PEYTO

Exploration & Development Corp.

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Interim Report
for the three months ended March 31, 2013

Highlights

	3 Months Ended Mar. 31		%
	2013	2012	Change
Operations			
Production			
Natural gas (mcf/d)	**297,191**	220,811	*35%*
Oil & NGLs (bbl/d)	**5,840**	4,101	*42%*
Thousand cubic feet equivalent (mcfe/d @ 1:6)	**332,230**	245,417	*35%*
Barrels of oil equivalent (boe/d @ 6:1)	**55,372**	40,903	*35%*
Product prices			
Natural gas ($/mcf)	**3.49**	3.53	*(1)%*
Oil & NGLs ($/bbl)	**75.88**	84.83	*(11)%*
Operating expenses ($/mcfe)	**0.31**	0.33	*(6)%*
Transportation ($/mcfe)	**0.12**	0.12	-
Field netback ($/mcfe)	**3.67**	3.75	*(2)%*
General & administrative expenses ($/mcfe)	**0.02**	0.04	*(50)%*
Interest expense ($/mcfe)	**0.21**	0.23	*(9)%*
Financial ($000, except per share)			
Revenue	**133,203**	102,496	*30%*
Royalties	**10,591**	8,835	*20%*
Funds from operations	**102,856**	77,645	*32%*
Funds from operations per share	**0.69**	0.56	*23%*
Total dividends	**26,766**	24,912	*7%*
Total dividends per share	**0.18**	0.18	-
Payout ratio	**26**	32	*(19)%*
Earnings	**36,405**	26,868	*35%*
Earnings per diluted share	**0.25**	0.19	*32%*
Capital expenditures	**169,099**	98,632	*71%*
Weighted average common shares outstanding	**148,672,664**	138,312,078	*7%*
As at March 31			
Net debt (before future compensation expense and unrealized hedging gains)	**749,546**	512,627	*46%*
Shareholders' equity	**1,197,254**	1,027,231	*17%*
Total assets	**2,281,387**	1,800,394	*27%*

	Three Months ended Mar. 31	
($000)	**2013**	2012
Cash flows from operating activities	**92,543**	59,383
Change in non-cash working capital	**7,775**	16,367
Change in provision for performance based compensation	**2,538**	1,895
Funds from operations	**102,856**	77,645
Funds from operations per share	**0.69**	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 2013 fiscal year. Peyto's production per share grew for the fourteenth consecutive quarter with first quarter operating margins of 77%[1] and profit margins of 27%[2]. First quarter 2013 highlights were as follows:

- **Production per share up 26%.** First quarter 2013 production increased 35% (26% per share) from 245 MMcfe/d (40,903 boe/d) in Q1 2012 to 332 MMcfe/d (55,372 boe/d) in Q1 2013.

- **Funds from operations of $0.69/share.** Generated a company record $103 million in Funds from Operations ("FFO") in Q1 2013 up 32% (23% per share) from $78 million in Q1 2012 due to increased production volumes.

- **Operating costs less than $2/boe.** Industry leading operating costs were further reduced from $0.33/mcfe ($1.96/boe) in Q1 2012 to $0.31/mcfe ($1.87/boe) in Q1 2013. Total cash costs, including royalties, operating costs, transportation, G&A and interest were $1.02/mcfe ($6.10/boe), resulting in a $3.44/mcfe ($20.64/boe) cash netback or 77% operating margin.

- **Capital investment of $169 million**. An organic capital program of $169 million was executed in the quarter resulting in production additions of 10,300 boe/d at quarter end. The annualized cost (trailing twelve months) to build new production was $18,900/boe/d (including capital for Peyto's enhanced liquids extraction facilities but excluding the Open Range acquisition). A total of 31 gross wells were drilled during the first quarter.

- **Earnings of $0.25/share, dividends of $0.18/share.** Earnings of $36 million were generated in the quarter while dividends of $27 million were paid to shareholders, representing a before tax payout ratio of 26% of FFO.

- **Dividend increase to $0.08/share.** The Board of Directors has approved a dividend increase of $0.02/share, starting in May 2013, to be paid on June 14, 2013 to shareholders of record as of May 31, 2013.

First Quarter 2013 in Review

The first quarter of 2013 was a continuation from the fourth quarter of 2012, with record levels of capital invested into the exploration and development of Peyto's Deep Basin resource plays. As a result, production continued to grow throughout the quarter while a strict focus on maintaining industry leading cash costs ensured funds from operations also grew proportionately. Peyto's realized natural gas prices were similar to the first quarter of 2012, although less supported by hedging gains, while realized liquids prices were down 10%. Despite the improvement in underlying natural gas prices, North American drilling activity did not increase, allowing Peyto to continue building and developing new production at its industry leading capital efficiencies. The enhanced liquids extraction facilities at Peyto's Oldman gas plant became fully operational at the start of the quarter, achieving the designed process temperatures and additional liquid recoveries, and thus increasing the price Peyto realizes for its production stream. Subsequent to the quarter, Peyto replaced its secured borrowing base revolving bank facility with an unsecured covenant based facility with 37% greater borrowing capacity. This new credit facility gives Peyto the ability to pursue even more opportunities at a lower cost of capital. At quarter end, 65% of the new borrowing capacity of $1.15 billion was utilized resulting in a net debt to annualized FFO ratio of 1.8 times. The strong financial and operating performance delivered in the quarter resulted in an annualized 12% 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 explore and develop many of its liquids rich, sweet gas resource plays in the Deep Basin throughout the first quarter of 2013. A total of 31 wells were drilled across the land base, targeting the many prospective zones, as shown in the following table:

	Field							Total
Zone	Sundance	Nosehill	Wildhay	Ansell	Berland	Kisku/ Kakwa	New Area	Wells Drilled
Cardium	2					1		3
Notikewin	3	2						5
Falher	4		4	1				9
Wilrich	1	1	2	3	2		2	11
Bluesky		3						3
Total	10	6	6	4	2	1	2	31

The majority of the activity focused on the Notikewin, Falher and Wilrich formations of the Spirit River group. Despite the lower natural gas liquids yields from these deeper Spirit River formations, economic returns were still determined to be greater due to the improved natural gas prices combined with greater productivity and recoveries.

In particular, considerable development occurred in the Falher formation where Peyto has now drilled 38 horizontal wells since the start of 2012 and sees significant unbooked drilling inventory that can continue to be proven. Drilling costs in the Falher to date have averaged $2.6 million/well, while completion costs have averaged $1.6 million/well.

In addition, Peyto has drilled a total of six Bluesky horizontal wells since the second quarter of 2012, helping to prove up substantial existing and future inventory in this formation. To date, Bluesky drilling and completion costs have averaged $2.9 million/well and $1.6 million/well, respectively.

Overall, Peyto continues to validate an ever greater inventory of profitable drilling locations within the numerous formations across its Deep Basin lands.

Capital Expenditures

During the first quarter of 2013, Peyto spent $75.5 million to spud 31 gross (28.3 net) horizontal wells and $41.2 million completing 25 gross (23.5 net) wells. Wellsite equipment and tie-ins accounted for $14.6 million, while a total of $36.0 million was invested in new pipelines and facilities including the balance of capital for the Oldman gas plant Deep Cut equipment. New lands were acquired for $0.8 million, or $373/acre, while new seismic accounted for $1.0 million.

In the quarter, 25 gross (23.1 net) wells were brought onstream which contributed 10,300 boe/d to the quarter end exit rate of 59,000 boe/d. Pipeline and facility capital of $36.0 million included the addition of one compressor each to the Wildhay and Nosehill gas plants; the construction of a strategically located 47 km pipeline from Peyto's Ansell property to its Swanson gas plant; the installation of natural gas fired power generation equipment at the Oldman gas plant; and the completion of the Oldman natural gas liquids ("NGLs") extraction facilities. These newly installed Deep Cut facilities are performing as designed, achieving process temperatures ranging from -75C to -80C and recovering an additional 12 to 15 bbl of high value NGLs per MMcf of sales gas.

Financial Results

Alberta monthly natural gas prices averaged $2.91/GJ in the first quarter 2013, resulting in a Peyto unhedged realized price of $3.31/mcf before hedging gains of $0.18/mcf. Meanwhile, Edmonton light oil prices averaged $88.60/bbl from which Peyto realized $75.72/bbl, before hedging gains of $0.16/bbl, for its natural gas liquids blend of condensate, pentane, butane and propane. Combined, Peyto's unhedged revenues totaled $4.30/mcfe ($4.46/mcfe including hedging gains), or 153% of the dry gas price, illustrating the benefit of high heat content, liquids rich natural gas production.

Royalties of $0.36/mcfe, operating costs of $0.31/mcfe, transportation costs of $0.12/mcfe, G&A of $0.02/mcfe and interest costs of $0.21/mcfe, combined for total cash costs of $1.02/mcfe. These industry leading total cash costs resulted in a cash netback of $3.44/mcfe or a 77% operating margin.

Depletion, depreciation and amortization charges of $1.73/mcfe, along with a provision for future tax and market based bonus payments reduced the cash netback to earnings of $1.22/mcfe, or a 27% profit margin.

Subsequent to the end of the first quarter, Peyto's $730 million credit facility was reviewed and the annual secured revolver was replaced by a $1.0 billion, two year, covenant based unsecured revolver. This increase in borrowing capacity was a reflection of the 2012 growth in volume and value of Peyto's Proved Producing reserves, as well as a reflection of the company's efficiency with which reserves are developed, produced and sold. The unsecured revolver contains the same financial covenants as the previous secured revolver (see the Management's Discussion & Analysis for a description of the covenants). Including the $150 million of senior unsecured notes, Peyto's total borrowing capacity increased to $1.15 billion.

Marketing

The first quarter 2013 AECO daily natural gas prices were 50% higher than the same period in 2012 due to a more balanced supply demand situation in North America coupled with more typical winter weather. March weather, however, was colder than normal and resulted in record volumes of gas being withdrawn from storage reservoirs, further driving up the natural gas price in both the US and Canada.

Despite this recovery in current natural gas prices, the price offered for future supplies has not increased materially since a year ago. AECO and NYMEX futures up to five years out are only 20% higher than today's price, indicating that natural gas supplies in North America, including those in the prolific US shale plays, will be sufficient to meet current demand growth projections.

The company's hedging practice of layering in future sales in the form of fixed price swaps, in order to smooth out the volatility in natural gas price, continued throughout the quarter. As at March 31, 2013, Peyto had committed to the future sale of 82,627,500 gigajoules (GJ) of natural gas at an average price of $3.23/GJ or $3.71/mcf, based on Peyto's historical heat content. As at May 8, 2013, the remaining hedged volumes and prices for the upcoming years are summarized in the following table.

	Future Sales		Average Price (CAD)	
	GJ	Mcf	$/GJ	$/Mcf
2013	47,322,500	41,150,000	3.22	3.70
2014	33,485,000	29,117,391	3.30	3.80
2015	450,000	391,304	3.60	4.14
Total	81,257,500	70,658,696	3.26	3.74

As illustrated in the following table, Peyto's unhedged realized natural gas liquids prices (1) were down 11% year over year but up 4% from the previous quarter.

	Three Months ended March 31		Q4
	2013	2012	2012
Condensate ($/bbl)	**96.63**	100.09	91.22
Propane ($/bbl)	**26.75**	31.86	25.58
Butane ($/bbl)	**61.40**	69.17	63.38
Pentane ($/bbl)	**107.13**	102.92	94.34
Total Oil and NGLs ($/bbl)	**75.72**	84.83	73.12

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

Peyto's hedging practice with respect to propane also continued in the quarter and as at March 31, 2013, Peyto had committed to the future sale of 288,000 bbls of propane at an average price of $34.61USD/bbl. As at May 8, 2013, the remaining hedged volumes and prices for the upcoming years are summarized in the following table.

	Propane	
	Future Sales (bbls)	Average Price ($USD/bbl)
2013	168,000	33.60
2014	96,000	36.59
Total	264,000	34.69

Activity Update

Peyto has concluded all of its drilling and completion activities leading up to this year's spring break-up period. Current production levels have ranged from 60,000 to 61,000 boe/d with new 2013 wells contributing 13,000 boe/d.

During April, 10 gross wells (9.5 net) were completed and brought onstream. Additionally, 6 gross wells (5.5 net) have finished drilling and await completion and/or tie in which will occur after break-up. Two wells were suspended at an intermediate stage of drilling operations due to spring break-up. Resumption of drilling, completion and tie in activity is anticipated for the last week of May.

The estimated production additions for the 6 wells awaiting completion and/or tie in, as well as one other previously drilled well in a new area, amount to greater than 5,000 boe/d.

Peyto is planning for the continuation of an active 10 rig drilling program after the breakup period. In order to accommodate the growth in production anticipated from this activity, equipment is currently being fabricated for three key facility projects. The first includes a new gas plant adjacent to the Oldman facility (Oldman North) that is being designed for an eventual 80 MMcf/d of capacity by the end of 2014. The facility will be brought on with initial compression totalling 30 MMcf/d and with an estimated start-up of September, 2013. The second is a 30 MMcf/d expansion to Peyto's Swanson gas plant which has been filled to its current 30 MMcf/d capacity over Q1 of this year. The estimated timing for that project is also September/October of 2013. The final facility project is a new plant contemplated for startup at the end of 2013 in a new area of development. It is being built for an initial capacity of approximately 20 MMcf/d but is fully expandable with continued development drilling success.

Dividend Increase

In keeping with Peyto's total return model, profitable growth in the Company's assets should ultimately yield growth in sustainable dividends for shareholders. Since the conversion back to a dividend paying, growth corporation at the end of 2010, when the current $0.06/month dividend rate was set, Peyto has increased production per share by 70% and grown proved plus probable additional reserves per share by over 30%. Over the same period, and despite lower natural gas prices, funds from operations per share also increased 30%. The strength of the Company's balance sheet has also improved over that time, with greater access to capital and at a lower cost, ensuring future capital programs can continue to be adequately funded.

Based on this recent profitable growth and financial strength, the Board of Directors of Peyto has approved a $0.02/share increase to the monthly dividend starting in May 2013.

Outlook

With the largest capital program in the company's history well underway, 2013 looks to be another record breaking year for Peyto. Near term natural gas prices have improved, driving returns on this capital even higher, while at the same time industry activity remains low, keeping costs down and ensuring services are readily available. Peyto's low cost advantage, which yields high operating and profit margins, ensures the growth in assets resulting from this capital program is profitable growth. Peyto's disciplined, returns driven, low cost strategy continues to reward investors willing to look beyond just the natural gas commodity to a profitable energy business with a clear vision for the future.

Annual General Meeting

Shareholders are invited to attend Peyto's AGM at 3:00 p.m. on Wednesday, June 5, 2013 at Livingston Place Conference Centre, +15 level, 222-3rd Avenue SW, Calgary, Alberta.

Darren Gee
President and CEO
May 8, 2013

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, 2013 and the audited consolidated financial statements of Peyto Exploration & Development Corp. ("Peyto" or the "Company") for the year ended December 31, 2012. 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 7, 2013. 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, 2012, Peyto's total Proved plus Probable reserves were 2,353 billion cubic feet equivalent (392.2 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, equity and available bank lines.

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

QUARTERLY FINANCIAL INFORMATION

	2013	2012				2011		
($000 except per share amounts)	**Q1**	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Total revenue (net of royalties)	122,612	111,105	95,409	80,471	93,661	104,394	98,261	91,186
Funds from operations	102,856	90,078	76,918	64,732	77,645	80,410	82,506	77,010
Per share – basic and diluted	0.69	0.62	0.54	0.47	0.56	0.60	0.62	0.58
Earnings	36,405	25,823	23,058	18,201	26,868	26,036	37,741	32,718
Per share – basic and diluted	0.25	0.18	0.16	0.13	0.19	0.19	0.28	0.25
Dividends	26,766	26,178	25,576	24,927	24,912	24,245	23,951	23,951
Per share – basic and diluted	0.18	0.18	0.18	0.18	0.18	0.18	0.18	0.18

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 March 31	
	2013	2012
Natural gas (mmcf/d)	**297.2**	220.8
Oil & natural gas liquids (bbl/d)	**5,840**	4,101
Barrels of oil equivalent (boe/d)	**55,372**	40,903
Thousand cubic feet equivalent (mmcfe/d)	**332.2**	245.4

Natural gas production averaged 297.2 mmcf/d in the first quarter of 2013, 35 percent higher than the 220.8 mmcf/d reported for the same period in 2012. Oil and natural gas liquids production averaged 5,840 bbl/d, an increase of 42 percent from 4,101 bbl/d reported in the prior year. First quarter production increased 35 percent from 245.4 mmcfe/d to 332.2 mmcfe/d. The production increases are attributable to Peyto's capital program and resulting production additions and to acquisition of Open Range Energy Corp.

Oil & Natural Gas Liquids Production by Component

	Three Months ended March 31	
	2013	2012
Condensate (bbl/d)	**2,044**	1,611
Propane (bbl/d)	**1,110**	669
Butane (bbl/d)	**1,093**	696
Pentane (bbl/d)	**1,385**	1,004
Other NGL's (bbl/d)	**208**	121
Oil & natural gas liquids (bbl/d)	**5,840**	4,101
Thousand cubic feet equivalent (mmcfe/d)	**35.0**	24.6

Commodity Prices

	Three Months ended March 31	
	2013	2012
Oil and natural gas liquids ($/bbl)	**75.72**	84.83
Hedging – ngls ($/bbl)	**0.16**	-
Oil and natural gas liquids – after hedging ($/mcf)	**75.88**	84.83
Natural gas ($/mcf)	**3.31**	2.67
Hedging – gas ($/mcf)	**0.18**	0.86

Natural gas – after hedging ($/mcf)	**3.49**	3.53

Total Hedging ($/mcfe)	**0.16**	0.77
Total Hedging ($/boe)	**0.96**	4.64

Peyto's natural gas price, before hedging gains, averaged $3.31/mcf during the first quarter of 2013, an increase of 24 percent from $2.67/mcf reported for the equivalent period in 2012. Oil and natural gas liquids prices before hedging averaged $75.88/bbl, a decrease of 11 percent from $84.83/bbl a year earlier. Hedging activity increased Peyto's achieved price/mcfe by 4% from $4.30 to $4.46 per mcfe for the quarter.

Oil & Natural Gas Liquids Prices by Component

	Three Months ended March 31	
	2013	2012
Condensate ($/bbl)	**96.63**	100.09
Propane ($/bbl)	**26.75**	31.86
Butane ($/bbl)	**61.40**	69.17
Pentane ($/bbl)	**107.13**	102.92

Revenue

	Three Months ended March 31	
($000)	**2013**	2012
Natural gas	**88,543**	53,565
Oil and natural gas liquids	**39,881**	31,656
Hedging gain	**4,779**	17,275
Total revenue	**133,203**	102,496

For the three months ended March 31, 2013, revenue increased 30 percent to $133.2 million from $102.5 million for the same period in 2012. The increase in revenue for the period was a result of increased production volumes offset by lower realized prices as detailed in the following table:

	Three Months ended March 31		
	2013	2012	**$million**
Total Revenue, March 31, 2012			**102.5**
Revenue change due to:			
Natural gas			
Volume (mmcf)	26,747	20,094	**23.5**
Price ($/mcf)	$3.49	$3.53	**(1.0)**
Oil & NGL			
Volume (mbbl)	526	373	**12.9**
Price ($/bbl)	$75.88	$84.83	**(4.7)**
Total Revenue, March 31, 2013			**133.2**

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 March 31	
($000 except per share amounts)	**2013**	2012
Royalties	**10,591**	8,835
% of sales before hedging	**8.3**	10.4
% of sales after hedging	**8.0**	8.6
$/mcfe	**0.36**	0.39
$/boe	**2.16**	2.37

For the first quarter of 2013, royalties averaged $0.36/mcfe or approximately 8% 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 January 1, 2009. These additional features include:

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

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

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 14 year history, Peyto has invested $3.0 billion in capital projects, found and developed 1.9 TCFe of gas reserves, and paid over $612 million in royalties.

Operating Costs & Transportation

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

	Three Months ended March 31	
	2013	2012
Operating costs ($000)	**9,306**	7,300
$/mcfe	**0.31**	0.33
$/boe	**1.87**	1.96
Transportation ($000)	**3,659**	2,606
$/mcfe	**0.12**	0.12
$/boe	**0.72**	0.72

Operating costs increased to $9.3 million in the first quarter of 2013 from $7.3 million for the equivalent period in 2012 due to increased production volumes and well count. On a unit-of-production basis, operating costs decreased 6% averaging $0.31/mcfe in the first quarter of 2013 compared to $0.33/mcfe for the equivalent period in 2012. Transportation expense remained relatively unchanged on a per mcfe basis.

General and Administrative Expenses

	Three Months ended March 31	
	2013	2012
G&A expenses ($000)	**3,325**	2,934
Overhead recoveries	**(2,844)**	(1,962)
Net G&A expenses	**481**	972
$/mcfe	**0.02**	0.04
$/boe	**0.12**	0.26

For the first quarter, general and administrative expenses before overhead recoveries increased 12% over the same quarter of 2012 due to increased wages and salaries costs. Capital overhead recoveries increased 35 percent for the first quarter from $2.0 million to $2.8 million due to increased capital spending**.** General and administrative expenses averaged $0.02/mcfe in the first quarter of 2013 compared to $0.04/mcfe for the equivalent period in 2012.

Interest Expense

	Three Months ended March 31	
	2013	2012
Interest expense ($000)	**6,310**	5,138
$/mcfe	**0.21**	0.23
$/boe	**1.26**	1.38
Average interest rate	**4.0%**	4.5%

First quarter 2013 interest expense was $6.3 million or $0.21/mcfe compared to $5.1 million or $0.23/mcfe for the first quarter 2012.

Netbacks

	Three Months ended March 31	
($/mcfe)	**2013**	2012
Gross Sale Price	**4.30**	3.82
Hedging gain	**0.16**	0.77
Net Sale Price	**4.46**	4.59
Less: Royalties	**0.36**	0.39
Operating costs	**0.31**	0.33
Transportation	**0.12**	0.12
Field netback	**3.67**	3.75
General and administrative	**0.02**	0.04
Interest on long-term debt	**0.21**	0.23
Cash netback ($/mcfe)	**3.44**	3.48
Cash netback ($/boe)	**20.64**	20.86

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 2013 first quarter provision for depletion, depreciation and amortization totaled $51.6 million as compared to $39.7 million in 2012 due to higher levels of production and a larger asset base. On a unit-of-production basis, depletion and depreciation costs averaged $1.73/mcfe as compared to $1.78/mcfe in 2012.

Income Taxes

The current provision for deferred income tax expense is $11.9 million (2012 - $9.0 million). Peyto paid no tax installments for the three months ended March 31, 2013 or for the comparative period in 2012. 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, 2013**	December 31, 2012	**Annual deductibility**
Canadian Oil and Gas Property Expense	257.7	263.4	10% declining balance
Canadian Development Expense	641.7	575.6	30% declining balance
Canadian Exploration Expense	182.0	181.0	100%
Undepreciated Capital Cost	263.5	228.4	25% declining balance
Non-capital loss carry forward	14.5	42.1	100%
Other	37.9	39.5	7% declining balance to 20%
Total Federal Tax Pools	**1,397.3**	1,330.0	
Additional Alberta Tax Pools	41.3	41.3	100% and 30% declining balance

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 2013, a realized hedging gain of $4.8 million was recorded as compared to $17.3 million for the equivalent period in 2012. A summary of contracts outstanding in respect of the hedging activities are as follows:

Propane **Period Hedged**	**Type**	**Monthly Volume**	**Price (USD)**
April 1, 2013 to June 30, 2013	Fixed Price	4,000 bbl	$34.86/bbl
April 1, 2013 to December 31, 2013	Fixed Price	4,000 bbl	$30.66/bbl
April 1, 2013 to December 31, 2013	Fixed Price	4,000 bbl	$32.34/bbl
April 1, 2013 to December 31, 2013	Fixed Price	4,000 bbl	$34.86/bbl
April 1, 2013 to December 31, 2013	Fixed Price	4,000 bbl	$35.39/bbl
April 1, 2013 to December 31, 2013	Fixed Price	4,000 bbl	$34.44/bbl
January 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	$35.70/bbl
January 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	$35.49/bbl

Natural Gas **Period Hedged**	**Type**	**Daily Volume**	**Price (CAD)**
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 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
May 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$2.30/GJ
August 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	$3.00/GJ
August 1, 2012 to October 31, 2014	Fixed Price	5,000 GJ	$3.10/GJ
November 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$2.60/GJ
November 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$3.005/GJ
November 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$3.00/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
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	$3.05/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	$3.02/GJ
November 1, 2012 to October 31, 2014	Fixed Price	5,000 GJ	$3.0575/GJ
January 1, 2013 to October 31, 2013	Fixed Price	5,000 GJ	$3.42/GJ
January 1, 2013 to December 31, 2013	Fixed Price	5,000 GJ	$3.105/GJ
January 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.00/GJ
January 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.02/GJ
April 1, 2013 to October 31, 2013	Fixed Price	5,000 GJ	$3.205/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.105/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.53/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.45/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.50/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.08/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.17GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.10/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.25/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.30/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.33/GJ
April 1, 2013 to October 31, 2014	Fixed Price	7,500 GJ	$3.20/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.22/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.20/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.1925/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.25/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.30/GJ
July 1, 2013 to October 31, 2013	Fixed Price	5,000 GJ	$3.34/GJ
August 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.55/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.71/GJ
November 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.50/GJ
November 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.53/GJ
November 1, 2013 to March 31, 2015	Fixed Price	5,000 GJ	$3.6025/GJ

As at March 31, 2013, Peyto had committed to the future sale of 288,000 barrels of propane at an average price of $34.61 per barrel and 82,627,500 gigajoules (GJ) of natural gas at an average price of $3.23 per GJ or $3.71 per mcf. Had these contracts been closed on March 31, 2013, Peyto would have realized a loss in the amount of $25.2 million.

Subsequent to March 31, 2013 Peyto entered into the following contracts:

Natural Gas Period Hedged	**Type**	**Daily Volume**	**Price (CAD)**
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.76/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.86/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$4.00/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.505/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.555/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.48/GJ

Commodity Price Sensitivity

Peyto's earnings are effected 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, 2013, the increase or decrease in earnings for each 100 bps (1%) change in interest rate paid on the outstanding revolving demand loan amounts to approximately $1.1 million per quarter. Average debt outstanding for the first quarter of 2013 was $625.5 million.

LIQUIDITY AND CAPITAL RESOURCES

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

	Three Months ended March 31	
($000)	**2013**	2012
Cash flows from operating activities	**92,543**	59,383
Change in non-cash working capital	**7,775**	16,367
Change in provision for performance based compensation	**2,538**	1,895
Funds from operations	**102,856**	77,645
Funds from operations per share	**0.69**	0.56

For the first quarter ended March 31, 2013, funds from operations totaled $102.9 million or $0.69 per share, as compared to $77.6 million, or $0.56 per share during the same quarter in 2012. Peyto's policy is to balance dividends to shareholders and funding for a capital program with cash flow, equity and available bank lines. Earnings and cash flow are sensitive to changes in commodity prices, exchange rates and other factors that are beyond Peyto's control. Current volatility in commodity prices creates uncertainty as to the funds from operations and capital expenditure budget. Accordingly, results are assessed throughout the year and operational plans revised as necessary to reflect the most current information.

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

Long-Term Debt

($000)	**March 31, 2013**	December 31, 2012
Bank credit facility	490,000	430,000
Senior secured notes	150,000	150,000
Balance, end of the year	**640,000**	580,000

As at March 31, 2013, the Company had a syndicated $730 million extendible revolving credit facility with a stated term date of April 28, 2013. The bank facility is made up of a $30 million working capital sub-tranche and a $700 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 the Company, 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 1.0% to prime plus 2.5% determined by the Company'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.

At March 31, 2013, $490 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, 2013, the working capital deficit was $136.0 million (including a non-cash current liability for an unrealized mark to market future hedging loss of $22.2 million).

Subsequent to March 31, 2013, Peyto has entered into a syndicated two year, unsecured, covenant based revolving credit facility in the amount of $1 billion with a stated term date of April 26, 2015. The note purchase agreement (discussed below) was amended and restated to reflect removal of security on the Senior Notes. Total borrowing capacity is now $1.15 billion.

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 is paid semi-annually in arrears.

On September 6, 2012, Peyto issued CDN $50 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 4.88% and mature on September 6, 2022. Interest is paid semi-annually in arrears.

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.

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 2013 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, 2013**	As at December 31, 2012	As at March 31, 2012
Bank credit facility	**490,000**	430,000	470,000

Senior secured notes	**150,000**	150,000	-
Working capital deficit	**135,980**	74,884	(1,710)
Financial derivative instruments	**(22,228)**	10,254	50,179
Provision for future performance based compensation	**(4,206)**	(2,677)	(5,842)
Net debt	**749,546**	662,461	512,627

Capital
Authorized: Unlimited number of voting common shares

Issued and Outstanding

Common Shares (no par value)	**Number of Common Shares**	**Amount $**
Balance, December 31, 2011	**137,960,301**	**889,115**
Common shares issued	4,628,750	115,024
Common shares issued for acquisition	5,404,007	112,187
Common shares issued by private placement	525,655	11,952
Common share issuance costs (net of tax)	-	(3,896)
Balance, December 31,2012	**148,518,713**	**1,124,382**
Common shares issued by private placement	240,210	5,742
Common share issuance costs, (net of tax)	-	(55)
Balance, March 31, 2013	**148,758,923**	**1,130,069**

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.

On August 14, 2012, Peyto issued 5,404,007 common shares which were valued at $112.2 million (net of issuance costs) ($20.76 per share) in relation to the closing of a corporate acquisition.

On December 11, 2012, Peyto closed an offering of 4,628,750 common shares at a price of $24.85 per common share, receiving proceeds of $110.0 million (net of issuance costs).

On December 31, 2012, Peyto completed a private placement of 154,550 common shares to employees and consultants for net proceeds of $3.5 million ($22.38 per share). These common shares were issued January 7, 2013.

On March 19, 2013, Peyto completed a private placement of 85,660 common shares to employees and consultants for net proceeds of $2.2 million ($26.65 per share).

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 $nil was recorded for the period ended March 31, 2013.

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, 2013, compensation costs related to 3.7 million non-vested rights (2.5% of the total number of common shares outstanding), with an average grant price of $21.93, are $2.5 million for the first quarter of 2013. Peyto records a non-cash provision for future compensation expense over the life of the rights calculated using a Black-Scholes valuation model (refer to Note 7 of the condensed financial statements for the more details). The cumulative provision totals $5.3 million.

Stock Appreciation Rights Outstanding

	To be Valued December 31, 2013			To be Valued December 31, 2014	
Vesting Date	**Number of Rights**	**Value ($)**		**Number of Rights**	**Average Grant Price ($)**
December 31, 2013	612,166	3,857,507	*	976,667	22.58
	71,667	174,000	**		
December 31, 2014	71,667	174,000	**	976,667	22.58
December 31, 2015	-	-		976,666	22.58

*Valued on December 31, 2011 at $24.75
**Valued on December 31, 2012 at $22.58

Capital Expenditures

Net capital expenditures for the first quarter of 2013 totaled $169.1 million. Exploration and development related activity represented $116.7 million (69% of total), while expenditures on facilities, gathering systems and equipment totaled $50.6 million (30% of total) and land, seismic and acquisitions/dispositions totaled $1.8 million (1% of total). The following table summarizes capital expenditures for the period:

	Three Months ended March 31	
($000)	**2013**	2012
Land	**757**	2,165
Seismic	**1,022**	636
Drilling	**75,545**	51,784
Completions	**41,203**	31,185
Equipping & Tie-ins	**14,564**	8,018
Facilities & Pipelines	**36,008**	4,844
Total Capital Expenditures	**169,099**	98,632

Dividends

	Three Months ended March 31	
	2013	2012
Funds from operations ($000)	**102,856**	77,645
Total dividends ($000)	**26,766**	24,912
Total dividends per share ($)	**0.18**	0.18
Payout ratio (%)	**26**	32

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

Contractual Obligations

Peyto has contractual obligations and commitments as follows:

	2013	**2014**	**2015**	**2016**	**2017**	**Thereafter**
Note repayment(1)	-	-	-	-	-	150,000
Interest payments(2)	3,415	6,830	6,830	6,830	6,830	18,785
Transportation commitments	10,300	13,217	9,913	5,224	1,688	1,235
Operating leases	1,258	1,694	522	-	-	-
Total	14,973	21,741	17,265	12,054	8,518	170,020

(1) Long-term debt repayment on senior secured notes
(2) Fixed interest payments on senior secured notes

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, 2013 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, 2012 were audited by independent petroleum engineers InSite Petroleum Consultants Ltd. InSite has been evaluating reserves in this area and for Peyto since inception.

Depletion and Depreciation Estimate

All costs of exploring for and developing petroleum and natural gas reserves, together with the costs of production equipment, are capitalized and then depleted and depreciated on the unit-of-production method based on 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 2013. 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
Peyto adopted the following standards on January 1, 2013:

IFRS 10 - Consolidated Financial Statements; supercedes IAS 27 "Consolidation and Separate Financial Statements" and SIC-12 "Consolidation – Special Purpose Entities". This standard provides a single model to be applied in control analysis for all investees including special purpose entities. This standard became applicable on January 1, 2013. Peyto adopted the standard on January 1, 2013, with no impact on Peyto's financial position or results of operations.

IFRS 11 - Joint Arrangements; requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting, whereas joint operations will require the venturer to recognize its share of the assets, liabilities, revenue and expenses. This standard became applicable on January 1, 2013. Peyto adopted the standard on January 1, 2013, with no impact on Peyto's financial position or results of operations.

IFRS 12 - Disclosure of Interests in Other Entities; establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off-balance-sheet vehicles. The standard carries forward existing disclosure and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities. This standard became effective for Peyto on January 1, 2013. Peyto adopted the standard on January 1, 2013, with no impact on Peyto's financial position or results of operations.

IFRS 13 - Fair Value Measurement; defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosure about fair value measurements. IFRS 13 applies to accounting standards that require or permit fair value measurements or disclosure about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosure about those measurements), except in specified circumstances. IFRS 13 became applicable on January 1, 2013. Peyto adopted the standard on January 1, 2013, with no impact on Peyto's financial position or results of operations.

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, 2012. The IASB did not issue any standards, interpretations or amendments during the first quarter of 2013.

- 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

	2013	2012			
	Q1	Q4	Q3	Q2	Q1
Operations					
Production					
Natural gas (mcf/d)	297,191	266,808	244,784	221,176	220,811
Oil & NGLs (bbl/d)	5,840	5,286	5,236	4,480	4,101
Barrels of oil equivalent (boe/d @ 6:1)	55,372	49,754	46,033	41,343	40,903
Thousand cubic feet equivalent (mcfe/d @ 6:1)	332,230	298,522	276,200	248,058	245,417
Average product prices					
Natural gas ($/mcf)	3.49	3.45	3.06	2.86	3.53
Oil & natural gas liquids ($/bbl)	75.88	73.01	68.62	71.27	84.83
$/MCFE					
Average sale price ($/mcfe)	4.46	4.38	4.01	3.83	4.59
Average royalties paid ($/mcfe)	0.36	0.34	0.26	0.26	0.39
Average operating expenses ($/mcfe)	0.31	0.31	0.35	0.29	0.33
Average transportation costs ($/mcfe)	0.12	0.11	0.11	0.12	0.12
Field netback ($/mcfe)	3.67	3.62	3.29	3.16	3.75
General & administrative expense ($/mcfe)	0.02	0.02	0.03	0.07	0.04
Interest expense ($/mcfe)	0.21	0.32	0.25	0.23	0.23
Cash netback ($/mcfe)	3.44	3.28	3.01	2.86	3.48
Financial ($000 except per share)					
Revenue	133,203	120,310	102,042	86,553	102,496
Royalties	10,591	9,205	6,632	6,082	8,835
Funds from operations	102,612	90,078	76,918	64,732	77,645
Funds from operations per share	0.69	0.62	0.54	0.47	0.56
Total dividends	26,766	26,178	25,576	24,927	24,912
Total dividends per share	0.18	0.18	0.18	0.18	0.18
Payout ratio	26%	28%	33%	39%	32%
Earnings	36,405	25,823	23,058	18,201	26,868
Earnings per diluted share	0.25	0.18	0.16	0.13	0.19
Capital expenditures	169,099	156,847	316,725	45,780	98,632
Weighted average shares outstanding	148,672,664	145,449,651	142,069,048	138,485,956	138,312,078

Peyto Exploration & Development Corp.

Condensed Balance Sheet *(unaudited)*

(Amount in $ thousands)

	March 31 2013	December 31 2012
Assets		
Current assets		
Accounts receivable	61,707	85,677
Due from private placement *(Note 6)*	-	3,459
Financial derivative instruments *(Note 8)*	-	10,254
Prepaid expenses	5,967	4,150
	67,674	**103,540**
Prepaid capital	-	3,714
Property, plant and equipment, net *(Note 3)*	2,213,713	2,096,270
	2,213,713	**2,099,984**
	2,281,387	**2,203,524**
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	168,296	164,946
Income taxes payable	-	1,890
Dividends payable *(Note 6)*	8,925	8,911
Financial derivative instruments *(Note 8)*	22,228	-
Provision for future performance based compensation *(Note 7)*	4,206	2,677
	203,655	**178,424**
Long-term debt *(Note 4)*	640,000	580,000
Long-term derivative financial instruments *(Note 8)*	2,957	2,532
Provision for future performance based compensation *(Note 7)*	1,068	59
Decommissioning provision *(Note 5)*	58,536	58,201
Deferred income taxes	177,917	174,241
	880,478	**815,033**
Equity		
Share capital *(Note 6)*	1,130,069	1,124,382
Shares to be issued *(Note 6)*	-	3,459
Retained earnings	84,886	75,247
Accumulated other comprehensive income (loss) *(Note 6)*	(17,701)	6,979
	1,197,254	**1,210,067**
	2,281,387	**2,203,524**

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 2013	2012
Revenue		
Oil and gas sales	128,424	85,221
Realized gain on hedges *(Note 8)*	4,779	17,275
Royalties	(10,591)	(8,835)
Petroleum and natural gas sales, net	**122,612**	**93,661**
Expenses		
Operating	9,306	7,300
Transportation	3,659	2,606
General and administrative	481	972
Future performance based compensation *(Note 7)*	2,538	1,895
Interest	6,310	5,138
Accretion of decommissioning provision *(Note 5)*	368	257
Depletion and depreciation *(Note 3)*	51,625	39,673
	74,287	**57,841**
Earnings before taxes	**48,325**	**35,820**
Income tax		
Deferred income tax expense	11,920	8,952
Earnings for the period	**36,405**	**26,868**
Earnings per share *(Note 6)*		
Basic and diluted	**$ 0.25**	**$ 0.19**
Weighted average number of common shares outstanding *(Note 6)*		
Basic and diluted	**148,672,664**	**138,312,078**

Peyto Exploration & Development Corp.

Condensed Statement of Comprehensive Income *(unaudited)*

(Amount in $ thousands)

	Three months ended March 31	
	2013	**2012**
Earnings for the period	**36,405**	**26,868**
Other comprehensive income		
Change in unrealized gain on cash flow hedges	(28,128)	27,116
Deferred tax recovery (expense)	8,227	(2,460)
Realized (gain) loss on cash flow hedges	(4,779)	(17,275)
Comprehensive income	**11,725**	**34,249**

Peyto Exploration & Development Corp.

Condensed Statement of Changes in Equity *(unaudited)*

(Amount in $ thousands)

	Three months ended March 31 2013	2012
Share capital, beginning of period	**1,124,382**	889,115
Common shares issued by private placement	5,742	11,952
Common shares issuance costs (net of tax)	(55)	(26)
Share capital, end of period	**1,130,069**	901,041

Common shares to be issued, beginning of period	**3,459**	9,740
Common shares issued	(3,459)	(9,740)
Common shares to be issued, end of period	**-**	-

Retained earnings, beginning of period	**75,247**	82,889
Earnings for the period	36,405	26,868
Dividends *(Note 6)*	(26,766)	(24,912)
Retained earnings, end of period	**84,886**	84,845

Accumulated other comprehensive income, beginning of period	**6,979**	33,964
Other comprehensive income (loss)	(24,680)	7,381
Accumulated other comprehensive income (loss), end of period	**(17,701)**	41,345

Total equity	**1,197,254**	1,027,231

Peyto Exploration & Development Corp.

Condensed Statement of Cash Flows *(unaudited)*

(Amount in $ thousands)

	Three months ended March 31 2013	Three months ended March 31 2012
Cash provided by (used in) operating activities		
Earnings	36,405	26,868
Items not requiring cash:		
Deferred income tax	11,920	8,952
Depletion and depreciation	51,625	39,673
Accretion of decommissioning provision	368	257
Change in non-cash working capital related to operating activities	(7,775)	(16,367)
	92,543	59,383
Financing activities		
Issuance of common shares	5,742	11,952
Issuance costs	(73)	(35)
Cash dividends paid	(26,752)	(24,881)
Increase in bank debt	60,000	-
	38,917	(12,964)
Investing activities		
Additions to property, plant and equipment	**(131,460)**	(103,643)
Net increase (decrease) in cash	**-**	(57,224)
Cash, Beginning of Period	**-**	57,224
Cash, End of Period	**-**	-

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

	2013	2012
Cash interest paid	**7,867**	4,313
Cash taxes paid	**1,890**	-

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.

On December 31, 2012, Peyto completed an amalgamation with its wholly-owned subsidiary Open Range Energy Corp. pursuant to section 184(1) of the *Business Corporations Act* (Alberta). Following the amalgamation, Peyto does not have any subsidiaries.

These financial statements were approved and authorized for issuance by the Audit Committee of Peyto on May 7, 2013.

2. Basis of presentation

The condensed financial statements have been prepared by management and reported in Canadian dollars in accordance with International Accounting Standard ("IAS") 34, "Interim Financial Reporting". These condensed financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the Company's consolidated financial statements as at and for the years ended December 31, 2012 and 2011.

Significant Accounting Policies

(a) Significant Accounting Judgments, Estimates and Assumptions

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

Except as disclosed below, 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 consolidated financial statements as at and for the years ended December 31, 2012 and 2011.

(b) Recent Accounting Pronouncements

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the International Accounting Standards Board (IASB) or International Financial Reporting Interpretations Committee (IFRIC) that are mandatory for accounting periods beginning January 1, 2013 or later periods. The affected standards are consistent with those disclosed in Peyto's consolidated financial statements as at and for the years ended December 31, 2012 and 2011.

Peyto adopted the following standards on January 1, 2013:

IFRS 10 - Consolidated Financial Statements; supercedes IAS 27 "Consolidation and Separate Financial Statements" and SIC-12 "Consolidation – Special Purpose Entities". This standard provides a single model to be applied in control analysis for all investees including special purpose entities. This standard became applicable on January 1, 2013. Peyto adopted the standard on January 1, 2013, with no impact on Peyto's financial position or results of operations.

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IFRS 12 - Disclosure of Interests in Other Entities; establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off-balance-sheet vehicles. The standard carries forward existing disclosure and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities. This standard became effective for Peyto on January 1, 2013. Peyto adopted the standard on January 1, 2013, with no impact on Peyto's financial position or results of operations.

IFRS 13 - Fair Value Measurement; defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosure about fair value measurements. IFRS 13 applies to accounting standards that require or permit fair value measurements or disclosure about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosure about those measurements), except in specified circumstances. IFRS 13 became applicable on January 1, 2013. Peyto adopted the standard on January 1, 2013, with no impact on Peyto's financial position or results of operations.

3. Property, plant and equipment, net

Cost	
At December 31, 2012	2,483,008
Additions	169,068
At March 31, 2013	2,652,076
Accumulated depreciation	
At December 31, 2012	(386,738)
Depletion and depreciation	(51,625)
At March 31, 2013	(438,363)
Carrying amount at December 31, 2012	**2,096,270**
Carrying amount at March 31, 2013	**2,213,713**

During the period ended March 31, 2013, Peyto capitalized \$2.6 million (2012 - \$1.7 million) of general and administrative expense directly attributable to production and development activities.

4. Long-term debt

	March 31, 2013	**December 31, 2012**
Bank credit facility	490,000	430,000
Senior secured notes	150,000	150,000
Balance, end of the year	**640,000**	580,000

As at March 31, 2013, the Company had a syndicated \$730 million extendible revolving credit facility with a stated term date of April 28, 2013. The bank facility is made up of a \$30 million working capital sub-tranche and a \$700 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 the Company, 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 1.0% to prime plus 2.5% determined by the Company'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.

Subsequent to March 31, 2013, Peyto has entered into a syndicated two year, unsecured, covenant based revolving credit facility in the amount of \$1 billion with a stated term date of April 26, 2015. The note purchase agreement (discussed below) was amended and restated to reflect removal of security on the Senior Notes.

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 is paid semi-annually in arrears.

On September 6, 2012, Peyto issued CDN $50 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 4.88% and mature on September 6, 2022. Interest is paid semi-annually in arrears.

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, 2013.

Total interest expense for the period ended March 31, 2013 was $6.3 million (2012 - $5.1 million) and the average borrowing rate for the period was 4.0% (2012 – 4.5%).

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, 2012	**58,201**
New or increased provisions	2,961
Accretion of decommissioning provision	368
Change in discount rate and estimates	(2,994)
Balance, March 31, 2013	**58,536**
Current	-
Non-current	58,536

Peyto has estimated the net present value of its total decommissioning provision to be $58.5 million as at March 31, 2013 ($58.2 million at December 31, 2012) based on a total future undiscounted liability of $134.8 million ($127.9 million at December 31, 2012). At March 31, 2013 management estimates that these payments are expected to be made over the next 50 years with the majority of payments being made in years 2041 to 2062. The Bank of Canada's long term bond rate of 2.50 per cent (2.36 per cent at December 31, 2012) and an inflation rate of two per cent (two per cent at December 31, 2012) were used to calculate the present value of the decommissioning provision.

6. Share capital

Authorized: Unlimited number of voting common shares

Issued and Outstanding

Common Shares (no par value)	Number of Common Shares	Amount $
Balance, December 31, 2011	137,960,301	889,115
Common shares issued	4,628,750	115,024
Common shares issued for acquisition	5,404,007	112,187
Common shares issued by private placement	525,655	11,952
Common share issuance costs (net of tax)	-	(3,896)
Balance, December 31,2012	148,518,713	1,124,382
Common shares issued by private placement	240,210	5,742
Common share issuance costs, (net of tax)	-	(55)
Balance, March 31, 2013	**148,758,923**	**1,130,069**

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).

On August 14, 2012, Peyto issued 5,404,007 common shares which were valued at $112.2 million (net of issuance costs) ($20.76 per share) in relation to the closing of a corporate acquisition.

On December 11, 2012, Peyto closed an offering of 4,628,750 common shares at a price of $24.85 per common share, receiving proceeds of $110.0 million (net of issuance costs).

On December 31, 2012, Peyto completed a private placement of 154,550 common shares to employees and consultants for net proceeds of $3.5 million ($22.38 per share). These common shares were issued January 7, 2013.

On March 19, 2013, Peyto completed a private placement of 85,660 common shares to employees and consultants for net proceeds of $2.2 million ($26.65 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, 2013 of 148,672,664 (2012 – 138,312,078). There are no dilutive instruments outstanding.

Dividends

During the period ended March 31, 2013, Peyto declared and paid dividends of $0.18 per common share or $0.06 per common share per month, totaling $26.8 million (2012 - $0.18 or $0.06 per share per month, $24.9 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, 2013	**March 31, 2012**
Share price	\$22.58 - \$26.94	\$16.38 -\$24.75
Exercise price	\$19.30 - \$22.58	\$12.06 - \$24.75
Expected volatility	25%	31%
Option life	1 year	1 year
Dividend yield	0%	0%
Risk-free interest rate	1.02%	1.19%

8. Financial instruments

Financial instrument classification and measurement
Financial instruments of the Company carried on the condensed balance sheet are carried at amortized cost with the exception of cash and financial derivative instruments, specifically fixed price contracts, which are carried at fair value. There are no significant differences between the carrying amount of financial instruments and their estimated fair values as at March 31, 2013.

The Company's areas of financial risk management and risks related to financial instruments remained unchanged from December 31, 2012.

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

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

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

Fair values of financial assets and liabilities
The Company's financial instruments include cash, accounts receivable, financial derivative instruments, due from private placement, current liabilities, provision for future performance based compensation and long-term debt. At March 31, 2013, cash and financial derivative instruments are carried at fair value. Accounts receivable, due from private placement, current liabilities and provision for future performance based compensation approximate their fair value due to their short term nature. The carrying value of the long-term debt approximates its fair value due to the floating rate of interest charged under the credit facility.

Commodity price risk management

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

Following is a summary of all risk management contracts in place as at March 31, 2013:

Propane Period Hedged	Type	Monthly Volume	Price (USD)
April 1, 2013 to June 30, 2013	Fixed Price	4,000 bbl	$34.86/bbl
April 1, 2013 to December 31, 2013	Fixed Price	4,000 bbl	$30.66/bbl
April 1, 2013 to December 31, 2013	Fixed Price	4,000 bbl	$32.34/bbl
April 1, 2013 to December 31, 2013	Fixed Price	4,000 bbl	$34.86/bbl
April 1, 2013 to December 31, 2013	Fixed Price	4,000 bbl	$35.39/bbl
April 1, 2013 to December 31, 2013	Fixed Price	4,000 bbl	$34.44/bbl
January 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	$35.70/bbl
January 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	$35.49/bbl

Natural Gas Period Hedged	Type	Daily Volume	Price (CAD)
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 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
May 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$2.30/GJ
August 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	$3.00/GJ
August 1, 2012 to October 31, 2014	Fixed Price	5,000 GJ	$3.10/GJ
November 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$2.60/GJ
November 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$3.005/GJ
November 1, 2012 to October 31, 2013	Fixed Price	5,000 GJ	$3.00/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
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	$3.05/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	$3.02/GJ
November 1, 2012 to October 31, 2014	Fixed Price	5,000 GJ	$3.0575/GJ
January 1, 2013 to October 31, 2013	Fixed Price	5,000 GJ	$3.42/GJ
January 1, 2013 to December 31, 2013	Fixed Price	5,000 GJ	$3.105/GJ
January 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.00/GJ
January 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.02/GJ
April 1, 2013 to October 31, 2013	Fixed Price	5,000 GJ	$3.205/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.105/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.53/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.45/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.50/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.08/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.17GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.10/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.25/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.30/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.33/GJ
April 1, 2013 to October 31, 2014	Fixed Price	7,500 GJ	$3.20/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.22/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.20/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.1925/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.25/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.30/GJ
July 1, 2013 to October 31, 2013	Fixed Price	5,000 GJ	$3.34/GJ
August 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.55/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.71/GJ
November 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.50/GJ

November 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	$3.53/GJ
November 1, 2013 to March 31, 2015	Fixed Price	5,000 GJ	$3.6025/GJ

As at March 31, 2013, Peyto had committed to the future sale of 288,000 barrels of propane at an average price of $34.61 per barrel and 82,627,500 gigajoules (GJ) of natural gas at an average price of $3.23 per GJ or $3.71 per mcf. Had these contracts been closed on March 31, 2013, Peyto would have realized a loss in the amount of $25.2 million. If the AECO gas price on March 31, 2013 were to increase by $1/GJ, the unrealized loss would increase by approximately $82.6 million. An opposite change in commodity prices rates would result in an opposite impact on other comprehensive income.

Subsequent to March 31, 2013 Peyto entered into the following contracts:

Natural Gas Period Hedged	**Type**	**Daily Volume**	**Price (CAD)**
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.76/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.86/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$4.00/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.505/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.555/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.48/GJ

9. Commitments

Following is a summary of Peyto's contractual obligations and commitments as at March 31, 2013.

	2013	**2014**	**2015**	**2016**	**2017**	**Thereafter**
Note repayment[1]	-	-	-	-	-	150,000
Interest payments[2]	3,415	6,830	6,830	6,830	6,830	18,785
Transportation commitments	10,300	13,217	9,913	5,224	1,688	1,235
Operating leases	1,258	1,694	522	-	-	-
Total	14,973	21,741	17,265	12,054	8,518	170,020

(1) Long-term debt repayment on senior secured notes

(2) Fixed interest payments on senior secured notes

Officers

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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

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Deloitte LLP

Solicitors

Burnet, Duckworth & Palmer LLP

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Royal Bank of Canada
Canadian Imperial Bank of Commerce
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