PEYTO

Exploration & Development Corp.

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Interim Report
for the six months ended June 30, 2001

Highlights

	Three Months Ended June 30			Six Months Ended June 30		
			%			%
	2001	2000	Change	**2001**	2000	Change
Operations						
Production						
Oil & NGLs (bbl/d)	**621**	236	*163*	**547**	165	*232*
Natural gas (mcf/d)	**15,502**	6,852	*126*	**14,603**	4,092	*257*
Barrels of oil equivalent (boe/d @ 10:1)	**2,171**	921	*136*	**2,007**	574	*250*
Average product prices						
Oil & NGLs ($/bbl)	**36.82**	36.46	*1*	**38.14**	36.67	*4*
Natural gas ($/mcf)	**7.02**	4.87	*44*	**8.55**	4.65	*84*
Average operating expenses ($/boe)	**2.29**	3.91	*(41)*	**2.18**	4.37	*(50)*
Financial ($000)						
Revenue	**11,987**	3,818	*214*	**26,373**	4,538	*481*
Royalties (net of ARTC)	**2,667**	779	*242*	**6,547**	954	*586*
Funds from operations	**8,160**	2,479	*229*	**17,841**	2,706	*559*
Net earnings	**4,450**	1,183	*276*	**9,068**	1,245	*628*
Capital expenditures	**18,641**	10,068	*85*	**39,454**	18,383	*115*
As at June 30						
Working capital deficit				**8,320**	2,049	*306*
Long term debt				**33,186**	9,543	*248*
Shareholders' equity				**30,342**	11,488	*164*
Total assets				**96,493**	28,169	*243*
Common shares outstanding (000)				**41,813**	33,199	*26*
Weighted average common shares outstanding (000)				**41,338**	30,276	*37*
Per share data ($/share)						
Funds from operations						
Basic	**0.20**	0.08	*150*	**0.43**	0.09	*378*
Diluted	**0.19**	0.07	*171*	**0.42**	0.08	*425*
Earnings						
Basic	**0.11**	0.04	*175*	**0.22**	0.04	*450*
Diluted	**0.10**	0.03	*233*	**0.21**	0.03	*600*

Report from the president

PEYTO Exploration & Development Corp. is pleased to present its second quarter financial and operating results for the period ended June 30, 2001.

Second quarter production increased 136% to 2,171 boe per day (barrels of oil equivalent with natural gas production converted on a 10:1 basis) from 921 boe per day for the same quarter in 2000. Peyto produced 15.5 million cubic feet (mmcf) of natural gas and 621 barrels of natural gas liquids and oil per day. Production gains, higher commodity prices and lower operating costs all combined to increase funds from operations from $2.5 million ($0.08 per share) in the second quarter of 2000 to $8.2 million ($0.20 per share) in the second quarter of 2001. Earnings increased 276% from $1.2 million ($0.04 per share) in the second quarter of 2000 to $4.5 million ($0.11 per share) in the second quarter of 2001. Product prices averaged $7.02 per mcf for gas and $36.82 per barrel for natural gas liquids and oil. Operating costs decreased from $3.91 to $2.29 per barrel of oil equivalent. The field netback realized was up 39% from a year ago to $44.88 per boe. Capital spending totaled $18.6 million for the quarter of which $13.7 million or 73% of the total were drilling costs.

The expansion of the Sundance gas processing facility to handle 48 mmcf per day of gas was completed in June 2001. The facility was originally constructed by Peyto in April 2000 to handle a capacity of 10 mmcf per day. Production processed at the facility was shut-in for a total of three days during the quarter to accommodate the expansion. Peyto drilled or re-entered a total of 9 gross (7.9 net) gas wells and pipeline connected one gross (0.6 net) well to the Sundance gas processing plant. One hundred percent of the drilling and re-entry operations were successful and are scheduled to be pipeline connected in the third quarter

Subsequent to spring break up, drilling, completion, equipping and pipeline operations have resumed. A total of 8 gross (6.9 net) gas wells have been connected and brought on production since the end of the quarter. Production currently exceeds 3,000 boe per day.

The proven exploration and development program that Peyto is executing in the area of West Central Alberta is forecast to generate significant production growth during the final half of 2001. Capital spending for the remainder of the year will continue to be focused on drilling multi zone low risk gas targets in Peyto's core area of Sundance, Alberta. Shareholders and interested investors should visit Peyto's website, www.peyto.com, to view the Company's presentation and past press releases.

Don T. Gray, P.Eng.
President and Chief Executive Officer
August 20, 2001

Management's discussion and analysis

Management's discussion and analysis of financial conditions and results of operations should be read in conjunction with the unaudited interim financial statements for the six months ended June 30, 2001 and the audited consolidated financial statements for the year ended December 31, 2000.

Gross revenues totaled $11.9 million during the second quarter of 2001 (Q2 2000 - $3.8 million) and $26.4 million for the first six months of 2001 (first half 2000 - $4.5 million). These increases of 214 percent and 481 percent, respectively, are a result of higher production volumes in combination with higher natural gas prices. The price of natural gas was $7.02 per mcf for the second quarter of 2001 (Q2 2000 - $4.87 per mcf) and $8.55 per mcf for the first six months of 2001 (first half 2000 - $4.65 per mcf). Oil and natural gas liquids prices averaged $36.82 for the second quarter of 2001 (Q2 2000 - $36.46 per barrel) and $38.14 per barrel for the first six months of 2001 (first half 2000 - $36.67 per barrel)

Natural gas production for the quarter increased by 126 percent to 15.5 mmcf per day from 6.8 mmcf per day in the same quarter of 2000. Oil and natural gas liquids production increased by 163 percent to 621 bbl/d in 2001 from 236 bbl/d in 2000. Production for the first half averaged 2,007 barrels of oil equivalent ("boe", natural gas converted on a 10:1 basis) per day up 250 percent from 574 boe per day for the first six months of 2000.

In the first half of 2001, royalties, net of Alberta Royalty Tax Credit (ARTC), increased by 586 percent to $6.5 million from $1.0 million in 2000 due to higher gross revenues associated with increased production volumes. The 2001 average royalty rate, before ARTC, was 26 percent.

Due to increased production volumes, operating costs for the half rose to $0.8 million in 2001 from $0.5 million in 2000. On a barrel of oil equivalent basis, operating costs declined by 50 percent to $2.18 per boe in 2001 from $4.37 per boe in 2000. The decrease in operating costs was primarily the result of the Peyto operated processing plant, which came on production in the second quarter of 2000 thereby eliminating the reliance on third party facilities as well as generating processing income.

Net general and administrative expenses increased by 37 percent to $372,000 in the first half of 2001 from $271,000 in 2000. On a boe basis, net general and administrative expenses decreased by 61 percent to $1.02 per boe in 2001 from $2.61 per boe in 2000. This reduction was the result of the increase in production volumes while maintaining a similar level of staff.

Financing charges for the first half of 2001 were $754,000 up from $154,000 in 2000. The increase was due to higher debt levels associated with Peyto's 2001 capital expenditures totaling $39.5 million compared with $18.4 million for the comparable period in 2000.

Depreciation, depletion and site restoration expenses were $2.3 million in the first half of 2001 compared to $0.5 million in the first half of 2000 as a direct result of Peyto's increased asset base and production volumes. On a per boe basis, the average depreciation, depletion and site restoration rate increased to $6.42 in 2001 from $4.53 in 2000 as a result of significant facilities, processing plant and pipeline investments incurred during the first half of 2001.

The provision for future income tax increased to $6.4 million in 2001 from $1.0 million in 2000. The increase in the tax provision in 2001 is a direct result of the increased profitability in Peyto due to significantly higher production volumes.

First half funds from operations for 2001 was $17.8 million compared with $2.7 million in 2000. This 559% increase was the result of increased production volumes, higher commodity prices and lower operating costs. On a per share basis, the first half of 2001 resulted in funds from operations of $0.43 per share versus $0.09 per share in the first half of 2000. Peyto's field netback for the half improved from $30.14 per boe in 2000 to $52.38 per boe in 2001. On the basis of operating costs plus depletion plus general and administrative costs per unit of production, Peyto has become one of the lowest cost producers among the industry's top 100 companies. Relative to the industry average in 2000, Peyto's 2001 costs were 56% lower. Net income in 2001 was $9.1 million or $0.22 per share compared with $1.2 million in 2000 or $0.04 per share.

At June 30, 2001, long term debt stood at $33.2 million and the Corporation had a working capital deficiency of $8.3 million resulting in a net debt to running cash flow ratio of approximately 1.2:1. Peyto's $39.4 million capital program was funded through cash flow, working capital and long term debt.

Quarterly information

	2001		2000		
	Q2	Q1	Q4	Q3	Q2
Operations					
Production					
Oil & NGLs (bbl/d)	**621**	472	348	313	236
Natural gas (mcf/d)	**15,502**	13,694	9,590	9,425	6,852
Barrels of oil equivalent (boe/d @ 10:1)	**2,171**	1,842	1,307	1,256	921
Average product prices					
Oil & NGLs ($/bbl)	**36.82**	39.89	43.92	38.83	36.46
Natural gas ($/mcf)	**7.02**	10.30	9.16	5.55	4.87
Average operating expenses ($/boe)	**2.29**	2.06	3.81	3.15	3.91
Field netback ($/boe)	**44.88**	61.33	56.63	35.70	32.34
Financial ($000)					
Revenue	**11,987**	14,386	9,486	5,930	3,818
Royalties (net of ARTC)	**2,667**	3,880	2,219	1,442	779
Funds from operations	**8,160**	9,681	5,947	3,805	2,479
Net earnings	**4,450**	4,618	2,946	1,715	1,183
Capital expenditures	**18,641**	20,813	19,821	5,383	10,068
Common shares outstanding (000)	**41,813**	41,646	39,799	37,699	33,199
Per share data ($/share)					
Funds from operations					
Basic	**0.20**	0.24	0.17	0.11	0.08
Diluted	**0.19**	0.23	0.15	0.11	0.07
Earnings					
Basic	**0.11**	0.11	0.09	0.05	0.04
Diluted	**0.10**	0.11	0.07	0.05	0.03

Financial statements

Balance Sheet

As at		June 30 2001 (unaudited)		Dec. 31 2000 (audited)
Assets				
Current assets				
Cash	**$**	**86,356**	$	53,027
Accounts receivable		**11,114,015**		11,620,928
Prepaids		**5,236**		247,053
		11,205,607		11,921,008
Property, plant and equipment *(Note 2)*		**90,412,497**		50,958,564
Accumulated depreciation & depletion		**(5,125,073)**		(2,822,474)
		85,287,424		48,136,090
	$	**96,493,031**	$	60,057,098
Liabilities and Shareholders' Equity				
Current				
Accounts payable and accrued liabilities	**$**	**19,451,662**	$	19,477,534
Capital taxes payable		**74,358**		68,804
		19,526,020		19,546,338
Long term debt *(Note 3)*		**33,185,750**		13,199,728
Site restoration provision		**146,112**		117,845
Future income taxes		**13,293,172**		6,884,091
Shareholders' equity				
Share capital *(Note 4)*		**15,516,208**		14,551,045
Retained earnings		**14,825,769**		5,758,051
		30,341,977		20,309,096
	$	**96,493,031**	$	60,057,098

Financial statements

Statements of Earnings and Retained Earnings (Deficit)
(unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
	2001	2000	**2001**	2000
Revenue				
Oil and gas sales, net	**$ 9,320,298**	$ 3,038,897	**$ 19,825,846**	$ 3,584,212
Interest and other income	**6,504**	312	**10,284**	596
	9,326,802	3,039,209	**19,836,130**	3,584,808
Expenses				
Operating	**452,336**	327,830	**793,457**	454,054
General and administrative	**206,858**	118,855	**372,377**	270,635
Interest	**459,050**	113,668	**754,290**	153,922
Depletion, depreciation and site restoration	**1,128,867**	363,256	**2,330,866**	470,090
	2,247,111	923,609	**4,250,990**	1,348,701
Earnings before taxes	**7,079,691**	2,115,600	**15,585,140**	2,236,107
Future income tax expense	**(2,581,761)**	(932,288)	**(6,442,214)**	(990,887)
Capital tax expense	**(48,281)**	-	**(75,208)**	-
Earnings for the period	**4,449,649**	1,183,312	**9,067,718**	1,245,220
Retained earnings (deficit), beginning of period	**10,376,120**	(86,254)	**5,758,051**	(148,162)
Retained earnings, end of period	**$ 14,825,769**	$ 1,097,058	**$ 14,825,769**	$ 1,097,058
Earnings per share				
Basic	**$0.11**	$0.04	**$0.22**	$0.04
Diluted	**$0.10**	$0.03	**$0.21**	$0.03

Financial statements

Statements of Cash Flows
(unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
	2001	2000	**2001**	2000
Cash provided by (used in) Operating Activities				
Earnings for the period	**$ 4,449,649**	$ 1,183,312	**$ 9,067,718**	$ 1,245,220
Items not requiring cash:				
Future income taxes	**2,581,761**	932,288	**6,442,214**	990,887
Depletion, depreciation and site restoration	**1,128,867**	363,256	**2,330,866**	470,090
Funds from operations	**8,160,277**	2,478,856	**17,840,798**	2,706,197
Change in non-cash working capital from operations	**4,185,652**	(1,926,833)	**7,184,497**	(1,833,699)
	12,345,929	552,023	**25,025,295**	872,498
Financing Activities				
Issue of common shares, net of costs	**62,387**	25,816	**932,030**	76,451
Convertible debenture	**-**	-	**-**	2,700,000
Increase in long term debt	**10,807,688**	5,211,163	**19,986,022**	6,828,121
	10,870,075	5,236,979	**20,918,052**	9,604,572
Investing Activities				
Additions to property, plant and equipment	**(18,641,261)**	(7,923,327)	**(39,453,933)**	(14,256,897)
Change in non-cash working capital related to investing activities	**(4,608,819)**	2,172,628	**(6,456,085)**	2,837,788
Cash acquired in acquisition of Largo Petroleum Inc.	**-**	-	**-**	543,148
	(23,250,080)	(5,750,699)	**(45,910,018)**	(10,875,961)
Net increase (decrease) in cash	**(34,076)**	38,303	**33,329**	(398,891)
Cash, beginning of period	**120,432**	6,531	**53,027**	443,725
Cash, end of period	**$ 86,356**	$ 44,834	**$ 86,356**	$ 44,834
Funds from operations per share				
Basic	**$0.20**	$0.08	**$0.43**	$0.09
Diluted	**$0.19**	$0.07	**$0.42**	$0.08

Notes to financial statements

1. Accounting Principles

The financial statements of the Company have been prepared by management in accordance with accounting principles generally accepted in Canada. These interim financial statements have been prepared on the same basis as the audited financial statements as at and for the year ended December 31, 2000 with the exception of diluted per share calculations. Management's discussion and analysis of financial conditions and results of operations should be read in conjunction with the unaudited interim financial statements for the six months ended June 30, 2001 and the audited consolidated financial statements for the year ended December 31, 2000. Effective January 1, 2001, the Company adopted the treasury stock method of calculating the dilutive effect of outstanding options to acquire common shares as recommended by the CICA. Comparative figures for 2000 have been restated accordingly.

2. Property, Plant and Equipment

	2001 $	2000 $
Property, plant and equipment	**90,193,317**	50,784,483
Office furniture and equipment	**219,180**	174,081
	90,412,497	50,958,564
Accumulated depletion and depreciation	**(5,125,073)**	(2,822,474)
	85,287,424	48,136,090

At June 30, 2001, costs of $8,250,000 (June 30, 2000 - nil) related to undeveloped land have been excluded from the depreciation calculation. No general and administration expenses relating to the Company's exploration, development and acquisition programs were capitalized.

3. Long Term Debt

In April 2001 Peyto entered into an agreement with the Royal Bank of Canada for a revolving credit facility to a maximum of $50,000,000. Outstanding amounts on this facility bear interest at bank prime and are due on demand. A General Security Agreement with a floating charge on land registered in Alberta is held as collateral by the bank.

4. Share Capital

Authorized

Unlimited number of common voting shares
Unlimited number of preferred shares, issuable in series

Issued - Common shares

	Number of Shares	**Amount** $
Balance, December 31, 2000	39,799,064	14,551,045
Exercise of stock options	2,014,333	1,009,789
Share issue costs, net of associated tax benefits	—	(44,626)
Balance, June 30, 2001	41,813,397	15,516,208

On May 28, 2001 Peyto's common shares commenced trading on the Toronto Stock Exchange under the symbol "PEY".

Stock Options

The Company has a director and employee stock option plan. The number of common shares reserved for issuance at any one time shall not exceed 10% of the issued and outstanding common shares. The exercise price of an option is set at the market price of the common shares at the date of grant. Each option vests over a three year period and has a term of 5 years.

	As at June 30, 2001		**As at June 30, 2000**	
	Options	**Weighted - Average Exercise Price**	**Options**	**Weighted-Average Exercise Price**
Opening	**2,987,000**	**$0.63**	1,305,000	$0.19
Granted	**2,655,334**	**$2.65**	1,742,000	$0.59
Exercised	**(2,014,333)**	**$0.48**	(370,667)	$0.27
Cancelled	**(1,371,120)**	**$1.82**	(239,333)	$0.33
Closing	**2,873,668**	**$2.29**	2,437,000	$0.45

Per Share Amounts

Earnings per share and funds from operations per share have been calculated based upon the weighted average number of common shares outstanding during the year of 41,338,377 (2000 – 30,276,479). Diluted per share amounts are calculated using the treasury stock method. The weighted average number of common shares used to determine diluted per share amounts in 2001 was 42,574,836 (2000 – 31,811,498).

5. Financial Instruments

Financial instruments of the Company consist of cash, accounts receivable, accounts payable and accrued liabilities and long term debt. As at June 30, 2001 there are no significant differences between their carrying values and their estimated market values.

The Company is a party to certain off balance sheet derivative financial instruments, including fixed price contracts. The Company enters into these contracts for the purpose of protecting a portion of its future earnings and cash flows from operations from the volatility of natural gas commodity process by locking in a minimum and maximum forward price.

A summary of contracts outstanding in respect to the hedging activities at June 30, 2001 were as follows:

Period Hedged	**Daily Volume**	**Floor**	**Ceiling**
April 1 to October 31, 2001	2,000 gigajoules	$5.50/gigajoule	$6.65/gigajoule
April 1 to October 31, 2001	2,000 gigajoules	$5.00/gigajoule	$7.10/gigajoule
April 1 to October 31, 2001	4,000 gigajoules	$5.50/gigajoule	$11.00/gigajoule
November 1, 2001 to April 1, 2002	2,000 gigajoules	$6.00/gigajoule	$10.55/gigajoule
November 1, 2001 to April 1, 2002	2,000 gigajoules	$6.00/gigajoule	$10.80/gigajoule
November 1, 2001 to April 1, 2002	2,000 gigajoules	$6.00/gigajoule	$10.10/gigajoule

Corporate information

Officers

Don Gray
President and Chief Executive Officer

Roberto Bosdachin
Vice-President, Exploration

Lyle Skaien
Vice President, Operations

Darren Gee
Vice President, Exploitation

Sandra Brick
Vice President, Finance

Steve Chetner
Corporate Secretary

Directors

Rick Braund

Don Gray

Mike Broadfoot

Brian Craig

Jim Riddell

Stephen Chetner

Auditors
Ernst & Young LLP

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