PEYTO

Exploration & Development Corp.

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Interim Report
for the three months ended March 31, 2012

Highlights

	3 Months Ended Mar. 31		%
	2012	2011	Change
Operations			
Production			
Natural gas (mcf/d)	**220,811**	166,710	*32%*
Oil & NGLs (bbl/d)	**4,101**	3,746	*9%*
Thousand cubic feet equivalent (mcfe/d @ 1:6)	**245,417**	189,187	*30%*
Barrels of oil equivalent (boe/d @ 6:1)	**40,903**	31,531	*30%*
Product prices			
Natural gas ($/mcf)	**3.53**	4.92	*(28)%*
Oil & NGLs ($/bbl)	**84.83**	76.19	*11%*
Operating expenses ($/mcfe)	**0.33**	0.39	*(15)%*
Transportation ($/mcfe)	**0.12**	0.13	*(8)%*
Field netback ($/mcfe)	**3.75**	4.75	*(21)%*
General & administrative expenses ($/mcfe)	**0.04**	0.09	*(56)%*
Interest expense ($/mcfe)	**0.23**	0.27	*(15)%*
Financial ($000, except per share)			
Revenue	**102,496**	99,577	*3%*
Royalties	**8,835**	9,922	*(11)%*
Funds from operations	**77,645**	74,696	*4%*
Funds from operations per share	**0.56**	0.56	-
Total dividends	**24,912**	23,921	*4%*
Total dividends per share	**0.18**	0.18	-
Payout ratio	**32**	32	-
Earnings	**26,868**	31,688	*(15)%*
Earnings per diluted share	**0.19**	0.24	*(21)%*
Capital expenditures	**98,632**	103,786	*(5)%*
Weighted average common shares outstanding	**138,312,078**	132,737,066	*4%*
As at March 31			
Net debt (before future compensation expense and unrealized hedging gains)	**512,627**	453,376	*13%*
Shareholders' equity	**1,027,231**	850,442	*21%*
Total assets	**1,800,394**	1,527,845	*18%*

	Three Months ended Mar. 31	
($000)	**2012**	2011
Cash flows from operating activities	**59,383**	43,644
Change in non-cash working capital	**16,367**	26,829
Change in provision for performance based compensation	**1,895**	4,223
Funds from operations	**77,645**	74,696
Funds from operations per share	**0.56**	0.56

(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 distributions may vary.

Report from the president

Peyto Exploration & Development Corp. ("Peyto") is pleased to present its operating and financial results for the first quarter of the 2012 fiscal year. Peyto's production per share grew for the tenth consecutive quarter while first quarter operating margins of 76%[(1)] and profit margins of 26%[(2)] were consistent with the previous quarter. First quarter 2012 highlights were as follows:

- **Production per share up 25%.** First quarter 2012 production increased 30% (25% per share) from 189 MMcfe/d (31,531 boe/d) in Q1 2011 to 245 MMcfe/d (40,903 boe/d) in Q1 2012.

- **Funds from operations of $0.56/share.** Generated $78 million in Funds from Operations ("FFO") in Q1 2012 up 4% from $75 million in Q1 2011. Increased production offset the 22% year over year reduction in realized commodity prices.

- **Operating costs less than $2/boe.** Industry leading operating costs were further reduced from $0.39/mcfe ($2.32/boe) in Q1 2011 to $0.33/mcfe ($1.96/boe) in Q1 2012. Total cash costs, including royalties, operating costs, transportation, G&A and interest were $1.11/mcfe ($6.67/boe), resulting in a $3.48/mcfe ($20.86/boe) cash netback or 76% operating margin.

- **Capital Investments of $99 million**. At quarter end, production additions resulting from the $99 million capital program totaled 8,000 boe/d. The annualized cost (trailing twelve months) to build new production has averaged approximately $18,000/boe/d over the last two and a half years. A total of 19 gross wells were drilled during the first quarter.

- **Earnings of $0.19/share, dividends of $0.18/share.** Earnings of $27 million were generated in the quarter while dividends of $25 million were paid to shareholders, representing a before tax payout ratio of 32% of FFO.

- N**GLs realized $85/boe.** Natural gas liquid production of 4,101 boe/d, comprised of approximately 65% condensate and pentanes, 17% butane, and 18% propane averaged 92% of Edmonton light oil price of $92/bbl.

First Quarter 2012 in Review

The first quarter was another active period as Peyto continued to deliver industry leading efficiency and results with its capital program. Drilling activity during the quarter focused on the liquids rich formations within Peyto's large inventory of opportunities. As well, Peyto successfully acquired 22 sections of new Deep Basin land, with drilling opportunities already identified, which will more than replace the 19 drilled locations. Peyto's natural gas liquids made up 10% of its production and realized 92% of the light oil price. The revenue from these liquids was more than sufficient to cover all of Peyto's cash costs, while a solid hedge book helped offset the 34% year over year drop in Alberta monthly natural gas prices. As a result of these low costs and production increases, funds from operations increased from the prior year's period. Subsequent to the quarter, Peyto's revolving bank line capacity was increased from $625 million to $700 million, for a total debt capacity of $800 million, including $100 million of senior secured notes. As of the quarter end, 64% of this capacity was utilized representing a net debt to annualized FFO ratio of 1.65 times. The strong financial and operating performance delivered in the quarter resulted in an annualized 11% Return on Equity (ROE) and 10% 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

Peyto continued to advance many of its Deep Basin plays in the quarter through exploratory and development drilling, land acquisitions, and seismic evaluations. A focus on liquids rich formations like the Cardium and Falher improved the corporate average liquid yield by over 10% from the start of the year.

In the Kiskiu-Smoky area, six horizontal Cardium wells were drilled during the winter program which further defined and proved up an inventory of over 40 locations. Natural gas liquid yields from the Kiskiu Cardium are the highest of any formation that Peyto develops with average first year condensate and pentane yields of 48 bbl/mmcf, butane yields of 12 bbl/mmcf and propane yields of 13 bbl/mmcf, totaling 73 bbls per mmcf of sales gas.

In Sundance, Peyto drilled and brought on production, with encouraging results, its first two Bluesky horizontal wells. Capital costs of $3.4 million to drill and $1.8 million to complete were in line with expectations and consistent with those of other Mannville zones that Peyto is developing in the area. Production performance over the next several months will assist in determining the full cycle returns that can be achieved from the Bluesky. The internal assessment of inventory in this formation currently stands at 20 locations.

The enhanced natural gas liquids recovery project at the Oldman plant in Sundance continues to advance with the fabrication of major equipment. Field construction is scheduled for July 2012 with startup anticipated in late September. In addition, engineering and procurement is proceeding on a similar facility for the Nosehill gas plant, with equipment fabrication expected to start in September. Nosehill site construction is forecast to occur at the end of 2012 and plant start-up is scheduled for early 2013.

In addition to focusing the majority of capital on maximizing liquids revenue in this time of low natural gas prices, Peyto continues to advance its drier gas plays in the Notikewin and Wilrich formations. Step out drilling in five new areas has proven successful, despite three of these areas remaining “behind pipe” or shut in until more attractive processing arrangements can be made or higher natural gas prices are achieved.

Capital Expenditures

During the first quarter 2012, Peyto spent $51.8 million to spud 19 gross (16.4 net) horizontal wells and $31.2 million completing 21 gross (19.8 net) zones. Wellsite equipment and tie-ins accounted for $8.5 million. A total of $4.3 million was invested in new facilities to complete the Nosehill gas plant expansion as well as progress payments on the Oldman Deep Cut equipment. New lands were acquired for $2.2 million, or $154/ acre, while new seismic accounted for $0.6 million.

Since Peyto began drilling horizontal multi-stage frac wells in the Deep Basin in the fall of 2009, a total of 136 horizontal wells have been drilled. By continuously evolving the design and improving the execution, drilling times have been reduced by over 30% from an average of 33 days (spud to rig release) down to 23 days. While this normally would have translated into substantial reductions in drilling cost, it has only served to offset the inflation in drilling rig rates and the increased fuel costs which have been driven by higher oil prices. In the present low gas price environment, fewer wells are being drilled which should bring lower service rates and allow Peyto to realize the financial gains of these operational efficiencies.

Despite this service rate inflation, a new drilling design has recently been tried that has resulted in measurable cost savings in Peyto’s Cardium play at Sundance. The last four Cardium horizontal wells were drilled using a monobore well design resulting in further reducing drilling times and eliminating some casing costs. This has lowered average drilling costs for this type of well by over 20% to $2.0 million. Peyto has attempted this same design on other formations but due to increased borehole risk, has only seen limited success to date.

Financial Results

Peyto realized an unhedged natural gas price of $2.67/mcf in the quarter, 15% greater than the volume weighted average AECO monthly natural gas price of $2.32/GJ due to above average heat content. Inclusive of natural gas liquids revenues, the realized effective natural gas price was $3.82/mcfe, before hedging gains of $0.77/mcfe. This realized effective price was 1.65 times that of dry gas and illustrates the benefit of high heat content, liquids rich natural gas production.

Total cash costs of $1.11/mcfe ($6.67/boe) comprised of $0.39/mcfe of royalties, $0.33/mcfe of operating costs, $0.12/mcfe of transportation, $0.04/mcfe of G&A and $0.23/mcfe of interest costs deducted from the realized hedged price of $4.59/mcfe ($27.54/boe) resulted in a cash netback of $3.48/mcfe ($20.86/boe) or an operating margin of 76%. Depletion, depreciation and amortization, along with a provision for future tax and market based bonus payments further reduced the cash netback to earnings of $1.20/mcfe. The profit margin, or earnings divided by revenue, was 26%, down from 35% in Q1 2011.

Subsequent to the end of the first quarter, Peyto’s credit facility was reviewed and the annual revolver increased to $700 million from $625 million. This increase was a reflection of the 2011 growth in volume and value of Peyto’s

Proved Producing reserves. Including the $100 million of senior secured notes, Peyto's total borrowing capacity increased to $800 million.

Marketing

North American natural gas prices fell dramatically during the first quarter in response to the abnormally warm winter weather and a lack of natural gas heating demand. Storage reservoirs, which are normally drawn down in the winter months, left the heating season with over 50% more in storage than normal and caused both Henry Hub (US) and AECO (Canadian) natural gas prices to drop by over 30%. By the end of the first quarter natural gas prices were at their lowest level in over a decade with Henry Hub at $2.00/MMBTU and AECO at $1.60/GJ. Peyto's practice of layering in future sales of natural gas provided insulation from this drop in gas prices.

The continued practice of Peyto's hedging strategy, designed to smooth out the volatility in the price of natural gas, has resulted in approximately 45% of current natural gas production being sold in 2012 for an average of $4.23/mcf. In addition to the forward sales of natural gas, Peyto is now applying the same strategy to Propane and Butane sales. Starting in April of 2012, Peyto began layering in small fixed price swaps for Propane and Butane volumes. These future sales have a term that begins in September of 2012, coincident with the anticipated startup of the Oldman Deep Cut facility. For detailed information on these contracts, see the Management Discussion and Analysis. As at March 31, 2012, Peyto had committed to the future sale of 14,000 barrels of propane at an average price of $49.56 per barrel and 41,750,000 gigajoules (GJ) of natural gas at an average price of $3.54 per GJ or $4.15 per mcf. Had these contracts been closed on March 31, 2012, Peyto would have realized a gain in the amount of $54.7 million.

Activity Update

Peyto is in the middle of spring breakup with 6 rigs employed but sitting idle as heavy traffic road bans are still in place. Three of the rigs had commenced drilling on wells prior to breakup and were shut down at intermediate progress points with the onset of the road bans. The timing for resumption of all six rigs is expected to occur in late May, leading to a typical breakup period of six weeks. After breakup, the drilling program will continue to target a mix of Cardium and Falher liquids-rich opportunities, primarily in the Greater Sundance Area. A Kakwa Cardium program is scheduled to commence later in the year.

Five gross (3.4 net) wells have been drilled and currently await completion and tie in after breakup. These include two Cardiums and two Falher wells. Additionally, Peyto has 4 new wells drilled and completed but not yet on production.

With the Oldman plant nearing capacity, a major intra-field pipeline project, designed to offload volumes from the Oldman plant to the Nosehill plant was completed in the first quarter of 2012. As a result of this volume shift, Peyto is well positioned with sufficient capacity in each of the gas plants to accommodate an aggressive drilling program and subsequent production growth into the second half of 2012.

Outlook

Current natural gas prices in both Canada and the US present substantial financial challenges for most gas producers. Few plays and even fewer operators are able to cover both the production costs and replacement costs at these levels, let alone generate a return for shareholders on the capital invested. Peyto is one of the few exceptions, with its industry leading low production costs and long life, liquids rich natural gas plays that can be efficiently developed. The combination of $1/mcfe cash cost, $2/mcfe PDP FD&A replacement cost, and a production stream that receives 165% of the dry gas price, means Peyto can generate positive total margins below $2/GJ.

Peyto is not content to sit on this advantage. Additional optimization can further reduce cash costs while investments in Deep Cut facilities can extract more propane and butane from the natural gas to improve realized prices. By operating over 99% of production and processing 98% in Peyto owned and operated facilities these strategies can be achieved in a timely manner to protect shareholder returns and monthly dividends from further natural gas price erosion.

The capital program for the year will remain flexible and be opportunistic. The current rate of capital spending would result in a $350 million capital program for 2012. Peyto's budget, however, looks to take advantage of reduced service costs and a foreseeable recovery in natural gas prices and has been approved to accommodate an acceleration in activity to spend $400 million with an option to increase spending to $450 million should market conditions allow. As always, capital investments will only be pursued if return objectives can be met.

Annual General Meeting

Shareholders are invited to attend Peyto's AGM at 3:00 p.m. on Wednesday, June 6, 2012 at Livingston Place Conference Centre, +15 level, 222-3rd Avenue SW, Calgary, Alberta.

Darren Gee
President and CEO
May 9, 2012

Management's discussion and analysis

This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the unaudited condensed financial statements for the period ended March 31, 2012 and the audited consolidated financial statements of Peyto Exploration & Development Corp. ("Peyto" or the "Company") for the year ended December 31, 2011. The financial statements have been prepared in accordance with the International Accounting Standards Board ("IASB") most current International Financial Reporting Standards ("IFRS") 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 May 9, 2012. 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, 2011, the total Proved plus Probable reserves were 1,935 billion cubic feet equivalent (322.4 million barrels of oil equivalent) as evaluated by the independent petroleum engineers. Production is weighted approximately 89% to natural gas and 11% to natural gas liquids and oil.

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

- 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 long life natural gas reserves.
- Balance dividends to shareholders and funding for the capital program with cash flow and available bank lines.

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

QUARTERLY FINANCIAL INFORMATION

	2012	2011				2010		
($000 except per share amounts)	**Q1**	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Total revenue (net of royalties)	**93,661**	104,394	98,261	91,186	89,655	80,921	69,650	64,649
Funds from operations	**77,645**	80,410	82,506	77,010	74,696	69,201	56,341	52,565
Per share – basic and diluted	**0.56**	0.60	0.62	0.58	0.56	0.55	0.46	0.44
Earnings	**26,868**	26,036	37,741	32,718	31,688	95,419	33,983	30,384
Per share – basic and diluted	**0.19**	0.19	0.28	0.25	0.24	0.76	0.28	0.25
Dividends	**24,912**	24,245	23,951	23,951	23,921	46,299	43,875	43,622
Per share – basic and diluted	**0.18**	0.18	0.18	0.18	0.18	0.36	0.36	0.36

Funds from Operations

"Funds from operations" is a non-IFRS 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 Peyto'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 IFRS measure is cash flows from operating activities.

RESULTS OF OPERATIONS

Production

	Three Months ended Mar. 31	
	2012	2011
Natural gas (mmcf/d)	**220.8**	166.7
Oil & natural gas liquids (bbl/d)	**4,101**	3,746
Barrels of oil equivalent (boe/d)	**40,903**	31,531
Thousand cubic feet equivalent (mmcfe/d)	**245.4**	189.2

Natural gas production averaged 220.8 mmcf/d in the first quarter of 2012, 32 percent higher than the 166.7 mmcf/d reported for the same period in 2011. Oil and natural gas liquids production averaged 4,101 bbl/d, an increase of 9 percent from 3,746 bbl/d reported in the prior year. First quarter production increased 30 percent from 189.2 mmcfe/d to 245.4 mmcfe/d. The production increases are attributable to Peyto's capital program and resulting production additions.

Oil & Natural Gas Liquids Production by Component

	Three Months ended Mar. 31	
	2012	2011
Condensate (bbl/d)	**1,611**	1,473
Propane (bbl/d)	**669**	602
Butane (bbl/d)	**696**	653
Pentane (bbl/d)	**1,004**	854
Other NGL's (bbl/d)	**121**	164
Oil & natural gas liquids (bbl/d)	**4,101**	3,746
Thousand cubic feet equivalent (mmcfe/d)	**24.6**	22.5

Commodity Prices

	Three Months ended Mar. 31	
	2012	2011
Oil and natural gas liquids ($/bbl)	**84.83**	76.19
Natural gas ($/mcf)	**2.67**	4.05
Hedging – gas ($/mcf)	**0.86**	0.87
Natural gas – after hedging ($/mcf)	**3.53**	4.92
Total Hedging ($/mcfe)	**0.77**	0.77
Total Hedging ($/boe)	**4.64**	4.62

Peyto’s natural gas price, before hedging gains, averaged $2.67/mcf during the first quarter of 2012, a decrease of 34 percent from $4.05/mcf reported for the equivalent period in 2011. Oil and natural gas liquids prices averaged $84.83/bbl, an increase of 11 percent from $76.19/bbl a year earlier. Hedging activity increased Peyto’s achieved price/mcfe by 23% from $3.73 to $4.59.

Oil & Natural Gas Liquids Prices by Component

	Three Months ended Mar. 31	
	2012	**2011**
Condensate ($/bbl)	**100.09**	88.28
Propane ($/bbl)	**31.86**	41.45
Butane ($/bbl)	**69.17**	57.06
Pentane ($/bbl)	**102.92**	89.49

Revenue

	Three Months ended Mar. 31	
($000)	**2012**	2011
Natural gas	**53,565**	60,770
Oil and natural gas liquids	**31,656**	25,688
Hedging gain	**17,275**	13,119
Total revenue	**102,496**	99,577

For the three months ended March 31, 2012, revenue increased 3 percent to $102.5 million from $99.6 million for the same period in 2011. The increase in revenue for the period was a result of increased production volumes and higher realized oil and NGL prices offset by lower realized natural gas prices as detailed in the following table:

	Three Months ended Mar. 31		
	2012	2011	**$million**
Total Revenue, March 31, 2011			**99.6**
Revenue change due to:			
Natural gas			
Volume (mmcf)	20,094	15,004	**25.0**
Price ($/mcf)	$3.53	$4.92	**(28.0)**
Oil & NGL			
Volume (mbbl)	373	337	**2.7**
Price ($/bbl)	$84.83	$76.19	**3.2**
Total Revenue, March 31, 2012			**102.5**

Royalties

Royalties are paid to the owners of the mineral rights with whom leases are held, including the provincial government of Alberta. Alberta 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 Mar. 31	
($000 except per share amounts)	**2012**	2011
Royalties	**8,835**	9,922
% of sales before hedging	**10.4**	10.7
% of sales after hedging	**8.6**	10.0
$/mcfe	**0.39**	0.58
$/boe	**2.37**	3.50

For the first quarter of 2012, royalties averaged $0.39/mcfe or approximately 9% of Peyto's total petroleum and natural gas sales.

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 Janaury 1, 2009. These additional features include:

1. A drilling royalty credit program that terminated on March 31, 2011. Under this program credits were earned at a rate of $200 per meter of newly drilled well depth and could be applied with certain limitations to the earning company's corporate royalty bill,
2. 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
3. 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 (2) above.

From the combination of these royalty programs, Peyto has experienced a decrease in overall corporate royalty rates. This, in part, can be attributed to a decline in commodity prices and the dependence of royalty rates on commodity prices. In its 12 year history, Peyto has invested $2.4 billion in capital projects, found and developed 1.4 TCFe of gas reserves, and paid over $581 million in royalties.

Operating Costs & Transportation

Peyto's operating expenses include all costs with respect to day-to-day well and facility operations. Processing and gathering income related to joint venture and third party production reduces operating expenses.

	Three Months ended Mar. 31	
	2012	2011
Operating costs ($000)		
Field expenses	**11,053**	8,735
Processing and gathering recoveries	**(3,753)**	(2,164)
Total operating costs	**7,300**	6,571
$/mcfe	**0.33**	0.39
$/boe	**1.96**	2.32
Transportation	**2,606**	2,163
$/mcfe	**0.12**	0.13
$/boe	**0.70**	0.76

Operating costs increased to $7.3 million in the first quarter of 2012 from $6.6 million for the equivalent period in 2011 due to increased production volumes. On a unit-of-production basis, operating costs decreased 15% averaging $0.33/mcfe in the first quarter of 2012 compared to $0.39/mcfe for the equivalent period in 2011. Transportation expense remained relatively unchanged on a per mcfe basis.

General and Administrative Expenses

	Three Months ended Mar. 31	
	2012	2011
G&A expenses ($000)	**2,934**	3,065
Overhead recoveries	**(1,962)**	(1,458)
Net G&A expenses	**972**	1,607
$/mcfe	**0.04**	0.09
$/boe	**0.26**	0.57

For the first quarter, general and administrative expenses before overhead recoveries were down 4% over the same quarter of 2011. Capital overhead recoveries increased 35 percent for the first quarter from $1.5 million to $2.0 million due to increased gross capital spending**.** General and administrative expenses averaged $0.04/mcfe in the first quarter of 2012 compared to $0.09/mcfe for the equivalent period in 2011.

Interest Expense

	Three Months ended Mar. 31	
	2012	2011
Interest expense ($000)	**5,138**	4,618
$/mcfe	**0.23**	0.27
$/boe	**1.38**	1.63
Average interest rate	**4.5%**	4.7%

First quarter 2012 interest expense was $5.1 million or $0.23/mcfe compared to $4.6 million or $0.27/mcfe for the first quarter 2011.

Netbacks

	Three Months ended Mar. 31	
($/mcfe)	**2012**	2011
Gross Sale Price	**3.82**	5.08
Hedging gain	**0.77**	0.77
Net Sale Price	**4.59**	5.85
Less: Royalties	**0.39**	0.58
Operating costs	**0.33**	0.39
Transportation	**0.12**	0.13
Field netback	**3.75**	4.75
General and administrative	**0.04**	0.09
Interest on long-term debt	**0.23**	0.27
Cash netback ($/mcfe)	**3.48**	4.39
Cash netback ($/boe)	**20.86**	26.32

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 2012 first quarter provision for depletion, depreciation and amortization totaled $39.7 million as compared to $29.0 million in 2011 due to higher levels of production and a larger asset base. On a unit-of-production basis, depletion and depreciation costs averaged $1.78/mcfe as compared to $1.70/mcfe in 2011.

Income Taxes

The current provision for deferred income tax expense is $9.0 million (2011 - $10.3 million). Peyto paid no cash taxes or tax installments for the three months ended March 31, 2012 or for the comparative period in 2011. Resource pools are generated from the capital program, which are available to offset current and deferred income tax liabilities.

Income Tax Pool type ($ millions)	**March 31, 2012**	December 31, 2011	**Annual deductibility**
Canadian Oil and Gas Property Expense	177.1	179.5	10% declining balance
Canadian Development Expense	487.1	457.3	30% declining balance
Canadian Exploration Expense	155.5	163.0	100%
Undepreciated Capital Cost	162.2	156.8	Primarily 25% declining balance
Other	40.0	41.5	Various rates, 7% declining balance to 20%
Total Federal Tax Pools	**1,021.9**	998.1	
Additional Alberta Tax Pools	56.5	56.5	Various rates, 25% declining balance to 100%

MARKETING

Commodity Price Risk Management

Peyto is a party to certain off balance sheet derivative financial instruments, including fixed price contracts. Peyto 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 that are members of Peyto's loan syndicate. During the first quarter of 2012, a realized hedging gain of $17.3 million was recorded as compared to $13.1 million for the equivalent period in 2011. A summary of contracts outstanding in respect of the hedging activities are as follows:

Propane **Period Hedged**	**Type**	**Monthly Volume**	**Price (CAD)**
September 1, 2012 to March 31, 2013	Fixed Price	2,000 BBL	$49.56/BBL

Natural Gas **Period Hedged**	**Type**	**Daily Volume**	**Price (CAD)**
April 1, 2011 to October 31, 2012	Fixed Price	5,000 GJ	$4.05/GJ
April 1, 2011 to October 31, 2012	Fixed Price	5,000 GJ	$4.15/GJ
April 1, 2011 to October 31, 2012	Fixed Price	5,000 GJ	$4.10/GJ
April 1, 2011 to October 31, 2012	Fixed Price	5,000 GJ	$4.00/GJ
April 1, 2011 to March 31, 2013	Fixed Price	5,000 GJ	$4.055/GJ
April 1, 2011 to March 31, 2013	Fixed Price	5,000 GJ	$3.80/GJ
June 1, 2011 to March 31, 2013	Fixed Price	5,000 GJ	$4.17/GJ
June 1, 2011 to March 31, 2013	Fixed Price	5,000 GJ	$4.10/GJ
June 1, 2011 to March 31, 2013	Fixed Price	5,000 GJ	$4.10/GJ
November 1, 2011 to March 31, 2013	Fixed Price	5,000 GJ	$4.00/GJ
April 1, 2012 to December 31, 2012	Fixed Price	5,000 GJ	$3.3125/GJ
April 1, 2012 to December 31, 2012	Fixed Price	5,000 GJ	$3.395/GJ
April 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$4.00/GJ
April 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$4.00/GJ
April 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$4.00/GJ
April 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$4.00/GJ
April 1, 2012 to March 31, 2013	Fixed Price	5,000 GJ	$2.20/GJ
April 1, 2012 to March 31, 2013	Fixed Price	5,000 GJ	$2.31/GJ
April 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$2.52/GJ
April 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	$3.00/GJ
June 1, 2012 to October 31, 2012	Fixed Price	5,000 GJ	$1.83/GJ
July 1, 2012 to October 31, 2012	Fixed Price	5,000 GJ	$2.32/GJ
July 1, 2012 to October 31, 2012	Fixed Price	5,000 GJ	$2.35/GJ

As at March 31, 2012, Peyto had committed to the future sale of 14,000 barrels of propane at an average price of $49.56 per barrel and 41,750,000 gigajoules (GJ) of natural gas at an average price of $3.54 per GJ or $4.15 per mcf. Had these contracts closed on March 31, 2012, Peyto would have realized a gain in the amount of $54.7 million.

Subsequent to March 31, 2012 Peyto entered into the following contracts:

Propane **Period Hedged**	**Type**	**Monthly Volume**	**Price (CAD)**
September 1, 2012 to March 31, 2013	Fixed Price	2,000 BBL	$44.10/BBL

Butane **Period Hedged**	**Type**	**Monthly Volume**	**Price (CAD)**
September 1, 2012 to March 31, 2013	Fixed Price	2,000 BBL	$80.64/BBL

Iso-Butane **Period Hedged**	**Type**	**Monthly Volume**	**Price (CAD)**
September 1, 2012 to March 31, 2013	Fixed Price	1,000 BBL	$82.32/BBL

Natural Gas Period Hedged	Type	Daily Volume	Price (CAD)
May 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$2.30/GJ
November 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$2.60/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	$2.81/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	$3.00/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 over which Peyto has no control. Low operating costs and a long reserve life reduce Peyto's sensitivity to changes in commodity prices.

Currency Risk Management

Peyto 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

Peyto is exposed to interest rate risk in relation to interest expense on its revolving demand facility. Currently there are no agreements to manage this risk. At March 31, 2012, 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 $0.9 million per quarter. Average debt outstanding for the first quarter of 2012 was $457.9 million.

LIQUIDITY AND CAPITAL RESOURCES

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

	Three Months ended Mar. 31	
($000)	**2012**	2011
Cash flows from operating activities	**59,383**	42,888
Change in non-cash working capital	**16,367**	27,585
Change in provision for performance based compensation	**1,895**	4,223
Funds from operations	**77,645**	74,696
Funds from operations per share	**0.56**	0.56

For the first quarter ended March 31, 2012, funds from operations totaled $77.6 million or $0.56 per share, as compared to $74.7 million, or $0.56 per share during the same quarter in 2011. Peyto's policy is to balance dividends to shareholders and funding for a capital program with cash flow 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.

Bank Debt

Peyto has a syndicated $725 million extendible revolving credit facility with a stated term date of April 29, 2012. The facility is made up of a $30 million working capital sub-tranche and a $695 million production line. The facilities are available on a revolving basis for a period of at least 364 days and upon the term out date may be extended for a further 364 day period at the request of Peyto, subject to approval by the lenders. In the event that the revolving period is not extended, the facility is available on a non-revolving basis for a one year term, at the end of which time the facility would be due and payable. The loan has therefore been classified as long-term on the balance sheet. The average borrowing rate for the three months ended March 31, 2012 was 4.5% (2011 – 4.7%). Outstanding amounts on this facility will bear interest at rates determined by Peyto's debt to cash flow ratio that range from prime plus 1.25% to prime plus 2.75% for debt to earnings before interest, taxes, depreciation, depletion and amortization (EBITDA) ratios ranging from less than 1:1 to greater than 2.5:1. A General Security Agreement with a floating charge on land registered in Alberta is held as collateral by the bank.

At March 31, 2012, $370 million was drawn under the facility. Working capital liquidity is maintained by drawing from and repaying the unutilized credit facility as needed. At March 31, 2012, the working capital surplus was $1.7 million (including a non-cash current asset for an unrealized mark to market future hedging gain of $50.2 million).

On January 3, 2012, Peyto issued CDN $100 million of senior secured notes pursuant to a note purchase and private shelf agreement with Prudential Investment Management, Inc. The notes were issued by way of private placement and rank equally with Peyto's obligations under its bank facility. The notes have a coupon rate of 4.39% and mature on January 3, 2019. Interest will be paid semi-annually in arrears. Proceeds from the notes were used to repay a portion of Peyto's outstanding bank debt. Peyto's total borrowing capacity remains at $725 million; however Peyto's net credit facility has been reduced to $625 million in conjunction with this private placement.

The private shelf agreement with Prudential provides for the issuance, on an uncommitted basis, of an additional US $25 million of senior notes on or prior to January 3, 2015.

Upon the issuance of the senior secured notes January 3, 2012, Peyto became subject to the following financial covenants as defined in the credit facility and note purchase and private shelf agreements:

- Senior Debt to EBITDA Ratio will not exceed 3.0 to 1.0.
- Total Debt to EBITDA Ratio will not exceed 4.0 to 1.0.
- Interest Coverage Ratio will not be less than 3.0 to 1.0
- Total Debt to Capitalization Ratio will not exceed 0.55:1.0

Peyto is in compliance with all financial covenants.

Subsequent to March 31, 2012, Peyto's banking syndicate has agreed to increase the credit facility to $800 million (net $700 million) and extend the stated term date of the credit facility to April 28, 2013.

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. The total amount of capital invested in 2012 will be driven by the number and quality of projects generated. Capital will only be invested if it meets the long term objectives of Peyto. The majority of the capital program will involve drilling, completion and tie-in of lower risk development gas wells. Peyto's rapidly scaleable business model has the flexibility to match planned capital expenditures to actual cash flow.

Net Debt

"Net debt" is a non-IFRS 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 Peyto. Net debt is reconciled below to long-term debt which is the most directly comparable IFRS measure:

($000)	**As at March 31, 2012**	As at December 31, 2011	As at March 31, 2011
Long-term debt	**470,000**	470,000	425,000
Working capital deficit (surplus)	**(1,710)**	(38,518)	17,391
Financial derivative instruments	**50,179**	38,530	19,454
Provision for future performance based compensation	**(5,842)**	(4,321)	(8,470)
Net debt	**512,627**	465,391	453,375

Capital

Authorized: Unlimited number of voting common shares

Issued and Outstanding

Common shares (no par value) ($000)	**Number of Shares**	**Amount**
Balance, December 31, 2010	**131,875,382**	**755,831**
Common shares issued by private placement	906,196	17,150
Common shares issued pursuant to DRIP	113,527	1,973

Common shares issued pursuant to OTUPP	166,196	2,889
Common shares issued	4,899,000	115,126
Common shares issuance costs (net of tax)	-	(3,854)
Balance, December 31, 2011	**137,960,301**	**889,115**
Common shares issued by private placement	525,655	11,926
Balance, March 31, 2012	**138,485,956**	**901,041**

Peyto reinstated its amended distribution reinvestment and optional trust unit purchase plan (the "Amended DRIP Plan") effective with the January 2010 distribution whereby eligible unitholders could elect to reinvest their monthly cash distributions in additional trust units at a 5 percent discount to market price. The DRIP plan incorporated an Optional Trust Unit Purchase Plan ("OTUPP") which provided unitholders enrolled in the DRIP with the opportunity to purchase additional trust units from treasury using the same pricing as the DRIP. The DRIP and the OTUPP plans were cancelled December 31, 2010.

On December 31, 2010, Peyto completed a private placement of 655,581 common shares to employees and consultants for net proceeds of $12.4 million ($18.95 per share). These shares were issued on January 6, 2011.

On January 14, 2011, 279,723 common shares (113,527 pursuant to the DRIP and 166,196 pursuant to the OTUPP) were issued for net proceeds of $4.9 million.

On March 25, 2011, Peyto completed a private placement of 250,615 common shares to employees and consultants for net proceeds of $4.6 million ($18.86 per share). Subsequent to the issuance of these shares, 133,061,301 common shares were outstanding.

On December 31, 2011, Peyto completed a private placement of 397,235 common shares to employees and consultants for net proceeds of $9.7 million ($24.52 per share). These shares were issued on January 13, 2012.

On March 23, 2012, Peyto completed a private placement of 128,420 common shares to employees and consultants for net proceeds of $2.2 million ($17.22 per share). Subsequent to the issuance of these shares, 138,485,956 common shares were outstanding.

Performance Based Compensation

Peyto 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%. This methodology can generate interim results which vary significantly from the final compensation paid. Compensation expense of $0.6 million was recorded for the period ended March 31, 2012.

Under the market based component, rights vesting over three years 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 share for that period.

Based on the weighted average trading price of the common shares for the period ended March 31, 2012, compensation costs related to 4.0 million non-vested rights (3% of the total number of common shares outstanding), with an average grant price of $21.45, are $1.3 million for the first quarter of 2012. 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 12 of the Condensed Interim Financial Statements for the more details). The cumulative provision totals $6.8 million.

Capital Expenditures

Net capital expenditures for the first quarter of 2012 totaled $98.6 million. Exploration and development related activity represented $83.0 million (84% of total), while expenditures on facilities, gathering systems and equipment totaled $12.9 million (13% of total) and land, seismic and acquisitions/dispositions totaled $2.7 million (3% of total). The following table summarizes capital expenditures for the period:

($000)	Three Months ended Mar. 31 2012	2011
Land	**2,165**	1,254
Seismic	**636**	88
Drilling – Exploratory & Development	**82,969**	83,457
Production Equipment, Facilities & Pipelines	**12,862**	14,638
Acquisitions	**-**	5,047
Dispositions	**-**	(698)
Total Capital Expenditures	**98,632**	103,786

Dividends

	Three Months ended Mar. 31 2012	2011
Funds from operations ($000)	**77,645**	74,696
Total dividends ($000)	**24,912**	23,921
Total dividends per share ($)	**0.18**	0.18
Payout ratio (%)	**32**	32

Peyto's policy is to balance dividends to shareholders and funding for a capital program with cash flow 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

Peyto is committed to payments under operating leases for office space as follows:

($000)	**March 31, 2012**
2012	803
2013	1,071
2014	1,071
	2,945

RELATED PARTY TRANSACTIONS

An officer and director of Peyto is a partner of a law firm that provides legal services to Peyto. The fees charged are based on standard rates and time spent on matters pertaining to Peyto.

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

Peyto'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 Peyto is made known to Peyto'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 Peyto 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 Peyto's disclosure controls and procedures at the year end of Peyto and have concluded that Peyto's disclosure controls and procedures are effective at the financial period end of Peyto for the foregoing purposes.

Internal Control over Financial Reporting

Peyto'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 Peyto's financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Such officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of Peyto's internal control over financial reporting at the financial period end of Peyto and concluded that Peyto's internal control over financial reporting is effective, at the financial period end of Peyto, 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 March 31, 2012 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 Peyto'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, 2011 were audited by independent petroleum engineers InSite Petroleum Consultants Ltd. InSite has been evaluating reserves in this area and for Peyto for 13 consecutive years.

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 estimated gross proven 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, dividend 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 2012. A quarterly provision for the reserve value based compensation is calculated using estimated proved producing reserve additions adjusted for changes in debt, equity, dividends, general and administrative expenses and interest expense. 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 Peyto’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 Peyto has not applied a new primary source of IFRS that has been issued, but is not effective, Peyto will disclose the fact along with information relevant to assessing the possible impact that application of the new primary source of IFRS will have on the financial statements in the period of initial application.

CHANGES IN ACCOUNTING POLICIES

Presentation of Financial Statements
As of January 1, 2012, Peyto adopted IAS 1, "Presentation of Items of OCI: Amendments to IAS 1 Presentation of Financial Statements." The amendments stipulate the presentation of net earnings and OCI and also require Peyto to group items within OCI based on whether the items may be subsequently reclassified to profit or loss.

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 year ended December 31, 2011. The IASB did not issue any standards, interpretations or amendments during the first quarter of 2012.

- IFRS 11, "Joint Arrangements," requires retrospective application and will be adopted by Peyto on January 1, 2013. The adoption of the standard is not expected to have a significant impact on Peyto's financial statements.

- IFRS 12, "Disclosure of Interest in Other Entities," requires retrospective application and will be adopted by Peyto on January 1, 2013. The adoption of the standard is not expected to have a significant impact on Peyto's financial statements.

- Amendments to IAS 28, "Investment in Associates and Joint Ventures," require retrospective application and will be adopted by Peyto on January 1, 2013. The adoption of the amended standard is not expected to have a material impact on Peyto's financial statements.

- IFRS 13, "Fair Value Measurement," requires prospective application and will be adopted by Peyto on January 1, 2013. The impact of adoption of IFRS 13 has not yet been determined.

- Amendments to IFRS 7, "Financial Instruments: Disclosures," require retrospective application and will be adopted by Peyto on January 1, 2013. The adoption of this standard is not expected to have a material impact on Peyto's financial statements.

- Amendments to IAS 32, "Financial Instruments: Presentation," require retrospective application and will be adopted by Peyto on January 1, 2014. The adoption of this standard is not expected to have a material impact on Peyto's financial statements.

- IFRS 9, "Financial Instruments," requires retrospective application and will be adopted by Peyto on January 1, 2015. The impact of the adoption of this standard has not yet been determined.

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

	2012	2011			
	Q1	Q4	Q3	Q2	Q1
Operations					
Production					
Natural gas (mcf/d)	220,811	212,715	194,832	183,790	166,710
Oil & NGLs (bbl/d)	4,101	3,947	3,918	3,811	3,746
Barrels of oil equivalent (boe/d @ 6:1)	40,903	39,399	36,390	34,443	31,531
Thousand cubic feet equivalent (mcfe/d @ 6:1)	245,417	236,394	218,338	206,657	189,187
Average product prices					
Natural gas ($/mcf)	3.53	4.21	4.43	4.43	4.92
Oil & natural gas liquids ($/bbl)	84.83	88.04	78.07	84.06	76.19
$/MCFE					
Average sale price ($/mcfe)	4.59	5.25	5.35	5.50	5.85
Average royalties paid ($/mcfe)	0.39	0.46	0.45	0.64	0.58
Average operating expenses ($/mcfe)	0.33	0.35	0.36	0.32	0.39
Average transportation costs ($/mcfe)	0.12	0.12	0.13	0.13	0.13
Field netback ($/mcfe)	3.75	4.32	4.41	4.41	4.75
General & administrative expense ($/mcfe)	0.04	0.05	0.04	0.07	0.09
Interest expense ($/mcfe)	0.23	0.35	0.26	0.24	0.27
Cash netback ($/mcfe)	3.48	3.92	4.11	4.10	4.39
Financial ($000 except per share)					
Revenue	102,496	114,263	107,526	103,193	99,577
Royalties	8,835	9,870	9,265	12,007	9,922
Funds from operations	77,645	80,410	82,506	77,010	74,696
Funds from operations per share	0.56	0.60	0.62	0.58	0.56
Total dividends	24,912	24,245	23,951	23,951	23,921
Total dividends per share	0.18	0.18	0.18	0.18	0.18
Payout ratio	32%	30%	29%	31%	32%
Earnings	26,868	26,036	37,341	32,718	31,688
Earnings per diluted share	0.19	0.19	0.28	0.25	0.24
Capital expenditures	98,632	94,688	111,570	69,017	103,786
Weighted average shares outstanding	138,312,078	133,913,301	133,061,301	133,061,301	132,737,066

Peyto Exploration & Development Corp.

Condensed Balance Sheet *(unaudited)*

(Amount in $ thousands)

	March 31 2012	December 31 2011
Assets		
Current assets		
Cash	-	57,224
Accounts receivable	45,753	53,829
Due from private placement *(Note 6)*	-	9,740
Financial derivative instruments *(Note 8)*	50,179	38,530
Prepaid expenses	6,087	3,991
	102,019	**163,314**
Long-term financial derivative instruments *(Note 8)*	4,495	6,304
Prepaid capital	6,342	1,414
Property, plant and equipment, net *(Note 3)*	1,687,538	1,629,220
	1,698,375	**1,636,938**
	1,800,394	**1,800,252**
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	86,158	110,483
Dividends payable *(Note 6)*	8,309	8,278
Provision for future performance based compensation *(Note 7)*	5,842	4,321
	100,309	**123,082**
Long-term debt *(Note 4)*	470,000	470,000
Provision for future performance based compensation *(Note 7)*	1,608	1,235
Decommissioning provision *(Note 5)*	37,652	38,037
Deferred income taxes	163,594	152,190
	672,854	**661,462**
Shareholders' equity		
Shareholders' capital *(Note 6)*	901,041	889,115
Shares to be issued *(Note 6)*	-	9,740
Retained earnings	84,845	82,889
Accumulated other comprehensive income *(Note 6)*	41,345	33,964
	1,027,231	**1,015,708**
	1,800,394	**1,800,252**

Approved by the Board of Directors

(signed) *"Michael MacBean"*
Director

(signed) *"Darren Gee"*
Director

Peyto Exploration & Development Corp.

Condensed Income Statement *(unaudited)*

(Amount in $ thousands)

	Three months ended March 31	
	2012	**2011**
Revenue		
Oil and gas sales	85,221	86,458
Realized gain on hedges *(Note 8)*	17,275	13,119
Royalties	(8,835)	(9,922)
Petroleum and natural gas sales, net	**93,661**	**89,655**
Expenses		
Operating	7,300	6,571
Transportation	2,606	2,163
General and administrative	972	1,607
Future performance based compensation *(Note 7)*	1,895	4,223
Interest	5,138	4,618
Accretion of decommissioning provision	257	232
Depletion and depreciation *(Note 3)*	39,673	29,026
Gain on disposition of assets *(Note 3)*	-	(818)
	57,841	**47,622**
Earnings before taxes	**35,820**	**42,033**
Income tax		
Deferred income tax expense	8,952	10,345
Earnings for the period	**26,868**	**31,688**
Earnings per share *(Note 6)*		
Basic and diluted	**$ 0.19**	**$ 0.24**
Weighted average number of common shares outstanding *(Note 6)*		
Basic and diluted	**138,312,078**	**132,737,066**

Peyto Exploration & Development Corp.

Condensed Statement of Comprehensive Income *(unaudited)*

(Amount in $ thousands)

	Three months ended March 31	
	2012	**2011**
Earnings for the period	**26,868**	**31,688**
Other comprehensive income		
Change in unrealized gain on cash flow hedges	24,656	6,350
(net of deferred tax; $2.5 million expense (2011 - $2.4 million recovery))		
Realized (gain) loss on cash flow hedges	(17,275)	(13,119)
Comprehensive income	**34,249**	**24,919**

Peyto Exploration & Development Corp.

Condensed Statement of Changes in Equity *(unaudited)*

(Amount in $ thousands)

	Three months ended March 31	
	2012	**2011**
Shareholders' capital, beginning of period	**889,115**	755,831
Common shares issued	-	-
Common shares issued by private placement	11,952	17,150
Common shares issuance costs (net of tax)	(26)	(65)
Common shares issued pursuant to DRIP	-	1,973
Common shares issued pursuant to OTUPP	-	2,889
Shareholders' capital, end of period	**901,041**	777,778

Common shares to be issued, beginning of period	**9,740**	17,285
Common shares issued	(9,740)	(17,285)
Common shares to be issued	-	-
Common shares to be issued, end of period	**-**	-

Retained earnings, beginning of period	**82,889**	50,774
Earnings for the period	26,868	31,688
Dividends *(Note 6)*	(24,912)	(23,921)
Retained earnings, end of period	**84,845**	58,541

Accumulated other comprehensive income, beginning of period	**33,964**	**20,893**
Other comprehensive income (loss)	7,381	(6,769)
Accumulated other comprehensive income, end of period	**41,345**	**14,124**

Total shareholders' equity	**1,027,231**	850,443

Peyto Exploration & Development Corp.

Condensed Statement of Cash Flows *(unaudited)*

(Amount in $ thousands)

	Three months ended March 31	
	2012	**2011**
Cash provided by (used in) operating activities		
Earnings	**26,868**	31,688
Items not requiring cash:		
Deferred income tax	**8,952**	10,345
Depletion and depreciation	**39,673**	29,026
Gain on disposition of assets	**-**	(818)
Accretion of decommissioning provision	**257**	232
Change in non-cash working capital related to operating activities	**(16,367)**	(27,585)
	59,383	42,888
Financing activities		
Issuance of common shares	**11,952**	17,150
Issuance costs	**(35)**	(86)
Cash dividends paid	**(24,881)**	(31,762)
Increase in bank debt	**-**	70,000
	(12,964)	55,302
Investing activities		
Additions to property, plant and equipment	**(103,643)**	(95,344)
Net increase (decrease) in cash	**(57,224)**	2,846
Cash, Beginning of Period	**57,224**	7,894
Cash, End of Period	**-**	10,740

The following amounts are included in cash flows from operating activities:

Cash interest paid	**4,313**	4,536
Cash taxes paid	**-**	-

(Amount in $ thousands, except as otherwise noted)

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 1500, 250 – 2nd Street SW, Calgary, Alberta, Canada, T2P 0C1.

These financial statements were approved and authorized for issuance by the Audit Committee of Peyto on May 8, 2012.

2. Basis of presentation

The condensed interim 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 interim 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 for the year ended December 31, 2011.

The timely preparation of the condensed interim 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 interim 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 audited Financial Statements as at and for the years ended December 31, 2011 and 2010.

3. Property, plant and equipment, net

	Development and Production Assets	Corporate Assets	Total Assets
Cost			
At December 31, 2011	1,842,759	1,007	1,843,766
Additions	97,991	-	97,991
Dispositions	-	-	-
At March 31, 2012	1,940,750	1,007	1,941,757
Accumulated depreciation			
At December 31, 2011	(213,755)	(791)	(214,546)
Depletion and depreciation	(39,659)	(14)	(39,673)
Dispositions	-	-	-
At March 31, 2012	(253,414)	(805)	(254,219)
Carrying amount at March 31, 2012	**1,687,336**	**202**	**1,687,538**

Proceeds received for assets disposed of during the period ended March 31, 2012 were $nil (2011 - $1.5 million).

During the period ended March 31 2012, Peyto capitalized $1.7 million (2011 - $1.2 million) of general and administrative expense directly attributable to production and development activities.

4. Long-term debt

Peyto has a syndicated $725 million extendible revolving credit facility with a stated term date of April 29, 2012. The bank facility is made up of a $30 million working capital sub-tranche and a $695 million production line. The facilities are available on a revolving basis for a period of at least 364 days and upon the term out date may be extended for a further 364 day period at the request of Peyto, subject to approval by the lenders. In the event that the revolving period is not extended, the facility is available on a non-revolving basis for a further one year term, at the end of which time the facility would be due and payable. Outstanding amounts on this facility will bear interest at rates ranging from prime plus 1.25% to prime plus 2.75% determined by Peyto's debt to earnings before interest, taxes, depreciation, depletion and amortization (EBITDA) ratios ranging from less than 1:1 to greater than 2.5:1. A General Security Agreement with a floating charge on land registered in Alberta is held as collateral by the bank.

On January 3, 2012, Peyto issued CDN $100 million of senior secured notes pursuant to a note purchase and private shelf agreement. The notes were issued by way of private placement and rank equally with Peyto's obligations under its bank facility. The notes have a coupon rate of 4.39% and mature on January 3, 2019. Interest will be paid semi-annually in arrears. The private shelf agreement provides for the issuance, on an uncommitted basis, of an additional US $25 million of senior notes on or prior to January 3, 2015. A General Security Agreement with a floating charge on land registered in Alberta is held as collateral by the bank. Peyto's total borrowing capacity remains at $725 million; however Peyto's net credit facility has been reduced to $625 million in conjunction with this private placement.\

Upon the issuance of the senior secured notes January 3, 2012, Peyto became subject to the following financial covenants as defined in the credit facility and note purchase and private shelf agreements:

- Senior Debt to EBITDA Ratio will not exceed 3.0 to 1.0.
- Total Debt to EBITDA Ratio will not exceed 4.0 to 1.0.
- Interest Coverage Ratio will not be less than 3.0 to 1.0
- Total Debt to Capitalization Ratio will not exceed 0.55:1.0

Peyto is in compliance with all financial covenants at March 31, 2012.

Total interest expense for the period ended March 31, 2012 was $5.1 million (2011 - $4.6 million) and the average borrowing rate for the period was 4.5% (2011 – 4.7%).

Subsequent to March 31, 2012, Peyto's banking syndicate has agreed to increase the credit facility to $800 million (net $700 million) and extend the stated term date of the credit facility to April 28, 2013.

5. Decommissioning provision

Peyto makes provision for the future cost of decommissioning wells, pipelines and facilities on a discounted basis based on the commissioning of these assets.

The decommissioning provision represents the present value of the decommissioning costs related to the above infrastructure, which are expected to be incurred over the economic life of the assets. The provisions have been based on Peyto's internal estimates of the cost of decommissioning, the discount rate, the inflation rate and the economic life of the infrastructure. Assumptions, based on the current economic environment, have been made which management believes are a reasonable basis upon which to estimate the future liability. These estimates are reviewed regularly to take into account any material changes to the assumptions. However, actual decommissioning costs will ultimately depend upon the future market prices for the necessary decommissioning work required which will reflect market conditions at the relevant time. Furthermore, the timing of the decommissioning is likely to depend on when production activities ceases to be economically viable. This in turn will depend and be directly related to the current and future commodity prices, which are inherently uncertain.

The following table reconciles the change in decommissioning provision:

Balance, December 31, 2011	**38,037**
New or increased provisions	1,600
Accretion of decommissioning provision	257
Change in discount rate and estimates	(2,242)
Balance, March 31, 2012	**37,652**
Current	-
Non-current	37,652

Peyto has estimated the net present value of its total decommissioning provision to be $37.7 million as at March 31, 2012 ($38.0 million at December 31, 2011) based on a total future undiscounted liability of $97.9 million ($101.2 million at December 31, 2011). At March 31, 2012 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 2061. The Bank of Canada's long term bond rate of 2.66 per cent (2.49 per cent at December 31, 2011) and an inflation rate of two per cent (two per cent at December 31, 2011) were used to calculate the present value of the decommissioning provision.

6. Shareholders' capital

Authorized: Unlimited number of voting common shares

Issued and Outstanding

Common Shares (no par value)	Number of Common Shares	Amount $
Balance, December 31, 2010	131,875,382	755,831
Common shares issued	4,899,000	115,126
Common share issuance costs (net of tax)	-	(3,854)
Common shares issued by private placement	906,196	17,150
Common shares issued pursuant to DRIP	113,527	1,973
Common shares issued pursuant to OTUPP	166,196	2,889
Balance, December 31, 2011	137,960,301	889,115
Common shares issued by private placement	525,655	11,952
Common share issuance costs (net of tax)	-	(26)
Balance, March 31, 2012	**138,485,956**	**901,041**

Peyto reinstated its amended distribution reinvestment and optional trust unit purchase plan (the "Amended DRIP Plan") effective with the January 2010 distribution whereby eligible unitholders could elect to reinvest their monthly cash distributions in additional trust units at a 5 percent discount to market price. The DRIP plan incorporated an Optional Trust Unit Purchase Plan ("OTUPP") which provided unitholders enrolled in the DRIP with the opportunity to purchase additional trust units from treasury using the same pricing as the DRIP. The DRIP and the OTUPP plans were cancelled December 31, 2010.

On December 31, 2010, Peyto completed a private placement of 655,581 common shares to employees and consultants for net proceeds of $12.4 million ($18.95 per share). These common shares were issued on January 6, 2011.

On January 14, 2011, 279,723 common shares (113,527 pursuant to the DRIP and 166,196 pursuant to the OTUPP) were issued for net proceeds of $4.9 million.

On March 25, 2011, Peyto completed a private placement of 250,615 common shares to employees and consultants for net proceeds of $4.7 million ($18.86 per share).

On December 16, 2011, Peyto closed an offering of 4,899,000 common shares at a price of $23.50 per common share, receiving proceeds of $110.1 million (net of issuance costs).

On December 31, 2011 Peyto completed a private placement of 397,235 common shares to employees and consultants for net proceeds of $9.7 million ($24.52 per share). These common shares were issued on January 13, 2012.

On March 23, 2012 Peyto completed a private placement of 128,420 common shares to employees and consultants for net proceeds of $2.2 million ($17.22 per share).

Per share amounts
Earnings per share or unit have been calculated based upon the weighted average number of common shares outstanding for the period ended March 31, 2012 of 138,312,078 (2011 - 132,737,066). There are no dilutive instruments outstanding.

Dividends
During the period ended March 31, 2012, Peyto declared and paid dividends of $0.18 per common share or $0.06 per common share per month, totaling $24.9 million (2011 - $0.18 or $0.06 per share per month, $23.9 million).

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:

	March 31 2012	March 31 2011
Share price	$16.38 -$24.75	$18.83 - $20.60
Exercise price	$12.06 - $24.75	$9.56 – $18.83
Expected volatility	31%	23%
Option life	1 year	1 year
Dividend yield	0%	0%
Risk-free interest rate	1.19%	1.77%

8. Risk management contracts

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 March 31, 2012:

Propane Period Hedged	Type	Monthly Volume	Price (CAD)
September 1, 2012 to March 31, 2013	Fixed Price	2,000 bbl	$49.56/bbl

Description	Notional [(1)]	Term	Effective Rate	Fair Value Level	March 31, 2012	December 31, 2011
Natural gas financial swaps - AECO	41.75GJ [(2)]	2012- 2014	$3.54/GJ	Level 1	54,674	44,834

[(1)] Notional values as at March 31, 2012 [(2)] Millions of gigajoules

As at March 31, 2012, Peyto had committed to the future sale of 14,000 barrels of propane at an average price of $49.56 per barrel and 41,750,000 gigajoules (GJ) of natural gas at an average price of $3.54 per GJ or $4.15 per mcf. Had these contracts been closed on March 31, 2012, Peyto would have realized a gain in the amount of $54.7 million. If the AECO gas price on March 31, 2012 were to increase by $1/GJ, the unrealized gain would decrease by approximately $41.8 million. An opposite change in commodity prices rates would result in an opposite impact on other comprehensive income.

Subsequent to March 31, 2012 Peyto entered into the following contracts:

Propane **Period Hedged**	**Type**	**Monthly Volume**	**Price (CAD)**
September 1, 2012 to March 31, 2013	Fixed Price	2,000 bbl	$44.10/bbl

Butane **Period Hedged**	**Type**	**Monthly Volume**	**Price (CAD)**
September 1, 2012 to March 31, 2013	Fixed Price	2,000 bbl	$80.64/bbl

ISO Butane **Period Hedged**	**Type**	**Monthly Volume**	**Price (CAD)**
September 1, 2012 to March 31, 2013	Fixed Price	1,000 bbl	$80.32/bbl

Natural Gas **Period Hedged**	**Type**	**Daily Volume**	**Price (CAD)**
May 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$2.30/GJ
November 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$2.60/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	$2.81/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	$3.00/GJ

9. Commitments and contingencies

Following is a summary of Peyto's commitment related to an operating lease as at March 31, 2012.

	2012	**2013**	**2014**	**2015**	**2016**	**Thereafter**
Operating lease	803	1,071	1,071	-	-	-
Total	803	1,071	1,071	-	-	-

Peyto has no other contractual obligations or commitments as at March 31, 2012.

Contingent liability

From time to time, Peyto is the subject of litigation arising out of its day-to-day operations. Damages claimed pursuant to such litigation may be material or may be indeterminate and the outcome of such litigation may materially impact Peyto's financial position or results of operations in the period of settlement. While Peyto assesses the merits of each lawsuit and defends itself accordingly, Peyto may be required to incur significant expenses or devote significant resources to defending itself against such litigation. These claims are not currently expected to have a material impact on Peyto's financial position or results of operations.

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

Stephen Chetner
Corporate Secretary

Tim Louie
Vice President, Land

David Thomas
Vice President, Exploration

Jean-Paul Lachance
Vice President, Exploitation

Directors

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

Auditors

Deloitte & Touche LLP

Solicitors

Burnet, Duckworth & Palmer LLP

Bankers

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

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