PEYTO

Exploration & Development Corp.

2

Interim Report
for the three and six months ended June 30, 2013

Highlights

	Three Months ended June 30		%	Six Months ended June 30		%
	2013	2012	Change	**2013**	2012	Change
Operations						
Production						
Natural gas (mcf/d)	**310,621**	221,176	*40%*	**303,943**	220,994	*38%*
Oil & NGLs (bbl/d)	**6,374**	4,480	*42%*	**6,109**	4,291	*42%*
Thousand cubic feet equivalent (mcfe/d @ 1:6)	**348,868**	248,058	*41%*	**340,595**	246,737	*38%*
Barrels of oil equivalent (boe/d @ 6:1)	**58,145**	41,343	*41%*	**56,766**	41,123	*38%*
Product prices						
Natural gas ($/mcf)	**3.72**	2.86	*30%*	**3.61**	3.19	*13%*
Oil & NGLs ($/bbl)	**67.82**	71.27	*(5)%*	**71.65**	77.75	*(8)%*
Operating expenses ($/mcfe)	**0.35**	0.29	*21%*	**0.33**	0.31	*6%*
Transportation ($/mcfe)	**0.12**	0.12	-	**0.12**	0.12	-
Field netback ($/mcfe)	**3.77**	3.16	*19%*	**3.72**	3.45	*8%*
General & administrative expenses ($/mcfe)	**0.05**	0.07	*(29)%*	**0.04**	0.06	*(33)%*
Interest expense ($/mcfe)	**0.25**	0.23	*9%*	**0.23**	0.22	*5%*
Financial ($000 except per share)						
Revenue	**144,614**	86,553	*67%*	**277,816**	189,049	*47%*
Royalties	**9,849**	6,082	*62%*	**20,440**	14,917	*37%*
Funds from operations	**109,987**	64,732	*70%*	**212,844**	142,377	*49%*
Funds from operations per share	**0.74**	0.47	*57%*	**1.43**	1.03	*39%*
Total dividends	**32,727**	24,927	*31%*	**59,493**	49,839	*19%*
Total dividends per share	**0.22**	0.18	*31%*	**0.40**	0.36	*11%*
Payout ratio	**30**	39	*(23)%*	**28**	35	*(20)%*
Earnings	**37,773**	18,201	*108%*	**74,179**	45,069	*65%*
Earnings per diluted share	**0.25**	0.13	*92%*	**0.50**	0.33	*52%*
Capital expenditures	**73,809**	45,924	*61%*	**242,908**	144,551	*68%*
Weighted average common shares outstanding	**148,758,923**	138,485,956	*7%*	**148,716,032**	138,399,017	*7%*
As at June 30						
Net debt (before future compensation expense and unrealized hedging gains)				**746,094**	519,328	*44%*
Shareholders' equity				**1,227,842**	999,057	*23%*
Total assets				**2,328,117**	1,789,210	*30%*

	Three Months ended June 30		Six Months ended June 30	
($000)	**2013**	2012	**2013**	2012
Cash flows from operating activities	**96,700**	74,551	**189,243**	133,934
Change in non-cash working capital	**6,728**	(10,934)	**14,504**	5,433
Change in provision for performance based compensation	**6,559**	1,115	**9,097**	3,010
Funds from operations	**109,987**	64,732	**212,844**	142,377
Funds from operations per share	**0.74**	0.47	**1.43**	1.03

(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 International Financial Reporting Standards ("IFRS") and does not have a standardized meaning prescribed by IFRS. 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 IFRS. Funds from operations cannot be assured and future dividends may vary.

Report from the president

Peyto Exploration & Development Corp. ("Peyto") is pleased to present its operating and financial results for the second quarter of the 2013 fiscal year. Peyto's production per share grew for the fifteenth consecutive quarter with second quarter operating margins of 76%(1) and profit margins of 26%(2). Second quarter 2013 highlights included:

- **Production per share up 31%.** Production increased 41% (31% per share) from 248 MMcfe/d (41,343 boe/d) in Q2 2012 to 349 MMcfe/d (58,145 boe/d) in Q2 2013, setting a new company record. Current production is approximately 60,000 boe/d.

- **Funds from operations per share up 57%.** Funds from Operations ("FFO") grew 70% (57% per share) from $65 million in Q2 2012 to $110 million in Q2 2013 due to increases in both production and natural gas price, also a new company record.

- **Operating costs of $2/boe.** Industry leading operating costs of $0.35/mcfe ($2.10/boe) for Q2 2013 were up slightly from $0.29/mcfe for Q2 2012 mostly due to an increase in power prices. Total cash costs, including royalties, operating costs, transportation, G&A and interest were $1.09/mcfe ($6.54/boe), resulting in a $3.47/mcfe ($20.82/boe) cash netback or 76% operating margin. Peyto has maintained this industry leading operating margin, in excess of 75%, for the past three years.

- **Capital investment of $74 million**. A total of 13 wells were drilled in the second quarter. During the quarter Peyto drilled its 245th horizontal well in the Deep Basin marking 1.0 million meters using the new horizontal multi-stage frac technology.

- **Earnings of $0.25/share, dividends of $0.22/share.** Earnings of $38 million were generated in the quarter while dividends of $33 million were paid to shareholders, representing a before tax payout ratio of 30% of FFO. The monthly dividend was increased in May 2013 from $0.06/share to $0.08/share.

Second Quarter 2013 in Review

The second quarter of 2013 was a period of reduced operational activity for Peyto due to a prolonged spring break-up and higher than normal rainfall. Southwestern Alberta experienced twice the normal rainfall in June causing wet surface conditions and flooding in many areas. As a result, much of Peyto's June drilling and completion operations were delayed to late July. Consequently, company record production levels of 60,000 boe/d, which were achieved in April, declined throughout the quarter as no new wells were connected. Peyto was able to advance three facility projects in the quarter, however, which together will increase total company processing capacity from 440 MMcf/d to 520 MMcf/d by Q4 2013. Realized natural gas prices improved from the previous quarter to almost double that of the previous year and when combined with increased average production drove company funds from operations to record levels. Peyto improved its financial flexibility in the quarter with an expanded credit facility and an increase in total borrowing capacity to $1.15 billion. At quarter end, 65% of this capacity was utilized resulting in a net debt to annualized FFO ratio of 1.7 times, down from 2.0 times in Q2 2012, and leaving over $400 million undrawn. 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

Second quarter drilling activity focused on the Greater Sundance core area and the many liquids rich, sweet gas resource plays currently under development. A total of 13 wells were drilled across this land base, targeting the prospective zones shown in the following table:

Q2 2013	Field							Total
Zone	Sundance	Nosehill	Wildhay	Ansell	Berland	Kisku/ Kakwa	New Area	Wells Drilled
Cardium	2							2
Notikewin				1				1
Falher	2		1					3
Wilrich	1	1	3					5
Bluesky	2							2
Total	7	1	4	1				13

Both the Bluesky and Falher formations continue to prove up significant additional inventory with each successful well drilled. To date Peyto has drilled and brought onto production ten Bluesky horizontal wells, which combined, currently contribute 5,000 boe/d to company total production. An additional 5 Bluesky wells are planned for the remainder of the year. As well, both Upper and Middle Falher horizontal wells, of which 26 have been brought on production in the last year, are contributing 8,000 boe/d currently, up from 3,000 boe/d a year ago. Peyto has plans to drill 10-15 Falher wells to the end of the year.

Over the past year and a half, Peyto has assembled a significant land base in a new core area in Brazeau River. In total, 98.5 sections (91.6 net) of contiguous land was purchased with previously identified prospectivity in the Spirit River section including the Notikewin, Falher and Wilrich formations. Average land cost to date has been less than $300/net acre of mineral rights. Thus far, Peyto has drilled three Wilrich wells with initial results that are comparable to those achieved in the Greater Sundance area. As well, Peyto has begun construction on a new 20 MMcf/d gas facility in the area, which should be operational by early November 2013. Peyto is encouraged by the initial results to date and the significant drilling inventory currently identified on these lands. Management believes capital invested in this area will meet or exceed Peyto's high return objectives. For the balance of the year, one drilling rig will be active in the Brazeau area.

Capital Expenditures

During the second quarter of 2013, Peyto spent $32.3 million to drill 13 gross (12.3 net) horizontal wells and $10.1 million completing 9 gross (8.0 net) wells. Wellsite equipment and tie-ins accounted for $7.3 million, to bring on production 11 gross (10.0 net) wells. Two major pipeline projects were completed early in the quarter in the Ansell and Berland areas, accounting for $4.1 million, which allowed Peyto to redirect existing production to owned facilities and lower cost processing alternatives. Ongoing progress on the three new gas plants that Peyto is constructing in 2013, at Oldman North, Swanson and Brazeau, accounted for remainder of the $18.5 million in pipeline and facilities capital.

Peyto invested $5.0 million into new lands in the quarter, primarily in the Brazeau, Berland and Sundance areas, as well as $0.6 million in new seismic, adding a significant number of new drilling locations to Peyto's vast, liquids rich, deep basin inventory.

Financial Results

Alberta daily natural gas prices averaged $3.35/GJ in Q2 2013, up 86% from Q2 2012, resulting in a Peyto unhedged realized price of $3.85/mcf before hedging losses of $0.13/mcf. Meanwhile, Edmonton light oil prices averaged $92.62/bbl from which Peyto realized $68.08/bbl, before hedging losses of $0.26/bbl, for its natural gas liquids blend of condensate, pentane, butane and propane. Combined, Peyto's unhedged revenues totaled $4.68/mcfe ($4.56/mcfe including hedging losses), or 138% of the dry gas price, illustrating the benefit of high heat content, liquids rich natural gas production.

Royalties of \$0.32/mcfe, operating costs of \$0.35/mcfe, transportation costs of \$0.12/mcfe, G&A of \$0.05/mcfe and interest costs of \$0.25/mcfe, combined for total cash costs of \$1.09/mcfe. These industry leading total cash costs resulted in a cash netback of \$3.47/mcfe or a 76% operating margin.

Depletion, depreciation and amortization charges of \$1.68/mcfe, along with a provision for future tax and market based bonus payments reduced the cash netback to earnings of \$1.19/mcfe, or a 26% profit margin.

During the second 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. Including the \$150 million of senior unsecured notes, Peyto's total borrowing capacity increased to \$1.15 billion.

Marketing

AECO daily natural gas price was much improved in the second quarter of 2013. This was due to a more typical storage balance entering the spring "shoulder season" than the previous year's excess. Both AECO and NYMEX futures prices for natural gas, however, are forecast to rise by less than 7% per year for the next five years on the expectation that ample supplies of natural gas are available for growing demand.

Approximately 57% of Peyto's (after royalty) natural gas production had been pre-sold for Q2 2013, at an average fixed price of \$3.19/GJ. This was the result of an active hedging program which layers in future sales in the form of fixed price swaps in order to smooth out the volatility in natural gas price.

Going forward, Peyto has committed to the future sale of 75,045,000 GJ of natural gas at an average price of \$3.34/GJ. As at August 12, 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	27,435,000	23,856,522	3.25	3.74
2014	44,010,000	38,269,565	3.37	3.88
2015	3,600,000	3,130,435	3.60	4.14
Total	75,045,000	65,256,522	3.34	3.84

As illustrated in the following table, Peyto's hedged realized natural gas liquids prices (1) were down 4% year over year and 10% from the previous quarter.

	Three Months ended June 30		Q1
	2013	2012	2013
Condensate (\$/bbl)	**92.44**	94.49	96.63
Propane (\$/bbl)	**23.70**	19.50	26.75
Butane (\$/bbl)	**48.12**	64.05	61.40
Pentane (\$/bbl)	**100.37**	97.95	107.13
Total Oil and NGLs (\$/bbl)	**68.08**	71.27	75.72

(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 of August 13, 2013, Peyto had committed to the future sale of 236,544 bbls of propane at an average price of \$35.69USD/bbl. As at August 12, 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	104,544	34.26
2014	132,000	36.94
Total	236,544	35.76

Activity Update

Since exiting the second quarter of 2013, Peyto has completed an additional 18 wells, 16 that have been brought on production, which has increased production from July’s 53,500 boe/d average to approximately 60,000 boe/d currently. The remaining wells will be tied in and producing by the end of August. In addition, 10 wells are currently drilled and waiting on completion, while ten drilling rigs are actively working in Peyto’s core Deep Basin areas drilling approximately 14 wells per month. There is also 2,500 boe/d of productive capability waiting on the new Brazeau processing facility, expected in Q4 2013.

On July 7, 2013, Peyto rig released its 245th horizontal well, marking the point at which Peyto had drilled over 1.0 million meters using horizontal well technology. Since the summer of 2009 when Peyto spud its first horizontal well in the Deep Basin, the combination of horizontal wells with multi-stage fracture stimulation technology has helped Peyto become one of the fastest growing E&P companies in Canada, effectively tripling corporate production over that time. The experience and knowledge gained from this activity makes Peyto one of the most proficient drillers in the Deep Basin.

Outlook

Near term Alberta natural gas prices have recently come under pressure due to high transportation tariffs and competition from North Eastern US supplies, however, the long term importance of natural gas in North America continues to increase. Alberta natural gas prices are currently forecast to recover to above $3/GJ by this coming winter season.

Based on continued profitability at these levels and at the current pace of activity, management believes that year end 2013 production will exceed the previous 67,000 boe/d exit guidance, once again achieving capital efficiencies of less than $18,000/boe/d.

Peyto’s high level of ownership and control, combined with a lean team, allows the company to be nimble with the ability to slow down or increase activity as market conditions dictate, taking advantage of opportunities to maximize shareholder returns. The low cost structure and high operating margins combined with a strong hedge book mean Peyto is also financially well positioned to withstand continued volatility in natural gas prices. As always, Peyto will maintain a strong balance sheet while only pursuing capital investments if its high return objectives can be met.

Darren Gee
President and CEO
August 13, 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 June 30, 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 August 12, 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)	**Q2**	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Total revenue (net of royalties)	**134,765**	122,612	111,105	95,409	80,471	93,661	104,394	98,261
Funds from operations	**109,987**	102,856	90,078	76,918	64,732	77,645	80,410	82,506
Per share – basic and diluted	**0.74**	0.69	0.62	0.54	0.47	0.56	0.60	0.62
Earnings	**37,773**	36,405	25,823	23,058	18,201	26,868	26,036	37,741
Per share – basic and diluted	**0.25**	0.25	0.18	0.16	0.13	0.19	0.19	0.28
Dividends	**32,727**	26,766	26,178	25,576	24,927	24,912	24,245	23,951
Per share – basic and diluted	**0.22**	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 June 30		Six Months ended June 30	
	2013	2012	**2013**	2012
Natural gas (mmcf/d)	**310.6**	221.2	**303.9**	221.0
Oil & natural gas liquids (bbl/d)	**6,374**	4,480	**6,109**	4,291
Barrels of oil equivalent (boe/d)	**58,145**	41,343	**56,766**	41,123
Thousand cubic feet equivalent (mmcfe/d)	**348.9**	248.1	**340.6**	246.7

Natural gas production averaged 310.6 mmcf/d in the second quarter of 2013, 40 percent higher than the 221.2 mmcf/d reported for the same period in 2012. Oil and natural gas liquids production averaged 6,374 bbl/d, an increase of 42 percent from 4,480 bbl/d reported in the prior year. Second quarter production increased 41 percent from 248.1 mmcfe/d to 348.9 mmcfe/d. The production increases are attributable to Peyto's capital program and resulting production additions (75%) and to the August 14, 2012 acquisition of Open Range Energy Corp (25%).

Oil & Natural Gas Liquids Production by Component

	Three Months ended June 30		Six Months ended June 30	
	2013	2012	**2013**	2012
Condensate (bbl/d)	**2,362**	1,544	**2,206**	1,577
Propane (bbl/d)	**1,410**	858	**1,258**	763
Butane (bbl/d)	**1,235**	868	**1,161**	782
Pentane (bbl/d)	**1,189**	1,090	**1,280**	1,047
Other NGL's (bbl/d)	**178**	120	**204**	122
Oil & natural gas liquids (bbl/d)	**6,374**	4,480	**6,109**	4,291
Thousand cubic feet equivalent (mmcfe/d)	**38.2**	26.9	**36.7**	25.7

Commodity Prices

	Three Months ended June 30		Six Months ended June 30	
	2013	2012	**2013**	2012
Oil and natural gas liquids ($/bbl)	**68.08**	71.27	71.71	77.75
Hedging – ngls ($/bbl)	**(0.26)**	-	**(0.06)**	-
Oil and natural gas liquids – after hedging ($/mcf)	**67.82**	71.27	**71.65**	77.75

Natural gas ($/mcf)	**3.85**	1.98	**3.59**	2.32
Hedging – gas ($/mcf)	**(0.13)**	0.88	**0.02**	0.87
Natural gas – after hedging ($/mcf)	**3.72**	2.86	**3.61**	3.19
Total Hedging ($/mcfe)	**(0.12)**	0.78	**0.02**	0.78
Total Hedging ($/boe)	**(0.72)**	4.70	**0.12**	4.67

Peyto's natural gas price, before hedging, averaged $3.85/mcf during the second quarter of 2013, an increase of 94 percent from $1.98/mcf reported for the equivalent period in 2012. Oil and natural gas liquids prices before hedging averaged $68.08/bbl, a decrease of 4 percent from $71.27/bbl a year earlier. Hedging activity decreased Peyto's achieved price/mcfe by 2% from $4.68 to $4.56 per mcfe for the quarter.

Oil & Natural Gas Liquids Prices by Component

	Three Months ended June 30		Six Months ended June 30	
	2013	2012	**2013**	2012
Condensate ($/bbl)	**92.44**	94.49	**94.37**	99.82
Propane ($/bbl) (includes hedging)	**23.70**	19.50	**25.04**	25.60
Butane ($/bbl) (includes hedging)	**48.12**	64.05	**54.34**	67.82
Pentane ($/bbl)	**100.37**	97.95	**104.04**	102.70

Revenue

	Three Months ended June 30		Six Months ended June 30	
($000)	**2013**	2012	**2013**	2012
Natural gas	**108,970**	39,823	**197,597**	93,388
Oil and natural gas liquids	**39,496**	29,056	**79,292**	60,711
Hedging gain (loss)	**(3,852)**	17,674	**927**	34,949
Total revenue	**144,614**	86,553	**277,816**	189,048

For the three months ended June 30, 2013, revenue increased 67 percent to $144.6 million from $86.6 million for the same period in 2012. The increase in revenue for the period was a result of increased production volumes and natural gas prices offset by lower oil and natural gas liquids prices as detailed in the following table:

	Three Months ended June 30			Six Months ended June 30		
	2013	2012	**$million**	2013	2012	**$million**
Total Revenue, June 30, 2012			**86.6**			**189.0**
Revenue change due to:						
Natural gas						
Volume (mmcf)	28,267	20,127	**23.3**	55,014	40,221	**47.2**
Price ($/mcf)	$3.72	$2.86	**24.3**	$3.61	$3.19	**23.1**
Oil & NGL						
Volume (mbbl)	580	408	**12.3**	1,106	781	**25.2**
Price ($/bbl)	$67.82	$71.27	**(1.9)**	$71.65	$77.75	**(6.7)**
Total Revenue, June 30, 2013			**144.6**			**277.8**

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 June 30		Six Months ended June 30	
($000 except per share amounts)	**2013**	2012	**2013**	2012
Royalties	**9,849**	6,082	**20,440**	14,917
% of sales before hedging	**6.6**	8.8	**7.4**	9.7
% of sales after hedging	**6.8**	7.0	**7.4**	7.9
$/mcfe	**0.32**	0.26	**0.34**	0.33
$/boe	**1.92**	1.56	**2.04**	1.99

For the second quarter of 2013, royalties averaged $0.32/mcfe or approximately 6.8% 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 $3.1 billion in capital projects, found and developed 1.9 TCFe of gas reserves, and paid over $622 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		Six Months ended June 30	
	2013	2012	**2013**	2012
Operating costs ($000)	**11,242**	6,603	**20,548**	13,904
$/mcfe	**0.35**	0.29	**0.33**	0.31
$/boe	**2.10**	1.76	**1.98**	1.66
Transportation ($000)	**3,796**	2,645	**7,455**	5,251
$/mcfe	**0.12**	0.12	**0.12**	0.12
$/boe	**0.72**	0.70	**0.72**	0.70

Operating costs increased to $11.2 million in the second quarter of 2013 from $6.6 million for the equivalent period in 2012 due to increased production volumes and well count. On a unit-of-production basis, operating costs increased 21% averaging $0.35/mcfe in the second quarter of 2013 compared to $0.29/mcfe for the equivalent period in 2012. This increase on a per unit basis was primarily attributable to increased electricity prices. Transportation expense remained unchanged on a per mcfe basis.

General and Administrative Expenses

	Three Months ended June 30		Six Months ended June 30	
	2013	2012	**2013**	2012
G&A expenses ($000)	**3,690**	2,810	**7,014**	5,744
Overhead recoveries	**(1,973)**	(1,171)	**(4,817)**	(3,134)
Net G&A expenses	**1,717**	1,639	**2,197**	2,610
$/mcfe	**0.05**	0.07	**0.04**	0.06
$/boe	**0.30**	0.44	**0.24**	0.35

For the second quarter, general and administrative expenses before overhead recoveries increased 31% over the same quarter of 2012 due to increased salary and benefit costs associated with increased staff levels. Capital overhead recoveries increased 68 percent for the second quarter from $1.2 million to $2.0 million due to increased capital spending**.** General and administrative expenses averaged $0.05/mcfe in the second quarter of 2013 compared to $0.07/mcfe for the equivalent period in 2012.

Interest Expense

	Three Months ended June 30		Six Months ended June 30	
	2013	2012	**2013**	2012
Interest expense ($000)	**8,022**	4,996	**14,332**	10,134
$/mcfe	**0.25**	0.23	**0.23**	0.22
$/boe	**1.50**	1.38	**1.38**	1.32
Average interest rate	**4.2%**	4.1%	**4.1%**	4.3%

Second quarter 2013 interest expense was $8.0 million or $0.25/mcfe compared to $5.0 million or $0.23/mcfe for the second quarter 2012.

Netbacks

	Three Months ended June 30		Six Months ended June 30	
($/mcfe)	**2013**	2012	**2013**	2012
Gross Sale Price	**4.68**	3.05	**4.49**	3.82
Hedging gain (loss)	**(0.12)**	0.78	**0.02**	0.77
Net Sale Price	**4.56**	3.83	**4.51**	4.59
Less: Royalties	**0.32**	0.26	**0.34**	0.39
Operating costs	**0.35**	0.29	**0.33**	0.33
Transportation	**0.12**	0.12	**0.12**	0.12
Field netback	**3.77**	3.16	**3.72**	3.75
General and administrative	**0.05**	0.07	**0.04**	0.04
Interest on long-term debt	**0.25**	0.23	**0.23**	0.23
Cash netback ($/mcfe)	**3.47**	2.86	**3.45**	3.48
Cash netback ($/boe)	**20.82**	17.17	**20.70**	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 second quarter provision for depletion, depreciation and amortization totaled $53.3 million as compared to $39.1 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 $1.68/mcfe as compared to $1.73/mcfe in 2012.

Income Taxes

The current provision for deferred income tax expense is $12.0 million (2012 - $15.0 million). Peyto paid no tax installments for the three months ended June 30, 2013 or for the comparative period in 2012. Resource pools are generated from the capital program, which are available to offset income tax liabilities.

Income Tax Pool type ($ millions)	**June 30, 2013**	December 31, 2012	**Annual deductibility**
Canadian Oil and Gas Property Expense	255.8	263.4	10% declining balance
Canadian Development Expense	625.0	575.6	30% declining balance
Canadian Exploration Expense	171.0	181.0	100%
Undepreciated Capital Cost	272.4	228.4	25% declining balance
Non-capital loss carry forward	24.9	42.1	100%
Other	36.1	39.5	7% declining balance to 20%
Total Federal Tax Pools	**1,385.2**	1,330.0	
Additional Alberta Tax Pools	44.9	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 second quarter of 2013, a realized hedging loss of $3.8 million was recorded as compared to a gain of $17.7 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 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	$34.885/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 March 31, 2014	Fixed Price	4,000 bbl	$37.80/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	$35.485/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 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
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.52/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
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
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.82/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.44/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.52/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.81/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.90/GJ

As at June 30, 2013, Peyto had committed to the future sale of 228,000 barrels of propane at an average price of $35.05 US per barrel and 78,325,000 gigajoules (GJ) of natural gas at an average price of $3.31 per GJ or $3.81 per mcf. Had these contracts been closed on June 30, 2013, Peyto would have realized a gain in the amount of $8.9 million.

Subsequent to June 30, 2013 Peyto entered into the following contracts:

Propane Period Hedged	**Type**	**Monthly Volume**	**Price (USD)**
October 1, 2013 to December 31, 2013	Fixed Price	4,000 bbl	$39.774/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	$36.54/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	$39.354/bbl

Natural Gas Period Hedged	**Type**	**Daily Volume**	**Price (CAD)**
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.4725/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.525/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.60/GJ

Commodity Price Sensitivity

Peyto's earnings are affected 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 June 30, 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 $1.4 million per quarter. Average debt outstanding for the second quarter of 2013 was $674.5 million.

LIQUIDITY AND CAPITAL RESOURCES

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

($000)	Three Months ended June 30 **2013**	2012	Six Months ended June 30 **2013**	2012
Cash flows from operating activities	**96,700**	74,551	**189,243**	133,934
Change in non-cash working capital	**6,728**	(10,934)	**14,504**	5,433
Change in provision for performance based compensation	**6,559**	1,115	**9,097**	3,010
Funds from operations	**109,987**	64,732	**212,844**	142,377
Funds from operations per share	**0.74**	0.47	**1.43**	1.03

For the second quarter ended June 30, 2013, funds from operations totaled $110.0 million or $0.74 per share, as compared to $64.7 million, or $0.47 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)	**June 30, 2013**	December 31, 2012
Bank credit facility	600,000	430,000
Senior unsecured notes	150,000	150,000
Balance, end of the period	**750,000**	580,000

As at June 30, 2013, the Company had a syndicated unsecured $1.0 billion extendible revolving credit facility with a stated term date of April 26, 2015. The bank facility is made up of a $30 million working capital sub-tranche and a $970 million production line. The facilities are available on a revolving basis for a two year period. Outstanding amounts on this facility will bear interest at rates ranging from prime plus 0.8% to prime plus 2.25% 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.

On January 3, 2012, Peyto issued CDN $100 million of senior unsecured 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 unsecured 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 unsecured 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 June 30, 2013**	As at December 31, 2012	As at June 30, 2012
Bank credit facility	**600,000**	430,000	395,000
Senior unsecured notes	**150,000**	150,000	100,000
Working capital deficit	**(2,497)**	74,884	3,492
Financial derivative instruments	**7,139**	10,254	27,409
Provision for future performance based compensation	**(8,548)**	(2,677)	(6,573)
Net debt	**746,094**	662,461	519,328

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, June 30, 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 $1.2 million was recorded for the period ended June 30, 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 June 30, 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 $22.01, are $5.4 million for the second 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 $8.9 million.

Stock Appreciation Rights Outstanding

	Valued but Not Paid			To be Valued December 31, 2013	
Vesting Date	**Number of Rights**	**Value ($)**		**Number of Rights**	**Average Grant Price ($)**
December 31, 2013	612,166	3,857,507	*	981,667	22.68
	71,667	174,000	**		
December 31, 2014	71,667	174,000	**	981,667	22.68
December 31, 2015	-	-		981,666	22.68

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

Capital Expenditures

Net capital expenditures for the second quarter of 2013 totaled $73.8 million. Exploration and development related activity represented $42.4 million (57% of total), while expenditures on facilities, gathering systems and equipment totaled $25.7 million (35% of total) and land, seismic and acquisitions/dispositions totaled $5.7 million (8% of total). The following table summarizes capital expenditures for the period:

	Three Months ended June 30		Six Months ended June 30	
($000)	**2013**	2012	**2013**	2012
Land	**3,211**	1,172	**3,968**	3,337
Seismic	**667**	24	**1,689**	660
Drilling	**32,257**	23,110	**107,802**	74,895
Completions	**10,117**	14,318	**51,320**	45,503
Equipping & Tie-ins	**7,264**	4,819	**21,828**	13,357
Facilities & Pipelines	**18,478**	2,485	**54,486**	6,809
Acquisitions	**1,815**	-	**1,815**	-
Dispositions	**-**	(4)	**-**	(4)
Total Capital Expenditures	**73,809**	45,924	**242,908**	144,557

Dividends

	Three Months ended June 30		Six Months ended June 30	
	2013	2012	**2013**	2012
Funds from operations ($000)	**109,987**	64,732	**212,844**	142,377
Total dividends ($000)	**32,727**	24,927	**59,493**	49,839
Total dividends per share ($)	**0.22**	0.18	**0.40**	0.36
Payout ratio (%)	**30**	39	**28**	35

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	6,993	13,338	10,059	5,177	1,685	1,235
Operating leases	1,126	2,392	1,228	712	360	-
Total	11,534	22,560	18,117	12,719	8,875	170,020

(1) Long-term debt repayment on senior unsecured notes
(2) Fixed interest payments on senior unsecured 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 yearend 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 June 30, 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 second 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		
	Q2	Q1	Q4	Q3	Q2
Operations					
Production					
Natural gas (mcf/d)	310,621	297,191	266,808	244,784	221,176
Oil & NGLs (bbl/d)	6,374	5,840	5,286	5,236	4,480
Barrels of oil equivalent (boe/d @ 6:1)	58,145	55,372	49,754	46,033	41,343
Thousand cubic feet equivalent (mcfe/d @ 6:1)	348,868	332,230	298,522	276,200	248,058
Average product prices					
Natural gas ($/mcf)	3.72	3.49	3.45	3.06	2.86
Oil & natural gas liquids ($/bbl)	67.82	75.88	73.01	68.62	71.27
$/MCFE					
Average sale price ($/mcfe)	4.56	4.46	4.38	4.01	3.83
Average royalties paid ($/mcfe)	0.32	0.36	0.34	0.26	0.26
Average operating expenses ($/mcfe)	0.35	0.31	0.31	0.35	0.29
Average transportation costs ($/mcfe)	0.12	0.12	0.11	0.11	0.12
Field netback ($/mcfe)	3.77	3.67	3.62	3.29	3.16
General & administrative expense ($/mcfe)	0.05	0.02	0.02	0.03	0.07
Interest expense ($/mcfe)	0.25	0.21	0.32	0.25	0.23
Cash netback ($/mcfe)	3.47	3.44	3.28	3.01	2.86
Financial ($000 except per share)					
Revenue	144,614	133,203	120,310	102,042	86,553
Royalties	9,849	10,591	9,205	6,632	6,082
Funds from operations	109,987	102,612	90,078	76,918	64,732
Funds from operations per share	0.74	0.69	0.62	0.54	0.47
Total dividends	32,727	26,766	26,178	25,576	24,927
Total dividends per share	0.22	0.18	0.18	0.18	0.18
Payout ratio	30%	26%	28%	33%	39%
Earnings	37,773	36,405	25,823	23,058	18,201
Earnings per diluted share	0.25	0.25	0.18	0.16	0.13
Capital expenditures	73,809	169,099	156,847	316,725	45,924
Weighted average shares outstanding	148,758,923	148,672,664	145,449,651	142,069,048	138,485,956

Peyto Exploration & Development Corp.

Condensed Balance Sheet *(unaudited)*

(Amount in $ thousands)

	June 30 2013	**December 31 2012**
Assets		
Current assets		
Cash	15,511	-
Accounts receivable	61,956	85,677
Due from private placement *(Note 6)*	-	3,459
Financial derivative instruments *(Note 8)*	7,139	10,254
Prepaid expenses	13,910	4,150
	98,516	**103,540**
Long term portion of financial derivative instruments *(Note 8)*	1,732	-
Prepaid capital	-	3,714
Property, plant and equipment, net *(Note 3)*	2,227,869	2,096,270
	2,229,601	**2,099,984**
	2,328,117	**2,203,524**
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	75,571	164,946
Income taxes payable	-	1,890
Dividends payable *(Note 6)*	11,901	8,911
Provision for future performance based compensation *(Note 7)*	8,548	2,677
	96,020	**178,424**
Long-term debt *(Note 4)*	750,000	580,000
Long-term derivative financial instruments *(Note 8)*	-	2,532
Provision for future performance based compensation *(Note 7)*	3,285	59
Decommissioning provision *(Note 5)*	52,540	58,201
Deferred income taxes	198,430	174,241
	1,004,255	**815,033**
Equity		
Share capital *(Note 6)*	1,130,069	1,124,382
Shares to be issued *(Note 6)*	-	3,459
Retained earnings	89,932	75,247
Accumulated other comprehensive income (loss) *(Note 6)*	7,841	6,979
	1,227,842	**1,210,067**
	2,328,117	**2,203,524**

Peyto Exploration & Development Corp.

Condensed Income Statement *(unaudited)*

(Amount in $ thousands)

	Three months ended June 30		Six months ended June 30	
	2013	2012	**2013**	2012
Revenue				
Oil and gas sales	148,466	68,879	276,889	154,100
Realized gain (loss) on hedges *(Note 8)*	(3,852)	17,674	927	34,949
Royalties	(9,849)	(6,082)	(20,440)	(14,917)
Petroleum and natural gas sales, net	**134,765**	80,471	**257,376**	174,132
Expenses				
Operating	11,242	6,603	20,548	13,904
Transportation	3,796	2,645	7,455	5,251
General and administrative	1,717	1,639	2,197	2,610
Future performance based compensation *(Note 7)*	6,559	1,115	9,097	3,010
Interest	8,022	4,996	14,332	10,134
Accretion of decommissioning provision *(Note 5)*	369	232	737	489
Depletion and depreciation *(Note 3)*	53,287	39,101	104,912	78,774
Gain on disposition of assets	-	(144)	-	(144)
	84,992	56,187	**159,278**	114,028
Earnings before taxes	**49,773**	24,284	**98,098**	60,104
Income tax				
Deferred income tax expense	12,000	6,083	23,919	15,035
Earnings for the period	**37,773**	18,201	**74,179**	45,069
Earnings per share *(Note 6)*				
Basic and diluted	**$0.25**	$ 0.13	**$ 0.50**	$ 0.33
Weighted average number of common shares outstanding *(Note 6)*				
Basic and diluted	**148,758,923**	138,485,956	**148,716,032**	138,399,017

Peyto Exploration & Development Corp.

Condensed Statement of Comprehensive Income *(unaudited)*

(Amount in $ thousands)

	Three months ended June 30		Six months ended June 30	
	2013	**2012**	**2013**	**2012**
Earnings for the period	**37,773**	18,201	**74,179**	45,069
Other comprehensive income				
Change in unrealized gain on cash flow hedges	30,204	(10,923)	2,076	16,194
Deferred tax recovery (expense)	(8,514)	7,149	(287)	4,689
Realized (gain) loss on cash flow hedges	3,852	(17,674)	(927)	(34,949)
Comprehensive income	**63,315**	(3,247)	**75,041**	31,003

Peyto Exploration & Development Corp.

Condensed Statement of Changes in Equity *(unaudited)*

(Amount in $ thousands)

	Six months ended June 30	
	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	74,179	45,069
Dividends *(Note 6)*	(59,494)	(49,839)
Retained earnings, end of period	**89,932**	78,119
Accumulated other comprehensive income, beginning of period	**6,979**	33,964
Other comprehensive income (loss)	862	(14,066)
Accumulated other comprehensive income (loss), end of period	**7,841**	19,898
Total equity	**1,227,842**	999,058

Peyto Exploration & Development Corp.

Condensed Statement of Cash Flows *(unaudited)*

(Amount in $ thousands)

	Three months ended June 30		Six months ended June 30	
	2013	**2012**	**2013**	**2012**
Cash provided by (used in) operating activities				
Earnings	**37,773**	18,201	**74,179**	45,069
Items not requiring cash:				
Deferred income tax	12,000	6,083	23,919	15,035
Depletion and depreciation	53,287	39,101	104,912	78,774
Accretion of decommissioning provision	369	232	737	489
Change in non-cash working capital related to operating activities	(6,729)	10,934	(14,504)	(5,433)
	96,700	74,551	**189,243**	133,934
Financing activities				
Issuance of common shares	-	-	5,742	11,952
Issuance costs	-	-	(73)	(35)
Cash dividends paid	(29,752)	(24,297)	(56,504)	(49,808)
Increase (decrease) in bank debt	110,000	25,000	170,000	(75,000)
Issuance of long term notes	-	-	-	100,000
	80,248	73	**119,165**	(12,891)
Investing activities				
Additions to property, plant and equipment	**(161,437)**	(74,624)	**(292,897)**	(178,267)
Net increase (decrease) in cash	**15,511**	-	**15,511**	(57,224)
Cash, beginning of period	**-**	-	**-**	57,224
Cash, end of period	**15,511**	-	**15,511**	-

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

Cash interest paid	**6,646**	4,122	**14,514**	8,435
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.

Effective 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 August 12, 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.

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.

3. Property, plant and equipment, net

Cost	
At December 31, 2012	2,483,007
Additions	236,511
At June 30, 2013	2,719,518
Accumulated depreciation	
At December 31, 2012	(386,737)
Depletion and depreciation	(104,912)
At June 30, 2013	(491,649)
Carrying amount at December 31, 2012	**2,096,270**
Carrying amount at June 30, 2013	**2,227,869**

During the three and six month periods ended June 30, 2013, Peyto capitalized $1.5 million and $4.1 million (2012 - $0.8 million and $2.5 million) of general and administrative expense directly attributable to production and development activities.

4. Long-term debt

	June 30, 2013	December 31, 2012
Bank credit facility	600,000	430,000
Senior unsecured notes	150,000	150,000
Balance, end of the period	**750,000**	580,000

As at June 30, 2013, the Company had a syndicated unsecured $1.0 billion extendible revolving credit facility with a stated term date of April 26, 2015. The bank facility is made up of a $30 million working capital sub-tranche and a $970 million production line. The facilities are available on a revolving basis for a two year period. Outstanding amounts on this facility will bear interest at rates ranging from prime plus 0.8% to prime plus 2.25% 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.

On January 3, 2012, Peyto issued CDN $100 million of senior unsecured 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 unsecured 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 unsecured 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 June 30, 2013.

Total interest expense for the three and six month periods ended June 30, 2013 was $8.0 million and $14.3 million (2012 - $5.0 million and $10.1 million) and the average borrowing rate for the period was 4.2% and 4.1% (2012 – 4.1% and 4.3%).

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	4,012
Accretion of decommissioning provision	737
Change in discount rate and estimates	(10,410)
Balance, June 30, 2013	**52,540**
Current	-
Non-current	52,540

Peyto has estimated the net present value of its total decommissioning provision to be $52.5 million as at June 30, 2013 ($58.2 million at December 31, 2012) based on a total future undiscounted liability of $137.5 million ($127.9 million at December 31, 2012). At June 30, 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 2.89 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, June 30, 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 three and six month periods ended June 30, 2013 of 148,758,923 and 148,716,032 (2012 – 138,485,956 and 138,399,017). There are no dilutive instruments outstanding.

Dividends

During the three and six month periods ended June 30, 2013, Peyto declared and paid dividends of $0.22 per common share ($0.06 per common share per month for April and $0.08 per common share per month for May and June) and $0.40 per common share, totaling $32.7 million and $59.5 million (2012 - $0.18 and $0.36 or $0.06 per share per month, $24.0 million and $49.9 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:

	June 30, 2013	June 30, 2012
Share price	\$22.58 - \$30.40	\$18.83 - \$24.75
Exercise price	\$19.30 - \$22.68	\$12.06 - \$24.55
Expected volatility	0% - 26%	0% - 36%
Option life	0.50 years	0.50 years
Dividend yield	0%	0%
Risk-free interest rate	1.25%	1.04%

8. Financial instruments

Financial instrument classification and measurement
Financial instruments of the Company carried on the condensed balance sheet are carried at amortized cost with the exception of cash and financial derivative instruments, specifically fixed price contracts, which are carried at fair value. There are no significant differences between the carrying amount of financial instruments and their estimated fair values as at June 30, 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 value drivers are observable in active markets.
- Level 3 – valuations derived from valuation techniques in which one or more significant inputs or value drivers are unobservable.

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

Fair values of financial assets and liabilities
The Company's financial instruments include cash, accounts receivable, financial derivative instruments, due from private placement, current liabilities, provision for future performance based compensation and long term debt. At June 30, 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 June 30, 2013:

Propane Period Hedged	Type	Monthly Volume	Price (USD)
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	$34.885/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 March 31, 2014	Fixed Price	4,000 bbl	$37.80/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	$35.485/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 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
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	$3.52/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
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
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.82/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.44/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.52/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.81/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.90/GJ

As at June 30, 2013, Peyto had committed to the future sale of 228,000 barrels of propane at an average price of $35.05 per barrel and 78,325,000 gigajoules (GJ) of natural gas at an average price of $3.31 per GJ. Had these contracts been closed on June 30, 2013, Peyto would have realized a gain in the amount of $8.9 million. Subsequent to June 30, 2013 Peyto entered into the following contracts:

Propane **Period Hedged**	**Type**	**Monthly Volume**	**Price** **(USD)**
October 1, 2013 to December 31, 2013	Fixed Price	4,000 bbl	$39.774/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	$36.54/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	$39.354/bbl

Natural Gas **Period Hedged**	**Type**	**Daily Volume**	**Price** **(CAD)**
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.4725/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.525/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.60/GJ

9. Commitments

Following is a summary of Peyto's contractual obligations and commitments as at June 30, 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	6,993	13,338	10,059	5,177	1,685	1,235
Operating leases	1,126	2,392	1,228	712	360	-
Total	11,534	22,560	18,117	12,719	8,875	170,020

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

(2) Fixed interest payments on senior unsecured 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
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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