PEYTO

Exploration & Development Corp.

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Interim Report
for the three months ended March 31, 2014

	3 Months Ended Mar. 31		%
	2014	2013	Change
Operations			
Production			
Natural gas (mcf/d)	**389,002**	297,191	*31%*
Oil & NGLs (bbl/d)	**7,375**	5,840	*26%*
Thousand cubic feet equivalent (mcfe/d @ 1:6)	**433,252**	332,230	*30%*
Barrels of oil equivalent (boe/d @ 6:1)	**72,209**	55,372	*30%*
Production per million common shares (boe/d)*	**476**	372	*28%*
Product prices			
Natural gas ($/mcf)	**4.45**	3.49	*28%*
Oil & NGLs ($/bbl)	**80.49**	75.88	*6%*
Operating expenses ($/mcfe)	**0.39**	0.31	*26%*
Transportation ($/mcfe)	**0.13**	0.12	*8%*
Field netback ($/mcfe)	**4.39**	3.67	*20%*
General & administrative expenses ($/mcfe)	**0.04**	0.02	*100%*
Interest expense ($/mcfe)	**0.23**	0.21	*10%*
Financial ($000, except per share*)			
Revenue	**209,318**	133,203	*57%*
Royalties	**17,861**	10,591	*69%*
Funds from operations	**160,785**	102,856	*56%*
Funds from operations per share	**1.06**	0.69	*54%*
Total dividends	**36,505**	26,766	*36%*
Total dividends per share	**0.24**	0.18	*33%*
Payout ratio	**23**	26	*(12)%*
Earnings	**62,129**	36,405	*71%*
Earnings per diluted share	**0.41**	0.25	*64%*
Capital expenditures	**179,378**	169,099	*6%*
Weighted average common shares outstanding	**151,826,431**	148,672,664	*2%*
As at March 31			
End of period shares outstanding	**153,690,808**	148,758,923	*3%*
Net debt	**838,495**	749,546	*12%*
Shareholders' equity	**1,344,704**	1,197,254	*12%*
Total assets	**2,686,661**	2,281,287	*18%*

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

	Three Months ended Mar. 31	
($000)	**2014**	2013
Cash flows from operating activities	**146,452**	92,543
Change in non-cash working capital	**7,964**	8,784
Change in provision for performance based compensation	**6,369**	1,529
Funds from operations	**160,785**	102,856
Funds from operations per share*	**1.06**	0.69

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

Report from the president

Peyto Exploration & Development Corp. ("Peyto" or the "Company") is pleased to present its operating and financial results for the first quarter of the 2014 fiscal year. Production per share growth of 28%, combined with earnings per share growth of 64%, support a 25% dividend increase. First quarter 2014 highlights, including a 77% operating margin[(1)] and a 30% profit margin[(2)], were as follows:

- **Production per share up 28%.** First quarter 2014 production increased 30% (28% per share) from 332 MMcfe/d (55,372 boe/d) in Q1 2013 to 433 MMcfe/d (72,209 boe/d) in Q1 2014.

- **Funds from operations per share up 54%.** Generated a Company record $161 million in Funds from Operations ("FFO") in Q1 2014 up 56% (54% per share) from $103 million in Q1 2013 due to increased production volumes and improved commodity prices.

- **Cash costs of $1.25/Mcfe.** Total cash costs, including royalties, operating costs, transportation, G&A and interest, were up from $1.02/Mcfe in Q1 2013 but still remain industry leading. This increase was primarily due to higher royalties, driven by higher commodity prices, and higher operating costs, due to front-end loaded chemical and maintenance costs. Higher revenues, combined with these cash costs, resulted in a cash netback of $4.12/Mcfe ($24.74/boe) or a 77% operating margin.

- **Capital investment of $179 million**. A capital program of $179 million was executed in the quarter resulting in production additions of 11,500 boe/d at quarter end. The annualized cost (trailing twelve months) to build this new production was $17,140/boe/d. A total of 31 gross wells were drilled during the first quarter.

- **Earnings of $0.41/share, dividends of $0.24/share.** Earnings of $62 million were generated in the quarter while dividends of $37 million were paid to shareholders, representing a before tax payout ratio of 23% of FFO.

- **Dividend increase to $0.10/share.** The Board of Directors has approved a monthly dividend increase of $0.02/share, starting in May 2014, to be paid on June 13, 2014 to shareholders of record as of May 31, 2014.

First Quarter 2014 in Review

The first quarter of 2014 was another active period for the Company with 9 drilling rigs developing the many Deep Basin resource plays within Peyto's portfolio. Natural gas prices during the quarter were extremely volatile as cold winter weather reduced storage volumes to multi-year lows causing gas prices to increase dramatically. Peyto increased its pace of activity and accelerated 2014 spending plans in response to the increase in natural gas prices with an urgency to deploy more capital earlier in the year, before potential cost inflation could occur. Drilling through spring break-up became part of that plan, as did stockpiling chemicals and accelerating facility maintenance during unscheduled transportation outages. These efforts, combined with increased government and regulatory fees, resulted in higher per unit operating costs for the first quarter. At just over $3/boe, Peyto's operating costs, inclusive of transportation, continue to lead the industry by a wide margin. Average first quarter production of 72,209 boe/d was up 7% sequentially from the fourth quarter 2013, while average realized prices were up 25%. These contributed to a record $161 million in FFO, despite a $30 million hedging loss. Progress on facility expansions continued in the quarter in anticipation of ongoing production growth later in 2014. The strong financial and operating performance delivered in the quarter resulted in an annualized 20% Return on Equity (ROE) and 15% Return on Capital Employed (ROCE).

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

Exploration & Development

Peyto's first quarter 2014 activity continued to be diversified across the many stacked resource plays in the Alberta Deep Basin, with all zones yielding liquids rich, sweet natural gas. A total of 31 wells were drilled across the land base, targeting the many prospective zones, as shown in the following table:

	Field							Total
Zone	Sundance	Nosehill	Wildhay	Ansell	Berland	Kisku/ Kakwa	Brazeau	Total Wells Drilled
Cardium	1	1	1	1				4
Notikewin			3					3
Falher	2	4					1	7
Wilrich	2	1	1	6	1			11
Bluesky	2	3		1				6
Total	7	9	5	8	1		1	31

The majority of the activity in the quarter focused on the deeper Falher, Wilrich and Bluesky formations. These formations are yielding greater economic returns due to a combination of higher natural gas prices, greater deep gas drilling royalty incentives combined with higher productivity and reserve recoveries.

Both the average depth and lateral length of Peyto's horizontal wells continued to increase in Q1 2014, as the Company attempts to develop more resource with each wellbore. At the same time, the drilling cost per meter and time required to drill, complete, and bring a new well on production continues to fall as Peyto's infrastructure (roads, wellsites, pipelines, etc.) expands and drilling practices are refined. The following table illustrates the ongoing efficiency gains which should contribute to lower development costs and greater returns:

	2011	2012	2013	2014 Q1
Gross Spuds	70	86	99	**31**
Measured Depth (m)	3,903	4,017	4,179	**4,236**
HZ Length (m)	1,303	1,358	1,409	**1,468**
Average Drilling ($MM)	$2.823	$2.789	$2.720	**$2,767**
$ per MD meter	$723	$694	$651	**$653**
Spud-Onstream (days)	59	50	59	**41**

Capital Expenditures

During the first quarter of 2014, Peyto spent $80.2 million to drill 31 gross (28.4 net) horizontal wells and $36.1 million completing 22 gross (21.5 net) wells. Wellsite equipment and tie-ins accounted for $15.7 million, while a total of $40.4 million was invested in pipelines and facilities. A 27 km, 8" pipeline was installed which connected a new growth area called Pedley to Peyto's Wildhay gas plant. This new pipeline corridor provides the necessary infrastructure for future wells and the ultimate expansion of the Wildhay gas plant later in the year. Additional compression was installed at Swanson and Oldman North gas plants, as well as two compressors and a refrigeration unit at the Brazeau River gas plant. New lands in Brazeau and Sundance were acquired for $2.9 million, or $246/acre, while new 3D seismic was acquired in Brazeau, Ansell and Sundance accounted for $3.9 million.

By the end of the quarter, the 22 gross (21.6 net) wells that were brought onstream were contributing 11,500 boe/d to the quarter end exit rate of 72,000 boe/d.

Financial Results

Alberta (AECO) daily natural gas prices averaged $5.36/GJ in Q1 2014, while AECO monthly prices averaged $4.52/GJ. Typically, the monthly price exceeds the daily price but this was not the case in the first quarter. As Peyto had committed 88% of its production to the monthly price, Peyto realized a volume weighted average natural gas price of $4.57/GJ or $5.23/mcf, prior to a $0.78/mcf hedging loss.

Peyto realized a blended oil and natural gas liquids price of $84.64/bbl in Q1 2014, prior to a $4.15/bbl hedging loss, for its blend of condensate, pentane, butane and propane, which represented 85% of the $99.81/bbl average Edmonton light oil price.

Combining realized natural gas and liquids prices, Peyto’s unhedged revenues totaled $6.14/mcfe ($5.37/mcfe including hedging losses), or 134% of the dry gas price, illustrating the benefit of high heat content, liquids rich natural gas production.

Royalties of $0.46/mcfe, operating costs of $0.39/mcfe, transportation costs of $0.13/mcfe, G&A of $0.04/mcfe and interest costs of $0.23/mcfe, combined for total cash costs of $1.25/mcfe ($7.47/boe). These industry leading total cash costs resulted in a cash netback of $4.12/mcfe or a 77% operating margin.

Depletion, depreciation and amortization charges of $1.77/mcfe, along with a provision for future tax and market based bonus payments reduced the cash netback to earnings of $1.59/mcfe, or a 30% profit margin, which funded dividends of $0.94/mcfe.

Subsequent to the end of the first quarter, Peyto’s $1.0 billion covenant based unsecured credit facility was renewed and extended for an additional two years. This new revolver has more attractive pricing and the same covenants as the previous revolver (see the Management’s Discussion & Analysis for a description of the covenants). Including the $270 million of senior unsecured notes, Peyto’s total borrowing capacity is $1.27 billion, leaving over $430 million of available capacity as at March 31, 2014.

Marketing

Significantly colder than normal winter weather across much of North America during the first quarter caused natural gas storage inventories to be drawn down to multi-year lows. This led to higher natural gas prices, especially in Alberta where AECO daily natural gas prices fluctuated from lows of $3.66/GJ to highs of $24.82/GJ. The average daily price over the 90 day period of $5.36/GJ was 19% higher than the average monthly price at $4.52/GJ.

For the quarter, approximately 57% of Peyto’s natural gas production received a fixed price of $3.38/GJ from hedges that were put in place over the previous 24 months, while the balance received the blended daily and monthly price of $4.57/GJ, resulting in an after-hedge price of $3.89/GJ or $4.45/mcf.

Peyto’s practice of layering in future sales in the form of fixed price swaps, and thus smoothing out the volatility in gas prices, continued throughout the quarter. As at March 31, 2014 Peyto had committed to the future sale of 100,285,000 GJ of natural gas at an average price of $3.58/GJ or $4.12/mcf based on Peyto’s historical heat content. The following table summarizes the remaining hedged volumes and prices for the upcoming years as of May 14, 2014.

	Future Sales		Average Price (CAD)	
	GJ	Mcf	$/GJ	$/Mcf
2014	65,095,000	56,604,348	3.58	4.12
2015	34,480,000	29,982,609	3.73	4.29
2016	1,820,000	1,582,609	3.97	4.57
Total	101,395,000	88,169,566	3.64	4.19

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

As illustrated in the following table, Peyto's realized natural gas liquids prices [1] were up 6% year over year with all but Butane receiving greater prices.

	Three Months ended March 31	
	2014	2013
Condensate ($/bbl)	**100.68**	92.18
Propane ($/bbl) (includes hedging)	**36.65**	25.52
Butane ($/bbl)	**55.98**	58.57
Pentane ($/bbl)	**105.37**	102.19
Total oil and natural gas liquids ($/bbl)	**80.49**	75.88
Edmonton par crude postings ($/bbl)	**99.81**	86.28

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

Peyto's hedging practice with respect to propane also continued in the quarter and as at March 31, 2014, Peyto had committed to the future sale of 204,000 bbls of propane at an average price of $45.82 CAD/bbl or $41.45USD/bbl.

Activity Update

Peyto has successfully maintained a high level of activity through April and into the beginning of May while most of the industry has shut down for spring break-up. Activity will continue provided that weather and surface access conditions remain acceptable. Peyto currently has 7 of its 9 rigs drilling and 3 completion spreads running. Since the end of the first quarter, an additional 11 gross (9.7 net) wells have been, or are in the process of being drilled and 12 more wells (11.2 net) have been completed and brought on production. New wells for 2014 are contributing 15,000 boe/d to the current total production of 73,000 boe/d.

Most recently, Peyto has drilled and completed the longest horizontal well so far in the Company's history. This Sundance horizontal Wilrich well was drilled with a 2,888 m horizontal lateral and completed with a 21 stage slickwater fracture stimulation. The Company expects that longer horizontal laterals will not be applicable to all zones, nor in all areas, and while it is still too early to determine with certainty, Peyto expects this well will achieve above average rates of return.

Facility and pipeline expansion work continues to progress in anticipation of production growth in the second half of the year. A twinning of the Wildhay sales pipeline is in the final stages of completion, as are fabrication of a second refrigeration package and compressor for the Oldman North plant expansion which is scheduled for a September startup.

Recent investment success has prompted renewed focus on the Wilrich and Falher formations in Ansell, the Bluesky play in North Sundance, the Falher and Notikewin in Central Sundance, and the Wilrich in Brazeau River.

Dividend Increase

In keeping with Peyto's total return model, profitable growth in the Company's assets should ultimately yield growth in sustainable dividends for shareholders. Over the last year, production per share and Proved Developed Producing reserves per share have grown 28% and 12%, respectively, while earnings per share have increased 64%. Based on this profitable growth, and irrespective of the recent strength in natural gas prices, the Board of Directors of Peyto has approved a $0.02/share increase to the monthly dividend starting in May 2014. This is the second dividend increase since Peyto converted to a dividend-paying, growth corporation at the end of 2010.

Outlook

Commodity prices for the balance of 2014 continue to look robust, and while higher commodity prices will drive higher funds from operations, Peyto will remain vigilant with respect to service cost inflation. Peyto is executing more of its 2014 capital program in the first half of the year in an attempt to mitigate this potential cost inflation and fully expects to meet its rate of return objectives. The Company remains committed to maximizing the returns on shareholder’s capital by continuing to be one of the lowest cost, most efficient and most profitable energy companies in the industry.

Annual General Meeting

Shareholders are invited to attend Peyto’s AGM at 3:00 p.m. on Tuesday, May 27, 2014 at Livingston Place Conference Centre, +15 level, 222-3rd Avenue SW, Calgary, Alberta.

Darren Gee
President and CEO
May 14, 2014

Management's discussion and analysis

This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the audited financial statements of Peyto Exploration & Development Corp. ("Peyto" or the "Company") for the years ended December 31, 2013 and 2012. The financial statements have been prepared in accordance with the International Accounting Standards Board ("IASB") most current International Financial Reporting Standards ("IFRS" or "GAAP") and International Accounting Standards ("IAS").

This discussion provides management's analysis of Peyto's historical financial and operating results and provides estimates of Peyto's future financial and operating performance based on information currently available. Actual results will vary from estimates and the variances may be significant. Readers should be aware that historical results are not necessarily indicative of future performance. This MD&A was prepared using information that is current as of May 13, 2014. 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 the Company'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. Other than is required pursuant to applicable securities legislation, Peyto does not undertake to update forward looking statements at any particular time.

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, 2013, the total Proved plus Probable reserves were 2,807 billion cubic feet equivalent (467.8 million barrels of oil equivalent) as evaluated by the independent petroleum engineers. Production is weighted approximately 90% to natural gas and 10% 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 with earnings and cash flow; funding for the capital program with cash flow, equity and available bank lines.

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

QUARTERLY FINANCIAL INFORMATION

	2014	2013				2012		
($000 except per share amounts)	**Q1**	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Total revenue (net of royalties)	191,457	154,167	123,851	134,765	122,612	111,105	95,409	80,471
Funds from operations	160,785	125,164	99,736	109,987	102,856	90,078	76,555	64,587
Per share – basic and diluted	1.06	0.84	0.67	0.74	0.69	0.62	0.54	0.47
Earnings	62,129	37,989	30,461	37,773	36,405	25,823	23,058	18,201
Per share – basic and diluted	0.41	0.26	0.21	0.25	0.25	0.18	0.16	0.13
Dividends	36,505	35,702	35,702	32,727	26,766	26,178	25,576	24,927
Per share – basic and diluted	0.24	0.24	0.24	0.22	0.18	0.18	0.18	0.18

Funds from Operations

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

RESULTS OF OPERATIONS

Production

	Three Months ended March 31	
	2014	2013
Natural gas (mmcf/d)	**389.0**	297.2
Oil & natural gas liquids (bbl/d)	**7,375**	5,840
Barrels of oil equivalent (boe/d)	**72,209**	55,372
Thousand cubic feet equivalent (mmcfe/d)	**433.3**	332.2

Natural gas production averaged 389.0 mmcf/d in the first quarter of 2014, 31 percent higher than the 297.2 mmcf/d reported for the same period in 2013. Oil and natural gas liquids production averaged 7,375 bbl/d, an increase of 26 percent from 5,840 bbl/d reported in the prior year. First quarter production increased 30 percent from 332.2 mmcfe/d to 433.3 mmcfe/d. The production increases are attributable to Peyto's capital program and resulting production additions.

Oil & Natural Gas Liquids Production by Component

	Three Months ended March 31	
	2014	2013
Condensate (bbl/d)	**2,971**	2,044
Propane (bbl/d)	**1,604**	1,110
Butane (bbl/d)	**1,358**	1,093
Pentane (bbl/d)	**1,242**	1,385
Other NGL's (bbl/d)	**200**	208
Oil & natural gas liquids (bbl/d)	**7,375**	5,840
Thousand cubic feet equivalent (mmcfe/d)	**44.2**	35.0

Commodity Prices

	Three Months ended March 31	
	2014	2013
Oil and natural gas liquids ($/bbl)	**84.64**	75.72
Hedging – ngls ($/bbl)	**(4.15)**	0.16
Oil and natural gas liquids – after hedging ($/mcf)	**80.49**	75.88
Natural gas ($/mcf)	**5.23**	3.31
Hedging – gas ($/mcf)	**(0.78)**	0.18
Natural gas – after hedging ($/mcf)	**4.45**	3.49
Total Hedging ($/mcfe)	**(0.77)**	0.16
Total Hedging ($/boe)	**(4.62)**	0.96

Peyto's natural gas price, before hedging gains, averaged $5.23/mcf during the first quarter of 2014, an increase of 58 percent from $3.31/mcf reported for the equivalent period in 2013. Oil and natural gas liquids prices before hedging averaged $84.64/bbl, an increase of 12 percent from $75.72/bbl a year earlier. Hedging activity decreased Peyto's achieved price/mcfe by 13% from $6.14 to $5.37 per mcfe for the quarter.

Oil & Natural Gas Liquids Prices by Component

	Three Months ended March 31	
	2014	2013
Condensate ($/bbl)	**100.68**	92.18
Propane ($/bbl) (includes hedging)	**36.65**	25.52
Butane ($/bbl)	**55.98**	58.57
Pentane ($/bbl)	**105.37**	102.19

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

Revenue

	Three Months ended March 31	
($000)	**2014**	2013
Natural gas	**183,247**	88,627
Oil and natural gas liquids	**56,174**	39,797
Hedging gain (loss)	**(30,103)**	4,779
Total revenue	**209,318**	133,203

For the three months ended March 31, 2014, revenue increased 57 percent to $209.3 million from $133.2 million for the same period in 2013. The increase in revenue for the period was a result of increased production volumes and realized prices as detailed in the following table:

	Three Months ended March 31		
	2014	2013	**$million**
Total Revenue, March 31, 2013			**133.2**
Revenue change due to:			
Natural gas			
Volume (mmcf)	35,010	26,747	**28.9**
Price ($/mcf)	$4.45	$3.49	**33.6**
Oil & NGL			
Volume (mbbl)	664	526	**10.5**
Price ($/bbl)	$80.49	$75.88	**3.1**
Total Revenue, March 31, 2014			**209.3**

Royalties

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

	Three Months ended March 31	
($000 except per share amounts)	**2014**	2013
Royalties	**17,861**	10,591
% of sales before hedging	**7.5**	8.3
% of sales after hedging	**8.5**	8.0
$/mcfe	**0.46**	0.36
$/boe	**2.75**	2.16

For the first quarter of 2014, royalties averaged $0.46/mcfe or approximately 8.5% 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.

In its 15 years history, Peyto has invested $3.6 billion in capital projects, found and developed 2.0 TCFe of gas reserves, and paid over $692 million in royalties.

Operating Costs & Transportation

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

	Three Months ended March 31	
	2014	2013
Operating costs ($000)	**15,230**	9,306
$/mcfe	**0.39**	0.31
$/boe	**2.34**	1.87
Transportation ($000)	**5,145**	3,659
$/mcfe	**0.13**	0.12
$/boe	**0.79**	0.72

Operating costs increased to $15.2 million in the first quarter of 2014 from $9.3 million for the equivalent period in 2013 due to the addition of two new plants late in the fourth quarter of 2013 combined with additional costs associated with stockpiling chemicals and accelerating facility maintenance during unscheduled transportation outages. On a unit-of-production basis, operating costs increased 26% averaging $0.39/mcfe in the first quarter of 2014 compared to $0.31/mcfe for the equivalent period in 2013.

Transportation expenses increased 8% from 0.12/mcfe in the first quarter 2013 to $0.13/mcfe in the first quarter 2014 due to increased TCPL tolls in September 2013.

General and Administrative Expenses

	Three Months ended March 31	
	2014	2013
G&A expenses ($000)	**4,344**	3,325
Overhead recoveries	**(2,788)**	(2,844)
Net G&A expenses	**1,556**	481
$/mcfe	**0.04**	0.02
$/boe	**0.24**	0.12

For the first quarter, general and administrative expenses before overhead recoveries increased 30% over the same quarter of 2013 primarily due to legal costs related to the Poseidon lawsuit, increased office space costs, and increased wages and salaries. General and administrative expenses averaged $0.04/mcfe in the first quarter of 2014 compared to $0.02/mcfe for the equivalent period in 2013.

Interest Expense

	Three Months ended March 31	
	2014	2013
Interest expense ($000)	**8,741**	6,310
$/mcfe	**0.23**	0.21
$/boe	**1.35**	1.26
Average interest rate	**4.3%**	4.0%

First quarter 2014 interest expense was $8.7 million or $0.23/mcfe compared to $6.3 million or $0.21/mcfe for the first quarter 2013.

Netbacks

	Three Months ended March 31	
($/mcfe)	**2014**	**2013**
Gross Sale Price	**6.14**	4.30
Hedging gain (loss)	**(0.77)**	0.16
Net Sale Price	**5.37**	4.46
Less: Royalties	**0.46**	0.36
Operating costs	**0.39**	0.31
Transportation	**0.13**	0.12
Field netback	**4.39**	3.67
General and administrative	**0.04**	0.02
Interest on long-term debt	**0.23**	0.21
Cash netback ($/mcfe)	**4.12**	3.44
Cash netback ($/boe)	**24.74**	20.64

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 2014 first quarter provision for depletion, depreciation and amortization totaled $68.9 million as compared to $51.6 million in 2013 due to higher levels of production and a larger asset base. On a unit-of-production basis, depletion and depreciation costs averaged $1.77/mcfe as compared to $1.73/mcfe in 2013.

Income Taxes

The current provision for deferred income tax expense is $20.7 million compared to $11.9 million in 2013. Resource pools are generated from the capital program, which are available to offset current and deferred income tax liabilities.

Income Tax Pool type ($ millions)	**March 31, 2014**	December 31, 2013	**Annual deductibility**
Canadian Oil and Gas Property Expense	242.0	245.1	10% declining balance
Canadian Development Expense	726.8	668.5	30% declining balance
Canadian Exploration Expense	158.6	208.7	100%
Undepreciated Capital Cost	347.4	312.3	Primarily 25% declining balance
Non-capital loss carry forward	-	19.7	100%
Other	37.5	32.5	Various, 7% declining balance to 20%
Total Federal Tax Pools	**1,512.3**	1,486.8	
Additional Alberta Tax Pools	44.9	44.9	Primarily 100%

MARKETING

Commodity Price Risk Management

The Company is a party to certain off balance sheet derivative financial instruments, including fixed price contracts. The Company enters into these forward contracts with well-established counterparties for the purpose of protecting a portion of its future revenues from the volatility of oil and natural gas prices. In order to minimize counterparty risk, these marketing contracts are executed with financial institutions that are members of Peyto's banking syndicate. During the first quarter of 2014, a realized hedging loss of $30.1 million was recorded as compared to a $4.8 million gain for the equivalent period in 2013. Prices for propane contracts are listed in USD at Conway. The price Peyto realizes is less: i) a market-basis differential from Conway to Edmonton, ii) currency exchange, and iii) a pipeline and fractionation fee, to get to Peyto's plant gate price. A summary of contracts outstanding in respect of the hedging activities are as follows:

Propane Period Hedged	**Type**	**Monthly Volume**	**Price (USD)**
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	$37.485/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	$41.79/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	$42.63/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	$44.31/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	$46.20/bbl
October 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	$42.84/bbl

Natural Gas Period Hedged	**Type**	**Daily Volume**	**Price (CAD)**
November 1, 2012 to October 31, 2014	Fixed Price	5,000 GJ	$3.0575/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
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 October 31, 2014	Fixed Price	5,000 GJ	$3.335/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.10/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.80/GJ

April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.825/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.95/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.98/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$4.07/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$4.32/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$4.35/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$4.55/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$4.42/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
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
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.27/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.41/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.5575/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.465/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.43/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.54/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.50/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.25/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.25/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.23/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.23/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.23/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.31/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.3525/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.40/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.49/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.54/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.61/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.70/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.75/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.81/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.83/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	$3.95/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.05/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.12/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.20/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.44/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.585/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.78/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.60/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.58/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.68/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.285/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.30/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.35/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.40/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.47/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.48/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.52/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.70/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.75/GJ

As at March 31, 2014, Peyto had committed to the future sale of 204,000 barrels of propane at an average price of $45.82 CAD ($41.45 USD) per barrel and 100,285,000 gigajoules (GJ) of natural gas at an average price of $3.58 per GJ or $4.12 per mcf. Had these contracts been closed on March 31, Peyto would have realized a loss in the amount of $82.0 million.

Subsequent to March 31, 2014 Peyto entered into the following contracts:

Natural Gas Period Hedged	Type	Daily Volume	Price (CAD)
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.68/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.80/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.87/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.9175/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.93/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$4.00/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$4.05/GJ

Commodity Price Sensitivity

Peyto's earnings are largely determined by commodity prices for crude oil and natural gas including the US/Canadian dollar exchange rate. Volatility in these oil and gas prices can cause fluctuations in Peyto's earnings over which the Company has no control. Low operating costs and a long reserve life reduce Peyto's sensitivity to changes in commodity prices.

Currency Risk Management

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

Interest Rate Risk Management

The Company is exposed to interest rate risk in relation to interest expense on its revolving credit facility while interest rates on the senior notes are fixed. Currently there are no agreements to manage the risk on the credit facility. At March 31 2014, 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 $1.3 million per quarter. Average debt outstanding for the quarter was $806.7 million (including $270 million fixed rate debt).

LIQUIDITY AND CAPITAL RESOURCES

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

	Three Months ended March 31	
($000)	**2014**	2013
Cash flows from operating activities	**146,452**	92,543
Change in non-cash working capital	**7,964**	7,775
Change in provision for performance based compensation	**6,369**	2,538
Funds from operations	**160,785**	102,856
Funds from operations per share	**1.06**	0.69

For the first quarter ended March 31, 2014, funds from operations totaled $160.8 million or $1.06 per share, as compared to $102.9 million, or $0.69 per share during the same quarter in 2013 due to increases in commodity prices and production. Peyto's policy is to balance dividends to shareholders with earnings and cash flow; 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

	March 31, 2014	December 31, 2013
Bank credit facility	**490,000**	605,000
Senior unsecured notes	**270,000**	270,000
Balance, end of the period	**760,000**	875,000

The Company has a syndicated $1.0 billion extendible revolving unsecured 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. Borrowings under the facility bear interest at Canadian bank prime (3% at both March 31, 2014 and December 31, 2013) or US base rate, or, at Peyto's option, Canadian dollar bankers' acceptances or US dollar LIBOR loan rates, plus applicable margin and stamping fees. The total stamping fees range between 80 basis points and 225 basis points on Canadian bank prime and US base rate borrowings and between 180 basis points and 325 basis points on Canadian dollar bankers' acceptance and US dollar LIBOR borrowings. The undrawn portion of the facility is subject to a standby fee in the range of 40.5 to 73.13 basis points.

Subsequent to March 31, 2014, Peyto's banking syndicate agreed to extend the stated term date of the credit facility to April 26, 2017. Borrowings under the amended facility bear interest at Canadian bank prime or US base rate, or, at Peyto's option, Canadian dollar bankers' acceptances or US dollar LIBOR loan rates, plus applicable margin and stamping fees. The total stamping fees range between 50 basis points and 215 basis points on Canadian bank prime and US base rate borrowings and between 150 basis points and 315 basis points on Canadian dollar bankers' acceptance and US dollar LIBOR borrowings. The undrawn portion of the facility is subject to a standby fee in the range of 30 to 63 basis points.

On December 4, 2013, Peyto issued $120 million of senior unsecured notes pursuant to a note purchase 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 4.50% and mature on December 4, 2020. Interest will be paid semi-annually in arrears.

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

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

Peyto is in compliance with all financial covenants and has no subordinated debt as at March 31, 2014.

Peyto's total borrowing capacity is $1.27 billion and Peyto's credit facility is $1.0 billion.

Peyto believes funds generated from operations, together with borrowings under the credit facility will be sufficient to maintain dividends, finance current operations, and fund the planned capital expenditure program of $575 to $625 million for 2014. The total amount of capital invested in 2014 will be driven by the number and quality of projects generated. Capital will only be invested if it meets the long term objectives of the Company. The majority of the capital program will involve drilling, completion and tie-in of lower risk development gas wells. Peyto's rapidly scaleable business model has the flexibility to match planned capital expenditures to actual cash flow.

Net Debt

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

($000)	**As at March 31, 2014**	As at December 31, 2013	As at March 31, 2013
Bank credit facility	**490,000**	605,000	490,000
Senior secured notes	**270,000**	270,000	150,000
Working capital deficit	**154,186**	103,247	135,980
Financial derivative instruments	**(64,221)**	(26,606)	(22,228)
Provision for future performance based compensation	**(11,470)**	**(5,100)**	**(4,206)**
Net debt	**838,495**	946,541	749,546

Capital
Authorized: Unlimited number of voting common shares

Issued and Outstanding
Issued and Outstanding

Common Shares (no par value)	Number of Common Shares	Amount $
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, December 31,2013	**148,758,923**	**1,130,069**
Common shares issued by private placement	211,885	6,997
Equity offering	4,720,000	160,480
Common share issuance costs, (net of tax)	-	(5,162)
Balance, March 31, 2014	**153,690,808**	**1,292,384**

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).

On December 31, 2013, Peyto completed a private placement of 190,525 common shares to employees and consultants for net proceeds of $6.2 million ($32.78 per share). These common shares were issued January 8, 2014

On February 5, 2014, Peyto closed an offering for 4,720,000 common shares at a price of $34.00 per common share, receiving net proceeds of $153.6 million.

On March 17, 2014, Peyto completed a private placement of 21,360 common shares to employees and consultants for net proceeds of $ 0.8 million ($35.20 per common share).

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

The reserve value based component is 4% of the incremental increase in value, if any, as adjusted to reflect changes in debt, equity and dividends, 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 $3.3 million was recorded for the period ended March 31, 2014.

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

Based on the weighted average trading price of the common shares for the period ended March 31, 2014, compensation costs related to 5.2 million non-vested rights (3.4% of the total number of common shares outstanding), with an average grant price of $28.58, are $5.3 million for the first quarter of 2014. 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 $13.6 million.

Stock Appreciation Rights Outstanding

	Valued but Not Vested			To be Valued December 31, 2014	
Vesting Date	**Number of Rights**	**Value ($)**		**Number of Rights**	**Average Grant Price ($)**
December 31, 2014	71,667	174,000	*	1,063,013	32.27
	974,540	10,043,131	**		
December 31, 2015	974,540	10,043,131	**	1,063,013	32.27
December 31, 2016	-	-		1,063,013	32.27

*Valued on December 31, 2012 at $22.58
**Valued on December 31, 2013 at $32.27

Capital Expenditures

Net capital expenditures for the first quarter of 2014 totaled $179.4 million. Exploration and development related activity represented $116.3 million (65% of total), while expenditures on facilities, gathering systems and equipment totaled $56.1 million (31% of total) land, seismic and acquisitions totaled $7.0 million (4% of total). The following table summarizes capital expenditures for the year:

	Three Months ended March 31	
($000)	**2014**	2013
Land	**2,855**	757
Seismic	**3,938**	1,022
Drilling	**80,248**	75,545
Completions	**36,087**	41,203
Equipping & Tie-ins	**15,713**	14,564
Facilities & Pipelines	**40,383**	36,008
Acquisitions	**154**	-
Total Capital Expenditures	**179,378**	169,099

Dividends

	Three Months ended March 31	
	2014	2013
Funds from operations ($000)	**160,785**	102,856
Total dividends ($000)	**36,505**	26,766
Total dividends per common share ($)	**0.24**	0.18
Payout ratio (%)	**23**	26

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

CONTRACTUAL OBLIGATIONS

Peyto has contractual obligations and commitments as follows:

	2014	2015	2016	2017	2018	Thereafter
Note repayment[1]	-	-	-	-	-	270,000
Interest payments[2]	8,815	12,230	12,230	12,230	12,230	22,755
Transportation commitments	13,580	19,531	18,796	14,975	11,261	13,356
Operating leases	2,126	2,380	1,863	1,654	1,295	10,356
Total	24,521	34,141	32,889	28,859	24,786	316,467

[1] Long-term debt repayment on senior unsecured notes
[2] Fixed interest payments on senior unsecured notes

LITIGATION

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

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

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

The allegations against New Open Range contained in the claims described above are based on factual matters that pre-existed the Company’s acquisition of New Open Range which makes them difficult to assess at this time. However the Company intends to aggressively protect its interests and the interests of its Shareholders and will seek all available legal remedies in defending the actions.

RELATED PARTY TRANSACTIONS

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 the Company 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. The Company 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, the Company must continue reinvesting in, drilling for or acquiring petroleum and natural gas. The capital expenditure program is funded primarily through funds from operations, debt and, if appropriate, equity.

CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

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

Internal Control over Financial Reporting

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

Peyto is required to disclose herein any change in Peyto's internal control over financial reporting that occurred during the period ended March 31, 2014 that has materially affected, or is reasonably likely to materially affect, Peyto's internal control over financial reporting. No material changes in Peyto's internal control over financial reporting were identified during such period that has materially affected, or are reasonably likely to materially affect, Peyto's internal control over financial reporting.

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

CRITICAL ACCOUNTING ESTIMATES

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

The Company's estimated quantities of proved and probable reserves at December 31, 2013 were audited by independent petroleum engineers InSite Petroleum Consultants Ltd. InSite has been evaluating reserves in this area and for Peyto for 15 consecutive years.

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

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

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

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

Reserve Value Performance Based Compensation
The reserve value based compensation is calculated using the year end independent reserves evaluation which was completed in February 2014. A quarterly provision for the reserve value based compensation is calculated using estimated proved producing reserve additions adjusted for changes in debt, equity and dividends. Actual proved producing reserves additions and forecasted commodity prices could vary significantly from those estimated and may have a material effect on the calculation.

Income Taxes
The determination of the Company’s income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the

lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded.

Accounting Changes

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

CHANGES IN ACCOUNTING POLICIES

Presentation of Financial Statements

Peyto adopted the following standards on January 1, 2014:

IAS 36 "Impairment of Assets" has been amended to reduce the circumstances in which the recoverable amount of cash generating units "CGUs" is required to be disclosed and clarify the disclosures required when an impairment loss has been recognized or reversed in the period. The retrospective adoption of these amendments will only impact Peyto's disclosures in the notes to the financial statements in periods when an impairment loss or impairment reversal is recognized.

IFRIC 21 "Levies" was developed by the IFRS Interpretations Committee ("IFRIC") and is applicable to all levies imposed by governments under legislation, other than outflows that are within the scope of other standards (e.g., IAS 12 "Income Taxes") and fines or other penalties for breaches of legislation. The interpretation clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. Lastly, the interpretation clarifies that a liability should not be recognized before the specified minimum threshold to trigger that levy is reached. The retrospective adoption of this interpretation does not have any impact on Peyto’s financial statements

STANDARDS ISSUED BUT NOT YET EFFECTIVE

The IASB issued the following standards and amendments which are not yet effective for Peyto and discussed in further detail in Note 2 to the Financial Statements for the fiscal period ended March 31, 2014.

IFRS 9, as issued, reflects part of the IASB’s work on the replacement of IAS 39 “Financial Instruments: Recognition and Measurement” and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39 and hedging transactions. The standard has no effective date. In subsequent phases, the IASB will address impairment of financial assets. The adoption of IFRS 9 may have an effect on the classification and measurement of the company’s financial assets and financial liabilities. The Company will quantify the effect in conjunction with the other phases, when the final standard including all phases is issued with an effective date.

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

	2014	2013			
	Q1	Q4	Q3	Q2	Q1
Operations					
Production					
Natural gas (mcf/d)	389,002	361,870	300,286	310,621	297,191
Oil & NGLs (bbl/d)	7,375	6,984	6,295	6,374	5,840
Barrels of oil equivalent (boe/d @ 6:1)	72,209	67,296	56,343	58,145	55,372
Thousand cubic feet equivalent (mcfe/d @ 6:1)	433,252	403,774	338,058	348,868	332,230
Average product prices					
Natural gas ($/mcf)	4.45	3.59	3.35	3.72	3.49
Oil & natural gas liquids ($/bbl)	80.49	69.84	70.91	67.82	75.88
$/MCFE					
Average sale price ($/mcfe)	5.37	4.43	4.29	4.56	4.46
Average royalties paid ($/mcfe)	0.46	0.28	0.31	0.32	0.36
Average operating expenses	0.39	0.35	0.37	0.35	0.31
Average transportation costs	0.13	0.13	0.12	0.12	0.12
Field netback ($/mcfe)	4.39	3.67	3.49	3.77	3.67
General & administrative expense ($/mcfe)	0.04	0.06	0.02	0.05	0.02
Interest expense ($/mcfe)	0.23	0.24	0.25	0.25	0.21
Cash netback ($/mcfe)	4.12	3.37	3.22	3.47	3.44
Financial ($000 except per share)					
Revenue	209,318	164,455	133,573	144,614	133,203
Royalties	17,861	10,288	9,722	9,849	10,591
Funds from operations	160,785	125,164	99,736	109,987	102,612
Funds from operations per share	1.06	0.84	0.67	0.74	0.69
Total dividends	36,505	35,702	35,702	32,727	26,766
Total dividends per share	0.24	0.24	0.24	0.22	0.18
Payout ratio	23%	29%	36%	30%	26%
Earnings	62,129	37,989	30,461	37,773	36,405
Earnings per diluted share	0.41	0.26	0.21	0.25	0.25
Capital expenditures	179,378	154,295	180,801	73,809	169,099
Weighted average shares outstanding	151,826,431	148,758,923	148,758,923	148,758,923	148,672,664

Peyto Exploration & Development Corp.

Condensed Balance Sheet *(unaudited)*

(Amount in $ thousands)

	March 31 2014	December 31 2013
Assets		
Current assets		
Accounts receivable	108,164	83,714
Due from private placement *(Note 6)*	-	6,245
Prepaid expenses	11,586	5,666
	119,750	95,625
Property, plant and equipment, net *(Note 3)*	2,566,911	2,459,531
	2,566,911	2,459,531
	2,686,661	2,555,156
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	185,950	155,265
Dividends payable *(Note 6)*	12,295	11,901
Derivative financial instruments *(Note 8)*	64,221	26,606
Provision for future performance based compensation *(Note 7)*	11,470	5,100
	273,936	198,872
Long-term debt *(Note 4)*	760,000	875,000
Long-term derivative financial instruments *(Note 8)*	17,735	5,180
Provision for future performance based compensation *(Note 7)*	5,426	3,200
Decommissioning provision *(Note 5)*	67,330	61,184
Deferred income taxes	217,530	211,082
	1,068,021	1,155,646
Equity		
Share capital *(Note 6)*	1,292,384	1,130,069
Shares to be issued *(Note 6)*	-	6,245
Retained earnings	112,599	86,975
Accumulated other comprehensive loss *(Note 6)*	(60,279)	(22,651)
	1,344,704	1,200,638
	2,686,661	2,555,156

See accompanying notes to the financial statements.

Approved by the Board of Directors

(signed) *"Michael MacBean"*
Director

(signed) *"Darren Gee"*
Director

Peyto Exploration & Development Corp.

Condensed Income Statement *(unaudited)*

(Amount in $ thousands)

	Three months ended March 31 2014	Three months ended March 31 2013
Revenue		
Oil and gas sales	239,421	128,424
Realized (loss) gain on hedges *(Note 8)*	(30,103)	4,779
Royalties	(17,861)	(10,591)
Petroleum and natural gas sales, net	**191,457**	122,612
Expenses		
Operating	15,230	9,306
Transportation	5,145	3,659
General and administrative	1,556	481
Future performance based compensation *(Note 7)*	8,596	2,538
Interest	8,741	6,310
Accretion of decommissioning provision *(Note 5)*	498	368
Depletion and depreciation *(Note 3)*	68,851	51,625
	108,617	74,287
Earnings before taxes	**82,840**	48,325
Income tax		
Deferred income tax expense	20,711	11,920
Earnings for the period	**62,129**	36,405
Earnings per share *(Note 6)*		
Basic and diluted	**$0.41**	$ 0.25
Weighted average number of common shares outstanding *(Note 6)*		
Basic and diluted	**151,826,431**	148,672,664

Peyto Exploration & Development Corp.

Condensed Statement of Comprehensive Income *(unaudited)*

(Amount in $ thousands)

	Three months ended March 31	
	2014	**2013**
Earnings for the period	**62,129**	36,405
Other comprehensive income		
Change in unrealized loss on cash flow hedges	(80,273)	(28,128)
Deferred tax expense	12,543	8,227
Realized (gain) loss on cash flow hedges	30,103	(4,779)
Comprehensive income	**24,502**	11,725

Peyto Exploration & Development Corp.

Condensed Statement of Changes in Equity *(unaudited)*

(Amount in $ thousands)

	Three months ended March 31	
	2014	**2013**
Share capital, beginning of period	**1,130,069**	1,124,382
Common shares issued by private placement	6,997	5,742
Equity offering	160,480	-
Common shares issuance costs (net of tax)	(5,162)	(55)
Share capital, end of period	**1,292,384**	1,130,069

Common shares to be issued, beginning of period	**6,245**	3,459
Common shares issued	(6,245)	(3,459)
Common shares to be issued, end of period	**-**	-

Retained earnings, beginning of period	**86,975**	75,247
Earnings for the period	62,129	36,405
Dividends *(Note 6)*	(36,505)	(26,766)
Retained earnings, end of period	**112,599**	84,886

Accumulated other comprehensive (loss) income, beginning of period	**(22,651)**	6,979
Other comprehensive loss	(37,628)	(24,680)
Accumulated other comprehensive loss, end of period	**(60,279)**	(17,701)

Total equity	**1,344,704**	1,197,254

Peyto Exploration & Development Corp.

Condensed Statement of Cash Flows *(unaudited)*

(Amount in $ thousands)

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

	Three months ended March 31 2014	Three months ended March 31 2013
Cash provided by (used in) operating activities		
Earnings	62,129	36,405
Items not requiring cash:		
Deferred income tax	20,711	11,920
Depletion and depreciation	68,851	51,625
Accretion of decommissioning provision	498	368
Long term portion of future performance based compensation	2,227	1,009
Change in non-cash working capital related to operating activities	(7,964)	(8,784)
	146,452	92,543
Financing activities		
Issuance of common shares	167,477	5,742
Issuance costs	(6,883)	(73)
Cash dividends paid	(36,110)	(26,752)
Increase (decrease) in bank debt	(115,000)	60,000
	9,484	38,917
Investing activities		
Additions to property, plant and equipment	(179,378)	(169,099)
Change in prepaid capital	8,795	3,714
Change in non-cash working capital relating to investing activities	14,647	33,925
	(155,936)	(131,460)
Net increase (decrease) in cash	**-**	-
Cash, Beginning of Period	**-**	-
Cash, End of Period	**-**	-

Cash interest paid	**8,330**	7,867
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.

These financial statements were approved and authorized for issuance by the Audit Committee of Peyto on May 13, 2014.

2. Basis of presentation

The condensed financial statements have been prepared by management and reported in Canadian dollars in accordance with International Accounting Standard ("IAS") 34, "Interim Financial Reporting". These condensed financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the Company's financial statements as at and for the years ended December 31, 2013 and 2012.

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 financial statements as at and for the years ended December 31, 2013 and 2012.

(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, 2014 or later periods. The affected standards are consistent with those disclosed in Peyto's financial statements as at and for the years ended December 31, 2013 and 2012.

Peyto adopted the following standards on January 1, 2014:

IAS 36 "Impairment of Assets" has been amended to reduce the circumstances in which the recoverable amount of cash generating units "CGUs" are required to be disclosed and clarify the disclosures required when an impairment loss has been recognized or reversed in the period. The retrospective adoption of these amendments will only impact Peyto's disclosures in the notes to the financial statements in periods when an impairment loss or impairment reversal is recognized.

IFRIC 21 "Levies" was developed by the IFRS Interpretations Committee ("IFRIC") and is applicable to all levies imposed by governments under legislation, other than outflows that are within the scope of other standards (e.g., IAS 12 "Income Taxes") and fines or other penalties for breaches of legislation. The interpretation clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. Lastly, the interpretation clarifies that a liability should not be recognized before the specified minimum threshold to trigger that levy is reached. The retrospective adoption of this interpretation does not have any impact on Peyto's financial statements

Standards issued but not yet effective

IFRS 9, as issued, reflects part of the IASB's work on the replacement of IAS 39 "Financial Instruments: Recognition and Measurement" and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39 and hedging transactions. The standard has no effective date. In subsequent phases, the IASB will address impairment of financial assets. The adoption of IFRS 9 may have an effect on the classification and measurement of the company's financial assets and financial liabilities. The Company will quantify the effect in conjunction with the other phases, when the final standard including all phases is issued with an effective date.

3. Property, plant and equipment, net

Cost	
At December 31, 2013	3,071,245
Additions	179,378
Decommissioning provision additions	5,648
Prepaid capital	(8,795)
At March 31, 2014	3,247,476
Accumulated depletion and depreciation	
At December 31, 2013	(611,714)
Depletion and depreciation	(68,851)
At March 31, 2014	(680,565)
Carrying amount at December 31, 2013	2,459,531
Carrying amount at March 31, 2014	**2,566,911**

During the period ended March 31, 2014, Peyto capitalized $2.8 million (2013 - $2.6 million) of general and administrative expense directly attributable to production and development activities.

4. Long-term debt

	March 31, 2014	**December 31, 2013**
Bank credit facility	490,000	605,000
Senior secured notes	270,000	270,000
Balance, end of the year	**760,000**	875,000

As at March 31, 2014, the Company had a syndicated $1 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. Borrowings under the facility bear interest at Canadian bank prime (3% at both December 31, 2013 and 2012) or US base rate, or, at Peyto's option, Canadian dollar bankers' acceptances or US dollar LIBOR loan rates, plus applicable margin and stamping fees. The total stamping fees range between 80 basis points and 225 basis points on Canadian bank prime and US base rate borrowings and between 180 basis points and 325 basis points on Canadian dollar bankers' acceptance and US dollar LIBOR borrowings. The undrawn portion of the facility is subject to a standby fee in the range of 40.5 to 73.13 basis points.

On December 4, 2013, Peyto issued $120 million of senior unsecured notes pursuant to a note purchase 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 4.50% and mature on December 4, 2020. Interest will be paid semi-annually in arrears.

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

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

Peyto is in compliance with all financial covenants at March 31, 2014.

Total interest expense for the period ended March 31, 2014 was $8.7 million (2013 - $6.3 million) and the average borrowing rate for the period was 4.4% (2013 – 4.0%).

Subsequent to March 31, 2014, Peyto's banking syndicate agreed to extend the stated term date of the credit facility to April 26, 2017. Borrowings under the amended facility bear interest at Canadian bank prime or US base rate, or, at Peyto's option, Canadian dollar bankers' acceptances or US dollar LIBOR loan rates, plus applicable margin and stamping fees. The total stamping fees range between 50 basis points and 215 basis points on Canadian bank prime and US base rate borrowings and between 150 basis points and 315 basis points on Canadian dollar bankers' acceptance and US dollar LIBOR borrowings. The undrawn portion of the facility is subject to a standby fee in the range of 30 to 63 basis points.

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, 2013	**61,184**
New or increased provisions	2,630
Accretion of decommissioning provision	498
Change in discount rate and estimates	3,018
Balance, March 31, 2014	**67,330**
Current	-
Non-current	67,330

Peyto has estimated the net present value of its total decommissioning provision to be $67.3 million as at March 31, 2014 ($61.2 million at December 31, 2013) based on a total future undiscounted liability of $178.5 million ($177.8 million at December 31, 2013). At March 31, 2014 management estimates that these payments are expected to be made over the next 50 years with the majority of payments being made in years 2040 to 2063. The Bank of Canada's long term bond rate of 2.96 per cent (3.24 per cent at December 31, 2013) and an inflation rate of two per cent (two per cent at December 31, 2013) 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, 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, December 31,2013	**148,758,923**	**1,130,069**
Common shares issued by private placement	211,885	6,997
Equity offering	4,720,000	160,480
Common share issuance costs, (net of tax)	-	(5,162)
Balance, March 31, 2014	**153,690,808**	**1,292,384**

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).

On December 31, 2013, Peyto completed a private placement of 190,525 common shares to employees and consultants for net proceeds of $6.2 million ($32.78 per share). These common shares were issued January 8, 2014

On February 5, 2014, Peyto closed an offering for 4,720,000 common shares at a price of $34.00 per common share, receiving net proceeds of $153.6 million.

On March 17, 2014, Peyto completed a private placement of 21,360 common shares to employees and consultants for net proceeds of $ 0.8 million ($35.20 per common share).

Per share amounts

Earnings per share or unit have been calculated based upon the weighted average number of common shares outstanding for the period ended March 31, 2014 of 151,826,431 (2013 – 148,672,664). There are no dilutive instruments outstanding.

Dividends

During the period ended March 31, 2014, Peyto declared and paid dividends of $0.24 per common share or $0.08 per common share per month, totaling $36.5 million (2013 - $0.18 or $0.06 per common share per month, $26.8 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 and losses

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

7. Future performance based compensation

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

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

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

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

	March 31, 2014	March 31, 2013
Share price	\$22.58 - \$37.72	\$22.58 - \$26.94
Exercise price	\$19.91 - \$32.03	\$19.30 - \$22.58
Expected volatility	24%	25%
Option life	1 year	1 year
Dividend yield	0%	0%
Risk-free interest rate	1.07%	1.02%

8. Financial instruments and Capital management

Financial instrument classification and measurement
Financial instruments of the Company carried on the condensed balance sheet are carried at amortized cost with the exception of cash and financial derivative instruments, specifically fixed price contracts, which are carried at fair value. There are no significant differences between the carrying amount of financial instruments and their estimated fair values as at March 31, 2014.

The Company's areas of financial risk management and risks related to financial instruments remained unchanged from December 31, 2013.

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

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

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

Fair values of financial assets and liabilities
The Company's financial instruments include cash, accounts receivable, financial derivative instruments, due from private placement, current liabilities, provision for future performance based compensation and long term debt. At March 31, 2014, cash and financial derivative instruments are carried at fair value. Accounts receivable, due from private placement, current liabilities and provision for future performance based compensation approximate their fair value due to their short term nature. The carrying value of the long term debt approximates its fair value due to the floating rate of interest charged under the credit facility.

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

Following is a summary of all risk management contracts in place as at March 31, 2014:

Propane Period Hedged	Type	Monthly Volume	Price (USD)
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	$37.485/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	$41.79/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	$42.63/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	$44.31/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	$46.20/bbl
October 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	$42.84/bbl

Natural Gas Period Hedged	Type	Daily Volume	Price (CAD)
November 1, 2012 to October 31, 2014	Fixed Price	5,000 GJ	$3.0575/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
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 October 31, 2014	Fixed Price	5,000 GJ	$3.335/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.10/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.80/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.825/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.95/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$3.98/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$4.07/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$4.32/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$4.35/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$4.55/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	$4.42/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
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
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.27/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.41/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.5575/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.465/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.43/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.54/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.50/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.25/GJ

April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.25/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.23/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.23/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.23/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.31/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.3525/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.40/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.49/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.54/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.61/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.70/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.75/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.81/GJ
April 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.83/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	$3.95/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.05/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.12/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.20/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.44/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.585/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.78/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.60/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.58/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.68/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.285/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.30/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.35/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.40/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.47/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.48/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.52/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.70/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.75/GJ

As at March 31, 2014, Peyto had committed to the future sale of 204,000 barrels of propane at an average price of $45.82 CAD ($41.45 USD) per barrel and 100,285,000 gigajoules (GJ) of natural gas at an average price of $3.58 per GJ or $4.12 per mcf. Had these contracts been closed on March 31, 2014, Peyto would have realized a loss in the amount of $82.0 million. If the AECO gas price on March 31, 2014 were to increase by $1/GJ, the unrealized loss would increase by approximately $100.3 million. An opposite change in commodity prices rates would result in an opposite impact on other comprehensive income.

Subsequent to March 31, 2014 Peyto entered into the following contracts:

Natural Gas Period Hedged	**Type**	**Daily Volume**	**Price (CAD)**
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.68/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.80/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.87/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.9175/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.93/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$4.00/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$4.05/GJ

9. Commitments

Following is a summary of Peyto's contractual obligations and commitments as at March 31, 2014.

	2014	2015	2016	2017	2018	Thereafter
Note repayment[1]	-	-	-	-	-	270,000
Interest payments[2]	8,815	12,230	12,230	12,230	12,230	22,755
Transportation commitments	13,580	19,531	18,796	14,975	11,261	13,356
Operating leases	2,126	2,380	1,863	1,654	1,295	10,356
Total	24,521	34,141	32,889	28,859	24,786	316,467

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

(2) Fixed interest payments on senior secured notes

10. Contingencies

On October 31, 2013, Peyto was named as a party to a statement of claim received with respect to transactions between Poseidon Concepts Corp. and Open Range Energy Corp. The allegations contained in the claim are based on factual matters that pre-existed Peyto's involvement with New Open Range which makes them difficult to assess at this time. However, Peyto intends to aggressively protect its interests and the interests of its shareholders and will seek all available legal remedies in defending the action. Management continues to assess the nature of this claim, in conjunction with their legal advisors.

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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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Solicitors

Burnet, Duckworth & Palmer LLP

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