

## NEWS RELEASE

AUGUST 13, 2014

SYMBOL: PEY – TSX

### PEYTO REPORTS Q2 2014 RESULTS AND SPUDS ITS 1,000<sup>th</sup> DEEP BASIN WELL

CALGARY, ALBERTA – Peyto Exploration & Development Corp. ("Peyto" or the "Company") is pleased to present its operating and financial results for the second quarter of the 2014 fiscal year. Profitable growth continued in the quarter with operating<sup>(1)</sup> and profit margins<sup>(2)</sup> of 78% and 30%, respectively. Additional highlights included:

- **Production per share up 20%.** Second quarter 2014 production increased 24% (20% per share) to 434 MMcfe/d (72,302 boe/d) from 349 MMcfe/d (58,145 boe/d) in Q2 2013.
- **Funds from operations per share up 42%.** Generated a record \$162 million in Funds from Operations ("FFO") in Q2 2014, up 47% (42% per share) from \$110 million in Q2 2013, due to increased production volumes and improved commodity prices.
- **Cash costs of \$1.17/Mcfe.** Total cash costs, including royalties, operating costs, transportation, G&A and interest, were \$1.17/Mcfe (\$6.99/boe) up 7% from \$1.09/Mcfe in Q2 2013, due primarily to higher royalties, driven by higher commodity prices. Excluding royalties, cash costs were 6% lower at \$0.72/Mcfe (\$4.30/boe) than Q2 2013. Higher revenues, combined with total cash costs, resulted in a Q2 2014 cash netback of \$4.09/Mcfe (\$24.56/boe) or a 78% operating margin.
- **Capital investment of \$151 million.** A total of 31 gross wells were drilled in the second quarter, with traditional spring breakup causing little interruption to field operations. New wells brought on production over the last 12 months accounted for 36,300 boe/d at the end of the quarter, which, when combined with trailing twelve month capital of \$665.8 million, equates to an annualized capital efficiency of \$18,340/boe/d.
- **Earnings of \$0.41/share, dividends of \$0.28/share.** Earnings of \$62 million were generated in the quarter while dividends of \$43 million were paid to shareholders, representing a before tax payout ratio of 27% of FFO. The monthly dividend was increased 25% to \$0.10/share effective May 2014.
- **Drilling milestone achieved.** On August 13, 2014 the Company spud its 1,000<sup>th</sup> well at 16-28-54-21W5 in Sundance.

#### Second Quarter 2014 in Review

Peyto had a very active second quarter despite spring breakup, which is the traditional period of reduced activity. Pad drilling, combined with active road maintenance in the Greater Sundance area, allowed for continuous drilling operations with an average of 8 rigs running throughout the quarter. This allowed the Company to maintain the industry leading capital efficiencies that have been achieved over the last few years, again adding new production for approximately \$18,000/boe/d. While new production additions offset the base well declines, overall production growth was partially impeded by downtime and unscheduled disruptions caused by higher sales line pressures and power outages. Second quarter production averaged 72,302 boe/d, up slightly from the first quarter. Peyto also expanded its owned and operated gas plant capacity in the quarter, adding an aggregate of 7,000 boe/d at the Wildhay, Swanson, and Brazeau River gas plants. This additional capacity will accommodate new production volumes resulting from the balance of the 2014 drilling program. Both natural gas and propane prices were slightly lower than the previous quarter, but so were Peyto's cash costs, resulting in cash netbacks that were approximately the same. The realized cash netbacks for the first half of 2014 are still up substantially (19%) from the previous year. These higher cash netbacks, combined with record production levels, lead to quarterly FFO of \$162 million, or \$1.05/share. The strong financial and operating performance delivered in the quarter resulted in an annualized 19% Return on Equity (ROE) and 14% Return on Capital Employed (ROCE).

1. Operating Margin is defined as funds from operations divided by revenue before royalties but including realized hedging gains/losses.

2. Profit Margin is defined as net earnings for the quarter divided by revenue before royalties but including realized hedging gains/losses.

Natural gas volumes recorded in thousand cubic feet (mcf) are converted to barrels of oil equivalent (boe) using the ratio of six (6) thousand cubic feet to one (1) barrel of oil (bbl). Natural gas liquids and oil volumes in barrel of oil (bbl) are converted to thousand cubic feet equivalent (Mcfe) using a ratio of one (1) barrel of oil to six (6) thousand cubic feet. This could be misleading, particularly if used in isolation as it is based on an energy equivalency conversion method primarily applied at the burner tip and does not represent a value equivalency at the wellhead.

	3 Months Ended June 30			6 Months Ended June 30		
	2014	2013	% Change	2014	2013	% Change
<b>Operations</b>						
Production						
Natural gas (mcf/d)	388,407	310,621	25%	388,703	303,943	28%
Oil & NGLs (bbl/d)	7,568	6,374	19%	7,472	6,109	22%
Thousand cubic feet equivalent (mcf/d @ 1:6)	433,812	348,868	24%	433,533	340,595	27%
Barrels of oil equivalent (boe/d @ 6:1)	72,302	58,145	24%	72,256	56,766	27%
Production per million common shares (boe/d)*	470	391	20%	473	382	24%
Product prices						
Natural gas (\$/mcf)	4.37	3.72	17%	4.41	3.61	22%
Oil & NGLs (\$/bbl)	77.30	67.82	14%	78.86	71.65	10%
Operating expenses (\$/Mcf)	0.36	0.35	3%	0.37	0.33	12%
Transportation (\$/Mcf)	0.13	0.12	8%	0.13	0.12	8%
Field netback (\$/Mcf)	4.32	3.77	15%	4.36	3.72	17%
General & administrative expenses (\$/Mcf)	0.01	0.05	(80)%	0.03	0.04	(25)%
Interest expense (\$/Mcf)	0.22	0.25	(12)%	0.22	0.23	(4)%
<b>Financial (\$000, except per share*)</b>						
Revenue	207,519	144,614	43%	416,837	277,816	50%
Royalties	17,689	9,849	80%	35,551	20,440	74%
Funds from operations	161,577	109,987	47%	322,362	212,844	51%
Funds from operations per share	1.05	0.74	42%	2.11	1.43	48%
Total dividends	43,033	32,727	31%	79,538	59,493	34%
Total dividends per share	0.28	0.22	27%	0.52	0.40	30%
Payout ratio	27	30	(10)%	25	28	(11)%
Earnings	62,159	37,773	65%	124,288	74,179	68%
Earnings per diluted share	0.41	0.25	64%	0.81	0.50	62%
Capital expenditures	151,290	73,809	105%	330,668	242,908	36%
Weighted average common shares outstanding	153,690,808	148,758,923	3%	152,763,770	148,716,032	3%
<b>As at June 30</b>						
End of period shares outstanding				153,690,808	148,758,923	3%
Net debt				880,386	746,094	18%
Shareholders' equity				1,392,911	1,227,842	13%
Total assets				2,781,258	2,328,117	19%

\*all per share amounts using weighted average

(\$000)	3 Months Ended June 30		6 Months Ended June 30	
	2014	2013	2014	2013
Cash flows from operating activities	152,170	96,700	298,624	189,243
Change in non-cash working capital	2,560	8,946	10,523	17,730
Change in provision for future compensation	6,847	4,341	13,215	5,871
Funds from operations	161,577	109,987	322,362	212,844
Funds from operations per share*	1.05	0.74	2.11	1.43

(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.

## Exploration & Development

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

Zone	Field							Total Wells Drilled
	Sundance	Nosehill	Wildhay	Ansell	Berland	Kisku/ Kakwa	Brazeau	
Cardium	2							2
Notikewin	3	1						4
Falher	4	5		1				10
Wilrich	8		4	1			1	14
Bluesky	1							1
<b>Total</b>	<b>18</b>	<b>6</b>	<b>4</b>	<b>2</b>			<b>1</b>	<b>31</b>

The majority of the activity in the quarter focused within the greater Sundance area where access to existing roads and leases was available.

## Capital Expenditures

Over the course of the second quarter, Peyto spent \$68.5 million to drill 31 gross (28.2 net) horizontal wells and \$48.0 million to complete 30 gross (28.0 net) wells. Additionally, 32 gross (29.8 net) wells were brought onstream with \$10.3 million of wellsite equipment and gathering pipelines. Major facility capital investment amounted to \$16.3 million and included the installation and commissioning of an eighth compressor at the Wildhay gas plant (adding 10 MMcf/d capacity), the twinning of the Wildhay sales pipeline (providing 35 MMcf/d of additional sales gas transmission capacity), the installation of a large gathering line between the Oldman and Nosehill plants to take advantage of spare Nosehill plant capacity, and the commissioning of a fourth compressor at the Swanson Plant (adding 18 MMcf/d). A refrigeration plant and an additional compressor was also installed at the Brazeau River gas plant (adding 10 MMcf/d). Lastly, \$1.0 million was directed towards preparation and fabrication for the planned Oldman North plant expansion (adding 40 MMcf/d with expected start-up in October).

During the second quarter, Peyto invested \$5.9 million at Alberta Crown land sales on highly prospective Wilrich lands adjacent to the company's existing Deep Basin land position. A total of 11 net sections (containing 34 internally identified new drilling locations) were added for \$833/acre. Additionally, \$2.3 million was spent on the acquisition of trade seismic data to support ongoing technical work in the Brazeau and Sundance areas.

By the end of the quarter, the 32 gross (29.8 net) wells brought onstream in Q2 2014 were contributing 14,850 boe/d to the quarter end exit rate of 73,000 boe/d.

## Financial Results

Daily natural gas prices in Alberta (AECO) averaged \$4.44/GJ in Q2 2014, while monthly AECO prices averaged \$4.43/GJ. As Peyto had committed 88% of its production to the monthly price, Peyto realized a volume weighted average natural gas price of \$4.44/GJ or \$5.02/mcf, prior to a \$0.65/mcf hedging loss.

Peyto realized a blended oil and natural gas liquids price of \$77.58/bbl in Q2 2014, prior to a \$0.28/bbl hedging loss, for its blend of condensate, pentane, butane and propane, which represented 74% of the \$104.30/bbl average Edmonton light oil price.

Combining realized natural gas and liquids prices, Peyto's unhedged revenues totaled \$5.85/Mcfe (\$5.26/Mcfe including hedging losses), or 132% of the dry gas price, illustrating the benefit of high heat content, liquids rich natural gas production.

Royalties of \$0.45/Mcfe, operating costs of \$0.36/Mcfe, transportation costs of \$0.13/Mcfe, G&A of \$0.01/Mcfe and interest costs of \$0.22/Mcfe, combined for total cash costs of \$1.17/Mcfe (\$6.99/boe). These industry leading total cash costs resulted in a cash netback of \$4.09/Mcfe (\$24.52/boe) or a 78% operating margin.

Royalties per Mcfe were up 40% due to higher natural gas and liquids prices while operating costs were in line with the previous year but down from the previous quarter as methanol and maintenance costs were lower.

Depletion, depreciation and amortization charges of \$1.73/Mcfe, along with a provision for future tax and market based bonus payments reduced the cash netback to earnings of \$1.57/Mcfe, or a 30% profit margin, which funded dividends of \$1.09/Mcfe.

Subsequent to the second quarter, Peyto issued CDN \$50 million of senior unsecured notes pursuant to a note purchase and private shelf agreement. The notes have a coupon rate of 3.79% and mature on July 3, 2022. As the notes rank equally with Peyto's obligations under its bank facility and existing note purchase agreements, Peyto's aggregate borrowing capacity increased by \$50 million to \$1.32 billion.

## Marketing

For the quarter, approximately 63% of Peyto's natural gas production received a fixed price of \$3.53/GJ from hedges that were put in place over the previous 16 months, while the balance received the blended daily and monthly price of \$4.44/GJ, resulting in an after-hedge price of \$3.87/GJ or \$4.37/mcf.

Peyto's practice of layering in future sales in the form of fixed price swaps, and thus smoothing out the volatility in gas prices, continued throughout the quarter. The following table summarizes the remaining hedged volumes and prices for the upcoming years, as of August 1, 2014.

	Future Sales		Average Price (CAD)	
	GJ	Mcf	\$/GJ	\$/Mcf
2014	42,155,000	36,656,522	3.66	4.21
2015	53,955,000	46,917,391	3.78	4.34
2016	5,005,000	4,352,174	3.79	4.35
Total	101,115,000	87,926,087	3.73	4.29

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

As illustrated in the following table, Peyto's realized natural gas liquids prices <sup>(1)</sup> were up 14% year over year but down 4% from the previous quarter.

	Three Months ended June 30		Q1
	2014	2013	2014
Condensate (\$/bbl)	<b>103.73</b>	88.18	100.68
Propane (\$/bbl) (includes hedging)	<b>23.05</b>	22.60	36.65
Butane (\$/bbl) (includes hedging)	<b>59.47</b>	45.90	55.98
Pentane (\$/bbl)	<b>106.58</b>	95.74	105.37
Total oil and natural gas liquids (\$/bbl)	<b>77.30</b>	67.82	80.49
Canadian Light Sweet postings (\$/bbl)	<b>104.30</b>	88.27	99.91

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

As a fixed offset to benchmark pricing can no longer be obtained for Propane and Butane prices, Peyto has discontinued the practice of forward selling these components of its natural gas liquids.

## Activity Update

Continuous operations, through break-up and into the summer months, has been very successful in accelerating the 2014 capital plans resulting in strong production growth over the past two months. Well results throughout all geographic areas and across all zones, particularly the Notikewin, Falher and Wilrich formations in Sundance, Obed and Ansell areas, have provided steady growth from an average of 71,500 boe/d in April to an average of 74,800 boe/d in July. Most recently, August daily production has averaged 78,500 boe/d. Peyto remains on track to meet or exceed previous guidance of \$625 million of capital and exit production of 81,500 boe/d.

Currently, the Company has all 9 of its drilling rigs active, with four completion spreads following up, and anticipates maintaining this activity level through to year end. One rig is currently drilling at Brazeau but will be accompanied by a second rig this fall. A major 23 km gathering line linking the Peyto Brazeau Gas Plant to the Company's south acreage is in progress and is expected to be completed by early October which will connect a 6 well program to be drilled in that area. Focused drilling in the heart of Sundance for Notikewin, Falher, Wilrich and Bluesky targets is also programmed and will serve to fill the 40 MMcf/d of new Oldman North Plant capacity.

On August 13, 2014, Peyto celebrated the spudding of its 1,000<sup>th</sup> gas well in the Alberta Deep Basin at 16-28-54-21W5M in Sundance. Remarkably, this location is directly adjacent to Peyto's original recompletion in Sundance at 15-30-54-21W5M, which continues to produce some 15 years later. Over the last five years Peyto has drilled over 400 natural gas wells, making Peyto the most active Alberta Deep Basin gas driller. While there are many stories told of the significant resource potential in the Alberta Deep Basin, Peyto has been the one turning that potential into reality and the Company continues to be an industry leader when it comes to profitable resource development.

## Outlook

Natural gas prices in both Canada and the US have recently softened as record US production and mild summer weather has refilled storage reservoirs faster than expected. This brings future natural gas prices in Canada back into Peyto's "sweet spot" where significant profitable development can occur in Peyto's many Deep Basin resource plays without the risk of increased activity driving cost inflation and eroding returns.

At no point in Peyto's history has the Company had more opportunities than it does today and yet the team at Peyto continues to find additional new lands and drilling locations faster than they can be harvested. As demand for natural gas in North America continues to expand, Peyto is well positioned to keep applying its low cost advantage and delivering superior returns on invested capital.

## Conference Call and Webcast

A conference call will be held with the senior management of Peyto to answer questions with respect to the 2014 second quarter on Thursday, August 14th, 2014, at 9:00 a.m. Mountain Daylight Time (MDT), or 11:00 a.m. Eastern Daylight Time (EDT). To participate, please call 1-416-340-8530 (Toronto area) or 1-800-766-6630 for all other participants. The conference call will also be available on replay by calling 1-905-694-9451 (Toronto area) or 1-800-408-3053 for all other parties, using passcode 7205959. The replay will be available at 11:00 a.m. MDT, 1:00 p.m. EDT Thursday, August 14th, 2014 until midnight EDT on Thursday, August 21st, 2014. The conference call can also be accessed through the internet at <http://www.gowebcasting.com/5612>. After this time the conference call will be archived on the Peyto Exploration & Development website at [www.peyto.com](http://www.peyto.com).

## Management's Discussion and Analysis

Management's Discussion and Analysis of this second quarter report is available on the Peyto website at <http://www.peyto.com/news/Q22014MDandA.pdf>. A complete copy of the second quarter report to shareholders, including the Management's Discussion and Analysis, and Financial Statements is also available at [www.peyto.com](http://www.peyto.com) and will be filed at SEDAR, [www.sedar.com](http://www.sedar.com), at a later date.

Darren Gee  
President and CEO  
August 13, 2014

*Certain information set forth in this document and Management's Discussion and Analysis, including management's assessment of Peyto's future plans and operations, capital expenditures and capital efficiencies, 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 Peyto will derive there from. In addition, Peyto is providing future oriented financial information set out in this press release for the purposes of providing clarity with respect to Peyto's strategic direction and readers are cautioned that this information may not be appropriate for any other purpose. Other than is required pursuant to applicable securities law, Peyto does not undertake to update forward looking statements at any particular time.*

# Peyto Exploration & Development Corp.

## Condensed Balance Sheet (unaudited)

(Amount in \$ thousands)

	June 30 2014	December 31 2013
<b>Assets</b>		
<b>Current assets</b>		
Accounts receivable	96,864	83,714
Due from private placement (Note 6)	-	6,245
Prepaid expenses	18,322	5,666
	<b>115,186</b>	<b>95,625</b>
Property, plant and equipment, net (Note 3)	2,665,253	2,459,531
Long-term derivative financial instruments (Note 8)	819	-
	<b>2,666,072</b>	<b>2,459,531</b>
	<b>2,781,258</b>	<b>2,555,156</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	155,203	155,265
Dividends payable (Note 6)	15,369	11,901
Derivative financial instruments (Note 8)	44,000	26,606
Provision for future performance based compensation (Note 7)	18,317	5,100
	<b>232,889</b>	<b>198,872</b>
Long-term debt (Note 4)	825,000	875,000
Long-term derivative financial instruments (Note 8)	-	5,180
Provision for future performance based compensation (Note 7)	8,382	3,200
Decommissioning provision (Note 5)	74,125	61,184
Deferred income taxes	247,951	211,082
	<b>1,155,458</b>	<b>1,155,646</b>
<b>Equity</b>		
Share capital (Note 6)	1,292,384	1,130,069
Shares to be issued (Note 6)	-	6,245
Retained earnings	131,725	86,975
Accumulated other comprehensive loss (Note 6)	(31,198)	(22,651)
	<b>1,392,911</b>	<b>1,200,638</b>
	<b>2,781,258</b>	<b>2,555,156</b>

See accompanying notes to the financial statements.

## Peyto Exploration & Development Corp.

### Condensed Income Statement *(unaudited)*

(Amount in \$ thousands except earnings per share amount)

	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
<b>Revenue</b>				
Oil and gas sales	230,995	148,466	470,415	276,889
Realized (loss) gain on hedges <i>(Note 8)</i>	(23,476)	(3,852)	(53,578)	927
Royalties	(17,689)	(9,849)	(35,551)	(20,440)
Petroleum and natural gas sales, net	<b>189,830</b>	134,765	<b>381,286</b>	257,376
<b>Expenses</b>				
Operating	14,059	11,242	29,289	20,548
Transportation	5,100	3,796	10,244	7,455
General and administrative	582	1,717	2,138	2,197
Future performance based compensation <i>(Note 7)</i>	9,803	6,559	18,399	9,097
Interest	8,512	8,022	17,252	14,332
Accretion of decommissioning provision <i>(Note 5)</i>	476	369	974	737
Depletion and depreciation <i>(Note 3)</i>	68,410	53,287	137,262	104,912
	<b>106,942</b>	84,992	<b>215,558</b>	159,278
<b>Earnings before taxes</b>	<b>82,888</b>	49,773	<b>165,728</b>	98,098
<b>Income tax</b>				
Deferred income tax expense	20,729	12,000	41,440	23,919
<b>Earnings for the period</b>	<b>62,159</b>	37,773	<b>124,288</b>	74,179
<b>Earnings per share <i>(Note 6)</i></b>				
<b>Basic and diluted</b>	<b>\$0.41</b>	\$0.25	<b>\$0.81</b>	\$ 0.50

See accompanying notes to the financial statements.

**Peyto Exploration & Development Corp.**  
**Condensed Statement of Comprehensive Income** *(unaudited)*  
(Amount in \$ thousands)

	<b>Three months ended June 30</b>		<b>Six months ended June 30</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>Earnings for the period</b>	<b>62,159</b>	37,773	<b>124,288</b>	74,179
<b>Other comprehensive income</b>				
Change in unrealized gain (loss) on cash flow hedges	14,942	30,204	(64,971)	2,076
Deferred tax (expense) recovery	(9,694)	(8,514)	2,846	(287)
Realized loss (gain) on cash flow hedges	23,476	3,852	53,578	(927)
<b>Comprehensive income</b>	<b>90,883</b>	63,315	<b>115,741</b>	75,041

See accompanying notes to the financial statements.

**Peyto Exploration & Development Corp.**  
**Condensed Statement of Changes in Equity** *(unaudited)*  
(Amount in \$ thousands)

	<b>Six months ended June 30</b>	
	<b>2014</b>	<b>2013</b>
<b>Share capital, beginning of period</b>	<b>1,130,069</b>	1,124,382
Common shares issued by private placement	6,997	5,742
Equity offering	160,480	-
Common shares issuance costs (net of tax)	(5,162)	(55)
<b>Share capital, end of period</b>	<b>1,292,384</b>	1,130,069
<b>Shares to be issued, beginning of period</b>	<b>6,245</b>	3,459
Shares issued	(6,245)	(3,459)
<b>Shares to be issued, end of period</b>	<b>-</b>	-
<b>Retained earnings, beginning of period</b>	<b>86,975</b>	75,247
Earnings for the period	124,288	74,179
Dividends <i>(Note 6)</i>	(79,538)	(59,494)
<b>Retained earnings, end of period</b>	<b>131,725</b>	89,932
<b>Accumulated other comprehensive income, beginning of period</b>	<b>(22,651)</b>	6,979
Other comprehensive (loss) income	(8,547)	862
<b>Accumulated other comprehensive (loss) income, end of period</b>	<b>(31,198)</b>	7,841
<b>Total equity</b>	<b>1,392,911</b>	1,227,842

See accompanying notes to the financial statements.

# Peyto Exploration & Development Corp.

## Condensed Statement of Cash Flows (unaudited)

(Amount in \$ thousands)

	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
<b>Cash provided by (used in):</b>				
<b>Operating activities</b>				
Earnings	62,159	37,773	124,288	74,179
Items not requiring cash:				
Deferred income tax	20,729	12,000	41,440	23,919
Depletion and depreciation	68,410	53,287	137,262	104,912
Accretion of decommissioning provision	476	369	974	737
Long term portion of future performance based compensation	2,956	2,217	5,183	3,226
Change in non-cash working capital related to operating activities	(2,560)	(8,946)	(10,523)	(17,730)
	<b>152,170</b>	<b>96,700</b>	<b>298,624</b>	<b>189,243</b>
<b>Financing activities</b>				
Issuance of common shares	-	-	167,477	5,742
Issuance costs	-	-	(6,883)	(73)
Cash dividends paid	(39,960)	(29,752)	(76,070)	(56,504)
Increase (decrease) in bank debt	65,000	110,000	(50,000)	170,000
	<b>25,040</b>	<b>80,248</b>	<b>34,524</b>	<b>119,165</b>
<b>Investing activities</b>				
Additions to property, plant and equipment	(151,290)	(73,809)	(330,668)	(242,908)
Change in prepaid capital	(9,143)	-	(349)	3,714
Change in non-cash working capital relating to investing activities	(16,777)	(87,628)	(2,131)	(53,703)
	<b>(177,210)</b>	<b>(161,437)</b>	<b>(333,148)</b>	<b>(292,897)</b>
<b>Net increase (decrease) in cash</b>	<b>-</b>	<b>15,511</b>	<b>-</b>	<b>15,511</b>
<b>Cash, beginning of period</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Cash, end of period</b>	<b>-</b>	<b>15,511</b>	<b>-</b>	<b>15,511</b>
The following amounts are included in cash flows from operating activities:				
Cash interest paid	<b>5,130</b>	6,646	<b>13,460</b>	14,514
Cash taxes paid	-	-	-	1,890

# **Peyto Exploration & Development Corp.**

## **Notes to Condensed Financial Statements *(unaudited)***

**As at June 30, 2014 and 2013**

(Amount 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 – 2<sup>nd</sup> Street SW, Calgary, Alberta, Canada, T2P 0C1.

These financial statements were approved and authorized for issuance by the Audit Committee of Peyto on August 12, 2014.

### **2. Basis of presentation**

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

### **Significant Accounting Policies**

#### **(a) Significant Accounting Judgments, Estimates and Assumptions**

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

Except as disclosed below, all accounting policies and methods of computation followed in the preparation of these financial statements are the same as those disclosed in Note 2 of Peyto's financial statements as at and for the years ended December 31, 2013 and 2012.

#### **(b) Recent Accounting Pronouncements**

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the International Accounting Standards Board (IASB) or International Financial Reporting Interpretations Committee (IFRIC) that are mandatory for accounting periods beginning January 1, 2014 or later periods. The affected standards are consistent with those disclosed in Peyto's financial statements as at and for the years ended December 31, 2013 and 2012.

Peyto adopted the following standards on January 1, 2014:

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

IFRIC 21 "Levies" was developed by the IFRS Interpretations Committee ("IFRIC") and is applicable to all levies imposed by governments under legislation, other than outflows that are within the scope of other standards (e.g., IAS 12 "Income Taxes") and fines or other penalties for breaches of legislation. The interpretation clarifies that an entity recognizes a liability for a levy when the activity that triggers

payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. Lastly, the interpretation clarifies that a liability should not be recognized before the specified minimum threshold to trigger that levy is reached. The retrospective adoption of this interpretation does not have any impact on Peyto's financial statements

### Standards issued but not yet effective

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

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

### 3. Property, plant and equipment, net

<b>Cost</b>	
At December 31, 2013	3,071,245
Additions	330,668
Decommissioning provision additions	11,967
Prepaid capital	349
At June 30, 2014	3,414,229
<b>Accumulated depletion and depreciation</b>	
At December 31, 2013	(611,714)
Depletion and depreciation	(137,262)
At June 30, 2014	(748,976)
Carrying amount at December 31, 2013	2,459,531
<b>Carrying amount at June 30, 2014</b>	<b>2,665,253</b>

During the three and six month periods ended June 30, 2014, Peyto capitalized \$3.1 million and \$5.9 million (2013 - \$1.5 million and \$4.1 million) of general and administrative expense directly attributable to exploration and development activities.

### 4. Long-term debt

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
Bank credit facility	555,000	605,000
Senior unsecured notes	270,000	270,000
<b>Balance, end of the period</b>	<b>825,000</b>	<b>875,000</b>

As at June 30, 2014, the Company had a syndicated \$1 billion extendible revolving credit facility with a stated term date of April 25, 2017. The bank facility is made up of a \$30 million working capital sub-tranche and a \$970 million production line. The facilities are available on a revolving basis for a three year period. Borrowings under the facility bear interest at Canadian bank prime or US base rate, or, at Peyto's option, Canadian dollar bankers' acceptances or US dollar LIBOR loan rates, plus applicable margin and stamping fees. The total stamping fees range between 50 basis points and 215 basis points on

Canadian bank prime and US base rate borrowings and between 150 basis points and 315 basis points on Canadian dollar bankers' acceptance and US dollar LIBOR borrowings. The undrawn portion of the facility is subject to a standby fee in the range of 30 to 63 basis points.

On July 3, 2014, Peyto issued CDN \$50 million of senior unsecured notes pursuant to a note purchase 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 3.79% and mature on July 3, 2022. Interest is paid semi-annually in arrears.

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

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

Peyto is in compliance with all financial covenants at June 30, 2014.

Total interest expense for the three and six month periods ended June 30, 2014 was \$8.5 million and \$17.3 million (2013 - \$8.0 million and \$14.3 million) and the average borrowing rate for the period was 4.2% and 4.3% (2013 - 4.2% and 4.1%).

## 5. Decommissioning provision

The following table reconciles the change in decommissioning provision:

<b>Balance, December 31, 2013</b>	<b>61,184</b>
New or increased provisions	5,365
Accretion of decommissioning provision	974
Change in discount rate and estimates	6,602
<b>Balance, June 30, 2014</b>	<b>74,125</b>
Current	-
Non-current	74,125

Peyto has estimated the net present value of its total decommissioning provision to be \$74.1 million as at June 30, 2014 (\$61.2 million at December 31, 2013) based on a total future undiscounted liability of \$185.4 million (\$177.8 million at December 31, 2013). At June 30, 2014 management estimates that these payments are expected to be made over the next 50 years with the majority of payments being made in years 2040 to 2063. The Bank of Canada's long term bond rate of 2.78 per cent (3.24 per cent at December 31, 2013) and an inflation rate of two per cent (two per cent at December 31, 2013) were used to calculate the present value of the decommissioning provision.

## 6. Share capital

**Authorized:** Unlimited number of voting common shares

### Issued and Outstanding

<b>Common Shares (no par value)</b>	<b>Number of Common Shares</b>	<b>Amount \$</b>
<b>Balance, December 31, 2013</b>	<b>148,758,923</b>	<b>1,130,069</b>
Common shares issued by private placement	211,885	6,997
Equity offering	4,720,000	160,480
Common share issuance costs, (net of tax)	-	(5,162)
<b>Balance, June 30, 2014</b>	<b>153,690,808</b>	<b>1,292,384</b>

Earnings per common share was determined based on the following:

	Three Months ended June 30		Six Months ended June 30	
	2014	2013	2014	2013
Weighted average common shares basic and diluted	<b>153,690,808</b>	148,758,923	<b>152,763,770</b>	148,716,032

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

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

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

### Dividends

During the three and six month periods ended June 30, 2014, Peyto declared and paid dividends of \$0.28 and \$0.52 per common share (\$0.08 per common share per month for January to April and \$0.10 per common share for the months of May and June), totaling \$42.9 million and \$79.5 million respectively (2013 - \$0.22 and \$0.40 or \$0.06 per share for the months of January to April and \$0.08 for the months of May and June, \$32.7 million and \$59.5 million).

### Comprehensive income

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

### Accumulated hedging gains

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

## 7. Future performance based compensation

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

### Reserve based component

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

### **Market based component**

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

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

	<b>June 30, 2014</b>	June 30, 2013
Share price	\$22.58-\$40.10	\$22.58 - \$30.40
Exercise price	\$19.91-\$31.75	\$19.30 - \$22.68
Expected volatility	0%-26%	0% - 26%
Option life	0.50 years	0.50 years
Dividend yield	0%	0%
Risk-free interest rate	1.09%	1.25%

## **8. Financial instruments**

### **Financial instrument classification and measurement**

Financial instruments of the Company carried on the condensed balance sheet are carried at amortized cost with the exception of cash and financial derivative instruments, specifically fixed price contracts, which are carried at fair value. There are no significant differences between the carrying amount of financial instruments and their estimated fair values as at June 30, 2014.

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

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

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

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

### **Fair values of financial assets and liabilities**

The Company's financial instruments include cash, accounts receivable, financial derivative instruments, due from private placement, current liabilities, provision for future performance based compensation and long term debt. At June 30, 2014, cash and financial derivative instruments are carried at fair value. Accounts receivable, due from private placement, current liabilities and provision for future performance based compensation approximate their fair value due to their short term nature. The carrying value of the long term debt approximates its fair value due to the floating rate of interest charged under the credit facility.

### **Commodity price risk management**

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

Following is a summary of all risk management contracts in place as at June 30, 2014:

<b>Propane Period Hedged</b>	<b>Type</b>	<b>Monthly Volume</b>	<b>Price (USD)</b>
January 1, 2014 to December 31, 2014	Fixed Price	8,000 bbl	\$35.70 to \$37.485/bbl
April 1, 2014 to September 30, 2014	Fixed Price	16,000 bbl	\$41.79/ to \$46.20 /bbl
October 1, 2014 to December 31, 2014	Fixed Price	4,000 bbl	\$42.84/bbl

<b>Natural Gas Period Hedged</b>	<b>Type</b>	<b>Daily Volume</b>	<b>Price (CAD)</b>
November 1, 2012 to October 31, 2014	Fixed Price	5,000 GJ	\$3.0575/GJ
April 1, 2013 to October 31, 2014	Fixed Price	47,500 GJ	\$3.1925- \$3.33/GJ
November 1, 2013 to October 31, 2014	Fixed Price	15,000 GJ	\$3.50- \$3.6025/GJ
April 1, 2014 to October 31, 2014	Fixed Price	70,000 GJ	\$3.10- \$4.55/GJ
April 1, 2014 to March 31, 2015	Fixed Price	140,000 GJ	\$3.20- \$3.83/GJ
November 1, 2014 to March 31, 2015	Fixed Price	90,000 GJ	\$3.81- \$4.87GJ
April 1, 2015 to October 31, 2015	Fixed Price	70,000 GJ	\$3.285- \$3.91/GJ
April 1, 2015 to March 31, 2016	Fixed Price	25,000 GJ	\$3.915-\$ 4.05/GJ

As at June 30, 2014, Peyto had committed to the future sale of 120,000 barrels of propane at an average price of \$43.81 CAD (\$41.03 USD) per barrel and 94,362,500 gigajoules (GJ) of natural gas at an average price of \$3.71 per GJ or \$4.26 per mcf. Had these contracts been closed on June 30, 2014, Peyto would have realized a net loss in the amount of \$43.2 million. If the AECO gas price on June 30, 2014 were to increase by \$1/GJ, the unrealized loss would increase by approximately \$94.4 million. An opposite change in commodity prices rates would result in an opposite impact on other comprehensive income.

Subsequent to June 30, 2014 Peyto entered into the following contracts:

<b>Natural Gas Period Hedged</b>	<b>Type</b>	<b>Daily Volume</b>	<b>Price (CAD)</b>
November 1, 2014 to March 31, 2015	Fixed Price	30,000 GJ	\$3.70- \$4.26/GJ
April 1, 2015 to March 31, 2016	Fixed Price	30,000 GJ	\$3.56 -\$4.00/GJ

## 9. Commitments

In addition to those recorded on the Company's balance sheet, the following is a summary of Peyto's contractual obligations and commitments as at June 30, 2014:

	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>Thereafter</b>
Interest payments(1)	6,115	12,230	12,230	12,230	12,230	22,755
Transportation commitments	9,002	19,785	19,431	15,631	11,917	15,793
Operating leases	1,209	2,380	1,863	1,654	1,295	10,356
<b>Total</b>	<b>16,326</b>	<b>34,395</b>	<b>33,524</b>	<b>29,515</b>	<b>25,442</b>	<b>48,904</b>

(1) Fixed interest payments on senior unsecured notes

## 10. Contingencies

On October 31, 2013, Peyto was named as a party to a statement of claim received with respect to transactions between Poseidon Concepts Corp. and Open Range Energy Corp. On July 3, 2014, the Plaintiffs filed a lawsuit with the Court against KPMG LLP, Poseidon's and Old Open Range's former auditors, making allegations substantially similar to those in the other claims. On July 29, 2014, KPMG LLP filed a statement of defense and a third party claim against Poseidon, the Company and the former directors and officers of Poseidon. The third party claim seeks, among other things, an indemnity, or alternatively contribution, from the third party defendants with respect to any judgment awarded against KPMG LLP. The allegations contained in these claims are based on factual matters that pre-existed Peyto's involvement with New Open Range. 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  
Bank of Nova Scotia  
HSBC Bank Canada  
Alberta Treasury Branches  
Canadian Western Bank

**Transfer Agent**

Valiant Trust Company

**Head Office**

1500, 250 – 2nd Street SW  
Calgary, AB  
T2P 0C1

Phone: 403.261.6081

Fax: 403.451.4100

Web: [www.peyto.com](http://www.peyto.com)

Stock Listing Symbol: PEY.TO

Toronto Stock Exchange