operating all of its production and processing facilities provided the flexibility to achieve this value capturing strategy. Drilling activity in the second quarter continued to take advantage of low industry activity and improved execution efficiency which resulted in a 12% reduction in drilling and completion cost per horizontal well from the first quarter of 2016, or 26% lower than the annual 2015 average cost. By the end of the quarter, natural gas prices had improved to over $2/GJ allowing Peyto to begin bringing back on the deferred volumes. Despite the effect of the low commodity prices in the quarter, the first half financial and operating performance resulted in an annualized 6% Return on Equity (ROE) and 6% Return on Capital Employed (ROCE).

1. Operating Margin is defined as funds from operations divided by revenue before royalties but including realized hedging gains/losses.
2. Profit Margin is defined as net earnings for the quarter divided by revenue before royalties but including realized hedging gains/losses.
Natural gas volumes recorded in thousand cubic feet (mcf) are converted to barrels of oil equivalent (boe) using the ratio of six (6) thousand cubic feet to one (1) barrel of oil (bbl). Natural gas liquids and oil volumes in barrel of oil (bbl) are converted to thousand cubic feet equivalent (Mcfe) using a ratio of one (1) barrel of oil to six (6) thousand cubic feet. This could be misleading, particularly if used in isolation as it is based on an energy equivalency conversion method primarily applied at the burner tip and does not represent a value equivalency at the wellhead.

Exploration & Development

Drilling activity in the second quarter was restricted to areas where pad drilling savings could be maximized and transportation restrictions minimized due to spring break-up and rain soaked conditions. Despite a short term deterioration in natural gas price, an ongoing reduction in drilling and completion costs ensured these locations still met Peyto's strict rate of return objectives. The bulk of the drilling efforts in the quarter were focused on the Wilrich formation across Peyto's Deep Basin lands, in particular in the Greater Sundance and Brazeau areas.

In total, 19 gross wells were drilled across the land base as shown in the following table:

	Field							Total
Zone	Sundance	Nosehill	Wildhay	Ansell	Berland	Kisku/ Kakwa	Brazeau	Wells Drilled
Cardium								
Notikewin	3							3
Falher	1							1
Wilrich	5	2	1	3			3	14
Bluesky	1							1
Total	10	2	1	3			3	19

Second quarter drilling costs per meter were 15% lower while completion costs per meter were 45% lower than average annual 2015 costs, as continued service cost reductions and efficiency gains were realized. The following table illustrates the ongoing efficiency gains which are contributing to lower overall development costs and helping enhance returns during periods of low natural gas prices:

	2010	2011	2012	2013	2014	2015	2016 Q1	2016 Q2
Gross Hz Spuds	52	70	86	99	123	140	36	**19**
Measured Depth (m)	3,762	3,903	4,017	4,179	4,251	4,309	4,231	**4,269**
Hz Length (m)	1,335	1,303	1,358	1,409	1,460	1,531	1,460	**1,444**
Drilling ($MM/well)	$2.763	$2.823	$2.789	$2.720	$2.660	$2.159	$1.916	**$1.824**
$ per meter	$734	$723	$694	$651	$626	$501	$453	**$427**
Completion ($MM/well)	$1.358	$1.676	$1.672	$1.625	$1.702	$1.212	$0.910	**$0.667**
$ per meter	$361	$429	$416	$389	$400	$281	$215	**$157**

Capital Expenditures

Capital investments in the second quarter of 2016 totalled $50.6 million, comprised of $37.9 million for drilling and completions, $2.4 million for wellsite equipment and well connections, $8.5 million for major pipelines and facilities, and $1.3 million for new land and seismic data. The balance of the capital, or $0.5 million, was for leasehold improvements to build out Peyto's new head office space.

In total, 19 gross wells (18 net) were spud in the quarter and 11 gross wells (10.7 net) were completed with 20 gross wells (19.1 net) ready to be placed on production. Facility and pipeline investments of $8.5 million included the balance of the Brazeau Gas Plant expansion which was commissioned in early April 2016. In addition, 10 new sections of prospective deep basin lands were added in the quarter, purchased at Crown land sales for an average price of $154/acre.

Summer Production Strategy

The decline of Alberta natural gas (AECO) prices for the first 5 months of 2016 prompted Peyto to adopt a summer production strategy that temporarily deferred the flush production from newly drilled, high rate wells, to take advantage of higher fall prices. This same strategy was successfully utilized in 2012 and 2013 in similar environments to improve the returns on the capital investment. This strategy was paired with an enhanced hedging strategy to prevent the follow-on winter prices from further deterioration, but left Peyto with the flexibility to respond quickly and bring on-stream the shut in volumes as prices recovered. Over the second quarter of 2016, Peyto left approximately 17,400 boe/d of production shut in from newly drilled wells. While Peyto's cash cost were low enough to generate positive operating income from these new wells, even at these low summer prices, the total return on the capital invested in these new wells was enhanced considerably through this proven hold-back strategy. It was only because of Peyto's strong infrastructure position and operating flexibility that the Company was able to take this very opportunistic approach to volatile natural gas prices.

Commodity Prices

US natural gas production, which peaked in Q1 2016, fell steadily during the second quarter which helped to erode the storage surplus that had been weighing heavily on natural gas prices. As a result, both US and Canadian natural gas prices climbed during the second quarter, faster than had been originally forecast. AECO daily natural gas prices rose from a low of $0.38 CAD/GJ on May 9, 2016 to end the quarter at $2.23 CAD/GJ on June 30, 2016, while Henry Hub daily prices rose from a low of $1.49 USD/MMBTU on April 13, 2016 to end the quarter at $2.82 USD/MMBTU.

The average second quarter 2016 Alberta (AECO) daily natural gas price was $1.33/GJ down 47% from $2.52/GJ in Q2 2015, while the average AECO monthly price was $1.18/GJ down 53% from $2.53/GJ a year prior. As Peyto had committed 97% of its production to the monthly price, Peyto realized a volume weighted average natural gas price of $1.21/GJ or $1.38/Mcf, after the TCPL fuel charge and prior to a $1.22/Mcf hedging gain.

As a result of the Company's hedging strategy, approximately 68% of Peyto's natural gas production received a fixed price of $2.74/GJ, or $3.17/Mcf, when including hedges that were put in place over the previous 24 months, while the balance received the blended daily and monthly price of $1.21/GJ, resulting in an after-hedge price of $2.26/GJ or $2.60/Mcf.

Natural gas liquid prices were impacted by the Fort McMurray forest fires as heavy oil production interruptions resulted in surplus diluent (condensate and pentanes) which temporarily suppressed those product prices. In addition, liquids trucking charges in the second quarter are traditionally higher due to spring breakup road bans, resulting in condensate and pentane prices, which traditionally sell for a premium to Canadian Light Sweet oil, trading at a discount. Peyto realized an oil and natural gas liquids price of $41.46/bbl in Q2 2016 for its blend of condensate, pentane, butane and propane, which represented 76% of the $54.70/bbl average Canadian Light Sweet posted price, down from 82% in Q1 2016, as shown in the following table.

Commodity Prices by Component

Three Months ended	**June 30 2016**	Mar 31 2016	June 30 2015
Natural gas – after hedging ($/mcf)	**2.60**	3.06	3.50
Natural gas – after hedging ($/GJ)	**2.26**	2.66	3.06
AECO monthly ($/GJ)	**1.18**	2.00	2.53
Oil and natural gas liquids ($/bbl)			
Condensate ($/bbl)	**47.83**	37.86	62.36
Propane ($/bbl)	**0.40**	(7.70)	(6.07)
Butane ($/bbl)	**19.52**	16.58	22.63
Pentane ($/bbl)	**50.67**	41.30	61.36
Total Oil and natural gas liquids ($/bbl)	**41.46**	33.60	43.54
Canadian Light Sweet postings ($/bbl)	**54.70**	40.83	68.50

Liquids prices are Peyto realized prices in Canadian dollars adjusted for fractionation and transportation.

Financial Results

Peyto's realized natural gas price combined with realized liquids prices, resulted in unhedged revenues for the second quarter of $1.79/Mcfe ($2.92/Mcfe including hedging gains). Royalties of $0.10/Mcfe, operating costs of $0.26/Mcfe, transportation costs of $0.17/Mcfe, G&A of $0.06/Mcfe and interest expense of $0.21/Mcfe, all combined for total cash costs of $0.80/Mcfe ($4.83/boe). These cash costs were higher than the $0.71/Mcfe total costs reported in Q1 2016, due to the deferral of approximately 17,400 boe/d of new production in the quarter, but lower than the $0.82/Mcfe for the same period in 2015. Had the deferred volumes been produced in the quarter, Peyto expects total Q2 2016 cash costs would have been approximately $0.74/Mcfe. When Q2 2016 total cash costs of $0.80/Mcfe were deducted from realized revenues, it resulted in a cash netback of $2.12/Mcfe or a 73% operating margin.

Depletion, depreciation and amortization charges of $1.60/Mcfe, along with a provision for deferred tax and market based bonus payments reduced the cash netback to earnings of $0.19/Mcfe, or a 7% profit margin. Dividends of $1.12/Mcfe were paid to shareholders.

On May 18, 2016, Peyto closed a bought deal equity offering for 5,390,625 common shares at a price of $32.00 per common share for net proceeds of $165.6 million which was initially used to reduce bank indebtedness.

Natural Gas Marketing

In accordance with Peyto's summer production strategy, the Board of Directors of Peyto, on April 12, 2016, approved an increase to the hedging limit for future natural gas sales from 65% to 85% of forecasted winter 2016/2017 production volumes. As a result, Peyto increased the frequency of future sales to approach this new target.

The following table summarizes the remaining hedged volumes and prices for the upcoming years as of August 10, 2016.

	Future Sales		Average Price (CAD)	
	GJ	Mcf	$/GJ	$/Mcf
2016	77,795,000	67,647,826	2.62	3.01
2017	148,900,000	129,478,261	2.55	2.94
2018	45,310,000	39,400,000	2.46	2.83
Total	272,005,000	236,526,087	2.56	2.94

**prices and volumes in mcf use Peyto's historic heat content premium of 1.15.*

Activity Update

The recovery of natural gas prices during June and July, to consistently above $2/GJ, has justified initiating the process of bringing on production the backlog of wells that were deferred due to much lower gas prices. As of early August, production has been restored to levels at or above 97,000 boe/d with an estimated 5,000 boe/d still remaining to be brought back on-line.

An unusually wet summer has hampered field activities through July and August, following the end of the break-up period in early June. Nonetheless, Peyto now has 8 drilling rigs running (6 in the greater Sundance area and 2 in the Brazeau area) that have spud 18 gross wells (16.5 net) since the end of the quarter. A 9^{th} drilling rig is expected to be added later in the quarter, operating in the Brazeau area, increasing the Brazeau rig count to three rigs. Completion operations have also been challenged with the wet summer weather, however, Peyto has successfully completed 16 gross wells (15.4 net) since the end of the quarter which are now at various stages of being tied in and brought on production. There still remains a backlog of 11 drilled but uncompleted wells that should be cleared up by early September as ground conditions improve. Peyto expects there will be some additional production impact until this completion backlog is resolved, however, a return to full production capacity is expected by mid-September and is well timed for the start of the winter heating season and expected higher gas prices.

In addition to the increased pace of drilling and completions, Peyto has been actively adding to its multi-year inventory of Deep Basin locations since quarter end. An acquisition of 10 sections of land in the Brazeau area is expected to close in the third quarter and the Company plans to begin drilling the opportunities on this land shortly thereafter. With 3 drilling rigs running in the Brazeau area, the newly expanded 120 MMcf/d Brazeau gas plant is expected to be full by year end, and recent drilling success in the Wilrich, Notikewin and Cardium plays will all be contributing to this result.

Outlook

While the near term outlook for natural gas price has improved faster than originally forecast, this past quarter of low gas price has illustrated just how uniquely profitable the Peyto strategy is relative to the rest of the Canadian and US natural gas industry. The Company's strategic focus on profitability and returns, rather than the more common focus on growth, along with an ability to quickly adjust to market conditions, will continue to set Peyto apart and serve shareholders well over the longer term.

Peyto's record activity levels for the remainder of 2016, will continue to take advantage of low service costs and low industry activity in order to maximize returns on shareholder's capital. The Company's operational and financial flexibility, quality asset base, and strong balance sheet position Peyto to remain opportunistic in this environment.

During the upcoming third quarter, with the September 15, 2016 payment, Peyto is excited to celebrate the culmination of $2 billion in dividend payments. This represents a total of $16.53/share that has been paid out of the Company's cumulative profits.

(signed) *"Darren Gee"*

Darren Gee
President and CEO
August 10, 2016

Management’s discussion and analysis

This Management's Discussion and Analysis (“MD&A”) should be read in conjunction with the audited financial statements of Peyto Exploration & Development Corp. (“Peyto” or the “Company”) for the years ended December 31, 2015 and 2014. The financial statements have been prepared in accordance with the International Accounting Standards Board (“IASB”) most current International Financial Reporting Standards (“IFRS” or “GAAP”) and International Accounting Standards (“IAS”).

This discussion provides management's analysis of Peyto's historical financial and operating results and provides estimates of Peyto's future financial and operating performance based on information currently available. Actual results will vary from estimates and the variances may be significant. Readers should be aware that historical results are not necessarily indicative of future performance. This MD&A was prepared using information that is current as of August 9, 2016. Additional information about Peyto, including the most recently filed annual information form is available at www.sedar.com and on Peyto’s website at www.peyto.com.

Certain information set forth in this MD&A, including management's assessment of Peyto's future plans and operations, contains forward-looking statements. By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond these parties' 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 that Peyto will derive there from.

All references are to Canadian dollars unless otherwise indicated. Natural gas liquids and oil volumes are recorded in barrels of oil (bbl) and are converted to a thousand cubic feet equivalent (mcfe) using a ratio of six (6) thousand cubic feet to one (1) barrel of oil (bbl). Natural gas volumes recorded in thousand cubic feet (mcf) are converted to barrels of oil equivalent (boe) using the ratio of six (6) thousand cubic feet to one (1) barrel of oil (bbl).

OVERVIEW

Peyto is a Canadian energy company involved in the development and production of natural gas in Alberta’s deep basin. As at December 31, 2015, the Company’s total Proved plus Probable reserves were 3.5 trillion cubic feet equivalent (590 million barrels of oil equivalent) as evaluated by its independent petroleum engineers. Production is weighted approximately 93% to natural gas and 7% to natural gas liquids and oil.

The Peyto model is designed to deliver a superior total return with growth in value, assets, production and income, all on a debt adjusted per share basis. The model is built around three key strategies:

- Use technical expertise to achieve the best return on capital employed through the development of internally generated drilling projects.
- Build an asset base which is made up of high quality natural gas reserves.
- Over time, balance dividends to shareholders paid with earnings, and cash flow, and balance funding for the capital program with cash flow, equity and available bank lines.

Operating results over the last seventeen years indicate that these strategies have been successfully implemented. This business model makes Peyto a truly unique energy company.

QUARTERLY FINANCIAL INFORMATION

	2016		2015				2014	
($000 except per share amounts)	**Q2**	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Total revenue (net of royalties)	**136,017**	172,366	184,943	163,727	166,327	175,820	205,125	196,062
Funds from operations	**102,178**	139,907	151,123	134,513	135,195	144,643	173,437	166,988
Per share – basic and diluted	**0.63**	0.88	0.95	0.85	0.86	0.94	1.13	1.09
Earnings	**9,102**	41,943	43,406	37,347	12,295	44,513	68,597	68,893
Per share – basic and diluted	**0.06**	0.26	0.27	0.23	0.08	0.29	0.45	0.45
Dividends	**53,735**	52,520	52,456	52,456	52,456	50,781	49,181	46,107
Per share – basic and diluted	**0.33**	0.33	0.33	0.33	0.33	0.33	0.32	0.30

Funds from Operations
"Funds from operations" is a non-GAAP measure which represents cash flows from operating activities before changes in non-cash operating working capital and provision for future performance based compensation. Management considers funds from operations and per share calculations of funds from operations to be key measures as they demonstrate the Company's ability to generate the cash necessary to pay dividends, repay debt and make capital investments. Management believes that by excluding the temporary impact of changes in non-cash operating working capital, funds from operations provides a useful measure of Peyto's ability to generate cash that is not subject to short-term movements in operating working capital. The most directly comparable GAAP measure is cash flows from operating activities.

RESULTS OF OPERATIONS

Production

	Three Months ended June 30		Six Months ended June 30	
	2016	2015	**2016**	2015
Natural gas (mmcf/d)	**489.3**	455.4	**528.3**	450.1
Oil & natural gas liquids (bbl/d)	**6,621**	6,843	**6,815**	7,148
Barrels of oil equivalent (boe/d)	**88,177**	82,750	**94,862**	82,172
Thousand cubic feet equivalent (mmcfe/d)	**529.1**	496.5	**569.2**	489.5

Natural gas production averaged 489.3 mmcf/d in the second quarter of 2016, 7 percent higher than the 455.4 mmcf/d reported for the same period in 2015. Oil and natural gas liquids production averaged 6,621 bbl/d, a decrease of 3 percent from 6,843 bbl/d reported in the prior year primarily due to propane rejection. Second quarter production increased 7 percent from 496.5 mmcfe/d to 529.1 mmcfe/d. The production increases are attributable to Peyto's capital program and resulting production additions.

Summer Production Strategy
The decline of Alberta natural gas (AECO) prices for the first 5 months of 2016 prompted Peyto to adopt a summer production strategy that temporarily deferred the flush production from newly drilled, high rate wells, to take advantage of higher fall prices. This same strategy was successfully utilized in 2012 and 2013 in similar environments to improve the returns on the capital investment. This strategy was paired with an enhanced hedging strategy to prevent the follow-on winter prices from further deterioration, but left Peyto with the flexibility to respond quickly and bring on-stream the shut in volumes as prices recovered. Over the second quarter of 2016, Peyto left approximately 17,400 boe/d of production shut in from newly drilled wells. While Peyto's cash cost were low enough to generate positive operating income from these new wells, even at these low summer prices, the total return on the capital invested in these new wells was enhanced considerably through this proven hold-back strategy. It was only because of Peyto's strong infrastructure position and operating flexibility that the Company was able to take this very opportunistic approach to volatile natural gas prices.

Oil & Natural Gas Liquids Production by Component

	Three Months ended June 30		Six Months ended June 30	
	2016	2015	**2016**	2015
Condensate (bbl/d)	**3,156**	2,736	**3,370**	2,902
Propane (bbl/d)	**357**	1,148	**301**	1,205
Butane (bbl/d)	**1,237**	1,331	**1,254**	1,392
Pentane (bbl/d)	**1,746**	1,466	**1,726**	1,480
Other NGL's (bbl/d)	**125**	162	**163**	169
Oil & natural gas liquids (bbl/d)	**6,621**	6,843	**6,815**	7,148
Million cubic feet equivalent (mmcfe/d)	**39.7**	41.1	**40.9**	42.9

Due to continuing low propane prices, propane recoveries were lowered at Peyto gas plants to an optimal point which coincides with maximizing the recovery of butanes and pentanes. Peyto is continuing to optimize its plant processes to leave as much propane in the gas stream as possible in order to realize a higher blended price for its NGLs, as evidenced in the drop in propane production from 1,148 boe/d in Q2 2015 to 357 boe/d in Q2 2016. Peyto's long-term strategy of owning and controlling production from the wellhead to the sales delivery point continues to allow the Company to respond quickly to changing conditions and thereby maximize profitability.

Commodity Prices

	Three Months ended June 30		Six Months ended June 30	
	2016	2015	**2016**	2015
Oil and natural gas liquids ($/bbl)	**41.46**	43.54	**37.42**	40.16
Hedging – ngls ($/bbl)	**-**	-	**-**	-
Oil and natural gas liquids – after hedging ($/mcf)	**41.46**	43.54	**37.42**	40.16
Natural gas ($/mcf)	**1.38**	2.86	**1.83**	3.00
Hedging – gas ($/mcf)	**1.22**	0.64	**1.02**	0.73
Natural gas – after hedging ($/mcf)	**2.60**	3.50	**2.85**	3.73
Total Hedging ($/mcfe)	**1.13**	0.59	**0.94**	0.66
Total Hedging ($/boe)	**6.79**	3.54	**5.65**	3.98

Peyto's natural gas price, before hedging, averaged $1.38/mcf during the second quarter of 2016, a decrease of 52 percent from $2.86/mcf reported for the equivalent period in 2015. Oil and natural gas liquids prices averaged $41.46/bbl, a decrease of 5 percent from $43.54/bbl a year earlier.

Commodity Prices by Component

	Three Months ended June 30		Six Months ended June 30	
	2016	2015	**2016**	2015
Natural gas – after hedging ($/mcf)	**2.60**	3.50	**2.85**	3.73
Natural gas – after hedging ($/GJ)	**2.26**	3.06	**2.48**	3.25
AECO monthly ($/GJ)	**1.18**	2.53	**1.59**	2.66
Oil and natural gas liquids ($/bbl)				
Condensate ($/bbl)	**47.83**	62.36	**42.53**	55.14
Propane ($/bbl)	**0.40**	(6.07)	**(2.89)**	(6.25)
Butane ($/bbl)	**19.52**	22.63	**18.03**	26.50
Pentane ($/bbl)	**50.67**	61.36	**46.04**	54.09
Total Oil and natural gas liquids ($/bbl)	**41.46**	43.54	**37.42**	40.16
Canadian Light Sweet postings ($/bbl)	**54.70**	68.50	**47.70**	60.61

liquids prices are Peyto realized prices in Canadian dollars adjusted for fractionation and transportation.

Revenue

($000)	Three Months ended June 30 **2016**	2015	Six Months ended June 30 **2016**	2015
Natural gas	**61,466**	118,444	**176,240**	244,820
Oil and natural gas liquids	**24,978**	27,111	**46,407**	51,961
Hedging gain (loss)	**54,447**	26,647	**97,596**	59,233
Total revenue	**140,891**	172,202	**320,243**	356,014

For the three months ended June 30, 2016, revenue decreased 18 percent to $140.9 million from $172.2 million for the same period in 2015. The decrease in revenue for the period was a result of increased natural gas production volumes offset by a decrease in realized commodity prices and NGL production volumes as detailed in the following table:

	Three Months ended June 30			Six Months ended June 30		
	2016	2015	**$million**	2016	2015	**$million**
Total Revenue, June 30, 2015			**172.2**			**356.0**
Revenue change due to:						
Natural gas						
Volume (mmcf)	44,530	41,444	**10.8**	96,148	81,477	**54.6**
Price ($/mcf)	$2.60	$3.50	**(40.1)**	$2.85	$3.73	**(84.7)**
Oil & NGL						
Volume (mbbl)	603	623	**(0.8)**	1,240	1,294	**(2.2)**
Price ($/bbl)	$41.46	$43.54	**(1.2)**	$37.42	$40.16	**(3.5)**
Total Revenue, June 30, 2016			**140.9**			**320.2**

Royalties

Royalties are paid to the owners of the mineral rights with whom leases are held, including the provincial government of Alberta. Alberta Natural Gas Crown royalties are invoiced on the Crown's share of production based on a monthly established Alberta Reference Price. The Alberta Reference Price is a monthly weighted average price of gas consumed in Alberta and gas exported from Alberta reduced for transportation and marketing allowances.

	Three Months ended June 30 **2016**	2015	Six Months ended June 30 **2016**	2015
Royalties ($000)	**4,874**	5,875	**11,859**	13,867
% of sales before hedging	**5.6**	4.0	**5.1**	4.7
% of sales after hedging	**3.5**	3.4	**3.7**	3.9
$/mcfe	**0.10**	0.13	**0.11**	0.16
$/boe	**0.61**	0.78	**0.69**	0.93

For the second quarter of 2016, royalties averaged $0.10/mcfe or approximately 5.6% of Peyto's total petroleum and natural gas sales excluding hedges.

Substantially all of Peyto’s production is in the Province of Alberta. Under the Alberta Royalty Framework (“ARF”) the Crown royalty rate varies with production rates and commodity prices. The royalty rate expressed as a percentage of sales revenue will fluctuate from period to period due to the fact that the Alberta Reference Price can differ significantly from the commodity prices realized by Peyto and that hedging gains and losses are not subject to royalties.

In addition to the basic underlying royalty structure (the ARF), Alberta has instituted additional features that impact the royalty paid on gas and gas liquids for new wells drilled subsequent to January 1, 2009. These additional features include:

1. A one year flat 5% royalty period (18 months for horizontal wells) for each new well but capped at a cumulative production level of 500 MMcf for each new well, and

2. A Natural Gas Deep Drilling Holiday program that provides a royalty holiday value for new wells based on meterage drilled. This holiday feature further reduces the royalty for new wells to a minimum of 5% for a maximum 5 year period from on-stream date. This benefit sequentially follows the benefit under point (1) above.

Alberta's Modernized Royalty Framework

On January 9, 2016 the Alberta Government released a report of its Royalty Review and Advisory Panel. The report sets forth a new Modernized Royalty Framework (MRF) that is scheduled to commence for wells drilled starting January 1, 2017. In general, the MRF looks to reward those companies who continuously innovate, strive to reduce their costs and environmental footprints. Peyto is already an industry leader in this regard. Peyto does not expect that the latest royalty framework will pose any significant additional burden to the Company's well investment economics over a reasonable commodity price range expected in the foreseeable future.

In its 17 year history, Peyto has invested over $4.9 billion in capital projects, found and developed 4.6 TCFe of gas reserves, and paid over $773 million in royalties.

Operating Costs & Transportation

Peyto's operating expenses include all costs with respect to day-to-day well and facility operations.

	Three Months ended June 30		Six Months ended June 30	
	2016	2015	**2016**	2015
Operating costs ($000)	**12,732**	14,117	**25,273**	28,006
$/mcfe	**0.26**	0.31	**0.25**	0.31
$/boe	**1.59**	1.87	**1.46**	1.88
Transportation ($000)	**8,190**	6,638	**16,859**	13,216
$/mcfe	**0.17**	0.15	**0.16**	0.15
$/boe	**1.02**	0.88	**0.98**	0.89

For the second quarter, operating expenses decreased 10% compared to the same quarter of 2015. On a unit-of-production basis, operating costs decreased 16% averaging $0.26/mcfe in the second quarter of 2016 compared to $0.31/mcfe for the equivalent period in 2015. These continued strong results were achieved despite increases in municipal taxes and Alberta Energy Regulator fee levy. Continued low commodity prices resulted in another quarter of historically low power and chemical costs. Peyto estimates operating costs for the quarter would have been approximately $0.23/mcfe had the company not deliberately restricted production in accordance with its summer gas strategy.

Transportation expenses increased 13% from 0.15/mcfe in the second quarter 2015 to $0.17/mcfe in the second quarter 2016 due to increased TCPL tolls.

General and Administrative Expenses

	Three Months ended June 30		Six Months ended June 30	
	2016	2015	**2016**	2015
G&A expenses ($000)	**3,931**	4,210	**8,101**	8,461
Overhead recoveries ($000)	**(1,078)**	(2,537)	**(3,391)**	(4,952)
Net G&A expenses ($000)	**2,853**	1,673	**4,710**	3,509
$/mcfe	**0.06**	0.04	**0.04**	0.04
$/boe	**0.36**	0.22	**0.27**	0.24

For the second quarter, general and administrative expenses before overhead recoveries remained essentially unchanged from the same quarter of 2015. Capital overhead recoveries declined as a result of reduced drilling and completion activity over spring breakup. Peyto drilled through spring breakup in 2015. General and administrative expenses averaged $0.08/mcfe before overhead recoveries of $0.02/mcfe for net general and administrative expenses of $0.06/mcfe in the second quarter of 2016.

Performance Based Compensation

The Company awards performance based compensation to employees and key consultants annually. The performance based compensation is comprised of market and reserve value based components.

The reserve value based component is 4% of the incremental increase in value, if any, as adjusted to reflect changes in debt, equity, dividends, general and administrative expenses and interest expense, of proved producing reserves calculated using a constant price at December 31 of the current year and a discount rate of 8%. An estimate of reserve additions is made quarterly and is used to calculate an accrued reserve value based expense for the period. This methodology can generate interim results which vary significantly from the final compensation paid. Compensation expense of $2.9 million was recorded for the quarter ended June 30, 2016. The cumulative provision totals $3.5 million.

Under the market based component, rights with a three year vesting period are allocated to employees and key consultants. The number of rights outstanding at any time is not to exceed 6% of the total number of common shares outstanding. At December 31 of each year, all vested rights are automatically cancelled and, if applicable, paid out in cash. Compensation is calculated as the number of vested rights multiplied by the total of the market appreciation (over the price at the date of grant) and associated dividends of a common share for that period.

Based on the weighted average trading price of the common shares for the period ended June 30, 2016, compensation costs related to 4.8 million non-vested rights (3.0% of the total number of common shares outstanding), with an average grant price of $25.83, are $9.6 million for the second quarter of 2016. Peyto records a non-cash provision for future compensation expense over the life of the rights calculated using a Black-Scholes valuation model (refer to Note 7 of the condensed financial statements for the more details). This methodology can generate interim results which vary significantly from the final compensation paid. The cumulative provision totals $15.6 million.

Rights Outstanding Under Market Based Compensation Plan

	Valued but Not Vested		To be Valued December 31, 2016	
Vesting Date	**Number of Rights**	**Value ($)**	**Number of Rights**	**Average Grant Price ($)**
December 31, 2016	1,004,718	3,107,496*	1,266,167	24.09
	-	-		
December 31, 2017	-	-	1,266,167	24.09
December 31, 2018	-	-	1,266,167	24.09

*Valued on December 31, 2014 at $34.34

Interest Expense

	Three Months ended June 30		Six Months ended June 30	
	2016	2015	**2016**	2015
Interest expense ($000)	**10,063**	8,703	**19,456**	17,579
$/mcfe	**0.21**	0.19	**0.19**	0.20
$/boe	**1.25**	1.16	**1.13**	1.18
Average interest rate	**3.7%**	3.7%	**3.6%**	3.6%

Second quarter 2016 interest expense was $10.1 million or $0.21/mcfe compared to $8.7 million or $0.19/mcfe for the second quarter 2015.

Netbacks

($/mcfe)	Three Months ended June 30 **2016**	2015	Six Months ended June 30 **2016**	2015
Gross Sale Price	**1.79**	3.22	**2.15**	3.33
Hedging gain (loss)	**1.13**	0.59	**0.94**	0.66
Net Sale Price	**2.92**	3.81	**3.09**	3.99
Less: Royalties	**0.10**	0.13	**0.11**	0.16
Operating costs	**0.26**	0.31	**0.25**	0.31
Transportation	**0.17**	0.15	**0.16**	0.15
Field netback	**2.39**	3.22	**2.57**	3.37
General and administrative	**0.06**	0.04	**0.04**	0.04
Interest on long-term debt	**0.21**	0.19	**0.19**	0.20
Cash netback ($/mcfe)	**2.12**	2.99	**2.34**	3.13
Cash netback ($/boe)	**12.73**	17.95	**14.02**	18.81

Netbacks are a non-IFRS measure that represents the profit margin associated with the production and sale of petroleum and natural gas. Netbacks are per unit of production measures used to assess Peyto's performance and efficiency. The primary factors that produce Peyto's strong netbacks and high margins are a low cost structure and the high heat content of its natural gas that results in higher commodity prices.

Depletion, Depreciation and Amortization

Under IFRS, Peyto uses proved plus probable reserves as its depletion base to calculate depletion expense. The 2016 second quarter provision for depletion, depreciation and amortization totaled $76.6 million as compared to $80.3 million in 2015. On a unit-of-production basis, depletion and depreciation costs averaged $1.60/mcfe as compared to $1.78/mcfe in 2015.

Income Taxes

The current provision for deferred income tax expense is $3.4 million compared to $41.5 million in 2015 when provision income tax rates were increased. Resource pools are generated from the capital program, which are available to offset current and deferred income tax liabilities.

Income Tax Pool type ($ millions)	**June 30, 2016**	December 31, 2015	**Annual deductibility**
Canadian Oil and Gas Property Expense	222.7	211.2	10% declining balance
Canadian Development Expense	884.7	857.6	30% declining balance
Canadian Exploration Expense	65.1	98.3	100%
Undepreciated Capital Cost	378.8	398.3	Primarily 25% declining balance
Other	38.9	32.8	Various, 7% declining balance to 20%
Total Federal Tax Pools	**1,590.2**	1,598.2	
Additional Alberta Tax Pools	44.9	44.9	Primarily 100%

MARKETING

Commodity Price Risk Management

The Company is a party to certain off balance sheet derivative financial instruments, including fixed price contracts. The Company enters into these forward contracts with well-established counterparties for the purpose of protecting a portion of its future revenues from the volatility of oil and natural gas prices. In order to minimize counterparty risk, these marketing contracts are executed with financial institutions which are members of Peyto's banking syndicate. During the second quarter of 2016, a realized hedging gain of $54.5 million was recorded as compared to a $26.6 million gain for the equivalent period in 2015. A summary of contracts outstanding in respect of the hedging activities are as follows:

Natural Gas Period Hedged	Type	Daily Volume	Price (CAD)
April 1, 2015 to October 31, 2016	Fixed Price	5,000 GJ	$2.855/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.83/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.90/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.97/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.98/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$3.05/GJ
May 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.82/GJ
November 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.84/GJ
November 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.88/GJ
November 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.92/GJ
November 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.925/GJ
November 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
November 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
November 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.975/GJ
November 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.975/GJ
December 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.55/GJ
January 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.54/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$2.40/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$2.45/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$2.50/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.05/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.24/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$ 3.35/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.35/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.37/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.40/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.43/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.58/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.64/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.6425/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.70/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.70/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.81/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.8525/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.86/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.88/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.90/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.92/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.92/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.94/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.975/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.98/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$3.00/GJ
April 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$3.01/GJ
April 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.42/GJ
April 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.50/GJ
April 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.5025/GJ
April 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.5125/GJ

April 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.515/GJ
April 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.59/GJ
April 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.605/GJ
April 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.615/GJ
April 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.66/GJ
April 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.6725/GJ
April 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.71/GJ
April 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.75/GJ
April 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.10/GJ
April 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.175/GJ
April 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.20/GJ
April 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.45/GJ
April 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.54/GJ
April 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.59/GJ
April 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.60/GJ
May 1, 2016 to October 31, 2017	Fixed Price	5,000 GJ	$2.11/GJ
May 1, 2016 to October 31, 2017	Fixed Price	5,000 GJ	$2.15/GJ
May 1, 2016 to October 31, 2017	Fixed Price	5,000 GJ	$2.22/GJ
May 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.20/GJ
May 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.30/GJ
May 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.30/GJ
May 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.305/GJ
May 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.35/GJ
June 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$1.52/GJ
June 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$1.56/GJ
June 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$1.5725/GJ
June 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$1.63/GJ
July 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$1.73/GJ
July 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.30/GJ
July 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.30/GJ
July 1, 2016 to October 31, 2017	Fixed Price	5,000 GJ	$2.375/GJ
July 1, 2016 to October 31, 2017	Fixed Price	5,000 GJ	$2.3775/GJ
July 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.28/GJ
July 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.3850/GJ
July 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.4225/GJ
July 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.45/GJ
August 1, 2016 to October 31, 2017	Fixed Price	5,000 GJ	$2.22/GJ
August 1, 2016 to October 31, 2017	Fixed Price	5,000 GJ	$2.25/GJ
August 1, 2016 to October 31, 2017	Fixed Price	5,000 GJ	$2.295/GJ
August 1, 2016 to October 31, 2017	Fixed Price	5,000 GJ	$2.30/GJ
August 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.3175/GJ
August 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.37/GJ
August 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.45/GJ
August 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.45/GJ
August 1, 2016 to October 31, 2018	Fixed Price	5,000 GJ	$2.5525/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.285/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.34/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.365/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.37/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.4125/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.43/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.435/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.45/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.50/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.50/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.50/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.50/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.50/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.51/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.51/GJ

November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.51/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.51/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.53/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.54/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.55/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.55/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.5625/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.72/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.7525/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.755/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.785/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.805/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.8175/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.88/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.90/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.955/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$3.00/GJ
November 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.51/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.23/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.25/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.40/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.40/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.4025/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.44/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.45/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.50/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.50/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.53/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.5775/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.605/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.64/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.74/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.80/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.845/GJ
April 1, 2017 to March 31, 2018	Fixed Price	5,000 GJ	$2.825/GJ
April 1, 2017 to March 31, 2018	Fixed Price	5,000 GJ	$2.825/GJ
April 1, 2017 to March 31, 2018	Fixed Price	5,000 GJ	$2.835/GJ
April 1, 2017 to March 31, 2018	Fixed Price	5,000 GJ	$2.85/GJ
April 1, 2017 to March 31, 2018	Fixed Price	5,000 GJ	$2.85/GJ
April 1, 2017 to March 31, 2018	Fixed Price	5,000 GJ	$2.87/GJ
April 1, 2017 to March 31, 2018	Fixed Price	5,000 GJ	$2.875/GJ
April 1, 2017 to March 31, 2018	Fixed Price	5,000 GJ	$2.945/GJ
April 1, 2017 to October 31, 2018	Fixed Price	5,000 GJ	$2.585/GJ

As at June 30, 2016, Peyto had committed to the future sale of 279,785,000 gigajoules (GJ) of natural gas at an average price of $2.56 per GJ or $2.94 per mcf. Had these contracts closed on June 30, 2016, Peyto would have realized a loss in the amount of $49.9 million.

Subsequent to June 30, 2016 Peyto entered into the following contracts:

Natural Gas Period Hedged	Type	Daily Volume	Price (CAD)
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.8875/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.6725/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.70/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.6725GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.60/GJ
April 1, 2017 to October 31, 2017	Fixed Price	5,000 GJ	$2.65GJ
April 1, 2017 to March 31, 2018	Fixed Price	5,000 GJ	$2.8225/GJ
April 1, 2017 to October 31, 2018	Fixed Price	5,000 GJ	$2.745/GJ

Commodity Price Sensitivity

Peyto's earnings are largely determined by commodity prices for crude oil and natural gas including the US/Canadian dollar exchange rate. Volatility in these oil and gas prices can cause fluctuations in Peyto's earnings. Low operating costs and a long reserve life reduce Peyto's sensitivity to changes in commodity prices.

Currency Risk Management

The Company is exposed to fluctuations in the Canadian/US dollar exchange ratio since commodities are effectively priced in US dollars and converted to Canadian dollars. In the short term, this risk is mitigated indirectly as a result of a commodity hedging strategy that is conducted in a Canadian dollar currency. Over the long term, the Canadian dollar tends to rise as commodity prices rise. There is a similar correlation between oil and gas prices. Currently Peyto has not entered into any agreements to further manage its currency risks.

Interest Rate Risk Management

The Company is exposed to interest rate risk in relation to interest expense on its revolving credit facility while interest rates on the senior notes are fixed. Currently there are no agreements to manage the risk on the credit facility. At June 30 2016, the increase or decrease in earnings for each 100 bps (1%) change in interest rate paid on the outstanding revolving demand loan amounts to approximately $1.6 million per quarter. Average debt outstanding for the quarter was $1,090 million (including $420 million fixed rate debt).

LIQUIDITY AND CAPITAL RESOURCES

Funds from operations is reconciled to cash flows from operating activities below:

	Three Months ended June 30		Six Months ended June 30	
($000)	**2016**	2015	**2016**	2015
Cash flows from operating activities	**103,123**	134,316	**241,241**	260,450
Change in non-cash working capital	**(9,279)**	(792)	**(10,391)**	14,695
Change in provision for performance based compensation	**8,334**	1,671	**11,235**	4,692
Funds from operations	**102,178**	135,195	**242,085**	279,837
Funds from operations per share	**0.63**	0.86	**1.51**	1.80

For the second quarter ended June 30, 2016, funds from operations totaled $102.2 million or $0.63 per share, as compared to $135.2 million or $0.86 per share during the same quarter in 2015 due to decreases in commodity prices offset in part by increases in production and decreases in cash costs.

Peyto's policy is to balance dividends to shareholders with earnings and cash flow, and to balance funding for the capital program with cash flow, equity and available bank lines. Earnings and cash flow are sensitive to changes in commodity prices, exchange rates and other factors that are beyond Peyto's control. Current volatility in commodity prices creates uncertainty as to the funds from operations and capital expenditure budget. Accordingly, results are assessed throughout the year and operational plans revised as necessary to reflect the most current information.

Revenues will be impacted by drilling success and production volumes as well as external factors such as the market prices for commodities and the exchange rate of the Canadian dollar relative to the US dollar.

Long-Term Debt

($000)	**June 30, 2016**	December 31, 2015
Bank credit facility	**625,000**	625,000
Senior unsecured notes	**420,000**	420,000
Balance, end of the period	**1,045,000**	1,045,000

The Company has a syndicated $1.0 billion extendible unsecured revolving credit facility with a stated term date of December 4, 2019. An accordion provision has been added that allows for the pre-approved increase of the facility up to $1.3 billion, at the Company’s request, subject to additional commitments by existing facility lenders or by adding new financial institutions to the syndicate. The bank facility is made up of a $30 million working capital sub-tranche and a $970 million production line. The facilities are available on a revolving basis. Borrowings under the facility bear interest at Canadian bank prime or US base rate, or, at Peyto’s option, Canadian dollar bankers’ acceptances or US dollar LIBOR loan rates, plus applicable margin and stamping fees. The total stamping fees range between 50 basis points and 215 basis points on Canadian bank prime and US base rate borrowings and between 150 basis points and 315 basis points on Canadian dollar bankers’ acceptance and US dollar LIBOR borrowings. The undrawn portion of the facility is subject to a standby fee in the range of 30 to 63 basis points.

Peyto is subject to the following financial covenants as defined in the credit facility and note purchase agreements:

- Long-term debt plus the average working capital deficiency (surplus) at the end of the two most recently completed fiscal quarters adjusted for non-cash items not to exceed 3.0 times trailing twelve month net income before non-cash items, interest and income taxes;

  as at June 30, 2016 – 1.9:1.0

- Long-term debt and subordinated debt plus the average working capital deficiency (surplus) at the end of the two most recently completed fiscal quarters adjusted for non-cash items not to exceed 4.0 times trailing twelve month net income before non-cash items, interest and income taxes;

  as at June 30, 2016 – 1.9:1.0

- Trailing twelve months net income before non-cash items, interest and income taxes to exceed 3.0 times trailing twelve months interest expense;

  as at June 30, 2016 – 15.0 times

- Long-term debt and subordinated debt plus the average working capital deficiency (surplus) at the end of the two most recently completed fiscal quarters adjusted for non-cash items not to exceed 55 per cent of shareholders’ equity and long-term debt and subordinated debt plus the average working capital deficiency (surplus) at the end of the two most recently completed fiscal quarters adjusted for non-cash items.

  as at June 30, 2016 – 39 per cent

Peyto is in compliance with all financial covenants and has no subordinated debt as at June 30, 2016.

Peyto’s total borrowing capacity is $1.42 billion of which the credit facility is $1.0 billion.

On April 26, 2016, the amended and restated note purchase and private shelf agreement dated January 3, 2012 and restated as of April 26, 2013 was amended to increase the shelf facility from $150 million to $250 million. $150 million has been drawn under this shelf facility.

Peyto believes funds generated from operations, together with borrowings under the credit facility will be sufficient to maintain dividends, finance current operations, and fund the planned capital expenditure program of $500 to $550 million for 2016. The total amount of capital invested in 2016 will be driven by the number and quality of projects generated. Capital will only be invested if it meets the long term objectives of the Company. The majority of the capital program will involve drilling, completion and tie-in of lower risk development gas wells. Peyto’s rapidly scalable business model has the flexibility to match planned capital expenditures to actual cash flow.

Net Debt

"Net debt" is a non-GAAP measure that is the sum of long-term debt and working capital excluding the current financial derivative instruments and current provision for future performance based compensation. It is used by management to analyze the financial position and leverage of the Company. Net debt is reconciled below to long-term debt which is the most directly comparable GAAP measure:

($000)	**As at June 30, 2016**	As at December 31, 2015	As at June 30, 2015
Bank credit facility	**625,000**	625,000	490,000
Senior unsecured notes	**420,000**	420,000	420,000
Current assets	**(110,297)**	(167,455)	(163,420)
Current liabilities	**117,065**	163,886	142,177
Financial derivative instruments	**(19,738)**	65,169	58,422
Provision for future performance based compensation	**(13,234)**	(1,998)	(12,917)
Net debt	**1,018,796**	1,104,602	934,262

Capital

Authorized: Unlimited number of voting common shares

Issued and Outstanding

Common Shares (no par value)	**Number of Common Shares**	**Amount ($000)**
Balance, December 31, 2015	**158,958,273**	**1,467,264**
Common shares issued by private placement	281,270	7,644
Equity offering	5,390,625	172,500
Common share issuance costs, (net of tax)	-	(5,402)
Balance, June 30, 2016	**164,630,168**	**1,642,006**

On December 31, 2015, Peyto completed a private placement of 149,030 common shares to employees and consultants for net proceeds of $3.8 million ($25.29 per share). These common shares were issued January 6, 2016.

On March 15, 2016, Peyto completed a private placement of 132,240 common shares to employees and consultants for net proceeds of $3.9 million ($29.30 per common share).

On May 18, 2016, Peyto completed a public offering for 5,390,625 common shares at a price of $32.00 per common share, for net proceeds of $165.6 million.

Capital Expenditures

Net capital expenditures for the second quarter of 2016 totaled $50.6 million. Exploration and development related activity represented $37.9 million (75% of total), while expenditures on facilities, gathering systems and equipment totaled $10.9 million (22% of total) land, seismic, leaseholds and dispositions totaled $1.8 million (3% of total). The following table summarizes capital expenditures for the year:

($000)	Three Months ended June 30 **2016**	2015	Six Months ended June 30 **2016**	2015
Land	**1,003**	426	**1,003**	1,266
Seismic	**338**	987	**3,872**	4,282
Drilling	**29,669**	59,411	**92,533**	128,920
Completions	**8,237**	33,332	**41,149**	75,823
Equipping & Tie-ins	**2,428**	10,745	**14,063**	17,982
Facilities & Pipelines	**8,511**	11,803	**45,366**	23,436
Acquisitions	**-**	-	**27,876**	3,053
Dispositions	**(25)**	(180)	**(28)**	(180)
Leasehold Improvements	**473**	119	**563**	138
Total Capital Expenditures	**50,634**	116,643	**226,397**	254,720

Dividends

	Three Months ended June 30 **2016**	2015	Six Months ended June 30 **2016**	2015
Funds from operations ($000)	**102,178**	135,195	**242,085**	279,837
Total dividends ($000)	**53,735**	52,456	**106,255**	103,237
Total dividends per common share ($)	**0.33**	0.33	**0.66**	0.66
Payout ratio (%)	**53**	39	**44**	37

Peyto's policy is to balance dividends to shareholders with earnings and cash flow; and funding for the capital program with cash flow, equity and available bank lines. The Board of Directors is prepared to adjust the payout ratio levels (dividends declared divided by funds from operations) to achieve the desired dividends while maintaining an appropriate capital structure.

Contractual Obligations

In addition to those recorded on the Company's balance sheet, the following is a summary of Peyto's contractual obligations and commitments as at June 30, 2016:

($000)	**2016**	**2017**	**2018**	**2019**	**2020**	**Thereafter**
Interest payments [1]	9,193	18,385	18,385	16,190	13,995	27,840
Transportation commitments	15,480	32,325	38,180	31,925	24,665	99,659
Operating leases	702	2,279	2,032	2,032	2,032	12,567
Other	880	-	-	-	-	-
Total	26,255	52,989	58,597	50,147	40,692	140,066

(1) Fixed interest payments on senior unsecured notes

LITIGATION

On October 1, 2013, two shareholders (the "Plaintiffs") of Poseidon Concepts Corp. ("Poseidon") filed an application to seek leave of the Alberta Court of Queen's Bench (the "Court") to pursue a class action lawsuit against the Company, as a successor to new Open Range Energy Corp. ("New Open Range") (the "Poseidon Shareholder Application"). The proposed action contains various claims relating to alleged misrepresentations in disclosure documents of Poseidon (not New Open Range), which claims are also alleged in class action lawsuits filed in Alberta, Ontario, and Quebec earlier in 2013 against Poseidon and certain of its current and former directors and officers, and underwriters involved in the public offering of common shares of Poseidon completed in February 2012. The proposed class action seeks various declarations and damages including compensatory damages which the Plaintiffs estimate at $651 million and punitive damages which the Plaintiffs estimate at $10 million, which damage amounts appear to be duplicative of damage amounts claimed in the class actions against Poseidon, certain of its current and former directors and officers, and underwriters.

New Open Range was incorporated on September 14, 2011 solely for purposes of participating in a plan of arrangement with Poseidon (formerly named Open Range Energy Corp. ("Old Open Range")), which was completed on November 1, 2011. Pursuant to such arrangement, Poseidon completed a corporate reorganization resulting in two separate publicly-traded companies: Poseidon, which continued to carry on the energy service and supply business; and New Open Range, which carried on Poseidon's former oil and gas exploration and production business. Peyto acquired all of the issued and outstanding common shares of New Open Range on August 14, 2012. On April 9, 2013, Poseidon obtained creditor protection under the Companies' Creditor Protection Act.

On October 31, 2013, Poseidon filed a lawsuit with the Court naming the Company as a co-defendant along with the former directors and officers of Poseidon, the former directors and officers of Old Open Range and the former directors and officers of New Open Range (the "Poseidon Action"). Poseidon claims, among other things, that the Company is vicariously liable for the alleged wrongful acts and breaches of duty of the directors, officers and employees of New Open Range.

On September 24, 2014 Poseidon amended its claim in the Poseidon Action to add Poseidon's auditor, KPMG LLP ("KPMG"), as a defendant.

On May 4, 2016, KPMG issued a third party claim in the Poseidon Action against Poseidon's former officers and directors and Peyto for any liability KPMG is determined to have to Poseidon. Peyto is not required to deliver a defence to this claim at this time.

On July 3, 2014, the Plaintiffs filed a lawsuit with the Court against KPMG LLP, Poseidon's and Old Open Range's former auditors, making allegations substantially similar to those in the other claims (the "KPMG Poseidon Shareholder KPMG Action"). On July 29, 2014, KPMG LLP filed a statement of defence and a third party claim against Poseidon, the Company and the former directors and officers of Poseidon. The third party claim seeks, among other things, an indemnity, or alternatively contribution, from the third party defendants with respect to any judgment awarded against KPMG LLP.

The allegations against New Open Range contained in the claims described above are based on factual matters that pre-existed the Company's acquisition of New Open Range. The Company has not yet been required to defend either of the actions. If it is required to defend the actions, the Company intends to aggressively protect its interests and the interests of its Shareholders and will seek all available legal remedies in defending the actions.

RELATED PARTY TRANSACTIONS

Certain directors of Peyto are considered to have significant influence over other reporting entities that Peyto engages in transactions with. Such services are provided in the normal course of business and at market rates. These directors are not involved in the day to day operational decision making of the Company. The dollar value of the transactions between Peyto and the related reporting entities is summarized below:

	Expense				Accounts Payable	
	Three Months ended June 30		Six Months ended June 30		As at June 30	
($000)	**2016**	2015	**2016**	2015	**2016**	2015
	288.4	817.9	**650.6**	766.8	**427.4**	376.4

RISK MANAGEMENT

Investors who purchase shares are participating in the total returns from a portfolio of western Canadian natural gas producing properties. As such, the total returns earned by investors and the value of the shares are subject to numerous risks inherent in the oil and natural gas industry.

Expected returns depend largely on the volume of petroleum and natural gas production and the price received for such production, along with the associated costs. The price received for oil depends on a number of factors, including West Texas Intermediate oil prices, Canadian/US currency exchange rates, quality differentials and Edmonton par oil prices. The price received for natural gas production is primarily dependent on current Alberta market prices. Peyto's marketing strategy is designed to smooth out short term fluctuations in the price of natural gas through future sales. It is meant to be methodical and consistent and to avoid speculation.

Although Peyto's focus is on internally generated drilling programs, any acquisition of oil and natural gas assets depends on an assessment of value at the time of acquisition. Incorrect assessments of value can adversely affect dividends to shareholders and the value of the shares. Peyto employs experienced staff and performs appropriate levels of due diligence on the analysis of acquisition targets, including a detailed examination of reserve reports; if appropriate, re-engineering of reserves for a large portion of the properties to ensure the results are consistent; site examinations of facilities for environmental liabilities; detailed examination of balance sheet accounts; review of contracts; review of prior year tax returns and modeling of the acquisition to attempt to ensure accretive results to the shareholders.

Inherent in development of the existing oil and gas reserves are the risks, among others, of drilling dry holes, encountering production or drilling difficulties or experiencing high decline rates in producing wells. To minimize these risks, Peyto employs experienced staff to evaluate and operate wells and utilize appropriate technology in operations. In addition, prudent work practices and procedures, safety programs and risk management principles, including insurance coverage protect Peyto against certain potential losses.

The value of Peyto's shares is based on among other things, the underlying value of the oil and natural gas reserves. Geological and operational risks can affect the quantity and quality of reserves and the cost of ultimately recovering those reserves. Lower oil and gas prices increase the risk of write-downs on oil and gas property investments. In order to mitigate this risk, proven and probable oil and gas reserves are evaluated each year by a firm of independent reservoir engineers. The reserves committee of the Board of Directors reviews and approves the reserve report.

Access to markets may be restricted at times by pipeline or processing capacity. These risks are minimized by controlling as much of the processing and transportation activities as possible and ensuring transportation and processing contracts are in place with reliable cost efficient counterparties.

The petroleum and natural gas industry is subject to extensive controls, regulatory policies and income and resource taxes imposed by various levels of government. These regulations, controls and taxation policies are amended from time to time. Peyto has no control over the level of government intervention or taxation in the petroleum and natural gas industry. Peyto operates in such a manner to ensure, to the best of its knowledge that it is in compliance with all applicable regulations and are able to respond to changes as they occur.

The petroleum and natural gas industry is subject to both environmental regulations and an increased environmental awareness. Peyto has reviewed its environmental risks and is, to the best of its knowledge, in compliance with the appropriate environmental legislation and have determined that there is no current material impact on operations. Peyto employs environmentally responsible business operations, and looks to both Alberta provincial authorities and Canada's federal authorities for direction and regulation regarding environmental and climate change legislation.

Peyto is subject to financial market risk. In order to maintain substantial rates of growth, Peyto must continue reinvesting in, drilling for or acquiring petroleum and natural gas. The capital expenditure program is funded primarily through funds from operations, debt and, if appropriate, equity.

CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, disclosure controls and procedures to provide reasonable assurance that: (i) material information relating to the Company is made known to the Company's Chief Executive Officer and Chief Financial Officer by others, particularly during the period in which the annual and interim filings are being prepared; and (ii) information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time period specified in securities legislation. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Company's disclosure controls and procedures at the year end of the Company and have concluded that the Company's disclosure controls and procedures are effective at the financial period end of the Company for the foregoing purposes.

Internal Control over Financial Reporting

The Company's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, internal control over financial reporting to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Company's internal control over financial reporting at the financial period end of the Company and concluded that the Company's internal control over financial reporting is effective, at the financial period end of the Company, for the foregoing purpose.

Peyto is required to disclose herein any change in Peyto's internal control over financial reporting that occurred during the period ended June 30, 2016 that has materially affected, or is reasonably likely to materially affect, Peyto's internal control over financial reporting. No material changes in Peyto's internal control over financial reporting were identified during such period that has materially affected, or are reasonably likely to materially affect, Peyto's internal control over financial reporting.

It should be noted that a control system, including the Company's disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

CRITICAL ACCOUNTING ESTIMATES

Reserve Estimates

Estimates of oil and natural gas reserves, by necessity, are projections based on geologic and engineering data, and there are uncertainties inherent to the interpretation of such data as well as the projection of future rates of production and the timing of development expenditures. Reserve engineering is an analytical process of estimating underground accumulations of oil and natural gas that can be difficult to measure. The accuracy of any reserve estimate is a function of the quality of available data, engineering and geological interpretation and judgment. Estimates of economically recoverable oil and natural gas reserves and future net cash flows necessarily depend upon a number of variable factors and assumptions, such as historical production from the area compared with production from other producing areas, the assumed effects of regulations by governmental agencies and assumptions governing future oil and natural gas prices, future royalties and operating costs, development costs and workover and remedial costs, all of which may in fact vary considerably from actual results. For these reasons, estimates of the economically recoverable quantities of oil and natural gas attributable to any particular group of properties, classifications of such reserves based on risk recovery, and estimates of the future net cash flows expected there from may vary substantially. Any significant variance in the assumptions could materially affect the estimated quantity and value of the reserves, which could affect the carrying value of Peyto's oil and natural gas properties and the rate of depletion of the oil and natural gas properties as well as the calculation of the reserve value based compensation. Actual production, revenues and expenditures with respect to Peyto's reserves will likely vary from estimates, and such variances may be material.

Peyto's estimated quantities of proved and probable reserves at December 31, 2015 were evaluated by independent petroleum engineers InSite Petroleum Consultants Ltd. InSite has been evaluating reserves in this area and for Peyto since inception.

Depletion and Depreciation Estimate

All costs of exploring for and developing petroleum and natural gas reserves, together with the costs of production equipment, are capitalized and then depleted and depreciated on the unit-of-production method based on proved plus probable reserves. Petroleum and natural gas reserves and production are converted into equivalent units based upon estimated relative energy content (6 mcf to 1 barrel of oil). Costs for gas plants and other facilities are capitalized and depreciated on a declining balance basis

Impairment of Long-Lived Assets

Impairment is indicated if the carrying value of the long-lived asset or oil and gas cash generating unit exceeds its recoverable amount under IFRS. If impairment is indicated, the amount by which the carrying value exceeds the estimated fair value of the long-lived asset is charged to earnings. The determination of the recoverable amount for impairment purposes under IFRS involves the use of numerous assumptions and judgments including future net cash flows from oil and gas reserves, future third-party pricing, inflation factors, discount rates and other uncertainties. Future revisions to these assumptions impact the recoverable amount.

Decommissioning Provision

The decommissioning provision is estimated based on existing laws, contracts or other policies. The fair value of the obligation is based on estimated future costs for abandonment and reclamation discounted at a credit adjusted risk free rate. The liability is adjusted each reporting period to reflect the passage of time and for revisions to the estimated future cash flows, with the accretion charged to earnings. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material.

Future Market Performance Based Compensation

The provision for future market based compensation is estimated based on current market conditions, distribution history and on the assumption that all outstanding rights will be paid out according to the vesting schedule. The conditions at the time of vesting could vary significantly from the current conditions and may have a material effect on the calculation.

Reserve Value Performance Based Compensation

The reserve value based compensation is calculated using the year end independent reserves evaluation which was completed in February 2016. A quarterly provision for the reserve value based compensation is calculated using estimated proved producing reserve additions adjusted for changes in debt, equity and dividends. Actual proved producing reserves additions and forecasted commodity prices could vary significantly from those estimated and may have a material effect on the calculation.

Income Taxes
The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded.

Accounting Changes
Voluntary changes in accounting policy are made only if they result in financial statements which provide more reliable and relevant information. Accounting policy changes are applied retrospectively unless it is impractical to determine the period or cumulative impact of the change. Corrections of prior period errors are applied retrospectively and changes in accounting estimates are applied prospectively by including these changes in earnings. When the Company has not applied a new primary source of GAAP that has been issued, but is not effective, the Company will disclose the fact along with information relevant to assessing the possible impact that application of the new primary source of GAAP will have on the financial statements in the period of initial application.

STANDARDS ISSUED BUT NOT YET EFFECTIVE

The IASB issued the following standards and amendments which are not yet effective for Peyto and discussed in further detail in Note 2 to the Financial Statements for the fiscal period ended June 30, 2016.

> In July 2014, the IASB completed the final elements of IFRS 9 "Financial Instruments." The Standard supersedes earlier versions of IFRS 9 and completes the IASB's project to replace IAS 39 "Financial Instruments: Recognition and Measurement." IFRS 9, as amended, includes a principle-based approach for classification and measurement of financial assets, a single 'expected loss' impairment model and a substantially-reformed approach to hedge accounting. The Standard will come into effect for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 9 will be applied by Peyto on January 1, 2018 and the Company is currently evaluating the impact of the standard on its financial statements.
>
> In May 2014, the IASB issued IFRS 15 "Revenue from Contracts with Customers," which replaces IAS 18 "Revenue," IAS 11 "Construction Contracts," and related interpretations. The standard is required to be adopted for fiscal years beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 15 will be applied by Peyto on January 1, 2018 and the Company is currently evaluating the impact of the standard on Peyto's financial statements.
>
> In January 2016, the IASB issued IFRS 16 "Leases", which replaces IAS 17 "Leases". For lessees applying IFRS 16, a single recognition and measurement model for leases would apply, with required recognition of assets and liabilities for most leases. The standard will come into effect for annual periods beginning on or after January 1, 2019, with earlier adoption permitted. The Company is currently evaluating the impact of the standard on the Company's financial statements.

ADDITIONAL INFORMATION

Additional information relating to Peyto Exploration & Development Corp. can be found on SEDAR at www.sedar.com and www.peyto.com.

Quarterly information

	2016		2015		
	Q2	Q1	Q4	Q3	Q2
Operations					
Production					
Natural gas (mcf/d)	489,337	567,230	540,512	455,137	455,443
Oil & NGLs (bbl/d)	6,621	7,008	6,943	5,352	6,843
Barrels of oil equivalent (boe/d @ 6:1)	88,177	101,546	97,028	81,208	82,750
Thousand cubic feet equivalent (mcfe/d @ 6:1)	529,064	609,278	582,167	487,250	496,498
Average product prices					
Natural gas ($/mcf)	2.60	3.06	3.34	3.57	3.50
Oil & natural gas liquids ($/bbl)	41.46	33.60	39.88	41.69	43.54
$/MCFE					
Average sale price ($/mcfe)	2.92	3.24	3.58	3.80	3.81
Average royalties paid ($/mcfe)	0.10	0.13	0.13	0.15	0.13
Average operating expenses ($/mcfe)	0.26	0.23	0.25	0.28	0.31
Average transportation costs ($/mcfe)	0.17	0.16	0.16	0.16	0.15
Field netback ($/mcfe)	2.39	2.72	3.04	3.21	3.22
General & administrative expense ($/mcfe)	0.06	0.03	0.05	0.02	0.04
Interest expense ($/mcfe)	0.21	0.17	0.16	0.19	0.19
Cash netback ($/mcfe)	2.12	2.52	2.82	3.00	2.99
Financial ($000 except per share)					
Revenue	140,891	179,351	191,606	170,216	172,202
Royalties	4,874	6,985	6,663	6,489	5,875
Funds from operations	102,178	139,907	151,123	134,513	135,195
Funds from operations per share	0.63	0.88	0.95	0.85	0.86
Total dividends	53,735	52,520	52,456	52,456	52,456
Total dividends per share	0.33	0.33	0.33	0.33	0.33
Payout ratio	53%	38%	35%	39%	39%
Earnings	9,102	41,943	43,406	37,347	12,295
Earnings per diluted share	0.06	0.26	0.27	0.23	0.08
Capital expenditures	50,634	175,763	162,442	176,618	116,643
Weighted average shares outstanding	161,845,999	159,142,526	158,958,273	158,958,273	158,117,853

Peyto Exploration & Development Corp.

Condensed Balance Sheet *(unaudited)*

(Amount in $ thousands)

	June 30 2016	December 31 2015
Assets		
Current assets		
Cash	25,457	-
Accounts receivable	63,773	85,525
Due from private placement *(Note 6)*	-	3,769
Derivative financial instruments *(Note 8)*	-	65,169
Prepaid expenses	21,067	12,992
	110,297	167,455
Property, plant and equipment, net *(Note 3)*	3,279,489	3,190,059
	3,279,489	3,190,059
	3,389,786	3,357,514
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	65,984	144,402
Dividends payable *(Note 6)*	18,109	17,486
Derivative financial instruments *(Note 8)*	19,738	-
Provision for future performance based compensation *(Note 7)*	13,234	1,998
	117,065	163,886
Long-term debt *(Note 4)*	1,045,000	1,045,000
Long-term derivative financial instruments *(Note 8)*	30,165	2,299
Provision for future performance based compensation (Note 7)	5,852	-
Decommissioning provision *(Note 5)*	144,385	118,882
Deferred income taxes	390,324	403,890
	1,615,726	1,570,071
Equity		
Share capital *(Note 6)*	1,642,006	1,467,264
Shares to be issued *(Note 6)*	-	3,769
Retained earnings	48,129	103,339
Accumulated other comprehensive (loss) income *(Note 6)*	(33,140)	49,185
	1,656,995	1,623,557
	3,389,786	3,357,514

See accompanying notes to the financial statements.

Peyto Exploration & Development Corp.

Condensed Income Statement *(unaudited)*

(Amount in $ thousands except earnings per share amount)

	Three months ended June 30		Six months ended June 30	
	2016	2015	**2016**	2015
Revenue				
Oil and gas sales	86,444	145,555	222,647	296,781
Realized gain on hedges *(Note 8)*	54,447	26,647	97,596	59,233
Royalties	(4,874)	(5,875)	(11,859)	(13,867)
Petroleum and natural gas sales, net	**136,017**	166,327	**308,384**	342,147
Expenses				
Operating	12,732	14,117	25,273	28,006
Transportation	8,190	6,638	16,859	13,216
General and administrative	2,853	1,673	4,710	3,509
Future performance based compensation *(Note 7)*	12,533	979	17,088	5,078
Interest	10,063	8,703	19,456	17,579
Accretion of decommissioning provision *(Note 5)*	543	616	1,147	1,127
Depletion and depreciation *(Note 3)*	76,635	80,252	166,594	160,933
Gain on disposition of assets *(Note 3)*	-	-	(12,668)	-
	123,549	112,978	**238,459**	229,448
Earnings before taxes	**12,468**	53,349	**69,925**	112,699
Income tax				
Deferred income tax expense	3,366	41,054	18,880	55,891
Earnings for the period	**9,102**	12,295	**51,045**	56,808
Earnings per share *(Note 6)*				
Basic and diluted	**$0.06**	$0.08	**$0.32**	$0.36

See accompanying notes to the financial statements.

Peyto Exploration & Development Corp.

Condensed Statement of Comprehensive Income (Loss) *(unaudited)*

(Amount in $ thousands)

	Three months ended June 30		Six months ended June 30	
	2016	2015	**2016**	2015
Earnings for the period	**9,102**	12,295	**51,045**	56,808
Other comprehensive (loss) income				
Change in unrealized (loss) on cash flow hedges	(110,733)	(21,712)	(15,178)	(46,749)
Deferred tax recovery	44,598	6,363	30,449	12,622
Realized (gain) on cash flow hedges	(54,446)	(26,647)	(97,596)	(59,233)
Comprehensive (loss) income	**(111,479)**	(29,701)	**(31,280)**	36,552

See accompanying notes to the financial statements.

Peyto Exploration & Development Corp.

Condensed Statement of Changes in Equity *(unaudited)*

(Amount in $ thousands)

	Six months ended June 30	
	2016	**2015**
Share capital, beginning of period	**1,467,264**	1,292,398
Common shares issued by private placement	7,644	7,732
Equity offering	172,500	172,517
Common shares issuance costs (net of tax)	(5,402)	(5,387)
Share capital, end of period	**1,642,006**	1,467,260
Shares to be issued, beginning of period	**3,769**	5,625
Shares issued	(3,769)	(5,625)
Shares to be issued, end of period	**-**	-
Retained earnings, beginning of period	**103,339**	173,927
Earnings for the period	51,045	56,808
Dividends *(Note 6)*	(106,255)	(103,237)
Retained earnings, end of period	**48,129**	127,498
Accumulated other comprehensive income, beginning of period	**49,185**	79,986
Other comprehensive loss	(82,325)	(34,127)
Accumulated other comprehensive (loss) income, end of period	**(33,140)**	45,859
Total equity	**1,656,995**	1,640,617

See accompanying notes to the financial statements.

Peyto Exploration & Development Corp.

Condensed Statement of Cash Flows *(unaudited)*

(Amount in $ thousands)

See accompanying notes to the financial statements

	Three months ended June 30		Six months ended June 30	
	2016	2015	**2016**	2015
Cash provided by (used in)				
operating activities				
Earnings	9,102	12,295	51,045	56,808
Items not requiring cash:				
Deferred income tax	3,366	41,054	18,880	55,891
Depletion and depreciation	76,635	80,252	166,594	160,933
Accretion of decommissioning provision	543	616	1,147	1,127
Gain on disposition of assets	-	-	(12,668)	-
Long term portion of future performance based compensation	4,198	(693)	5,852	386
Change in non-cash working capital related to operating activities	9,279	792	10,391	(14,695)
	103,123	134,316	**241,241**	260,450
Financing activities				
Issuance of common shares	172,507	172,517	180,144	180,249
Issuance costs	(7,381)	(7,342)	(7,399)	(7,380)
Cash dividends paid	(53,142)	(51,902)	(105,631)	(102,657)
Increase (decrease) in bank debt	(95,000)	(205,000)	-	(115,000)
Issuance of senior unsecured notes	-	100,000	-	100,000
	16,984	8,273	**67,114**	55,212
Investing activities				
Additions to property, plant and equipment	(50,634)	(116,643)	(226,397)	(254,720)
Change in prepaid capital	233	(1,255)	7,733	(13,879)
Change in non-cash working capital relating to investing activities	(47,991)	(24,691)	(64,234)	(47,063)
	(98,392)	(142,589)	**(282,898)**	(315,662)
Net increase (decrease) in cash	**21,715**	-	**25,457**	-
Cash, beginning of period	**3,742**	-	**-**	-
Cash, end of period	**25,457**	-	**25,457**	-

The following amounts are included in cash flows from operating activities:				
Cash interest paid	**13,764**	5,189	**19,407**	14,648
Cash taxes paid	**-**	-	**-**	-

1. Nature of operations

Peyto Exploration & Development Corp. ("Peyto" or the "Company") is a Calgary based oil and natural gas company. Peyto conducts exploration, development and production activities in Canada. Peyto is incorporated and domiciled in the Province of Alberta, Canada. The address of its registered office is 300, 600 – 3rd Avenue SW, Calgary, Alberta, Canada, T2P 0G5.

These financial statements were approved and authorized for issuance by the Audit Committee of Peyto on August 9, 2016.

2. Basis of presentation

The condensed financial statements have been prepared by management and reported in Canadian dollars in accordance with International Accounting Standard ("IAS") 34, "Interim Financial Reporting". These condensed financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the Company's financial statements as at and for the years ended December 31, 2015 and 2014.

Significant Accounting Policies

(a) Significant Accounting Judgments, Estimates and Assumptions

The timely preparation of the condensed financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies, if any, as at the date of the financial statements and the reported amounts of revenue and expenses during the period. By their nature, estimates are subject to measurement uncertainty and changes in such estimates in future years could require a material change in the condensed financial statements.

All accounting policies and methods of computation followed in the preparation of these financial statements are the same as those disclosed in Note 2 of Peyto's financial statements as at and for the years ended December 31, 2015 and 2014.

(b) Standards issued but not yet effective

In July 2014, the IASB completed the final elements of IFRS 9 "Financial Instruments." The Standard supersedes earlier versions of IFRS 9 and completes the IASB's project to replace IAS 39 "Financial Instruments: Recognition and Measurement." IFRS 9, as amended, includes a principle-based approach for classification and measurement of financial assets, a single 'expected loss' impairment model and a substantially-reformed approach to hedge accounting. The Standard will come into effect for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 9 will be applied by Peyto on January 1, 2018 and the Company is currently evaluating the impact of the standard on its financial statements.

In May 2014, the IASB issued IFRS 15 "Revenue from Contracts with Customers," which replaces IAS 18 "Revenue, "IAS 11 "Construction Contracts," and related interpretations. The standard is required to be adopted for fiscal years beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 15 will be applied by Peyto on January 1, 2018 and the Company is currently evaluating the impact of the standard on Peyto's financial statements.

In January 2016, the IASB issued IFRS 16 "Leases", which replaces IAS 17 "Leases". For lessees applying IFRS 16, a single recognition and measurement model for leases would apply, with required recognition of assets and liabilities for most leases. The standard will come into effect for annual periods beginning on or after January 1, 2019, with earlier adoption permitted. The Company is currently evaluating the impact of the standard on the Company's financial statements.

3. Property, plant and equipment, net

Cost	
At December 31, 2015	4,416,643
Additions	237,214
Decommissioning provision additions	24,356
Prepaid capital	(7,733)
At June 30, 2016	**4,670,480**
Accumulated depletion and depreciation	
At December 31, 2015	(1,226,584)
Depletion and depreciation	(164,407)
At June 30, 2016	**(1,390,991)**
Carrying amount at December 31, 2015	3,190,059
Carrying amount at June 30, 2016	**3,279,489**

During the six months ended June 30, 2016, the Company closed an asset swap arrangement. For purposes of determining a gain on disposition, the estimated fair value was based on the fair value of the assets received. The Company recorded a gain of $12.7 million for the six months ended June 30, 2016.

During the three and six month periods ended June 30, 2016, Peyto capitalized $0.9 million and $3.1 million (2015 - $1.8 million and $3.8 million) of general and administrative expense directly attributable to exploration and development activities.

4. Long-term debt

	June 30, 2016	December 31, 2015
Bank credit facility	625,000	625,000
Senior unsecured notes	420,000	420,000
Balance, end of the period	**1,045,000**	1,045,000

The Company has a syndicated $1.0 billion extendible unsecured revolving credit facility with a stated term date of December 4, 2019. An accordion provision has been added that allows for the pre-approved increase of the facility up to $1.3 billion, at the Company's request, subject to additional commitments by existing facility lenders or by adding new financial institutions to the syndicate. The bank facility is made up of a $30 million working capital sub-tranche and a $970 million production line. The facilities are available on a revolving basis. Borrowings under the facility bear interest at Canadian bank prime or US base rate, or, at Peyto's option, Canadian dollar bankers' acceptances or US dollar LIBOR loan rates, plus applicable margin and stamping fees. The total stamping fees range between 50 basis points and 215 basis points on Canadian bank prime and US base rate borrowings and between 150 basis points and 315 basis points on Canadian dollar bankers' acceptance and US dollar LIBOR borrowings. The undrawn portion of the facility is subject to a standby fee in the range of 30 to 63 basis points.

Peyto is subject to the following financial covenants as defined in the credit facility and note purchase agreements:

- Long-term debt plus the average working capital deficiency (surplus) at the end of the two most recently completed fiscal quarters adjusted for non-cash items not to exceed 3.0 times trailing twelve month net income before non-cash items, interest and income taxes;
- Long-term debt and subordinated debt plus the average working capital deficiency (surplus) at the end of the two most recently completed fiscal quarters adjusted for non-cash items not to exceed 4.0 times trailing twelve month net income before non-cash items, interest and income taxes;
- Trailing twelve months net income before non-cash items, interest and income taxes to exceed 3.0 times trailing twelve months interest expense;
- Long-term debt and subordinated debt plus the average working capital deficiency (surplus) at the end of the two most recently completed fiscal quarters adjusted for non-cash items not to exceed 55 per cent of the book value of shareholders' equity and long-term debt and subordinated debt.

Peyto is in compliance with all financial covenants at June 30, 2016.

On April 26, 2016, the amended and restated note purchase and private shelf agreement dated January 3, 2012 and restated as of April 26, 2013 was amended to increase the shelf facility from $150 million to $250 million. $150 million has been drawn under this shelf facility.

Total interest expense for the three and six month periods ended June 30, 2016 was $10.1 million and $19.5 million (2015 - $8.7 million and $17.6 million) and the average borrowing rate for the period was 3.7% and 3.6% (2015– 3.7% and 3.6%).

5. Decommissioning provision

The following table reconciles the change in decommissioning provision:

Balance, December 31, 2015	**118,882**
New or increased provisions	8,314
Accretion of decommissioning provision	1,147
Change in discount rate and estimates	16,042
Balance, June 30, 2016	**144,385**
Current	-
Non-current	144,385

Peyto has estimated the net present value of its total decommissioning provision to be $144.4 million as at June 30, 2016 ($118.9 million at December 31, 2015) based on a total future undiscounted liability of $245.8 million ($239.0 million at December 31, 2015). At June 30, 2016 management estimates that these payments are expected to be made over the next 50 years with the majority of payments being made in years 2040 to 2064. The Bank of Canada's long term bond rate of 1.72 per cent (2.15 per cent at December 31, 2015) and an inflation rate of 2.0 per cent (2.0 per cent at December 31, 2015) were used to calculate the present value of the decommissioning provision.

6. Share capital

Authorized: Unlimited number of voting common shares

Issued and Outstanding

Common Shares (no par value)	**Number of Common Shares**	**Amount $**
Balance, December 31, 2015	**158,958,273**	**1,467,264**
Common shares issued by private placement	281,270	7,644
Equity offering	5,390,625	172,500
Common share issuance costs, (net of tax)	-	(5,402)
Balance, June 30, 2016	**164,630,168**	**1,642,006**

Earnings per common share has been determined based on the following:

	Three Months ended June 30		Six Months ended June 30	
	2016	2015	**2016**	2015
Weighted average common shares basic and diluted	**161,845,999**	158,117,853	**160,494,262**	155,996,994

On December 31, 2015, Peyto completed a private placement of 149,030 common shares to employees and consultants for net proceeds of $3.8 million ($25.29 per share). These common shares were issued January 6, 2016.

On March 15, 2016, Peyto completed a private placement of 132,240 common shares to employees and consultants for net proceeds of $3.9 million ($29.30 per common share).

On May 18, 2016, Peyto completed a public offering for 5,390,625 common shares at a price of $32.00 per common share, for net proceeds of $165.6 million.

Dividends
During the three and six month periods ended June 30, 2016, Peyto declared and paid dividends of $0.33 and $0.66 per common share ($0.11 per common share for the months of January to June 2016), totaling $53.7 million and $106.3 million respectively (2015 - $0.33 and $0.66 ($0.11 per common share for the months of January to June 2015), totaling $52.0 million and $103.0 million respectively).

Comprehensive income
Comprehensive income consists of earnings and other comprehensive income ("OCI"). OCI comprises the change in the fair value of the effective portion of the derivatives used as hedging items in a cash flow hedge. "Accumulated other comprehensive income" is an equity category comprised of the cumulative amounts of OCI.

Accumulated hedging gains
Gains and losses from cash flow hedges are accumulated until settled. These outstanding hedging contracts are recognized in earnings on settlement with gains and losses being recognized as a component of net revenue. Further information on these contracts is set out in Note 8.

7. Future performance based compensation

Peyto awards performance based compensation to employees annually. The performance based compensation is comprised of reserve and market value based components.

Reserve based component
The reserves value based component is 4% of the incremental increase in value, if any, as adjusted to reflect changes in debt, equity, dividends, general and administrative costs and interest, of proved producing reserves calculated using a constant price at December 31 of the current year and a discount rate of 8%.

Market based component
Under the market based component, rights with a three year vesting period are allocated to employees. The number of rights outstanding at any time is not to exceed 6% of the total number of common shares outstanding. At December 31 of each year, all vested rights are automatically cancelled and, if applicable, paid out in cash. Compensation is calculated as the number of vested rights multiplied by the total of the market appreciation (over the price at the date of grant) and associated dividends of a common share for that period.

The fair values were calculated using a Black-Scholes valuation model. The principal inputs to the option valuation model were:

	June 30, 2016	June 30, 2015
Share price	$24.09-$34.68	$30.53-$32.27
Exercise price	$23.43-$33.02	$21.70-$33.68
Expected volatility	38.9%	21.9%
Option life	0.50 years	0.50 years
Dividend yield	0%	0%
Risk-free interest rate	0.52%	0.49%

8. Financial instruments

Financial instrument classification and measurement
Financial instruments of the Company carried on the condensed balance sheet are carried at amortized cost with the exception of cash and financial derivative instruments, specifically fixed price contracts, which are carried at fair value. There are no significant differences between the carrying amount of financial instruments and their estimated fair values as at June 30, 2016.

The Company's areas of financial risk management and risks related to financial instruments remained unchanged from December 31, 2015.

The fair value of the Company's cash and financial derivative instruments are quoted in active markets. The Company classifies the fair value of these transactions according to the following hierarchy.

- Level 1 – quoted prices in active markets for identical financial instruments.
- Level 2 – quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and value drivers are observable in active markets.
- Level 3 – valuations derived from valuation techniques in which one or more significant inputs or value drivers are unobservable.

The Company's cash and financial derivative instruments have been assessed on the fair value hierarchy described above and classified as Level 1.

Fair values of financial assets and liabilities

The Company's financial instruments include cash, accounts receivable, financial derivative instruments, due from private placement, current liabilities, provision for future performance based compensation and long term debt. At June 30, 2016, cash and financial derivative instruments are carried at fair value. Accounts receivable, due from private placement, current liabilities and provision for future performance based compensation approximate their fair value due to their short term nature. The carrying value of the long term debt approximates its fair value due to the floating rate of interest charged under the credit facility.

Commodity price risk management

Peyto uses derivative instruments to reduce its exposure to fluctuations in commodity prices. Peyto considers all of these transactions to be effective economic hedges for accounting purposes.

Following is a summary of all risk management contracts in place as at June 30, 2016:

Natural Gas Period Hedged	**Type**	**Daily Volume**	**Price (CAD)**
April 1, 2015 to October 31, 2016	Fixed Price	5,000 GJ	$2.885/GJ
April 1, 2015 to March 31, 2017	Fixed Price	50,000 GJ	$2.83/GJ to $3.05/GJ
May 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.82/GJ
November 1, 2015 to March 31, 2017	Fixed Price	40,000 GJ	$2.84/GJ to $2.975/GJ
December 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.55/GJ
January 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.54/GJ
April 1, 2016 to October 31, 2016	Fixed Price	50,000 GJ	$2.40/GJ to $3.43/GJ
April 1, 2016 to March 31, 2017	Fixed Price	95,000 GJ	$2.58/GJ to $3.01/GJ
April 1, 2016 to March 31, 2018	Fixed Price	60,000 GJ	$2.42/GJ to $2.75/GJ
April 1, 2016 to October 31, 2018	Fixed Price	35,000 GJ	$2.10/GJ to $2.60/GJ
May 1, 2016 to October 31, 2017	Fixed Price	15,000 GJ	$2.11/GJ to $2.22/GJ
May 1, 2016 to October 31, 2018	Fixed Price	25,000 GJ	$2.20/GJ to $2.35/GJ
June 1, 2016 to October 31, 2016	Fixed Price	20,000 GJ	$1.52/GJ to $1.63/GJ
July 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$1.73/GJ
July 1, 2016 to March 31, 2017	Fixed Price	10,000 GJ	$2.30/GJ
July 1, 2016 to October 31, 2017	Fixed Price	10,000 GJ	$2.375/GJ to $2.3775/GJ
July 1, 2016 to October 31, 2018	Fixed Price	20,000 GJ	$2.28/GJ to $2.45/GJ
August 1, 2016 to October 31, 2017	Fixed Price	20,000 GJ	$2.22/GJ to $2.30/GJ
August 1, 2016 to October 31, 2018	Fixed Price	25,000 GJ	$2.3175/GJ to $2.5525/GJ
November 1, 2016 to March 31, 2017	Fixed Price	165,000 GJ	$2.285/GJ to $3.00/GJ
November 1, 2016 to March 31, 2018	Fixed Price	5,000 GJ	$2.51/GJ
April 1, 2017 to October 31, 2017	Fixed Price	80,000 GJ	$2.23/GJ to $2.845/GJ
April 1, 2017 to March 31, 2018	Fixed Price	40,000 GJ	$2.825/GJ to $2.945/GJ
April 1, 2017 to October 31, 2018	Fixed Price	5,000 GJ	$2.585/GJ

As at June 30, 2016, Peyto had committed to the future sale of 279,785,000 gigajoules (GJ) of natural gas at an average price of $2.56 per GJ or $2.94 per mcf. Had these contracts been closed on June 30, 2016, Peyto would have realized a net loss in the amount of $49.9 million. If the AECO gas price on June 30, 2016 were to decrease by $0.10/GJ, the financial derivative liability would decrease by approximately $29.8 million. An opposite change in commodity prices rates would result in an opposite impact.

Subsequent to June 30, 2016 Peyto entered into the following contracts:

Natural Gas Period Hedged	**Type**	**Daily Volume**	**Price (CAD)**
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.8875/GJ
April 1, 2017 to October 31, 2017	Fixed Price	25,000 GJ	$2.60/GJ to $2.70/GJ
April 1, 2017 to March 31, 2018	Fixed Price	5,000 GJ	$2.8225/GJ
April 1, 2017 to October 31, 2018	Fixed Price	5,000 GJ	$2.745/GJ

9. Related party transactions

Certain directors of Peyto are considered to have significant influence over other reporting entities that Peyto engages in transactions with. Such services are provided in the normal course of business and at market rates. These directors are not involved in the day to day operational decision making of the Company. The dollar value of the transactions between Peyto and the related reporting entities is summarized below:

Expense				Accounts Payable	
Three Months ended June 30		Six Months ended June 30		As at June 30	
2016	2015	**2016**	2015	**2016**	2015
288.4	817.9	**650.6**	766.8	**427.4**	376.4

10. Commitments

In addition to those recorded on the Company’s balance sheet, the following is a summary of Peyto’s contractual obligations and commitments as at June 30, 2016:

	2016	**2017**	**2018**	**2019**	**2020**	**Thereafter**
Interest payments(1)	9,193	18,385	18,385	16,190	13,995	27,840
Transportation commitments	15,480	32,325	38,180	31,925	24,665	99,659
Operating leases	702	2,279	2,032	2,032	2,032	12,567
Other	880	-	-	-	-	-
Total	26,255	52,989	58,597	50,147	40,692	140,066

(1) Fixed interest payments on senior unsecured notes

11. Contingencies

On October 1, 2013, two shareholders (the "Plaintiffs") of Poseidon Concepts Corp. ("Poseidon") filed an application to seek leave of the Alberta Court of Queen's Bench (the "Court") to pursue a class action lawsuit against the Company, as a successor to new Open Range Energy Corp. ("New Open Range") (the “Poseidon Shareholder Application”). The proposed action contains various claims relating to alleged misrepresentations in disclosure documents of Poseidon (not New Open Range), which claims are also alleged in class action lawsuits filed in Alberta, Ontario, and Quebec earlier in 2013 against Poseidon and certain of its current and former directors and officers, and underwriters involved in the public offering of common shares of Poseidon completed in February 2012. The proposed class action seeks various declarations and damages including compensatory damages which the Plaintiffs estimate at $651 million and punitive damages which the Plaintiffs estimate at $10 million, which damage amounts appear to be duplicative of damage amounts claimed in the class actions against Poseidon, certain of its current and former directors and officers, and underwriters.

New Open Range was incorporated on September 14, 2011 solely for purposes of participating in a plan of arrangement with Poseidon (formerly named Open Range Energy Corp. ("Old Open Range")), which was completed on November 1, 2011. Pursuant to such arrangement, Poseidon completed a corporate reorganization resulting in two separate publicly-traded companies: Poseidon, which continued to carry on the energy service and supply business; and New Open Range, which carried on Poseidon's former oil and gas exploration and production business. Peyto acquired all of the issued and outstanding common shares of New Open Range on August 14, 2012. On April 9, 2013, Poseidon obtained creditor protection under the Companies' Creditor Protection Act.

On October 31, 2013, Poseidon filed a lawsuit with the Court naming the Company as a co-defendant along with the former directors and officers of Poseidon, the former directors and officers of Old Open Range and the former directors and officers of New Open Range (the “Poseidon Action”). Poseidon claims, among other things, that the Company is vicariously liable for the alleged wrongful acts and breaches of duty of the directors, officers and employees of New Open Range.

On September 24, 2014 Poseidon amended its claim in the Poseidon Action to add Poseidon’s auditor, KPMG LLP (“KPMG”), as a defendant.

On May 4, 2016, KPMG issued a third party claim in the Poseidon Action against Poseidon’s former officers and directors and Peyto for any liability KPMG is determined to have to Poseidon. Peyto is not required to deliver a defence to this claim at this time.

On July 3, 2014, the Plaintiffs filed a lawsuit with the Court against KPMG LLP, Poseidon's and Old Open Range's former auditors, making allegations substantially similar to those in the other claims (the “KPMG Poseidon Shareholder KPMG Action”). On July 29, 2014, KPMG LLP filed a statement of defence and a third party claim against Poseidon, the Company and the former directors and officers of Poseidon. The third party claim seeks, among other things, an indemnity, or alternatively contribution, from the third party defendants with respect to any judgment awarded against KPMG LLP.

The allegations against New Open Range contained in the claims described above are based on factual matters that pre-existed the Company’s acquisition of New Open Range. The Company has not yet been required to defend either of the actions. If it is required to defend the actions, the Company intends to aggressively protect its interests and the interests of its Shareholders and will seek all available legal remedies in defending the actions.

Officers

Darren Gee
President and Chief Executive Officer

Scott Robinson
Executive Vice President and Chief Operating Officer

Kathy Turgeon
Vice President, Finance and Chief Financial Officer

Lee Curran
Vice President, Drilling and Completions

Stephen Chetner
Corporate Secretary

Tim Louie
Vice President, Land

David Thomas
Vice President, Exploration

Jean-Paul Lachance
Vice President, Exploitation

Todd Burdick
Vice President, Production

Directors
Don Gray, Chairman
Stephen Chetner
Brian Davis
Michael MacBean, Lead Independent Director
Darren Gee
Gregory Fletcher
Scott Robinson

Auditors
Deloitte LLP

Solicitors
Burnet, Duckworth & Palmer LLP

Bankers
Bank of Montreal
Union Bank, Canada Branch
Royal Bank of Canada
Canadian Imperial Bank of Commerce
The Toronto-Dominion Bank
Bank of Nova Scotia
Alberta Treasury Branches
Canadian Western Bank

Transfer Agent
Computershare

Head Office
300, 600 – 3 Avenue SW
Calgary, AB
T2P 0G5
Phone: 403.261.6081
Fax: 403.451.4100
Web: www.peyto.com
Stock Listing Symbol: PEY.TO
Toronto Stock Exchange