Management's Discussion and Analysis
For the year ended December 31, 2012

This Management's Discussion and Analysis ("MD&A"), dated March 7, 2013, should be read in conjunction with the audited Consolidated Financial Statements of Paramount Resources Ltd. ("Paramount" or the "Company") for the year ended December 31, 2012. Financial data included in this MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS") and is stated in millions of Canadian dollars, unless otherwise noted. The Company's accounting policies have been applied consistently to all periods presented.

This document contains forward-looking information, non-GAAP measures and disclosures of barrels of oil equivalent volumes. Readers are referred to the Advisories section of this document concerning such matters. Certain comparative figures have been reclassified to conform to the current years' presentation. Additional information concerning Paramount, including its Annual Information Form, can be found on the SEDAR website at www.sedar.com.

About Paramount

Paramount is an independent, publicly traded, Canadian corporation that explores for and develops conventional petroleum and natural gas prospects, pursues longer-term non-conventional exploration and pre-development projects and holds investments in other entities. The Company's principal properties are located in Alberta, the Northwest Territories and British Columbia.

Paramount has spun-out three public entities: (i) Paramount Energy Trust, now Perpetual Energy Inc. ("Perpetual"), in February, 2003; (ii) Trilogy Energy Trust, now Trilogy Energy Corp. ("Trilogy"), in April, 2005; and (iii) MGM Energy Corp. ("MGM Energy") in January, 2007. Paramount continues to hold investments in the securities of Trilogy and MGM Energy in its portfolio of Strategic Investments.

Paramount's operations are divided into three business segments, established by management to assist in resource allocation, to assess operating performance and to achieve long-term strategic objectives: i) Principal Properties; ii) Strategic Investments; and iii) Corporate.

Paramount's Principal Properties are divided into four Corporate Operating Units ("COUs") as follows:

- the Kaybob COU, which includes properties in West Central Alberta;
- the Grande Prairie COU, which includes properties in the Peace River Arch area of Alberta;
- the Southern COU, which includes properties in Southern Alberta; and
- the Northern COU, which includes properties in Northern Alberta, the Northwest Territories and Northeast British Columbia.

Strategic Investments include: (i) investments in other entities, including affiliates; (ii) investments in exploration and development stage assets, where there is no near-term expectation of production or revenue, but a longer-term value proposition based on spin-outs, dispositions, or future revenue generation, including oil sands and carbonate bitumen interests held by Paramount's wholly-owned subsidiary, Cavalier Energy Inc. ("Cavalier Energy") and prospective shale gas acreage; and (iii) drilling rigs owned by Paramount's wholly-owned subsidiary Fox Drilling Inc. ("Fox Drilling").

The Corporate segment is comprised of income and expense items, including general and administrative expense and interest expense, which have not been specifically allocated to Principal Properties or Strategic Investments.

2012 OVERVIEW

- Paramount's net loss was $61.9 million in 2012 compared to a net loss of $232.0 million in 2011, primarily due to a $157.2 million gain on the sale of 5.0 million shares of Trilogy and lower write-downs of petroleum and natural gas properties and goodwill in 2012.
- Funds flow from operations was $58.1 million in 2012, $38.1 million lower than 2011, primarily because of a 29 percent decrease in average realized prices and lower Southern COU sales volumes following the May 2012 United States property disposition. These decreases were partially offset by higher sales volumes in Kaybob and higher other income, primarily due to $6.2 million in cash proceeds from a business interruption insurance settlement.

Principal Properties

- Natural gas and NGLs sales volumes increased by approximately 20 percent despite downstream processing and transportation constraints which impacted the Company's operations in the second half of the year.
- The Company's new 45 MMcf/d refrigeration facility at Musreau (the "Musreau Refrig Facility") operated near capacity following its re-commissioning in March 2012.
- Operating expenses from continuing operations decreased 11 percent to $9.29 per Boe in 2012 compared to $10.40 per Boe in 2011 due to the sale of higher cost US properties and processing cost savings from the Musreau Refrig Facility.
- Construction of the Company's wholly-owned 200 MMcf/d deep cut facility at Musreau (the "Musreau Deep Cut Facility") commenced in the third quarter of 2012 following the receipt of regulatory approval. The project continues to be on-schedule, with commissioning expected to commence by the end of the third quarter of 2013.
- Advance drilling for the deep cut facility expansions at Musreau and Smoky continued. The Company currently has an inventory of 43 (35 net) Kaybob Deep Basin wells drilled and awaiting the start-up of the facilities.
- In May, Paramount's wholly-owned subsidiary, Summit Resources, Inc. ("Summit"), closed the sale of all of its operated properties for cash proceeds of approximately US$70 million. In February 2013, Summit closed the sale of substantially all of its remaining US properties for cash proceeds of US$22.5 million, subject to closing adjustments. Since 2011, the Company has realized aggregate cash proceeds of approximately US$130 million on the sale of its US properties.

Strategic Investments

- Paramount drilled and completed its first horizontal shale gas exploration well at Patry in Northeast British Columbia in March 2013. In order to further evaluate well performance, the Company plans to bring the well on production by the end of 2013.
- Cavalier Energy recorded probable bitumen reserves following its regulatory applications for the initial 10,000 Bbl/d phase of the Hoole Grand Rapids development.
- Fox Drilling completed the construction of two new walking drilling rigs, which will drill on multi-well pad sites in the Kaybob COU.

Corporate

- To fund the Company's growth initiatives, Paramount raised over $700 million in aggregate cash proceeds in 2012, including over $400 million from equity offerings, the sale of investments and non-core oil and gas properties and $300 million from the notes offering.
- At February 28, 2013, Paramount had cash balances of $109.2 million and its $300 million credit facility was undrawn.

Highlights[1]

	2012	2011	2010
FINANCIAL			
Petroleum and natural gas sales – continuing operations	**185.7**	213.4	157.5
Petroleum and natural gas sales – discontinued operations	**11.4**	28.3	26.9
Petroleum and natural gas sales	**197.1**	241.7	184.4
Funds flow from operations – continuing operations	**51.6**	80.8	80.3
Funds flow from operations – discontinued operations	**6.5**	15.4	13.7
Funds flow from operations	**58.1**	96.2	94.0
Per share – basic and diluted ($/share)	**0.67**	1.23	1.29
Net loss – continuing operations	**(92.1)**	(256.3)	(93.0)
Per share – basic and diluted ($/share)	**(1.06)**	(3.27)	(1.28)
Net loss	**(61.9)**	(232.0)	(90.0)
Per share – basic and diluted ($/share)	**(0.71)**	(2.96)	(1.24)
Exploration and development expenditures	**523.1**	465.7	199.0
Investments in other entities – market value[3]	**704.8**	1,077.3	502.9
Total assets	**2,037.0**	1,725.7	1,391.3
Long-term debt	**660.7**	427.2	294.2
Net debt	**701.4**	513.4	295.2
OPERATIONAL			
Sales volumes[2]			
Natural gas (MMcf/d)	**98.5**	81.6	57.7
NGLs (Bbl/d)	**1,873**	1,542	932
Oil (Bbl/d)	**1,620**	2,291	2,485
Total (Boe/d)	**19,917**	17,426	13,029
Net wells drilled (excluding oil sands evaluation)	**34**	48	43
Net oil sands evaluation wells drilled	**1**	27	45
FUNDS FLOW FROM OPERATIONS ($/Boe) [2]			
Petroleum and natural gas sales	**27.04**	38.00	38.77
Royalties	**(2.27)**	(3.47)	(4.46)
Operating expense and production tax	**(9.58)**	(11.20)	(10.70)
Transportation	**(2.98)**	(3.23)	(3.62)
Netback	**12.21**	20.10	19.99
Financial commodity contract settlements	**(0.02)**	0.03	2.72
Insurance settlement	**0.85**	–	–
Netback including commodity contract and insurance settlements	**13.04**	20.13	22.71
General and administrative – corporate	**(1.61)**	(1.90)	(2.43)
General and administrative – strategic	**(0.88)**	(0.76)	(0.76)
Interest	**(4.74)**	(5.26)	(2.79)
Dividends from investments	**1.10**	1.79	2.73
Acquisition transaction costs	**–**	(0.16)	(0.06)
Other	**1.06**	1.28	0.37
Funds flow from operations	**7.97**	15.12	19.77

(1) Readers are referred to the advisories concerning non-GAAP measures and oil and gas measures and definitions in the Advisories section of this document.
(2) Amounts include the results of discontinued operations.
(3) Based on the period-end closing prices of publicly traded enterprises and the book value of the remaining investments.

Consolidated Results

Net Income (Loss)

Year ended December 31	2012	2011	2010
Principal Properties	(194.1)	(279.9)	(107.7)
Strategic Investments	134.0	5.1	16.5
Corporate	(65.6)	(61.1)	(65.3)
Tax recovery	33.6	79.6	63.5
Loss from continuing operations	**(92.1)**	(256.3)	(93.0)
Income from discontinued operations, net of tax	30.2	24.3	3.0
Net loss	**(61.9)**	(232.0)	(90.0)

Paramount recorded a loss from continuing operations of $92.1 million for the year ended December 31, 2012 compared to $256.3 million in 2011. Significant factors contributing to the change are shown below:

	Year ended December 31
Loss from continuing operations – 2011	**(256.3)**
• Higher income from equity-accounted investments mainly due to a $157.2 million gain on the sale of 5.0 million non-voting shares of Trilogy in January 2012	152.1
• Lower depletion, depreciation and impairment mainly due to lower write-downs of petroleum and natural gas properties and goodwill	85.8
• Higher gains on the sale of property, plant and equipment related to continuing operations	21.6
• Lower income tax recovery compared to 2011	(46.0)
• Lower netback primarily due to a 27 percent decrease in average realized prices	(30.2)
• Lower other income, mainly because 2011 included gains related to previous investments in NuLoch Resources Inc. and ProspEx Resources Ltd.	(10.1)
• Higher stock-based compensation expense	(7.6)
• Higher exploration and evaluation expense mainly due to higher dry hole expense	(6.4)
• Other	5.0
Loss from continuing operations – 2012	**(92.1)**

Income from discontinued operations ("IFDO") in 2012 was $30.2 million, $5.9 million higher than in 2011. IFDO in 2012 included a $50.7 million pre-tax gain on the sale of discontinued operations. IFDO in 2011 included a $37.2 million pre-tax gain on the sale of undeveloped land. The netback from discontinued operations in 2012 was $8.7 million lower than in 2011 because of a partial year of operations from the sold properties as a result of their sale May 2012.

Paramount's loss from continuing operations for the year ended December 31, 2011 was $256.3 million, $163.3 million higher than 2010. Significant factors contributing to the change are shown below:

	Year ended December 31
Loss from continuing operations – 2010	**(93.0)**
• Higher depletion, depreciation and impairment mainly due to an increase of $167.7 million in write-downs of petroleum and natural gas properties and goodwill and $49.0 million of higher Principal Properties depletion expense due to higher production	(215.3)
• Lower income from equity-accounted investments, as 2010 included $36.8 million of earnings related to Trilogy's conversion from a trust structure to a corporate structure	(34.8)
• Higher interest expense due to higher 2011 debt levels	(20.5)
• Loss on financial commodity contracts compared to a gain in 2010	(11.7)
• Lower stock-based compensation expense	33.8
• Higher netback mainly due to a 34 percent increase in sales volumes	31.7
• Higher other income primarily due to the recognition of $11.1 million in gains on the sale of the shares of NuLoch and its successor, Magnum Hunter Resources Corporation	19.8
• Higher income tax recovery compared to 2010	16.1
• Lower exploration and evaluation expense	13.9
• Higher gains on the sale of property plant and equipment related to continuing operations	4.5
• Other	(0.8)
Loss from continuing operations – 2011	**(256.3)**

Income from discontinued operations in 2011 was $24.3 million compared to $3.0 million in 2010. The increase was primarily due to the recognition of a $37.2 million pre-tax gain on sale of undeveloped land in 2011.

Funds Flow From Operations (1)(2)

The following is a reconciliation of funds flow from operations to the nearest GAAP measure:

Year ended December 31	2012	2011	2010
Cash from operating activities	**55.2**	84.9	59.2
Change in non-cash working capital	**(12.1)**	(3.0)	23.5
Geological and geophysical expenses	**7.0**	6.8	8.1
Asset retirement obligations settlements	**8.0**	7.5	3.2
Funds flow from operations	**58.1**	96.2	94.0
Funds flow from operations ($/Boe)	**7.97**	15.12	19.77

(1) Refer to the advisories concerning non-GAAP measures in the Advisories section of this document.
(2) Includes the results of discontinued operations.

Year ended December 31	2012	2011	2010
Funds flow from operations – continuing operations	**51.6**	80.8	80.3
Funds flow from operations – discontinued operations	**6.5**	15.4	13.7
Funds flow from operations	**58.1**	96.2	94.0

Funds flow from operations attributable to continuing operations in 2012 was $51.6 million, $29.2 million lower than 2011, primarily becuase of the impact of a 27 percent decrease in average realized prices, partially offset by higher other income, primarily due to $6.2 million in cash proceeds from a business interruption insurance settlement. Funds flow from operations attributable to discontinued operations in

2012 decreased by $8.9 million compared to the prior year because 2012 includes a partial year of operations from the sold properties as a result of their May 2012 sale.

Funds flow from operations attributable to continuing operations in 2011 increased $0.5 million compared to 2010, primarily due to a $55.9 million increase in petroleum and natural gas sales, offset by a $20.2 million increase in operating expenses, a $20.1 million increase in interest expense and a $12.7 million decrease in commodity contract settlements received. Funds flow from operations attributable to discontinued operations in 2011 increased by $1.7 million compared to 2010 due to higher revenues in 2011, partially offset by higher royalties.

Discontinued Operations

In May 2012, Summit closed the sale of all of its operated properties in North Dakota and all of its properties in Montana (the "Sold Properties") for cash proceeds of approximately US$70.0 million. The Company recorded a pre-tax gain of $50.7 million on this transaction.

Results of the Sold Properties have been presented as discontinued operations and prior year comparative results have been adjusted to conform to the current year's basis of presentation. The Principal Properties section of this Management's Discussion & Analysis provides an analysis of the results of the Company's continuing operations. The following table reconciles Paramount's earnings from continuing operations, earnings from discontinued operations and net income:

Earnings from Continuing Operations ("CO") and Discontinued Operations ("DO")

Year ended December 31	2012						2011					
	CO	DO	Total	CO	DO	Total	CO	DO	Total	CO	DO	Total
	($ millions)			($/Boe except natural gas[1])			($ millions)			($/Boe except natural gas[1])		
Natural gas revenue	98.1	0.1	98.2	2.72	2.31	2.72	119.8	0.4	120.2	4.04	4.36	4.04
NGLs revenue	45.7	0.3	46.0	67.08	62.67	67.10	44.1	0.7	44.8	79.79	67.48	79.56
Oil revenue	38.3	11.0	49.3	83.67	82.06	83.16	45.5	27.2	72.7	90.38	81.87	87.00
Royalty and sulphur revenue	3.6	–	3.6	–	–	–	4.0	–	4.0	–	–	–
Petroleum and natural gas sales	185.7	11.4	197.1	25.98	79.53	27.04	213.4	28.3	241.7	35.55	79.11	38.00
Royalties	(14.6)	(1.9)	(16.5)	(2.04)	(13.45)	(2.27)	(17.4)	(4.7)	(22.1)	(2.90)	(12.99)	(3.47)
Operating expense	(66.4)	(3.5)	(69.9)	(9.29)	(23.90)	(9.58)	(62.4)	(8.9)	(71.3)	(10.40)	(24.58)	(11.20)
Transportation	(21.8)	–	(21.8)	(3.05)	–	(2.98)	(20.5)	–	(20.5)	(3.42)	–	(3.23)
Netback	82.9	6.0	88.9	11.60	42.18	12.21	113.1	14.7	127.8	18.83	41.54	20.10
Financial commodity contract settlements	(0.1)	–	(0.1)	(0.02)	–	(0.02)	0.2	–	0.2	0.04	–	0.03
Insurance settlement	6.2	–	6.2	0.87	–	0.85	–	–	–	–	–	–
Netback including commodity contract and insurance settlements	89.0	6.0	95.0	12.45	42.18	13.04	113.3	14.7	128.0	18.87	41.54	20.13
General and administrative	(18.1)	–	(18.1)	(2.54)	–	(2.49)	(16.9)	–	(16.9)	(2.82)	–	(2.66)
Interest	(34.6)	–	(34.6)	(4.84)	–	(4.74)	(33.4)	–	(33.4)	(5.57)	–	(5.26)
Dividends from investments	8.0	–	8.0	1.13	–	1.10	11.4	–	11.4	1.89	–	1.79
Other	7.3	0.5	7.8	1.01	2.57	1.06	6.4	0.7	7.1	1.07	1.88	1.12
Funds flow from operations	51.6	6.5	58.1	7.21	44.75	7.97	80.8	15.4	96.2	13.44	43.42	15.12
DD&A / Accretion	(287.5)	(1.4)	(288.9)				(377.9)	(7.6)	(385.5)			
Gain on sale of PP&E	26.4	50.8	77.2				4.9	37.1	42.0			
Stock-based compensation	(29.1)	–	(29.1)				(21.5)	–	(21.5)			
Income from equity-acct. investments	153.3	–	153.3				1.2	–	1.2			
Other	(40.4)	(0.2)	(40.6)				(23.4)	(2.8)	(26.2)			
Income tax (expense) recovery	33.6	(25.5)	8.1				79.6	(17.8)	61.8			
Net income (loss)	(92.1)	30.2	(61.9)				(256.3)	24.3	(232.0)			

[1] Natural gas revenue shown per Mcf.

Principal Properties

Netback and Segment Loss – Continuing Operations

Year ended December 31	**2012**		2011	
		($/Boe)		*($/Boe)*
Petroleum and natural gas sales	**185.7**	***25.98***	213.4	*35.55*
Royalties	**(14.6)**	***(2.04)***	(17.4)	*(2.90)*
Operating expense	**(66.4)**	***(9.29)***	(62.4)	*(10.40)*
Transportation	**(21.8)**	***(3.05)***	(20.5)	*(3.42)*
Netback	**82.9**	***11.60***	113.1	*18.83*
Financial commodity contract settlements	**(0.1)**	***(0.02)***	0.2	*0.04*
Insurance settlement	**6.2**	***0.87***	–	–
Netback including commodity & insurance settlements	**89.0**	***12.45***	113.3	*18.87*
Other principal property items (see below)	**(283.1)**		(393.2)	
Segment loss	**(194.1)**		(279.9)	

Petroleum and Natural Gas Sales – Continuing Operations

Year ended December 31	**2012**	2011	% Change
Natural gas	**98.1**	119.8	(18)
NGLs	**45.7**	44.1	4
Oil	**38.3**	45.5	(16)
Royalty and sulphur revenue	**3.6**	4.0	(10)
	185.7	213.4	(13)

Petroleum and natural gas sales in 2012 were $185.7 million, a decrease of $27.7 million from the prior year, primarily due to the impact of lower realized prices, partially offset by higher natural gas and NGLs sales volumes.

The impact of changes in prices and sales volumes on petroleum and natural gas sales are as follows:

	Natural gas	**NGLs**	**Oil**	**Royalty and sulphur**	**Total**
Year ended December 31, 2011	119.8	44.1	45.5	4.0	213.4
Effect of changes in prices	(47.4)	(8.7)	(3.1)	–	(59.2)
Effect of changes in sales volumes	25.7	10.3	(4.1)	–	31.9
Change in royalty and sulphur	–	–	–	(0.4)	(0.4)
Year ended December 31, 2012	**98.1**	**45.7**	**38.3**	**3.6**	**185.7**

Sales Volumes

	Natural Gas (MMcf/d)			**NGLs** (Bbl/d)			**Oil** (Bbl/d)			**Total** (Boe/d)		
	2012	2011	% Change	**2012**	2011	% Change	**2012**	2011	% Change	**2012**	2011	% Change
Kaybob	**59.5**	44.5	34	**924**	868	6	**62**	72	(14)	**10,910**	8,361	30
Grande Prairie	**20.9**	16.0	31	**749**	505	48	**307**	393	(22)	**4,536**	3,568	27
Southern	**9.7**	10.5	(8)	**158**	120	32	**647**	574	13	**2,419**	2,442	(1)
Northern	**8.3**	10.3	(19)	**29**	19	53	**235**	343	(31)	**1,657**	2,073	(20)
Continuing Ops	**98.4**	81.3	21	**1,860**	1,512	23	**1,251**	1,382	(9)	**19,522**	16,444	19
Discontinued Ops	0.1	0.3	(67)	13	30	(57)	369	909	(59)	395	982	(60)
Total	98.5	81.6	21	1,873	1,542	21	1,620	2,291	(29)	19,917	17,426	14

Natural gas sales volumes increased 17.1 MMcf/d or 21 percent to 98.4 MMcf/d in 2012 compared to 81.3 MMcf/d in 2011. NGLs sales volumes increased 348 Bbl/d or 23 percent to 1,860 Bbl/d in 2012 compared to 1,512 Bbl/d in 2011. The increases in natural gas and NGLs sales volumes were primarily related to new well production from the Company's 2011 / 2012 drilling program at Musreau and Resthaven within the Kaybob COU and at Valhalla within the Grande Prairie COU and wells added through the May 2011 acquisition of ProspEx Resources Ltd. The Company's new 45 MMcf/d natural gas refrigeration processing facility at Musreau was re-commissioned during March, allowing the Company to begin producing incremental volumes that had been shut-in due to capacity constraints since the fourth quarter of 2011.

The ability of Paramount to maximize production through its firm capacity and owned facilities in 2012, including the Musreau Refrig Facility and Valhalla gathering and compression system, was impacted by various third party downstream disruptions and capacity constraints (the "Third Party Disruptions"), which reduced sales volumes at times by up to 6,000 Boe/d. The Third Party Disruptions mainly related to reduced throughput at third party NGLs de-ethanization and fractionation facilities at Fort Saskatchewan, which resulted in the apportionment of available processing capacity. The Third Party Disruptions were also caused by NGLs and natural gas pipeline takeaway constraints and scheduled and unscheduled downtime at third party natural gas processing facilities. The Company estimates that average sales volumes in the second half of 2012 were reduced by approximately 3,000 Boe/d, including reduced liquids yields as the Company preferentially flowed lower liquids content wells. Sales volumes in December 2012 and January 2013 were constrained to approximately 22,000 Boe/d.

In addition to the downstream third party NGLs processing constraints, Paramount's production within the Kaybob COU remains constrained by available owned and contracted natural gas processing capacity, pending completion of deep cut facilities expansions at Musreau and Smoky. Paramount continues to utilize its own facilities and third party processing capacity to maximize production while the expansions are in progress. In the interim, behind pipe wells will be produced where capacity is available.

Oil sales volumes decreased nine percent to 1,251 Bbl/d in 2012 compared to 1,382 Bbl/d in 2011, primarily due to declines at Cameron Hills in the Northern COU and at Crooked Creek in the Grande Prairie COU, partially offset by production from new wells in the Southern COU.

Average Realized Prices – Continuing Operations

Year ended December 31	2012	2011	% Change
Natural gas ($/Mcf)	2.72	4.04	(33)
NGLs ($/Bbl)	67.08	79.79	(16)
Oil ($/Bbl)	83.67	90.38	(7)
Total ($/Boe)	25.98	35.55	(27)

Paramount's average realized prices for natural gas, NGLs and oil decreased in 2012 compared to 2011, consistent with declines in market prices.

Paramount's natural gas sales portfolio primarily consists of sales priced at the Alberta spot market, Eastern Canadian market, and California market and is sold in a combination of daily and monthly contracts. Paramount's Canadian oil and NGLs sales portfolio primarily consists of sales priced relative to Alberta and United States market indexes, adjusted for transportation and quality differentials.

Commodity Prices

Key monthly average commodity price benchmarks and foreign exchange rates are as follows:

	2012	2011	% Change
Natural Gas			
AECO (Cdn$/GJ)	2.27	3.48	(35)
NYMEX (Henry Hub US$/MMbtu)	2.80	4.07	(31)
Crude Oil			
Edmonton par (Cdn$/Bbl)	86.53	95.16	(9)
West Texas Intermediate (US$/Bbl)	94.19	95.00	(1)
Foreign Exchange			
$Cdn / 1 $US	1.00	0.99	1

Commodity Price Management

From time-to-time Paramount uses financial and physical commodity price contracts to manage exposure to commodity price volatility. Paramount has not designated any of its financial commodity contracts as hedges and, as a result, changes in the fair value of these contracts are recognized in earnings.

Receipts (payments) on the settlement of financial commodity contracts are as follows:

Year ended December 31	2012	2011
Oil contracts	(0.1)	0.2

At December 31, 2012 there were no financial commodity contracts outstanding.

Royalties – Continuing Operations

Year ended December 31	2012	Rate	2011	Rate
Royalties	14.6	8.0%	17.4	8.3%

Royalties decreased $2.8 million to $14.6 million in 2012 compared to $17.4 million in 2011, primarily as a result of the significant decline in natural gas prices, higher gas cost allowance deductions and lower oil sales volumes. These reductions were partially offset by higher NGLs royalties due to higher sales volumes.

Operating Expense – Continuing Operations

Year ended December 31	2012	2011	% Change
Operating expense	66.4	62.4	6

Operating expenses increased $4.0 million or six percent to $66.4 million in 2012 compared to $62.4 million in 2011, primarily related to higher processing and operating costs at Valhalla in the Grande Prairie COU where new wells were brought-on and the new gathering and compression system was commissioned. Operating expenses in the Kaybob COU did not increase in 2012 despite increased sales volumes, as higher operating costs related to the new Musreau Refrig Facility and new wells brought-on production were more than offset by the impact of higher processing income and lower third party processing fees. Operating costs in the Northern and Southern COUs also decreased in 2012 as a result of asset sales and lower production.

Operating expenses per Boe decreased 11 percent to $9.29 in 2012 compared to $10.40 in 2011, primarily due to lower per unit operating costs in the Kaybob COU and a lower proportion of sales volumes being from the Northern and Southern COUs, which have higher per unit operating costs.

Transportation Expense – Continuing Operations

Year ended December 31	2012	2011	% Change
Transportation expense	21.8	20.5	6

Transportation expense increased to $21.8 million in 2012 compared to $20.5 million in 2011 as a result of increased sales volumes in the Kaybob and Grande Prairie COUs, partially offset by a reduction in sales volumes in the Northern COU, which has higher transportation costs. Transportation expense per Boe decreased 11 percent to $3.05 in 2012 compared to $3.42 in 2011 as a result of the increase in sales volumes over the fixed portion of transportation costs and the Northern COU comprising a lower proportion of overall sales volumes. In the fourth quarter of 2012, a long-term natural gas export transportation agreement expired, which further reduced fixed transportation costs by approximately $0.5 million per month.

Insurance Settlement

In 2012, the Company received $6.2 million in respect of a business interruption insurance claim related to an electrical equipment failure at the Musreau Refrig Facility in the fourth quarter of 2011.

Other Principal Property Items – Continuing Operations

Year ended December 31	2012	2011
Commodity contracts – net of settlements	(2.6)	1.9
Depletion and depreciation (excluding write-downs)	146.5	141.9
Write-down of petroleum and natural gas properties and goodwill	135.6	225.7
Exploration and evaluation	32.0	25.6
Gain on sale of property, plant and equipment	(26.4)	(4.9)
Accretion of asset retirement obligations	3.3	7.8
Other income	(5.3)	(4.8)
Total	283.1	393.2

Depletion and depreciation expense increased to $146.5 million ($20.51 per Boe) in 2012 compared to $141.9 million ($23.65 per Boe) in 2011 due to higher 2012 sales volumes. The decrease in depletion per Boe was mainly due to a higher proportion of sales volumes being from the Kaybob COU, where oil and gas properties have a lower carrying value per Boe of proved reserves assigned.

The Company recorded an impairment write-down related to its petroleum and natural gas assets and goodwill of $135.6 million (2011 – $225.7 million). The impairment write-down was primarily related to the Bistcho/Cameron Hills and Clarke Lake area in the Northern COU, the Elmworth area in the Grande Prairie COU and at Chain in the Southern COU. The impairment resulted from a combination of the decline in forecast oil, natural gas, and natural gas liquids prices, higher well costs than reserves values assigned, and declines in reserves assigned due to well performance.

Exploration and evaluation expense includes the cost of expired undeveloped land leases, geological and geophysical costs and dry hole expense. Exploration and evaluation expense included expired lease costs of $18.7 million ($17.5 million - 2011).

The gain on sale of property, plant and equipment recorded for 2012 is primarily related to the sale of non-core properties at West Pembina, Alberta and at Kindersley, Saskatchewan in the Southern COU and at East Negus in the Northern COU for aggregate proceeds of approximately $49.2 million. These properties did not have significant associated production.

In February 2013, Summit closed the sale of its non-operated joint venture operations and lands in North Dakota for aggregate gross proceeds of US$22.5 million, subject to closing adjustments. This disposition included approximately 200 Boe/d of production and undeveloped land. With the closing of this transaction, the Company has completed the sale of substantially all of its US assets.

In March 2013, Paramount sold its properties in the Bistcho area of Alberta and the Cameron Hills area of the Northwest Territories for approximately $9 million, subject to closing adjustments. Average sales volumes for these properties were approximately 1,000 Boe/d in 2012.

Strategic Investments

Year ended December 31	**2012**	2011
Income from equity–accounted investments	**153.3**	1.2
Drilling rig revenue	**7.5**	8.3
Drilling rig expense	**(4.7)**	(4.6)
General and administrative	**(6.4)**	(4.9)
Stock-based compensation	**(10.9)**	(5.8)
Interest	**(1.5)**	(1.2)
Gain on investments	**–**	15.7
Other	**(3.3)**	(3.6)
Segment Income	**134.0**	5.1

Income from equity-accounted investments for 2012 was $153.3 million compared to $1.2 million in the prior year. In January 2012, Paramount closed the sale of 5.0 million of its non-voting Trilogy shares for net cash proceeds of $181.7 million, recognizing a gain of $157.2 million.

General and administrative costs of the Company's Strategic Investments business segment increased primarily because of higher staff and office costs related to Cavalier Energy.

The gain on investments in 2011, totalling $15.7 million, mainly related to the sale of the Company's investment in NuLoch Resources Inc. and shares in the successor company by acquisition, Magnum Hunter Resources Corp., for aggregate gross proceeds of $15.8 million. The Company recognized aggregate gains of $11.1 million in connection with these transactions.

Strategic Investments at December 31, 2012 include:

- investments in the shares of Trilogy, MEG Energy Corp. ("MEG"), MGM Energy, Paxton Corporation, and other public and private corporations;

- prospective shale gas acreage in the Liard and Horn River Basins in Northeast British Columbia and the Northwest Territories;

- oil sands and carbonate bitumen interests owned by Paramount's wholly-owned subsidiary, Cavalier Energy, including oil sands reserves and resources at Hoole, situated within the western portion of the Athabasca Oil Sands region, and carbonate bitumen holdings in Northeast Alberta, including at Saleski; and

- five drilling rigs operated by Paramount's wholly-owned subsidiary, Fox Drilling.

The Company's investments in other entities are as follows:

	Carrying Value		**Market Value**[1]	
As at December 31	**2012**	2011	**2012**	2011
Trilogy[2]	**82.4**	118.3	**557.3**	907.1
MEG	**112.6**	153.8	**112.6**	153.8
MGM Energy	**2.3**	1.7	**13.5**	10.6
Other[3]	**21.4**	5.8	**21.4**	5.8
Total	**218.7**	279.6	**704.8**	1,077.3

(1) Based on the period-end closing price of publicly-traded investments and book value of remaining investments.
(2) December 31, 2011 balances include five million shares that were sold in January 2012, having a December 31, 2011 carrying value of $24.2 million and a December 31, 2011 market value of $187.9 million.
(3) Includes investments in Paxton Corporation and other public and private corporations.

Shale Gas

Paramount's shale gas holdings encompass approximately 260 (220 net) sections in the Liard Basin and the Horn River Basin in Northeast British Columbia and the Northwest Territories.

Paramount drilled and completed its first horizontal shale gas exploration well at Patry in Northeast British Columbia. The well was drilled to a vertical depth of approximately 3,400 meters with a horizontal bore of approximately 1,200 meters, and was completed with a 10-stage fracture stimulation in the Besa River formation in early March 2013 that included the injection of approximately 120,000 barrels of completion fluids.

The Company is working to confirm that all 10 stages of the fracture stimulation are open and contributing. In order to further evaluate well performance, the Company plans to tie the Patry well into existing pipeline infrastructure located within two miles of the well site and plans to bring the well on production by the end of 2013.

The Company re-commenced drilling operations on its initial shale gas evaluation well at Dunedin in February 2013 after drilling operations were suspended there in the spring of 2012 due to warm weather. Paramount plans to drill this well to the intended vertical depth of approximately 4,500 meters at which point it will evaluate further plans to complete the vertical wellbore and/or drill a horizontal leg. This activity is expected to extend the mineral rights surrounding the well location for an additional decade and provide information useful for future development.

Cavalier Energy

Cavalier Energy is designed to be a focused, self-funding entity, which was created in 2011 as a wholly-owned subsidiary of Paramount to execute the development of the Company's oil sands and carbonate bitumen assets.

The initial focus of Cavalier Energy is to develop the Grand Rapids formation in its 100 percent owned in-situ oil sands leases in the Hoole area of Alberta (the "Hoole Project"). The Hoole Project is 10 kilometers northeast of Wabasca-Desmarais, Alberta. Since 2004, approximately $60 million has been invested through land acquisitions, stratigraphic drilling, engineering studies, and environmental field programs to bring this asset to the development stage.

In 2012, Cavalier Energy focused its efforts on recruiting its leadership team and developing the project strategy, including the project size, use of technologies and execution approach. These actions provided the necessary information for the regulatory application and the company's development strategy.

In November 2012, Cavalier Energy submitted regulatory applications for the initial 10,000 Bbl/d phase of the Hoole Grand Rapids development ("Hoole Grand Rapids Phase 1") to the Energy Resources Conservation Board and Alberta Environment and Sustainable Resource Development. Cavalier Energy anticipates regulatory approvals to be received in the first half of 2014. Construction of Hoole Grand Rapids Phase 1 is dependent upon the receipt of regulatory approvals, sanctioning by the Board of Directors, and securing funding.

During 2013, Cavalier Energy plans to complete the front-end engineering and design work for Hoole Grand Rapids Phase 1 along with geotechnical work and the drilling of additional source water and disposal wells. Estimated costs of these activities, totalling $15 million, are expected to be funded with drawings on Cavalier Energy's $40 million credit facility.

Fox Drilling

Fox Drilling now owns five triple-sized rigs in Canada, including two new built-for-purpose walking rigs and a rig previously owned by Paramount Drilling U.S. that was moved in the fourth quarter of 2012 from the United States. Fox Drilling's two original rigs drilled on the Company's lands in Alberta throughout 2012. The two new walking drilling rigs will be deployed on multi-well pad sites in the Kaybob COU's Deep Basin development. Fox Drilling's rigs are designed to drill the deep horizontal wells that industry is currently focusing on in the Deep Basin of Alberta.

Corporate

Year ended December 31	2012	2011
General and administrative	**11.7**	12.1
Stock-based compensation	**18.2**	15.6
Depletion and depreciation	**0.3**	0.5
Interest	**33.8**	32.9
Acquisition transaction costs	**–**	1.0
Foreign exchange	**1.6**	(1.0)
Segment loss	**65.6**	61.1

The corporate segment loss increased in 2012 to $65.6 million compared to $61.2 million in 2011, primarily as a result of a $2.6 million increase in stock-based compensation expense and the impact of foreign exchange on the Company's US dollar denominated balances.

Corporate general and administrative costs decreased to $11.7 million in 2012 compared to $12.1 million in 2011.

Exploration and Capital Expenditures

Year ended December 31	2012	2011
Geological and geophysical	**6.0**	5.5
Drilling, completion and tie-ins	**304.6**	303.7
Facilities and gathering	**212.5**	156.5
Exploration and development expenditures(1)	**523.1**	465.7
Land and property acquisitions	**25.2**	38.2
Principal Properties	**548.3**	503.9
Strategic Investments(2)	**82.5**	28.0
Corporate	**0.4**	0.1
	631.2	532.0

(1) Exploration and development expenditures include $4.6 million (2011 - $3.2 million) of capitalized interest.
(2) Strategic Investments includes $7.0 million of undeveloped land purchases in 2012.

Exploration and development expenditures in 2012 were $523.1 million compared to $465.7 million in 2011. Current year drilling, completion and tie-in costs were focused on new wells at Musreau, Smoky and Resthaven in the Kaybob COU where advance drilling is ongoing for the deep cut facilities expansions. The Company also drilled and completed wells at Valhalla in the Grande Prairie COU, at Birch in the Northern COU and at Harmattan in the Southern COU. Facilities and gathering expenditures focused on the deep cut facility expansions at Musreau and Smoky and the expansion of gathering and compression capacity at Valhalla to 28 MMcf/d. Exploration and development spending in 2012 exceeded the Company's $475 million original budget mainly due to higher drilling, completion and facilities costs in the Grande Prairie COU at Valhalla and Karr and higher spending at Birch in the Northern COU.

Strategic investments capital expenditures in 2012 included $33.3 million related to the Company's shale gas drilling activities at Dunedin and Patry in Northeast British Columbia, $33.0 million related to the construction of two triple-sized walking drilling rigs and $16.2 million related to Cavalier Energy, including $7.0 million for the purchase of undeveloped oil sands leases. Strategic Investments capital spending exceeded the Company's $60 million original budget primarily due to the addition of the Patry well, which was not included in the original 2012 exploration program.

Fourth quarter 2012 exploration and development expenditures of $166.8 million (2011 – $144.1 million) were primarily focused on drilling and well completions in the Kaybob Deep Basin development, at Karr-Gold Creek in the Grande Prairie COU and at Harmattan in the Southern COU, and construction activities related to the deep cut facility expansions at Musreau and Smoky.

Wells drilled are as follows:

	2012		2011	
(wells drilled)	**Gross**(1)	**Net**(2)	Gross(1)	Net(2)
Natural gas	**44**	**34**	47	32
Oil	**1**	**–**	26	15
Oil sands evaluation	**1**	**1**	28	27
Dry and abandoned	**–**	**–**	1	1
Total	**46**	**35**	102	75

(1) Gross is the number of wells in which Paramount has a working interest or a royalty interest that may be converted to a working interest.
(2) Net is the aggregate number of wells obtained by multiplying each gross well by Paramount's percentage of working interest.

Kaybob Deep Basin Natural Gas Development

To support the accelerated development of Paramount's Deep Basin lands, the Company constructed a wholly-owned 45 MMcf/d natural gas refrigeration processing facility at Musreau, is building a 200 MMcf/d deep cut processing facility at Musreau at the same location and is participating in the expansion of the non-operated Smoky facility, which together will more than triple Paramount's current gas processing capacity to over 300 MMcf/d. The Company has also entered into long-term agreements to transport, de-ethanize and fractionate NGLs streams that will be produced from these new facilities, and has entered into a long-term ethane sales agreement with a petrochemical company.

Construction of the Musreau Deep Cut Facility commenced in the third quarter of 2012 following the receipt of regulatory approval. Site preparation is complete and piling and concrete work continues. Major equipment, including compressors, generators and storage vessels, have been and will continue to be delivered to the facility site over the winter so that construction can continue through break-up. Paramount has awarded the structural steel contract and anticipates awarding the mechanical contracts shortly, with electrical and instrumentation contracts to follow. Approximately $100 million has been incurred on the project to December 31, 2012 and an additional $80 million is budgeted for 2013 to complete construction.

Paramount is currently developing its commissioning plan. Commissioning of the facility is expected to begin towards the end of the third quarter of 2013 and span approximately two months, a process which involves testing and calibrating the individual components and control systems, purging vessels and piping, and pressure testing the system.

Paramount has secured a long-term firm service arrangement for the transportation of NGLs produced from its Kaybob area facilities commencing in December 2013. The Company has also entered into a long-term firm service arrangement with a midstream company for the de-ethanization and fractionation of NGLs volumes commencing in April 2014. The Company is working on procuring interruptible NGLs fractionation capacity for the period between the planned December 2013 start-up of the Musreau Deep Cut Facility and the commencement of the long-term firm service fractionation arrangement.

The Company is also constructing an amine processing train at the Musreau Deep Cut Facility, which will provide the capability to treat sour gas production at the facility instead of at well sites. This enhancement is expected to cost approximately $50 million, and will decrease equipping costs by over $1 million per well and reduce ongoing well operating costs. Design work for the amine facility has been completed and long lead-time components have been ordered. The amine processing train is scheduled to be on-stream in the first half of 2014.

Paramount is also participating in the expansion of the non-operated Smoky facility (the "Smoky Deep Cut Facility"), expected to be commissioned in the second half of 2014. The Company will have a 20 percent interest in the expanded 200 MMcf/d (40 MMcf/d net) deep cut facility, an increase from its 10 percent interest in the existing 100 MMcf/d (10 MMcf/d net) dew point facility. Paramount's share of the Smoky Deep Cut Facility expansion costs is expected to total $65 million, of which approximately $30 million has been incurred to December 31, 2012.

During 2012, Paramount was active drilling and completing wells in the Deep Basin, continuing to build production deliverability ahead of the startup of the new deep cut facilities. Paramount currently has five drilling rigs working in the Deep Basin, which continue to add to the Company's inventory of wells that will feed the Musreau and Smoky deep cut facilities.

Outlook

Paramount plans to invest approximately $500 million in its Principal Properties in 2013, excluding land acquisitions and capitalized interest, primarily focused on the Kaybob COU's Deep Basin development. Construction of the Musreau Deep Cut Facility is scheduled to be completed in the fourth quarter and construction of the third-party Smoky Deep Cut Facility will continue into 2014. In preparation for the start-up of the deep cut facilities, the Company plans to drill and complete up to 40 new wells in Kaybob in 2013. Budgeted activities also include the drilling, completion and tie-in of middle Montney wells at Karr-Gold Creek.

The Company plans to invest approximately $50 million in its Strategic Investments in 2013, directed towards drilling and completions in the Liard Basin and continued pre-development work for oil sands projects within Cavalier Energy.

Average sales volumes in January 2013 were constrained to approximately 22,000 Boe/d and increased to approximately 23,500 Boe/d in the last week of February 2013. Paramount's ability to maximize production through its Company-owned and firm-service contracted capacity will likely continue to be impacted by downstream NGLs processing and transportation constraints until the fourth quarter of 2013.

Sales volumes for the first three quarters of 2013 are expected to range between 21,000 Boe/d and 25,000 Boe/d, after giving effect to the first quarter property dispositions, depending upon the availability of downstream NGLs transportation and processing capacity. Sales volumes are expected to increase in the fourth quarter once the expansion of a third-party NGLs pipeline is completed, additional fractionation capacity is secured and the Musreau Deep Cut Facility is on-stream.

After the Musreau Deep Cut Facility starts up in late-2013, the Company will have owned and firm-service contracted natural gas processing capacity of 279 MMcf/d, which will increase to over 300 MMcf/d in 2014 with the addition of the Smoky Deep Cut Facility. Sales volumes are expected to increase to over 50,000 Boe/d by late-2014 as facility processes are optimized and the new long-term NGLs processing contracts come into effect.

Liquidity and Capital Resources

Paramount manages its capital structure to support current and future business plans and periodically adjusts the structure in response to changes in economic conditions and the risk characteristics of the Company's underlying assets and operations. Paramount may adjust its capital structure by issuing or repurchasing shares, altering debt levels, modifying capital programs, acquiring or disposing of assets or participating in joint ventures.

As at December 31	2012	2011	Change %
Adjusted Working Capital Deficit (Surplus)[1]	**(9.3)**	59.2	(116)
Demand Facilities	**40.7**	22.8	79
Credit Facility	**–**	61.4	(100)
Senior Notes[2]	**670.0**	370.0	81
Net Debt[3]	**701.4**	513.4	37
Share Capital	**921.7**	810.8	14
Accumulated Deficit	**(165.5)**	(103.6)	(60)
Reserves	**94.9**	116.7	(19)
Total Capital	**1,552.5**	1,337.3	16

(1) Adjusted working capital excludes demand facilities, risk management assets and liabilities, assets and liabilities held for sale and accounts payable and accrued liabilities relating to the Company's obligation to renounce qualifying expenditures for flow-through share issuances (December 31, 2012 – $10.8 million, December 31, 2011 – $5.9 million).

(2) Excludes unamortized issue premiums and financing costs.

(3) Net debt excludes the $20 million deposit on account with the CRA, pending resolution of the Company's notices of objection.

Adjusted Working Capital

Paramount had an adjusted working capital surplus at December 31, 2012 of $9.3 million compared to a deficit of $59.2 million at December 31, 2011. The working capital surplus at December 31, 2012 included $146.7 million of cash and cash equivalents, $32.8 million of accounts receivable and $172.7 million of accounts payable and accrued liabilities. The change in working capital is primarily due to proceeds from the December 2012 senior notes offering, the sale of 5.0 million Trilogy shares in January 2012, equity issuances and the sale of non-core petroleum and natural gas properties and funds flow from operations, partially offset by capital spending related to the Company's 2012 capital program and the repayment of $61.4 million of the Company's credit facility.

Paramount raised approximately $710 million in aggregate net cash proceeds in 2012 through financing transactions, the sale of investments and the sale of non-core oil and gas properties. These transactions included a $300 million senior notes offering, the issuance of a total of 4.2 million flow-through Common Shares, the sale of a portion of the Company's investment in Trilogy for $181.7 million and sales of non-core properties for aggregate proceeds of approximately $110 million.

Proceeds from these offerings and asset sales were used, and are expected to be used, to further the development and exploration of the Company's properties, including drilling and completion work and facilities construction at Musreau and Smoky in the Kaybob COU and at Valhalla in the Grande Prairie COU and drilling and completion work in Northeast British Columbia. Proceeds from Common Shares issued on a flow-through basis in respect of Canadian Development Expenses ("CDE") were used to incur eligible CDE. Proceeds from Common Shares issued on a flow-through basis in respect of Canadian Exploration Expenses ("CEE") were used and are expected to be used to incur eligible CEE. Proceeds from the offerings and asset sales were also used for the non-permanent repayment of indebtedness under the Company's credit facility.

Paramount expects to fund its 2013 operations, obligations and capital expenditures with existing cash and cash equivalents, funds flow from operations, drawings on its bank credit facilities, proceeds from the sale of non-core assets and by accessing the capital markets, if required. The Company anticipates its funds flow from operations to increase when the Musreau Deep Cut Facility is brought on-stream in late-2013.

Demand Facilities

Drilling Rig Loans

In 2009, Paramount entered into a $30.4 million non-revolving demand loan facility with a Canadian bank ("Drilling Rig Loan I"). The loan was drawn in full at closing and aggregate principal payments of $12.6 million have been made to December 31, 2012. Unless demanded by the bank, scheduled principal repayments on Drilling Rig Loan I are $5.1 million in 2013, with the remaining outstanding balance payable in 2014.

In January 2012, Paramount entered into a new $30.0 million non-revolving demand loan facility with the same Canadian bank to partially fund the construction of two new triple-sized walking rigs ("Drilling Rig Loan II"). Advances on Drilling Rig Loan II are available during the construction period, with scheduled principal repayments to commence in 2013. As of December 31, 2012, $21.0 million was drawn on Drilling Rig Loan II. Unless demanded by the bank, scheduled principal repayments on Drilling Rig Loan II are $3.5 million in 2013, $6.3 million in 2014, $6.3 million in 2015 and $4.9 million in 2016.

Recourse and security for Drilling Rig Loan I and Drilling Rig Loan II (the "Drilling Rig Loans") is limited to the drilling rigs and drilling contracts guaranteed by Paramount. Interest is payable at the bank's prime lending rate or bankers' acceptance rate, as selected at the discretion of the Company, plus an applicable margin. The effective interest rate on the Drilling Rig Loans for the year ended December 31, 2012 was 4.4 percent (2011 - 4.7 percent).

Cavalier Facility

In January 2012, Cavalier Energy entered into a $21.0 million demand loan facility with a syndicate of Canadian banks (the "Cavalier Facility"). The Cavalier Facility bears interest at the lenders' prime lending rates, US base rates, or bankers' acceptance rates, as selected at the discretion of Cavalier Energy, plus an applicable margin. The Cavalier Facility is non-recourse to Paramount and is secured by all of the assets of Cavalier Energy, including oil sands and carbonate bitumen lands. At December 31, 2012, $1.9 million was drawn on the Cavalier Facility. In March 2013, the size of the Cavalier Facility was increased to $40.0 million, with all other material terms remaining unchanged.

Bank Credit Facility

Paramount's $300 million bank credit facility (the "Facility") is available in two tranches. The first tranche ("Tranche A") has a borrowing base and lender commitments of $225 million and is available on a revolving basis to November 30, 2013. In the event the revolving period is not extended, Tranche A would be available on a non-revolving basis for an additional year, at which time it would be due and payable. The second tranche ("Tranche B") is available on a revolving basis, has a credit limit of up to $75 million and is due November 30, 2013 in the event the due date is not earlier extended. The Facility is secured by a first fixed and floating charge over substantially all of the assets of Paramount, excluding assets securing the Drilling Rig Loans and the Cavalier Facility. Balances drawn under Tranche B are secured by the pledge of certain of the Company's equity investments.

The Facility bears interest at the lenders' prime lending rates, US base rates, bankers' acceptance or LIBOR rates, as selected at the discretion of Paramount, plus an applicable margin which is dependent upon the Company's debt to cash flow ratio and the tranche under which borrowings are made. The maximum amount that Paramount may borrow under the Facility is subject to periodic review, and is dependent upon the Company's reserves, lenders' projections of future commodity prices and the market value of equity investments pledged by Paramount from time-to-time under Tranche B, among other factors. Increases in the borrowing base and lender commitments under Tranche A reduce the credit limit under Tranche B by an equivalent amount.

At December 31, 2012, no amounts were drawn under the Facility (December 31, 2011 - $61.4 million). Paramount had undrawn letters of credit outstanding at December 31, 2012 totalling $42.7 million that reduce the amount available to the Company.

Senior Notes

In December 2010, Paramount completed a public offering of $300 million principal amount of senior unsecured notes, due 2017 (the "2017 Senior Notes") at par.

In February 2011, Paramount completed a public offering of an additional $70 million principal amount of 2017 Senior Notes at a price of $1,030 per $1,000 principal amount, of which $1.4 million principal amount was purchased by an entity that is controlled by the Company's Chairman and Chief Executive Officer. The 2017 Senior Notes bear interest at 8.25 percent per annum, payable semi-annually in arrears on June 13 and December 13 in each year and mature on December 13, 2017. The 2017 Senior Notes are direct senior unsecured obligations of Paramount and rank equally with all other senior unsecured indebtedness of the Company. The Company has the right to redeem all or a portion of the 2017 Notes at par, plus accrued and unpaid interest to the date of redemption, plus a redemption premium, if applicable, which varies based on the date of redemption.

In December 2012, Paramount completed a public offering of $300 million principal amount of senior unsecured notes, due 2019 (the "2019 Senior Notes") at par, of which $9.6 million principal amount was purchased by certain officers, management and associates of the Company.

The 2019 Senior Notes bear interest at 7.625 percent per annum, payable semi-annually in arrears on June 4 and December 4 in each year and mature on December 4, 2019. The 2019 Senior Notes are direct senior unsecured obligations of Paramount and rank equally with all other senior unsecured indebtedness of the Company. The Company has the right to redeem all or a portion of the 2019 Notes at par, plus accrued and unpaid interest to the date of redemption, plus a redemption premium, if applicable, which varies based on the date of redemption.

Share Capital

In September 2012, Paramount issued 646,000 Common Shares on a flow-through basis in respect of CEE at a price of $31.00 per share and 1,244,000 Common Shares on a flow-through basis in respect of CDE at a price of $28.15 per share to a corporation controlled by the Company's Chairman and Chief Executive Officer for aggregate proceeds of $55.0 million.

In October 2012, Paramount issued 1,936,000 Common Shares on a flow-through basis in respect of CEE at a price of $31.00 per share and 356,000 Common Shares on a flow-through basis in respect of CDE at a price of $28.15 per share for aggregate gross proceeds of $70.0 million, pursuant to a public offering. Certain officers and Management of the Company participated in this offering.

The Company is committed to incur $80.0 million of qualifying expenditures related to the 2012 offerings of CEE flow-though Common Shares by December 31, 2013. As of December 31, 2012, the Company had incurred $22.5 million of qualifying CEE. Paramount has incurred sufficient qualifying expenditures to satisfy commitments associated with CDE flow-through Common Shares issued in 2012 and the CEE and CDE flow-through Common Shares issued in 2011.

At March 5, 2013, Paramount had 90,107,374 Common Shares and 6,582,350 Paramount Options outstanding, of which 2,689,134 Paramount Options are exercisable.

Deposit

In October 2010, the Company received reassessments from the Canada Revenue Agency (the "CRA") and provincial tax authorities of its income taxes relating to a prior year transaction (the "Reassessments"). Paramount disagrees with the Reassessments and has filed notices of objection with the CRA and provincial tax authorities. Despite its disagreement, and as a condition of its right to proceed with its objection to the Reassessments, the Company was required to deposit approximately $20 million with the CRA, which amount will remain on account until the dispute is resolved.

Quarterly Information

Operating Results – Continuing Operations

Sales Volumes

Three months ended December 31	**Natural Gas** (MMcf/d)			**NGLs** (Bbl/d)			**Oil** (Bbl/d)			**Total** (Boe/d)		
	2012	2011	% Change	**2012**	2011	% Change	**2012**	2011	% Change	**2012**	2011	% Change
Kaybob	**63.3**	50.8	25	**901**	901	–	**64**	62	3	**11,501**	9,437	22
Grande Prairie	**23.5**	19.4	21	**1,008**	480	110	**317**	333	(5)	**5,243**	4,048	30
Southern	**9.0**	11.1	(19)	**150**	191	(21)	**566**	687	(18)	**2,223**	2,741	(19)
Northern	**8.3**	9.9	(16)	**51**	23	122	**266**	410	(35)	**1,707**	2,068	(17)
Continuing Ops	**104.1**	91.2	14	**2,110**	1,595	32	**1,213**	1,492	(19)	**20,674**	18,294	13
Discontinued Ops	–	0.3	(100)	–	25	(100)	–	864	(100)	–	929	(100)
Total	104.1	91.5	14	2,110	1,620	30	1,213	2,356	(49)	20,674	19,223	8

Netback – Continuing Operations

Three months ended December 31	**2012**		2011	
		($/Boe)[1]		*($/Boe)*[1]
Natural gas	**33.1**	***3.45***	30.4	*3.62*
NGLs	**11.9**	***61.23***	11.4	*77.98*
Oil	**8.9**	***79.72***	13.4	*97.02*
Royalty and sulphur revenue	**0.7**	–	1.0	–
Petroleum and natural gas sales	**54.6**	***28.70***	56.2	*33.38*
Royalties	**(4.5)**	***(2.38)***	(4.4)	*(2.61)*
Operating expense	**(17.9)**	***(9.41)***	(19.3)	*(11.45)*
Transportation	**(5.5)**	***(2.91)***	(5.1)	*(3.03)*
Netback	**26.7**	***14.00***	27.4	*16.29*
Financial commodity contract settlements	**0.7**	***0.38***	0.3	*0.18*
Netback including financial commodity contract settlements	**27.4**	***14.38***	27.7	*16.47*

(1) Natural gas revenue shown per Mcf.

Paramount's fourth quarter average sales volumes were 20,674 Boe/d in 2012, an increase of 13 percent over the fourth quarter of 2011. Natural gas sales volumes increased in the Kaybob COU as a result of new production from wells producing through the Company's new Musreau Refrig Facility. Sales volumes also increased at Valhalla in the Grande Prairie COU where a new gathering and compression system was commissioned in the first quarter of 2012. Sales volumes in the Southern and Northern COUs decreased due to natural declines.

Fourth quarter 2012 petroleum and natural gas sales were $54.6 million, a decrease of $1.6 million from the fourth quarter of 2011, as a 14 percent decrease in average realized prices more than offset the 13 percent increase in sales volumes.

Natural gas and NGLs sales volumes in the fourth quarter of 2012 were reduced due to Third Party Disruptions, which required Paramount to restrict NGLs recovery rates and curtail production in the Kaybob and Grande Prairie COUs. The Company estimates that average sales volumes in the fourth quarter were reduced by approximately 3,000 Boe/d as a result, including reduced liquids yields as the Company preferentially flowed lower liquids content wells. Sales volumes in December 2012 and January 2013 were constrained to approximately 22,000 Boe/d.

Operating expenses decreased $1.4 million in the fourth quarter of 2012 compared to the prior year, as higher operating costs related to the new Musreau Refrig Facility and new wells brought-on production were more than offset by the impact of higher processing income and lower third party processing fees. Operating costs per Boe decreased to $9.41 in the fourth quarter of 2012 compared to $11.45 in the fourth quarter of 2011. The per-unit decrease is primarily due to a higher proportion of sales from the Kaybob COU, which has per unit operating costs of approximately $5.00 per Boe before accounting for the impact of third party processing income. Operating expenses in the fourth quarter include the cost of seasonal maintenance in the Northern COU at remote locations.

Net Loss

Three months ended December 31	**2012**	2011
Principal Properties	**(167.6)**	(253.7)
Strategic Investments	**(9.1)**	(3.4)
Corporate	**(14.7)**	(16.2)
Tax Recovery	**39.6**	62.5
Loss from continuing operations	**(151.8)**	(210.8)
Discontinued Operations, net of tax	**–**	0.9
Net Loss	**(151.8)**	(209.9)

Three months ended December 31	2012	2011
Netback	**26.7**	27.4
Gain (loss) on financial commodity contracts	**0.6**	(7.7)
General and administrative	**(4.0)**	(4.0)
Stock-based compensation	**(7.0)**	(6.2)
Depletion and depreciation	**(183.1)**	(271.7)
Exploration and evaluation	**(13.8)**	(7.2)
Gain (loss) on sale of property, plant and equipment	**(1.8)**	3.0
Interest expense	**(11.6)**	(8.6)
Other expenses	**(0.8)**	(0.9)
Loss from equity-accounted investments	**(0.4)**	(1.0)
Other income	**3.8**	3.5
Tax Recovery	**39.6**	62.6
Loss from continuing operations	**(151.8)**	(210.8)
Discontinued Operations, net of tax	**–**	0.9
Net Loss	**(151.8)**	(209.9)

Paramount recorded a loss from continuing operations of $151.8 million for the three months ended December 31, 2012 compared to a loss from continuing operations of $210.8 million in the same period of 2011. Significant factors contributing to the change are shown below:

	Three months ended December 31
Loss from continuing operations – 2011	**(210.8)**
• Lower depletion, depreciation and impairment mainly due to lower write-downs of petroleum and natural gas properties and goodwill	88.6
• Gain on financial commodity contracts compared to a loss in 2011	8.3
• Lower income tax recovery in 2012	(23.0)
• Higher exploration and evaluation expense	(6.6)
• Loss on sale of property, plant and equipment compared to a gain in 2011	(4.8)
• Higher interest in 2012 due to higher debt levels	(3.0)
• Other	(0.5)
Loss from continuing operations – 2012	**(151.8)**

Funds Flow from Operations[1]

Three months ended December 31	2012	2011[2]
Cash from operating activities	**(13.2)**	7.2
Change in non-cash working capital	**27.2**	14.9
Geological and geophysical expenses	**1.0**	1.9
Asset retirement obligations settled	**2.7**	2.1
Funds flow from operations	**17.7**	26.1
Funds flow from operations ($/Boe)	**9.29**	14.73

[1] Refer to the advisories concerning non-GAAP measures in the Advisories section of this document.
[2] Includes the results of discontinued operations.

Funds flow from operations decreased by $8.4 million in the fourth quarter of 2012 compared to the same period in 2011, primarily as a result the sale of the US properties, which generated $4.0 million of funds flow from operations in the fourth quarter of 2011, and higher interest expense.

	2012				2011			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Petroleum and natural gas sales – CO	**54.6**	41.3	43.2	46.6	56.2	63.9	52.9	40.4
Petroleum and natural gas sales – DO	**–**	–	3.3	8.1	7.1	6.6	8.2	6.4
Petroleum and natural gas sales	**54.6**	41.3	46.5	54.7	63.3	70.5	61.1	46.8
Funds flow from operations – CO	**17.7**	15.5	10.2	8.2	22.1	29.8	18.7	10.2
Funds flow from operations – DO	**–**	–	1.9	4.6	4.0	3.0	4.7	3.7
Funds flow from operations	**17.7**	15.5	12.1	12.8	26.1	32.8	23.4	13.9
Total per share – diluted ($/share)	**0.20**	0.18	0.15	0.15	0.33	0.42	0.29	0.19
Income (loss) – CO	**(151.8)**	(34.6)	(30.9)	125.2	(210.8)	(23.5)	10.8	(32.7)
Continuing per share – basic ($/share)	**(1.69)**	(0.40)	(0.36)	1.46	(2.55)	(0.30)	0.14	(0.44)
Continuing per share – diluted ($/share)	**(1.69)**	(0.40)	(0.36)	1.43	(2.55)	(0.30)	(0.04)	(0.44)
Net income (loss)	**(151.8)**	(34.6)	–	124.5	(209.9)	(22.4)	12.2	(11.9)
Per share – basic ($/share)	**(1.69)**	(0.40)	–	1.46	(2.54)	(0.28)	0.16	(0.16)
Per share – diluted ($/share)	**(1.69)**	(0.40)	–	1.42	(2.54)	(0.28)	(0.02)	(0.16)
Sales volumes								
Natural gas (MMcf/d)	**104.1**	95.3	106.2	88.3	91.2	97.5	77.4	58.5
NGLs (Bbl/d)	**2,110**	1,755	1,966	1,604	1,595	2,024	1,478	938
Oil (Bbl/d)	**1,213**	1,081	1,289	1,421	1,492	1,425	1,109	1,497
Total Continuing (Boe/d)	**20,674**	18,712	20,946	17,755	18,294	19,705	15,501	12,176
Discontinued (Boe/d)	**–**	–	528	1,058	929	1,002	1,071	921
Total (Boe/d)	**20,674**	18,712	21,474	18,813	19,223	20,707	16,572	13,097
Average realized price								
Natural gas ($/Mcf)	**3.45**	2.58	2.09	2.77	3.62	4.12	4.36	4.05
NGLs ($/Bbl)	**61.23**	60.65	69.76	78.92	77.98	81.22	82.18	75.96
Oil ($/Bbl)	**79.72**	81.28	81.79	89.97	97.02	82.18	101.72	83.66
Continuing ($/Boe)	**28.70**	24.00	22.65	28.84	33.38	35.24	37.53	36.92
Discontinued ($/Boe)	**–**	–	69.96	84.20	83.45	72.48	83.77	75.09
Total ($/Boe)	**28.70**	24.00	23.82	31.95	35.80	37.03	40.52	39.67

Significant Items Impacting Quarterly Results

Significant impacts to quarterly earnings include the effects of changing production volumes and commodity prices and the following:

- Fourth quarter 2012 earnings include a $135.6 million write-down of petroleum and natural gas properties and goodwill, and $6.5 million in dry hole charges.

- Third quarter 2012 earnings includes $6.2 million in respect of a business interruption insurance settlement related to an electrical equipment failure at the Musreau Refrig Facility in the fourth quarter of 2011.

- Second quarter 2012 earnings include a $50.7 million pre-tax gain recognized on the disposition of United States properties.

- First quarter 2012 earnings include a $157.2 million pre-tax gain on the sale of 5.0 million Trilogy shares and a $28.3 million gain on the sale of property, plant and equipment, partially offset by higher tax expense, operating expenses and depletion and depreciation.

- Fourth quarter 2011 earnings include a $225.7 million write-down of petroleum and natural gas properties and goodwill, and $7.6 million of losses on financial commodity contracts, partially offset by an $8.4 million decrease in stock-based compensation expense and a $3.1 million gain on the sale of property, plant and equipment.

- Third quarter 2011 earnings include $14.6 million of stock-based compensation expense, a decrease of $15.4 million in gains on the sale of securities and an increase of $8.3 million in depletion and depreciation.

- Second quarter 2011 earnings include the recognition of $15.4 million of gains on investments in securities and a $10.6 million stock-based compensation recovery, partially offset by higher depletion and depreciation and interest.

- First quarter 2011 earnings include gains of $39.6 million on the sale of property, plant and equipment, partially offset by $11.3 million of stock-based compensation charges.

Other Information

Related Party Transactions

Service Agreements

Paramount engages in transactions with Trilogy, MGM Energy, Paxton and Perpetual in the normal course of business, including joint venture operations. Paramount is considered related to Trilogy, MGM Energy, Paxton and Perpetual because of common significant influence. All transactions between Paramount and the entities are recorded at their exchange amounts.

During 2012, Paramount charged $0.4 million (2011 – $0.9 million) to Trilogy in respect of operational and administrative services. Also, Paramount received $8.0 million (2011 - $10.1 million) in dividends from Trilogy. As of December 31, 2012, Paramount had a receivable balance due from Trilogy of $0.9 million (2011 - $0.3 million).

Contractual Obligations

Paramount had the following contractual obligations at December 31, 2012:

($ millions)	2013	2014-2015	2016-2017	After 2017	Total
Senior notes[1]	53.4	106.8	475.3	344.1	979.6
Drilling Rig Loans[1]	10.5	26.8	5.1	–	42.4
Cavalier Facility[1]	1.9	–	–	–	1.9
Transportation and processing commitments[2]	17.1	85.5	87.9	217.2	407.7
Operating leases	2.8	3.8	3.6	8.8	19.0
Capital spending commitments[3]	12.8	–	–	–	12.8
Total	**98.5**	**222.9**	**571.9**	**570.1**	**1,463.4**

(1) Including interest and principal repayments.
(2) Certain pipeline transportation and NGLs processing commitments are secured by outstanding letters of credit totalling $27.3 million at December 31, 2012 (2011 - $12.8 million).
(3) Relates to contractual obligations for purchases of major equipment.

Transportation and processing commitments include long-term firm service arrangements entered into during 2012 for the transportation of NGLs commencing in December 2013 and for the downstream processing of NGLs volumes commencing in April 2014.

Operating Lease Commitment

Paramount's head office lease expires in 2022. The Company incurred office lease costs of $3.2 million in 2012 (2011 – $2.8 million).

Contingencies

Paramount is a party to various legal claims associated with the ordinary conduct of business. Paramount does not anticipate that these claims will have a material impact on its financial position.

Tax and royalty legislation and regulations, and government interpretation and administration thereof, continually changes. As a result, there are often tax and royalty matters under review by relevant government authorities. All tax filings are subject to subsequent government audit and potential reassessments. Accordingly, the final liability may differ materially from amounts estimated and recorded.

Change In Accounting Policies

As of January 1, 2013, Paramount will be required to adopt certain standards and amendments issued by the International Accounting Standards Board ("IASB") as described below, for which the Company is currently assessing the impact on its Consolidated Financial Statements:

- **IFRS 10, "Consolidated Financial Statements"** is the result of the IASB's project to replace Standing Interpretations Committee 12, "Consolidation – Special Purpose Entities" and the consolidation requirements of IAS 27, "Consolidated and Separate Financial Statements". The new standard eliminates the current risk and rewards approach and establishes control as the single basis for determining the consolidation of an entity.

- **IFRS 11, "Joint Arrangements"** is the result of the IASB's project to replace IAS 31, "Interests in Joint Ventures". The new standard redefines "joint operations" and "joint ventures" and requires joint operations to be proportionately consolidated and joint ventures to be equity accounted.

Under IAS 31, joint ventures could be proportionately accounted. The Company expects its joint venture arrangements will continue to meet the definition of "joint operations" and that proportionate consolidation of such arrangements will continue under the new standard.

- **IFRS 12, "Disclosure of Interests in Other Entities"** outlines the required disclosures for interests in subsidiaries and joint arrangements. The new standard requires disclosure of information that will assist financial statement users to evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries and joint arrangements.

- **IFRS 13, "Fair Value Measurement"** provides a common definition of fair value, establishes a framework for measuring fair value under IFRS and enhances the disclosures required for fair value measurements. The standard applies where fair value measurements are required and does not require new fair value measurements.

In December 2011 the IASB approved a proposal to move the effective date for the adoption of IFRS 9, "Financial Instruments: Classification and Measurement" to January 1, 2015. This new standard, which reflects the first phase of the IASB's work on the replacement of IAS 39, "Financial Instruments – Recognition and Measurement" applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39.

Disclosure Controls and Procedures

As of the year ended December 31, 2012, an evaluation of the effectiveness of Paramount's disclosure controls and procedures, as defined by the rules of the Canadian Securities Administrators, was performed by the Company's management with the oversight of the chief executive officer and chief financial officer. Based upon that evaluation, the Company's chief executive officer and chief financial officer have concluded that as of the end of that fiscal year, the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company is (i) recorded, processed, summarized and reported within the time periods specified in Canadian securities law and (ii) accumulated and communicated to the Company's management, including its chief executive officer and chief financial officer as appropriate, to allow timely decisions regarding required disclosure.

It should be noted that while the Company's chief executive officer and chief financial officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the Company's disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Internal Controls Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over the Company's financial reporting. The Company's internal control system was designed to provide reasonable assurance that all transactions are accurately recorded, that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS, that the Company's assets are safeguarded, and that expenditures are made in accordance with appropriate authorization.

Management has assessed the effectiveness of the Company's internal control over financial reporting as at December 31, 2012. In making its assessment, management used the Committee of Sponsoring

Organizations of the Treadway Commission ("COSO") framework in Internal Control – Integrated Framework to evaluate the effectiveness of the Company's internal control over financial reporting. Based on this assessment, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2012.

Internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Changes in Internal Controls Over Financial Reporting

During the fiscal year and quarter ended December 31, 2012, there was no change in the Company's internal control over financial reporting that materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

Critical Accounting Estimates

The timely preparation of financial statements requires management to make certain estimates that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Changes in estimates and assumptions based on new information could result in a material change to the carrying amount of assets or liabilities and have a material impact on revenue and expenses in future periods. The following is a discussion of the accounting estimates that are considered significant:

Reserves Estimates

Reserve engineering is an inherently complex and subjective process of estimating underground accumulations of petroleum and natural gas. The process relies on assumptions based on the interpretation of available geological, geophysical, engineering and production data. The accuracy of a reserves estimate is a function of the quality and quantity of available data, the interpretation of that data, the accuracy of various economic factors and the judgment of those preparing the estimate. Because these estimates depend on many assumptions, all of which may differ from actual results, reserves estimates, commodity price estimates and estimates of future net revenue will be different from the sales volumes ultimately recovered and net revenues actually realized. Changes in market conditions, regulatory matters and the results of subsequent drilling, testing and production may require revisions to the original estimates.

Estimates of reserves impact: (i) the assessment of whether a new well has found economically recoverable reserves; (ii) depletion rates; and (iii) the estimated recoverable amount of petroleum and natural gas properties used in impairment assessments, all of which could have a material impact on net income.

Business Combinations

Business combinations are accounted for using the acquisition method of accounting, where the net identifiable assets acquired are recorded at fair value. Any excess of the consideration transferred over the fair value of the net identifiable assets acquired is recognized as goodwill. Any deficiency in the consideration transferred versus the fair value of the net identifiable assets acquired is recognized in earnings. The fair value of individual assets is often required to be estimated, which may involve estimating the fair values of reserves and resources, tangible assets, undeveloped land, intangible assets and other assets acquired. These estimates are based on assumptions regarding appropriate indicators of fair value. Changes in any of the estimates or assumptions used in determining the fair value of the net identifiable assets acquired may impact the carrying values assigned and net income.

Asset Retirement Obligations

Estimates of asset retirement costs are based on assumptions regarding the methods, timing, economic environment and regulatory standards that are expected to exist at the time assets are retired. Management adjusts estimated amounts periodically as assumptions are changed to incorporate new information. Actual payments to settle the obligations may differ materially from amounts estimated.

Share-Based Payments

The Company estimates the grant date value of stock options awarded using the Black-Scholes-Merton model. The inputs used to determine the estimated value of the options are based on assumptions regarding share price volatility, the expected life of the options, expected forfeiture rates and future interest rates. By their nature, these inputs are subject to measurement uncertainty and changes to any of these assumptions impacts amounts recognized as stock-based compensation expense and contributed surplus.

Paramount previously accounted for Paramount Options as cash-settled awards due to its past practice of accepting requests to settle Paramount Options with a cash payment. In recent years, the Company has not been granting requests to settle Paramount Options in cash, and does not expect to do so in the future. As a result, Paramount has accounted for Paramount Options as equity-settled stock-based compensation transactions from of October 1, 2011. The change in accounting method resulted in the reclassification of the September 30, 2011 stock-based compensation liability of $68.7 million to Contributed Surplus.

Income Taxes

Accounting for income taxes is a complex process requiring management to interpret frequently changing laws and regulations and make judgments related to the application of tax law, estimate the timing of temporary difference reversals, and estimate the realization of tax assets. All tax filings are subject to subsequent government audits and potential reassessment. These interpretations and judgments and changes related to them impact current and deferred tax provisions, deferred income tax assets and liabilities and net income.

Advisories

FORWARD-LOOKING INFORMATION

Certain statements in this document constitute forward-looking information under applicable securities legislation. Forward-looking information typically contains statements with words such as "anticipate", "believe", "estimate", "expect", "plan", "schedule", "intend", "propose", or similar words suggesting future outcomes or an outlook. Forward looking information in this document includes, but is not limited to:

- expected production and sales volumes and the timing thereof;
- exploration, development and strategic investment plans and strategies and the anticipated costs, timing, and results thereof;
- budget allocations and capital spending flexibility;
- the availability and adequacy of facilities to process, de-ethanize, fractionate and transport natural gas and NGLs production;
- the scope, timing, and cost of proposed new facilities and facilities expansions and the expected capacity and benefits of such facilities;
- the negotiation and completion of arrangements for the transportation and sales of natural gas, NGLs, and bitumen;
- the timing and scope of the anticipated development of oilsands, carbonate bitumen, and shale gas assets;
- future taxes payable or owing;
- business strategies and objectives;
- sources of and plans for funding Paramount's exploration, development, facilities and other expenditures;
- acquisition and disposition plans;
- operating and other costs and royalty rates;
- regulatory applications and the anticipated timing, results and scope thereof;
- expected drilling programs, well tie-ins, facility construction and expansions, completions and the timing, scope and results thereof; and
- the outcome and timing of any legal claims, insurance claims, audits, assessments and regulatory matters and proceedings.

Such forward-looking information is based on a number of assumptions which may prove to be incorrect. The following assumptions have been made, in addition to any other assumptions identified in this document:

- future oil, gas, NGLs, and bitumen prices and general economic, business, and market conditions;
- the ability to obtain required capital, through access to capital markets and other means, to finance exploration and development activities and new and expanded facilities;
- the ability to obtain equipment, services, supplies and personnel in a timely manner and at an acceptable cost to carry out activities;
- the ability to market oil, natural gas, NGLs and bitumen successfully to current and new customers;
- the ability to secure adequate product processing, fractionation, transportation and storage;
- the ability of Paramount and its industry partners to obtain drilling success and production levels consistent with expectations, including with respect to anticipated reserves additions and NGLs yields;
- the timely receipt of required regulatory approvals;
- expected timelines and budgets being met and anticipated results achieved, in respect of facilities and infrastructure development;
- anticipated rates of return from existing and planned projects relative to other opportunities;
- estimates of input and labour costs; and
- currency exchange and interest rates.

Although Paramount believes that the expectations reflected in such forward looking information is reasonable, undue reliance should not be placed on it as Paramount can give no assurance that such expectations will prove to be correct. Forward-looking information is based on current expectations, estimates and projections that involve a number of risks and uncertainties which could cause actual results to differ materially from those anticipated by Paramount and described in the forward looking information. These risks and uncertainties include, but are not limited to:

- fluctuations in oil, natural gas, NGLs and bitumen prices and commodity price differentials;
- fluctuations in foreign currency exchange rates and interest rates;
- the uncertainty of estimates and projections relating to future revenue, future production, NGLs yields, costs and expenses and the timing thereof;
- the ability to secure adequate product processing, de-ethanization, fractionation, transportation and storage;
- uncertainties associated with exploration and development drilling and related activities;
- operational risks in exploring for, developing and producing oil, natural gas, NGLs and bitumen and the timing thereof;
- the ability to obtain equipment, services, supplies and personnel in a timely manner and at an acceptable cost;
- potential disruptions, unexpected technical difficulties or other constraints in designing, developing, operating or utilizing new, expanded or existing facilities, including third-party facilities;
- risks and uncertainties involving the geology of oil and gas deposits;
- the uncertainty of reserves and resource estimates;
- the ability to generate sufficient cash flow from operations and obtain other sources of financing at an acceptable cost to fund planned operational, exploration and development activities, including costs of anticipated new and expanded facilities and other projects, and to meet current and future obligations;
- the ability to fulfill pipeline transportation, processing, de-ethanization and fractionation commitments;
- changes to, or in the interpretation or application of, laws, regulations or policies;
- changes in environmental laws including potential emission reduction obligations and fracing regulations;
- the receipt, timing, and scope of governmental or regulatory approvals;
- potential title defects affecting Paramount's properties;
- uncertainties regarding aboriginal land claims and co-existing with local populations and stakeholders;
- the effects of weather;
- the timing and cost of future abandonment and reclamation activities;
- clean-up costs or business interruptions resulting from environmental damage and contamination;
- the ability to enter into or continue leases;
- existing and potential lawsuits and regulatory actions;
- general economic, business and market conditions;
- industry wide pipeline, processing, de-ethanization and fractionation constraints; and
- other risks and uncertainties described elsewhere in this document and in Paramount's other filings with Canadian securities authorities.

The foregoing list of risks is not exhaustive. Additional information concerning these and other factors which could impact Paramount, its operations and its financial condition are included in Paramount's Annual Information Form for the year ended December 31, 2012. The forward-looking information contained in this document is made as of the date hereof and, except as required by applicable securities law, Paramount undertakes no obligation to update publicly or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise.

NON-GAAP MEASURES

In this document "Funds flow from operations", "Funds flow from operations - per Boe", "Funds flow from operations per share - diluted", "Netback", "Netback including commodity & insurance contract settlements", "Net Debt", "Adjusted Working Capital", "Exploration and development expenditures" and "Investments in other entities – market value", collectively the "Non-GAAP measures", are used and do not have any standardized meanings as prescribed by IFRS.

Funds flow from operations refers to cash from operating activities before net changes in operating non-cash working capital, geological and geophysical expenses and asset retirement obligation settlements. Funds flow from operations is commonly used in the oil and gas industry to assist management and investors in measuring the Company's ability to fund capital programs and meet financial obligations. **Netback** equals petroleum and natural gas sales less royalties, operating costs, production taxes and transportation costs. Netback is commonly used by management and investors to compare the results of the Company's oil and gas operations between periods. **Net Debt** is a measure of the Company's overall debt position after adjusting for certain working capital amounts and is used by management to assess the Company's overall leverage position. Refer to the liquidity and capital resources section of Management's Discussion and Analysis. **Adjusted Working Capital** equals cash and cash equivalents plus accounts receivable less accounts payable. **Exploration and development expenditures** refer to capital expenditures and geological and geophysical costs incurred by the Company's COUs (excluding land and acquisitions). The exploration and development expenditure measure provides management and investors with information regarding the Company's Principal Property spending on drilling and infrastructure projects, separate from land acquisition activity. **Investments in other entities – market value** reflects the Company's investments in enterprises whose securities trade on a public stock exchange at their period end closing price (e.g. Trilogy, MEG Energy, MGM Energy and others), and investments in all other entities at book value. Paramount provides this information because the market values of equity-accounted investments, which are significant assets of the Company, are often materially different than their carrying values.

Non-GAAP measures should not be considered in isolation or construed as alternatives to their most directly comparable measure calculated in accordance with GAAP, or other measures of financial performance calculated in accordance with GAAP. The Non-GAAP measures are unlikely to be comparable to similar measures presented by other issuers.

OIL AND GAS MEASURES AND DEFINITIONS

This document contains disclosures expressed as "Boe" and "Boe/d". All oil and natural gas equivalency volumes have been derived using the ratio of six thousand cubic feet of natural gas to one barrel of oil. Equivalency measures may be misleading, particularly if used in isolation. A conversion ratio of six thousand cubic feet of natural gas to one barrel of oil is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the well head. The term "liquids" is used to represent oil and natural gas liquids.

During 2012, the value ratio between crude oil and natural gas was approximately 31:1. This value ratio is significantly different from the energy equivalency ratio of 6:1. Using a 6:1 ratio would be misleading as an indication of value.