PEYTO

Exploration & Development Corp.

2014

Annual Report

Chairman’s Message

Peyto has now been in business for 16 years and I’m pleased to report that our team has put another great performance in the bank.

One of the reasons Peyto has performed so well, year after year, is that we constantly strive to innovate and challenge ourselves to do things better, and we aren’t afraid to buck conventional wisdom in the process. Let me give you an example. In the early part of 2003, we decided to convert from a company to an income trust and add a monthly cash distribution. At the time, our plan was unique because we distributed a relatively low amount of our cash flow, 50%, and planned to profitably grow our asset base with the other 50%. This payout ratio of 50% was considerably less than the then industry average of 80-90%. We chose this more sustainable model because we had such a strong business into which we could reinvest cash flow and because we felt it would allow us to grow production and our distribution (now dividend) over time. From the start, our unique, common sense approach was met with cynicism from many analysts. Initially, the market followed their lead and reacted negatively to our plan. One such analyst titled his piece “Yet Another Income Trust”. He went on to write that our growth was behind us and that we were making this conversion to a distribution paying income trust because our assets were mature and could no longer support growth. We knew that giving our unitholders liquidity through a distribution that was funded from the sale of production would be a good thing. We felt strongly that there should always be a competition between the capital program developed by the team and the capital required to fund the monthly distribution. Competition leads to the best results. We also understood that Peyto was fundamentally different than the other juniors we were being compared to. Peyto had been built by profitably finding and developing long life low cost oil and gas assets.

After twelve years as a distribution paying trust, and now a dividend paying company, we can now look back and see how our plan worked out. Our share price has appreciated from $7.71/share (post-split) to the current price of $35/share. On top of that we have distributed out $14.66/share in cash to our shareholders. Our production has grown from 13,300 boe/d in the second quarter of 2003 to 83,250 boe/d in the fourth quarter of 2014. On a per share basis, Peyto's production is 3.5 times higher today than it was when we converted to a dividend paying model. The Peyto approach was the right one, and many in the industry eventually copied us. We put ourselves then into a position, which continues today, that enhanced our accountability to shareholders.

At Peyto we have always believed that our core values not only set us apart from the industry, they bring out the best in us. Our company works best when the shareholders and managements interests are aligned. When we empower our employees. When we are held accountable.

I’m honored to be a part of the Peyto story. I’m very proud of the company we have built. I’m excited about our future. On behalf of the board of the directors and the shareholders of Peyto, I extend a big thank you to the Peyto team.

(signed) *“Don T. Gray”*
Chairman of the Board

Report from the President

Peyto Exploration & Development Corp. ("Peyto" or the "Company") is pleased to report operating and financial results for the fourth quarter and 2014 fiscal year which set Company records in virtually all categories.

- **Record production -** *Fourth quarter 2014 production was a record 500 MMCFe/d (83,251 boe/d), with exit production of 85,700 boe/d. Q4 2014 production was up 24% (20% per share) from Q4 2013 while average annual production increased 29% (25% per share) from 59,313 boe/d in 2013 to 76,372 boe/d in 2014.*

- **Record reserves** – *Producing reserves topped 1.2 TCFe (200 mmboes), up 13% from 2013 or 10% per share, while Proved plus Probable Additional reserves exceeded 3.1 TCFe.*

- **Record revenues** – *Annual revenues of $844 million were 47% greater than in 2013 while Q4 2014 revenue of $216 million was 32% higher than the comparable quarter in 2013, both Company records.*

- **Record funds from operations** – *Annual Funds from Operations ("FFO") of $663 million was 51% greater (47% per share) than in 2013 while Q4 2014 FFO of $173 million was 39% higher (33% per share), again both Company records.*

- **Record operating margin** – *Annual cash costs including royalties, operating costs, transportation, G&A and interest totaled $1.08/Mcfe ($6.49/boe) leaving a record 79% of revenue as funds from operations. Fourth quarter 2014 cash costs were $0.93/Mcfe ($5.60/boe), the lowest in Company history, delivering an 80% operating margin.*

- **Record capital investment**– *A record $690 million was invested in building the largest wedge of incremental production in Company history, peaking at 41,000 boe/d, for a cost of $16,800/boe/d. The 2014 capital program was 19% greater than 2013 but yielding similar returns.*

- **Record earnings** – *Annual earnings of $262 million for 2014 were 84% higher (78% per share) than in 2013, while Q4 2014 earnings of $69 million were up 81% from the previous year. The record earnings funded $175 million in dividends to shareholders in 2014.*

- **Record well(s) drilled** – *Peyto drilled a record number of new wells in 2014 with 123 gross (114 net) wells rig released by year end. In addition, the longest horizontal well in Company history was drilled to 6,000 m measured depth. Since inception, the Company has drilled over 1,000 gas wells in the Alberta Deep Basin including over 450 horizontal wells.*

2014 in Review

By essentially all measures, 2014 was an outstanding year for Peyto. A record $690 million of capital was invested into the organic development Peyto's many Alberta Deep Basin resource plays. In total, 123 wells were drilled, adding 41,000 boe/d of new production by year end. More importantly, that investment is forecast to deliver a 26%, before tax, internal rate of return. This return is inclusive of the $141 million that was invested in land, seismic and facility expansions. For every location drilled in 2014, 2.5 new locations were recognized in the Company's reserve report, further expanding Peyto's value and drilling inventory. The combination of 26% higher realized prices, 29% greater production and a 79% operating margin led to a record $663 million in funds from operations and $262 million in earnings. These record profits funded $175 million in dividends to shareholders and supported the third dividend increase in the last two years. Over this same two year period, investors have realized a 54% total return.

(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 year divided by Revenue before Royalties but including realized hedging gains (losses).
(3) Total return is calculated using the December 31, 2012 share price of $22.99 and December 31, 2014 share price of $33.47, along with $2.02/share of dividend.
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 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.

	3 Months Ended December 31		%	12 Months Ended December 31		%
	2014	2013	Change	**2014**	2013	Change
Operations						
Production						
Natural gas (mcf/d)	**451,044**	361,870	*25%*	**412,441**	317,622	*30%*
Oil & NGLs (bbl/d)	**8,077**	6,984	*16%*	**7,632**	6,376	*20%*
Thousand cubic feet equivalent (mcfe/d @ 1:6)	**499,505**	403,774	*24%*	**458,232**	355,880	*29%*
Barrels of oil equivalent (boe/d @ 6:1)	**83,251**	67,296	*24%*	**76,372**	59,313	*29%*
Production per million common shares (boe/d)*	**542**	452	*20%*	**498**	399	*25%*
Product prices						
Natural gas ($/mcf)	**4.22**	3.59	*18%*	**4.30**	3.54	*21%*
Oil & NGLs ($/bbl)	**55.47**	69.84	*-21%*	**70.68**	70.97	*0%*
Operating expenses ($/mcfe)	**0.31**	0.35	*-11%*	**0.34**	0.35	*-3%*
Transportation ($/mcfe)	**0.13**	0.13	*0%*	**0.13**	0.12	*8%*
Field netback ($/mcfe)	**4.03**	3.67	*10%*	**4.19**	3.65	*15%*
General & administrative expenses ($/mcfe)	**0.06**	0.06	*0%*	**0.03**	0.04	*-25%*
Interest expense ($/mcfe)	**0.19**	0.24	*-21%*	**0.21**	0.24	*-13%*
Financial ($000, except per share*)						
Revenue	**216,321**	164,455	*32%*	**843,797**	575,845	*47%*
Royalties	**11,196**	10,288	*9%*	**61,324**	40,450	*52%*
Funds from operations	**173,437**	125,164	*39%*	**662,788**	437,742	*51%*
Funds from operations per share	**1.13**	0.84	*33%*	**4.33**	2.94	*47%*
Total dividends	**49,181**	35,702	*38%*	**174,826**	130,898	*34%*
Total dividends per share	**0.32**	0.24	*33%*	**1.14**	0.88	*30%*
Payout ratio	**29**	29	*0%*	**26**	30	*-13%*
Earnings	**68,597**	37,989	*81%*	**261,778**	142,627	*83%*
Earnings per diluted share	**0.45**	0.26	*73%*	**1.71**	0.96	*78%*
Capital expenditures	**179,697**	154,295	*16%*	**690,389**	578,003	*19%*
Weighted average common shares outstanding	**153,690,808**	148,758,923	*3%*	**153,231,099**	148,737,654	*3%*
As at December 31						
End of period shares outstanding (includes shares to be issued				**153,859,728**	148,949,448	*3%*
Net debt				**1,009,508**	946,541	*7%*
Shareholders' equity				**1,551,936**	1,200,638	*29%*
Total assets				**3,127,065**	2,555,156	*22%*

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

	3 Months Ended December 31		12 Months Ended December 31	
($000 except per share)	**2014**	2013	**2014**	2013
Cash flows from operating activities	**193,145**	116,852	**642,531**	407,357
Change in non-cash working capital	**(24,898)**	(1,759)	**(2,046)**	11,667
Change in provision for performance based compensation	**(13,987)**	(6,226)	**3,126**	2,421
Performance based compensation	**19,177**	16,297	**19,177**	16,297
Funds from operations	**173,437**	125,164	**662,788**	437,742
Funds from operations per share	**1.13**	0.84	**4.33**	2.94

(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.

The Peyto Strategy

The Peyto strategy is premised on the belief that not only is natural gas the favoured fuel for the future, but that a real profit can be generated for investors in the exploration and development of natural gas resources if a Company focuses on being the lowest cost, most efficient producer in the industry. As a result, Peyto's focus has always been on cost control, efficiency and profitability. By focusing on costs, rather than revenues, Peyto helps to insulate itself from the volatility in prices inherent in a commodity business. This continuous focus on costs and profitability is evident in Peyto's history throughout various commodity price cycles as illustrated in the following table.

($/Mcfe)	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Average
Sales Price	$7.32	$8.87	$8.76	$8.93	$9.54	$6.75	$6.15	$5.47	$4.21	$4.43	**$5.04**	100%
Cost to develop[1]	($1.60)	($2.39)	($2.95)	($2.11)	($2.88)	($2.26)	($2.10)	($2.12)	($2.22)	($2.35)	**($2.25)**	(33%)
Cost to produce[2]	($2.21)	($2.76)	($2.66)	($2.75)	($3.01)	($1.75)	($1.63)	($1.35)	($1.05)	($1.06)	**($1.08)**	(28%)
"Profit"	**$3.51**	**$3.72**	**$3.15**	**$4.07**	**$3.65**	**$2.74**	**$2.42**	**$2.00**	**$0.94**	**$1.02**	**$1.71**	38%
Payout[3]	$2.28	$2.81	$3.47	$3.92	$4.25	$4.03	$3.37	$1.24	$1.04	$1.01	**$1.05**	(38%)

1. Cost to develop is the PDP FD&A
2. Cost to produce is the total cash costs including Royalties, Operating costs, Transportation, G&A and Interest.
3. Payout is the annual distribution or dividend in $/mcfe of production.

On average, over the last decade, Peyto has yielded approximately 38% of every dollar of revenue in profit. The consistency and repeatability of this result is a testament to the success of this strategy.

Capital Expenditures

Peyto deployed it's largest ever capital program in 2014, investing $312 million to drill 123 gross (114 net) horizontal gas wells, $183 million to complete them with 1,234 total frac stages, and $54 million to install wellsite equipment and pipelines connecting them to Company owned and operated facilities. Drilling costs per meter of wellbore continued to decrease as execution improved, despite a 5% per year annual inflation in service costs. The table below outlines the past five years of average horizontal drilling and completion costs.

	2010	2011	2012	2013	2014
Gross Spuds	52	70	86	99	**123**
Length (m)	3,762	3,903	4,017	4,179	**4,251**
Drilling ($MM)	$2.763	$2.823	$2.789	$2.720	**$2.660**
$ per meter	$734	$723	$694	$651	**$626**
Completion ($MM)	$1.358	$1.676	$1.672	$1.625	**$1.693**
$ per meter	$361	$429	$416	$389	**$398**

Peyto also invested $120 million in the expansion of the Brazeau River, Oldman North, Wildhay and Swanson gas plants adding a total of 105 mmcf/d of gas processing capacity. New land purchases accounted for $13 million, as 44 net sections were added for an average of $459/acre, while 847 km^2 of 3-dimensional seismic was acquired for $8.1 million. The following table summarizes the capital investments for the fourth quarter and 2014 fiscal year.

	Three Months ended December 31		Twelve Months ended December 31	
($000)	**2014**	2013	**2014**	2013
Land	**4,012**	1,144	**12,750**	6,427
Seismic	**1,731**	683	**8,114**	2,984
Drilling	**80,578**	59,825	**311,794**	254,000
Completions	**53,481**	46,836	**183,471**	151,752
Equipping and tie-ins	**16,687**	12,389	**53,777**	48,303
Facilities and pipelines	**23,208**	33,418	**120,210**	112,054
Acquisitions	**-**	-	**273**	2,483
Total Capital Expenditures	**179,697**	154,295	**690,389**	578,003

Reserves

Peyto was successful growing reserves and values in all categories in 2014, despite the year over year reduction in commodity price forecasts. The following table illustrates the change in reserve volumes and Net Present Value ("NPV") of future cash flows, discounted at 5%, before income tax and using forecast pricing.

	As at December 31		% Change	% Change, debt adjusted per share†
	2014	2013		
Reserves (BCFe)				
Proved Producing	**1,200**	1,061	13%	9%
Total Proved	**2,085**	1,827	14%	10%
Proved + Probable Additional	**3,189**	2,807	14%	10%
Net Present Value ($millions) Discounted at 5%				
Proved Producing	**$3,447**	$3,156	9%	7%
Total Proved	**$4,852**	$4,544	7%	3%
Proved + Probable Additional	**$7,161**	$6,587	9%	6%

†Per share reserves are adjusted for changes in net debt by converting debt to equity using the Dec 31 share price of $33.47 for 2014 and share price of $32.51 for 2013. Net Present Values are adjusted for debt by subtracting net debt from the value prior to calculating per share amounts.
Note: based on the InSite Petroleum Consultants ("InSite") report effective December 31, 2014. The InSite price forecast is available at www.InSitepc.com. For more information on Peyto's reserves, refer to the Press Release dated February 18, 2015 announcing the Year End Reserve Report which is available on the website at www.peyto.com. The complete statement of reserves data and required reporting in compliance with NI 51-101 will be included in Peyto's Annual Information Form to be released in March 2015.

Value Reconciliation

In order to measure the success of all of the capital invested in 2014, it is necessary to quantify the total amount of value added during the year and compare that to the total amount of capital invested. The independent engineers have run last year's reserve evaluation with this year's price forecast to remove the change in value attributable to both commodity prices and changing royalties. This approach isolates the value created by the Peyto team from the value created (or lost) by those changes outside of their control (ie. commodity prices). Since the capital investments in 2014 were funded from a combination of cash flow, debt and equity, it is necessary to know the change in debt and the change in shares outstanding to see if the change in value is truly accretive to shareholders.

At year-end 2014, Peyto's estimated net debt had increased by $63.0 million to $1.01 billion while the number of shares outstanding had increased by 4.91 million shares to 153.860 million shares. The change in debt includes all of the capital expenditures, as well as any acquisitions, and the total fixed and performance based compensation paid out for the year.

Based on this reconciliation of changes in BT NPV, the Peyto team was able to create $1.0 billion of Proved Producing, $1.2 billion of Total Proven, and $1.8 billion of Proved plus Probable Additional undiscounted reserve value, with $690 million of capital investment. The ratio of capital expenditures to value creation is what Peyto refers to as the NPV recycle ratio, which is simply the undiscounted value addition, resulting from the capital program, divided by the capital investment. For 2014, the Proved Producing NPV recycle ratio is 1.5. This means for each dollar invested, the Peyto team was able to create 1.5 new dollars of Proved Producing reserve value.

The historic NPV recycle ratios are presented in the following table.

Value Creation	31-Dec-06	31-Dec-07	31-Dec-08	31-Dec-09	31-Dec-10	31-Dec-11	31-Dec-12	31-Dec-13	**31-Dec-14**
NPV_0 Recycle Ratio									
Proved Producing	2.9	4.7	2.1	5.4	3.5	2.4	1.6	1.5	**1.5**
Total Proved	2.9	5.5	2.5	18.9	6.1	4.7	2.2	2.0	**1.7**
Proved + Probable	3.8	3.8	2.2	27.1	10.3	6.6	3.2	4.0	**2.6**

**NPV_0 (net present value) recycle ratio is calculated by dividing the undiscounted NPV of reserves added in the year by the total capital cost for the period (eg. 2014 Proved Producing ($1,017/$690) = 1.5).*

Performance Measures

There are a number of performance measures that are used in the oil and gas industry in an attempt to evaluate how profitably capital has been invested. Peyto believes the value analysis and reconciliation presented above is the best determination of profitability as it compares the value of what was created relative to what was invested. This is because the NPV of an oil and gas asset takes into consideration the reserves, the production forecast, the future royalties and operating costs, future capital and the current commodity price outlook.

The following table highlights annual performance ratios both before and after the implementation of horizontal wells in late 2009. These can be used for comparative purposes, but it is cautioned that on their own they do not measure investment success.

	2014	**2013**	**2012**	**2011**	**2010**	**2009**	**2008**	**2007**
Proved Producing								
FD&A ($/mcfe)	**$2.25**	$2.35	$2.22	$2.12	$2.10	$2.26	$2.88	$2.11
RLI (yrs)	**7**	7	9	9	11	14	14	13
Recycle Ratio	**1.9**	1.6	1.6	1.9	2.0	1.8	2.3	2.8
Reserve Replacement	**183%**	190%	284%	230%	239%	79%	110%	127%
Total Proved								
FD&A ($/mcfe)	**$2.37**	$2.23	$2.04	$2.13	$2.35	$1.73	$3.17	$1.57
RLI (yrs)	**11**	12	15	16	17	21	17	16
Recycle Ratio	**1.8**	1.6	1.7	1.9	1.8	2.3	2.1	3.7
Reserve Replacement	**254%**	230%	414%	452%	456%	422%	139%	175%
Future Development Capital ($ millions)	**$1,721**	$1,406	$1,318	$1,111	$741	$446	$222	$169
Proved plus Probable Additional								
FD&A ($/mcfe)	**$2.01**	$1.86	$1.68	$1.90	$2.19	$1.47	$3.88	$1.56
RLI (yrs)	**18**	19	22	22	25	29	23	21
Recycle Ratio	**2.1**	2.0	2.1	2.1	1.9	2.8	1.7	3.7
Reserve Replacement	**328%**	450%	527%	585%	790%	597%	122%	117%
Future Development Capital ($millions)	**$2,963**	$2,550	$2,041	$1,794	$1,310	$672	$390	$321

- FD&A (finding, development and acquisition) costs are used as a measure of capital efficiency and are calculated by dividing the capital costs for the period, including the change in undiscounted future development capital ("FDC"), by the change in the reserves, incorporating revisions and production, for the same period (eg. Total Proved ($690.4+$315.2)/(347.419-304.494+27.876) = $2.37/mcfe or $14.20/boe).

- The reserve life index (RLI) is calculated by dividing the reserves (in boes) in each category by the annualized average production rate in boe/year (eg. Proved Producing 200,068/(83.251x365) = 6.6). Peyto believes that the most accurate way to evaluate the current reserve life is by dividing the proved developed producing reserves by the actual fourth quarter average production. In Peyto's opinion, for comparative purposes, the proved developed producing reserve life provides the best measure of sustainability.

- The Recycle Ratio is calculated by dividing the field netback per MCFe, by the FD&A costs for the period (eg. Proved Producing (($25.22)/$13.52=1.9). The recycle ratio is comparing the netback from existing reserves to the cost of finding new reserves and may not accurately indicate investment success unless the replacement reserves are of equivalent quality as the produced reserves.

- The reserve replacement ratio is determined by dividing the yearly change in reserves before production by the actual annual production for the year (eg. Total Proved ((347.419-304.494+27.876)/27.876) = 254%).

Quarterly Review

Peyto maintained its pace of activity throughout the final quarter of 2014, drilling 29 gross (27.2 net) wells, completing 36 gross (32.3 net) wells, and installing wellsite equipment to bringing on production 36 gross (32.3 net) wells. In total, $180 million of capital was invested in the quarter, or 26% of the annual capital program, with $81 million spent on drilling, $53 million on completions, $17 million on pipelines, $23 million on facilities and $6 million on lands and seismic.

In total, the 29 wells that were drilled across Peyto's core areas in the Deep Basin targeted the following zones:

Zone	Field							Total Wells Drilled
	Sundance	Nosehill	Wildhay	Ansell	Berland	Kisku/ Kakwa	Brazeau	
Cardium				1				1
Notikewin	3	1	1	1		1	4	11
Falher	3		1	2			2	8
Wilrich	1	1	3	3				8
Bluesky	1							1
Total	8	2	5	7	0	1	6	29

Production in the fourth quarter 2014 averaged 83,251 boe/d, up 24% from 67,296 in Q4 2013, made up of 451 mmcf/d of natural gas and 8,077 bbl/d of natural gas liquids. Peyto's realized price for natural gas in Q4 2014 was $4.24/mcf, prior to a $0.02/mcf hedging loss, while it's realized liquids price was $55.13/bbl, prior to a $0.34/bbl hedging gain, yielding a combined revenue stream of $4.71/mcfe. This net sales price was 6% higher than same period a year ago.

Total cash costs for Q4 2014 of $0.93/mcfe, including royalties of $0.24/mcfe, operating costs of $0.31/mcfe, transportation of $0.13/mcfe, G&A of $0.06/mcfe and interest of $0.19/mcfe were the lowest cash costs of any quarter in Peyto's 16 year history. Both operating costs and interest costs were lower than Q4 2013, contributing to this new record.

Peyto generated total funds from operations of $173 million in the quarter, or $3.77/mcfe, equating to an 80% operating margin which was also a new record. DD&A charges of $1.82/mcfe, as well as a provision for current and future performance based compensation and income tax, reduced FFO to earnings of $1.49/mcfe, or a 32% profit margin, which funded the $1.07/mcfe dividend to shareholders.

Marketing

Abundant supply of natural gas continues to outweigh the colder than normal winter weather in North America, and despite average storage levels for this time of year, the current natural gas price outlook is for much lower prices than a year ago. The AECO Monthly strip for the next 12 months is currently trading at close to $2.70/GJ or approximately 40% lower than the $4.70/GJ forecast at this time last year. The same forward strip shows 2016 and 2017 AECO prices of $2.95/GJ and $3.23/GJ, respectively, ultimately reverting to the average of the past 5 years, or $3.36/GJ.

To prevent the short term volatility in natural gas prices from interfering with capital planning, Peyto uses a hedging strategy that is designed to smooth out the short term fluctuations in the price of natural gas through future sales. This is done by selling approximately 35% of the total natural gas production (inclusive of Crown Royalty volumes) on the daily and monthly spot markets while the balance (approximately 65%) is pre-sold or hedged. These hedges are meant to be methodical and consistent and to avoid speculation. In general, this approach will show hedging losses when short term prices climb and hedging gains when short term prices fall. Peyto generally sells its contracts in either the 7 month summer or the 5 month winter season. Peyto has deployed this strategy for over a decade now, which has resulted in $200 million in cumulative gains over the past 13 years. Over the longer term, however, Peyto expects to break even on forward sales and achieve price security for little to no cost.

For 2014, Peyto realized a natural gas price of $3.77/GJ or $4.30/Mcf, for its natural gas sales. This was a combination of 40% being sold in the daily or monthly spot market and 60% having been pre-sold at an average hedged price of $3.56/GJ. The following table summarizes the remaining hedged volumes for the upcoming years effective March 10, 2015:

	Future Sales		Average Price (CAD)	
	GJ	Mcf*	$/GJ	$/Mcf*
2015	87,375,000	76,454,202	3.48	3.98
2016	41,250,000	36,094,258	3.26	3.73
2017	4,050,000	3,543,800	2.95	3.37
Total	132,675,000	116,092,260	3.40	3.88

**Assuming historical heat content*

As illustrated in the following table, Peyto's unhedged annual realized NGL prices(1) were effectively the same on a year over year basis, and represented 75% of the $94/bbl average Edmonton par oil price in 2014.

Commodity Prices by Component

	Three Months ended December 31		Twelve Months ended December 31	
	2014	2013	**2014**	2013
Natural gas – after hedging ($/GJ)	**3.70**	3.15	**3.77**	3.11
Natural gas – after hedging ($/mcf)	**4.22**	3.59	**4.30**	3.54
AECO monthly ($/GJ)	**3.80**	2.99	**4.19**	3.00
Oil and natural gas liquids ($/bbl)				
Condensate ($/bbl)	**68.72**	84.92	**90.31**	89.85
Propane ($/bbl) (includes hedging)	**20.45**	28.55	**26.58**	25.38
Butane ($/bbl) (includes hedging)	**46.44**	57.26	**53.03**	52.73
Pentane ($/bbl)	**72.30**	90.59	**92.86**	97.14
Total Oil and natural gas liquids ($/bbl)	**55.47**	69.84	**70.68**	70.97
Canadian Light Sweet postings ($/bbl)	**74.41**	86.28	**94.04**	92.83

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

Activity Update

Peyto deliberately postponed certain drilling activity in the first two months of 2015 in response to rapidly falling service costs and restrictions in natural gas transportation service. Now that the service sector has begun reducing costs and most of the restrictions in takeaway capacity have been resolved, activity has resumed to Q4 2014 levels.

So far this quarter, 25 gross (24 net) wells have been spud with 18 gross (18 net) wells having been completed and brought onstream. The Company currently has 8 drilling rigs running and plans for continued drilling and completion activity over the traditional April to mid-June breakup period. As with last year, the level and progress of this planned activity will be weather and access dependent. Post breakup, Peyto will be prepared with drill-ready locations and the flexibility to increase the rig count to 10 rigs depending on the service costs, commodity price environment and potential improvement in returns.

Daily production is currently between 83,000 and 85,000 boe/d, with daily variances due mostly to existing wells being taken temporarily offline for safety concerns when new wells, in close proximity, are being completed. As has become the trend in recent years, Peyto is utilizing pad drilling efficiencies wherever possible to minimize environmental impact and to reduce the costs associated with new surface leases and pipelines.

Facility preparations are underway for the continued expansion of several of Peyto's gas plants. The Swanson plant will be expanded in the summer of 2015, adding an additional 40 mmcf/d of processing capacity with the installation of a third refrigeration module and two more compressors. The Wildhay gas plant will be expanded over the third and fourth quarter with another compressor addition, and the Brazeau gas plant will be expanded towards the end of 2015, coincident with a TCPL meter station expansion, with additional compression and possibly additional refrigeration processing equipment. In total, Peyto expects to have close to 750 mmcf/d of processing capacity operational by the end of Q1 2016.

2015 Outlook

Last year was a year of robust commodity prices and enthusiasm in the industry. While still very active, Peyto remained naturally guarded as that enthusiasm could have driven cost inflation and so it required greater vigilance to ensure return expectations were met. This year looks to be the exact opposite. Commodity prices are much lower, industry activity is greatly restrained and costs are deflating. While the focus on returns will remain the same, Peyto is eager to take advantage of this environment, and "be greedy when others are fearful." The Company currently has a deep inventory of profitable drilling locations but looks to opportunistically add to this inventory at a time when prices and competition are expected to be reduced.

The Company expects that with its disciplined, returns driven strategy, its focus on maintaining a low cost advantage, and its experience generating repeatable low risk returns in the Alberta Deep Basin, 2015 could be just as record breaking and should be another year of profitable growth for Peyto.

Annual General Meeting

Peyto's Annual General Meeting of Shareholders is scheduled for 3:00 p.m. on Tuesday, May 12, 2015 at Livingston Place Conference Centre, +15 level, 222-3rd Avenue SW, Calgary, Alberta. Shareholders are encouraged to visit the Peyto website at www.peyto.com where there is a wealth of information designed to inform and educate investors. A monthly President's Report can also be found on the website which follows the progress of the capital program and the ensuing production growth, along with video and audio commentary from Peyto's senior management.

(signed) "*Darren Gee*"
President and CEO
March 11, 2015

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, 2014 and 2013. The financial statements have been prepared in accordance with the International Accounting Standards Board ("IASB") most current International Financial Reporting Standards ("IFRS") and International Accounting Standards ("IAS").

This discussion provides management's analysis of Peyto's historical financial and operating results and provides estimates of Peyto's future financial and operating performance based on information currently available. Actual results will vary from estimates and the variances may be significant. Readers should be aware that historical results are not necessarily indicative of future performance. This MD&A was prepared using information that is current as of March 10, 2015. Additional information about Peyto, including the most recently filed annual information form is available at www.sedar.com and on Peyto's website at www.peyto.com.

Certain information set forth in this MD&A, including management's assessment of Peyto's future plans and operations, contains forward-looking statements. By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond these parties' control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Peyto's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits that Peyto will derive there from.

All references are to Canadian dollars unless otherwise indicated. Natural gas liquids and oil volumes are recorded in barrels of oil (bbl) and are converted to a thousand cubic feet equivalent (mcfe) using a ratio of six (6) thousand cubic feet to one (1) barrel of oil (bbl). Natural gas volumes recorded in thousand cubic feet (mcf) are converted to barrels of oil equivalent (boe) using the ratio of six (6) thousand cubic feet to one (1) barrel of oil (bbl).

OVERVIEW

Peyto is a Canadian energy company involved in the development and production of natural gas in Alberta's deep basin. As at December 31, 2014, the total Proved plus Probable reserves were 3,188.2 billion cubic feet equivalent (531.4 million barrels of oil equivalent) as evaluated by its 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 natural gas reserves.
- Balance dividends to shareholders with earnings, and cash flow, and balance funding for the capital program with cash flow, equity and available bank lines.

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

ANNUAL FINANCIAL INFORMATION

The following is a summary of selected financial information of the Company for the periods indicated. Reference should be made to the audited consolidated financial statements of the Company, which are available at www.sedar.com.

Year Ended December 31 ($000 except per share amounts)	**2014**	2013	2012
Total revenue (before royalties)	**843,797**	575,845	411,401
Funds from operations	**662,788**	437,742	308,865
Per share – basic and diluted	**4.33**	2.94	2.19
Earnings	**261,778**	142,627	93,951
Per share – basic and diluted	**1.71**	0.96	0.67
Total assets	**3,127,065**	2,555,156	2,203,524
Total long-term debt	**925,000**	875,000	580,000
Dividends per share	**1.14**	0.88	0.72

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.

QUARTERLY FINANCIAL INFORMATION

	2014				**2013**			
($000 except per share amounts)	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Total revenue (net of royalties)*	205,125	196,062	189,830	191,457	154,167	123,851	134,765	122,612
Funds from operations	173,437	166,988	161,577	160,785	125,164	99,736	109,987	102,856
Per share – basic and diluted	1.13	1.09	1.05	1.06	0.84	0.67	0.74	0.69
Earnings	68,597	68,893	62,159	62,129	37,989	30,461	37,773	36,405
Per share – basic and diluted	0.45	0.45	0.41	0.41	0.26	0.21	0.25	0.25
Dividends	49,181	46,107	43,033	36,505	35,702	35,702	32,727	26,766
Per share – basic and diluted	0.32	0.30	0.28	0.24	0.24	0.24	0.22	0.18

*includes realized hedging gains/losses

RESULTS OF OPERATIONS

Production

	Three Months ended December 31		Twelve Months ended December 31	
	2014	2013	**2014**	2013
Natural gas (mmcf/d)	**451.0**	361.9	**412.4**	317.6
Oil & natural gas liquids (bbl/d)	**8,077**	6,984	**7,632**	6,376
Barrels of oil equivalent (boe/d)	**83,251**	67,296	**76,372**	59,313
Million cubic feet equivalent (mmcfe/d)	**499.5**	403.8	**458.2**	355.9

Natural gas production averaged 451.0 mmcf/d in the fourth quarter of 2014, 25 percent higher than the 361.9 mmcf/d reported for the same period in 2013. Oil and natural gas liquids production averaged 8,077 bbl/d, an increase of 16 percent from 6,984 bbl/d reported in the prior year. Aggregate fourth quarter production increased 24 percent from 403.8 mmcfe/d to 499.5 mmcfe/d. Production for the year increased 29 percent from 355.9 mmcfe/d to 458.2 mmcfe/d (59,313 boe/d to 76,372 boe/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 December 31		Twelve Months ended December 31	
	2014	2013	**2014**	2013
Condensate (bbl/d)	**2,984**	2,797	**2,851**	2,336
Propane (bbl/d)	**1,724**	1,492	**1,676**	1,372
Butane (bbl/d)	**1,513**	1,250	**1,425**	1,193
Pentane (bbl/d)	**1,638**	1,248	**1,488**	1,268
Other NGL's (bbl/d)	**218**	197	**192**	207
Oil & natural gas liquids (bbl/d)	**8,077**	6,984	**7,632**	6,376
Million cubic feet equivalent (mmcfe/d)	**48.5**	41.9	**45.8**	38.3

Commodity Prices

	Three Months ended December 31		Twelve Months ended December 31	
	2014	2013	**2014**	2013
Oil and natural gas liquids ($/bbl)	**55.13**	71.98	**71.71**	71.81
Hedging – ngls ($/bbl)	**0.34**	(2.14)	**(1.03)**	(0.84)
Oil and natural gas liquids – after hedging ($/bbl)	**55.47**	69.84	**70.68**	70.97
Natural gas ($/mcf)	**4.24**	3.43	**4.72**	3.40
Hedging – gas ($/mcf)	**(0.02)**	0.16	**(0.42)**	0.14
Natural gas – after hedging ($/mcf)	**4.22**	3.59	**4.30**	3.54
Total Hedging ($/mcfe)	**(0.01)**	0.11	**(0.40)**	0.11
Total Hedging ($/boe)	**(0.07)**	0.64	**(2.39)**	0.66

Peyto's natural gas price, before hedging, averaged $4.24/mcf during the fourth quarter of 2014, an increase of 24 percent from $3.43/mcf reported for the equivalent period in 2013. Oil and natural gas liquids prices before hedging averaged $55.13/bbl, a decrease of 23 percent from $71.98/bbl a year earlier.

Commodity Prices by Component

	Three Months ended December 31		Twelve Months ended December 31	
	2014	2013	**2014**	2013
Natural gas – after hedging ($/mcf)	**4.22**	3.59	**4.30**	3.54
Natural gas – after hedging ($/GJ)	**3.70**	3.15	**3.77**	3.11
AECO monthly ($/GJ)	**3.80**	2.99	**4.19**	3.00
Oil and natural gas liquids ($/bbl)				
Condensate ($/bbl)	**68.72**	84.92	**90.31**	89.85
Propane ($/bbl) (includes hedging)	**20.45**	28.55	**26.58**	25.38
Butane ($/bbl) (includes hedging)	**46.44**	57.26	**53.03**	52.73
Pentane ($/bbl)	**72.30**	90.59	**92.86**	97.14
Total Oil and natural gas liquids ($/bbl)	**55.47**	69.84	**70.68**	70.97
Canadian Light Sweet postings ($/bbl)	**74.41**	86.28	**94.04**	92.83

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

Revenue

	Three Months ended December 31		Twelve Months ended December 31	
($000)	**2014**	2013	**2014**	2013
Natural gas	**175,653**	114,259	**710,585**	394,524
Oil and natural gas liquids	**41,221**	46,248	**199,827**	167,121
Hedging gain (loss) on gas	**(806)**	5,324	**(63,748)**	16,153
Hedging loss on oil and natural gas liquids	**253**	(1,376)	**(2,867)**	(1,953)
Total revenue	**216,321**	164,455	**843,797**	575,845

For the three months ended December 31, 2014, revenue increased 32 percent to $216.3 million from $164.5 million for the same period in 2013. Revenue for 2014 increased 47 per cent to $843.8 million from $575.8 million in 2013. The increase in revenue was a result of increased production volumes and realized natural gas prices offset by lower oil and NGL prices as detailed in the following table:

	Three Months ended December 31			Twelve Months ended December 31		
	2014	2013	**$million**	2014	2013	**$million**
Total Revenue, December 31, 2013			**164.5**			**575.8**
Revenue change due to:						
Natural gas						
Volume (mmcf)	41,496	33,292	**29.4**	109,045	115,932	**122.4**
Price ($/mcf)	$4.22	$3.59	**26.1**	$4.30	$3.54	**114.3**
Oil & NGL						
Volume (mbbl)	743	643	**7.0**	2,043	12,327	**32.4**
Price ($/bbl)	$55.47	$69.84	**(10.7)**	$70.68	$70.97	**(1.1)**
Total Revenue, December 31, 2014			**216.3**			**843.8**

Royalties

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

	Three Months ended December 31		Twelve Months ended December 31	
($000 except per share amounts)	**2014**	2013	**2014**	2013
Royalties	**11,196**	10,288	**61,324**	40,450
% of sales before hedging	**5.2**	6.4	**6.7**	7.2
% of sales after hedging	**5.2**	6.3	**7.3**	7.0
$/mcfe	**0.24**	0.28	**0.37**	0.31
$/boe	**1.46**	1.66	**2.20**	1.87

For the fourth quarter of 2014, royalties averaged $0.24/mcfe or approximately 5.2% 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 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 16 years history, Peyto has invested $4.1 billion in capital projects, found and developed 4.0 TCFe of gas reserves, and paid over $736 million in royalties.

Operating Costs and Transportation

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

	Three Months ended December 31		Twelve Months ended December 31	
	2014	2013	**2014**	2013
Operating costs ($000)	**14,380**	13,032	**57,575**	45,235
$/mcfe	**0.31**	0.35	**0.34**	0.35
$/boe	**1.88**	2.10	**2.07**	2.09
Transportation ($000)	**6,014**	4,887	**21,917**	16,221
$/mcfe	**0.13**	0.13	**0.13**	0.12
$/boe	**0.79**	0.79	**0.79**	0.75

Operating costs increased to $14.4 million in the fourth quarter of 2014 from $13.0 million for the equivalent period in 2013 due to increased production volumes and well count. On a unit-of-production basis, operating costs decreased 11% averaging $0.31/mcfe in the fourth quarter of 2014 compared to $0.35/mcfe for the equivalent period in 2013. Operating costs decreased 3% from $0.35/mcfe in 2013 to $0.34/mcfe in 2014.

Transportation expenses were unchanged at $0.13/mcfe in the fourth quarters 2014 and 2013 but increased 8% to $0.13/mcfe in 2014 from $0.12/mcfe in 2013 due to increased TCPL tolls in September 2013.

General and Administrative Expenses

	Three Months ended December 31		Twelve Months ended December 31	
	2014	2013	**2014**	2013
G&A expenses ($000)	**3,804**	3,489	**15,765**	14,306
Capital and operating overhead recoveries	**(1,094)**	(1,183)	**(9,968)**	(9,102)
Net G&A expenses	**2,710**	2,306	**5,797**	5,204
$/mcfe	**0.06**	0.06	**0.03**	0.04
$/boe	**0.35**	0.37	**0.21**	0.24

For the fourth quarter, general and administrative expenses before and after overhead recoveries were relatively flat compared to the same quarter of 2013. General and administrative expenses averaged $0.06/mcfe in the fourth quarter of 2014 compared to $0.06/mcfe for the equivalent period in 2013. General and administrative expenses for 2014 were $0.03/mcfe, down 25% from $0.04/mcfe in 2013.

Peyto capitalizes general and administrative costs and market and reserves based compensation related to the execution of its capital program. The majority of Peyto's general and administrative costs are related to the execution of its capital program. In 2014, Peyto capitalized $7.8 million of expenses directly attributable to exploration and development activities compared to $7.2 million in 2013.

Performance Based Compensation

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

The reserve value based component is 4% of the incremental increase in value, if any, as adjusted to reflect changes in debt, equity, dividends, general and administrative expenses and interest expense, of proved producing reserves calculated using a constant price at December 31 of the current year and a discount rate of 8%. This methodology can generate interim results which vary significantly from the final compensation paid. Compensation expense recovery of $4.0 million was recorded for the quarter ended December 31, 2014 ($5.8 million year to date).

($millions except per share values)	2014	2013	Change
Net present value of proved producing reserves @ 8% based on constant InSite 2014 price forecast	2,018.6	2,005.3	
Net debt before performance based compensation	(997.7)	(946.5)	
2014 dividends, G&A and interest		(215.0)	
Net value	1,020.9	843.8	
Shares outstanding (millions)	153.691	148.948	
Net value per share	6.6430	5.6647	**0.9783**
Shares outstanding at beginning of year (millions)			**148.948**
Equity adjusted increase in value			**145.7**
2014 reserve value based compensation @ 4%			**5.8**

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. The 2014 market based component was based on i) 0.07 million vested rights at an average grant price of $20.63, average cumulative dividends of $0.48 and a ten day weighted average price of $22.58, ii) 1.0 million vested rights at an average grant price of $22.83, average cumulative dividends of $0.88 and a ten day weighted average price of $32.27 and iii) 1.0 million vested rights at an average grant price of $32.43, average cumulative dividends of $1.14 and a ten day weighted average price of $34.34.

The total amount expensed under these plans was as follows:

($000)	**2014**	2013
Market based compensation	13,348	14,061
Reserve based compensation	5,829	2,236
Total market and reserves based compensation	**19,177**	16,297

For the future market based component, compensation costs as at December 31, 2014 were $0.9 million related to 1.0 million non-vested rights with an average grant price of $22.83, average cumulative dividends of $0.88 and 2.1 million non-vested rights with an average grant price of $32.43 and average cumulative dividends of $1.14. (2013 – $5.6 million related to 2.0 million non-vested rights with an average grant price of $22.83, average cumulative dividends of $0.88 and 0.1 million non-vested rights with an average grant price of $20.63 and average cumulative dividends of $0.48). The cumulative provision for future performance based compensation as at December 31, 2014 was $9.2 million (2013 - $8.3 million).

Subsequent to December 31, 2014, 3.4 million rights were granted at a price of $34.34 to be valued at the ten day weighted average market price at December 31, 2015 and vesting 1/3 on each of December 31, 2015, December 31, 2016 and December 31, 2017.

Rights Outstanding Under Market Based Compensation Plan

	Valued but Not Vested			**To be Valued December 31, 2015**	
Vesting Date	**Number of Rights**	**Value ($)**		**Number of Rights**	**Average Grant Price ($)**
December 31, 2015	964,003	9,931,752	*	1,130,567	34.34
	1,048,552	3,242,681	**		
December 31, 2016	1,048,552	3,242,681	**	1,130,567	34.34
December 31, 2017	-	-		1,130,567	34.34

*Valued on December 31, 2013 at $32.27
**Valued on December 31, 2014 at $34.34

Interest Expense

	Three Months ended December 31		Twelve Months ended December 31	
	2014	2013	**2014**	2013
Interest expense ($000)	**8,585**	8,778	**34,397**	30,991
$/mcfe	**0.19**	0.24	**0.21**	0.24
$/boe	**1.12**	1.42	**1.23**	1.43
Average interest rate	**3.8%**	4.1%	**4.0%**	4.2%

Fourth quarter 2014 interest expense was $8.6 million or $0.19/mcfe compared to $8.8 million or $0.24/mcfe for the fourth quarter 2013. 2014 interest expense was $34.4 million or $0.21/mcfe compared to $31.0 million or $0.24/mcfe for the equivalent period in 2013.

Netbacks

	Three Months ended December 31		Twelve Months ended December 31	
($/mcfe)	**2014**	2013	**2014**	2013
Gross Sale Price	**4.72**	4.32	**5.44**	4.32
Hedging gain (loss)	**(0.01)**	0.11	**(0.40)**	0.11
Net Sale Price	**4.71**	4.43	**5.04**	4.43
Less: Royalties	**0.24**	0.28	**0.38**	0.31
Operating costs	**0.31**	0.35	**0.34**	0.35
Transportation	**0.13**	0.13	**0.13**	0.12
Field netback	**4.03**	3.67	**4.19**	3.65
General and administrative	**0.06**	0.06	**0.03**	0.04
Interest on long-term debt	**0.19**	0.24	**0.21**	0.24
Cash netback ($/mcfe)	**3.78**	3.37	**3.95**	3.37
Cash netback ($/boe)	**22.64**	20.22	**23.72**	20.22

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

Depletion, depreciation and accretion for the fourth quarter of 2014 was $83.6 million. The 2014 provision for depletion, depreciation and accretion totaled $291.7 million compared to $225.0 million in 2013. On a unit-of-production basis, depletion, depreciation and amortization costs for 2014 averaged $1.74/mcfe compared to $1.73/mcfe for 2013.

Income Taxes

The deferred income tax expense is $22.7 million for the three months ended December 31, 2014 (2013 - $12.7 million). Deferred income tax expense for 2014 is $87.3 million (2013 - $46.7 million). Resource pools are generated from the capital program, which are available to offset income tax liabilities.

Income Tax Pool type ($ millions)	**December 31, 2014**	December 31, 2013	**Annual deductibility**
Canadian Oil and Gas Property Expense	**232.3**	245.1	10% declining balance
Canadian Development Expense	**806.6**	668.5	30% declining balance
Canadian Exploration Expense	**85.7**	208.7	100%
Undepreciated Capital Cost	**385.3**	312.3	25% declining balance
Non-capital loss carry forward	**-**	19.7	100%
Other	**32.1**	32.5	7% declining balance to 20%
Total Federal Tax Pools	**1,542.0**	1,486.8	
Additional Alberta Tax Pools	44.9	44.9	100% and 30% declining balance

MARKETING

Commodity Price Risk Management

Peyto is a party to certain off balance sheet derivative financial instruments, including fixed price contracts. Peyto enters into these forward contracts with well established counterparties for the purpose of protecting a portion of its future revenues from the volatility of oil and natural gas prices. In order to minimize counterparty risk, these marketing contracts are executed with financial institutions that are members of Peyto's banking syndicate. During the fourth quarter of 2014, a realized hedging loss of $0.5 million was recorded as compared to a gain of $3.9 million for the equivalent period in 2013. A summary of contracts outstanding in respect of the hedging activities are as follows:

Natural Gas Period Hedged	Type	Daily Volume	Price (CAD)
November 1, 2013 to March 31, 2015	Fixed Price	5,000 GJ	$3.6025/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
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
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.50/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.57/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.69/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.50/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.26/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.10/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.86/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.85/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.90/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.00/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.00/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.00/GJ

November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.9025/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	$4.01/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.94/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.03/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.123/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.61/GJ
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.57/GJ
December 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.63/GJ
December 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.71/GJ
December 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$3.85/GJ
December 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	$4.18/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
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.78/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.79/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.91/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.865/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$3.75/GJ
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$2.75/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
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.915/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.73/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.70/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.56/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.57/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.62/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.70/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.70/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.70/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.71/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.67/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.74/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.72/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.70/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.71/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.75/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.65/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.41/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.41/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.45/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.50/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.58/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.65/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.515/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.45/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.45/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.40/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.30/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.25/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$3.305/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.37/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.43/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.40/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.35/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.35/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.24/GJ
April 1, 2016 to October 31, 2016	Fixed Price	5,000 GJ	$3.05/GJ

As at December 31, 2014, Peyto had committed to the future sale of 115,910,000 gigajoules (GJ) of natural gas at an average price of $3.68 per GJ or $4.20 per mcf. Had these contracts been closed on December 31, 2014, Peyto would have realized a gain in the amount of $105.1 million.

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

Natural Gas Period Hedged	**Type**	**Daily Volume**	**Price (CAD)**
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$2.75/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$2.7525/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$2.76/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$2.8675/GJ
April 1, 2015 to March 31, 2016	Fixed Price	5,000 GJ	$2.925/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.97/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.855/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.98/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.83/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$3.05/GJ
April 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.90/GJ
November 1, 2015 to March 31, 2017	Fixed Price	5,000 GJ	$2.95/GJ
November 1, 2016 to March 31, 2017	Fixed Price	5,000 GJ	$2.975/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

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

Interest Rate Risk Management

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 December 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 $1.4 million per quarter. Average debt outstanding for the quarter was $850.9 million (including $320 million fixed rate debt).

LIQUIDITY AND CAPITAL RESOURCES

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

	Three Months ended Dec. 31		**Twelve Months ended Dec. 31**	
($000)	**2014**	2013	**2014**	2013
Cash flows from operating activities	**193,145**	116,852	**642,531**	407,357
Change in non-cash working capital	**(24,898)**	(1,759)	**(2,046)**	11,667
Change in provision for future performance based compensation	**(13,987)**	(6,226)	**3,126**	2,421
Performance based compensation	**19,177**	16,297	**19,177**	16,297
Funds from operations	**173,437**	125,164	**662,788**	437,742
Funds from operations per share	**1.13**	0.84	**4.33**	2.94

For the fourth quarter ended December 31, 2014, funds from operations totaled $173.4 million or $1.13 per share, as compared to $125.2 million, or $0.84 per share during the same quarter in 2013. Funds from operations for the year increased 51% to $662.8 million due to production growth and stronger natural gas prices.

Peyto's policy is to balance dividends to shareholders with earnings and cash flow, and balance funding for the capital program with cash flow, equity and available bank lines. Earnings and cash flow are sensitive to changes in commodity prices, exchange rates and other factors that are beyond Peyto's control. Current volatility in commodity prices creates uncertainty as to the funds from operations and capital expenditure budget. Accordingly, results are assessed throughout the year and operational plans revised as necessary to reflect the most current information.

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

Long Term Debt

($000)	**December 31, 2014**	December 31, 2013
Bank credit facility	**605,000**	605,000
Senior unsecured notes	**320,000**	270,000
Balance, end of the period	**925,000**	875,000

As at December 31, 2014, the Company had a syndicated $1 billion extendible revolving credit facility with a stated term date of April 25, 2017. 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 three year period. Borrowings under the 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 July 3, 2014, Peyto issued CDN $50 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 3.79% and mature on July 3, 2022. Interest is 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 shareholders' equity and 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.

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

Peyto's total borrowing capacity is $1.32 billion of which the 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 $560 to $600 million for 2015. The total amount of capital invested in 2015 will be driven by the number and quality of projects generated. Capital will only be invested if it meets the long term rate of return 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-IFRS measure that is the sum of long-term debt and working capital excluding the current financial derivative instruments and current provision for future performance based compensation. It is used by management to analyze the financial position and leverage of Peyto. Net debt is reconciled below to long-term debt which is the most directly comparable IFRS measure:

($000)	**As at December 31, 2014**	As at December 31, 2013
Bank credit facility	**605,000**	605,000
Senior unsecured notes	**320,000**	270,000
Current assets	**(218,097)**	(95,626)
Current liabilities	**217,443**	198,873
Financial derivative instruments	**93,387**	(26,606)
Provision for future performance based compensation	**(8,225)**	(5,100)
Net debt	**1,009,508**	946,541

Capital

Authorized: Unlimited number of voting common shares

Issued and Outstanding

Common Shares (no par value)	**Number of Common Shares**	**Amount ($000)**
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)	-	(5,148)
Balance, December 31, 2014	**153,690,808**	**1,292,398**

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).

Shares to be issued

On December 31, 2014 the Company completed a private placement of 168,920 common shares to employees and consultants for net proceeds of $5.6 million ($33.30 per share). These common shares were issued on January 7, 2015.

Capital Expenditures

Net capital expenditures for the fourth quarter of 2014 totaled $179.7 million. Exploration and development related activity represented $134.1 million (75% of total), while expenditures on facilities, gathering systems and equipment totaled $39.9 million (22% of total) and land, seismic and acquisitions/dispositions totaled $5.7 million.

The following table summarizes capital expenditures for the period:

	Three Months ended December 31		Twelve Months ended December 31	
($000)	**2014**	2013	**2014**	2013
Land	**4,012**	1,144	**12,750**	6,427
Seismic	**1,731**	683	**8,114**	2,984
Drilling	**80,578**	59,825	**311,794**	254,000
Completions	**53,481**	46,836	**183,471**	151,752
Equipping and tie-ins	**16,687**	12,389	**53,777**	48,303
Facilities and pipelines	**23,208**	33,418	**120,210**	112,054
Acquisitions	**-**	-	**273**	2,483
Total Capital Expenditures	**179,697**	154,295	**690,389**	578,003

Dividends

	Three Months ended December 31		Twelve Months ended December 31	
	2014	2013	**2014**	2013
Funds from operations ($000)	**171,737**	125,164	**661,088**	437,742
Total dividends ($000)	**49,181**	35,702	**174,826**	130,898
Total dividends per share ($)	**0.32**	0.24	**1.14**	0.88
Payout ratio (%)	**29**	29	**26**	30

Peyto's policy is to balance dividends to shareholders with earnings and cash flow; and balance 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

In addition to those recorded on the Company's balance sheet, the following is a summary of Peyto's contractual obligations and commitments as at December 31, 2014:

	2015	2016	2017	2018	2019	Thereafter
Interest payments [(1)]	14,125	14,125	14,125	14,125	11,930	18,405
Transportation commitments	20,566	20,240	16,298	13,019	9,020	12,773
Operating leases	2,549	1,914	1,654	1,295	1,295	9,062
Other	2,603	-	-	-	-	-
Total	39,843	36,279	32,077	28,439	22,245	40,240

(1) Fixed interest payments on senior unsecured notes

Litigation

On October 1, 2013, two shareholders (the "Plaintiffs") 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 estimate 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.

On July 3, 2014, the Plaintiffs filed a lawsuit with the Court against KPMG LLP, Poseidon's and Old Open Range's former auditors, making allegations substantially similar to those in the other claims. On July 29, 2014, KPMG LLP filed a statement of defense and a third party claim against Poseidon, the Company and the former directors and officers of Poseidon. The third party claim seeks, among other things, an indemnity, or alternatively contribution, from the third party defendants with respect to any judgment awarded against KPMG LLP.

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. The Company has not yet been required to defend either of the actions. If it is required to defend the actions, 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 the Company is a partner of a law firm that provides legal services to the Company. For the year ended December 31, 2014, legal fees totaled $0.7 million (2013 - $0.7 million). As at December 31, 2014, an amount due to this firm of $0.7 million was included in accounts payable (2013 - $0.7 million).

Certain directors of Peyto are also directors of reporting entities that Peyto engages in transactions with either through the parent or the subsidiary. Peyto is considered related to these reporting entities because of common significant influence. Such services are provided in the normal course of business and at market rates. For the year ended December 31, 2014, expenses totaled $0.8 million (2013 - $0.2 million). As at December 31, 2014, an amount due to these companies of $0.1 million was included in accounts payable (2013 - $0.1 million).

RISK MANAGEMENT

Investors who purchase shares are participating in the total returns from a portfolio of western Canadian natural gas producing properties. As such, the total returns earned by investors and the value of the shares are subject to numerous risks inherent in the oil and natural gas industry.

Expected returns depend largely on the volume of petroleum and natural gas production and the price received for such production, along with the associated costs. The price received for oil depends on a number of factors, including West Texas Intermediate oil prices, Canadian/US currency exchange rates, quality differentials and Edmonton par oil prices. The price received for natural gas production is primarily dependent on current Alberta market prices. Peyto's marketing strategy is designed to smooth out short term fluctuations in the price of natural gas through future sales. It is meant to be methodical and consistent and to avoid speculation.

Although Peyto's focus is on internally generated drilling programs, any acquisition of oil and natural gas assets depends on an assessment of value at the time of acquisition. Incorrect assessments of value can adversely affect dividends to shareholders and the value of the shares. Peyto employs experienced staff and performs appropriate levels of due diligence on the analysis of acquisition targets, including a detailed examination of reserve reports; if appropriate, re-engineering of reserves for a large portion of the properties to ensure the results are consistent; site examinations of facilities for environmental liabilities; detailed examination of balance sheet accounts; review of contracts; review of prior year tax returns and modeling of the acquisition to attempt to ensure accretive results to the shareholders.

Inherent in development of the existing oil and gas reserves are the risks, among others, of drilling dry holes, encountering production or drilling difficulties or experiencing high decline rates in producing wells. To minimize these risks, Peyto employs experienced staff to evaluate and operate wells and utilize appropriate technology in operations. In addition, prudent work practices and procedures, safety programs and risk management principles, including insurance coverage protect Peyto against certain potential losses.

The value of Peyto's shares is based on among other things, the underlying value of the oil and natural gas reserves. Geological and operational risks can affect the quantity and quality of reserves and the cost of ultimately recovering those reserves. Lower oil and gas prices increase the risk of write-downs on oil and gas property investments. In order to mitigate this risk, proven and probable oil and gas reserves are evaluated each year by a firm of independent reservoir engineers. The reserves committee of the Board of Directors reviews and approves the reserve report.

Access to markets may be restricted at times by pipeline or processing capacity. These risks are minimized by controlling as much of the processing and transportation activities as possible and ensuring transportation and processing contracts are in place with reliable cost efficient counterparties.

The petroleum and natural gas industry is subject to extensive controls, regulatory policies and income and resource taxes imposed by various levels of government. These regulations, controls and taxation policies are amended from time to time. Peyto has no control over the level of government intervention or taxation in the petroleum and natural gas industry. Peyto operates in such a manner to ensure, to the best of its knowledge that it is in compliance with all applicable regulations and are able to respond to changes as they occur.

The petroleum and natural gas industry is subject to both environmental regulations and an increased environmental awareness. Peyto has reviewed its environmental risks and is, to the best of its knowledge, in compliance with the appropriate environmental legislation and have determined that there is no current material impact on operations. Peyto employs environmentally responsible business operations, and looks to both Alberta provincial authorities and Canada's federal authorities for direction and regulation regarding environmental and climate change legislation.

Peyto is subject to financial market risk. In order to maintain substantial rates of growth, Peyto must continue reinvesting in, drilling for or acquiring petroleum and natural gas. The capital expenditure program is funded primarily through funds from operations, debt and, if appropriate, equity.

CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

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

Internal Control over Financial Reporting

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

Peyto is required to disclose herein any change in Peyto's internal control over financial reporting that occurred during the period ended December 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 Peyto's disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

CRITICAL ACCOUNTING ESTIMATES

Reserve Estimates

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

Peyto's estimated quantities of proved and probable reserves at December 31, 2014 were audited by independent petroleum engineers InSite Petroleum Consultants Ltd. InSite has been evaluating reserves in this area and for Peyto since inception.

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

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

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

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

Reserve Value Performance Based Compensation
The reserve value based compensation is calculated using the year end independent reserves evaluation which was completed in February 2015. A quarterly provision for the reserve value based compensation is calculated using estimated proved producing reserve additions adjusted for changes in debt, equity, dividends, general and administrative expenses and interest expense. Actual proved producing reserves additions and forecasted commodity prices could vary significantly from those estimated and may have a material effect on the calculation.

Income Taxes
The determination of Peyto's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded.

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

CHANGES IN ACCOUNTING POLICIES

Presentation of Financial Statements

Peyto adopted the following standards on January 1, 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 December 31, 2014.

In July 2014, the IASB completed the final elements of IFRS 9 "Financial Instruments." The Standard supersedes earlier versions of IFRS 9 and completes the IASB’s project to replace IAS 39 "Financial Instruments: Recognition and Measurement." IFRS 9, as amended, includes a principle-based approach for classification and measurement of financial assets, a single 'expected loss’ impairment model and a substantially-reformed approach to hedge accounting. The Standard will come into effect for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 9 will be applied by Peyto on January 1, 2018 and the Company is currently evaluating the impact of the standard on its financial statements.

In May 2014, the IASB issued IFRS 15 "Revenue from Contracts with Customers," which replaces IAS 18 "Revenue," IAS 11 "Construction Contracts," and related interpretations. The standard is required to be adopted either retrospectively or using a modified transition approach for fiscal years beginning on or after January 1, 2017, with earlier adoption permitted. IFRS 15 will be applied by Peyto on January 1, 2017 and the Company is currently evaluating the impact of the standard on Peyto's financial statements.

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
	Q4	Q3	Q2	Q1	Q4
Operations					
Production					
Natural gas (mcf/d)	451,044	420,538	388,407	389,002	361,870
Oil & NGLs (bbl/d)	8,077	7,502	7,568	7,375	6,984
Barrels of oil equivalent (boe/d @ 6:1)	83,251	77,592	72,302	72,209	67,296
Thousand cubic feet equivalent (mcfe/d @ 6:1)	499,505	465,550	433,812	433,252	403,774
Average product prices					
Natural gas ($/mcf)	4.22	4.18	4.37	4.45	3.59
Oil & natural gas liquids ($/bbl)	55.47	71.01	77.30	80.49	69.84
$/MCFE					
Average sale price ($/mcfe)	4.71	4.92	5.26	5.37	4.43
Average royalties paid ($/mcfe)	0.24	0.34	0.45	0.46	0.28
Average operating expenses ($/mcfe)	0.31	0.33	0.36	0.39	0.35
Average transportation costs ($/mcfe)	0.13	0.13	0.13	0.13	0.13
Field netback ($/mcfe)	4.03	4.12	4.32	4.39	3.67
General & administrative expense ($/mcfe)	0.06	0.02	0.01	0.04	0.06
Interest expense ($/mcfe)	0.19	0.20	0.22	0.23	0.24
Cash netback ($/mcfe)	3.78	3.90	4.09	4.12	3.37
Financial ($000 except per share)					
Revenue	216,321	210,640	207,519	209,318	164,455
Royalties	11,196	14,578	17,689	17,861	10,288
Funds from operations	173,147	166,988	161,577	160,785	125,164
Funds from operations per share	1.13	1.09	1.05	1.06	0.84
Total dividends	49,181	46,107	43,033	36,505	35,702
Total dividends per share	0.32	0.30	0.28	0.24	0.24
Payout ratio	29%	28%	27%	23%	29%
Earnings	68,597	68,893	62,159	62,129	37,989
Earnings per diluted share	0.45	0.45	0.41	0.41	0.26
Capital expenditures	179,697	180,024	151,290	179,378	154,295
Weighted average shares outstanding	153,690,808	153,690,808	153,690,808	151,826,431	148,758,923

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Independent Auditor's Report
To the Shareholders of Peyto Exploration & Development Corp.

We have audited the accompanying financial statements of Peyto Exploration & Development Corp., which comprise the balance sheets as at December 31, 2014 and 2013, and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Peyto Exploration & Development Corp. as at December 31, 2014 and 2013, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

(signed) "Deloitte LLP"
Chartered Accountants
March 10, 2015
Calgary, Alberta

Peyto Exploration & Development Corp.
Balance Sheet
(Amounts in $ thousands)

	December 31 2014	December 31 2013
Assets		
Current assets		
Accounts receivable	98,699	83,714
Due from private placement *(Note 6)*	5,625	6,245
Derivative financial instruments *(Note 11)*	93,387	-
Prepaid expenses	20,386	5,666
	218,097	95,625
Long-term derivative financial instruments *(Note 11)*	11,677	-
Property, plant and equipment, net *(Note 3)*	2,897,291	2,459,531
	2,908,968	2,459,531
	3,127,065	2,555,156
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	192,312	155,265
Dividends payable *(Note 6)*	16,906	11,901
Derivative financial instruments *(Note 11)*	-	26,606
Provision for future performance based compensation *(Note 9)*	8,225	5,100
	217,443	198,872
Long-term debt *(Note 4)*	925,000	875,000
Long-term derivative financial instruments *(Note 11)*	-	5,180
Provision for future performance based compensation *(Note 9)*	1,024	3,200
Decommissioning provision *(Note 5)*	100,815	61,184
Deferred income taxes *(Note 10)*	330,847	211,082
	1,357,686	1,155,646
Equity		
Shareholders' capital *(Note 6)*	1,292,398	1,130,069
Shares to be issued *(Note 6)*	5,625	6,245
Retained earnings	173,927	86,975
Accumulated other comprehensive income (loss) *(Note 6)*	79,986	(22,651)
	1,551,936	1,200,638
	3,127,065	2,555,156

Approved by the Board of Directors

(signed) *"Michael MacBean"*
Director

(signed) *"Darren Gee"*
Director

Peyto Exploration & Development Corp.
Income Statement
(Amounts in $ thousands)

	Year ended December 31	
	2014	**2013**
Revenue		
Oil and gas sales	910,412	561,645
Realized (loss) gain on hedges *(Note 11)*	(66,615)	14,200
Royalties	(61,324)	(40,450)
Petroleum and natural gas sales, net	**782,473**	535,395
Expenses		
Operating (*Note 7)*	57,575	45,235
Transportation	21,917	16,221
General and administrative	5,797	5,204
Market and reserves based bonus *(Note 9)*	19,177	16,297
Future performance based compensation *(Note 9)*	949	5,564
Interest *(Note 8)*	34,397	30,991
Accretion of decommissioning provision *(Note 5)*	1,883	1,544
Depletion and depreciation *(Note 3)*	291,731	224,976
	433,426	346,032
Earnings before taxes	**349,047**	189,363
Income tax		
Deferred income tax expense *(Note 10)*	87,269	46,736
Earnings for the year	**261,778**	142,627
Earnings per share *(Note 6)*		
Basic and diluted	**$ 1.71**	$ 0.96
Weighted average number of common shares outstanding *(Note 6)*		
Basic and diluted	**153,231,099**	148,737,654

Peyto Exploration & Development Corp.
Statement of Comprehensive Income
(Amounts in $ thousands)

	Year ended December 31	
	2014	**2013**
Earnings for the year	**261,778**	142,627
Other comprehensive income		
Change in unrealized gain (loss) on cash flow hedges	70,234	(25,307)
Deferred tax (expense) recovery	(34,212)	9,877
Realized loss (gain) on cash flow hedges	66,615	(14,200)
Comprehensive Income	**364,415**	112,997

Peyto Exploration & Development Corp.

Statement of Changes in Equity

(Amounts in $ thousands)

	Year ended December 31	
	2014	**2013**
Shareholders' capital, Beginning of Year	**1,130,069**	1,124,382
Equity offering	160,480	-
Common shares issued by private placement	6,997	5,742
Common shares issuance costs (net of tax)	(5,148)	(55)
Shareholders' capital, End of Year	**1,292,398**	1,130,069

Common shares to be issued, Beginning of Year	**6,245**	3,459
Common shares issued	(6,245)	(3,459)
Common shares to be issued	5,625	6,245
Common shares to be issued, End of Year	**5,625**	6,245

Retained earnings, Beginning of Year	**86,975**	75,247
Earnings for the year	261,778	142,627
Dividends *(Note 7)*	(174,826)	(130,899)
Retained earnings, End of Year	**173,927**	86,975

Accumulated other comprehensive income, Beginning of Year	**(22,651)**	6,979
Other comprehensive income (loss)	102,637	(29,630)
Accumulated other comprehensive income, End of Year	**79,986**	(22,651)

Total Equity	**1,551,936**	1,200,638

Peyto Exploration & Development Corp.

Statement of Cash Flows

(Amounts in $ thousands)

	Year ended December 31	
	2014	**2013**
Cash provided by (used in)		
Operating activities		
Earnings	261,778	142,627
Items not requiring cash:		
Deferred income tax	87,269	46,736
Depletion and depreciation	291,731	224,976
Accretion of decommissioning provision	1,883	1,544
Long term portion of future performance based compensation	(2,176)	3,141
Change in non-cash working capital related to operating activities	2,046	(11,667)
	642,531	407,357
Financing activities		
Issuance of common shares	167,477	5,742
Issuance costs	(6,865)	(73)
Cash dividends paid	(169,821)	(127,908)
Increase (decrease) in bank debt	-	175,000
Issuance of long term notes	50,000	120,000
	40,791	172,761
Investing activities		
Additions to property, plant and equipment	(690,389)	(578,003)
Change in prepaid capital	(1,354)	(5,081)
Change in non-cash working capital relating to investing activities	8,421	2,966
	(683,322)	(580,118)
Net increase in cash	-	-
Cash, beginning of year	-	-
Cash, end of year	**-**	**-**

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

Cash interest paid	**32,130**	23,920
Cash taxes paid	**-**	1,800

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 Board of Directors of Peyto on March 10, 2015.

2. Basis of presentation

These financial statements ("financial statements") as at and for the years ended December 31, 2014 and December 31, 2013 represent the Company's results and financial position in accordance with International Financial Reporting Standards ("IFRS").

a) Summary of significant accounting policies

The precise determination of many assets and liabilities is dependent upon future events and the preparation of periodic financial statements necessarily involves the use of estimates and approximations. Accordingly, actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the Company's basis of presentation as disclosed.

b) Significant accounting estimates and judgements

The timely preparation of the financial statements in conformity with IFRS requires that management make estimates and assumptions and use judgment regarding the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

Amounts recorded for depreciation, depletion and amortization, decommissioning costs, reserve based bonus and obligations and amounts used for impairment calculations are based on estimates of gross proved plus probable reserves and future costs required to develop those reserves. By their nature, these estimates of reserves, including the estimates of future prices and costs, and the related future cash flows are subject to measurement uncertainty, and the impact in the financial statements of future periods could be material.

The determination of CGUs requires judgment in defining a group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. CGUs are determined by, shared infrastructure, commodity type, similar exposure to market risks and materiality.

The amount of compensation expense accrued for future performance based compensation arrangements are subject to management's best estimate of whether or not the performance criteria will be met and what the ultimate payout amount to be paid out.

Tax interpretations, regulations and legislation in the various jurisdictions in which the Company operates are subject to change. As such, income taxes are subject to measurement uncertainty.

c) Recent Accounting Pronouncement

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

d) Standards issued but not yet effective

In July 2014, the IASB completed the final elements of IFRS 9 "Financial Instruments." The Standard supersedes earlier versions of IFRS 9 and completes the IASB’s project to replace IAS 39 "Financial Instruments: Recognition and Measurement." IFRS 9, as amended, includes a principle-based approach for classification and measurement of financial assets, a single 'expected loss’ impairment model and a substantially-reformed approach to hedge accounting. The Standard will come into effect for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 9 will be applied by Peyto on January 1, 2018 and the Company is currently evaluating the impact of the standard on its financial statements

In May 2014, the IASB issued IFRS 15 "Revenue from Contracts with Customers," which replaces IAS 18 "Revenue," IAS 11 "Construction Contracts," and related interpretations. The standard is required to be adopted either retrospectively or using a modified transition approach for fiscal years beginning on or after January 1, 2017, with earlier adoption permitted. IFRS 15 will be applied by Peyto on January 1, 2017 and the Company is currently evaluating the impact of the standard on Peyto's financial statements.

e) Presentation currency

All amounts in these financial statements are expressed in Canadian dollars, as this is the functional and presentation currency of the Company.

f) Cash Equivalents

Cash equivalents include term deposits or a similar type of instrument, with a maturity of three months or less when purchased.

g) Jointly controlled operations and assets

Certain activities of the Company are conducted jointly with others where the participants have a direct ownership interest in, and jointly control, the related assets. Accordingly, the accounts of Peyto reflect only its working interest share of revenues, expenses and capital expenditures related to these jointly controlled assets.

Processing recoveries related to joint venture partners reduces operating expenses.

h) Exploration and evaluation assets

Pre-license costs

Costs incurred prior to obtaining the legal right to explore for hydrocarbon resources are expensed in the period in which they are incurred. The Company has no pre-license costs.

Exploration and evaluation costs

Once the legal right to explore has been acquired, costs directly associated with an exploration well are capitalized as exploration and evaluation intangible assets until the drilling of the well is complete and the results have been evaluated. All such costs are subject to technical feasibility, commercial viability and management review as well as review for impairment at least once a year to confirm the continued intent to develop or otherwise extract value from the discovery. The Company has no exploration or evaluation assets.

i) Property, plant and equipment

Oil and gas properties and other property, plant and equipment are stated at cost, less accumulated depreciation and accumulated impairment losses.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the decommissioning provision and borrowing costs for qualifying assets. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. Costs include expenditures on the construction, installation or completion of infrastructure such as well sites, pipelines and facilities including activities such as drilling, completion and tie-in costs, equipment and installation costs, associated geological and human resource costs, including unsuccessful development or delineation wells.

Oil and natural gas asset swaps

For exchanges or parts of exchanges that involve assets, the exchange is accounted for at fair value. Assets are then de-recognized at their current carrying amount.

Depletion and depreciation

Oil and natural gas properties are depleted on a unit-of-production basis over the proved plus probable reserves. All costs related to oil and natural gas properties (net of salvage value) and estimated costs of future development of proved plus probable undeveloped reserves are depleted and depreciated using the unit-of-production method based on estimated gross proved plus probable reserves as determined by independent reservoir engineers. For purposes of the depletion and depreciation calculation, relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Other property, plant and equipment are depreciated using a declining balance method over useful life of 20 years.

j) Corporate assets

Corporate assets not related to oil and natural gas exploration and development activities are recorded at historical costs and depreciated over their useful life. These assets are not significant or material in nature.

k) Impairment of non-financial assets

The Company assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Company estimates the asset's recoverable amount. An asset's recoverable amount is the higher of fair value less costs to sell or value-in-use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is assessed as part of a cash generating unit ("CGU"). If the carrying amount of an asset or CGU exceeds its recoverable amount, the asset or CGU is considered impaired and is written down to its recoverable amount. In assessing value-in-use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, recent market transactions are taken into account, if available. If no such transactions can be identified, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded securities or other available fair value indicators.

Impairment losses of continuing operations are recognized in the income statement.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Company estimates the asset's or cash-generating unit's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years.

l) Leases

Leases or other arrangements entered into for the use of an asset are classified as either finance or operating leases. Finance leases transfer to the Company substantially all of the risks and benefits incidental to ownership of the leased asset. Assets under finance lease are amortized over the shorter of the estimated useful life of the assets and the lease term. All other leases are classified as operating leases and the payments are amortized on a straight-line basis over the lease term.

m) Financial instruments

Financial instruments within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* ("IAS 39") are initially recognized at fair value on the balance sheet. The Company has classified each financial instrument into the following categories: "fair value through profit or loss"; "loans & receivables"; and "other liabilities". Subsequent measurement of the financial instruments is based on their classification. Unrealized gains and losses on fair value through profit or loss financial instruments are recognized in earnings. The other categories of financial instruments are recognized at amortized cost using the effective interest method. The Company has made the following classifications:

Financial Assets & Liabilities	**Category**
Cash	Fair value through profit or loss
Accounts Receivable	Loans & receivables
Due from Private Placement	Loans & receivables
Accounts Payable and Accrued Liabilities	Other liabilities
Provision for Future Performance Based Compensation	Other liabilities
Dividends Payable	Other liabilities
Long Term Debt	Other liabilities
Derivative Financial Instruments	Fair value through profit or loss

Derivative instruments and risk management

Derivative instruments are utilized by the Company to manage market risk against volatility in commodity prices. The Company's policy is not to utilize derivative instruments for speculative purposes. The Company has chosen to designate its existing derivative instruments as cash flow hedges. The Company assesses, on an ongoing basis, whether the derivatives that are used as cash flow hedges are highly effective in offsetting changes in cash flows of hedged items. All derivative instruments are recorded on the balance sheet at their fair value. The effective portion of the gains and losses is recorded in other comprehensive income until the hedged transaction is recognized in earnings. When the earnings impact of the underlying hedged transaction is recognized in the income statement, the fair value of the associated cash flow hedge is reclassified from other comprehensive income into earnings. Any hedge ineffectiveness is immediately recognized in earnings. The fair values of forward contracts are based on forward market prices.

Embedded derivatives

An embedded derivative is a component of a contract that causes some of the cash flows of the combined instrument to vary in a way similar to a stand-alone derivative. This causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified variable, such as interest rate, financial instrument price, commodity price, foreign exchange rate, a credit rating or credit index, or other variables to be treated as a financial derivative. The Company has no contracts containing embedded derivatives.

Normal purchase or sale exemption

Contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the Company's expected purchase, sale or usage requirements fall within the exemption from IAS 32 *Financial Instruments: Presentation* ("IAS 32") and IAS 39, which is known as the 'normal purchase or sale exemption'. The Company recognizes such contracts in its balance sheet only when one of the parties meets its obligation under the contract to deliver either cash or a non-financial asset.

n) Hedging

The Company uses derivative financial instruments from time to time to hedge its exposure to commodity price fluctuations. All derivative financial instruments are initiated within the guidelines of the Company's hedging policy. This includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company enters into hedges of its exposure to petroleum and natural gas commodity prices by entering into propane and natural gas fixed price contracts, when it is deemed appropriate. These derivative contracts, accounted for as hedges, are recognized on the balance sheet. Realized gains and losses on these contracts are recognized in revenue and cash flows in the same period in which the revenues associated with the hedged transaction are recognized. For derivative financial contracts settling in future periods, a financial asset or liability is recognized in the balance sheet and measured at fair value, with changes in fair value recognized in other comprehensive income.

o) Inventories

Inventories are stated at the lower of cost and net realizable value. Cost of producing oil and natural gas is accounted on a weighted average basis. This cost includes all costs incurred in the normal course of business in bringing each product to its present location and condition.

p) Provisions

General

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability

Decommissioning provision

Decommissioning provision is recognized when the Company has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of obligation can be made. A corresponding amount equivalent to the provision is also recognized as part of the cost of the related property, plant and equipment. The amount recognized is the estimated cost of decommissioning, discounted to its present value using a risk-free rate. Changes in the estimated timing of decommissioning or decommissioning cost estimates are dealt with prospectively by recording an adjustment to the provision, and a corresponding adjustment to property, plant and equipment.

q) Taxes

Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date, in Canada.

Current income tax relating to items recognized directly in equity is recognized in equity and not in the income statement. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

Deferred income tax

The Company follows the liability method of accounting for income taxes. Under this method, income tax assets and liabilities are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. Deferred income tax assets are only recognized to the extent it is probable that sufficient future taxable income will be available to allow the deferred income tax asset to be realized. Accumulated deferred income tax balances are adjusted to reflect changes in income tax rates that are enacted or substantively enacted with the adjustment being recognized in earnings in the period that the change occurs, except for items recognized in equity.

r) Revenue recognition

Revenue from the sale of oil, natural gas and natural gas liquids is recognized when the significant risks and rewards of ownership have been transferred, which is when title passes to the purchaser. This generally occurs when product is physically transferred into a pipe or other delivery system.

Gains and losses on disposition

For all dispositions, either through sale or exchange, gains and losses are calculated as the difference between the sale or exchange value in the transaction and the carrying amount of the assets disposed. Gains and losses on disposition are recognized in earnings in the same period as the transaction date.

s) Borrowing costs

Borrowing costs directly relating to the acquisition, construction or production of a qualifying capital project under construction are capitalized and added to the project cost during construction until such time the assets are substantially ready for their intended use, which is when they are capable of commercial production. Where the funds used to finance a project form part of general borrowings, the amount capitalized is calculated using a weighted average of rates applicable to relevant general borrowings of the Company during the period. All other borrowing costs are recognized in the income statement in the period in which they are incurred.

t) Share-based payments

Cash-settled share-based payments to employees are measured at the fair value of the liability award at the grant date. A liability equal to fair value of the payments is accrued over the vesting period measured at fair value using the Black-Scholes option pricing model.

The fair value determined at the grant date of the cash-settled share-based payments is expensed on a graded basis over the vesting period, based on the Company's estimate of liability instruments that will eventually vest. At the end of each reporting period, the Company revises its estimate of the number of liability instruments expected to vest. The impact of the revision of the original estimates, if any, is recognized in the income statement such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the related liability on the balance sheet.

u) Earnings per share

Basic and diluted earnings per share is computed by dividing the net earnings available to common shareholders by the weighted average number of shares outstanding during the reporting period. The Company has no dilutive instruments outstanding which would cause a difference between the basic and diluted earnings per share.

v) Share capital

Common shares are classified within equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from Share capital.

3. Property, plant and equipment, net

Cost	
At December 31, 2012	2,486,722
Additions	578,003
Decommissioning provision additions	1,439
Dispositions	-
Prepaid capital	5,081
At December 31, 2013	3,071,245
Additions	690,389
Decommissioning provision additions	37,748
Capital inventory	1,354
At December 31, 2014	3,800,736
Accumulated depletion and depreciation	
At December 31, 2012	(386,738)
Depletion and depreciation	(224,976)
At December 31, 2013	(611,714)
Depletion and depreciation	(291,731)
At December 31, 2014	(903,445)
Carrying amount at December 31, 2013	2,459,531
Carrying amount at December 31, 2014	**2,897,291**

Proceeds received for assets disposed of during 2014 were $nil (2013 - $nil).

During, 2014 Peyto capitalized $7.8 million (2013 - $7.2 million) of general and administrative expense directly attributable to exploration and development activities.

As indicators of impairment existed in the current year an impairment test was done. No impairment existed. In the prior year there were no indicators of impairment so testing was not completed.

4. Long-term debt

	December 31, 2014	**December 31, 2013**
Bank credit facility	605,000	605,000
Senior unsecured notes	320,000	270,000
Balance, end of the year	**925,000**	875,000

The Company has a syndicated $1.0 billion extendible unsecured revolving credit facility with a stated term date of April 26, 2017. 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 three year period. Borrowings under the 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 April 26, 2013, the security on the notes issued on January 3, 2012 in the amount of $100 million and September 6, 2012 in the amount of $50 million was released pursuant to the amended and restated note purchase and private shelf agreement.

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.

On July 3, 2014, Peyto issued CDN $50 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 3.79% and mature on July 3, 2022. Interest is 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 December 31, 2014.

Peyto's total borrowing capacity is $1.32 billion and Peyto's credit facility is $1.0 billion.

The fair value of all senior notes as at December 31, 2014, is $311.2 million compared to a carrying value of $320.0 million.

Total interest expense for 2014 was $34.4 million (2013 - $30.9 million) and the average borrowing rate for 2014 was 4.04% (2013 – 4.2%).

5. Decommissioning provision

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

The following table reconciles the change in decommissioning provision:

Balance, December 31, 2012	**58,201**
New or increased provisions	10,216
Accretion of discount	1,544
Change in discount rate and estimates	(8,777)
Balance, December 31, 2013	**61,184**
New or increased provisions	11,005
Accretion of discount	1,883
Change in discount rate and estimates	26,743
Balance, December 31, 2014	**100,815**
Current	-
Non-current	100,815

The Company has estimated the net present value of its total decommissioning provision to be $100.8 million as at December 31, 2014 ($61.2 million at December 31, 2013) based on a total future undiscounted liability of $214.1 million ($177.8 million at December 31, 2013). At December 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 2064. The Bank of Canada's long term bond rate of 2.33 per cent (3.24 per cent at December 31, 2013) and an inflation rate of 2.0 per cent (2.0 per cent at December 31, 2013) were used to calculate the present value of the decommissioning provision.

6. Equity

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)	-	(5,148)
Balance, December 31, 2014	**153,690,808**	**1,292,398**

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).

Shares to be issued
On December 31, 2014, Peyto completed a private placement of 168,920 common shares to employees and consultants for net proceeds of $5.6 million ($33.30 per share). These common shares were issued January 7, 2015.

Per share amounts
Earnings per share or unit have been calculated based upon the weighted average number of common shares outstanding for the year ended December 31, 2014 of 153,231,099 (2013 – 148,737,654). There are no dilutive instruments outstanding.

Dividends
During the year ended December 31, 2014, Peyto declared and paid dividends of $1.14 per common share or $0.08 per common share for the months of January to April 2014, $0.10 per common share for the months of May to October 2014, and $0.11 per common share for the months of November and December totaling $174.8 million (2013 - $0.88 or $0.06 per common share for the months of January to April 2013 and $0.08 per common share for the months of May to December 2013, $130.9 million).

On January 15, 2015, Peyto declared dividends of $0.11 per common share paid on February 13, 2015. On February 13, 2015, Peyto declared dividends of $0.11 per common share to be paid to shareholders of record on February 28, 2015. These dividends will be paid on March 13, 2015.

Accumulated other comprehensive income
Comprehensive income consists of earnings and other comprehensive income ("OCI"). OCI comprises the change in the fair value of the effective portion of the derivatives used as hedging items in a cash flow hedge. "Accumulated other comprehensive income" is an equity category comprised of the cumulative amounts of OCI.

Accumulated hedging gains
Gains and losses from cash flow hedges are accumulated until settled. These outstanding hedging contracts are recognized in earnings on settlement with gains and losses being recognized as a component of net revenue. Further information on these contracts is set out in Note 11.

7. Operating expenses

The Company's operating expenses include all costs with respect to day-to-day well and facility operations. Processing and gathering recoveries related to jointly owned production reduces gross field expenses to Peyto's operating expenses.

	Years ended December 31	
	2014	**2013**
Gross field expenses	71,967	58,963
Cost recoveries related to processing and gathering of partner production	(14,392)	(13,728)
Total operating expenses	**57,575**	45,235

8. Finance costs

	Years ended December 31	
	2014	**2013**
Interest expense	34,397	30,991
Accretion of decommissioning provisions	1,883	1,544
Total finance costs	**36,280**	32,535

9. Future performance based compensation

The Company 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 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.

The total amount expensed under these plans was as follows:

($000)	**2014**	**2013**
Market based compensation	13,348	14,061
Reserve based compensation	5,829	2,236
Total market and reserves based compensation	**19,177**	16,297

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

	December 31 2014	**December 31 2013**
Share price	$34.34	$32.27
Exercise price	$21.70-$31.29	$19.91 - $21.70
Expected volatility	0%	0%
Option life	1 - 2 years	1 - 2 years
Forfeiture rate	6%	10%
Dividend yield	0%	0%
Risk-free interest rate	0%	0%

Subsequent to December 31, 2014, 3.4 million rights were granted at a price of $34.34 to be valued at the ten day weighted average market price at December 31, 2015 and vesting 1/3 on each of December 31, 2015, December 31, 2016 and December 31, 2017.

10. Income taxes

($000)	**2014**	**2013**
Earnings before income taxes	349,047	189,363
Statutory income tax rate	25.00%	25.00%
Expected income taxes	87,262	47,341
Increase (decrease) in income taxes from:		
True-up tax pools	7	(443)
Resolution of reassessment and other	-	(162)
Total income tax expense	**87,269**	**46,736**

Deferred income tax expense	87,269	46,736
Current income tax expense	-	-
Total income tax expense	**87,269**	**46,736**
Differences between tax base and reported amounts for depreciable assets	(340,090)	(249,382)
Derivative financial instruments	(26,266)	7,947
Share issuance costs	2,171	1,826
Future performance based bonuses	2,312	2,075
Provision for decommission provision	25,204	15,296
Cumulative eligible capital	5,709	6,139
Charitable donations	26	-
Tax loss carry-forwards recognized	87	5,017
Deferred income taxes	**(330,847)**	(211,082)

At December 31, 2014 the Company has tax pools of approximately $1,542.0 million (2013 - $1,486.8 million) available for deduction against future income. The Company has $nil in loss carry-forwards (2013 - $19.7 million) available to reduce future taxable income.

11. Financial instruments

Financial instrument classification and measurement
Financial instruments of the Company carried on the balance sheet are carried at amortized cost with the exception of cash derivative financial 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 December 31, 2014.

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

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

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

Fair values of financial assets and liabilities
The Company's financial instruments include cash, accounts receivable, derivative financial instruments, due from private placement, current liabilities, provision for future performance based compensation and long term debt. At December 31, 2014 and 2013, cash and derivative financial 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.

Market risk
Market risk is the risk that changes in market prices will affect the Company's earnings or the value of its financial instruments. Market risk is comprised of commodity price risk and interest rate risk. The objective of market risk management is to manage and control exposures within acceptable limits, while maximizing returns. The Company's objectives, processes and policies for managing market risks have not changed from the previous year.

Commodity price risk management
The Company is a party to certain derivative financial instruments, including fixed price contracts. The Company enters into these contracts with well-established counterparties for the purpose of protecting a portion of its future earnings and cash flows from operations from the volatility of petroleum and natural gas prices. The Company believes the derivative financial instruments are effective as hedges, both at inception and over the term of the instrument, as the term and notional amount do not exceed the Company's firm commitment or forecasted transactions and the underlying basis of the instruments correlate highly with the Company's exposure.

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

Natural Gas Period Hedged	**Type**	**Daily Volume**	**Price (CAD)**
November 1, 2013 to March 31, 2015	Fixed Price	20,000 GJ	$3.6025/GJ to 3.94/GJ
April 1, 2014 to March 31, 2015	Fixed Price	140,000 GJ	$3.23/GJ- $3.83/GJ
November 1, 2014 to March 31, 2015	Fixed Price	100,000 GJ	$3.81/GJ- $4.87GJ
December 1, 2014 to March 31, 2015	Fixed Price	55,000 GJ	$3.63/GJ – $4.18/GJ
April 1, 2015 to October 31, 2015	Fixed Price	185,000 GJ	$3.24/GJ-$4.05/GJ
April 1, 2015 to March 31, 2016	Fixed Price	95,000 GJ	$2.75/GJ- $3.91/GJ
April 1, 2015 to October 31, 2016	Fixed Price	20,000 GJ	$3.05/GJ to $4.123/GJ

As at December 31, 2014, Peyto had committed to the future sale of 115,910,000 gigajoules (GJ) of natural gas at an average price of $3.68 per GJ or $4.20 per mcf. Had these contracts been closed on December 31, 2014, Peyto would have realized a gain in the amount of $105.1 million. If the AECO gas price on December 31, 2014 were to increase by

$1/GJ, the unrealized gain would increase by approximately $115.9 million. An opposite change in commodity prices rates would result in an opposite impact on other comprehensive income.

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

Natural Gas Period Hedged	Type	Daily Volume	Price (CAD)
April 1, 2015 to October 31, 2015	Fixed Price	5,000 GJ	$2.75GJ
April 1, 2015 to March 31, 2016	Fixed Price	20,000 GJ	$2.7525/GJ -$2.925GJ
April 1, 2015 to March 31, 2017	Fixed Price	40,000 GJ	$2.83GJ -$3.05/GJ
November 1, 2016 to March 31, 2017	Fixed Price	10,000 GJ	$2.95/GJ-$2.975/GJ

Interest rate risk

The Company is exposed to interest rate risk in relation to interest expense on its revolving credit facility. Currently, the Company has not entered into any agreements to manage this risk. If interest rates applicable to floating rate debt were to have increased by 100 bps (1%) it is estimated that the Company's earnings before income tax for the year ended December 31, 2014 would decrease by $5.6 million. An opposite change in interest rates would result in an opposite impact on earnings before income tax.

Credit risk

A substantial portion of the Company's accounts receivable is with petroleum and natural gas marketing entities. Industry standard dictates that commodity sales are settled on the 25th day of the month following the month of production. The Company generally extends unsecured credit to purchasers, and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions and may accordingly impact the Company's overall credit risk. Management believes the risk is mitigated by the size, reputation and diversified nature of the companies to which they extend credit. Credit limits exceeding $2,000,000 per month are not granted to non-investment grade counterparties unless the Company receives either i) a parental guarantee from an investment grade parent; or ii) an irrevocable letter of credit for two months revenue. The Company has not previously experienced any material credit losses on the collection of accounts receivable. Of the Company's revenue for the year ended December 31, 2014, approximately 62% was received from five companies (15%, 14%, 12%, 11%, and 10%) (December 31, 2013 – 62% was received from five companies (15%, 13%, 13%, 11%, and 10%)). Of the Company's accounts receivable at December 31, 2014, approximately 53% was receivable from four companies (15%, 14%, 12%, and 12%) (December 31, 2013 approximately 61% was receivable from five companies (14%, 14%, 11%, 11%, and 11%) 14%. The maximum exposure to credit risk is represented by the carrying amount on the balance sheet. There are no material financial assets that the Company considers past due and no accounts have been written off.

The Company's accounts receivable was aged as follows at December 31, 2014:

($000)	December 31, 2014
Current (less than 30 days)	91,017
31-60 days	4,444
61-90 days	775
Past due (more than 90 days)	2,433
Balance, December 31, 2014	**98,699**

The Company may be exposed to certain losses in the event of non-performance by counterparties to commodity price contracts. The Company mitigates this risk by entering into transactions with counterparties that have investment grade credit ratings.

Counterparties to financial instruments expose the Company to credit losses in the event of non-performance. Counterparties for derivative instrument transactions are limited to high credit-quality financial institutions, which are all members of our syndicated credit facility.

The Company assesses quarterly if there should be any impairment of financial assets. At December 31, 2014, there was no impairment of any of the financial assets of the Company.

Liquidity risk
Liquidity risk includes the risk that, as a result of operational liquidity requirements:

- The Company will not have sufficient funds to settle a transaction on the due date;
- The Company will be forced to sell financial assets at a value which is less than what they are worth; or
- The Company may be unable to settle or recover a financial asset at all.

The Company's operating cash requirements, including amounts projected to complete our existing capital expenditure program, are continuously monitored and adjusted as input variables change. These variables include, but are not limited to, available bank lines, oil and natural gas production from existing wells, results from new wells drilled, commodity prices, cost overruns on capital projects and changes to government regulations relating to prices, taxes, royalties, land tenure, allowable production and availability of markets. As these variables change, liquidity risks may necessitate the need for the Company to conduct equity issues or obtain debt financing. The Company also mitigates liquidity risk by maintaining an insurance program to minimize exposure to certain losses.

The following are the contractual maturities of financial liabilities as at December 31, 2014:

	< 1 Year	**1-2 Years**	**3-5 Years**	**Thereafter**
Accounts payable and accrued liabilities	192,312	-	-	-
Dividends payable	16,906	-	-	-
Provision for future market and reserves based bonus	8,225	1,024	-	-
Long-term debt(1)	-	-	605,000	-
Unsecured senior notes	-	-	100,000	220,000

(1) Revolving credit facility renewed annually (*see Note 5*)

Capital disclosures

The Company's objectives when managing capital are: (i) to maintain a flexible capital structure, which optimizes the cost of capital at acceptable risk; and (ii) to maintain investor, creditor and market confidence to sustain the future development of the business.

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its underlying assets. The Company considers its capital structure to include equity, debt and working capital. To maintain or adjust the capital structure, the Company may from time to time, issue common shares, raise debt, adjust its capital spending or change dividends paid to manage its current and projected debt levels. The Company monitors capital based on the following measures: current and projected debt to earnings before interest, taxes, depreciation, depletion and amortization ("EBITDA") ratios, payout ratios and net debt levels. To facilitate the management of these ratios, the Company prepares annual budgets, which are updated depending on varying factors such as general market conditions and successful capital deployment. Currently, all ratios are within acceptable parameters. The annual budget is approved by the Board of Directors.

There were no changes in the Company's approach to capital management from the previous year.

	December 31 2014	**December 31 2013**
Equity	1,551,936	1,200,638
Long-term debt	925,000	875,000
Working capital (surplus) deficit	654	103,247
	2,477,590	2,178,885

12. Related party transactions

An officer and director of the Company is a partner of a law firm that provides legal services to the Company. For the year ended December 31, 2014, legal fees totaled $0.7 million (2013 - $0.7 million). As at December 31, 2014, an amount due to this firm of $0.7 million was included in accounts payable (2013 - $0.7 million).

Certain directors of Peyto are also directors of reporting entities that Peyto engages in transactions with either through the parent or the subsidiary. Peyto is considered related to these reporting entities because of common significant influence. Such services are provided in the normal course of business and at market rates. For the year ended December 31, 2014, expenses totaled $0.8 million (2013 - $0.2 million). As at December 31, 2014, an amount due to these companies of $0.1 million was included in accounts payable (2013 - $0.1 million).

The Company has determined that the key management personnel consists of key employees, officers and directors. In addition to the salaries and directors' fees paid to these individuals, the Company also provides compensation in the form of market and reserve based bonus to some of these individuals. Compensation expense of $1.5 million is included in general and administrative expenses and $7.6 million in market and reserves based bonus relating to key management personnel for the year 2014 (2013 - $1.4 million in general and administrative and $6.5 million in market and reserves based bonus).

13. Commitments

In addition to those recorded on the Company's balance sheet, the following is a summary of Peyto's contractual obligations and commitments as at December 31, 2014:

	2015	2016	2017	2018	2019	Thereafter
Interest payments[(1)]	14,125	14,125	14,125	14,125	11,930	18,405
Transportation commitments	20,566	20,240	16,298	13,019	9,020	12,773
Operating leases	2,549	1,914	1,654	1,295	1,295	9,062
Other	2,603	-	-	-	-	-
Total	39,843	36,279	32,077	28,439	22,245	40,240

(1) Fixed interest payments on senior unsecured notes

14. 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 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. The Company has not yet been required to defend either of the actions. If it is required to defend the actions, 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.

Officers

Darren Gee
President and Chief Executive Officer

Scott Robinson
Executive Vice President and Chief Operating Officer

Kathy Turgeon
Vice President, Finance and Chief Financial Officer

Lee Curran
Vice President, Drilling and Completions

Todd Burdick
Vice President, Production

Tim Louie
Vice President, Land

David Thomas
Vice President, Exploration

Jean-Paul Lachance
Vice President, Exploitation

Stephen Chetner
Corporate Secretary

Directors

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

Auditors

Deloitte LLP

Solicitors

Burnet, Duckworth & Palmer LLP

Bankers

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

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