

PEYTO

Exploration & Development Corp.

2013



Annual Report

Chairman's Message

This past year marks Peyto's 15th year in the business of finding oil and gas. In 2013, Peyto was recognized as the "Producer of the Year" by Oilweek magazine. I'd like to congratulate the Peyto team for this long overdue award.

It seems like only yesterday, in July of 1998, I teamed up with Buck Braund, Brian Craig and Mike Broadfoot to build Peyto. These three individuals played a significant role laying Peyto's foundation. On day one, Peyto had 35 boe/day of production in southwest Saskatchewan and \$200,000 in the bank. My job was to set the strategy for the company and find a geographic area for us to exploit. To say I was new to running an oil and gas company and new to the capital markets would have been a gross understatement, however, I did understand how to create real value exploring and developing for oil and gas. I was dead set against being a company that chased the market like a feather in the wind. The first ten years of my career I worked for companies who in a lot of ways showed me how not to run a company. At Peyto we were going to do what made sense for its long term viability.

For a couple of reasons, the fall of 1998 was a very difficult time to raise capital for a start-up oil and gas company. The first was that oil and gas prices were quite low and most investors were in a state of fear. At that time, the price of oil was roughly \$12/bbl and the price of natural gas was \$2.00/mcf. I learned quickly that very few so-called sophisticated investors were willing to practice Warren Buffett's mantra of "being greedy when others are fearful and fearful when others are greedy." The second was the failure of a number of highly promoted junior oil and gas companies, which rightfully tainted the sector in the eyes of the investors. While trying to raise capital for Peyto, I met with quite a few investors who had been conditioned to avoid junior oil and gas companies like the plague.

Very few people know that, in the early days, Peyto raised all of its capital directly, without the help of a brokerage firm. It was six years after we had started when our share price was \$42.65 (\$21.33 on a split adjusted basis) per share that Peyto did its first equity offering using investment banks. We had a market capitalization over \$2 billion at that time. What this means is we grew up with a strong and direct relationship with our investors, not the brokers and investment bankers. I can remember our first equity issue in 1998. We were trying to raise \$1 million dollars by issuing shares at \$0.075/share, but this offering went undersubscribed and we ended up raising only \$450,000. We were doing this capital raise in order to drill our first Deep Basin Cardium gas well. My parents were one of the investors in that financing. Despite my dad's desire for me to do this on my own, I managed to convince them to invest. In fact, when my dad said "Put us down for 30,000", I automatically assumed he meant \$30,000 dollars. I was a little disappointed when I realized it was 30,000 shares or \$4,500 (30,000 shares at \$0.15/share, before split). It's amazing when I look back today, that \$4,500 investment has distributed back \$791,400 in cash and is valued in the market at approximately \$2.1 million. I'm very fortunate to know many friends, family and business associates that have been rewarded handsomely for the trust they placed in us. At Peyto, we have always seen the shareholder as our partner. These were people we knew, people trusting us to honestly invest their hard earned capital, people giving us a chance to succeed. It was these people that gave us the strength to do what was right for the long-term success of the company. Today, because of our humble beginnings, I believe Peyto is a much different company than so many others in the Canadian public oil and gas sector.

At Peyto we believe our core values set us apart from the industry. We believe our company works best when we align the shareholder's interest with the interests of the people who run the company. We believe in empowering our employees so that they use their expertise and experience to invest our capital in the most effective way possible. We also believe strongly in accountability.

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.

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 the 2013 fiscal year which culminate 15 years of success in the Canadian Energy Industry. Peyto set new production and reserves per share records in 2013 while delivering a 76% operating margin¹ and a 25% profit margin². A 10% return on capital and a 12% return on equity were achieved in 2013 along with the following Q4 and annual highlights:

- **Production per share up 26%.** Fourth quarter production was up 35%, also 35% per share, from 299 MMcfe/d (49,754 boe/d) in Q4 2012 to 404 MMcfe/d (67,296 boe/d) in Q4 2013. Annual production increased 33%, or 26% per share, from 267 MMcfe/d in 2012 to 356 MMcfe/d in 2013.
- **Reserves per share up 19%.** Proved Producing (“PP”), Total Proved (“TP”) and Proved plus Probable Additional (“P+P”) reserves increased 12%, 10%, and 19% (the same per share) to 1.1, 1.8, and 2.8 TCFe, respectively.
- **Maintained industry leading total cash costs.** Royalties, operating costs, transportation, G&A and interest expense totaled \$1.06/MCFe (\$6.36/boe) in both Q4 and on average in 2013, consistent with \$1.05/MCFe on average in 2012.
- **Funds from operations per share up 34%.** Generated \$438 million in Funds from Operations (“FFO”) in 2013, or \$2.94/share, up 34% from \$2.19/share in 2012. Q4 FFO per share was up 35% from \$0.62 to \$0.84.
- **Organic capital investment up 28%.** Invested a record \$578 million to build 38,400 boe/d at a cost of \$15,100/boe/d in 2013, up 28% from the \$452 million of organic capital spent in 2012.
- **P+P FD&A was half the field netback.** All in FD&A cost for PP, TP and P+P reserves was \$2.35/MCFe, \$2.23/MCFe and \$1.86/MCFe (\$11.16/boe), respectively, including changes in Future Development Capital (“FDC”), while the average field netback was \$3.65/MCFe (\$21.89/boe).
- **NAV per share of \$38.** Net Asset Value (“NAV”) or the Net Present Value per share, debt adjusted (discounted at 5%) of the P+P reserves was \$23/share of developed reserves and \$15/share of undeveloped reserves.
- **Earnings per share up 43% and dividends per share up 22%.** A total of \$143 million in earnings were generated in 2013 (\$0.96/share), and \$131 million in dividends were paid to shareholders (\$0.88/share). Cumulative dividend/distribution payments made by Peyto to date total \$1.47 Billion (\$13.19/share).

2013 in Review

The year 2013 marked Peyto’s 15th year in the business of profitably finding, developing, and producing natural gas in Alberta’s Deep Basin. Peyto invested a record \$578 million into drilling and completing 99 new gas wells, building two new gas plants at Oldman North and Brazeau River, expanding a third plant at Swanson, acquiring 49 sections of new multi-zone mineral rights and purchasing over 170 square miles of 3D seismic. For every well drilled, two new drilling locations were recognized in Peyto’s reserve report further expanding the Company’s NAV. A 42% increase in annual funds from operations was primarily the result of the 33% growth in production, as realized commodity prices were only up 5%. A 52% increase in earnings was commensurate with the increase in FFO, which allowed for a 33% increase in the monthly dividend mid-way through the year. The solid returns generated with the annual capital program drove a 10% return on capital and 12% return on equity. Including dividends, investors realized a 45% return³ from year end 2012 to year end 2013.

(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, 2013 share price of \$32.51, along with \$0.88/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 (mcf) 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		
	2013	2012	% Change	2013	2012	% Change
Operations						
Production						
Natural gas (mcf/d)	361,870	266,808	36%	317,622	238,490	33%
Oil & NGLs (bbl/d)	6,984	5,286	32%	6,376	4,778	33%
Thousand cubic feet equivalent (mcf/d @ 1:6)	403,774	298,522	35%	355,880	267,160	33%
Barrels of oil equivalent (boe/d @ 6:1)	67,296	49,754	35%	59,313	44,527	33%
Product prices						
Natural gas (\$/mcf)	3.59	3.45	4%	3.54	3.23	10%
Oil & NGLs (\$/bbl)	69.84	73.01	(4)%	70.97	73.92	(4)%
Operating expenses (\$/mcf)	0.35	0.31	13%	0.35	0.32	9%
Transportation (\$/mcf)	0.13	0.11	18%	0.12	0.12	-
Field netback (\$/mcf)	3.67	3.62	1%	3.65	3.46	5%
General & administrative expenses (\$/mcf)	0.06	0.02	200%	0.04	0.04	-
Interest expense (\$/mcf)	0.24	0.32	(25)%	0.24	0.26	(8)%
Financial (\$000, except per share)						
Revenue	164,455	120,310	37%	575,845	411,400	40%
Royalties	10,288	9,205	12%	40,450	30,754	32%
Funds from operations	125,164	90,078	39%	437,742	308,865	42%
Funds from operations per share	0.84	0.62	35%	2.94	2.19	34%
Total dividends	35,702	26,178	36%	130,898	101,593	29%
Total dividends per share	0.24	0.18	33%	0.88	0.72	22%
Payout ratio (%)	29	28	4%	30	33	(9)%
Earnings	37,989	25,823	47%	142,627	93,951	52%
Earnings per share	0.26	0.18	44%	0.96	0.67	43%
Capital expenditures	154,295	156,847	(2)%	578,003	617,985	(6)%
Weighted average shares outstanding	148,758,923	145,449,651	2%	148,737,654	141,093,829	5%
As at December 31						
End of period shares outstanding (includes shares to be issued)				148,949,448	148,673,263	-
Net debt (before future compensation expense and unrealized hedging gains)				946,541	662,461	43%
Shareholders' equity				1,200,638	1,210,067	(1)%
Total assets				2,555,156	2,203,524	16%

(\$000)	3 Months Ended December 31		12 Months Ended December 31	
	2013	2012	2013	2012
Cash flows from operating activities	116,852	78,878	407,357	284,309
Change in non-cash working capital	(1,759)	4,457	11,667	12,920
Change in provision for performance based compensation	(6,226)	(7,712)	2,421	(2,819)
Income tax paid on account of 2003 reassessment	-	1,868	-	1,868
Performance based compensation	16,297	12,587	16,297	12,587
Funds from operations	125,164	90,078	437,742	308,865
Funds from operations per share	0.84	0.62	2.94	2.19

(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.

Historical Milestones

Peyto Exploration & Development Corp. was founded in October 1998 with the sole purpose of investing shareholder capital into oil and gas development for maximum possible return. Now, 15 years later, that goal remains exactly the same. Only now, there are 15 years of results against which that objective can be measured. In aggregate, approximately \$3.5 billion has been invested, mostly in the drilling of nearly 1,000 natural gas wells in Alberta's Deep Basin, and in the construction of over 1,100 km of pipelines and 7 gas processing facilities. These investments have generated \$4.4 billion in revenue, paid \$675 million in royalties to Albertans, delivered \$3.1 billion in funds from operations and funded \$1.5 billion in distributions and dividend payments to shareholders. On top of that, shareholders today own assets independently valued at \$6.6 billion¹, 60% of which are already developed. The value of a share of Peyto, including dividends and distributions, has compounded at 53% annually over its history. It is fair to say that the Peyto strategy has been successful in achieving its objective.

In simple terms, Peyto is a profitable business – finding, developing and producing for less than what it receives in sales. The profitability of the business model is illustrated in the following table:

(\$/Mcf)	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Average
Sales Price	\$7.21	\$7.32	\$8.87	\$8.76	\$8.93	\$9.54	\$6.75	\$6.15	\$5.47	\$4.21	\$4.43	\$7.06
Cost to develop ²	(\$1.33)	(\$1.60)	(\$2.39)	(\$2.95)	(\$2.11)	(\$2.88)	(\$2.26)	(\$2.10)	(\$2.12)	(\$2.22)	(\$2.35)	(\$2.21)
Cost to produce ³	(\$2.16)	(\$2.21)	(\$2.76)	(\$2.66)	(\$2.75)	(\$3.01)	(\$1.75)	(\$1.63)	(\$1.35)	(\$1.05)	(\$1.06)	(\$2.04)
“Profit”	\$3.72	\$3.51	\$3.72	\$3.15	\$4.07	\$3.65	\$2.74	\$2.42	\$2.00	\$0.94	\$1.02	\$2.81
Payout ⁴	\$1.36	\$2.28	\$2.81	\$3.47	\$3.92	\$4.25	\$4.03	\$3.37	\$1.24	\$1.04	\$1.01	\$2.62

1. Based on Insite's 2013 reserves report for P+P NPV, 5% discount

2. Cost to develop is the PDP FD&A

3. Cost to produce is the total cash costs including Royalties, Operating costs, Transportation, G&A and Interest.

4. Payout is the annual distribution or dividend in \$/mcf of production.

The predictability and repeatability of annual performance is a testament to the success of the Peyto's strategy and the execution of its business plan. After 15 years, there appears to be no reason to change.

Capital Expenditures

Peyto executed its largest ever drilling program in 2013, investing \$254 million to drill 99 gross (93.4 net) horizontal gas wells, \$152 million on their multi-stage fracture completions, and \$48.3 million in wellsite equipment and pipelines to connect them to Company owned gathering systems. Drilling and completion costs per meter of wellbore have been decreasing, despite a 3% per year annual inflation in service costs, as execution has continued to improve. The table below outlines the past four years of horizontal drilling and completion costs.

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

The Company invested \$112 million in 2013 to build new gas plants at Oldman North (30 MMcf/d) and Brazeau River (20 MMcf/d), as well as expand the existing Swanson gas plant (+30 MMcf/d), to accommodate increased production volumes. A total of \$6.4 million was invested in 49.25 sections of new crown lands (\$202/acre) and \$2.5 million on tuck-in acquisitions. In addition, 173 km of 2D and 448 km² of 3D seismic was acquired for \$3 million, for total capital expenditures of \$578 million.

The following table summarizes the capital investments for the fourth quarter and 2013 year.

(\$000)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Land	1,144	5,206	6,427	10,770
Seismic	683	612	2,984	1,741
Drilling	59,825	77,295	254,000	210,946
Completions	46,836	46,484	151,752	127,042
Equipping and tie-ins	12,389	22,168	48,303	46,246
Facilities and pipelines	33,418	25,846	112,054	38,236
Acquisition of Open Range	-	-	-	187,187
Acquisitions	-	75	2,483	17,841
Dispositions	-	(16,969)	-	(17,646)
(Gains) Losses on Dispositions	-	(3,870)	-	(4,378)
Total Capital Expenditures	154,295	156,847	578,003	617,985

Reserves

Peyto was successful growing reserves and values in all categories in 2013, 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 2013	2012	% Change	% Change, debt adjusted per share [†]
Reserves (BCFe)				
Proved Producing	1,061	945	12%	13%
Total Proved	1,827	1,659	10%	11%
Proved + Probable Additional	2,807	2,353	19%	20%
Net Present Value (\$millions) Discounted at 5%				
Proved Producing	\$3,156	\$2,806	12%	3%
Total Proved	\$4,544	\$4,166	9%	2%
Proved + Probable Additional	\$6,587	\$5,732	15%	11%

[†]Per share reserves are adjusted for changes in net debt by converting debt to equity using the Dec 31 share price of \$22.99 for 2012 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, 2013. The InSite price forecast is available at www.InSitepc.com. For more information on Peyto’s reserves, refer to the Press Releases dated February 12, 2014 and February 14, 2013 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 2014.

Value Creation/Reconciliation

In order to measure the success of all of the capital invested in 2013, 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 2013 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 2013, Peyto’s estimated net debt had increased by \$284.1 million to \$946.5 million while the number of shares outstanding had increased by 0.276 million shares to 148.949 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 \$867 million of Proved Producing, \$1.129 billion of Total Proven, and \$2.307 billion of Proved plus Probable Additional undiscounted reserve value, with \$578 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 2013, 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 average Proved Producing NPV Recycle Ratio over the last 5 years is 2.9 times for undiscounted future values or 2.0 times for future values discounted at 10%.

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
NPV ₀ Recycle Ratio								
Proved Producing	2.9	4.7	2.1	5.4	3.5	2.4	1.6	1.5
Total Proved	2.9	5.5	2.5	18.9	6.1	4.7	2.2	2.0
Proved + Probable	3.8	3.8	2.2	27.1	10.3	6.6	3.2	4.0

*NPV₀ (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. Proved Producing (\$867/\$578) = 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 that 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 additional 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.

	2013	2012	2011	2010	2009	2008	2007
Proved Producing							
FD&A (\$/mcf)	\$2.35	\$2.22	\$2.12	\$2.10	\$2.26	\$2.88	\$2.11
RLI (yrs)	7	9	9	11	14	14	13
Recycle Ratio	1.5	1.3	1.9	2.0	1.8	2.6	2.8
Reserve Replacement	190%	284%	230%	239%	79%	110%	127%
Total Proved							
FD&A (\$/mcf)	\$2.23	\$2.04	\$2.13	\$2.35	\$1.73	\$3.17	\$1.57
RLI (yrs)	12	15	16	17	21	17	16
Recycle Ratio	1.6	1.4	1.9	1.8	2.3	2.3	3.7
Reserve Replacement	230%	414%	452%	456%	422%	139%	175%
Future Development Capital (\$ millions)	\$1,406	\$1,318	\$1,111	\$741	\$446	\$222	\$169
Proved plus Probable Additional							
FD&A (\$/mcf)	\$1.86	\$1.68	\$1.90	\$2.19	\$1.47	\$3.88	\$1.56
RLI (yrs)	19	22	22	25	29	23	21
Recycle Ratio	1.9	1.7	2.1	1.9	2.8	1.7	3.7
Reserve Replacement	450%	527%	585%	790%	597%	122%	117%
Future Development Capital (\$ millions)	\$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 (\$578.0+\$87.9)/(304.494-276.419+21.649) = \$2.23/mcf or \$13.39/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 $176,882/(67.296 \times 365) = 7.2$). 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, before hedging, by the FD&A costs for the period (eg. Proved Producing $(\$21.23)/\$14.08=1.5$). 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 $((176.882-157.491+21.649)/21.649) = 190\%$).

Quarterly Review

Peyto was very active in the fourth quarter of 2013, drilling and connecting new natural gas wells and commissioning new processing facilities, just as natural gas prices improved. A total of 21 gross (20.1 net) wells were drilled, 31 gross (28.3 net) wells completed and 32 gross (29.5 net) wells equipped and brought on production. In total, \$154.2 million of capital was invested in the quarter, or 27% of the annual capital program, with \$59.8 million spent on drilling, \$46.8 million on completions, \$12.4 million on pipelines, \$33.4 million on facilities and \$1.8 million on lands and seismic.

Production grew over 25%, from 59,000 boe/d at the start of the fourth quarter, to 75,000 boe/d by the end of the quarter, averaging 67,296 boe/d, up 35% over Q4 2012. Alberta daily natural gas prices climbed 45% from \$2.31/GJ in the previous quarter to \$3.35/GJ in Q4 2013, just as production rose. Fourth quarter 2013 prices were 4% higher than the same period in 2012. Peyto's realized price for natural gas in Q4 2013 was \$3.43/mcf, prior to a \$0.16/mcf hedging gain, while it's realized liquids price was \$71.98/bbl, prior to a \$2.14/bbl hedging loss, yielding a combined revenue stream of \$4.43/mcfe. This net sales price was 1% higher than same period a year ago.

Total cash costs for Q4 2013 of \$1.06/mcfe included royalties of \$0.28/mcfe, operating costs of \$0.35/mcfe, transportation of \$0.13/mcfe, G&A of \$0.06/mcfe and interest of \$0.24/mcfe. Quarterly cash costs were down slightly from \$1.10/mcfe in Q4 2012 but in line with the previous year's average of \$1.05/mcfe.

Peyto generated total funds from operations of \$125 million in the quarter, or \$3.37/mcfe, equating to a 76% operating margin. DD&A charges of \$1.77/mcfe, as well as a provision for current and future performance based compensation and tax, reduced FFO to earnings of \$1.02/mcfe, or a 23% profit margin, which funded the \$0.96/mcfe dividend to shareholders.

Marketing

The current natural gas price outlook is for much improved prices over the next 12 months as cold winter weather has reduced storage volumes to below seasonal levels. The AECO Monthly strip for the next 12 months is currently trading at close to \$4.70/GJ, almost 50% higher than the previous 12 months. Beyond that, prices are expected to return to previous levels as low cost supplies, reversal of coal-to-gas switching and more seasonal weather patterns return storage to normal levels. The AECO Monthly strip for the second year out is currently priced at approximately \$3.80/GJ.

Peyto uses a hedging strategy that is designed to smooth out the short term fluctuations in the price of natural gas and NGLs through future sales in order to provide security of price for capital planning purposes. 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. In order to minimize counterparty risk, these marketing contracts are all with financial institutions that are also members of Peyto's banking syndicate. Peyto has deployed this strategy for over a decade now, which has resulted in \$260 million in cumulative gains. Over the long run, however, Peyto expects to break even on forward sales, having achieved price security for little to no cost.

For 2013, Peyto realized a natural gas price of \$3.10/GJ or \$3.54/Mcf, for its natural gas sales. This was a combination of 47% being sold in the daily or monthly spot market, which averaged \$2.98/GJ, and 53% having been

pre-sold at an average hedged price of \$3.20/GJ. The following table summarizes the remaining hedged volumes for the upcoming years effective March 5, 2014:

	Future Sales		Average Price (CAD)	
	GJ	Mcf	\$/GJ	\$/Mcf
2014	79,117,500	68,839,982	\$3.52	\$4.05
2015	24,140,000	21,004,167	\$3.57	\$4.11
Total	103,257,500	89,844,148	\$3.54	\$4.06

As illustrated in the following table, Peyto's unhedged annual realized NGL prices⁽¹⁾ were approximately 3% lower on a year over year basis, and represented 77% of the \$93.13/bbl average Edmonton par oil price in 2013, down from 86% the previous year. Lower relative Pentane and Butane prices and increased transportation charges contributed to the increased offset to light oil prices.

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Condensate (\$/bbl)	84.92	87.02	89.85	90.41
Propane (\$/bbl)	28.55	24.40	25.38	23.01
Butane (\$/bbl)	57.26	60.46	52.73	61.09
Pentane (\$/bbl)	90.59	89.99	97.14	94.36
Total oil and natural gas liquids (\$/bbl)	71.98	73.12	71.81	73.96
Edmonton par crude postings (\$/bbl)	86.19	84.43	93.13	85.91

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

Peyto's hedging practice with respect to propane is similar to that for natural gas. Effective March 5, 2014, Peyto had a total of 212,000 bbls of Propane forward sold for the remainder of 2014 at \$USD 40.74/bbl.

Activity Update

Drilling activity for the first quarter of 2014 continues to be robust. Peyto is currently running a 9 rig drilling program extending across the Greater Sundance area, through Ansell and down to Brazeau River. The program is targeting ongoing development of the Bluesky, Wilrich, Falher, Notikewin, and Cardium formations. In addition to the drilling, a 27 km pipeline was recently completed connecting a new growth area to Peyto's existing Wildhay Gas Plant. The new pipeline corridor will provide the necessary infrastructure for approximately 7 to 10 wells that will be drilled in that area over the balance of 2014.

Production is currently between 73,000 and 75,000 boe/d with the exception of a four day period in mid-January during which a powerful windstorm unexpectedly knocked out power in the Greater Sundance area for 40 hours and caused the shut in of approximately 60,000 boe/d (655 boe/d on average for the quarter).

Thus far in the quarter, 19 gross (18.1 net) new wells have been spud with 13 gross (13 net) wells having been completed and brought onstream. The Company is planning for a continuation of drilling and completion activity over the traditional April to mid-June breakup period this year. The level and progress of this planned activity will be weather and access dependent.

Facility preparations are well underway for continued expansion at key gas plants. The new Oldman North Gas Plant was expanded in late February from 30 to 50 MMcf/d with the addition of a third compressor. This facility will be further expanded to 80 MMcf/d by the fall. The installation of a refrigeration module and third compressor at the Brazeau Plant is in the final stages which will take that facility to 30 MMcf/d of capacity. One additional compressor is expected after breakup for total Brazeau capacity of 40 MMcf/d. Beyond that, additional compressors and refrigeration modules are in the fabrication stage for a late summer to early fall installation at the Oldman North, Wildhay and Swanson facilities which will bring total capacity additions for the year to above 100 MMcf/d.

2014 Outlook

The year 2014 looks to be another record breaking year for Peyto with continued profitable growth. As always, the primary focus is on maximizing returns, with profitable growth being the by-product of that success. Peyto's counter-

cyclical investment strategy over the past four years, that has resulted in more than a tripling of production, should pay off in 2014 as natural gas prices are forecast to be 50% higher than 2013. These higher prices, however, will require even greater vigilance with respect to cost control as it is in these environments when inflation of service costs can begin to erode future returns. This focus on costs has been at the heart of Peyto's strategy over the past 15 years and will continue to be a foundation of the Company's success in the future.

With a firm belief in the future of natural gas and strengthened with a decade and a half of experience, Peyto remains well positioned to lead the industry as one of the lowest cost, most efficient and most profitable energy companies.

Annual General Meeting

Peyto's Annual General Meeting of Shareholders is scheduled for 3:00 p.m. on Tuesday, May 27, 2014 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.



Darren Gee
President and CEO
March 5, 2014

Management's discussion and analysis

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

This discussion provides management's analysis of Peyto's historical financial and operating results and provides estimates of Peyto's future financial and operating performance based on information currently available. Actual results will vary from estimates and the variances may be significant. Readers should be aware that historical results are not necessarily indicative of future performance. This MD&A was prepared using information that is current as of March 4, 2014. Additional information about Peyto, including the most recently filed annual information form is available at www.sedar.com and on Peyto's website at www.peyto.com.

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

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

OVERVIEW

Peyto is a Canadian energy company involved in the development and production of natural gas in Alberta's deep basin. As at December 31, 2013, the total Proved plus Probable reserves were 2,807 billion cubic feet equivalent (467.8 million barrels of oil equivalent) as evaluated by the independent petroleum engineers. Production is weighted approximately 89% to natural gas and 11% to natural gas liquids and oil.

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

- Use technical expertise to achieve the best return on capital employed through the development of internally generated drilling projects.
- Build an asset base which is made up of high quality long life natural gas reserves.
- Balance dividends to shareholders and funding for the capital program with cash flow, equity and available bank lines.

Operating results over the last fifteen 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	2013	2012	2011
(\$000 except per share amounts)			
Total revenue (before royalties)	575,845	411,401	424,560
Funds from operations	437,742	308,865	314,622
Per share – basic and diluted	2.94	2.19	2.36
Earnings	142,627	93,951	128,183
Per share – basic and diluted	0.96	0.67	0.96
Total assets	2,555,156	2,203,524	1,800,252
Total long-term debt	875,000	580,000	470,000
Dividends per share	0.88	0.72	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

(\$000 except per share amounts)	2013				2012			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Total revenue (net of royalties)	154,167	123,851	134,765	122,612	111,105	95,409	80,471	93,661
Funds from operations	125,164	99,736	109,987	102,856	90,078	76,555	64,587	77,645
Per share – basic and diluted	0.84	0.67	0.74	0.69	0.62	0.54	0.47	0.56
Earnings	37,989	30,461	37,773	36,405	25,823	23,058	18,201	26,868
Per share – basic and diluted	0.26	0.21	0.25	0.25	0.18	0.16	0.13	0.19
Dividends	35,702	35,702	32,727	26,766	26,178	25,576	24,927	24,912
Per share – basic and diluted	0.24	0.24	0.22	0.18	0.18	0.18	0.18	0.18

RESULTS OF OPERATIONS

Production

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Natural gas (mmcf/d)	361.9	266.8	317.6	238.5
Oil & natural gas liquids (bbl/d)	6,984	5,286	6,376	4,778
Barrels of oil equivalent (boe/d)	67,296	49,754	59,313	44,527
Thousand cubic feet equivalent (mmcfe/d)	403.8	298.5	355.9	267.2

Natural gas production averaged 361.9 mmcf/d in the fourth quarter of 2013, 36% higher than the 266.8 mmcf/d reported for the same period in 2012. Oil and natural gas liquids production averaged 6,984 bbl/d, up 32% from 5,286 bbl/d reported in the prior year. Production for the year increased 33% from 267.2 mmcfe/d to 355.9 mmcfe/d (44,527 boe/d to 59,313 boe/d). The production increases are attributable to Peyto’s successful capital program.

Oil & Natural Gas Liquids Production by Component

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Condensate (bbl/d)	2,797	1,847	2,336	1,675
Propane (bbl/d)	1,492	872	1,372	832
Butane (bbl/d)	1,250	962	1,193	876
Pentane (bbl/d)	1,248	1,380	1,268	1,181
Other NGL's (bbl/d)	197	225	207	214
Oil & natural gas liquids (bbl/d)	6,984	5,286	6,376	4,778
Thousand cubic feet equivalent (mmcf/d)	41.9	31.7	38.3	28.7

Commodity Prices

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Oil and natural gas liquids (\$/bbl)	71.98	73.12	71.81	73.96
Hedging – ngl's (\$/bbl)	(2.14)	(0.11)	(0.84)	(0.04)
Oil and natural gas liquids – after hedging (\$/mcf)	69.84	73.01	70.97	73.92
Natural gas (\$/mcf)	3.43	3.31	3.40	2.61
Hedging – gas (\$/mcf)	0.16	0.14	0.14	0.62
Natural gas – after hedging (\$/mcf)	3.59	3.45	3.54	3.23
Total Hedging (\$/mcf)	0.11	0.13	0.11	0.55
Total Hedging (\$/boe)	0.64	0.77	0.66	3.29

Peyto's natural gas price, before hedging gains, averaged \$3.43/mcf during the fourth quarter of 2013, an increase of 4% from \$3.31/mcf reported for the equivalent period in 2012. Oil and natural gas liquids prices before hedging averaged \$71.98/bbl, a decrease of 2% from \$73.12/bbl from the fourth quarter of 2012. Average natural gas prices for the year were up 30% to \$3.40/mcf while oil and natural gas liquids prices were down 3% to \$71.81/bbl. Hedging activity increased Peyto's achieved price/mcfe by 3% from \$4.32 to \$4.43 per mcfe for the fourth quarter and for the year.

Oil & Natural Gas Liquids Prices by Component

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Condensate (\$/bbl)	84.92	87.02	89.85	90.41
Propane (\$/bbl) (includes hedging)	28.55	24.40	25.38	23.01
Butane (\$/bbl) (includes hedging)	57.26	60.46	52.73	61.09
Pentane (\$/bbl)	90.59	89.99	97.14	94.36

Revenue

(\$000)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Natural gas	114,259	81,249	394,524	228,398
Oil and natural gas liquids	46,248	35,557	167,121	129,335
Hedging gain	3,948	3,504	14,200	53,667
Total revenue	164,455	120,310	575,845	411,400

For the three months ended December 31, 2013, revenue increased 37% to \$164.5 million from \$120.3 million for the equivalent period in 2012. Revenue for 2013 increased 40% to \$575.8 million from \$411.4 million in 2012. 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 Dec. 31			Twelve Months ended Dec. 31		
	2013	2012	\$million	2013	2012	\$million
Total Revenue, December 31, 2012			120.3			411.4
Revenue change due to:						
Natural gas						
Volume (mmcf)	33,292	24,546	30.2	115,932	87,487	92.5
Price (\$/mcf)	\$3.59	\$3.45	4.7	\$3.54	\$3.23	35.9
Oil & NGL						
Volume (mdbl)	643	486	11.4	12,327	1,749	42.8
Price (\$/bbl)	\$69.84	\$73.01	(2.1)	\$70.97	\$73.92	(6.8)
Total Revenue, December 31, 2013			164.5			575.8

Royalties

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

(\$000 except per share amounts)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Royalties	10,288	9,205	40,450	30,754
% of sales before hedging	6.4	8	7.2	9
% of sales after hedging	6.3	8	7.0	8
\$/mcf	0.28	0.34	0.31	0.31
\$/boe	1.66	2.01	1.87	1.89

For the fourth quarter of 2013, royalties averaged \$0.28/mcfe or approximately 6% of Peyto's total petroleum and natural gas sales, an 18% decrease from the fourth quarter 2012. Royalties for 2013 were the same as 2012 at \$0.31/mcfe.

Substantially all of Peyto's production is in the Province of Alberta. Under the Alberta Royalty Framework ("ARF") the Crown royalty rate varies with production rates and commodity prices. The royalty rate expressed as a percentage of sales revenue will fluctuate from period to period due to the fact that the Alberta Reference Price can differ significantly from the commodity prices realized by Peyto and that hedging gains and losses are not subject to royalties.

In addition to the basic underlying royalty structure (the ARF), Alberta has instituted additional features that impact the royalty paid on gas and gas liquids for new wells drilled subsequent to January 1, 2009. These additional features include:

1. A one year flat 5% royalty period (18 months for horizontal wells) for each new well but capped at a cumulative production level of 500 MMcf for each new well, and
2. A Natural Gas Deep Drilling Holiday program that provides a royalty holiday value for new wells based on meterage drilled. This holiday feature further reduces the royalty for new wells to a minimum of 5% for a maximum 5 year period from on-stream date. This benefit sequentially follows the benefit under point (1) above.

From the combination of these royalty programs, Peyto has experienced a decrease in overall corporate royalty rates. This, in part, can be attributed to sustained low natural gas prices and the dependence of royalty rates on commodity prices. In its 15 years history, Peyto has invested \$3.5 billion in capital projects, found and developed 2.0 TCF of gas reserves, and paid over \$675 million in royalties.

Operating Costs & Transportation

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

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Operating costs (\$000)	13,032	8,513	45,235	31,260
\$/mcf	0.35	0.31	0.35	0.32
\$/boe	2.10	1.86	2.09	1.92
Transportation (\$000)	4,887	3,124	16,221	11,275
\$/mcf	0.13	0.11	0.12	0.12
\$/boe	0.79	0.68	0.75	0.69

Operating costs were \$13.0 million in the fourth quarter of 2013 compared to \$8.5 million for the equivalent period in 2012. On a unit-of-production basis, operating costs increased 13% to \$0.35/mcf in the fourth quarter of 2013 compared to \$0.31/mcf for the equivalent period in 2012. Operating costs increased 9% from 0.32/mcf in 2012 to \$0.35/mcf in 2013.

Transportation expenses were 18% higher in 2013 quarter over quarter due to increased TCPL tolls in September 2013 and unchanged year over year on a per mcf basis.

General and Administrative Expenses

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
G&A expenses (\$000)	3,489	3,742	14,306	12,822
Overhead recoveries	(1,183)	(3,265)	(9,102)	(8,976)
Net G&A expenses	2,306	477	5,204	3,846
\$/mcf	0.06	0.02	0.04	0.04
\$/boe	0.37	0.10	0.24	0.24

For the fourth quarter, general and administrative expenses before overhead recoveries were down 7% over the same quarter of 2012 and up 12% on an annual basis due to increases in staffing and office rent costs. Capital overhead recoveries decreased 64% for the fourth quarter from \$3.3 million to \$1.2 million and 1% on an annual basis. Capital overhead recoveries were reduced by \$1.5 million in the fourth quarter of 2013 to reflect 2013 actual directly attributable capital costs.

Interest Expense

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Interest expense (\$000)	8,778	8,914	30,991	25,401
\$/mcf	0.24	0.32	0.24	0.26
\$/boe	1.42	1.95	1.43	1.56
Average interest rate	4.1%	5.5%	4.2%	4.7%
Average interest rate excluding interest associated with 2003 income tax reassessment	4.1%	4.5%	4.2%	4.7%

Fourth quarter 2013 interest expense was \$8.8 million or \$0.24/mcf compared to \$8.9 million or \$0.32/mcf for the equivalent period in 2012. 2013 interest expense was \$31.0 million or \$0.24/mcf compared to \$25.4 million or \$0.26/mcf for the equivalent period in 2012. Interest expense included \$1.4 million in the fourth quarter of 2012 due to the payment of interest charges relating to the reassessment of the 2003 Alberta income tax return filed at the date of conversion to an income trust.

Netbacks

(\$/mcf)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Gross Sale Price	4.32	4.25	4.32	3.66
Hedging gain	0.11	0.13	0.11	0.55
Net Sale Price	4.43	4.38	4.43	4.21
Less: Royalties	0.28	0.34	0.31	0.31
Operating costs	0.35	0.31	0.35	0.32
Transportation	0.13	0.11	0.12	0.12
Field netback	3.67	3.62	3.65	3.46
General and administrative	0.06	0.02	0.04	0.04
Interest on long-term debt	0.24	0.32	0.24	0.26
Cash netback (\$/mcf)	3.37	3.28	3.37	3.16
Cash netback (\$/boe)	20.22	19.68	20.22	18.96

Netbacks are a non-GAAP 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 the Company'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.

The impact of cash taxes paid as a result of the reassessment of Peyto's 2003 income tax return have not been included in the cash netback. This was a one-time item related to the treatment of the payout of stock options for income tax upon conversion to an income trust. The reassessment was paid in 2008. The Alberta Government subsequently reassessed the 2003 Alberta income tax return in January, 2013 which was paid in the same month and accrued in the 2012 financial results.

Depletion, Depreciation and Amortization

The 2013 provision for depletion, depreciation and accretion totaled \$225.0 million compared to \$172.3 million in 2012. On a unit-of-production basis, depletion, depreciation and amortization costs for 2013 averaged \$1.73/mcf compared to \$1.76/mcf for 2012.

Income Taxes

The current provision for deferred income tax expense is \$46.7 million (2012 – \$34.3 million). Resource pools are generated from the capital program, which are available to offset current and deferred income tax liabilities.

Income Tax Pool type (\$ millions)	December 31,	December 31,	Annual deductibility
	2013	2012	
Canadian Oil and Gas Property Expense	245.1	263.4	10% declining balance
Canadian Development Expense	668.5	575.6	30% declining balance
Canadian Exploration Expense	208.7	181.0	100%
Undepreciated Capital Cost	312.3	228.4	Primarily 25% declining balance
Non-capital loss carry forward	19.7	42.1	100%
Other	32.5	39.5	Various, 7% declining balance to 20%
Total Federal Tax Pools	1,486.8	1,330.0	
Additional Alberta Tax Pool	44.9	41.3	Various rates, 25% declining balance to 100%

MARKETING

Commodity Price Risk Management

The Company is a party to certain off balance sheet derivative financial instruments, including fixed price contracts. The Company enters into these forward contracts with well-established counterparties for the purpose of protecting a portion of its future revenues from the volatility of oil and natural gas prices. In order to minimize counterparty risk, these marketing contracts are executed with financial institutions that are members of Peyto's banking syndicate. During 2013, a realized hedging gain of \$14.2 million was recorded as compared to \$53.7 million in 2012. Prices for propane contracts are listed in USD at Conway. The price Peyto realizes is less: i) a market-basis differential from Conway to Edmonton, ii) currency exchange, and iii) a pipeline and fractionation fee, to get to Peyto's plant gate price. A summary of contracts outstanding in respect of the hedging activities are as follows:

Propane Period Hedged	Type	Monthly Volume	Price (USD)
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	\$37.80/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	\$36.54/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	\$39.354/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	\$41.37/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	\$44.94/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	\$49.455/bbl
January 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	\$35.70/bbl
January 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	\$37.485/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	\$41.79/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	\$42.63/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	\$44.31/bbl
October 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	\$42.84/bbl

Natural Gas Period Hedged	Type	Daily Volume	Price (CAD)
April 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	\$3.00/GJ
August 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	\$3.00/GJ
August 1, 2012 to October 31, 2014	Fixed Price	5,000 GJ	\$3.10/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	\$2.81/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	\$3.00/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	\$3.05/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	\$3.02/GJ
November 1, 2012 to October 31, 2014	Fixed Price	5,000 GJ	\$3.0575/GJ
January 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.00/GJ
January 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.02/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.105/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.53/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.45/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.50/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.08/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.17GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.10/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	\$3.25/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	\$3.30/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	\$3.33/GJ
April 1, 2013 to October 31, 2014	Fixed Price	7,500 GJ	\$3.20/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	\$3.22/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	\$3.20/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	\$3.1925/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	\$3.25/GJ
April 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	\$3.30/GJ
August 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.55/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.71/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.76/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.86/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$4.00/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.90/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.52/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.1025/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.245/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.45/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.3075/GJ
November 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.25/GJ
November 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	\$3.50/GJ
November 1, 2013 to October 31, 2014	Fixed Price	5,000 GJ	\$3.53/GJ
November 1, 2013 to March 31, 2015	Fixed Price	5,000 GJ	\$3.6025/GJ
December 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.50/GJ
January 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$3.295/GJ

January 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$3.35/GJ
January 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$3.51/GJ
January 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$3.60/GJ
January 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$3.65/GJ
February 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$3.70/GJ
February 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$3.80/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.505/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.555/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.48/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.335/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.10/GJ
April 1, 2014 to 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
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	\$3.81/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

As at December 31, 2013, Peyto had committed to the future sale of 252,000 barrels of propane at an average price of \$42.67 CAD (\$40.12 USD) per barrel and 96,070,000 gigajoules (GJ) of natural gas at an average price of \$3.40 per GJ or \$3.91 per mcf. Had these contracts been closed on December 31, Peyto would have realized a loss in the amount of \$31.7 million.

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

Propane		Monthly	Price
Period Hedged	Type	Volume	(USD)
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	\$46.20/bbl

Natural Gas		Daily	Price
Period Hedged	Type	Volume	(CAD)
February 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$3.90/GJ
February 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$3.85/GJ
March 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$4.15/GJ
March 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$4.24/GJ
March 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$5.10/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.80/GJ

April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.825/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.95/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.98/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$4.07/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$4.32/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$4.35/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$4.55/GJ
April 1, 2014 to 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 October 31, 2015	Fixed Price	5,000 GJ	\$3.95/GJ
November 1, 2014 to October 31, 2015	Fixed Price	5,000 GJ	\$4.05/GJ
November 1, 2014 to October 31, 2015	Fixed Price	5,000 GJ	\$4.12/GJ
November 1, 2014 to October 31, 2015	Fixed Price	5,000 GJ	\$4.20/GJ
November 1, 2014 to October 31, 2015	Fixed Price	5,000 GJ	\$4.44/GJ
November 1, 2014 to October 31, 2015	Fixed Price	5,000 GJ	\$4.585/GJ
November 1, 2014 to October 31, 2015	Fixed Price	5,000 GJ	\$4.78/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

Commodity Price Sensitivity

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

Currency Risk Management

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

Interest Rate Risk Management

The Company is exposed to interest rate risk in relation to interest expense on its revolving credit facility while interest rates on the senior notes are fixed. Currently there are no agreements to manage the risk on the credit facility. At December 31, 2013, the increase or decrease in earnings for each 100 bps (1%) change in interest rate paid on the outstanding revolving demand loan amounts to approximately \$1.5 million per quarter or \$5.8 million per annum. Average debt outstanding was \$851.3 million for the fourth quarter and \$641.3 million for 2012.

LIQUIDITY AND CAPITAL RESOURCES

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

(\$000)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Cash flows from operating activities	116,852	78,878	407,357	284,309
Change in non-cash working capital	(1,759)	4,457	11,667	12,920
Change in provision for future performance based compensation	(6,226)	(7,712)	2,421	(2,819)
Income tax paid on account of 2003 reassessment	-	1,868	-	1,868
Performance based compensation	16,297	12,587	16,297	12,587
Funds from operations	125,164	90,078	437,742	308,865
Funds from operations per share	0.84	0.62	2.94	2.19

For the fourth quarter ended December 31, 2013, funds from operations totaled \$125.2 million or \$0.84 per share, as compared to \$90.1 million, or \$0.62 per share during the same quarter in 2012. Funds from operations for the year increased 42% to \$437.7 million. Increases were due to production growth and stronger natural gas prices.

Peyto's policy is to balance dividends to shareholders and funding for a capital program with cash flow, equity and available bank lines. Earnings and cash flow are sensitive to changes in commodity prices, exchange rates and other

factors that are beyond Peyto's control. Current volatility in commodity prices creates uncertainty as to the funds from operations and capital expenditure budget. Accordingly, results are assessed throughout the year and operational plans revised as necessary to reflect the most current information.

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

Long-Term Debt

	December 31, 2013	December 31, 2012
Bank credit facility	605,000	430,000
Senior unsecured notes	270,000	150,000
Balance, end of the period	875,000	580,000

The Company has a syndicated \$1.0 billion extendible revolving unsecured credit facility with a stated term date of April 26, 2015. The bank facility is made up of a \$30 million working capital sub-tranche and a \$970 million production line. The facilities are available on a revolving basis for a two year period. Borrowings under the facility bear interest at Canadian bank prime (3% at both December 31, 2013 and 2012) or US base rate, or, at Peyto's option, Canadian dollar bankers' acceptances or US dollar LIBOR loan rates, plus applicable margin and stamping fees. The total stamping fees range between 80 basis points and 225 basis points on Canadian bank prime and US base rate borrowings and between 180 basis points and 325 basis points on Canadian dollar bankers' acceptance and US dollar LIBOR borrowings. The undrawn portion of the facility is subject to a standby fee in the range of 40.5 to 73.13 basis points.

On January 3, 2012, Peyto issued \$100 million of senior secured notes pursuant to a Note Purchase and Private Shelf agreement. The notes were issued by way of private placement and rank equally with Peyto's obligations under its bank facility. The notes have a coupon rate of 4.39% and mature on January 3, 2019. Interest will be paid semi-annually in arrears.

On September 6, 2012, Peyto issued \$50 million of senior secured notes pursuant to a Note Purchase and Private Shelf agreement. The notes were issued by way of private placement and rank equally with Peyto's obligations under its bank facility. The notes have a coupon rate of 4.88% and mature on September 6, 2022. Interest will be paid semi-annually in arrears.

On April 26, 2013, security on the notes issued on January 3, 2012 and September 6, 2012 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.

Upon the issuance of the senior unsecured notes on April 26, 2013 and December 4, 2013, 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, 2013.

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

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

Net Debt

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

(\$000)	As at December 31, 2013	As at December 31, 2012
Unsecured bank credit facility	605,000	430,000
Senior unsecured notes	270,000	150,000
Working capital deficit	103,247	74,884
Financial derivative instruments	(26,606)	10,254
Provision for future performance based compensation	(5,100)	(2,677)
Net debt	946,541	662,461

Capital

Authorized: Unlimited number of voting common shares

Issued and Outstanding

Common Shares (no par value)	Number of Common Shares	Amount \$
Balance, December 31, 2011	137,960,301	889,115
Common shares issued	4,628,750	115,024
Common shares issued for acquisitions	5,404,007	112,187
Common share issuance costs (net of tax)	-	(3,896)
Common shares issued by private placement	525,655	11,952
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

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

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

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

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

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

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

Shares to be issued

On December 31, 2013 the Company 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 on January 8, 2014.

Subsequent to December 31, 2013, 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. The offering closed on February 5, 2014.

Performance Based Compensation

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

The reserve value based component is 4% of the incremental increase in value, if any, as adjusted to reflect changes in debt, equity and dividends, of proved producing reserves calculated using a constant price at December 31 of the current year and a discount rate of 8%. This methodology can generate interim results which vary significantly from the final compensation paid. Compensation expense of \$2.2 million was recorded for the year ended December 31, 2013.

(\$millions except per share values)	2013	2012	Change
Net present value of proved producing reserves @ 8% based on constant InSite 2013 price forecast	2,132.6	1,969.1	
Net debt before performance based compensation	(936.5)	(662.5)	
2013 dividends, G&A and interest		(167.1)	
Net value	1,196.1	1,139.5	
Shares outstanding (millions)	148.759	148.673	
Net value per share	8.0409	7.6649	0.376
Shares outstanding at beginning of year (millions)			148.673
Equity adjusted increase in value			55.9
2013 reserve value based compensation @ 4%			2.2

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 2013 market based component was based on 0.6 million vested rights at an average grant price of \$19.12, average cumulative distributions of \$0.72 and a ten day weighted average price of \$24.75, ii) 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 and iii) 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.

The total amount expensed under these plans was as follows:

(\$000)	2013	2012
Market based compensation	14,061	7,762
Reserve based compensation	2,236	4,825
Total market and reserves based compensation	16,297	12,587

For the future market based component, compensation costs as at December 31, 2013 were \$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. (2012 – \$2.8 million related to 0.6 million non-vested rights with an average grant price of \$19.13, average cumulative dividends of \$0.72 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, 2013 was \$8.3 million (2012 - \$2.7 million).

Subsequent to December 31, 2013, 3.2 million rights were granted at a price of \$32.27 to be valued at the ten day weighted average market price at December 31, 2014 and vesting 1/3 on each of December 31, 2014, December 31, 2015 and December 31, 2016.

Stock Appreciation Rights Outstanding

Vesting Date	Valued but Not Vested		To be Valued December 31, 2014		
	Number of Rights	Value (\$)		Number of Rights	Average Grant Price (\$)
December 31, 2014	71,667	174,000	*	1,064,500	32.27
	981,593	10,117,682	**		
December 31, 2015	981,593	10,117,682	**	1,064,500	32.27
December 31, 2016	-	-		1,064,500	32.27

*Valued on December 31, 2012 at \$22.58

**Valued on December 31, 2013 at \$32.27

Capital Expenditures

Net capital expenditures for the fourth quarter of 2013 totaled \$154.3 million. Exploration and development related activity represented \$106.7 million (69% of total), while expenditures on facilities, gathering systems and equipment totaled \$45.8 million (30% of total) land, seismic and acquisitions totaled \$1.8 million (1% of total). Capital expenditures of \$578.0 million for 2013 were 6% lower than 2012 capital expenditures. The following table summarizes capital expenditures for the year:

(\$000)	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Land	1,144	5,206	6,427	10,770
Seismic	683	612	2,984	1,741
Drilling	59,825	77,295	254,000	210,946
Completions	46,836	46,484	151,752	127,042
Equipping and tie-ins	12,389	22,168	48,303	46,246
Facilities and pipelines	33,418	25,846	112,054	38,236
Acquisition of Open Range	-	-	-	187,187
Acquisitions	-	75	2,483	17,841
Dispositions	-	(16,969)	-	(17,646)
(Gains) Losses on Dispositions	-	(3,870)	-	(4,378)
Total Capital Expenditures	154,295	156,847	578,003	617,985

Dividends

	Three Months ended Dec. 31		Twelve Months ended Dec. 31	
	2013	2012	2013	2012
Funds from operations (\$000)	125,164	90,078	437,742	308,865
Total dividends (\$000)	35,702	26,178	130,898	101,593
Total dividends per share (\$)	0.24	0.18	0.88	0.72
Payout ratio (%)	29	28	30	33

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

CONTRACTUAL OBLIGATIONS

Peyto has contractual obligations and commitments as follows:

	2014	2015	2016	2017	2018	Thereafter
Note repayment ⁽¹⁾	-	-	-	-	-	270,000
Interest payments ⁽²⁾	12,230	12,230	12,230	12,230	12,230	22,755
Transportation commitments	18,350	16,354	12,276	8,414	6,175	4,873
Operating leases	2,412	2,380	1,863	1,654	1,295	10,356
Total	32,992	30,964	26,369	22,298	19,700	307,984

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

⁽²⁾ Fixed interest payments on senior unsecured notes

LITIGATION

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

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

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

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

RELATED PARTY TRANSACTIONS

An officer and director of the Company is a partner of a law firm that provides legal services to the Company. For the year ended December 31, 2013, legal fees totaled \$0.7 million (2012 - \$1.2 million). As at December 31, 2013, an amount due to this firm of \$0.7 million was included in accounts payable (2012 - \$1.2 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 the Company against certain potential losses.

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

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

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

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

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

CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

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

Internal Control over Financial Reporting

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

The Company is required to disclose herein any change in the Company's internal control over financial reporting that occurred during the year ended December 31, 2013 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. No material changes in the Company's internal control over financial reporting were identified during such period that has materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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

CRITICAL ACCOUNTING ESTIMATES

Reserve Estimates

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

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

Depletion and Depreciation Estimate

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

Impairment of Long-Lived Assets

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

Decommissioning Provision

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

Future Market Performance Based Compensation

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

Reserve Value Performance Based Compensation

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

Income Taxes

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

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

Accounting Changes

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

CHANGES IN ACCOUNTING POLICIES

Presentation of Financial Statements

Peyto adopted the following standards on January 1, 2013:

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

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

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

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

STANDARDS ISSUED BUT NOT YET EFFECTIVE

The IASB issued the following standards and amendments which are not yet effective for Peyto and discussed in further detail in Note 2 to the Financial Statements for the fiscal year ended December 31, 2013.

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

In May 2013, the IASB issued amendments to IAS 36 "Impairment of Assets" which reduce the circumstances in which the recoverable amount of CGUs is required to be disclosed and clarify the disclosures required when an impairment loss has been recognized or reversed in the period. The amendments are required to be adopted retrospectively for fiscal years beginning January 1, 2014, with earlier adoption permitted. These amendments will be applied by Peyto on January 1, 2014 and the adoption will only impact disclosures in the notes to the financial statements in periods when an impairment loss or impairment reversal is recognized.

In May 2013, the IASB issued IFRIC 21 "Levies," which was developed by the IFRS Interpretations Committee ("IFRIC"). IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by

the relevant legislation, occurs. The interpretation also clarifies that no liability should be recognized before the specified minimum threshold to trigger that levy is reached. IFRIC 21 is required to be adopted retrospectively for fiscal years beginning January 1, 2014, with earlier adoption permitted. IFRIC 21 will be applied by Peyto on January 1, 2014 and the adoption may have an impact on Peyto's accounting for production and similar taxes, which do not meet the definition of an income tax in IAS 12 "Income Taxes." Peyto is currently assessing and quantifying the effect on its 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

	2013				2012
	Q4	Q3	Q2	Q1	Q4
Operations					
Production					
Natural gas (mcf/d)	361,870	300,286	310,621	297,191	266,808
Oil & NGLs (bbl/d)	6,984	6,295	6,374	5,840	5,286
Barrels of oil equivalent (boe/d @ 6:1)	67,296	56,343	58,145	55,372	49,754
Thousand cubic feet equivalent (mcf/d @ 6:1)	403,774	338,058	348,868	332,230	298,522
Average product prices					
Natural gas (\$/mcf)	3.59	3.35	3.72	3.49	3.45
Oil & natural gas liquids (\$/bbl)	69.84	70.91	67.82	75.88	73.01
\$/MCFE					
Average sale price (\$/mcf)	4.43	4.29	4.56	4.46	4.38
Average royalties paid (\$/mcf)	0.28	0.31	0.32	0.36	0.34
Average operating expenses (\$/mcf)	0.35	0.37	0.35	0.31	0.31
Average transportation costs (\$/mcf)	0.13	0.12	0.12	0.12	0.11
Field netback (\$/mcf)	3.67	3.49	3.77	3.67	3.62
General & administrative expense (\$/mcf)	0.06	0.02	0.05	0.02	0.02
Interest expense (\$/mcf)	0.24	0.25	0.25	0.21	0.32
Cash netback (\$/mcf)	3.37	3.22	3.47	3.44	3.28
Financial (\$000 except per share)					
Revenue	164,455	133,573	144,614	133,203	120,310
Royalties	10,288	9,722	9,849	10,591	9,205
Funds from operations	125,164	99,736	109,987	102,612	90,078
Funds from operations per share	0.84	0.67	0.74	0.69	0.62
Total dividends	35,702	35,702	32,727	26,766	26,178
Total dividends per share	0.24	0.24	0.22	0.18	0.18
Payout ratio	29%	36%	30%	26%	28%
Earnings	37,989	30,461	37,773	36,405	25,823
Earnings per diluted share	0.26	0.21	0.25	0.25	0.18
Capital expenditures	154,295	180,801	73,809	169,099	156,847
Weighted average shares outstanding	148,758,923	148,758,923	148,758,923	148,672,664	145,449,651



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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, 2013 and 2012, 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, 2013 and 2012, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Deloitte LLP.

Chartered Accountants

March 4, 2014
Calgary, Alberta

Peyto Exploration & Development Corp.

Balance Sheet

(Amounts in \$ thousands)

	December 31 2013	December 31 2012
Assets		
Current assets		
Cash	-	-
Accounts receivable	83,714	85,677
Due from private placement (Note 7)	6,245	3,459
Derivative financial instruments (Note 13)	-	10,254
Prepaid expenses	5,666	4,150
	95,625	103,540
Property, plant and equipment, net (Note 4)	2,459,531	2,099,984
	2,459,531	2,099,984
	2,555,156	2,203,524
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	155,265	164,968
Current income tax	-	1,868
Dividends payable (Note 7)	11,901	8,911
Derivative financial instruments (Note 13)	26,606	-
Provision for future performance based compensation (Note 11)	5,100	2,677
	198,872	178,424
Long-term debt (Note 5)	875,000	580,000
Long-term derivative financial instruments (Note 13)	5,180	2,532
Provision for future performance based compensation (Note 11)	3,200	59
Decommissioning provision (Note 6)	61,184	58,201
Deferred income taxes (Note 12)	211,082	174,241
	1,155,646	815,033
Equity		
Shareholders' capital (Note 7)	1,130,069	1,124,382
Shares to be issued (Note 7)	6,245	3,459
Retained earnings	86,975	75,247
Accumulated other comprehensive income (Note 7)	(22,651)	6,979
	1,200,638	1,210,067
	2,555,156	2,203,524

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	
	2013	2012
Revenue		
Oil and gas sales	561,645	357,734
Realized gain on hedges <i>(Note 13)</i>	14,200	53,667
Royalties	(40,450)	(30,754)
Petroleum and natural gas sales, net	535,395	380,647
Expenses		
Operating <i>(Note 8)</i>	45,235	31,260
Transportation	16,221	11,275
General and administrative <i>(Note 9)</i>	5,204	3,846
Market and reserves based bonus <i>(Note 11)</i>	16,297	12,587
Future performance based compensation <i>(Note 11)</i>	5,564	(2,819)
Interest <i>(Note 10)</i>	30,991	25,401
Accretion of decommissioning provision <i>(Note 10)</i>	1,544	1,044
Depletion and depreciation <i>(Note 4)</i>	224,976	172,338
Gain on disposition of assets <i>(Note 4)</i>	-	(4,378)
	346,032	250,554
Earnings before taxes	189,363	130,093
Income tax		
Deferred income tax expense <i>(Note 12)</i>	46,736	34,274
Current Income tax expense <i>(Note 12)</i>	-	1,868
Earnings for the year	142,627	93,951
Earnings per share <i>(Note 7)</i>		
Basic and diluted	\$ 0.96	\$ 0.67
Weighted average number of common shares outstanding <i>(Note 7)</i>		
Basic and diluted	148,737,654	141,093,829

Peyto Exploration & Development Corp.

Statement of Comprehensive Income

(Amounts in \$ thousands)

	Year ended December 31	
	2013	2012
Earnings for the year	142,627	93,951
Other comprehensive income		
Change in unrealized gain (loss) on cash flow hedges	(25,307)	17,687
Deferred tax recovery	9,877	8,995
Realized (gain) loss on cash flow hedges	(14,200)	(53,667)
Comprehensive Income	112,997	66,966

Peyto Exploration & Development Corp.

Statement of Changes in Equity

(Amounts in \$ thousands)

	Year ended December 31	
	2013	2012
Shareholders' capital, Beginning of Year	1,124,382	889,115
Common shares issued	-	115,024
Common shares issued pursuant to acquisition of Open Range Energy Corp.	-	112,187
Common shares issued by private placement	5,742	11,952
Common shares issuance costs (net of tax)	(55)	(3,896)
Shareholders' capital, End of Year	1,130,069	1,124,382
Common shares to be issued, Beginning of Year	3,459	9,740
Common shares issued	(3,459)	(9,740)
Common shares to be issued	6,245	3,459
Common shares to be issued, End of Year	6,245	3,459
Retained earnings, Beginning of Year	75,247	82,889
Earnings for the year	142,627	93,951
Dividends (<i>Note 7</i>)	(130,899)	(101,593)
Retained earnings, End of Year	86,975	75,247
Accumulated other comprehensive income, Beginning of Year	6,979	33,964
Other comprehensive income (loss)	(29,630)	(26,985)
Accumulated other comprehensive income, End of Year	(22,651)	6,979
Total Equity	1,200,638	1,210,067

Peyto Exploration & Development Corp.

Statement of Cash Flows

(Amounts in \$ thousands)

	Year ended December 31	
	2013	2012
Cash provided by (used in)		
Operating activities		
Earnings	142,627	93,951
Items not requiring cash:		
Deferred income tax	46,736	34,274
Gain on disposition of assets	-	(4,378)
Depletion and depreciation	224,976	172,338
Accretion of decommissioning provision	1,544	1,044
Long term portion of future performance based compensation	3,141	-
Change in non-cash working capital related to operating activities	(11,667)	(12,920)
	407,357	284,309
Financing activities		
Issuance of common shares	5,742	126,976
Issuance costs	(73)	(5,195)
Cash dividends paid	(127,908)	(100,960)
Increase (decrease) in bank debt	175,000	(40,000)
Issuance of long term notes	120,000	150,000
Repayment of Open Range bank debt	-	(72,000)
	172,761	58,821
Investing activities		
Additions to property, plant and equipment	(578,003)	(429,737)
Change in prepaid capital	(5,081)	(2,300)
Change in non-cash working capital relating to investing activities	2,966	31,683
	(580,118)	(400,354)
	(580,118)	(400,354)
Net increase in cash	-	(57,224)
Cash, beginning of year	-	57,224
Cash, end of year	-	-

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

Cash interest paid	23,920	23,460
Cash taxes paid	1,800	-

Peyto Exploration & Development Corp.

Notes to Financial Statements

As at December 31, 2013 and 2012

(Amounts in \$ thousands, except as otherwise noted)

1. Nature of operations

Peyto Exploration & Development Corp. (“Peyto” or the “Company”) is a Calgary based oil and natural gas company. Peyto conducts exploration, development and production activities in Canada. Peyto is incorporated and domiciled in the Province of Alberta, Canada. The address of its registered office is 1500, 250 – 2nd Street SW, Calgary, Alberta, Canada, T2P 0C1.

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

These financial statements were approved and authorized for issuance by the Board of Directors of Peyto on March 4, 2014.

2. Basis of presentation

These financial statements (“financial statements”) as at and for the years ended December 31, 2013 and December 31, 2012 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 fiscal year beginning January 1, 2013 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, 2012 and 2011.

Peyto adopted the following standards on January 1, 2013:

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

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

d) Standards issued but not yet effective

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

In May 2013, the IASB issued amendments to IAS 36 "Impairment of Assets" which reduce the circumstances in which the recoverable amount of CGUs is required to be disclosed and clarify the disclosures required when an impairment loss has been recognized or reversed in the period. The amendments are required to be adopted retrospectively for fiscal years beginning January 1, 2014, with earlier adoption permitted. These amendments will be applied by Peyto on January 1, 2014 and the adoption will only impact disclosures in the notes to the financial statements in periods when an impairment loss or impairment reversal is recognized.

In May 2013, the IASB issued IFRIC 21 "Levies," which was developed by the IFRS Interpretations Committee ("IFRIC"). IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. The interpretation also clarifies that no liability should be recognized before the specified minimum threshold to trigger that levy is reached. IFRIC 21 is required to be adopted retrospectively for fiscal years beginning January 1, 2014, with earlier adoption permitted. IFRIC 21 will be applied by Peyto on January 1, 2014 and the adoption may have an impact on Peyto's accounting for production and similar taxes, which do not meet the definition of an income tax in IAS 12 "Income Taxes". Peyto is currently assessing and quantifying the effect on its 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 assets

A jointly controlled asset involves joint control and offers joint ownership by the Company and other partners of assets contributed to or acquired for the purpose of the jointly controlled assets, without the formation of a corporation, partnership or other entity.

The Company accounts for its share of the jointly controlled assets, any liabilities it has incurred, its share of any liabilities jointly incurred with its partners, income from the sale or use of its share of the joint asset's output, together with its share of the expenses incurred by the jointly controlled asset and any expenses it incurs in relation to its interest in the jointly controlled asset.

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 risk management 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. Corporate Acquisition

On August 14, 2012, Peyto completed the acquisition, by plan of arrangement, of all issued and outstanding common shares of Open Range. The total consideration of approximately \$187.2 million was paid for by the issuance of 5.4 million common shares of Peyto and the assumption of Open Range's long-term debt and working capital deficiency (\$190.4 million was allocated to Property, plant & equipment). Transaction costs of approximately \$0.7 million were included in general and administrative expenses in the Income Statement.

Fair value of net assets acquired	
Working capital	(1,868)
Property, plant and equipment	190,385
Financial derivative instruments	(1,132)
Bank debt	(72,000)
Decommissioning provision	(5,127)
Deferred income taxes	1,929
Total net assets acquired	112,187
Consideration	
Shares issued (5,404,007 shares)	112,187
Total purchase price	112,187

If Peyto had acquired Open Range on January 1, 2012, the pro-forma results of the oil and gas sales, net income and comprehensive income for the period ended December 31, 2012 would have been as follows;

	As Stated December 31, 2012	Open Range January 1, 2012 to August 14, 2012	Pro Forma December 31, 2012
Oil and gas sales	380,647	27,756	408,403
Net income	93,951	1,134	95,085
Comprehensive income	66,966	1,134	68,100

4. Property, plant and equipment, net

Cost		
At December 31, 2011		1,845,180
Acquisitions through business combinations		190,385
Additions		447,386
Decommissioning provision additions		19,120
Dispositions		(17,649)
Prepaid capital		2,300
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
Accumulated depletion and depreciation		
At December 31, 2011		(214,546)
Depletion and depreciation		(172,338)
Dispositions		146
At December 31, 2012		(386,738)
Depletion and depreciation		(224,976)
Dispositions		-
At December 31, 2013		(611,714)
Carrying amount at December 31, 2012		2,099,984
Carrying amount at December 31, 2013		2,459,531

Proceeds received for assets disposed of during 2013 were \$nil (2012 - \$21.9 million).

In September 2012, Peyto acquired producing properties for \$16.7 million, which were allocated to property, plant and equipment of \$17.4 million and decommissioning liabilities of \$0.7 million. The properties are in Peyto's core area of production. The impact on revenue and net income is not significant.

During, 2013 Peyto capitalized \$7.8 million (2012 - \$7.8 million) of general and administrative expense directly attributable to exploration and development activities.

The Company did not have any indicators of impairment in the current or prior years.

5. Long-term debt

	December 31, 2013	December 31, 2012
Bank credit facility	605,000	430,000
Senior unsecured notes	270,000	150,000
Balance, end of the year	875,000	580,000

The Company has a syndicated \$1.0 billion extendible unsecured revolving credit facility with a stated term date of April 26, 2015. The bank facility is made up of a \$30 million working capital sub-tranche and a \$970 million production line. The facilities are available on a revolving basis for a two year period. Borrowings under the facility

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

On January 3, 2012, Peyto issued \$100 million of senior secured notes pursuant to a Note Purchase and Private Shelf agreement. The notes were issued by way of private placement and rank equally with Peyto's obligations under its bank facility. The notes have a coupon rate of 4.39% and mature on January 3, 2019. Interest will be paid semi-annually in arrears.

On September 6, 2012, Peyto issued \$50 million of senior secured notes pursuant to a Note Purchase and Private Shelf agreement. The notes were issued by way of private placement and rank equally with Peyto's obligations under its bank facility. The notes have a coupon rate of 4.88% and mature on September 6, 2022. Interest will be paid semi-annually in arrears.

On April 26, 2013, the security on the notes issued on January 3, 2012 and September 6, 2012 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.

Upon the issuance of the senior unsecured notes on April 26, 2013 and December 4, 2013, 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, 2013.

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

The fair value of all senior notes as at December 31, 2013, is \$269.2 million compared to a carrying value of \$270.0 million.

Total interest expense for 2013 was \$30.9 million (2012 - \$25.4 million) and the average borrowing rate for 2013 was 4.2% (2012 - 4.7%).

6. Decommissioning provision

The Company makes provision for the future cost of decommissioning wells, pipelines and facilities 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, 2011	38,037
New or increased provisions	13,908
Accretion of discount	1,044
Change in discount rate and estimates	5,212
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
Current	-
Non-current	61,184

The Company has estimated the net present value of its total decommissioning provision to be \$61.2 million as at December 31, 2013 (\$58.2 million at December 31, 2012) based on a total future undiscounted liability of \$177.8 million (\$127.9 million at December 31, 2012). At December 31, 2013 management estimates that these payments are expected to be made over the next 50 years with the majority of payments being made in years 2040 to 2064. The Bank of Canada's long term bond rate of 3.24 per cent (2.36 per cent at December 31, 2012) and an inflation rate of 2.0 per cent (2.0 per cent at December 31, 2012) were used to calculate the present value of the decommissioning provision.

7. Equity

Share capital

Authorized: Unlimited number of voting common shares

Issued and Outstanding

	Number of Common Shares	Amount \$
Common Shares (no par value)		
Balance, December 31, 2011	137,960,301	889,115
Common shares issued	4,628,750	115,024
Common shares issued for acquisition	5,404,007	112,187
Common share issuance costs (net of tax)	-	(3,896)
Common shares issued by private placement	525,655	11,952
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

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

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

On August 14, 2012 Peyto issued 5,404,007 common shares which were valued at \$112.2 million (net of issuance costs) (\$20.76 per share) in relation to the closing of a corporate acquisition (Note 3).

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

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

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

Subsequent to December 31, 2013, 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. The offering closed on February 5, 2014.

Shares to be issued

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.

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, 2013 of 148,737,654 (2012 – 141,093,829). There are no dilutive instruments outstanding.

Dividends

During the year ended December 31, 2013, Peyto declared and paid dividends of \$0.88 per common share 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, totaling \$130.9 million (2012 - \$0.72 or \$0.06 per share per month, \$101.6 million).

On January 15, 2014 Peyto declared dividends of \$0.08 per common share paid on February 14, 2014. On February 14, 2014, Peyto declared dividends of \$0.08 per common share to be paid to shareholders of record on February 28, 2014. These dividends will be paid on March 14, 2014.

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 13.

8. 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 controlled assets and third party natural gas reduce operating expenses.

	Years ended December 31	
	2013	2012
Field expenses	58,963	46,591
Processing and gathering recoveries	(13,728)	(15,331)
Total operating expenses	45,235	31,260

9. General and administrative expenses

General and administrative expenses are reduced by operating and capital overhead recoveries from operated properties.

	Years ended December 31	
	2013	2012
General and administrative expenses	14,306	12,822
Overhead recoveries	(9,102)	(8,976)
Net general and administrative expenses	5,204	3,846

10. Finance costs

	Years ended December 31	
	2013	2012
Interest expense	30,991	25,401
Accretion of decommissioning provisions	1,544	1,044
Total finance costs	32,535	26,445

11. 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 2013 market based component was based on i) 0.6 million vested rights at an average grant price of \$19.12, average cumulative distributions of \$0.72 and a ten day weighted average price of \$24.75; ii) 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 and iii) 1.0 million vested rights at an average grant price of \$22.83, average cumulative distributions of \$0.88 and a ten day weighted average price of \$32.27. The 2012 market based component was based on i) 0.5 million vested rights at an average grant price of \$13.50, average cumulative distributions of \$1.44 and a ten day weighted average closing price of \$18.83, ii) 0.6 million vested rights at an average grant price of \$19.13, average cumulative distributions of \$0.72 and a ten day weighted average price of \$24.75 and iii) 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.

The total amount expensed under these plans was as follows:

(\$000)	2013	2012
Market based compensation	14,061	7,762
Reserve based compensation	2,236	4,825
Total market and reserves based compensation	16,297	12,587

For the future market based component, compensation costs as at December 31, 2013 were \$5.56 million (2012 - \$2.82 million recovery) related to 0.1 million non-vested rights with an average grant price of \$20.63, average cumulative dividends of \$0.48 and 2.0 million non-vested rights with an average grant price of \$22.83 and average cumulative dividends of \$0.88. (2012 - 0.6 million non-vested rights with an average grant price of \$19.13 and 0.1 million non-vested rights with an average grant price of \$20.63 were a recovery of \$2.8 million). The cumulative provision for future performance based compensation as at December 31, 2013 was \$8.3 million (2012 - \$2.7 million).

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

	December 31 2013	December 31 2012
Share price	\$32.27	\$22.58
Exercise price	\$19.91 - \$21.70	\$18.41 - \$19.91
Expected volatility	0%	0%
Option life	1 - 2 years	1 - 2 years
Dividend yield	0%	0%
Risk-free interest rate	1.13%	1.08%

Subsequent to December 31, 2013, 3.2 million rights were granted at a price of \$32.78 to be valued at the ten day weighted average market price at December 31, 2013 and vesting one third on each of December 31, 2014, December 31, 2015 and December 31, 2016.

12. Income taxes

(\$000)	2013	2012
Earnings before income taxes	189,363	130,093
Statutory income tax rate	25.00%	25.00%
Expected income taxes	47,341	32,523
Increase (decrease) in income taxes from:		
True-up tax pools	(443)	1,634
Resolution of reassessment and other	(162)	1,985
Total income tax expense	46,736	36,142
Deferred income tax expense	46,736	34,274
Current income tax expense	-	1,868
Total income tax expense	46,736	36,142
Differences between tax base and reported amounts for depreciable assets	(249,382)	(207,805)
Derivative financial instruments	7,947	1,930
Share issuance costs	1,826	(3,095)
Future performance based bonuses	2,075	(684)
Provision for decommission provision	15,296	(14,550)
Cumulative eligible capital	6,139	(6,599)
Attributable crown royalty income carryforward	-	-
Tax loss carry-forwards recognized	5,017	(10,566)
Deferred income taxes	(211,082)	(174,241)

At December 31, 2013 the Company has tax pools of approximately \$1,467.1 million (2012 - \$1,288.0 million) available for deduction against future income. The Company has approximately \$19.7 million in loss carry-forwards (2012 - \$42.1 million) available to reduce future taxable income.

Canada Revenue Agency ("CRA") conducted an audit of restructuring costs incurred in the 2003 trust conversion. On September 25, 2008, the CRA reassessed on the basis that \$41 million of these costs were not deductible and treated them as an eligible capital amount. The Company filed a notice of objection and the CRA confirmed the reassessment. Examinations for discovery have been completed. The Tax Court of Canada had agreed to both parties' request to hold the Company's appeal in abeyance pending a decision of the Supreme Court of Canada to hear another taxpayer's appeal. The other appeal raised issues that are similar in principle to those raised in the Company's appeal. As the other taxpayer's appeal was unsuccessful with the Federal Court of Appeal, in 2011, the Company expensed the income tax of \$4.9 million and interest charges of \$2.2 million assessed and paid in 2008. Subsequently, the Alberta Government reassessed the same time period resulting in income taxes payable of \$1.8 million and interest charges of \$1.4 million paid in 2013.

13. 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, 2013.

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, 2013 and 2012, 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, 2013:

Propane Period Hedged	Type	Monthly Volume	Price (USD)
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	\$37.80/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	\$36.54/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	\$39.354/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	\$41.37/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	\$44.94/bbl
January 1, 2014 to March 31, 2014	Fixed Price	4,000 bbl	\$49.455/bbl
January 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	\$35.70/bbl
January 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	\$37.485/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	\$41.79/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	\$42.63/bbl
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	\$44.31/bbl
October 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	\$42.84/bbl

Natural Gas Period Hedged	Type	Daily Volume	Price (CAD)
April 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	\$3.00/GJ
August 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	\$3.00/GJ
August 1, 2012 to October 31, 2014	Fixed Price	5,000 GJ	\$3.10/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	\$2.81/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	\$3.00/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	\$3.05/GJ
November 1, 2012 to March 31, 2014	Fixed Price	5,000 GJ	\$3.02/GJ
November 1, 2012 to October 31, 2014	Fixed Price	5,000 GJ	\$3.0575/GJ
January 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.00/GJ
January 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.02/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.105/GJ
April 1, 2013 to March 31, 2014	Fixed Price	5,000 GJ	\$3.53/GJ

April 1, 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
November 1, 2014 to March 31, 2015	Fixed Price	5,000 GJ	\$3.81/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

As at December 31, 2013, Peyto had committed to the future sale of 252,000 barrels of natural gas liquids at an average price of \$42.67 CAD (\$40.12 USD) per barrel and 96,070,000 gigajoules (GJ) of natural gas at an average price of \$3.40 per GJ or \$3.91 per mcf. Had these contracts been closed on December 31, 2013, Peyto would have realized a loss in the amount of \$31.7 million. If the AECO gas price on December 31, 2013 were to increase by \$1/GJ, the unrealized loss would increase by approximately \$96.1 million. An opposite change in commodity prices rates would result in an opposite impact on other comprehensive income.

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

Propane Period Hedged	Type	Monthly Volume	Price (USD)
April 1, 2014 to September 30, 2014	Fixed Price	4,000 bbl	\$46.20/bbl

Natural Gas Period Hedged	Type	Daily Volume	Price (CAD)
February 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$3.90/GJ
February 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$3.85/GJ
March 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$4.15/GJ
March 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$4.24/GJ
March 1, 2014 to March 31, 2014	Fixed Price	5,000 GJ	\$5.10/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.80/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.825/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.95/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$3.98/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$4.07/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$4.32/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$4.35/GJ
April 1, 2014 to October 31, 2014	Fixed Price	5,000 GJ	\$4.55/GJ
April 1, 2014 to 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 October 31, 2015	Fixed Price	5,000 GJ	\$3.95/GJ
November 1, 2014 to October 31, 2015	Fixed Price	5,000 GJ	\$4.05/GJ
November 1, 2014 to October 31, 2015	Fixed Price	5,000 GJ	\$4.12/GJ
November 1, 2014 to October 31, 2015	Fixed Price	5,000 GJ	\$4.20/GJ
November 1, 2014 to October 31, 2015	Fixed Price	5,000 GJ	\$4.44/GJ
November 1, 2014 to October 31, 2015	Fixed Price	5,000 GJ	\$4.585/GJ
November 1, 2014 to October 31, 2015	Fixed Price	5,000 GJ	\$4.78/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

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, 2013 would decrease by \$5.8 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, 2013, approximately 62% was received from five companies (15%, 13%, 13%, 11%, and 10%) (December 31, 2012 – 14%, one company). Of the Company's accounts receivable at December 31, 2013, approximately 61% was receivable from five companies (14%, 14%, 11%, 11%, and 11%) (December 31, 2012 – 14%, one company). 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 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, 2013, 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, 2013:

	< 1 Year	1-2 Years	3-5 Years	Thereafter
Accounts payable and accrued liabilities	155,265	-	-	-
Dividends payable	11,901	-	-	-
Provision for future market and reserves based bonus	5,100	3,200	-	-
Current taxes payable	-	-	-	-
Long-term debt ⁽¹⁾	-	605,000	-	-
Unsecured senior notes	-	-	-	270,000

(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 2013	December 31 2012
Equity	1,200,638	1,210,067
Long-term debt	875,000	580,000
Working capital (surplus) deficit	103,247	74,884
	2,178,885	1,864,951

14. 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, 2013, legal fees totaled \$0.7 million (2012 - \$1.2 million). As at December 31, 2013, an amount due to this firm of \$0.7 million was included in accounts payable (2012 - \$1.2 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 \$1.4 million is included in general and administrative expenses and \$6.5 million in market and reserves based bonus relating to key management personnel for the year 2013 (2012 - \$1.3 million in general and administrative and \$5.0 million in market and reserves based bonus).

15. Commitments

Peyto has contractual obligations and commitments as follows:

	2014	2015	2016	2017	2018	Thereafter
Note repayment ⁽¹⁾	-	-	-	-	-	270,000
Interest payments ⁽²⁾	12,230	12,230	12,230	12,230	12,230	22,755
Transportation commitments	18,350	16,354	12,276	8,414	6,175	4,873
Operating leases	2,412	2,380	1,863	1,654	1,295	10,356
Total	32,992	30,964	26,369	22,298	19,700	307,984

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

⁽²⁾ Fixed interest payments on senior unsecured notes

16. Contingencies

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

Officers

Darren Gee
President and Chief Executive Officer

Scott Robinson
Executive Vice President and Chief Operating Officer

Kathy Turgeon
Vice President, Finance and Chief Financial Officer

Stephen Chetner
Corporate Secretary

Tim Louie
Vice President, Land

David Thomas
Vice President, Exploration

Jean-Paul Lachance
Vice President, Exploitation

Directors

Don Gray, Chairman
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
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