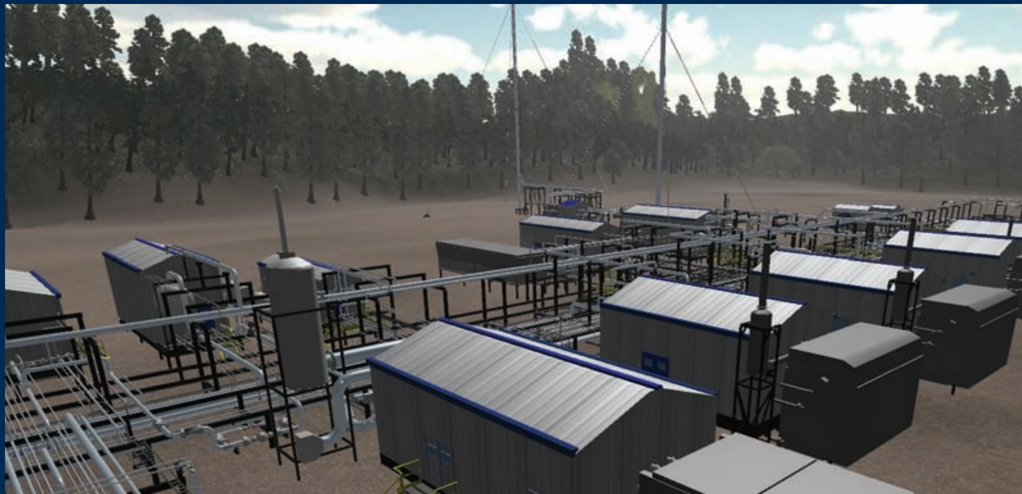

Paramount *resources ltd.*

ANNUAL REPORT 2011

FROM PLANNING TO PRODUCTION

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ANNUAL MEETING OF SHAREHOLDERS

Shareholders are cordially invited to attend
the Annual Meeting of Shareholders to be held
Wednesday, May 9, 2012 at 10:30 AM MDT
at Centrium Place in the Conference Centre,
332 6th Avenue S.W., Calgary, Alberta.

FINANCIAL AND OPERATING HIGHLIGHTS[1]

($ millions, except as noted)	Year ended December 31 2011	2010	% Change
Financial			
Petroleum and natural gas sales	**241.7**	184.4	31
Funds flow from operations[2]	**96.2**	94.0	2
Per share – basic and diluted ($/share)	**1.23**	1.29	(5)
Net loss	**(232.0)**	(90.0)	(158)
Per share – basic and diluted ($/share)	**(2.96)**	(1.24)	(139)
Exploration and development expenditures	**465.7**	199.0	134
Investments in other entities – market value[3]	**1,077.3**	502.9	114
Total assets	**1,725.7**	1,391.3	24
Net debt	**513.4**	295.2	74
Common shares outstanding (thousands)	**85,500**	75,183	14
Operating			
Sales volumes			
Natural gas (MMcf/d)	**81.6**	57.7	41
NGLs (Bbl/d)	**1,542**	932	65
Oil (Bbl/d)	**2,291**	2,485	(8)
Total (Boe/d)	**17,426**	13,029	34
Gas weighting	**78%**	74%	
Average realized price			
Natural gas ($/Mcf)	**4.10**	4.50	(9)
NGLs ($/Bbl)	**82.24**	70.58	17
Oil ($/Bbl)	**87.81**	72.30	21
Net wells drilled	**75**	88	(15)
Net undeveloped land (thousands of acres)	**1,225**	1,198	2
Reserves[4]			
Proved plus probable			
Natural gas (Bcf)	**244.1**	181.8	34
Crude oil and NGLs (MBbl)	**12,333**	9,782	26
Total (MBoe)	**53,015**	40,087	32
Finding and development costs before facilities expenditures (proved plus probable) ($/Boe)	**24.19**	20.76	17
Reserves replacement (proved plus probable)	**193%**	160%	
NPV future net revenue before tax @ 10%			
Proved	**611.4**	397.8	54
Proved plus probable	**832.2**	556.0	50

[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] The Company has adjusted its funds flow from operations measure for all periods presented. Refer to the advisories concerning non-GAAP measures in the "Advisories" section of this document.
[3] Based on the period-end closing prices of publicly traded enterprises and book value of the remaining investments.
[4] Working interest reserves before royalty deductions, using forecast prices and costs.

PRESIDENT'S MESSAGE

Paramount achieved significant progress in all three main facets of our business strategy over the past year. Significant production ramp-ups have begun in our Kaybob Deep Basin and Grande Prairie Montney horizontal plays. The market value of our investment portfolio appreciated materially to over one billion dollars, a portion of which was realized through the secondary offering of some of our Trilogy Energy holdings near the end of the year. Our strategic investments in oilsands and northern shale gas were also advanced with the creation of Cavalier Energy Inc. and our initial drilling in the Liard Basin.

During 2011, Paramount's average daily production increased 34 percent from prior year levels to 17,426 Boe/d. Production during the fourth quarter of 2011 increased 43 percent from the same period in 2010 to average 19,223 Boe/d. The Company generated funds flow from operations in 2011 of $96.2 million, a 2 percent increase year-over-year, despite the lower natural gas price environment. We continue to improve the cost structure of our operations, with our per unit general and administrative costs declining further in 2011 following reductions in 2010. We expect per unit cost reductions in operating and general and administrative costs in 2012 and beyond as fixed costs are spread over our higher forecast production.

The Company invested $465.7 million in its exploration and development program in 2011, including $156.5 million in facilities, principally in the Kaybob and Grand Prairie areas, and $303.7 million in drilling and completion activities. In addition, Paramount expended $38.2 million on land acquisitions and $28.0 million on strategic investments, primarily in oilsands assets. Net debt totaled $513.4 million at year end 2011. This was subsequently reduced with proceeds from the $189.5 million secondary offering of five million of Paramount's Trilogy shares in January 2012 and $50 million from property sales in the first quarter of 2012.

Paramount has demonstrated considerable success in its horizontal drilling program at Kaybob, principally in the Montney, Fahler, and Dunvegan formations, and has invested substantial time and resources in the build-out of the infrastructure to produce these reserves. The Company has completed the construction of a new 45 MMcf/d gas plant at Musreau, which has now been re-commissioned and placed on production, following equipment failures which delayed the ramp up of production for approximately three months. Work is also progressing on the construction of a new 200 MMcf/d deep-cut facility at Musreau. Much of the detailed engineering for this facility has been completed and procurement of longer lead time items has been initiated. Completion of the new plant is anticipated during the second half of 2013. Paramount is also participating in the expansion of the third-party operated Smoky plant from 100 MMcf/d to 300 MMcf/d. The Company will hold capacity of 60 MMcf/d when this expansion is completed near the end of 2013. We are continuing an aggressive drilling program in Kaybob to ensure sufficient well deliverability to fill these plants when they come into service.

The Company is building two new state-of-the-art drilling rigs, which should provide significant cost savings for our drilling programs on our resource plays. We are also continuing to adapt our drilling program to the changing commodity price environment, and are now targeting wells with the highest possible liquids contents to take advantage of higher relative pricing for natural gas liquids, particularly compared to the price of dry natural gas.

At Valhalla, Paramount continues to successfully drill horizontal wells into the Lower Montney formation, and has now de-risked for development two additional intervals in the Lower Doig and Upper Montney. This has significantly increased the location inventory in the area. During 2011 the Company completed the construction of new facilities at Valhalla that can handle 14 MMcf/d of raw gas production, and has recently finished an expansion to double processing capacity to 28 MMcf/d. With three resource targets in the Upper Montney,

Lower Montney and Doig formations, Paramount expects that Valhalla could be an exciting area of material production and reserve growth in the next several years.

Paramount was also successful in late 2011 in testing a new Montney horizontal liquids rich natural gas play at Birch in Northeast British Columbia. The initial well tested at approximately 2.7 MMcf/d of gas and 65 Bbl/MMcf of associated NGLs. The Company drilled two additional wells into the play in early 2012 and has constructed a pilot facility with capacity to handle approximately 4 MMcf/d in order to assess the longer term performance of these wells. Should this pilot be successful, Birch could prove to be a considerable resource for the Company to exploit in the future.

In the Southern area, Paramount completed a successful drilling program in the Enchant area in 2011, offsetting production declines in this operating unit with new oil production from the Arcs formation.

In North Dakota, Paramount sold approximately 6,000 net acres of undeveloped land for approximately US$40 million, approximately $6,700/acre, and four additional wells were drilled on the Company's joint venture lands with improved results. Paramount has initiated a process to sell all of its U.S. assets, which are held in its wholly-owned US subsidiary, Summit Resources, Inc. Results of this process are expected in the second quarter of 2012.

Non-core asset sales in the Southern area were completed in early 2012 generating proceeds of approximately $50 million, with negligible loss of existing production. The sales did result in the loss of approximately 2,500 Boe/d of production that would have otherwise come on stream in late 2012.

Through its 2011 capital expenditure program and acquisitions, Paramount grew its proved reserves 39 percent to 35.7 MMBoe, its proved plus probable reserves by 32 percent to 53.0 MMBoe and replaced 193 percent of 2011 production. The Company was able to add proved plus probable reserves, excluding major facility costs, at a finding and development cost of $24.19/Boe. The Kaybob area, where the majority of the Company's capital spending is focused, delivered proved plus probable finding and development costs of $13.57/Boe in 2011, excluding major facility costs. These finding and development costs compare favorably to the estimated netback of over $30.00/Boe Paramount expects to receive in the Kaybob area when its deep cut facilities are completed, and would result in a 2.2 times recycle ratio.

The market value of Paramount's investment portfolio increased dramatically during 2011 to reach $1.1 billion at year-end, a 114 percent increase from $502.9 million at the end of 2010. Paramount's most significant holdings at December 31, 2011 included 24.1 million shares of Trilogy Energy Corp., 3.7 million shares of MEG Energy Corp. and three drilling rigs which operate under Fox Drilling and Paramount Drilling U.S. In January 2012, Paramount completed a secondary offering of 5 million of its Trilogy Energy shares for gross proceeds of $189.5 million. The market value of Paramount's investment portfolio at the end of February 2012 was approximately $800 million which represents slightly less than $10.00 per Paramount share in value. Paramount continues to be excited with the business prospects of these entities and believes that their success will provide further increases to Paramount's shareholder value.

During 2011 Paramount created a new entity, Cavalier Energy Inc., to hold and develop the Company's oilsands assets. The short term goals for Cavalier are to submit an application for the first phase of development of the Hoole property, to continue to build a management team capable of executing oilsands development projects, and to source financing to pursue its projects. In 2011, Paramount received an updated evaluation of the Hoole asset which showed the best estimate economic contingent resource to be 763 million barrels with an NPV 10% value of $2.8 billion. During the year Paramount also received an independent assessment that estimated over 6 billion barrels of Discovered and Undiscovered Exploitable Bitumen in Place in Cavalier's Grosmont Carbonate lands. Paramount is excited about the business prospects for Cavalier and looks forward to it making rapid progress in achieving its goals during 2012.

In May 2011, Paramount completed the corporate acquisition of ProspEx Resources. This acquisition added production of approximately 3,200 Boe/d and proved plus probable reserves of approximately 6.9 million Boe as of June 1, 2011. The principal objective of this acquisition was the strategic consolidation of lands and facilities in Musreau and Kakwa in the Kaybob area.

Paramount continues to adapt to the rapidly changing business environment in which we operate. Industry, including Paramount, continues to drive the advancement of new technologies to maximize return on investment. These new technologies have changed the industry resulting in a material oversupply of natural gas in the short term. This has served to push the price of natural gas to below $2.00/Mcf. While Paramount believes the current low natural gas price is unsustainable, the reality is that the longer term price will be lower than that enjoyed over the last 10 years when supplies were not as plentiful. Prices for oil have behaved much differently than those for natural gas, with a tightening supply/demand balance and geopolitical pressures increasing crude oil market prices to over $100/Bbl. Paramount believes that it can be very competitive in the current commodity price environment, and grow its netback on its production by focusing its development activities on its most liquids rich natural gas projects and building the facilities necessary to profitably produce this liquids rich gas stream. The multi-year projects that Paramount has chosen to pursue are much larger and more integrated than in the past, and will cause the Company's growth to occur in step changes.

Paramount believes it has captured and now controls some of the best and most economic liquids rich natural gas prospects. We expect the large disparity between natural gas prices and oil prices will subside with time as end-users capitalize on the low cost of natural gas, thereby increasing the demand for gas at the expense of oil and coal. At the same time, the supply of natural gas should decline rapidly as capital spending on natural gas is reduced due to poor economics at these low natural gas price levels. We are already seeing this happening as the number of rigs drilling for natural gas has dropped from over 900 to less than 650. The natural gas price recovery will take time. Paramount is confident that with its competitive advantages of an extensive inventory of low cost liquids rich gas prospects and ownership of growing processing capacity, it can capitalize on its opportunities and generate high margins and returns on its invested capital in the current price environment. As prices improve, this will only serve to further increase shareholder value.

Paramount's 2012 guidance forecasts a 43 percent increase in production to an average of 25,000 Boe/d based on an exploration and development capital expenditure budget of $475 million, with operating costs of about $10.00/Boe. Paramount also plans to invest a further $60 million in its strategic investments in drilling rigs, oilsands, and shale gas. In addition to anticipated 2012 cash flows, the Company has funded most of its aggressive 2012 capital program in advance through approximately $220 million of equity financings in late 2011, $190 million of gross proceeds from the sale of Trilogy shares and $50 million of proceeds from non-core property dispositions. The Company's 2012 capital program includes significant investments in facilities and wells to provide for continued production growth through 2013 and 2014.

/s/ J.H.T. Riddell

J.H.T. Riddell
President and Chief Operating Officer
March 26, 2012

2011 OVERVIEW

Principal Properties

- Proved reserves increased by 39 percent to 35.7 MMBoe. Proved plus probable reserves increased by 32 percent to 53.0 MMBoe. The Company replaced 193 percent of 2011 production.
- Proved plus probable finding and development costs, excluding facilities and gathering system construction costs, were $24.19/Boe for the Company and $13.57/Boe for the Kaybob COU.
- Average sales volumes in 2011 increased 34 percent to 17,426 Boe/d. Netback increased 34 percent to $127.8 million in 2011 compared to $95.1 million in 2010.
- The Kaybob COU increased its sales volumes by 86 percent to 8,361 Boe/d in 2011 compared to 4,495 Boe/d in 2010. Construction of phase two of the Musreau facility, an incremental 200 MMcf/d deep cut liquids extraction plant, will begin in 2012. Procurement of long lead-time equipment has already commenced.
- In May 2011, Paramount completed its acquisition of ProspEx Resources Ltd. ("ProspEx"), adding significant land holdings and producing assets in the Deep Basin at Kakwa, Elmworth and Wapiti and land holdings at Pembina and Brazeau in Southern Alberta.
- The Southern COU divested non-core properties during the first quarter of 2012 at West Pembina, Alberta and Kindersley, Saskatchewan for total proceeds of approximately $50 million.
- In the first quarter of 2012 Paramount and its wholly-owned subsidiary Summit Resources, Inc. ("Summit") initiated a process to sell Summit and its United States properties.

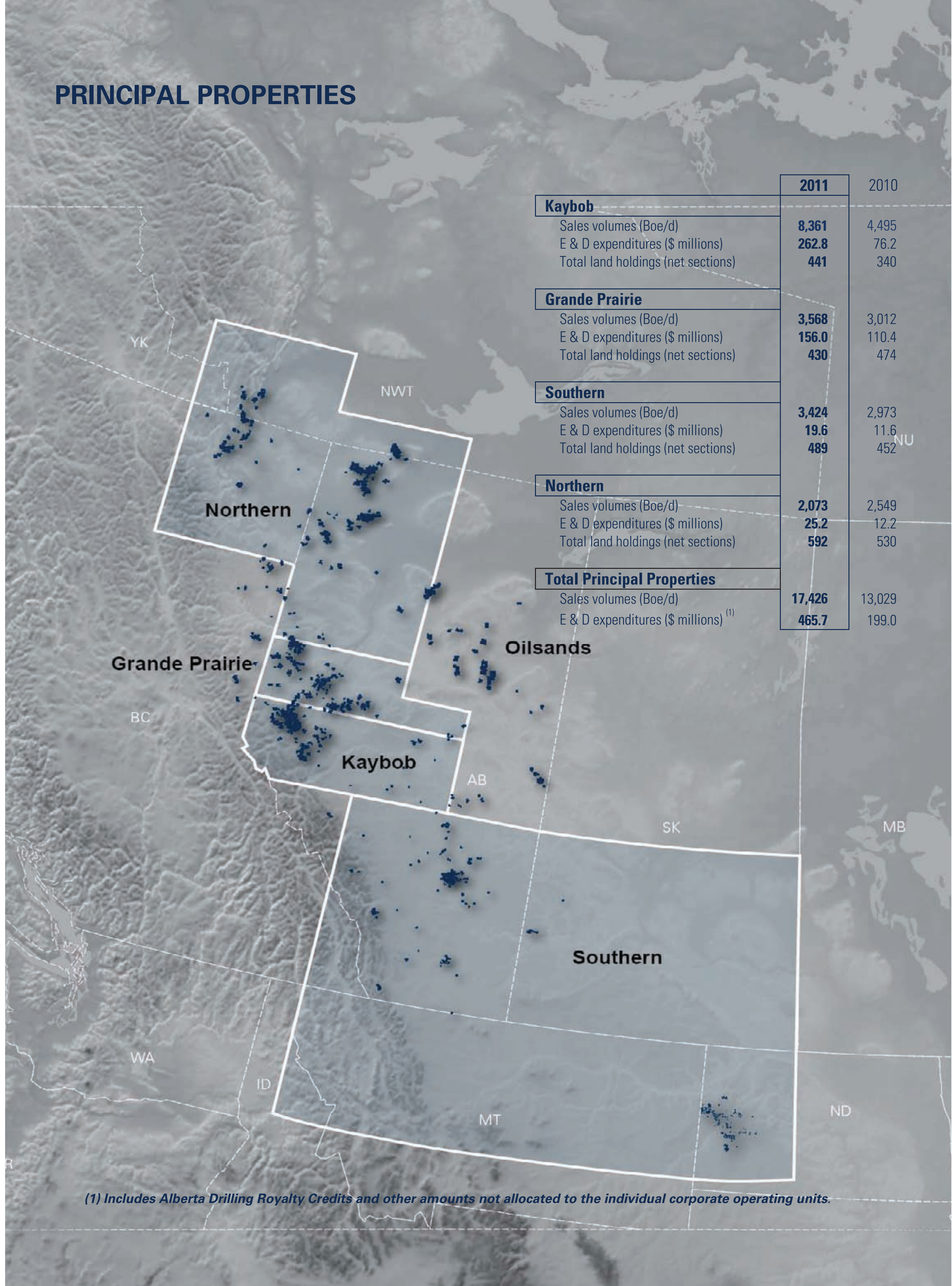
Strategic Investments

- The market value of Paramount's portfolio of investments in other oil and gas entities increased 114 percent to $1.1 billion at December 31, 2011, primarily due to an increase in the market price of Trilogy Energy Corp. ("Trilogy") shares. In January 2012, Paramount received $189.5 million in gross proceeds from the sale of 5.0 million of its 24.1 million Trilogy shares.
- In July 2011, the Company received an updated independent evaluation of its bitumen resources within the Grand Rapids formation at its Hoole oil sands property. Estimated economic contingent bitumen resources increased 20 percent from the April 2010 evaluation to 763 million barrels (Best Estimate (P50)). The before-tax net present value of future net revenue of such economic contingent resources, discounted at ten percent (Best Estimate (P50)), increased 49 percent to $2.8 billion.
- In November 2011, Paramount reorganized all of the Company's oil sands and carbonate bitumen interests into a new wholly-owned subsidiary; Cavalier Energy Inc. ("Cavalier Energy"). The reorganization was undertaken to create a focused, self-funding oil sands entity in order to accelerate the development of Paramount's bitumen interests.

Corporate

- Between December 2010 and November 2011, Paramount raised approximately $650 million through debt and equity issuances, providing financial flexibility to support the Company's plans for a large-scale Deep Basin liquids-rich natural gas development and strengthening its balance sheet.
- General and administrative costs per Boe decreased 17 percent in 2011 to $2.66 per Boe compared to $3.19 per Boe in 2010.

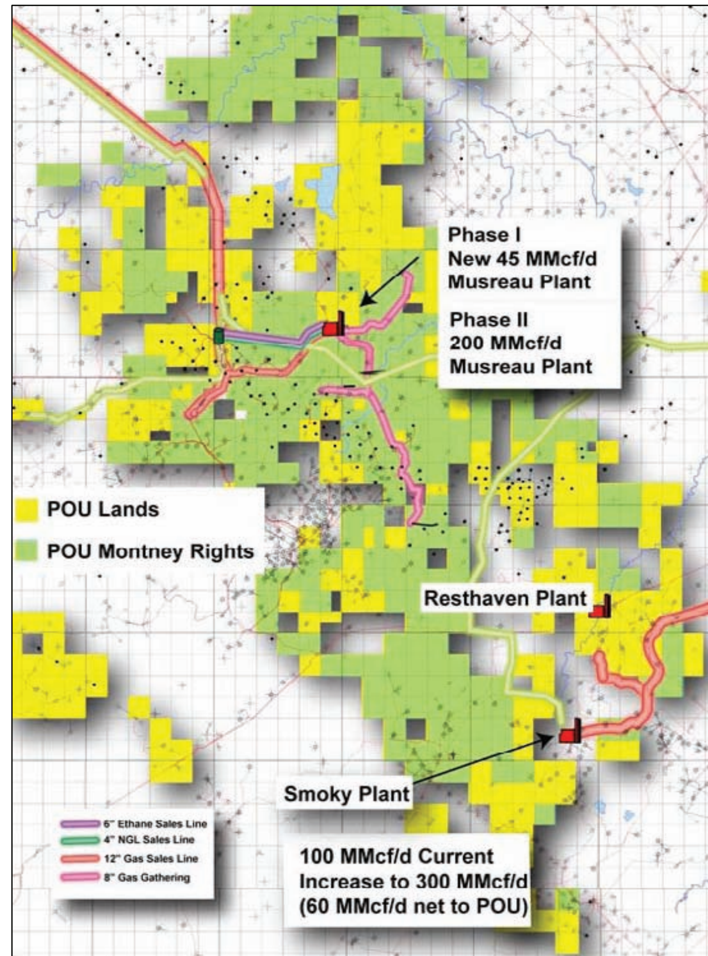
PRINCIPAL PROPERTIES



	2011	2010
Kaybob		
Sales volumes (Boe/d)	**8,361**	4,495
E & D expenditures ($ millions)	**262.8**	76.2
Total land holdings (net sections)	**441**	340
Grande Prairie		
Sales volumes (Boe/d)	**3,568**	3,012
E & D expenditures ($ millions)	**156.0**	110.4
Total land holdings (net sections)	**430**	474
Southern		
Sales volumes (Boe/d)	**3,424**	2,973
E & D expenditures ($ millions)	**19.6**	11.6
Total land holdings (net sections)	**489**	452
Northern		
Sales volumes (Boe/d)	**2,073**	2,549
E & D expenditures ($ millions)	**25.2**	12.2
Total land holdings (net sections)	**592**	530
Total Principal Properties		
Sales volumes (Boe/d)	**17,426**	13,029
E & D expenditures ($ millions) [(1)]	**465.7**	199.0

(1) Includes Alberta Drilling Royalty Credits and other amounts not allocated to the individual corporate operating units.

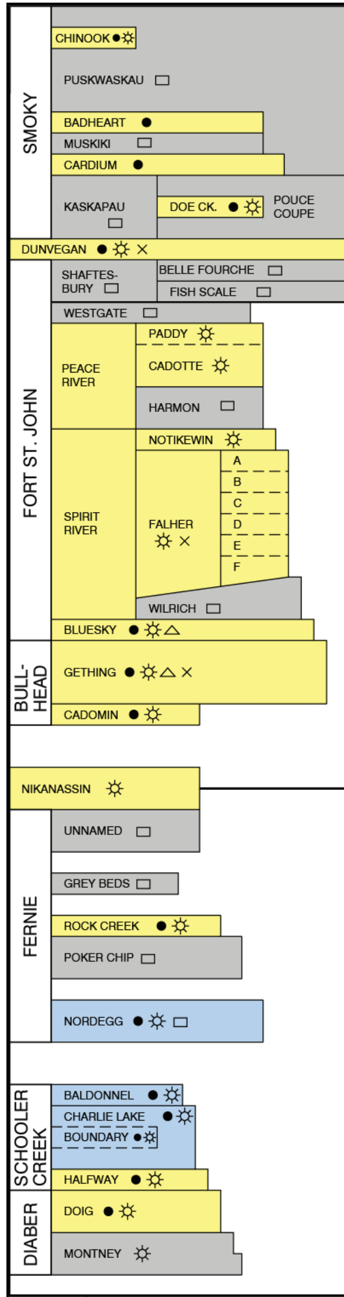
KAYBOB



	2011		2010		% Change
Sales Volumes					
Natural Gas (MMcf/d)	**44.5**		23.5		89
NGLs (Bbl/d)	**868**		495		75
Oil (Bbl/d)	**72**		79		(9)
Total (Boe/d)	**8,361**		4,495		86
Exploration and Development Expenditures[(1)] ($ millions)					
Exploration, drilling, completions and tie-ins	**171.2**		61.8		177
Facilities and gathering	**91.6**		14.4		536
	262.8		76.2		245
	Gross	**Net**	Gross	Net	
Total Land Holdings (sections)	**792**	**441**	661	340	
Wells drilled	**28**	**18**	16	7	

(1) Before the deduction of Alberta Drilling Royalty credits.

The Kaybob corporate operating unit ("COU") operates in West Central Alberta, where its core properties are in the Deep Basin at Musreau, Smoky and Resthaven. The Company has assembled an extensive land holding of 792 (441 net) sections with varying rights to multiple formations from the Cretaceous to the Montney. With well densities of up to eight wells per section per formation forecast to be required to recover these resources, Paramount's Deep Basin land position represents a multi-decade inventory of drilling locations.



Paramount is executing a large-scale development on these lands that is expected to significantly increase the Kaybob COU's production volumes. The Company's drilling activities over the past few years have substantially de-risked the Cretaceous Dunvegan and Falher formations, which are high pressure, liquids rich, tight gas formations with large reserves potential. With the high liquids content in these formations, these plays continue to be economic despite the current low natural gas price environment. Paramount has also continued the evaluation of its Montney holdings, a deeper horizon in which the Company's initial wells have exhibited higher liquids yields than the Cretaceous zones and are expected to provide higher rates of return despite higher drilling costs related to increased depths. A combination of Cretaceous and Montney opportunities will support the Company's accelerated development plans and the construction of deep-cut processing facilities.

Average daily sales volumes in the Kaybob COU during 2011 were 8,361 Boe/d, an increase of 86 percent compared to 2010. The increase was primarily the result of new wells being brought on in Musreau and Resthaven, and wells added through the acquisition of ProspEx. During the year, the Kaybob COU reached the limit of its available owned capacity, contracted firm service capacity and interruptible processing capacity, which resulted in the temporary shut-in of a number of wells. In mid-December the Company completed construction of its new 45 MMcf/d processing facility at Musreau. A key electrical component within the facility failed shortly after start-up, resulting in the plant having to be shut-down for repairs. Commissioning of the facility is underway, and gas sales are expected to recommence in mid-March.

During 2011 the Kaybob COU drilled 28 (18.3 net) wells, completed and tied-in 17 (10.0 net) wells, including 10 (6.8 net) operated Falher and Dunvegan wells. Subsequent to year-end, an additional seven (3.8 net) Falher and Dunvegan wells were completed, of which three (3.0 net) were equipped and tied-in. Some of these wells are shut-in in preparation for the Musreau plant to be ramped up to design capacity before they are brought on production. Paramount currently has an additional two (2.0 net) Falher and Dunvegan wells awaiting completion and tie-in.

The following table summarizes test results and average natural gas sales volumes for operated Cretaceous wells rig released during 2011:

Location	Formation	Test Results[1] Avg. Rate (MMcf/d)	Test Results[1] Pressure[2] (PSI)	Test Results[1] Duration (Hrs)	Average Sales Volumes First Month (MMcf/d)	Average Sales Volumes First 3 Months (MMcf/d)	Average Sales Volumes Liquids Yield (Bbl/MMcf)
Resthaven	Dunvegan	16.1	2,422	8.5	9.0	5.0	25
Resthaven	Dunvegan	12.5	1,820	6.5	7.4	◈	✦
Smoky	Dunvegan	13.8	1,340	8.5	6.4	6.2	38
Smoky	Dunvegan	10.8	1,837	6	4.5	◈	✦
Smoky	Dunvegan	13.5	2,546	16.5	◆	◈	✦
Smoky	Dunvegan	14.4	1,670	2.5	◆	◈	✦
Musreau	Dunvegan	5.1	1,014	8.5	◆	◈	✦
Musreau	Falher	21.4	3,026	1.5	7.7	8.5	14
Musreau	Falher	18.9	3,125	2.0	10.6	8.9	19
Musreau	Falher	17.7	2,883	3.5	7.8	6.1	21
Musreau	Falher	18.4	2,929	1.5	7.7	6.1	16
Musreau	Falher	19.6	2,765	13	7.1	◈	✦
Musreau	Falher	13.7	1,880	10	◆	◈	✦
Musreau	Falher	20.5	3,284	9.5	◆	◈	✦
Musreau	Falher	19.4	3,177	10.5	◆	◈	✦
Musreau	Falher	29.6	2,668	1.5	◆	◈	✦
Musreau	Falher	14.0	1,901	6.5	◆	◈	✦

(1) Readers are referred to the heading "Test Results" within the "Advisories" section of this document for further information.
(2) Average flow-back casing pressure for the duration of the test.
(◆) Well has not been on production one month or longer.
(◈) Well has not been on production three months or longer.
(✦) Load fluids have not been fully recovered.

The Company has assembled a total of 209 (176 net) sections of Montney rights, and has drilled and completed five (4.5 net) horizontal wells to date. The first Montney well (0.5 net) was tied-in during 2011, with sales volumes averaging approximately 4.1 MMcf/d of natural gas and 79 Bbl/MMcf of NGLs over its first 90 days of production. The Company anticipates two (2.0 net) Montney wells will be brought on production in the third quarter of 2012. The following table summarizes test results and average natural gas sales volumes for operated Montney wells rig released during 2011:

Location	Formation	Test Results[1] Avg. Rate (MMcf/d)	Test Results[1] Pressure[2] (PSI)	Test Results[1] Duration (Hrs)	Average Sales Volumes First Month (MMcf/d)	Average Sales Volumes First 3 Months (MMcf/d)	Average Sales Volumes Liquids Yield (Bbl/MMcf)
Musreau	Montney	12.0	2,030	5.5	3.1	◈	✦
Musreau	Montney	8.5	1,589	15	◆	◈	✦
Musreau	Montney	7.2	2,430	6	◆	◈	✦

(1) Readers are referred to the heading "Test Results" within the "Advisories" section of this document for further information.
(2) Average flow-back casing pressure for the duration of the test.
(◆) Well has not been on production one month or longer.
(◈) Well has not been on production three months or longer.
(✦) Load fluids have not been fully recovered.

The Kaybob COU is currently operating four drilling rigs on its Deep Basin properties, and the Company has commissioned the construction of an additional two triple-sized walking rigs to be owned and operated by Fox Drilling Inc. ("Fox Drilling"), a wholly-owned subsidiary of Paramount, that are expected to drill on the Kaybob lands during the 2012/2013 winter drilling season. The Company plans to drill and complete additional wells throughout 2012 and 2013 in preparation for new processing capacity that will be added during the second half of 2013, and in the interim will produce volumes held behind pipe on interruptible service to maximize value. The Kaybob COU currently anticipates drilling up to 27 (18.3 net) wells in 2012, including up to five (4.0 net) Montney wells.

Design and procurement of long lead-time equipment has commenced for phase two of the Musreau processing facility, an incremental 200 MMcf/d deep cut liquids extraction facility. Construction is

anticipated to begin this fall once regulatory approvals have been obtained. The incremental capacity will be used to process Paramount natural gas as well as third party natural gas for a fee. It is anticipated that construction of this second phase will be completed during the second half of 2013 at an estimated cost of $180 million. The addition of deep cut facilities will add significant value to Paramount's natural gas production due to the price premium realized from the extraction and sale of additional NGLs volumes that would otherwise be sold as slightly higher heat content natural gas.

At Smoky, procurement activities relating to the expansion of a non-operated processing plant have also commenced, with orders being placed for long lead-time components. The existing 100 MMcf/d (10 MMcf/d net) facility is being expanded to 300 MMcf/d (60 MMcf/d net) and upgraded to operate as a deep cut liquids extraction facility. Initially, compression capacity for 200 MMcf/d will be installed, with an additional 100 MMcf/d of compression to be added when production volumes warrant the investment, thereby deferring a portion of the capital costs. The expansion is expected to be completed in late-2013.

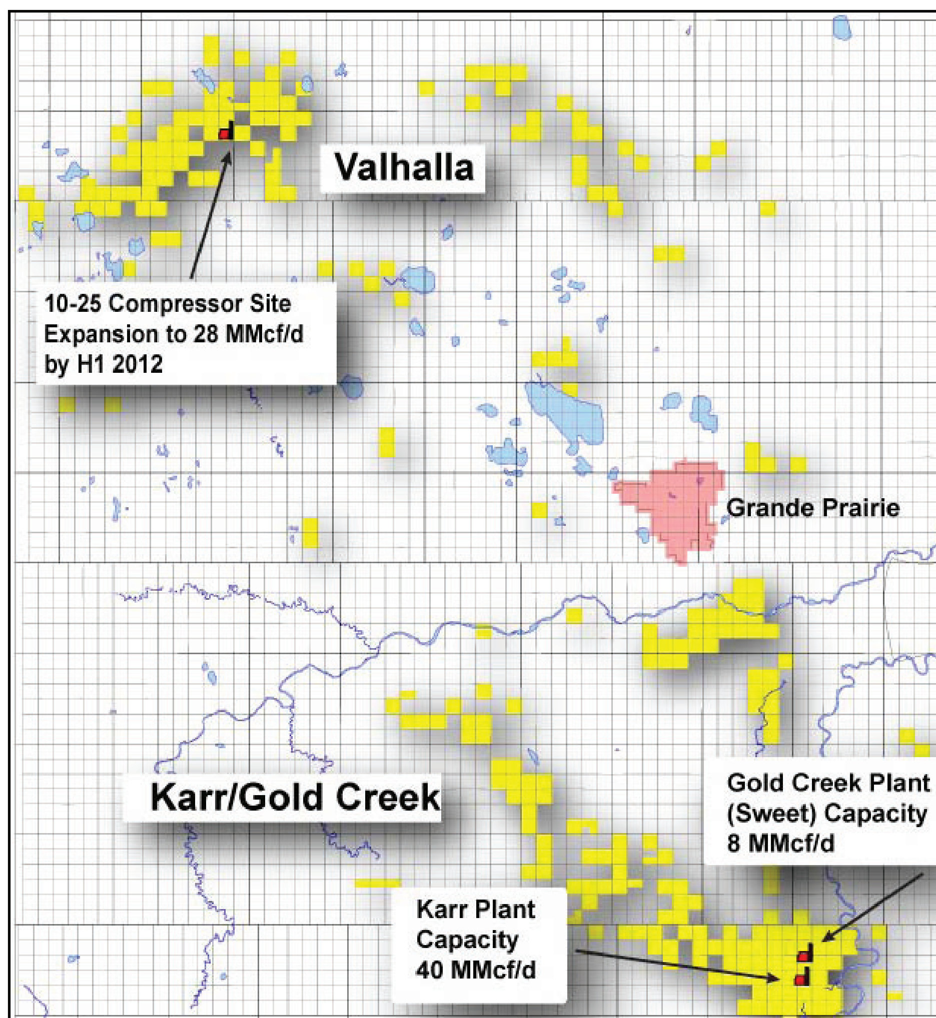
With the start-up of the first phase of the Musreau plant, Paramount will have 49 MMcf/d of Company owned capacity and 10 MMcf/d of firm-service third-party processing capacity in Musreau-Kakwa. Paramount also has 20 MMcf/d of Company-owned processing capacity in the Resthaven-Smoky area. Throughout 2012 and into 2013, the Company expects to have an aggregate of 79 MMcf/d of Company-owned and third party firm service capacity and will utilize interruptible service where available until the expansions of the Musreau and Smoky plants are completed. Paramount currently has access to an additional 10 to 12 MMcf/d of interruptible capacity at Musreau/Cutbank.

The Kaybob COU's current and expected future Company-owned and firm-service third-party processing capacity in the Deep Basin is as follows:

	Gross Raw Gas Plant Capacity	**Net Paramount Raw Gas Plant Capacity**	**Net Paramount Estimated Sales Plant Capacity[1]**
Current Capacity	(MMcf/d)	(MMcf/d)	(Boe/d)
Musreau – Operated	45	45	**8,600**
Kakwa – Non-operated	40	4	**720**
Musreau/Cutbank – Contracted firm service	10	10	**1,800**
Resthaven – Non-operated	20	10	**1,800**
Smoky Plant – Non-operated	100	10	**1,800**
	215	**79**	**14,720**
Future Capacity			
Musreau Phase II Deep-Cut – Operated	200	200	**50,000**
Smoky/Resthaven Deep-Cut – Non-operated	200	30	**6,750**
	400	**230**	**56,750**
Total – Year-end 2013	**615**	**309**	**71,470**

[1] Estimated

GRANDE PRAIRIE



	2011		2010		% Change
Sales Volumes					
Natural Gas (MMcf/d)	**16.0**		12.4		29
NGLs (Bbl/d)	**505**		367		38
Oil (Bbl/d)	**393**		583		(33)
Total (Boe/d)	**3,568**		3,012		18
Exploration and Development Expenditures[(1)] ($ millions)					
Exploration, drilling, completions and tie-ins	**106.4**		81.6		30
Facilities and gathering	**49.6**		28.8		72
	156.0		110.4		41
	Gross	**Net**	Gross	Net	
Total Land Holdings (sections)	**629**	**430**	703	474	
Wells drilled	**22**	**15**	16	14	

(1) Before the deduction of Alberta Drilling Royalty credits.

The Grande Prairie COU operates in the Peace River Arch area of Alberta. Core producing areas include Karr-Gold Creek, Valhalla and Mirage. Average daily sales volumes in the Grande Prairie COU during 2011 were 3,568 Boe/d, an increase of 18 percent compared to 2010. The increase was primarily the result of production increases in Valhalla, as a new gathering and compression system was brought on stream, and at Karr-Gold Creek.

VALHALLA

Valhalla is located approximately 70 km northwest of Grande Prairie. Paramount owns approximately 67 (47 net) sections of land in this area which has multi-zone potential, including in the Montney and Lower Doig formations. The Company's activities at Valhalla accelerated in 2011, with the drilling of 8 (5.7 net) wells and 7 (5.3 net) wells being brought on production. The wells drilled in 2011, which primarily target the Montney formation, have yielded promising results, with significant liquids yields.

A new 10 MMcf/d compression and gathering system was commissioned in the second quarter of 2011. Construction of an expansion to this system to bring total capacity to 28 MMcf/d is near completion and expected to be operational in the second quarter of 2012. Due to capacity constraints four (2.2 net) wells have been temporarily shut-in and will be re-started when the expanded compression capacity is available.

The Grande Prairie COU plans to drill up to 9 (5.0 net) operated and non-operated wells at Valhalla in 2012.

KARR-GOLD CREEK

Paramount has assembled a land position of approximately 180 (148 net) sections at Karr-Gold Creek, located 50 km southwest of Grande Prairie. Exploration activities continued on the play during 2011, as the Company worked to optimize recovery systems and increase production from existing wells. Since commencing exploration of Karr-Gold Creek in 2008, the Company has brought 10 (9.7 net) lower Montney horizontal wells on production. To date, the performance of these wells has been below expectations, with current aggregate production averaging approximately 6 MMcf/d. A number of operational challenges in 2011 impacted the Company's effort to improve well performance, including inconsistent production resulting from multiple unplanned third party processing interruptions totalling 77 days and delays in the delivery of surface equipment.

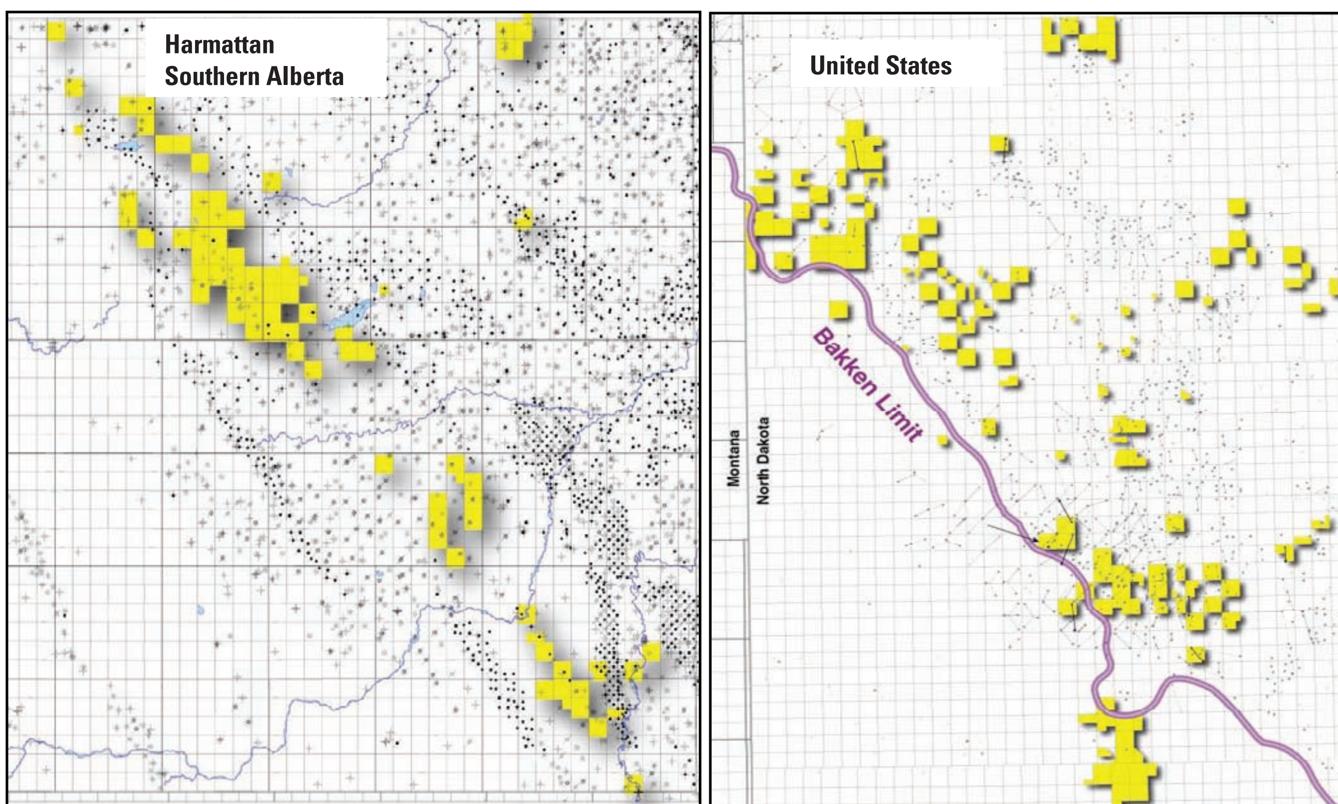
During 2012, Paramount plans to bring three (3.0 net) lower Montney horizontal wells that were drilled during 2011 onto production and complete a previously drilled horizontal well in a Middle Montney reservoir.

The Company completed expansions to gathering and compression systems at Karr-Gold Creek during the year, with sour gas capacity being increased to 40 MMcf/d and sweet gas capacity of 8 MMcf/d. The sweet development at Karr-Gold Creek has targeted various Deep Basin Cretaceous formations and the Triassic Nikanassin formation, with ten (6.0 net) wells being drilled in 2011 and 9 (6.1 net) wells being placed on production. The sweet compression facility is operating near capacity, with five (3.5 net) wells awaiting tie-in. Two (1.5 net) sweet wells are planned to be drilled in 2012.

ANTE CREEK

Three (2.0 net) wells were drilled at Ante Creek in 2011 targeting oil from the Montney formation. The first well is producing at approximately 200 Bbl/d (100 Bbl/d net), the maximum currently permitted under regulation, a second well was dry and abandoned and a third well was completed during the first quarter of 2012. The exploration program at Ante Creek has experienced delays due to regulatory issues, production equipment failures and midstream service interruptions. Paramount anticipates developing plans for further activities at Ante Creek once the performance of the latest well is known and the regulatory matters have been successfully resolved.

SOUTHERN



	2011		2010		% Change
Sales Volumes					
Natural Gas (MMcf/d)	**10.8**		9.3		16
NGLs (Bbl/d)	**150**		59		154
Oil (Bbl/d)	**1,483**		1,363		9
Total (Boe/d)	**3,424**		2,973		15
Exploration and Development Expenditures[1] ($ millions)					
Exploration, drilling, completions and tie-ins	**14.9**		9.3		60
Facilities and gathering	**4.7**		2.3		104
	19.6		11.6		69
	Gross	**Net**	Gross	Net	
Total Land Holdings (sections)	**708**	**489**	638	452	
Wells drilled	**22**	**12**	27	17	

[1] Before the deduction of Alberta Drilling Royalty credits.

The Southern COU operates in Southern Alberta, Saskatchewan, North Dakota and Montana. Core areas in Southern Alberta include the natural gas producing Chain-Craigmyle and Harmattan properties and the oil producing property at Enchant. In the United States, the Southern COU's core oil producing area is in North Dakota near Medora. The Southern COU's average sales volumes increased 15 percent in 2011 compared to 2010, primarily as a result of production from wells added through the ProspEx acquisition at Harmattan and Pembina.

CANADA

At Chain, 13 (13.0 net) wells were brought on production in 2011, which added new production to replace natural declines. The Company does not plan to carry out any natural gas drilling at Chain in 2012 due to the current low natural gas price environment.

During the first quarter of 2012, Paramount closed dispositions of non-core properties at West Pembina, Alberta and Kindersley, Saskatchewan for total proceeds of approximately $50 million. These properties did not have significant production volumes.

The Southern COU plans to drill up to 9 (7.5 net) oil wells in Harmattan, Enchant, Delia and Pembina in 2012.

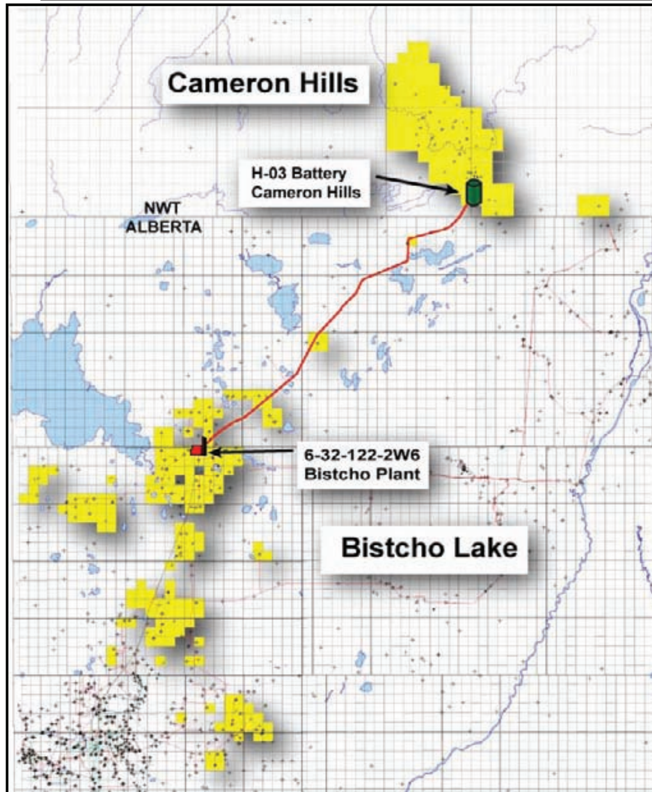
UNITED STATES

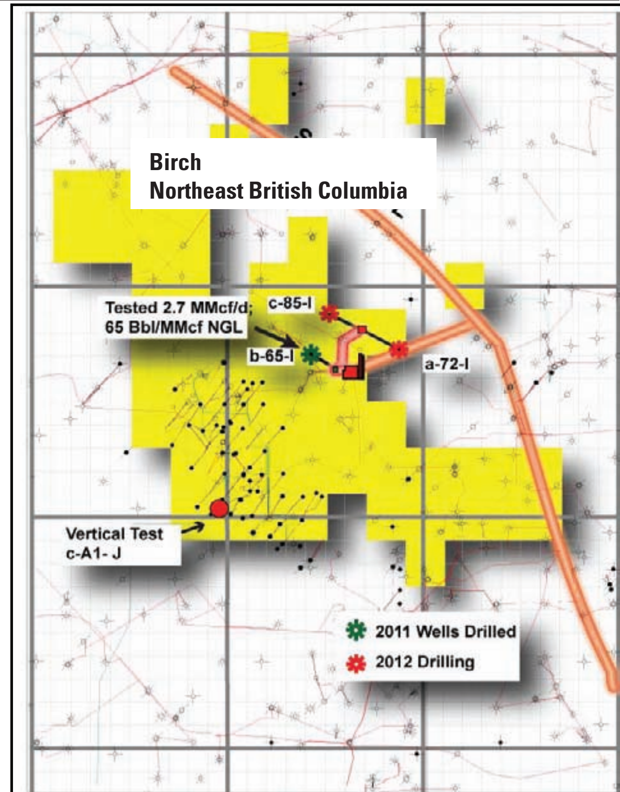
In the United States, Paramount operates through its wholly-owned subsidiary, Summit. In February 2011, Summit sold approximately 6,000 net acres of undeveloped land in North Dakota for cash proceeds of US$40 million.

During the fourth quarter of 2011, Summit's joint venture partner drilled and completed the final earning wells under the parties' joint development agreement, earning an undivided 50 percent interest in Summit's undeveloped Bakken/Three Forks lands in North Dakota.

In the first quarter of 2012 Paramount and Summit initiated a process to sell Summit and all of its United States properties.

NORTHERN





	2011		2010		% Change
Sales Volumes					
Natural Gas (MMcf/d)	**10.3**		12.5		(18)
NGLs (Bbl/d)	**19**		11		73
Oil (Bbl/d)	**343**		460		(25)
Total (Boe/d)	**2,073**		2,549		(19)
Exploration and Development Expenditures[1] ($ millions)					
Exploration, drilling, completions and tie-ins	**21.8**		11.1		96
Facilities and gathering	**3.4**		1.1		209
	25.2		12.2		107
	Gross	**Net**	Gross	Net	
Total Land Holdings (sections)	**959**	**592**	820	530	
Wells drilled	**2**	**2**	5	5	

[1] Before the deduction of Alberta Drilling Royalty credits.

The Northern COU's significant properties are located in the Northwest Territories at Cameron Hills and Liard, in Alberta at Bistcho and in Northeast British Columbia at Birch and Clarke Lake. The Northern COU's average sales volumes decreased by 19 percent in 2011 compared to 2010, primarily as a result of production declines at Cameron Hills and Bistcho.

Paramount owns 60 (60 net) sections of land at Birch that are prospective for liquids-rich natural gas from the Montney formation. The Birch acreage was acquired in 2011 as part of the ProspEx acquisition and through crown land sale purchases. During the third quarter of 2011, Paramount completed its initial

exploratory well with promising results, indicating significant liquid yields. The Company has secured limited access to a gathering system and the well will be brought on production in 2012. Two (2.0 net) additional wells were drilled and completed in the first quarter of 2012 and are expected to be tied-in later in the year.

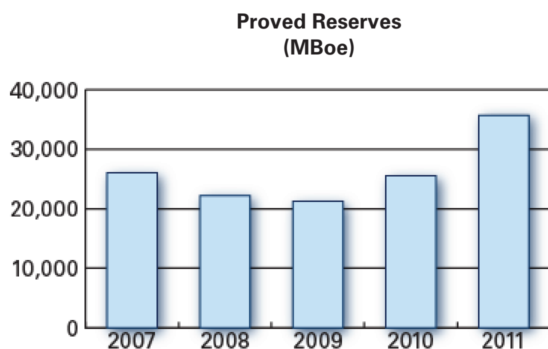
RESERVES

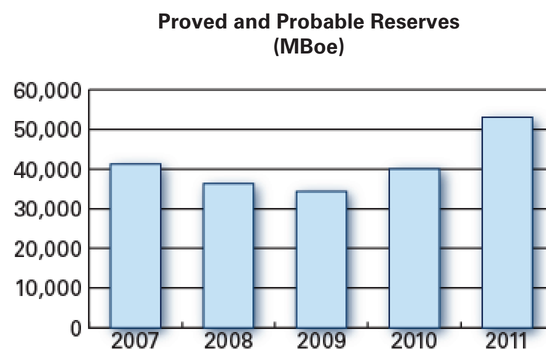
Paramount's estimated proved reserve volumes increased by 39 percent to 35.7 MMBoe at December 31, 2011 compared to 25.6 MMBoe in the prior year. The Company's estimated proved and probable reserve volumes increased by 32 percent to 53.0 MMBoe at December 31, 2011 compared to 40.1 MMBoe in the prior year. The Company achieved a 193 percent reserves replacement ratio on a proved and probable basis, excluding acquisitions. New reserves were added primarily at Musreau, Resthaven and Smoky in the Kaybob COU and from the ProspEx acquisition, partially offset by negative price revisions due to a 22 percent decline in forecast natural gas prices compared to December 2010 and technical revisions due to well performance in certain properties within the Grande Prairie and Northern COUs.

Paramount's reserves for the year ended December 31, 2011 were evaluated by McDaniel & Associates Consultants Ltd. ("McDaniel") and prepared in accordance with National Instrument 51-101 definitions, standards and procedures. The Company's working interest reserves and before tax net present value of future net revenues for the year ended December 31, 2011 using forecast prices and costs are as follows:

	Gross Proved and Probable Reserves[1]				Before Tax Net Present Value[1] ($ millions)		
	Natural Gas	Light & Medium Crude Oil	Natural Gas Liquids	Total	Discount Rate		
Reserves Category	**(Bcf)**	**(MBbl)**	**(MBbl)**	**(MBoe)[2]**	**0%**	**10%**	**15%**
Canada							
Proved							
Developed Producing	120.4	1,930	2,381	24,375	565.3	420.4	374.8
Developed Non-producing	30.6	241	1,128	6,469	147.9	101.3	88.6
Undeveloped	10.5	–	216	1,964	33.1	21.8	18.2
Total Proved	161.5	2,171	3,725	32,808	746.3	543.5	481.6
Total Probable	82.0	981	1,941	16,588	428.7	204.2	155.3
Total Proved plus Probable Canada	243.5	3,152	5,665	49,395	1,175.1	747.7	636.9
United States							
Proved							
Developed Producing	0.5	2,702	75	2,858	109.1	68.3	58.2
Developed Non-producing	–	–	–	–	(0.4)	(0.3)	(0.3)
Undeveloped	–	–	–	–	–	–	–
Total Proved	0.5	2,702	75	2,858	108.7	68.0	57.9
Total Probable	0.1	719	20	762	41.9	16.5	12.3
Total Proved plus Probable USA	0.6	3,421	95	3,620	150.5	84.5	70.2
Total Company							
Total Proved	162.0	4,874	3,799	35,665	855.0	611.4	539.5
Total Probable	82.1	1,699	1,961	17,349	470.6	220.7	167.6
Total Proved plus Probable	**244.1**	**6,573**	**5,760**	**53,015**	**1,325.6**	**832.2**	**707.0**

[1] Columns may not add due to rounding.
[2] Refer to the oil and gas measures and definitions in the "Advisories" section of this document.





Reserves Reconciliation

	Proved Reserves[1]			Probable Reserves[1]			Proved & Probable Reserves[1]		
	Natural Gas	Oil and NGLs	Total	Natural Gas	Oil and NGLs	Total	Natural Gas	Oil and NGLs	Total
	(Bcf)	(MBbl)	(MBoe)[2]	(Bcf)	(MBbl)	(MBoe)[2]	(Bcf)	(MBbl)	(MBoe)[2]
January 1, 2011	112.0	6,906	25,576	69.8	2,876	14,511	181.8	9,782	40,087
Extensions & discoveries	53.2	2,364	11,237	25.9	1,374	5,693	79.2	3,737	16,930
Technical revisions	9.5	(15)	1,576	(13.0)	(831)	(2,994)	(3.4)	(846)	(1,418)
Economic factors	(8.5)	(104)	(1,522)	(9.8)	(49)	(1,690)	(18.4)	(154)	(3,212)
Acquisitions	25.6	929	5,199	9.2	293	1,833	34.9	1,221	7,032
Dispositions	(0.2)	(8)	(40)	–	(1)	(4)	(0.2)	(9)	(44)
Production	(29.8)	(1,399)	(6,360)	–	–	–	(29.8)	(1,399)	(6,360)
December 31, 2011	162.0	8,673	35,666	82.1	3,660	17,349	244.1	12,333	53,015

[1] Columns and rows may not add due to rounding.
[2] Refer to the oil and gas measures and definitions in the "Advisories" section of this document.

Capital Expenditures

Year ended December 31	**2011**	2010
Geological and geophysical	**5.5**	7.6
Drilling, completion and tie-ins	**303.7**	144.8
Facilities and gathering	**156.5**	46.6
Exploration and development expenditures[1]	**465.7**	199.0
Land and property acquisitions	**38.2**	82.7
Principal Properties	**503.9**	281.7
Strategic Investments	**28.0**	16.3
Corporate	**0.1**	0.1
	532.0	298.1

[1] Exploration and development expenditures are presented after the deduction of Alberta Drilling Royalty credits

Finding and Development Costs

Total Company

	Exploration & Development Capital[(1)]		Reserve Additions[(2)]		Finding & Development Costs[(2)]	
	Proved	**Proved Plus Probable**	**Proved**	**Proved Plus Probable**	**Proved**	**Proved Plus Probable**
	($ millions)	($ millions)	(Mboe)	(Mboe)	($/Boe)	($/Boe)
Exploration, drilling, completions and tie-ins	309.2	309.2				
Change in future capital	3.6	(11.6)				
	312.8	**297.6**	**11,291**	**12,300**	**27.70**	**24.19**
Facilities and gathering	156.5	156.5			–	–
Total finding and development capital	**469.3**	**454.1**	**11,291**	**12,300**	**41.57**	**36.92**

[(1)] The aggregate of the exploration and development costs incurred in the most recent financial year and the change during that year in estimated future development costs generally will not reflect total finding and development costs related to reserve additions for that year.
[(2)] Refer to the oil and gas measures and definitions in the "Advisories" section of this document.

Total finding and development costs by year ($/Boe)	**2011**	2010	2009	3-Year Average
Finding and development costs before facilities expenditures				
Proved	**$ 27.70**	$ 21.04	$ 18.47	$ 24.03
Proved plus Probable	**$ 24.19**	$ 20.76	$ 19.07	$ 22.45
Finding and development costs including facilities expenditures				
Proved	**$ 41.57**	$ 27.45	$ 24.05	$ 34.12
Proved plus Probable	**$ 36.92**	$ 26.91	$ 26.76	$ 32.38

Finding and development costs in 2011 were impacted by technical revisions at Karr-Gold Creek and Valhalla in the Grande Prairie COU and at the Nahanni property in the Northern COU.

Finding and development costs for the Kaybob COU, where Paramount is currently focused in developing a large-scale liquids rich play were $13.57 on a proved plus probable basis (excluding facilities and gathering expenditures):

Kaybob COU

	Exploration & Development Capital[(1)]		Reserve Additions[(2)]		Finding & Development Costs[(2)]	
	Proved	**Proved Plus Probable**	**Proved**	**Proved Plus Probable**	**Proved**	**Proved Plus Probable**
	($ millions)	($ millions)	(Mboe)	(Mboe)	($/Boe)	($/Boe)
Exploration, drilling, completions and tie-ins	**171.2**	**171.2**				
Change in future capital	6.4	(15.3)				
	177.6	**155.9**	**9,947**	**11,481**	**17.85**	**13.57**
Facilities and gathering	91.6	91.6			–	–
Total finding and development capital	**269.2**	**247.5**	**9,947**	**11,481**	**27.06**	**21.56**

[(1)] The aggregate of the exploration and development costs incurred in the most recent financial year and the change during that year in estimated future development costs generally will not reflect total finding and development costs related to reserve additions for that year.
[(2)] Refer to the oil and gas measures and definitions in the "Advisories" section of this document.

Total finding and development costs by year ($/Boe)	**2011**	2010	2009	**3 Year Average**
Finding and development costs before facilities expenditures				
Proved	**$ 17.85**	$ 15.79	$ 15.72	$ 17.11
Proved plus Probable	**$ 13.57**	$ 13.18	$ 15.58	$ 13.71
Finding and development costs including facilities expenditures				
Proved	**$ 27.06**	$ 19.63	$ 22.60	$ 24.73
Proved plus Probable	**$ 21.56**	$ 16.30	$ 20.44	$ 20.05

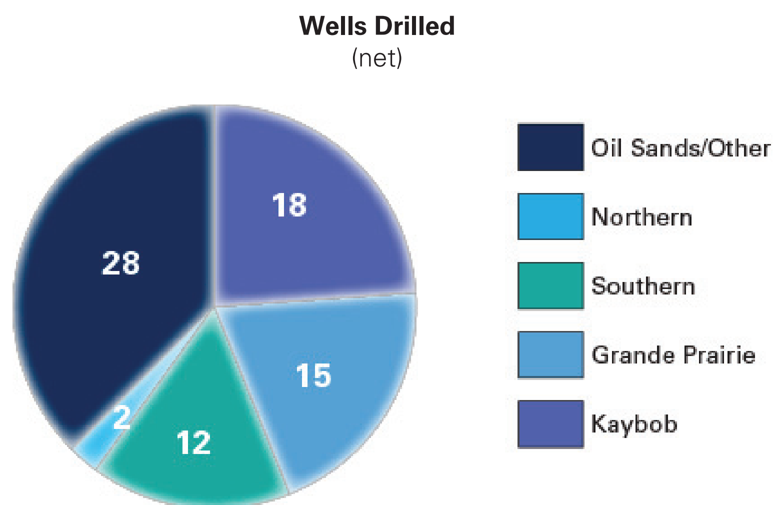
DRILLING AND LAND

Paramount's drilling activities in 2011 focused on liquids-rich natural gas and oil targets opportunities. The Company's drilling activities have increased as a result of the expansion of Deep Basin development in the Kaybob COU and oil wells drilled in Saskatchewan, Southern Alberta and North Dakota. Resources are being allocated to the highest quality assets with the highest expected rates of return, and the Company is positioned for material production and reserve growth over the next few years.

Drilling	**2011**		2010	
(wells drilled)	**Gross**[1]	**Net**[2]	Gross[1]	Net[2]
Gas	**47**	**32**	34	23
Coal bed methane	**–**	**–**	13	10
Oil	**26**	**15**	13	6
Oil sands evaluation	**28**	**27**	45	45
Dry and abandoned	**1**	**1**	4	4
Total	**102**	**75**	109	88

(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.

Wells Drilled
(net)



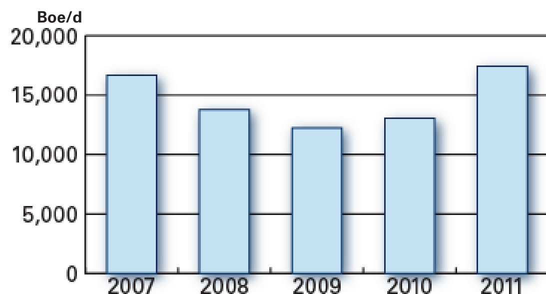
Land	**2011**			2010		
(000's of acres)	**Gross[(1)]**	**Net[(2)]**	**Average Working Interest**	Gross[(1)]	Net[(2)]	Average Working Interest
Undeveloped land	**1,736**	**1,225**	**71%**	1,682	1,198	71%
Acreage assigned reserves	**574**	**334**	**58%**	580	311	54%
	2,310	**1,559**	**67%**	2,262	1,509	67%
Value of undeveloped land[(3)] ($ millions)	**$ 224.3**			$ 236.3		

(1) "Gross" acres means the total acreage in which Paramount has an interest.
(2) "Net" acres means Paramount's gross working interest acres multiplied by Paramount's working interest therein.
(3) Based on McDaniel's Evaluation of Unproven Acreage Interests.

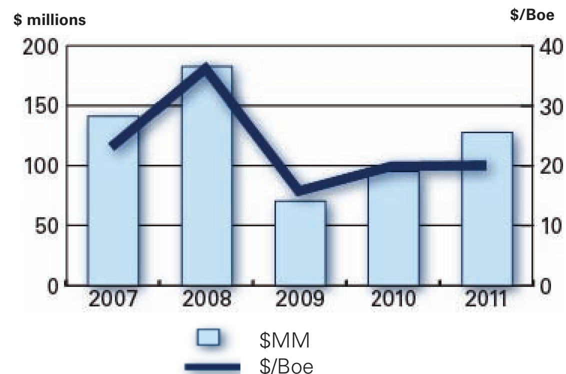
OPERATING RESULTS

Paramount's average sales volumes increased 34 percent in 2011 compared to the prior year, and current production levels are the highest the Company has achieved in the last five years. Paramount continues to focus on controlling its operating and general and administrative costs, and per unit costs are expected to decrease further as additional production is added without significantly impacting the Company's operating structure.

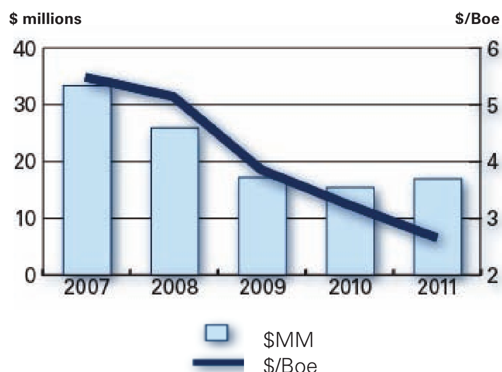
Average Sales Volumes



Netback



General and Administrative Expenses



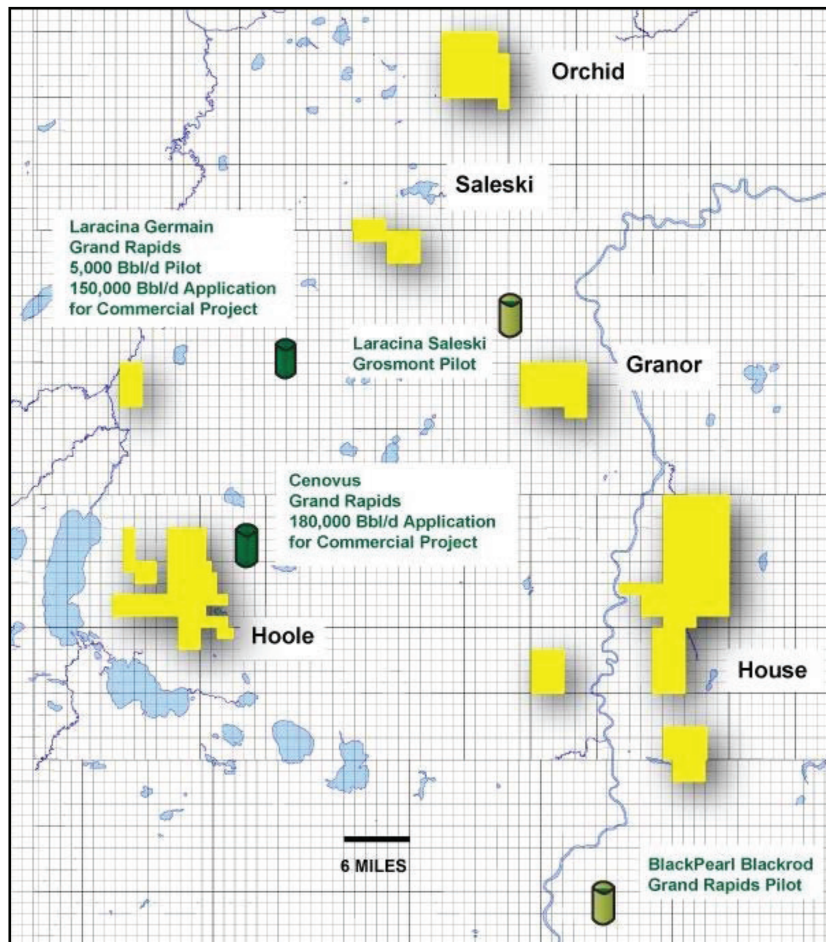
Operating Expenses

STRATEGIC INVESTMENTS

OIL SANDS

In November, 2011 Paramount reorganized all of its oil sands and carbonate bitumen interests into a new wholly-owned subsidiary, Cavalier Energy and assembled its executive leadership team. The reorganization was undertaken to create a focused, self-funding oil sands entity in order to accelerate the development of Paramount's bitumen interests.

Cavalier Energy owns approximately 275 sections of Crown oil sands leases in the western Athabasca region of Alberta, of which 267 sections are 100 percent owned and 8 sections are 50 percent owned. Cavalier Energy's properties include approximately 56 sections of land at Hoole, which are primarily prospective for bitumen in the Grand Rapids formation and carbonate properties, which are primarily prospective for bitumen in the Grosmont formation. The carbonate properties include approximately 15 sections of land at Saleski and 186 sections of land in other areas (the "Other Carbonate Lands"), including leases at Orchid, Granor and House. Cavalier Energy also owns approximately 18 additional sections of oil sands rights in the Athabasca oil sands area of northeastern Alberta.



During 2011, Paramount received an updated independent evaluation of the bitumen resources within the Grand Rapids formation at the Hoole oil sands property in July and an initial independent evaluation of the bitumen resources within the Grosmont formation at Saleski and the Other Carbonate Lands in November. The evaluations were conducted by McDaniel, the Company's independent reserves evaluator. The table below summarizes the results of McDaniel's evaluation of the volumes attributable

to Cavalier Energy's bitumen resources and the estimated net present value of future net revenue at Hoole:

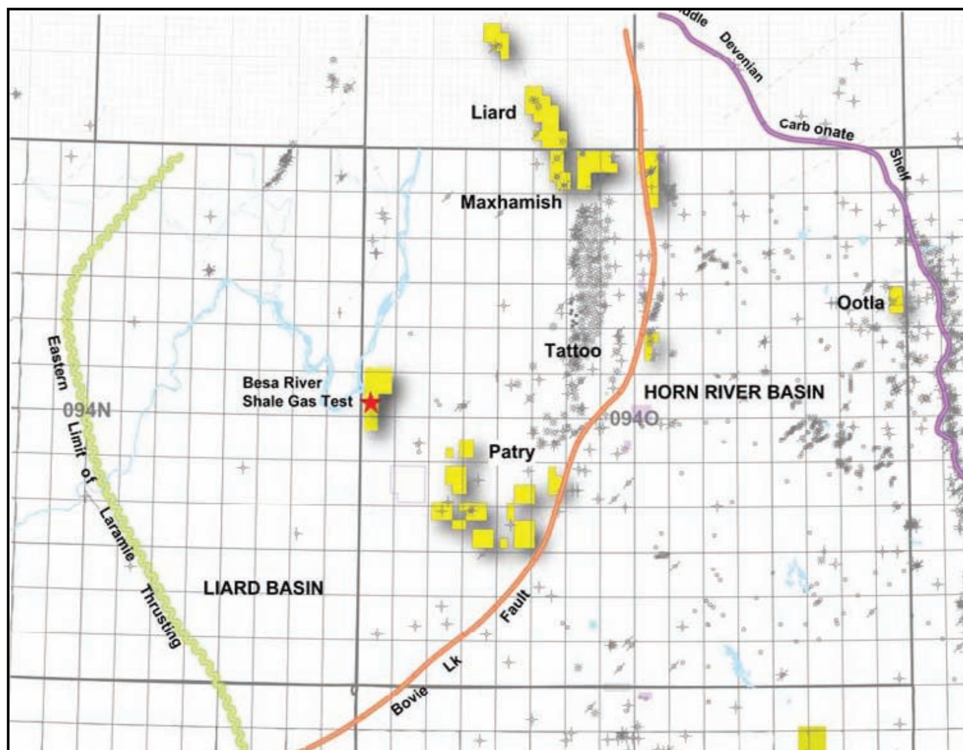
	Hoole[1]	Saleski[1]	Other Carbonate Lands[1]
Discovered Exploitable Bitumen In Place [3] (MBbl)	1,631,742	1,184,641	430,586
Economic Contingent Resources[2][4] (MBbl)	762,661	N/A	N/A
Contingent Resources (Technology Under Development)[8] (MBbl)	N/A	380,493	111,118
NPV of Future Net Revenue (Discounted at 10%)[5] ($MM)	2,834	N/A	N/A
Undiscovered Exploitable Bitumen In Place[6] (MBbl)	N/A	109,332	4,418,573
Prospective Resources[7] (MBbl)	N/A	34,006	1,073,439

MBbl means thousands of barrels.
All amounts presented in the table above are categorized as "Best Estimate".[9]
See the "Advisories" section of this document for note references.

Cavalier Energy's near-term plans are to focus on the development of its 100 percent owned oil sands leases at Hoole, including finalizing the scope and design of the initial phase of the development, submitting an application for commercial development, and evaluating funding alternatives. Cavalier Energy will also continue to further delineate its carbonate bitumen leases at Saleski and the Other Carbonate Lands.

SHALE GAS

Paramount's shale gas land position encompasses 150,000 (127,000 net) acres which has potential for production from the Besa River shale gas formation in the Horn River and Liard Basins.



The Company has commenced drilling an initial vertical evaluation well in the Dunedin area of the Liard Basin of Northeast British Columbia. This well is expected to be drilled to 4,500 meters and will be cored and logged for evaluation. Paramount continues to monitor industry activities in the Horn River and Liard Basins where operators are applying multi-stage fracturing technology to maximize production rates and

reserve recoveries. The Company is taking a conservative approach to de-risking its shale gas holdings in the current low natural gas price environment while taking steps to maintain its mineral rights.

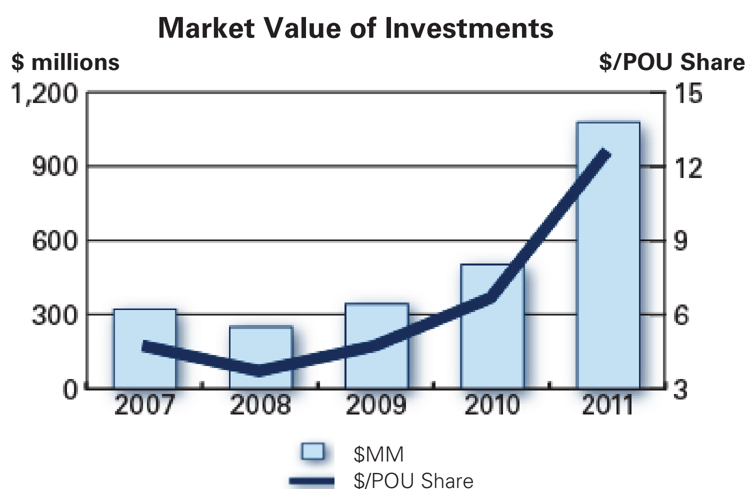
INVESTMENTS IN OTHER ENTITIES

Market Value[1]

	2011			2010		
As at December 31	***Shares (000's)***	***($ millions)***	***($/share)***	*Shares (000's)*	*($ millions)*	*($/share)*
Trilogy	**24,144**	**$ 907.1**	**37.57**	*24,144*	$ 297.0	12.30
MEG Energy Corp.	**3,700**	**153.8**	**41.57**	*3,700*	168.3	45.49
MGM Energy Corp.	**43,834**	**10.5**	**0.24**	*43,834*	8.8	0.20
Other[2]		**5.9**			28.8	
Total		**$ 1,077.3**			$ 502.9	

[1] Based on the period-end closing price of publicly traded investments and book value of remaining investments.
[2] Includes investments in other public and private corporations.

The market value of Paramount's portfolio of investments in other oil and gas entities has increased significantly over the past five years to a value of $1.1 billion at December 31, 2011. In January 2012, Paramount received $189.5 million in gross proceeds from the sale of 5.0 million of its 24.1 million Trilogy shares.



Trilogy is a Canadian energy corporation formed through a spinout of assets from Paramount in April 2005. Originally an income trust, Trilogy converted to a corporate structure in February 2010.

Trilogy is a growing petroleum and natural gas-focused Canadian energy corporation that actively develops, produces and sells natural gas, crude oil and natural gas liquids. Trilogy's geographically concentrated assets are primarily low-risk, high working interest properties that provide abundant infill drilling opportunities and good access to infrastructure and processing facilities, many of which are operated and controlled by Trilogy.

MEG Energy Corp. ("MEG") is a public energy company based in Calgary, Alberta. MEG is an oil sands company focused on sustainable in situ oil sands development and production in the southern Athabasca region of Alberta, Canada. MEG is actively developing enhanced oil recovery projects that utilize steam assisted gravity drainage ("SAGD") extraction methods. MEG is not engaged in oil sands mining.

MEG owns a 100% working interest in over 900 sections of oil sands leases. MEG has identified two commercial SAGD projects, the Christina Lake project and the Surmont project. MEG believes that the Christina Lake project can support over 200,000 Bbl/d of sustained production for 30 years and that the Surmont project can support 100,000 Bbl/d of sustained production for over 20 years. In addition, MEG holds other leases at other properties that are in the resource definition stage and that could provide significant additional development opportunities.

Paramount acquired its ownership interest in MEG in 2007 as partial consideration for the sale of certain oil sands leases and related properties to MEG.

MGM Energy Corp. ("MGM Energy") is a Canadian energy company focused on the acquisition and development of hydrocarbon resources in the Northwest Territories. The company's business strategy is to acquire interests in prospective lands and existing discoveries in the Canadian North, and to employ current technology in exploring those lands, with the ultimate intention of developing projects that will ship hydrocarbons through the Mackenzie Valley pipeline, when built.

MGM Energy is currently active in two areas: the Mackenzie Delta, where it owns interests in six discoveries and the Colville Lake/Sahtu region of the Central Mackenzie Valley, where it owns interests in two discoveries. MGM Energy's land holdings include both Federal Lands and First Nations Oil and Gas Concessions.

MGM Energy was formed through the 2007 spinout by Paramount of certain farm-in rights and other assets in the Northwest Territories.

Paramount's wholly-owned subsidiaries, Fox Drilling and Paramount Drilling U.S. LLC, currently own three custom built triple-sized drilling rigs with diesel-electric power top drives and dual mud pumps. These rigs are designed to drill the deep horizontal wells that the industry is currently focusing on. Two of the rigs are being used in the Company's drilling program in the Kaybob COU and the third rig is contracted to third parties in the United States until mid-2012. The Company has recently commenced construction of two triple-sized walking rigs, at an estimated cost of $20 million per rig, which are expected to be available to drill on Company properties in Canada in late-2012.

MANAGEMENT'S DISCUSSION & ANALYSIS

This Management's Discussion and Analysis ("MD&A"), dated March 6, 2012, 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, 2011.

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. Additional information concerning Paramount, including its Annual Information Form, can be found on the SEDAR website at *www.sedar.com*.

Canadian Generally Accepted Accounting Principles ("GAAP"), as issued by the Canadian Institute of Chartered Accountants, were converted to International Financial Reporting Standards ("IFRS") effective for fiscal years beginning on or after January 1, 2011. The Company's audited Consolidated Financial Statements for the year ended December 31, 2011 have been prepared in accordance with IFRS 1 - First-time Adoption of IFRS. Paramount's IFRS accounting policies and significant accounting judgments, estimates, and assumptions are described in Note 1 and Note 2 to the Company's December 31, 2011 audited Consolidated Financial Statements. Note 24 to the Company's December 31, 2011 audited Consolidated Financial Statements contains reconciliations of IFRS amounts as at January 1, 2010 (the "Transition Date") and as at and for the twelve months ended December 31, 2010 to amounts previously published in accordance with Canadian GAAP in effect prior to January 1, 2011 ("Previous GAAP").

In order to prepare comparative information, the Company has applied IFRS as of the Transition Date and amounts included in this MD&A related to periods on or after the Transition Date have been adjusted to conform to the Company's IFRS accounting policies. Amounts related to periods prior to the Transition Date included in this MD&A have not been adjusted, and are denoted as being prepared in accordance with Previous GAAP.

About Paramount

Paramount Resources Ltd. is an independent, publicly traded, Canadian corporation that explores for and develops conventional petroleum and natural gas prospects, pursues long-term non-conventional exploration and pre-development projects and holds a portfolio of investments in other entities. Paramount's principal properties are located in Alberta, the Northwest Territories and British Columbia in Canada, and in North Dakota and Montana in the United States.

Paramount has spun-out three public entities: (i) Paramount Energy Trust, now Perpetual Energy Inc., 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, Saskatchewan, North Dakota and Montana; 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 resources 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 subsidiaries Fox Drilling Inc. ("Fox Drilling") in Canada and Paramount Drilling U.S. L.L.C. ("Paramount Drilling") in the United States.

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.

All amounts in Management's Discussion and Analysis are presented in millions of Canadian dollars unless otherwise noted.

HIGHLIGHTS[1]

	2011	2010	2009
FINANCIAL			
Petroleum and natural gas sales	**241.7**	184.4	161.7
Funds flow from operations[2]	**96.2**	94.0	68.3
per share – diluted ($/share)[2]	**1.23**	1.29	1.02
Net loss[4]	**(232.0)**	(90.0)	(97.9)
per share – basic and diluted ($/share)[4]	**(2.96)**	(1.24)	(1.46)
Exploration and development expenditures	**465.7**	199.0	93.4
Investments in other entities – market value[3]	**1,077.3**	502.9	342.9
Total assets[4]	**1,725.7**	1,391.3	1,102.0
Long-term debt	**427.2**	294.2	93.7
Net debt	**513.4**	295.2	50.9
OPERATIONAL			
Sales volumes			
Natural gas (MMcf/d)	**81.6**	57.7	51.8
NGLs (Bbl/d)	**1,542**	932	756
Oil (Bbl/d)	**2,291**	2,485	2,824
Total (Boe/d)	**17,426**	13,029	12,207
Net wells drilled (excluding oil sands evaluation)	**48**	43	14
Net oil sands evaluation wells drilled	**27**	45	7
FUNDS FLOW FROM OPERATIONS ($/Boe)[2]			
Petroleum and natural gas sales	**38.00**	38.77	36.29
Royalties	**(3.47)**	(4.46)	(4.64)
Operating expense and production tax	**(11.20)**	(10.70)	(12.72)
Transportation	**(3.23)**	(3.62)	(3.11)
Netback	**20.10**	19.99	15.82
Financial commodity contract settlements	**0.03**	2.72	2.89
Netback including financial commodity contract settlements	**20.13**	22.71	18.71
General and administrative	**(2.66)**	(3.19)	(3.86)
Interest	**(5.26)**	(2.79)	(2.52)
Dividends from investments	**1.79**	2.73	3.37
Acquisition transaction costs	**(0.16)**	(0.06)	–
Other	**1.28**	0.37	(0.38)
	15.12	19.77	15.32

[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] The Company has adjusted its funds flow from operations measure for all periods presented. Refer to the advisories concerning non-GAAP measures in the "Advisories" section of this document.
[3] Based on the period-end closing prices of publicly traded enterprises and the book value of the remaining investments.
[4] 2009 amounts prepared in accordance with Previous GAAP.

2011 OVERVIEW

Principal Properties

- Average sales volumes for the year ended December 31, 2011 increased 34 percent to 17,426 Boe/d compared to 13,029 Boe/d for the year ended December 31, 2010.
- Netback increased 34 percent to $127.8 million for the year ended December 31, 2011 from $95.1 million for the year ended December 31, 2010.
- The Kaybob COU increased sales volumes by 86 percent to 8,361 Boe/d in 2011 compared to 4,495 Boe/d in 2010.
- Construction of phase one of the Musreau processing plant (45 MMcf/d raw gas capacity) was completed. The failure of a key electrical component resulted in the plant being shut down shortly after its December 2011 start-up. The plant is currently being re-commissioned. Work is commencing for phase two of the facility, an incremental 200 MMcf/d raw gas capacity deep cut liquids extraction facility to be built alongside the initial phase.
- The Smoky non-operated plant expansion has now been approved by the partners. The existing 100 MMcf/d (10 MMcf/d net) raw gas capacity facility will be expanded to 300 MMcf/d (60 MMcf/d net) and upgraded to operate as a deep cut liquids extraction facility. The expansion is expected to be complete in late-2013.
- In May 2011, Paramount completed its acquisition of ProspEx Resources Ltd. ("ProspEx"), adding significant land holdings and producing assets in the Deep Basin at Kakwa, Elmworth and Wapiti and land holdings at Pembina and Brazeau in Southern Alberta.
- The Grande Prairie COU commissioned a 10 MMcf/d raw gas capacity compression and gathering system at Valhalla in July 2011. Work has commenced to expand the system to 28 MMcf/d of raw gas capacity, which is expected to be brought onstream at the end of March 2012.
- In the first quarter of 2011, Paramount closed the sale of approximately 6,000 net acres of undeveloped 100 percent working interest land in North Dakota for cash proceeds of US$40 million.
- In January 2012, the Southern COU divested non-core properties at West Pembina, Alberta and Kindersley, Saskatchewan for total proceeds of approximately $50 million.
- In the first quarter of 2012, Paramount and its wholly owned subsidiary, Summit Resources, Inc. ("Summit"), initiated a process to sell Summit and all of its United States properties.

Strategic Investments

- The market value of Paramount's portfolio of investments in other oil and gas entities increased 114 percent to $1.1 billion at December 31, 2011, primarily due to an increase in the market price of Trilogy shares. In January 2012, Paramount received $189.5 million in gross proceeds from the sale of 5.0 million of its 24.1 million Trilogy shares
- In November, 2011 Paramount reorganized all of the Company's oil sands and carbonate bitumen interests into a new wholly-owned subsidiary, Cavalier Energy Inc. The reorganization was undertaken to create a focused, self-funding oil sands entity in order to accelerate the development of Paramount's bitumen interests.

Corporate

- Between January 2011 and November 2011, Paramount raised $343 million through debt and equity issuances, strengthening its balance sheet and providing financial flexibility to support the Company's plans for a large-scale Deep Basin liquids-rich natural gas drilling and infrastructure development.
- General and administrative costs per Boe decreased 17 percent in 2011 to $2.66 per Boe compared to $3.19 per Boe in 2010.

CONSOLIDATED RESULTS

Net Loss

Year ended December 31	2011	2010	2009[1]
Principal Properties	**(235.4)**	(102.1)	(106.9)
Strategic Investments	**5.1**	16.5	(18.0)
Corporate	**(63.5)**	(65.1)	(27.6)
Tax Recovery	**61.8**	60.7	54.6
Net Loss	**(232.0)**	(90.0)	(97.9)

(1) Prepared in accordance with Previous GAAP.

The 2011 net loss increased by $142.0 million compared to 2010, primarily as a result of:

- An increase of $167.7 million in write-downs of petroleum and natural gas properties and goodwill;
- An increase of $49.0 million in Principal Property depletion expense primarily due to higher production levels;
- A decrease of $34.8 million in income from equity-accounted investments, as the prior year included $36.8 million of earnings related to Trilogy's conversion from a trust structure to a corporate structure;
- An increase of $20.5 million in interest expense due to higher current year debt levels;
- An increase of $20.4 million in operating expense, primarily due to higher production levels; and
- A decrease of $11.7 million in income from financial commodity contracts;

Partially offset by:

- An increase of $57.3 million in petroleum and natural gas sales;
- An increase of $41.6 million in gains on the sale of property plant and equipment, primarily relating to the sale of approximately 6,000 net acres of undeveloped 100 percent working interest land in North Dakota;
- A decrease of $33.8 million in stock-based compensation expense: and
- An increase of $19.7 million in other income primarily due to the recognition of $11.1 million in gains on sale of investments in the shares of NuLoch and its successor, Magnum Hunter Resources Corporation ("Magnum Hunter").

2009 Results

Paramount's 2009 financial results were prepared in accordance with Previous GAAP. As the Company's IFRS transition date was January 1, 2010, comparative information for 2009 has not been restated, with the exception of the 2009 funds flow from operations measure.

Paramount's December 31, 2009 Previous GAAP consolidated financial results were as follows: total assets of $1,102.0 million; long-term debt of $93.7 million; annual revenues net of royalties and gains on financial commodity contracts of $146.3 million; a net loss of $97.9 million, with a basic and diluted loss per share of $1.46. The Company's 2009 Previous GAAP net loss was impacted by:

- Average commodity prices of $36.29/Boe and average sales volumes of 12,207 Boe/d.
- A dry hole charge of $24.3 million;
- A $14.9 million write-down of petroleum and natural gas properties;
- A loss from investments of $7.3 million;
- $17.6 million of stock-based compensation expense; and
- A tax recovery of $54.6 million.

Funds Flow From Operations[1]

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

Year ended December 31	2011	2010	2009
Cash from operating activities	**84.9**	59.2	76.0[2]
Change in non-cash working capital	**(3.0)**	23.5	(11.8)[2]
Geological and geophysical expenses	**6.8**	8.1	N/A
Asset retirement obligations settled	**7.5**	3.2	4.1
Funds flow from operations	**96.2**	94.0	68.3
Funds flow from operations ($/Boe)	**15.12**	19.77	15.32

[1] The Company has adjusted its funds flow from operations measure for all periods. Refer to the advisories concerning non-GAAP measures in the "Advisories" section of this document.
[2] Prepared in accordance with Previous GAAP.

- Funds flow from operations in 2011 increased $2.2 million compared to the prior year, primarily due to an increase in petroleum and natural gas sales, partially offset by a $20.4 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 in 2010 increased $25.7 million compared to 2009, primarily due to the impact of higher petroleum and natural gas sales and lower operating and general and administrative expenses, partially offset by higher transportation and interest expenses.

PRINCIPAL PROPERTIES

Netback and Segment Loss

Year ended December 31	2011		2010	
		($/Boe)		*($/Boe)*
Petroleum and natural gas sales	**241.7**	***38.00***	184.4	*38.77*
Royalties	**(22.1)**	***(3.47)***	(21.2)	*(4.46)*
Operating expense and production tax	**(71.3)**	***(11.20)***	(50.9)	*(10.70)*
Transportation	**(20.5)**	***(3.23)***	(17.2)	*(3.62)*
Netback	**127.8**	***20.10***	95.1	*19.99*
Financial commodity contract settlements	**0.2**	***0.03***	12.9	*2.72*
Netback including financial commodity contract settlements	**128.0**	***20.13***	108.0	*22.71*
Other principal property items (see below)	**(363.4)**		(210.1)	
Segment loss	**(235.4)**		(102.1)	

Petroleum and Natural Gas Sales

Year ended December 31	2011	2010	% Change
Natural gas	**122.0**	94.8	29
NGLs	**46.3**	24.0	93
Oil	**73.4**	65.6	12
	241.7	184.4	31

In 2011, petroleum and natural gas sales were $241.7 million, an increase of $57.3 million from the prior year, primarily due to the impact of higher natural gas and NGLs sales volumes and higher oil and NGLs prices, partially offset by lower natural gas prices and lower oil sales volumes.

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

	Natural Gas	NGLs	Oil	Total
Year ended December 31, 2010	94.8	24.0	65.6	184.4
Effect of changes in prices	(12.1)	6.6	13.0	7.5
Effect of changes in sales volumes	39.3	15.7	(5.2)	49.8
Year ended December 31, 2011	**122.0**	**46.3**	**73.4**	**241.7**

Sales Volumes

	Natural Gas (MMcf/d)			**NGLs** (Bbl/d)			**Oil** (Bbl/d)			**Total** (Boe/d)		
	2011	2010	Change %	**2011**	2010	Change %	**2011**	2010	Change %	**2011**	2010	Change %
Kaybob	**44.5**	23.5	89	**868**	495	75	**72**	79	(9)	**8,361**	4,495	86
Grande Prairie	**16.0**	12.4	29	**505**	367	38	**393**	583	(33)	**3,568**	3,012	18
Southern	**10.8**	9.3	16	**150**	59	154	**1,483**	1,363	9	**3,424**	2,973	15
Northern	**10.3**	12.5	(18)	**19**	11	73	**343**	460	(25)	**2,073**	2,549	(19)
	81.6	57.7	41	**1,542**	932	65	**2,291**	2,485	(8)	**17,426**	13,029	34

Natural gas sales volumes increased 23.9 MMcf/d or 41 percent to 81.6 MMcf/d in 2011 compared to 57.7 MMcf/d in 2010. NGLs sales volumes increased 65 percent to 1,542 Bbl/d in 2011 compared to 932 Bbl/d in the same period of the prior year. The increase in natural gas and NGLs sales volumes was

primarily related to new well production at Musreau and Smoky within the Kaybob COU and at Valhalla and Karr-Gold Creek within the Grande Prairie COU from the Company's 2010/2011 drilling program and new well production from the acquisitions of ProspEx and Redcliffe Exploration Inc. ("Redcliffe"). Sales volume increases were partially offset by the impact of production declines.

Oil sales volumes decreased eight percent to 2,291 Bbl/d in 2011 compared to 2,485 Bbl/d in 2010, primarily due to declines at Crooked Creek in the Grande Prairie COU and at Cameron Hills in the Northern COU. These decreases were partially offset by increased sales volumes related to new well production from the acquisitions of ProspEx and Redcliffe and due to new well production in the Southern COU.

Total average sales volumes increased 4,397 Boe/d or 34 percent in 2011 to 17,426 Boe/d compared to 13,029 Boe/d in 2010. The Company did not achieve its expected average annual sales volumes for 2011 due to the impact of third party facility outages and capacity restrictions at Musreau, Smoky, Valhalla and Karr-Gold Creek, weaker than expected well performance at the Karr-Gold Creek property, and the delayed start-up of the Musreau plant.

Average Realized Prices

Year ended December 31	2011	2010	% Change
Natural gas ($/Mcf)	**4.10**	4.50	(9)
NGLs ($/Bbl)	**82.24**	70.58	17
Oil ($/Bbl)	**87.81**	72.30	21
Total ($/Boe)	**38.00**	38.77	(2)

Paramount's average realized natural gas price for 2011, before financial commodity contract impacts, was $4.10/Mcf compared to $4.50/Mcf in 2010. 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.

The average realized NGLs price for 2011 increased to $82.24/Bbl compared to $70.58/Bbl in 2010. The average realized oil price, before financial commodity contract impacts, increased to $87.81/Bbl compared to $72.30/Bbl in 2010. Paramount's Canadian oil and NGLs sales portfolio primarily consists of sales priced relative to Edmonton Par and United States market hubs, adjusted for transportation and quality differentials. The Company's United States oil and NGLs sales portfolio is sold at the well head with negotiated differentials relative to West Texas Intermediate crude oil prices.

Commodity Prices

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

Year Ended December 31	2011	2010	% Change
Natural Gas			
AECO (Cdn$/GJ)	**3.48**	3.91	(11)
NYMEX (Henry Hub US$/MMbtu)	**4.07**	4.40	(7)
Crude Oil			
Edmonton par (Cdn$/Bbl)	**95.16**	76.80	24
West Texas Intermediate (US$/Bbl)	**95.00**	78.39	21
Foreign Exchange			
$Cdn / 1 $US	**0.99**	1.04	(5)

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 from the settlement of financial commodity contracts are as follows:

Year ended December 31	2011	2010
Natural gas contracts	–	12.9
Oil contracts	0.2	–
	0.2	12.9

At December 31, 2011, Paramount had the following financial commodity contracts outstanding:

Instruments	Notional	Average Fixed Price	Fair Value	Remaining Term
Oil – NYMEX WTI Swap	500 Bbl/d	US $101.01/Bbl	$ 139	January – May 2012
Oil – NYMEX WTI Collar	500 Bbl/d	Floor – US $85.00/Bbl Ceiling – US $116.85/Bbl	45	January – May 2012
Oil – NYMEX WTI Swap	500 Bbl/d	US $101.65 /Bbl	223	January – June 2012
Oil – NYMEX WTI Swap	500 Bbl/d	US $97.25/Bbl	(288)	January – December 2012
Oil – NYMEX WTI Swap	1,000 Bbl/d	US $91.50/Bbl	(2,722)	January – December 2012
			$ (2,603)	

Royalties

Year ended December 31	2011	Royalty rate (%)	2010	Royalty rate (%)
Royalties	22.1	9.1%	21.2	11.5%

Royalties increased by $0.9 million to $22.1 million in 2011 compared to $21.2 million in 2010. Natural gas and NGLs royalties increased to $11.1 million in 2011 from $9.8 million in 2010 due to production from new wells and higher NGLs prices, partially offset by a decrease in royalty rates from 8.3 percent to 6.6 percent as a result of a greater proportion of production qualifying for Alberta new well royalty incentive programs.

Oil royalties decreased to $11.0 million in 2011 from $11.4 million in 2010 due to a decrease in royalty rates from 17.3 percent to 15.0 percent, primarily as a result of a reduction in maximum Alberta oil royalty rates (50 percent in 2010 to 40 percent in 2011), partially offset by the impact of higher oil revenue.

Operating Expense and Production Tax

Year ended December 31	2011	2010	% Change
Operating Expense	68.6	48.6	41
Production Tax	2.7	2.3	17
Total	71.3	50.9	40

Operating expense and production taxes increased by $20.4 million in 2011 to $71.3 million compared to $50.9 million in 2010. The increases in 2011 primarily relate to new well production at Musreau and Smoky in the Kaybob COU and at Karr-Gold Creek and Valhalla in the Grande Prairie COU. Operating expenses also increased as a result of wells added through the acquisitions of ProspEx and Redcliffe and because of suspension and workover activity during 2011 in the Northern COU at remote locations.

Transportation Expense

Year ended December 31	2011	2010	% Change
Transportation Expense	**20.5**	17.2	19

Transportation costs increased to $20.5 million in 2011 compared to $17.2 million in 2010, primarily as a result of a 34 percent increase in sales volumes and a $0.7 million increase in trucking costs in the Northern COU during a liquids pipeline service interruption. Transportation costs decreased to $3.23 per Boe in 2011 compared to $3.62 per Boe in 2010, due primarily to lower per unit fixed transportation costs as a result of increased sales volumes, primarily in the Kaybob and Grande Prairie COUs.

Other Principal Property Items

Year ended December 31	2011	2010
Commodity contracts – net of settlements	**1.9**	2.9
Depletion and depreciation (excluding write-downs)	**150.0**	101.0
Write-down of petroleum and natural gas properties and goodwill	**225.7**	57.9
Exploration and evaluation	**25.7**	41.8
Gain on sale of property, plant and equipment	**(42.0)**	(0.4)
Accretion of asset retirement obligations	**7.3**	7.9
Other income	**(5.2)**	(1.0)
Total	**363.4**	210.1

During 2011, Paramount recorded a write-down of petroleum and natural gas properties and goodwill of $225.7 million compared to $57.9 million in the prior year. The 2011 write-down primarily related to properties in the Grande Prairie COU at Karr-Gold Creek and Valhalla, in the Southern COU at Chain and Delia and in the Northern COU at Cameron Hills and Bistcho. The impairment resulted from a combination of declines in reserves assigned due to well performance and the decline in forecast natural gas prices.

Depletion and depreciation expense (excluding the write-downs) increased to $150.0 million or $23.64 per Boe in 2011 compared to $101.0 million or $21.23 per Boe in the prior year. The increase in depletion and depreciation expense was primarily due to higher production.

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 $18.2 million in 2011 compared to $24.2 million in 2010. Evaluation expense included $2.4 million of dry hole expense in 2011 compared to $8.3 million in 2010.

The gain on sale of property, plant and equipment recorded for the year ended December 31, 2011 is primarily related to the sale of approximately 6,000 net acres of undeveloped land in North Dakota, unrelated to the farm-out lands, for cash proceeds of US$40 million.

Other income in 2011 includes $4.4 million in respect of lower royalties related to prior years, primarily as a result of the resolution of audits and increased gas cost allowance claims.

STRATEGIC INVESTMENTS

Year ended December 31	2011	2010
Income from equity-accounted investments	**1.2**	36.0
Drilling rig revenue	**22.4**	13.4
Drilling rig expense	**(11.1)**	(8.0)
General and administrative	**(4.9)**	(3.6)
Stock-based compensation	**(5.8)**	(16.6)
Interest	**(1.2)**	(1.2)
Gain on investments	**15.7**	3.5
Other expense	**(11.2)**	(7.0)
Segment Earnings (Loss)	**5.1**	16.5

Income from equity-accounted investments in 2011 was $1.2 million compared to income of $36.0 million in the prior year. In 2010, the Company recorded $36.8 million of equity earnings related to Trilogy's conversion from a trust structure to a corporate structure.

Strategic Investments at December 31, 2011 include:

- investments in the shares of Trilogy, MEG Energy Corp. ("MEG"), MGM Energy, Paxton Corporation ("Paxton"), and other public and private corporations;
- oil sands and carbonate bitumen interests owned by Paramount's wholly owned subsidiary, Cavalier Energy, including oil sands resources at Hoole, situated within the western portion of the Athabasca Oil Sands region, and carbonate bitumen holdings in Northeast Alberta, including at Saleski;
- prospective shale gas acreage in the Horn River and Liard Basins in Northeast British Columbia and the Northwest Territories; and
- drilling rigs operated by Paramount's wholly-owned subsidiaries: Fox Drilling in Canada and Paramount Drilling in the United States.

In April 2011, Paramount sold 3.3 million of the 6.6 million NuLoch shares it held for cash proceeds of $8.1 million. In May 2011, Magnum Hunter acquired NuLoch and Paramount's remaining 3.3 million NuLoch shares were exchanged for 1.1 million Magnum Hunter shares, which the Company subsequently sold in July 2011 for $7.7 million in cash. The Company recognized aggregate gains of $11.1 million in gain on investments on the dispositions, which previously had been recorded in reserves.

On May 31, 2011, Paramount acquired all 54.9 million of the issued and outstanding shares of ProspEx not already owned in exchange for $64.8 million in cash and the issuance of 2.0 million Paramount Common Shares. ProspEx was a Calgary-based exploration and development company with interests in petroleum and natural gas properties in western Canada. The accumulated gain of $4.4 million to May 31, 2011 that had been recorded in reserves in respect of the Company's investment in the shares of ProspEx was recognized in gain on investments.

In January 2012, Paramount closed the sale of five million of its Trilogy non-voting shares for gross proceeds of $189.5 million.

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

	Carrying Value		Market Value[1]	
As at December 31	**2011**	2010	**2011**	2010
Trilogy[3]	**118.3**	125.7	**907.1**	297.0
MEG	**153.8**	168.3	**153.8**	168.3
MGM Energy	**1.7**	5.2	**10.6**	8.8
NuLoch Resources	–	13.7	–	13.7
ProspEx	–	7.4	–	7.4
Other[2]	**5.8**	7.7	**5.8**	7.7
Total	**279.6**	328.0	**1,077.3**	502.9

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

Cavalier Energy

In November 2011, Paramount reorganized of all of its oil sands and carbonate bitumen interests into a new wholly-owned subsidiary, Cavalier Energy and assembled its executive leadership team. The reorganization was undertaken to create a focused, self-funding oil sands entity in order to accelerate the development of Paramount's bitumen interests.

During 2011, Paramount received an updated independent evaluation of the bitumen resources within the Grand Rapids formation at the Hoole oil sands property and an initial independent evaluation of the bitumen resources within the Grosmont formation at Saleski and other properties. Details concerning these evaluations are contained in Paramount's Annual Information Form dated March 6, 2012.

Cavalier Energy's near-term plans are to focus on the development of its 100 percent owned oil sands leases at Hoole, including finalizing the scope and design of the initial phase of the development, submitting an application for commercial development and evaluating funding opportunities. Cavalier Energy will also continue to further delineate its carbonate bitumen leases at Saleski and its other carbonate leases.

Shale Gas

Paramount's shale gas land position encompasses 150,000 (127,000 net) acres which has potential for production from the Besa River shale gas formation in the Horn River and Liard Basins.

The Company has commenced drilling an initial vertical evaluation well in the Dunedin area of the Liard Basin. This well is expected to be drilled to 4,500 meters at a cost of approximately $15 million and will be cored and logged for evaluation. Paramount continues to monitor industry activities in the Horn River and Liard Basins, where operators are applying multi-stage fracturing technology to maximize production rates and reserve recoveries. The Company is taking a conservative approach to de-risking its shale gas holdings in the current low natural gas price environment while taking steps to maintain its mineral rights.

Drilling Subsidiaries

Fox Drilling's two Canadian-based drilling rigs drilled on Company lands in Alberta for the duration of 2011. The Paramount Drilling US drilling rig was contracted to third parties throughout the year and is currently contracted to a third party until mid-2012.

During December 2011, Fox Drilling commenced the construction of two new "triple-sized" walking drilling rigs to be deployed on the Company's lands in Canada. These rigs are expected to be operational in late-2012 at an expected cost of $20 million each.

CORPORATE

Year ended December 31	2011	2010
General and administrative	12.1	11.5
Stock-based compensation	15.6	38.7
Depletion and depreciation	0.5	0.7
Interest	32.9	12.3
Debt extinguishment	–	1.7
Acquisition transaction costs	1.0	0.3
Foreign exchange	1.4	(0.2)
Other	–	0.1
	63.5	65.1

Corporate segment net costs decreased to $63.5 million in 2011 compared to $65.1 million in 2010.

Stock-based compensation decreased $23.1 million to $15.6 million in 2011 compared to $38.7 million in 2010 as a result of a significant prior year increase in the market price of the Company's Common Shares.

Interest expense increased $20.6 million to $32.9 million in 2011 compared to $12.3 million in 2010 due to the Senior Notes issuances in December 2010 and February 2011 and drawings throughout 2011 on the Company's credit facility.

EXPLORATION AND CAPITAL EXPENDITURES

Year ended December 31	2011	2010
Geological and geophysical	5.5	7.6
Drilling, completion and tie-ins	303.7	144.8
Facilities and gathering	156.5	46.6
Exploration and development expenditures	465.7	199.0
Land and property acquisitions	38.2	82.7
Principal Properties	503.9	281.7
Strategic Investments	28.0	16.3
Corporate	0.1	0.1
	532.0	298.1

Exploration and development expenditures in 2011 were $465.7 million compared to $199.0 million in 2010. Spending in 2011 focused on drilling and completing gas wells in the Kaybob COU's Deep Basin development, at Karr-Gold Creek and Valhalla in the Grande Prairie COU and at Birch in the Northern COU. Additions to property, plant and equipment include $3.2 million of capitalized interest in 2011 (2010 – nil) for qualifying assets in the construction phase.

Facilities and gathering expenditures in 2011 primarily related to the construction of new plants and gathering systems within the Kaybob COU in order to provide increased Company-owned capacity for planned production growth in the area, including phase one of the new Musreau plant, long lead-time

equipment orders for phase two of the Musreau plant and for the non-operated Smoky plant expansion. In the Grande Prairie COU, facilities and gathering expenditures related to construction at Valhalla and Karr-Gold Creek.

Land and property acquisitions include purchases of Deep Basin undeveloped land in the Kaybob COU.

Strategic investments capital expenditures in 2011 include $19.9 million related to Saleski and Hoole, $5.0 million related to the construction of two triple-sized drilling rigs and $3.1 million related to the initial shale gas well being drilled in Dunedin in Northeast British Columbia.

In the fourth quarter of 2011, Paramount entered into agreements to sell certain oil and gas properties in the Southern COU and the Northern COU for aggregate gross proceeds of approximately $50 million. The transactions closed in early 2012.

During the fourth quarter of 2011, Summit's partner drilled and completed the final wells under the joint development agreement, earning an undivided 50 percent interest in Summit's Bakken/Three Forks lands in North Dakota.

In the first quarter of 2012, Paramount and its wholly owned subsidiary, Summit, initiated a process to sell Summit and all of its United States properties.

Wells drilled are as follows:

	Year ended December 31			
	2011		2010	
(wells drilled)	**Gross**[1]	**Net**[2]	Gross[1]	Net[2]
Gas	**47**	**32**	34	23
Coal bed methane	**–**	**–**	13	10
Oil	**26**	**15**	13	6
Oil sands evaluation	**28**	**27**	45	45
Dry and abandoned	**1**	**1**	4	4
Total	**102**	**75**	109	88

[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.

OUTLOOK

Paramount plans to invest $475 million in its Principal Properties in 2012 (excluding land acquisitions and capitalized interest), primarily focused in the Kaybob COU's Deep Basin development. Construction of the Musreau and Smoky deep-cut facilities will commence during the year, and drilling and completion activities will continue in preparation for start-up in the second half of 2013. Planned 2012 activities also include drilling at Valhalla in the Grande Prairie COU and at Birch in the Northern COU.

The Company also plans to invest approximately $60 million in its Strategic Investments in 2012 to complete construction of two new triple-sized walking drilling rigs within Fox Drilling; to continue pre-development activities for oil sands projects within Cavalier Energy; and to drill a shale gas well in the Liard Basin.

Production during the first quarter of 2012 has been impacted by capacity constraints in the Kaybob COU as a result of the failure of a key electrical component at the Musreau 45 MMcf/d facility and the expiry of certain firm processing contracts in November 2011; and in the Grande Prairie COU due to delays in the delivery of surface equipment. First quarter 2012 sales volumes are expected to average approximately 18,000 Boe/d.

The Musreau facility is currently being commissioned, with gas sales expected to recommence in mid-March, and the Valhalla gas gathering system expansion and installation of surface equipment at Karr-Gold Creek are scheduled to be completed by the end of March. Sales volumes for the remainder of 2012 are forecast to range between 26,000 and 28,000 Boe/d. The Company expects its sales volumes will continue to be in this range until facility expansions at Musreau and Smoky are completed and brought on-stream in the second half of 2013.

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 and participating in joint ventures.

As at December 31	2011	2010	Change
Working capital deficit (surplus)[1]	**82.0**	(4.8)	86.8
Credit facility	**61.4**	–	61.4
Senior Notes[2]	**370.0**	300.0	70.0
Net debt[3]	**513.4**	295.2	218.2
Share capital	**810.8**	481.8	329.0
Accumulated (deficit) earnings	**(103.6)**	128.4	(231.5)
Reserves	**116.7**	72.0	44.7
Total Capital	**1,337.3**	977.4	359.9

(1) Excludes risk management assets and liabilities, stock-based compensation 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, 2011 – $5.9 million, December 31, 2010 – $6.1 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.

Working Capital

Paramount's working capital deficit at December 31, 2011 was $82.0 million compared to a surplus of $4.8 million at December 31, 2010. The working capital deficit at December 31, 2011 included $130.9 million of accounts payable and accrued liabilities, $40.2 million of accounts receivable, $29.0 million of cash and cash equivalents, the $22.8 million drilling rig loan and $2.6 million of prepaid and other expenses. The decrease in working capital is primarily a result of the Company's 2011 capital program and the ProspEx acquisition, partially offset by equity issuances, funds flow from operations, proceeds from the Senior Notes offering, drawings on the Company's bank credit facility, and the undeveloped land sale in the United States. During 2011, aggregate principal payments of $4.0 million were made on the drilling rig loan.

Between December 2010 and November 2011, Paramount closed public offerings of an aggregate $370 million principal amount of senior notes and $263.9 million of Common Shares and flow-through Common Shares. Proceeds from these offerings were used to further the exploration and development of the Company's properties, including drilling and completion work and facilities construction at Musreau and Smoky in the Kaybob COU and at Karr-Gold Creek and Valhalla in the Grande Prairie COU. Approximately $92 million of the proceeds from the senior notes offering were used for the purchase and redemption of the remaining outstanding balance of the Company's 8½% U.S. senior notes. Proceeds from flow-through share offerings were used and are expected to be used to incur eligible Canadian exploration expenses. Proceeds were also used for the non-permanent repayment of indebtedness under the Company's credit facility and for general corporate purposes.

Paramount expects to fund its 2012 operations, obligations and capital expenditures with proceeds from the sale of the five million Trilogy shares, funds flow from operations, proceeds from the sale of the non-core properties, existing cash and cash equivalents, drawings on its bank credit facility, and by accessing the capital markets, if required.

Demand Facilities

Drilling Rig Loan

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 $7.5 million have been made to December 31, 2011. Unless demanded by the bank, annual scheduled principal repayments are $5.1 million in each of 2012 and 2013, with the remaining outstanding balance of $12.6 million 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 year long construction period with scheduled principal repayments to commence in 2013. Drilling Rig Loan II is currently undrawn.

Recourse and security for Drilling Rig Loan I and Drilling Rig Loan II (collectively, the "Drilling Rig Loans") is limited to the three existing drilling rigs, the two rigs to be constructed, and drilling contracts guaranteed by Paramount. The carrying value of the three existing rigs is $37.6 million (2010 - $38.0 million). 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 Drilling Rig Loan I for the period ended December 31, 2011 was 4.7 percent (2010 - 4.2 percent).

Cavalier Facility

In January 2012, Cavalier 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 Paramount, plus an applicable margin. The Cavalier Facility is non-recourse to Paramount and is secured by all of the assets of Cavalier, including oil sands and carbonate bitumen lands.

Bank Credit Facility

In June 2011, Paramount renewed its bank credit facility (the "Facility"), increasing the total credit limit from $160 million to $300 million, which 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 June 30, 2012. 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 June 30, 2012 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, 2011, $61.4 million (December 31, 2010 – nil) was drawn on Tranche A of the Facility. Paramount had undrawn letters of credit outstanding at December 31, 2011 totaling $26.3 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 ("Senior Notes") at par, of which $11.4 million principal amount was purchased by certain directors, associates, officers, and management of the Company.

In February 2011, Paramount completed a public offering of an additional $70 million principal amount of 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 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 Senior Notes are direct senior unsecured obligations of Paramount and rank equally with all other senior unsecured indebtedness of the Company.

The Company may redeem all or any portion of the Senior Notes at any time on or prior to December 13, 2013 at par, plus accrued and unpaid interest, plus a redemption premium equal to the greater of: (i) one percent; and (ii) a make-whole amount based on the then current yield of a Government of Canada bond with a similar maturity. Paramount may also redeem up to an aggregate of 35 percent of the Senior Notes with the net cash proceeds of an equity offering at any time prior to December 13, 2013, at par plus a redemption premium of 8.25 percent. On or after December 13, 2013, the Company may redeem some or all of the Senior Notes at par plus a redemption premium, if applicable, of up to 4.125 percent depending on when redeemed, plus accrued and unpaid interest.

US Senior Notes

During the fourth quarter of 2010, Paramount's obligations under the indenture governing its US$90.2 million principal amount of US senior notes ("US Senior Notes") were discharged as a result of Paramount: (i) purchasing US$64.2 million principal amount of US Senior Notes pursuant to a tender offer; (ii) delivering all US Senior Notes held by the Company to the trustee for cancellation; (iii) issuing a redemption notice for US$26.0 million principal amount of US Senior Notes not tendered under the tender offer (the "Redeemed Notes"); and (iv) irrevocably depositing sufficient cash with the trustee to pay all amounts due on the Redeemed Notes on the January 31, 2011 redemption date.

Share Capital

In April 2011, Paramount issued 1,500,000 Common Shares at a price of $32.50 per share for gross proceeds of $48.8 million pursuant to a public offering. In April 2011, Paramount also issued 150,000 Common Shares on a "flow-through" basis in respect of Canadian development expenses at a price of $36.50 per share for gross proceeds of $5.5 million to a company controlled by the Company's Chairman and Chief Executive Officer. In May 2011, the Company issued 2,000,000 Common Shares in connection with the ProspEx acquisition. In October 2011, Paramount issued 1,450,000 Common Shares on a "flow-through" basis in respect of Canadian exploration expenses ("CEE") pursuant to a public offering at a price of $40.50 per share for gross proceeds of $58.7 million. Also in October 2011, the Company issued 100,000 Common Shares on a "flow-through basis" in respect of CEE at a price of $40.50 per share for

gross proceeds of $4.1 million to companies controlled by the Company's Chairman and Chief Executive Officer. In November 2011, Paramount issued 4,500,000 Common Shares at a price of $34.75 per share for gross proceeds of $156.4 million through a public offering.

The Company is committed to incur $62.8 million of qualifying expenditures related to the 2011 offering of CEE flow-through Common Shares by October 19, 2012. As of December 31, 2011, the Company had incurred $33.1 million of qualifying CEE.

Paramount has incurred sufficient qualifying expenditures to satisfy its commitments associated with flow-through shares issued in November 2010 and April 2011.

In April 2010, Paramount received regulatory approval under Canadian securities laws to purchase Common Shares under a normal course issuer bid ("NCIB") commencing April 13, 2010 for a 12-month period. Under the NCIB, Paramount was permitted to purchase for cancellation up to 3,626,476 Common Shares. No shares were purchased under the NCIB, which expired on March 3, 2011.

At March 2, 2012, Paramount had 85.6 million Common Shares and 5.7 million Paramount Options outstanding (1.8 million exercisable).

QUARTERLY INFORMATION

	2011				2010			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Petroleum and natural gas sales	**63.3**	70.5	61.1	46.8	46.0	44.9	44.6	48.9
Funds flow from operations	**26.1**	32.8	23.4	13.9	21.3	24.1	25.2	23.5
per share – diluted ($/share)	**0.33**	0.42	0.29	0.19	0.29	0.33	0.35	0.33
Net income (loss)	**(209.9)**	(22.4)	12.2	(11.9)	(106.3)	6.9	(17.5)	26.9
per share – basic ($/share)	**(2.54)**	(0.28)	0.16	(0.16)	(1.44)	0.09	(0.24)	0.37
per share – diluted ($/share)	**(2.54)**	(0.28)	(0.02)	(0.16)	(1.44)	0.09	(0.24)	0.37
Sales volumes								
Natural gas (MMcf/d)	**91.5**	97.8	77.7	58.7	60.4	62.9	57.0	50.2
NGLs (Bbl/d)	**1,620**	2,062	1,504	968	1,030	1,099	821	775
Oil (Bbl/d)	**2,356**	2,344	2,110	2,353	2,357	2,381	2,466	2,739
Total (Boe/d)	**19,223**	20,707	16,572	13,097	13,461	13,967	12,787	11,875
Average realized price								
Natural gas ($/Mcf)	**3.65**	4.16	4.43	4.26	4.04	4.12	4.49	5.59
NGLs ($/Bbl)	**81.27**	83.68	83.17	79.29	75.52	59.90	77.26	72.22
Oil ($/Bbl)	**94.33**	80.06	95.64	81.91	75.45	68.60	69.34	75.51

Significant Items Impacting Quarterly Results

Quarterly earnings variances include the impacts of changing production volumes and market prices.

- 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.
- Fourth quarter 2010 earnings include $33.7 million of stock-based compensation charges, a $57.9 million write-down of petroleum and natural gas properties and goodwill and $11.9 million of expired lease costs.
- Third quarter 2010 earnings include a future income tax recovery of $33.0 million and $8.1 million of stock-based compensation charges.
- Second quarter 2010 earnings include increased depletion, depreciation and accretion expense and $6.8 million of stock-based compensation charges.
- First quarter 2010 earnings include $36.8 million of equity earnings related to Trilogy's conversion from a trust structure to a corporate structure, $8.2 million of dry hole expenses and $6.7 million of stock-based compensation charges.

Fourth Quarter Review

Net Loss

Three months ended December 31	**2011**	2010
Principal Properties	**(250.3)**	(84.6)
Strategic Investments	**(3.4)**	(10.9)
Corporate	**(16.3)**	(32.7)
Tax Recovery	**60.1**	21.9
Net Loss	**(209.9)**	(106.3)

Netback

Three months ended December 31	**2011**		2010	
		($/Boe)		*($/Boe)*
Petroleum and natural gas sales	**63.3**	**35.80**	46.0	37.11
Royalties	**(5.5)**	**(3.13)**	(4.4)	(3.51)
Operating expense and production tax	**(21.2)**	**(11.98)**	(12.8)	(10.37)
Transportation	**(5.1)**	**(2.88)**	(4.3)	(3.46)
Netback	**31.5**	**17.81**	24.5	19.77
Financial commodity contract settlements	**0.3**	**0.17**	1.8	1.44
Netback including financial commodity contract settlements	**31.8**	**17.98**	26.3	21.21

Funds Flow from Operations[1]

Three months ended December 31	2011	2010
Cash from operating activities	7.2	10.4
Change in non-cash working capital	14.9	8.8
Geological and geophysical expenses	1.9	1.5
Asset retirement obligations settled	2.1	0.6
Funds flow from operations	**26.1**	21.3
Funds flow from operations ($/Boe)	**19.77**	17.17

[1] The Company has adjusted its funds flow from operations measure for all periods. Refer to the advisories concerning non-GAAP measures in the "Advisories" section of this document.

Sales Volumes

Three months ended December 31	Natural Gas (MMcf/d)			NGLs (Bbl/d)			Oil (Bbl/d)			Total (Boe/d)		
	2011	2010	Change %	2011	2010	Change %	2011	2010	Change %	2011	2010	Change %
Kaybob	**50.8**	28.8	76	**901**	614	47	**62**	98	(37)	**9,437**	5,506	71
Grande Prairie	**19.4**	11.4	70	**480**	333	44	**333**	428	(22)	**4,048**	2,667	52
Southern	**11.4**	9.1	25	**216**	59	266	**1,551**	1,397	11	**3,670**	2,976	23
Northern	**9.9**	11.1	(11)	**23**	24	(4)	**410**	434	(6)	**2,068**	2,312	(11)
	91.5	60.4	51	**1,620**	1,030	57	**2,356**	2,357	0	**19,223**	13,461	43

Paramount's fourth quarter average sales volumes were 19,223 Boe/d, consisting of 91.5 MMcf/d of natural gas and 3,976 Bbl/d of oil and NGLs. Petroleum and natural gas sales were $63.3 million, an increase of $17.3 million from the fourth quarter of 2010 due to increased production volumes from new wells and acquisitions and higher oil and NGLs prices, partially offset by lower natural gas prices. Production levels in the Kaybob COU in the fourth quarter of 2011 were impacted by lower firm processing capacity in Musreau and equipment failures shortly after the start-up of the new Musreau plant resulting in some production being temporarily shut-in.

Fourth quarter 2011 royalties increased to $5.5 million in 2011 compared to $4.4 million in 2010, primarily as a result of increased revenue. The average royalty rate decreased from 9.3% to 8.7%, as a greater proportion of current production is subject to the Alberta new well and deep drilling royalty incentive programs. Operating expenses were $8.4 million higher in the fourth quarter of 2011 compared to the prior year primarily due to higher production volumes from new well production and acquisitions. Operating costs per Boe increased to $11.98 in the fourth quarter of 2011 compared to $10.37 in the fourth quarter of 2010. The per unit increase is due primarily to an equalization adjustment for processing fees at a third party midstream facility and higher 2011 costs related to winter ice roads and well work-overs.

Funds flow from operations in the fourth quarter of 2011 increased by $4.8 million to $26.1 million compared to $21.3 million in 2010, primarily due to the increase in petroleum and natural gas sales, partially offset by higher operating expenses and interest.

Fourth quarter exploration and development expenditures of $78.1 million were primarily related to the Deep Basin development in the Kaybob COU and spending at Karr-Gold Creek and Valhalla in the Grande Prairie COU.

OTHER INFORMATION

Related Party Transactions

Service Agreements

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

During 2011, Paramount charged $0.9 million (2010 – $0.5 million) to Trilogy in respect of operational and administrative services. Also, Paramount received $10.1 million (2010: $10.5 million) in annual dividends from Trilogy. As of December 31, 2011, Paramount had a receivable balance due from Trilogy of $0.3 million (2010: $0.3 million).

Contractual Obligations

Paramount had the following contractual obligations at December 31, 2011:

($ millions)	2012	2013-2014	2015-2016	After 2016	Total
Senior notes[1]	30.5	61.1	61.1	399.3	552.0
Drilling rig loan[1]	6.1	5.3	13.0	–	24.4
Pipeline transportation commitments[2]	16.4	33.2	27.7	55.5	132.8
Operating leases	3.6	3.5	3.5	10.6	21.2
Capital spending commitments	54.2	–	–	–	54.2
Credit facility[1]	3.3	63.0	–	–	66.3
Total	**114.1**	**166.1**	**105.3**	**465.4**	**850.9**

[1] Including interest
[2] Certain of the pipeline transportation commitments are secured by outstanding letters of credit totaling $12.8 million at December 31, 2011 (2010 - $10.4 million).

Operating Lease Commitment

During the year, the Company renewed and extended its head office lease to 2022. The Company incurred office lease costs of $2.8 million in 2011 (2010 - $2.3 million).

Flow-Through Shares

As a result of flow through share issuances in the fourth quarter of 2011, Paramount is required to incur and renounce $29.7 million of Canadian Exploration Expense during 2012.

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

IFRS Transition

As noted previously, Canadian GAAP was converted to IFRS effective for fiscal years beginning on or after January 1, 2011. Paramount's audited Consolidated Financial Statements as at and for the year ended December 31, 2011 have been prepared in accordance with IFRS 1 - First-time Adoption of IFRS ("IFRS 1"). The adoption of IFRS has not had a material impact on the Company's operations, cash flows, capital expenditures or strategic objectives.

The Company's IFRS accounting policies are provided in Note 1 to the audited Consolidated Financial Statements. In addition, Note 24 presents reconciliations between the Company's 2010 Previous GAAP results and the 2010 IFRS results. The reconciliations include the Consolidated Balance Sheet as at January 1, 2010 and December 31, 2010, and Consolidated Statement of Comprehensive Income, Changes in Shareholders' Equity and Cash Flows for the twelve months ended December 31, 2010. Summary amounts from these reconciliations are included below.

As the IFRS accounting policies and processes were determined, corresponding changes to internal controls over financial reporting and disclosure controls procedures were made to ensure controls remained effective.

IFRS Transition Exemptions

The transition provisions of IFRS require changes in accounting policies to be applied on a retroactive basis, except for certain mandatory and optional exemptions. Paramount has elected to apply the following exemptions:

a) the exemption to measure certain assets at fair value on transition to IFRS and subsequently deem that fair value to be historical cost;

b) the exemption to deem cumulative foreign exchange translation differences related to foreign subsidiaries as of January 1, 2010 to be nil;

c) the exemption that permits amounts recorded in respect of options settled prior to January 1, 2010 not to be retrospectively restated;

d) the exemption that permits business combinations completed prior to January 1, 2010 not to be restated. Paramount's initial business combination recorded in accordance with IFRS 3 was the acquisition of Redcliffe in June 2010;

e) the exemption to measure asset retirement obligations at the Transition Date in accordance with IFRS 1;

f) the exemption to assess lease arrangements using the facts and circumstances as of the Transition Date under International Financial Reporting Interpretations Committee Interpretation 4, "Determining whether an Arrangement contains a Lease"; and

g) the exemption that permits borrowing costs directly attributable to the acquisition or construction of qualifying assets not to be capitalized on a retroactive basis prior to January 1, 2010.

Significant Accounting Policy Changes

Changes to the Company's accounting policies on conversion to IFRS and the related adjustments to the Company's financial statement balances are described below. Readers are referred to Notes 1 and 24 of the Company's December 31, 2011 audited Consolidated Financial Statements regarding Paramount's IFRS accounting policies and IFRS adjustments.

a) Property, Plant and Equipment

Under IFRS, the type and method of calculating petroleum and natural gas reserves used in determining depletion on a unit-of-production basis is not specifically prescribed. Under Previous GAAP, the Company was required to use a reserve estimate based on average commodity prices of the preceding year. On adoption of IFRS, Paramount amended its depletion policy to use a reserves estimate based on proved developed reserves and forecast commodity prices.

IFRS requires an impairment write down to be recorded when the carrying value of an asset exceeds its recoverable amount. The recoverable amount is defined as the greater of value in use and fair value less costs to sell. Under Previous GAAP, a two-step approach was used to determine impairment write-downs: (i) the carrying value of a property was compared to its expected undiscounted before-tax cash flows, and (ii) where the carrying value exceeded the expected undiscounted before-tax cash flows, an impairment write-down was calculated based on the difference between the property's carrying value and its expected discounted before-tax cash flows. The IFRS method of determining impairments resulted in the recognition of additional impairment write-downs of petroleum and natural gas properties of $65.4 million on the Transition Date. For the twelve months ended December 31, 2010, additional write-downs of $32.6 million were recognized, including a goodwill impairment charge of $3.6 million.

b) Asset Retirement Obligations

Under IFRS the Company's policy is to re-measure asset retirement obligations at each reporting date using the period-end risk-free rate. Under Previous GAAP, credit-adjusted risk-free rates were applied to each obligation when initially recognized, and that rate was not adjusted in future periods. On Transition Date, the Company recorded a $91.6 million increase in the asset retirement obligation liability due to a decrease in discount rates, from approximately eight percent under Previous GAAP to four percent under IFRS.

c) Foreign exchange translation

Under IFRS, assets and liabilities of subsidiaries with functional currencies that are not the presentation currency are translated at the exchange rate in effect at the end of the reporting period and the resulting exchange differences are recognized in other comprehensive income. Under Previous GAAP, the assets and liabilities of the Company's integrated foreign operations were translated into Canadian dollars using the temporal method, where non-monetary items were translated at historical exchange rates and monetary assets and liabilities were translated at the exchange rate in effect at the end of the reporting period, with resulting exchange differences recognized in income.

d) Stock-based compensation

Prior to October 1, 2011, Paramount accounted for Paramount Options as cash-settled awards, where a liability was recognized initially based on the grant date fair value of the options. The liability was subsequently adjusted each period for vesting and changes in the fair value of the options, until the options were exercised, surrendered or expired, with an offsetting entry to stock-based compensation expense. The fair value of the options were determined using the Black-Scholes-Merton model. When options were exercised for Common Shares, the consideration paid by the option holder and the previously recognized liability associated with the options were recorded as an increase to share capital.

When options were surrendered for cash, the cash settlement was applied against the liability and any difference was recognized as stock-based compensation expense.

As of October 1, 2011, the Company accounts for Paramount Options as equity-settled stock-based compensation transactions, where the grant date fair value of stock options awarded is recognized as stock-based compensation expense over the vesting period, with a corresponding increase in Contributed Surplus. The grant date fair value of stock options is estimated using the Black-Scholes-Merton model and such value is not adjusted in future periods. The amount of stock-based compensation expense recognized each period reflects the portion of the vesting term that elapsed and an estimate of the number of options that are expected to vest. That estimate is adjusted each period such that the cumulative amount recognized on the vesting date reflects the actual number of stock options that ultimately vest. Upon the exercise of a stock option, the Company transfers the cumulative amount recognized in respect of the award from Contributed Surplus to Share Capital.

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.

e) Flow-through shares

Under IFRS, proceeds from the issuance of flow-through shares are allocated between the sale of the shares, which are recorded in share capital, and the sale of the tax benefits, which are initially recorded as an accrued liability. The allocation is made based on the difference between the issue price of flow-through shares and the market price of the Common Shares on the date the offering is priced. The liability related to the sale of the tax benefits is reversed as qualifying expenditures intended for renunciation to subscribers are incurred, and a deferred tax liability is recorded. The difference between the deferred tax liability recorded and the liability related to the sale of tax benefits is recognized as deferred tax expense. Under Previous GAAP, when flow-through shares were issued, they were recorded in share capital based on proceeds received. Upon filing the renunciation documents with the tax authorities, a future tax liability was recognized and share capital was reduced for the tax effect of expenditures renounced to subscribers. The IFRS adjustment on Transition Date associated with flow-through shares was to increase share capital by $25.1 million, reduce retained earnings by $30.4 million, increase deferred tax liabilities by $2.9 million, and increase accrued liabilities by $2.4 million.

f) Equity Accounted Investments

The equity method of accounting requires an investor to adjust the carrying value of its investment in an investee for the investor's proportionate share of changes in the investee's net assets. On Transition Date, the carrying value of Paramount's equity accounted investments was decreased by an aggregate of $7.6 million to reflect Paramount's proportionate share of the adjustments Trilogy and MGM Energy recorded in respect of their IFRS transitions. For the twelve months ended December 31, 2010, the carrying values of Paramount's equity accounted investments were increased by $30.3 million due to adjustments recorded by Trilogy and MGM Energy.

g) Deferred Income Tax

On Transition Date, the Company's deferred income tax asset balance was increased by $2.5 million, the deferred income tax liability balance was decreased by $34.0 million, and the equity accounted investments balance was increased by $1.9 million to reflect the tax impacts of the IFRS adjustments as described in the preceding discussion. For the twelve months ended December 31, 2010, the deferred income tax asset balance was decreased by $3.7 million, the equity accounted investments balance was

decreased by $1.9 million and deferred income tax expense was increased by $6.2 million. Deferred income tax on foreign exchange differences on translation of the US subsidiaries was $0.6 million for the twelve months ended December 31, 2010.

h) Statement of Cash Flows

Under IFRS, cash from operating activities is reduced by geological and geophysical expenses and excludes cash outflows related to purchases of Paramount's Common Shares under the Company's stock incentive plan and the effect of changes in foreign exchange rates in respect of foreign currency cash and cash equivalent balances. Under Previous GAAP, geological and geophysical expenses were included in cash used in investing activities and cash outflows related to the purchase of Paramount's Common Shares under the Company's stock incentive plan and the effect of changes in foreign exchange rates in respect of foreign currency cash and cash equivalent balances were included in cash from operating activities.

Impacts of Accounting Policy Changes

Summarized reconciliations of Paramount's 2010 Previous GAAP amounts to IFRS amounts are as follows:

Balance Sheet

	December 31, 2010			January 1, 2010		
	Previous GAAP	IFRS Adjustments	**IFRS**	Previous GAAP	IFRS Adjustments	**IFRS**
Current assets	110.5	–	**110.5**	121.2	–	**121.2**
Long term assets	1,266.7	14.1	**1,280.8**	980.8	(65.1)	**915.7**
	1,377.2	14.1	**1,391.3**	1,102.0	(65.1)	**1,036.9**
Current liabilities	151.6	7.1	**158.7**	87.0	4.8	**91.8**
Long term liabilities	439.9	110.5	**550.4**	242.1	61.4	**303.5**
	591.5	117.6	**709.1**	329.1	66.2	**395.3**
Equity	785.7	(103.5)	**682.2**	772.9	(131.3)	**641.6**
	1,377.2	14.1	**1,391.3**	1,102.0	(65.1)	**1,036.9**

Comprehensive Income

	Twelve months ended December 31, 2010	Three months ended December 31, 2010
Comprehensive (Loss) – Previous GAAP	**$ (54.0)**	**$ (12.6)**
IFRS Adjustments:		
Adjustments to PP&E related to impairments and changes in depletion	9.2	12.7
Accretion of asset retirement obligations	1.8	0.5
Change in currency translation method related to foreign subsidiaries	(3.5)	(2.1)
Change in stock-based compensation	3.5	1.0
Change in method of accounting for flow-through shares	(5.3)	(1.4)
Change in income from equity accounted investments	30.4	31.9
Adjustment to deferred tax	(5.7)	(3.0)
Comprehensive (Loss) Income – IFRS	**$ (23.6)**	**$ 27.0**

Cash Flows

	Twelve months ended December 31, 2010	Three months ended December 31, 2010
Cash from operating activities under Previous GAAP	**$ 63.4**	$ 11.1
Adjustments under IFRS:		
Exploration costs	**(8.2)**	1.5
Common shares purchased under stock incentive plan	**2.9**	–
Foreign exchange on cash and cash equivalents	**1.1**	0.8
Cash from operating activities under IFRS	**$ 59.2**	$ 10.4
Cash from financing activities under Previous GAAP	**$ 251.9**	$ 149.3
Adjustment under IFRS:		
Common shares purchased under stock incentive plan	**(2.9)**	–
Cash from financing activities under IFRS	**$ 249.0**	$ 149.3
Cash used in investing activities under Previous GAAP	**$ (333.9)**	$ (108.5)
Adjustment under IFRS:		
Exploration costs	**8.2**	1.5
Cash used in investing activities under IFRS	**$ (325.7)**	$ (107.0)
Net decrease	**$ (17.5)**	$ 52.7
Foreign exchange on cash and cash equivalents	**(1.0)**	0.8
Cash and cash equivalents, beginning of period	**93.2**	21.2
Cash and cash equivalents, end of year	**$ 74.7**	$ 74.7

Future Changes in Accounting Standards

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.

The adoption of these standards and amendments are not expected to have a material impact on the company's business or result in changes in business practices.

DISCLOSURE CONTROLS AND PROCEDURES

As of the year ended December 31, 2011, 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, 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, 2011. 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, 2011.

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 procedure may deteriorate.

Changes in Internal Controls Over Financial Reporting

During the fiscal year and quarter ended December 31, 2011, 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 judgments based on assumptions and estimates that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. The following is a discussion of the accounting judgments, estimates and assumptions that are considered significant:

Exploration and Evaluation Assets

The accounting for exploration and evaluation assets requires management to make certain judgments based on assumptions and estimates as to future events and circumstances, including the designation of wells as being exploratory or development and whether exploratory wells have discovered economically recoverable quantities of reserves. Designations are sometimes revised as new information becomes available.

If an exploratory well encounters hydrocarbons, but further appraisal activity is required in order to conclude whether the hydrocarbons are economically recoverable, the well costs remain capitalized as long as sufficient progress is being made in assessing the economic and operating viability of the well. Criteria utilized in making this determination include evaluation of the reservoir characteristics and hydrocarbon properties, expected additional development activities, and regulatory matters. The concept of "sufficient progress" is a judgmental area, and it is possible to have exploratory costs remain capitalized for several years while additional drilling is performed or the Company seeks government, regulatory or partner approval of development plans.

Where it is determined that an exploratory well or project is unsuccessful, the costs are written-off as exploration and evaluation expense.

Reserves Estimates

Reserve engineering is an inherently complex and subjective process of estimating underground accumulations of petroleum and natural gas. The process relies on judgments 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 prices 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 estimation of the recoverable amount of petroleum and natural gas properties used in impairment assessments, all of which could have a material impact on earnings.

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. Estimates of fair value require management to make assumptions about future events, including reserves estimates. These assumptions are based on management's judgments regarding the use of appropriate indicators of fair value. Changes in any of the assumptions or estimates used in determining the fair value of the net identifiable assets acquired may impact the carrying values assigned and earnings.

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 applies judgment in determining such assumptions and adjusts estimated amounts periodically to incorporate new information. Accordingly, actual payments to settle the obligations may differ materially from amounts estimated.

Share-Based Payments

Use of the Black-Scholes-Merton method to estimate the fair value of the Company's stock options requires the application of various assumptions including future risk-free rates, option lives, forfeiture rates, dividends, stock price and volatility. Changes in any of these variables could have a material impact on stock-based compensation expense.

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", "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 volumes and the timing thereof;
- planned exploration and development expenditures and the timing thereof;
- exploration and development potential and/or plans and strategies and the anticipated costs and results thereof;
- budget allocations and capital spending flexibility;
- adequacy of facilities to process and transport natural gas production;
- the scope and timing of proposed new facilities and expansions to existing facilities and the expected capacity and utilization of such facilities;
- estimated reserves and resources and the undiscounted and discounted present value of future net revenues from such reserves and resources (including the forecast prices and costs and the timing of expected production volumes and future development capital);
- timing of regulatory applications;
- the timing of the anticipated development of Paramount's oil sands, carbonate and shale gas assets;
- ability to fulfill future pipeline transportation commitments;
- future taxes payable or owing;
- undeveloped land lease expiries;
- timing and cost of future abandonment and reclamation;
- business strategies and objectives;
- sources of and plans for financing;
- acquisition and disposition plans;
- operating and other costs and royalty rates;
- regulatory applications and the anticipated timing, results and scope thereof;
- anticipated increases in future reserves estimates;
- expected drilling programs, well tie-ins, facility construction and expansions, completions and the timing thereof; and
- the outcome of any legal claims, audits, assessments or other regulatory matters or 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 crude oil, bitumen, natural gas and NGLs prices and general economic , business conditions, and market conditions;
- the ability of Paramount to obtain required capital to finance its exploration, development and operations;
- the ability of Paramount to obtain equipment, services, supplies and personnel in a timely manner and at an acceptable cost to carry out its activities;
- the ability of Paramount to market its oil and natural gas successfully to current and new customers;
- the ability of Paramount to secure adequate product processing, transportation and storage;
- the ability of Paramount and its industry partners to obtain drilling success consistent with expectations;
- the timely receipt of required regulatory approvals;
- expected timelines being met in respect of facility development and construction projects;
- access to capital markets and other sources of funding;
- well economics relative to other projects; 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 crude oil, bitumen, natural gas and NGLs prices, foreign currency exchange rates and interest rates;
- the uncertainty of estimates and projections relating to future revenue, future production, costs and expenses and the timing thereof;
- the ability to secure adequate product processing,
- changes to the status or interpretation of laws, regulations or policies;
- changes in environmental laws including emission reduction obligations;
- the receipt, timing, and scope of governmental or regulatory approvals;
- changes in economic, business and market

transportation and storage;
- the uncertainty of exploration, development and drilling activities;
- operational risks in exploring for, developing and producing crude oil and natural gas, and the timing thereof;
- the ability to obtain equipment, services, supplies and personnel in a timely manner and at an acceptable cost;
- potential disruptions or unexpected technical difficulties in designing, developing or operating new, expanded or existing facilities including, third party facilities that service Company production;
- 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 other sources of financing at an acceptable cost to meet current and future obligations, including costs of anticipated projects; conditions;
- uncertainty regarding aboriginal land claims and co-existing with local populations;
- the effects of weather;
- the ability to fund exploration, development and operational activities and meet current and future obligations;
- the timing and cost of future abandonment and reclamation activities;
- cleanup costs or business interruptions due to environmental damage and contamination;
- the ability to enter into or continue leases;
- existing and potential lawsuits and regulatory actions; and
- other risks and uncertainties described elsewhere in this document and in Paramount's other filings with Canadian securities authorities, including its Annual Information Form.

The foregoing list of risks is not exhaustive. Additional information concerning these and other factors which could impact Paramount are included in Paramount's most recent Annual Information Form. 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 financial commodity contract settlements", "Net Debt", "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 GAAP.

The Company has adjusted its funds flow from operations measure for all periods subsequent to exclude asset retirement obligation settlements, cash outflows related to the purchase of Paramount's Common Shares under the Company's stock incentive plan and the effect of changes in foreign exchange rates in respect of foreign currency cash and cash equivalent balances. 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 calculation of Net Debt in the liquidity and capital resources section of Management's Discussion and Analysis. Exploration and development expenditures refer to capital expenditures 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 , MGM Energy and others), and investments in all other entities at book value. Paramount provides this information in its MD&A 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, natural gas liquids ("NGLs") and condensate. The term "liquids-rich" is used to represent natural gas streams with associated liquids volumes.

For fiscal 2011, the value ratio between crude oil and natural gas was approximately 23:1. 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.

The reserves replacement disclosure herein was calculated as the net increase in proved and probable reserves estimates from extensions and discoveries, technical revisions and economic factors divided by the total production in the year.

NOTES

(1) Hoole was evaluated by McDaniel as of April 30, 2011. Saleski and the Other Carbonate Lands were evaluated by McDaniel as of October 31, 2011.

(2) **Contingent Resources** are those quantities of bitumen estimated, as of a given date, to be potentially recoverable from known accumulations using established technology or technology under development, but are classified as a resource rather than a reserve due to one or more contingencies, such as the absence of regulatory approvals, detailed design estimates or near term development plans. There is no certainty that it will be commercially viable to produce any portion of the contingent resources. For the Hoole oil sands property, contingencies which must be overcome to enable the reclassification of bitumen contingent resources as reserves include the finalization of plans for the initial development, a regulatory application submission with no major issues raised, access to capital markets and other sources of funding and management's intent to proceed evidenced by a development plan with major capital expenditures. **Economic Contingent Resources** are those Contingent Resources that are economically recoverable based on specific forecasts of commodity prices and costs (based on McDaniel's forecast prices and costs as of April 1, 2011).

(3) **Discovered Exploitable Bitumen In Place** is the estimated volume of bitumen, as of a given date, which is contained in a subsurface stratigraphic interval of a known accumulation that meets or exceeds certain reservoir characteristics, such as minimum continuous net pay, porosity and mass bitumen content. For the Hoole oil sands property, the presence of these characteristics is considered necessary for the commercial application of known recovery technologies. For the Saleski property and the Other Carbonate Lands, these volumes have been constrained to areas that have a minimum thickness of 10 meters of substantially clean, continuous predominantly bitumen-saturated carbonate with log porosity meeting a minimum of 10 percent and bitumen saturation greater than 50 percent, respectively and with both competent top and lateral reservoir containment. These carbonate bitumen resources are constrained to one mile in area around known data points that penetrate the zone and possess definitive geophysical log data. Discovered Exploitable Bitumen in Place for the Saleski property and the Other Carbonate Lands may be assigned outside of the one mile area if reservoir continuity between offsetting delineation is expected. The technology required to economically produce bitumen from carbonate formations is currently in the development stage and has not been proven on a commercial scale. There is no certainty that it will be commercially viable to produce any portion of the resources from the Hoole oil sands property, the Saleski property or the Other Carbonate Lands.

(4) Represents the Company's share of recoverable volumes before deduction of royalties. In the assessment of Economic Contingent Resources, McDaniel used a minimum net pay cut-off of 10 meters in the best estimate case.

(5) **NPV** means net present value and represents the Company's share of future net revenue, before the deduction of income tax from the Economic Contingent Resources in the Grand Rapids formation within the Hoole oil sands property. The calculation considers such items as revenues, royalties, operating costs, abandonment costs and capital expenditures. Royalties have been calculated based on Alberta's Royalty Framework applicable to oil sands projects in Alberta. The calculation does not consider financing costs and general and administrative costs. NPVs were calculated assuming natural gas is used as a fuel for steam generation. Revenues and expenditures were calculated based on McDaniel's forecast prices and costs as of April 1, 2011. The estimated net present values disclosed in this press release do not represent fair market value.

(6) **Undiscovered Exploitable Bitumen In Place** is the volume of petroleum estimated, as of a given date, to be contained in accumulations yet to be discovered. These resources are mapped using known data points penetrating the zone and possess definitive geophysical log data along with seismic data and regional mapping.

There is no certainty that any portion of the resources will be discovered. If discovered, there is no certainty that it will be commercially viable to produce any portion of the resources.

(7) **Prospective Resources** are those quantities of bitumen estimated, as of a given date, to be potentially recoverable from undiscovered accumulations by application of future development projects. Prospective resources have both an associated chance of discovery and a chance of development. Prospective Resources have not been, and may never be, discovered.

(8) **Contingent Resources/Technology Under Development** are those quantities of bitumen estimated, as of a given date, to be potentially recoverable from known accumulations using established technology or technology under development, but are classified as a resource rather than a reserve due to one or more contingencies, such as the absence of regulatory approvals, detailed design estimates or near term development plans. There is no certainty that it will be commercially viable to produce any portion of the contingent resources. For the Saleski property and the Other Carbonate Lands, because of the lack of demonstrated commercial SAGD production within carbonate reservoirs, the recoverable resources assigned are contingent upon successful application of SAGD to the subject reservoir or a reasonable analog. The successful implementation of SAGD technology in carbonate reservoirs is a significant contingency associated with these assignments that separate them from typical McMurray clastic SAGD contingent and prospective resources, where the technology has been proven effective. In addition to the technical contingency, additional contingencies applicable to the carbonate resources include being in the early evaluation stage, the economic viability of development and the absence of regulatory approvals. The economic status of these resources are undetermined.

(9) **Best Estimate** is considered to be the best estimate of the quantity of resources that will actually be recovered. It is equally likely that the actual remaining quantities recovered will be greater or less than the best estimate. Those resources that fall within the best estimate have a 50 percent confidence level that the actual quantities recovered will equal or exceed the estimate.

TEST RESULTS

Test rates disclosed in this document represent the average rate of gas-flow during post clean-up production tests at the largest choke setting up 4½" casing. All wells were stimulated using frac oil and substantially all fluids recovered during the test periods were load fluids. As a result, recovered fluid volumes for the duration of the tests have not been disclosed. Pressure transient analyses and well-test interpretations have not been carried out for the wells disclosed and as such, data should be considered to be preliminary until such analysis or interpretation has been done. Test results are not necessarily indicative of long-term performance or of ultimate recovery. Liquids yields under the heading "Average Sales Volumes" are presented for the period following recovery of all load fluids. Liquids yields are not presented where recovery of load fluids is incomplete.

FINANCIAL STATEMENTS

Management's Report

The accompanying Consolidated Financial Statements of Paramount Resources Ltd. (the "Company") are the responsibility of Management and have been approved by the Board of Directors. The Consolidated Financial Statements have been prepared by Management in Canadian dollars in accordance with International Financial Reporting Standards and include certain estimates that reflect Management's best judgments. When alternative accounting methods exist, Management has chosen those it considers most appropriate in the circumstances. Financial information contained throughout the Company's annual report is consistent with these Consolidated Financial Statements.

Management is also 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 International Financial Reporting Standards, and that the Company's assets are safeguarded.

The Board of Directors is responsible for ensuring that Management fulfills its responsibilities for financial reporting and internal control. The Board of Directors exercises this responsibility through the Audit Committee. The Audit Committee meets regularly with Management and the independent auditors to ensure that Management's responsibilities are properly discharged and to review the Consolidated Financial Statements. The Audit Committee reports its findings to the Board of Directors for consideration when approving the annual Consolidated Financial Statements for issuance to the shareholders. The Audit Committee also considers, for review by the Board of Directors and approval by the shareholders, the engagement or re-appointment of the external auditors. The Audit Committee of the Board of Directors is comprised entirely of non-management directors.

Ernst & Young LLP, independent auditors appointed by the shareholders of the Company, conducts an examination of the Consolidated Financial Statements in accordance with Canadian Generally Accepted Auditing Standards. Ernst & Young LLP has full and free access to the Audit Committee and Management.

/s/ Clayton H. Riddell
Clayton H. Riddell
Chief Executive Officer

/s/ Bernard K. Lee
Bernard K. Lee
Chief Financial Officer

March 6, 2012

INDEPENDENT AUDITORS' REPORT

To the shareholders of Paramount Resources Ltd.:

We have audited the accompanying consolidated financial statements of Paramount Resources Ltd. which comprise the consolidated balance sheets as at December 31, 2011 and 2010, and January 1, 2010, and the consolidated statements of comprehensive loss, shareholders equity and cash flows for the years ended December 31, 2011 and 2010, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Paramount Resources Ltd. as at December 31, 2011 and 2010, and January 1, 2010, and its financial performance and its cash flows for the years ended December 31, 2011 and 2010 in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Calgary, Canada
6 March 2012

Chartered accountants

PARAMOUNT RESOURCES LTD.
Consolidated Balance Sheet
($ thousands)

As at	Note	**December 31 2011**	December 31 2010 (note 24)	January 1 2010 (note 24)
ASSETS				
Current assets				
Cash and cash equivalents	20	**$ 29,000**	$ 74,659	$ 93,238
Accounts receivable	19	**40,181**	33,280	23,488
Risk management	19	**184**	–	2,187
Prepaid expenses and other		**2,551**	2,572	2,301
Assets held for sale	6	**58,038**	–	–
		129,954	110,511	121,214
Deposit	18	**20,043**	19,788	–
Exploration and evaluation	7	**390,742**	269,084	151,283
Property, plant and equipment, net	8	**808,617**	580,334	503,106
Equity-accounted investments	9	**101,543**	138,300	113,471
Investments in securities	10	**153,840**	189,717	115,383
Deferred income tax	18	**117,548**	75,575	32,423
Goodwill	11	**3,426**	8,012	–
		$ 1,725,713	$ 1,391,321	$ 1,036,880
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Demand facilities	12	**$ 22,842**	$ 26,880	$ 29,380
Accounts payable and accrued liabilities	19	**136,820**	84,928	48,571
Risk management	19	**2,787**	693	–
Stock-based compensation	1,17	**–**	46,187	13,827
Liabilities associated with assets held for sale	6	**13,040**	–	–
		175,489	158,688	91,778
Long-term debt	13	**427,186**	294,205	93,655
Asset retirement obligations	14	**299,202**	241,770	195,088
Stock-based compensation	1,17	**–**	14,460	4,721
Deferred income tax	18	**–**	–	10,034
		901,877	709,123	395,276
Commitments and contingencies	23			
Shareholders' equity				
Share capital	15	**810,781**	481,827	418,191
Accumulated (deficit) earnings		**(103,615)**	128,375	218,386
Reserves	16	**116,670**	71,996	5,027
		823,836	682,198	641,604
		$ 1,725,713	$ 1,391,321	$ 1,036,880

See the accompanying notes to these Consolidated Financial Statements.

On behalf of the Board

/s/ J.H.T. Riddell
J.H.T. Riddell, Director

/s/ J.C. Gorman
J.C. Gorman, Director

PARAMOUNT RESOURCES LTD.
Consolidated Statement of Comprehensive Loss
($ thousands, except as noted)

Year ended December 31	Note	2011	2010 (note 24)
Petroleum and natural gas sales		**$ 241,713**	$ 184,395
Royalties		**(22,056)**	(21,227)
Revenue		**219,657**	163,168
Gain (loss) on financial commodity contracts	19	**(1,699)**	10,047
		217,958	173,215
Expenses			
Operating expense and production tax		**71,253**	50,892
Transportation		**20,519**	17,219
General and administrative		**16,934**	15,150
Stock-based compensation	1,17	**21,462**	55,278
Depletion and depreciation	8	**378,077**	160,650
Exploration and evaluation	7	**27,330**	42,721
Gain on sale of property, plant and equipment		**(42,021)**	(380)
Interest		**34,109**	13,560
Accretion of asset retirement obligations		**7,374**	7,975
Debt extinguishment		**–**	1,708
Acquisition transaction costs		**1,044**	267
Foreign exchange		**1,377**	(298)
		537,458	364,742
Income from equity-accounted investments	9	**1,201**	35,999
Other income	5,10	**24,528**	4,784
Net loss before tax		**(293,771)**	(150,744)
Income tax expense (recovery)	18		
Current		**12**	213
Deferred		**(61,793)**	(60,946)
		(61,781)	(60,733)
Net loss		**$ (231,990)**	$ (90,011)
Other comprehensive income (loss), net of tax	16		
Change in market value of securities		**(19,913)**	68,434
Exchange differences on translation of US subsidiaries		**1,197**	(2,028)
		(18,716)	66,406
Comprehensive loss		**$ (250,706)**	$ (23,605)
Net loss per common share ($/share)	15		
Basic and diluted		**$ (2.96)**	$ (1.24)

See the accompanying notes to these Consolidated Financial Statements.

PARAMOUNT RESOURCES LTD.
Consolidated Statement of Cash Flows
($ thousands)

Year ended December 31	Note	2011	2010 (note 24)
Operating activities			
Net loss		**$ (231,990)**	$ (90,011)
Add (deduct)			
Items not involving cash	20	**310,074**	161,171
Dividends from equity accounted investments		**11,360**	12,986
Asset retirement obligations settled	14	**(7,520)**	(3,209)
Debt extinguishment costs		**–**	1,708
Change in non-cash working capital		**3,036**	(23,467)
Cash from operating activities		**84,960**	59,178
Financing activities			
Drilling rig loan repayments		**(4,038)**	(2,500)
Proceeds from Senior Notes, net of issue costs		**70,899**	294,171
Repayment of US Senior Notes		**–**	(92,234)
Repayment of debt assumed on acquisitions	4	**(37,824)**	(10,521)
Net draw of revolving long-term debt	13	**61,383**	–
Common shares issued, net of issue costs		**268,627**	62,989
Common shares purchased under stock incentive plan		**(2,974)**	(2,901)
Cash from financing activities		**356,073**	249,004
Investing activities			
Property, plant and equipment and exploration		**(525,239)**	(289,969)
Proceeds on sale of property, plant and equipment		**45,385**	1,196
Proceeds on sale of investment		**16,129**	–
Corporate acquisitions	4	**(64,759)**	(46,172)
Investments in securities		**–**	(9,648)
Equity accounted investments		**–**	(1,452)
Deposit	18	**–**	(19,788)
Change in non-cash working capital		**41,769**	40,138
Cash used in investing activities		**(486,715)**	(325,695)
Net decrease		**(45,682)**	(17,513)
Foreign exchange on cash and cash equivalents		**23**	(1,066)
Cash and cash equivalents, beginning of year		**74,659**	93,238
Cash and cash equivalents, end of year		**$ 29,000**	$ 74,659
Supplemental cash flow information	20		

See the accompanying notes to these Consolidated Financial Statements.

PARAMOUNT RESOURCES LTD.

Consolidated Statement of Shareholders' Equity

($ thousands, except as noted)

Year ended December 31	Note	2011 Shares (000's)	2011	2010 Shares (000's)	2010 (note 24)
Share Capital					
Balance, beginning of year		***75,034***	**$ 481,827**	*72,058*	$ 418,191
Issued		***8,316***	**271,683**	*2,948*	63,734
Issued on acquisition of ProspEx	4	***2,000***	**57,280**	–	–
Change in unvested common shares for stock incentive plan	17	***64***	**(9)**	*28*	(98)
Balance, end of year		***85,414***	**$ 810,781**	*75,034*	$ 481,827
Accumulated (Deficit) Earnings					
Balance, beginning of year			**$ 128,375**		$ 218,386
Net loss			**(231,990)**		(90,011)
Balance, end of year			**$ (103,615)**		$ 128,375
Reserves	16				
Balance, beginning of year			**$ 71,996**		$ 5,027
Other comprehensive income (loss)			**(18,716)**		66,406
Contributed surplus			**65,792**		–
Stock-based compensation - investee options			**(2,402)**		563
Balance, end of year			**$ 116,670**		$ 71,996
Total Shareholders' Equity			**$ 823,836**		$ 682,198

See the accompanying notes to these Consolidated Financial Statements.

1. SIGNIFICANT ACCOUNTING POLICIES

Paramount Resources Ltd. ("Paramount" or the "Company") is an independent, publicly traded, Canadian corporation that explores for and develops conventional petroleum and natural gas prospects, pursues long-term non-conventional exploration and pre-development projects and holds a portfolio of investments in other entities. Paramount's principal properties are located in Alberta, the Northwest Territories and British Columbia in Canada, and in North Dakota and Montana in the United States. Paramount is the ultimate parent company of the consolidated group of companies. Paramount has divided its operations into three business segments: Principal Properties, Strategic Investments and Corporate.

Paramount Resources Ltd. is incorporated and domiciled in Canada. The address of its registered office is 4700, 888 3rd Street S.W., Calgary, Alberta, Canada, T2P 5C5.

These Consolidated Financial Statements were authorized for issuance by the Board of Directors of Paramount Resources Ltd. on March 6, 2012.

a) Basis of Preparation

These Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), are stated in Canadian dollars and have been prepared on a historical cost basis, except for certain financial instruments. These Consolidated Financial Statements include the accounts of Paramount and its subsidiaries and partnerships, including Summit Resources, Inc., Cavalier Energy Inc., Paramount Drilling U.S. LLC. and Fox Drilling Inc.

Canadian Generally Accepted Accounted Principles ("GAAP"), as issued by the Canadian Institute of Chartered Accountants, were converted to IFRS effective for fiscal years beginning on or after January 1, 2011. These Consolidated Financial Statements represent Paramount's initial presentation of its annual results of operations and financial position under IFRS, and include transition disclosures as required by IFRS 1 - First-time Adoption of IFRS. In order to prepare comparative information, the Company has applied IFRS as of January 1, 2010 (the "Transition Date") and the accounting, estimation and valuation policies adopted on conversion to IFRS, as described below, have been consistently applied to all periods presented herein. A reconciliation of comparative amounts included herein to amounts previously published in accordance with Canadian GAAP in effect prior to January 1, 2011 ("Previous GAAP") has been provided in Note 24.

The preparation of these Consolidated Financial Statements requires the use of certain accounting estimates and also requires management to exercise judgment in applying the Company's accounting policies. Areas involving a higher degree of judgment or complexity, and areas where assumptions and estimates are significant to the financial statements are described in Note 2.

The financial statements of Paramount's subsidiaries and partnerships are prepared for the same reporting periods as the parent in accordance with the Company's accounting policies. All intercompany balances and transactions have been eliminated.

b) Revenue Recognition

Petroleum and natural gas sales revenues are recognized when title passes to third parties and the significant risks and rewards of ownership have been transferred.

Drilling services are billed to customers on a per-day basis and revenues are recognized as services are rendered and collectability is reasonably assured. When the Company's drilling rigs (the "Rigs") drill on a property owned by Paramount, the Company capitalizes its working interest share of the drilling expenses, and eliminates the associated drilling revenue.

Interest revenue is recognized as earned, using the effective interest method.

c) Cash and Cash Equivalents

Cash and cash equivalents are recorded at cost and include short-term investments with maturities of three months or less from the date of acquisition.

d) Trade and Other Receivables

Accounts receivable are recorded as revenue is recognized or costs are incurred on behalf of partners. An allowance for doubtful accounts is recognized based on management's best estimate of accounts that may not be collectible, which is reviewed and adjusted on a quarterly basis.

e) Equity-Accounted Investments

Investments in entities in which Paramount does not have direct or joint control over strategic operating, investing, and financing decisions, but over which it has significant influence, are accounted for using the equity method. Under this method, the Company recognizes its proportionate share of the earnings of investees in its earnings. As dividends are received, the carrying value of Paramount's investment in the investee is reduced. The Company is generally considered to have significant influence over an investee where its equity interest exceeds 20 percent, or where significant influence can be clearly demonstrated. Paramount accounts for its investments in MGM Energy Corp. ("MGM Energy") and Paxton Corporation ("Paxton") using the equity method, even though it holds less than a 20 percent interest in these corporations, because the Company and each of MGM Energy and Paxton share common directors and/or members of management. All other investments are accounted for as financial instruments.

The carrying values of the Company's equity accounted investments are reviewed at each reporting date to determine whether any indicators of impairment are present. If an indicator of impairment is identified, the recoverable amount of the investment is estimated. If the carrying value of the investment exceeds the estimated recoverable amount, an impairment charge is recognized.

f) Joint Arrangements

Paramount recognizes its proportionate interest of the revenues, expenses, assets, and liabilities of jointly controlled assets.

g) Exploration and Evaluation

Costs related to the exploration for and evaluation of hydrocarbon resources, including costs of drilling and completing exploratory wells, acquiring unproved property and estimated asset retirement costs, are initially capitalized, pending determination of technical feasibility and commercial viability. If hydrocarbons are found, but further appraisal activity is required to conclude whether they are economically recoverable, the costs continue to be recognized as an asset. All such costs are subject to technical, commercial, and management review at least annually to confirm the continued intent to develop the discovery. All direct costs related to pre-development activities in connection with oil sands properties are considered pre-operating and are capitalized, including the costs to acquire mineral rights, conduct

delineation drilling, and design and construct plant and equipment. When a project has been determined to be technically feasible and commercially viable, the exploration and evaluation ("E&E") costs are transferred to petroleum and natural gas assets, subject to an impairment assessment. When the Company determines that a project is no longer viable, its carrying value is charged to earnings.

Exploratory geological and geophysical costs, pre-license costs, and annual lease rentals are expensed as incurred.

h) Oil and Gas Properties and Other Property, Plant and Equipment

Oil and gas properties are carried at cost, net of accumulated depletion, depreciation and impairments, and include costs related to drilling and completing development wells, infrastructure construction, successful E&E projects and asset retirement.

Paramount's Rigs are carried at cost, net of accumulated depreciation and include costs of material, machinery, labour, and directly attributable overhead. Costs incurred to improve the capabilities of the Rigs, extend their useful lives or replace significant components are capitalized. When a significant component is replaced, the carrying value of the replaced part is written off. Costs incurred to maintain and repair the Rigs are expensed as incurred.

Other property, plant and equipment, including leasehold improvements, are carried at cost net of accumulated depreciation.

Depletion and Depreciation

Capitalized costs of proved oil and gas properties are depleted over proved developed reserves using the unit-of-production method. For purposes of these calculations, natural gas production and reserves are converted to barrels on an energy equivalent basis. Depletion rates are revised annually or more frequently when events dictate. E&E costs are not depleted.

Capitalized costs of gathering systems and production equipment are depleted on a unit-of-production basis over the proved developed reserves of the field to which they relate. Capitalized costs of processing plants are depreciated on a straight line basis over their expected useful lives.

Leasehold improvements are depreciated over the term of the lease. Other assets are depreciated using the declining balance method at rates varying from 35 to 50 percent.

The Rigs are depreciated by component over their expected useful lives, varying from 1,000 to 3,600 drilling days.

Impairment of Non-Financial Assets

The carrying values of the Company's non-financial assets, excluding goodwill, are reviewed at each reporting date to determine whether any indicators of impairment are present. If an indicator of impairment is identified, the asset's recoverable amount is estimated. For the purpose of impairment testing, assets are tested individually or, in certain circumstances, assets are grouped together into a cash-generating unit ("CGU"), which consists of the smallest group of assets that generate cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The recoverable amount of an asset or CGU is the greater of its fair value less costs to sell and its value in use. In assessing fair value less costs to sell, the Company estimates the value a potential purchaser would ascribe to an asset or CGU, by estimating its expected discounted after-tax future net cash flows. For oil

and gas properties, discounted after-tax future net cash flows are generally determined using forecast commodity prices and costs over the expected economic life of proved and probable reserves, discounted using market-based rates. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the asset or CGU. If the carrying value of an asset or CGU exceeds its estimated recoverable amount, an impairment charge is recognized.

When it is determined that there has been a subsequent increase in the recoverable amount ascribed to an asset or CGU, reversals of impairments are recognized net of any depletion and depreciation that would have been recorded since the date of the impairment charge.

Alberta Drilling Royalty Credits

Paramount recognized Alberta drilling royalty credits as a reduction to the cost of drilling wells. The credits were recognized as they were earned, as determined by well depth, to the extent the Company anticipated being able to use the credits to reduce crown royalties.

i) Business Combinations and Goodwill

Business combinations are accounted for using the acquisition method of accounting. Under this method, the net identifiable assets acquired are measured at fair value on acquisition date. Costs incurred to affect the transaction are expensed. 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.

Goodwill is tested for impairment at least annually, or when a potential impairment indicator is identified. In testing goodwill for impairment, the carrying value of a CGU (or group of CGUs), including allocated goodwill, is compared to the CGU's (or group of CGUs') estimated recoverable amount. An impairment charge is recognized to the extent that the carrying amount of the CGU including goodwill exceeds its estimated recoverable amount. Impairment charges relating to goodwill are not reversed in future periods.

Recoverable amounts are determined based on the greater of a CGU's fair value less costs to sell and value in use. In assessing fair value less costs to sell, the Company estimates the value a potential purchaser would ascribe to the CGU by estimating the CGU's expected discounted after-tax future net cash flows. Discounted after-tax future net cash flows are generally determined using forecast commodity prices and costs over the expected economic life of proved and probable reserves, discounted using market-based rates. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the CGU.

j) Borrowing Costs

Borrowing costs directly associated with the acquisition, construction or production of a qualifying asset are capitalized while the asset is being constructed or otherwise prepared for its intended productive use. All other borrowing costs are recognized as an expense in the period in which they are incurred.

k) Asset Retirement Obligations

Asset retirement obligations include those legal obligations where Paramount will be required to retire assets including oil and gas wells, gathering systems, processing plants and access roads at the end of their productive lives. The Company recognizes the present value of an asset retirement obligation in the

period in which it is incurred and when its fair value can be reasonably estimated. The present value of the obligation is determined using the applicable period-end risk free discount rate and is adjusted for the passage of time, which is recognized as accretion expense. Revisions to the timing, amount or applicable discount rate relating to the estimated liability are accounted for prospectively by recording an adjustment to the asset retirement obligation liability, with a corresponding adjustment to the carrying value of the related asset. The present value of estimated future asset retirement costs are capitalized as part of the related long-lived asset and depreciated on the same basis as the underlying asset.

Actual costs incurred to retire assets are applied against the asset retirement obligation liability. Differences between the actual costs incurred and the liability accrued are recognized in earnings when reclamation of the area is completed.

l) Foreign Currency Translation

Paramount's functional and presentation currency is the Canadian dollar. The functional currencies of subsidiaries of the Company are determined by the nature and location of their operations, and amounts included in their individual financial statements are measured in that functional currency.

Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at average monthly exchange rates. Monetary assets and liabilities of the Company and its Canadian subsidiaries that are denominated in foreign currencies are translated into Canadian dollars at the period-end exchange rate. Gains or losses are recognized in net income.

For the purposes of consolidation, the assets and liabilities of the Company's foreign subsidiaries are translated into Canadian dollars using the period-end exchange rate. Cumulative translation gains and losses related to the translation of foreign subsidiaries are accumulated in reserves. When the Company reduces its net investment in a foreign subsidiary, the corresponding amount of the cumulative translation gain or loss is recognized in net income.

m) Financial Instruments, Comprehensive Income and Hedges

Paramount periodically uses derivative instruments such as forwards, swaps and options to manage its exposure to fluctuations in petroleum and natural gas prices, foreign exchange rates, and interest rates.

Financial Instruments

Financial instruments are measured at fair value on initial recognition. Measurement in subsequent periods is dependent upon whether the financial instrument has been classified as "fair value through profit or loss", "available-for-sale", "held-to-maturity", "loans and receivables", or "other financial liabilities" as defined by the relevant standard. Paramount does not presently employ hedge accounting for any of its financial instruments.

Fair value through profit or loss financial assets and financial liabilities are measured at fair value, and changes in fair values over time are recognized in earnings. Derivative financial instruments are classified as fair value through profit or loss unless designated for hedge accounting. Available-for-sale financial assets are measured at fair value, and changes in fair values over time are recognized in other comprehensive income ("OCI"). Held-to-maturity financial assets, loans and receivables and other financial liabilities, including transaction costs, are measured at amortized cost using the effective interest method.

Other Comprehensive Income

For Paramount, other comprehensive income ("OCI") is comprised of changes in the market value of investments in available-for-sale securities and foreign exchange translation gains and losses relating to the Company's United States subsidiaries. OCI is presented in the Consolidated Statement of Comprehensive Loss. The cumulative changes in OCI are included in reserves, which is presented within shareholders' equity.

n) Income Taxes

Paramount follows the liability method of accounting for income taxes. Under this method, deferred income taxes are recognized for the effect of any temporary difference between the carrying amount of an asset or liability reported in the Consolidated Financial Statements and its respective tax basis, using substantively enacted income tax rates. Deferred income tax balances are adjusted to reflect changes in substantively enacted income tax rates expected to apply when assets are realized or liabilities are settled, with adjustments being recognized in the period in which the change occurs.

Deferred income tax assets are recognized to the extent future recovery is probable. Deferred tax assets are reduced to the extent that it is no longer probable that sufficient taxable earnings will be available to allow all or part of the asset to be recovered.

o) Flow-Through Shares

The proceeds of flow-through share issuances are allocated between the sale of Paramount's Class A Common Shares ("Common Shares") and the sale of tax benefits on initial recognition, with share capital being increased based on the market price of Common Shares on the date the offering is priced and accounts payable and accrued liabilities being increased based on the difference between the issue price of the flow-through shares and the market price of Common Shares on the date the offering is priced.

As qualifying expenditures intended for renunciation to subscribers are incurred, the Company recognizes a deferred tax liability, reduces the accounts payable and accrued liabilities amount and records any difference as deferred tax expense.

p) Stock-Based Compensation

Paramount Stock Option Plan

Paramount has a stock option plan that enables the Board of Directors or its Compensation Committee to grant to key employees and directors options to acquire Common Shares of the Company ("Paramount Options"). Paramount Options generally vest over five years and expire within six years after the grant date. The provisions of the plan permit the Company to settle the options in Common Shares of the Company or in cash.

Prior to October 1, 2011, Paramount accounted for Paramount Options as cash-settled awards, where a liability was recognized initially based on the grant date fair value of the options. The liability was subsequently adjusted each period for vesting and changes in the fair value of the options, until the options were exercised, surrendered or expired, with an offsetting entry to stock-based compensation expense. The fair value of the options were determined using the Black-Scholes-Merton model. When options were exercised for Common Shares, the consideration paid by the option holder and the previously recognized liability associated with the options were recorded as an increase to share capital.

When options were surrendered for cash, the cash settlement was applied against the liability and any difference was recognized as stock-based compensation expense.

As of October 1, 2011, the Company accounts for Paramount Options as equity-settled stock-based compensation transactions, where the grant date fair value of stock options awarded is recognized as stock-based compensation expense over the vesting period, with a corresponding increase in Contributed Surplus. The grant date fair value of stock options is estimated using the Black-Scholes-Merton model and such value is not adjusted in future periods. The amount of stock-based compensation expense recognized each period reflects the portion of the vesting term that elapsed and an estimate of the number of options that are expected to vest. That estimate is adjusted each period such that the cumulative amount recognized on the vesting date reflects the actual number of stock options that ultimately vest. Upon the exercise of a Paramount Option, the Company transfers the cumulative amount recognized in respect of the award from Contributed Surplus to Share Capital.

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.

Cavalier Energy Stock Option Plan

In the fourth quarter of 2011, Paramount reorganized all of its oil sands and carbonate bitumen interests into a new wholly-owned subsidiary, Cavalier Energy Inc. ("Cavalier Energy"). Cavalier Energy has a stock option plan that enables its Board of Directors to grant to key employees and directors options ("Cavalier Options") to acquire common shares of Cavalier Energy. Cavalier Options generally vest over five years and expire within seven years after the grant date. The provisions of the stock option plan permit Cavalier Energy to settle Cavalier Options in common shares of Cavalier Energy or in cash, at the discretion of Cavalier Energy. Cavalier Options are accounted for as equity-settled stock-based compensation transactions.

Stock Incentive Plan

Paramount’s stock incentive plan ("SIP") provides that rights to Common Shares may be awarded to employees annually. Common Shares are purchased in the open market and held by an independent trustee until completion of the vesting period. Generally, one third of an award vests immediately, with the remaining tranches vesting annually over two years. The unvested portion of the awards is initially recorded as a reduction of share capital. The cost of the unvested Common Shares is then recognized over the vesting period as stock-based compensation expense, with a corresponding increase to Paramount’s share capital.

q) Non-current assets held for sale

Non-current assets are reclassified as assets held for sale: (i) when it is expected that their carrying amount will be recovered principally through sale rather than from continuing use; (ii) such assets are available for immediate sale in their present condition subject only to terms that are usual and customary for the sale of such property; and (iii) the completion of the transaction is highly probable. The property is measured at the lower of carrying amount or fair value less costs to sell. Non-current assets held for sale are not depreciated or amortized.

An impairment loss is recognized for any write-down of the asset to its fair value less costs to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on re-measurement are recognized in the Statement of Comprehensive Loss.

2. SIGNIFICANT ACCOUNTING ESTIMATES, ASSUMPTIONS AND JUDGMENTS

The timely preparation of financial statements requires management to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and disclosures regarding contingent assets and liabilities. The following is a discussion of the accounting estimates, assumptions and judgments that are considered significant:

Exploration and Evaluation Assets

The accounting for exploration and evaluation assets requires management to make certain judgments based on assumptions and estimates as to future events and circumstances, including the designation of wells as being exploratory or development and whether exploratory wells have discovered economically recoverable quantities of reserves. Designations are sometimes revised as new information becomes available.

If an exploratory well encounters hydrocarbons, but further appraisal activity is required in order to conclude whether the hydrocarbons are economically recoverable, the well costs remain capitalized as long as sufficient progress is being made in assessing the economic and operating viability of the well. Criteria utilized in making this determination include evaluation of the reservoir characteristics and hydrocarbon properties, expected additional development activities, and regulatory matters. The concept of "sufficient progress" is a judgmental area, and it is possible to have exploratory costs remain capitalized for several years while additional drilling is performed or the Company seeks government, regulatory or partner approval of development plans.

Where it is determined that an exploratory well or project is unsuccessful, the costs are written-off as exploration and evaluation expense.

Reserves Estimates

Reserve engineering is an inherently complex and subjective process of estimating underground accumulations of petroleum and natural gas. The process relies on judgments 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. Estimates of fair value require management to make assumptions about future events, including reserves estimates. These assumptions are based on management's judgments regarding the use of appropriate indicators of fair value. Changes in any of the assumptions or estimates 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 applies judgment in determining such assumptions and adjusts estimated amounts periodically to incorporate new information. Accordingly, actual payments to settle the obligations may differ materially from amounts estimated.

Share-Based Payments

The Company estimates the 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 management's 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 require management to exercise judgment in determining which assumptions are the most appropriate.

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.

3. FUTURE CHANGES IN ACCOUNTING STANDARDS

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.

4. ACQUISITIONS

ProspEx Resources Ltd.

On May 31, 2011, Paramount acquired all 54.9 million of the issued and outstanding common shares of ProspEx Resources Ltd. ("ProspEx") not already owned for consideration of $64.8 million cash and the issuance by Paramount of 2.0 million Common Shares. Immediately prior to the acquisition, Paramount owned 5.6 million shares of ProspEx (nine percent voting interest). ProspEx was a publicly traded energy company with the majority of its properties located in Alberta. The acquisition of ProspEx increased Paramount's Deep Basin land holdings in the Kakwa, Elmworth and Wapiti areas of Alberta. These financial statements include the results of operations of the acquired business for the period following the closing of the transaction on May 31, 2011.

The acquisition of ProspEx was accounted for using the acquisition method whereby all of the assets acquired and liabilities assumed were recorded at fair value. The following table summarizes the net assets acquired:

Accounts receivable	$	10,423
Exploration and evaluation		82,100
Property, plant, and equipment		107,148
Goodwill		5,477
Accounts payable and accrued liabilities		(10,355)
Bank debt		(37,824)
Asset retirement obligations		(11,943)
Deferred income tax liability		(10,610)
Other		279
Net assets acquired	**$**	**134,695**

Cash paid	$	64,759
Paramount Common Shares issued [1]		57,280
Fair value of ProspEx shares previously held [2]		12,656
Total	**$**	**134,695**

[1] Based on 2.0 million Paramount Common Shares issued and the acquisition date closing price of Paramount Common Shares of $28.64 per share.
[2] Based on 5.6 million ProspEx shares held by Paramount prior to the acquisition and the acquisition date closing price of ProspEx common shares of $2.25 per share.

Accounts receivable included $4.1 million of revenue receivable and $6.3 million of joint venture receivables. Accounts payable included $10.4 million of trade payables.

Upon the acquisition of ProspEx, a gain of $4.4 million related to the ProspEx shares held by Paramount at the acquisition date was recognized in other income based on the closing market price of the ProspEx common shares of $2.25. The gain had previously been recorded in other comprehensive income. Goodwill recorded on the acquisition of ProspEx is primarily related to the Company's recognition of deferred income tax liabilities. The goodwill recognized in the transaction is not deductible for tax purposes. The net assets acquired, including goodwill, have been allocated to the Principal Properties business segment.

Paramount incurred $1.0 million of transaction costs related to the acquisition, which were recognized in acquisition transaction costs in the Statement of Comprehensive Loss.

Since May 31, 2011, the Company recorded $15.4 million of petroleum and natural gas sales in respect of properties added through the ProspEx acquisition. If the acquisition of ProspEx had been completed on January 1, 2011, Paramount's petroleum and natural gas sales for the year ended December 31, 2011 would have been $258.6 million (unaudited). The impact of the acquisition on net income for the period is impracticable to determine.

Redcliffe Exploration Inc.

On June 29, 2010, Paramount acquired, for cash consideration of $46.2 million, all 109.9 million issued and outstanding Class A shares of Redcliffe Exploration Inc. ("Redcliffe") that it did not already own, including 340,000 Class A shares owned by certain officers of Paramount. Immediately prior to the acquisition, Paramount owned 23.5 million Class A shares of Redcliffe. Redcliffe was a Calgary based company with interests in petroleum and natural gas properties primarily in the Karr-Gold Creek and Greater Pembina areas of Alberta. These financial statements include the results of operations of the acquired business for the period following the closing of the transaction on June 29, 2010.

The acquisition of Redcliffe was accounted for using the acquisition method whereby all of the assets acquired and liabilities assumed were recorded at fair value. The following table summarizes the net assets acquired:

Accounts receivable	$ 2,995
Exploration and evaluation	29,754
Property, plant, and equipment	37,189
Goodwill	11,589
Accounts payable and accrued liabilities	(3,701)
Bank debt	(10,521)
Asset retirement obligations	(8,541)
Deferred income tax liability	(2,716)
Net assets acquired	$ 56,048

Cash paid	$ 46,172
Fair value of Redcliffe shares previously held[1]	9,876
Total	$ 56,048

[1] Based on 23.5 million Redcliffe shares held by Paramount prior to the acquisition and the acquisition date closing price of Redcliffe shares of $0.42 per share.

Upon the acquisition of Redcliffe, a gain of $3.5 million previously recorded in Paramount's OCI related to its investment in Redcliffe was reclassified to other income. Goodwill recorded on the acquisition of Redcliffe is primarily related to the Company's recognition of asset retirement obligations and deferred income tax liabilities. Goodwill recorded on the acquisition of Redcliffe is not deductible for tax purposes. The net assets acquired, including goodwill, have been allocated to the Principal Properties business segment.

Paramount incurred $0.3 million of transaction costs related to the Redcliffe acquisition, which were recognized in acquisition transaction costs in the Statement of Comprehensive Loss.

If the acquisition of Redcliffe had been completed on January 1, 2010, Paramount's petroleum and natural gas sales for the twelve months ended December 31, 2010 would have been $190.6 million (unaudited). From the date of acquisition to December 31, 2010, petroleum and natural gas sales related to properties acquired through the Redcliffe acquisition were $4.2 million (unaudited). The impact of the acquisition on net income for the period is impracticable to determine.

5. SEGMENTED INFORMATION

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:

- **Principal Properties:** Principal properties consist of: (i) the Kaybob Corporate Operating Unit ("COU"), which includes properties in West Central Alberta; (ii) the Grande Prairie COU, which includes properties in the Peace River Arch area of Alberta; (iii) the Southern COU, which includes properties in Southern Alberta, Saskatchewan, North Dakota, and Montana; and (iv) the Northern COU, which includes properties in Northern Alberta, the Northwest Territories and Northeast British Columbia.

- **Strategic Investments:** 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 resources held by Paramount's wholly-owned subsidiary, Cavalier Energy, and prospective shale gas acreage; and (iii) drilling rigs owned by Fox Drilling Inc. and Paramount Drilling U.S. L.L.C., wholly-owned subsidiaries of the Company.

- **Corporate:** Corporate 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.

Year ended December 31, 2011	**Principal Properties**	**Strategic Investments**	**Corporate**	**Inter-segment Eliminations**	**Total**
Revenue	$ 219,657	$ –	$ –	$ –	**$ 219,657**
Loss on financial commodity contracts	(1,699)	–	–	–	**(1,699)**
	217,958	–	–	–	**217,958**
Expenses					
Operating expense and production tax	71,253	–	–	–	**71,253**
Transportation	20,519	–	–	–	**20,519**
General and administrative	–	4,880	12,054	–	**16,934**
Stock-based compensation	–	5,842	15,620	–	**21,462**
Depletion and depreciation	375,694	5,639	454	(3,710)	**378,077**
Exploration and evaluation	25,726	1,604	–	–	**27,330**
Gain on sale of property, plant and equipment	(42,021)	–	–	–	**(42,021)**
Interest	–	1,195	32,914	–	**34,109**
Accretion of asset retirement obligations	7,324	50	–	–	**7,374**
Acquisition transaction costs	–	–	1,044	–	**1,044**
Foreign exchange	–	(30)	1,407	–	**1,377**
	458,495	19,180	63,493	(3,710)	**537,458**
Income from equity-accounted investments	–	1,201	–	–	**1,201**
Other	5,131	15,703	–	–	**20,834**
Drilling rig revenue	–	22,376	–	(14,039)	**8,337**
Drilling rig expense	–	(11,072)	–	6,429	**(4,643)**
	(235,406)	9,028	(63,493)	(3,900)	**(293,771)**
Inter-segment eliminations	–	(3,900)	–	3,900	–
Segment earnings (loss)	$ (235,406)	$ 5,128	$ (63,493)	$ –	**(293,771)**
Income tax recovery					**61,781**
Net loss					**$ (231,990)**

Year ended December 31, 2010	Principal Properties	Strategic Investments	Corporate	Inter-segment Eliminations	Total
Revenue	$ 163,168	$ –	$ –	$ –	$ 163,168
Gain on financial commodity contracts	10,047	–	–	–	10,047
	173,215	–	–	–	173,215
Expenses					
Operating expense and production tax	50,892	–	–	–	50,892
Transportation	17,219	–	–	–	17,219
General and administrative	–	3,602	11,548	–	15,150
Stock-based compensation	–	16,583	38,695	–	55,278
Depletion and depreciation	158,909	3,781	716	(2,756)	160,650
Exploration and evaluation	41,819	902	–	–	42,721
Gain on sale of property, plant and equipment	(380)	–	–	–	(380)
Interest	–	1,243	12,317	–	13,560
Accretion of asset retirement obligations	7,917	58	–	–	7,975
Debt extinguishment	–	–	1,708	–	1,708
Acquisition transaction costs	–	–	267	–	267
Foreign exchange	–	(57)	(241)	–	(298)
	276,376	26,112	65,010	(2,756)	364,742
Income from equity-accounted investments	–	35,999	–	–	35,999
Other	1,066	2,600	(109)	–	3,557
Drilling rig revenue	–	13,425	–	(9,534)	3,891
Drilling rig expense	–	(8,001)	–	5,337	(2,664)
	(102,095)	17,911	(65,119)	(1,441)	(150,744)
Inter-segment eliminations	–	(1,441)	–	1,441	–
Segment earnings (loss)	$ (102,095)	$ 16,470	$ (65,119)	$ –	(150,744)
Income tax recovery					60,733
Net loss					$ (90,011)

Total Assets	**December 31, 2011**	December 31, 2010	January 1, 2010
Principal Properties	**$ 1,216,808**	$ 816,279	$ 634,860
Strategic Investments	**361,909**	397,009	286,392
Corporate	**146,996**	178,033	115,628
	$ 1,725,713	$ 1,391,321	$ 1,036,880

	2011			2010		
Geographical Information	**Canada**	**United States**	**Total**	Canada	United States	Total
Revenue	**$ 183,344**	**$ 36,313**	**$ 219,657**	$ 131,607	$ 31,561	$ 163,168
Exploration and evaluation assets	**374,364**	**16,378**	**390,742**	247,009	22,075	269,084
Property, plant and equipment, net	**753,167**	**55,450**	**808,617**	513,689	66,645	580,334
Goodwill	**3,426**	**–**	**3,426**	8,012	–	8,012

For the year ended December 31, 2011, the Company had sales to two customers which exceeded $30 million and to one customer which exceeded $20 million.

Other Income

Year ended December 31	**2011**	2010
Gain on investments	**$ 15,703**	$ 3,499
Write-down of investments	**–**	(899)
Drilling revenue	**8,337**	3,891
Drilling rig expense	**(4,643)**	(2,664)
Other	**5,131**	957
	$ 24,528	$ 4,784

6. ASSETS HELD FOR SALE

During the fourth quarter of 2011, the Company entered into an agreement with a syndicate of underwriters to sell five million non-voting shares of Trilogy Energy Corp. ("Trilogy") for gross proceeds of $189.5 million. The sale closed in January 2012.

During the fourth quarter of 2011, Paramount entered into agreements to sell certain oil and gas properties within the Southern and Northern COUs for aggregate gross proceeds of approximately $50 million. The transactions closed in early-2012.

The December 31, 2011 carrying value of assets held for sale and related liabilities are as follows:

	Principal Properties	Trilogy	Total
Exploration and evaluation	$ 5,052	$ –	**$ 5,052**
Property, plant and equipment, net	28,251	–	**28,251**
Equity-accounted investments	–	24,196	**24,196**
Goodwill	539	–	**539**
Asset retirement obligations	$ (13,040)	$ –	**$ (13,040)**

7. EXPLORATION AND EVALUATION

Year ended December 31	**2011**	2010
Balance, beginning of year	**$ 269,084**	$ 151,283
Additions	**229,347**	175,495
Transfer to assets held for sale	**(5,052)**	–
Corporate acquisitions	**82,100**	29,754
Transfers to property, plant and equipment	**(161,853)**	(51,828)
Impairment	–	(1,739)
Dry hole	**(2,371)**	(8,479)
Expired lease costs	**(18,195)**	(24,248)
Dispositions	**(3,052)**	(586)
Foreign exchange	**734**	(568)
Balance, end of year	**$ 390,742**	$ 269,084

Additions to exploration and evaluation assets totaled $207.5 million (2010 - $160.4 million) for Principal Properties and $21.8 million (2010 - $15.1 million) for Strategic Investments.

Exploration and Evaluation Expense

Year ended December 31	**2011**	2010
Geological and geophysical	**$ 6,764**	$ 10,719
Dry hole	**2,371**	7,754
Expired lease costs	**18,195**	24,248
	$ 27,330	$ 42,721

8. PROPERTY, PLANT AND EQUIPMENT

Year ended December 31, 2011	**Petroleum and natural gas assets**	**Drilling rigs**	**Other**	**Total**
Cost				
Balance, December 31, 2010	$ 873,822	$ 46,146	$ 19,850	**$ 939,818**
Additions	295,733	4,974	81	**300,788**
Corporate acquisitions	107,148	–	–	**107,148**
Transfer to assets held for sale	(29,859)	–	–	**(29,859)**
Transfer from exploration and evaluation	161,853	–	–	**161,853**
Dispositions	(4,943)	–	–	**(4,943)**
Change in asset retirement provision	61,125	–	–	**61,125**
Currency translation differences	1,228	351	12	**1,591**
Cost, December 31, 2011	**1,466,107**	**51,471**	**19,943**	**1,537,521**
Accumulated depletion, depreciation and write-downs				
Balance, December 31, 2010	$ (333,455)	$ (8,157)	$ (17,872)	**$ (359,484)**
Transfer to assets held for sale	1,608	–	–	**1,608**
Depletion and depreciation	(150,372)	(5,595)	(498)	**(156,465)**
Write-downs, net	(215,156)	–	–	**(215,156)**
Dispositions	1,217	–	–	**1,217**
Currency translation differences	(472)	(147)	(5)	**(624)**
Accumulated depletion, depreciation and write-downs, December 31, 2011	(696,630)	(13,899)	(18,375)	**(728,904)**
Net book value, December 31, 2010	540,367	37,989	1,978	**580,334**
Net book value, December 31, 2011	**$ 769,477**	**$ 37,572**	**$ 1,568**	**$ 808,617**

Year ended December 31, 2010	Petroleum and natural gas assets	Drilling rigs	Other	Total
Cost				
Balance, January 1, 2010	$ 641,265	$ 46,840	$ 19,720	$ 707,825
Additions	118,457	1,208	161	119,826
Corporate acquisitions	37,189	–	–	37,189
Transfer from exploration and evaluation	51,828	–	–	51,828
Dispositions	(6,342)	(1,121)	–	(7,463)
Change in asset retirement provision	34,063	–	–	34,063
Currency translation differences	(2,638)	(781)	(31)	(3,450)
Cost, December 31, 2010	873,822	46,146	19,850	939,818
Accumulated depletion, depreciation and write-downs				
Balance, January 1, 2010	$ (184,315)	$ (3,274)	$ (17,130)	$ (204,719)
Depletion and depreciation	(100,982)	(5,135)	(751)	(106,868)
Write-downs, net	(54,350)	–	–	(54,350)
Dispositions	5,896	–	–	5,896
Currency translation differences	296	252	9	557
Accumulated depletion, depreciation and write-downs, December 31, 2010	(333,455)	(8,157)	(17,872)	(359,484)
Net book value, January 1, 2010	456,950	43,566	2,590	503,106
Net book value, December 31, 2010	$ 540,367	$ 37,989	$ 1,978	$ 580,334

Depletion and Depreciation

Year ended December 31	2011	2010
Depletion and depreciation	$ 156,465	$ 106,868
Write-down of property, plant and equipment	215,156	54,350
Goodwill impairment	10,502	3,577
Inter-segment eliminations	(4,046)	(4,145)
	$ 378,077	$ 160,650

At December 31, 2011, $111.4 million (December 31, 2010 – $20.0 million) of capitalized costs related to incomplete development wells and infrastructure projects are currently not subject to depletion.

Additions to property, plant and equipment include $3.2 million of capitalized interest for qualifying assets in the construction phase (2010 – nil) at a weighted average interest rate of eight percent. Additions were $295.7 million (2010 - $118.6 million) for Principal Properties, $5.0 million (2010 - $1.2 million) for Strategic Investments and $0.1 million (2010 – $0.2 million) for Corporate.

The Company recorded an impairment write-down related to its petroleum and natural gas assets of $215.2 million (2010 – $54.4 million) within the principal properties segment. The impairment write-down was primarily related to the Elmworth CGU (Karr–Gold Creek and Valhalla) in the Grande Prairie COU, the Southern CGU (Chain and Delia) in Canada, and the Bistcho/Pedigree CGU (Bistcho and Cameron Hills) in the Northern COU, where the carrying value of the properties exceeded their expected discounted cash flows from the production of estimated proved and probable reserves. The impairment resulted from a combination of declines in reserves assigned due to well performance and the decline in forecast natural gas prices.

Write-downs were recognized to the extent that the carrying value of each CGU exceeded its expected recoverable amount. The recoverable amount was estimated on a fair value less costs to sell basis using a discounted cash flow method, which is an approach commonly employed by market participants to value oil and gas properties. Cash flows were projected over the expected remaining life of each CGU's reserves, at an after-tax discount rate of eight percent at December 31, 2011 (December 31, 2010 – eight percent). The forecast prices used to determine the recoverable amount reflect the following benchmark prices, adjusted for basis differentials to determine local reference prices, transportation costs and quality:

(Average for the period)	2012	2013	2014	2015	2016	2017-2026	Thereafter
Natural Gas							
AECO ($/MMBtu)	3.50	4.20	4.70	5.10	5.55	5.90 - 7.55	+2%/yr
Henry Hub (US$/MMBtu)	3.75	4.50	5.05	5.50	5.95	6.35 - 8.10	+2%/yr
Crude Oil							
Edmonton - Light Sweet ($/Bbl)	99.00	99.00	101.50	102.30	103.20	104.20 - 120.50	+2%/yr
WTI (US$/Bbl)	97.50	97.50	100.00	100.80	101.70	102.70 - 118.80	+2%/yr

9. EQUITY ACCOUNTED INVESTMENTS

	December 31, 2011			December 31, 2010			January 1, 2010		
	Shares (000's)	**Carrying Value**	**Market Value[1]**	*Shares (000's)*	Carrying Value	Market Value[1]	*Shares (000's)*	Carrying Value	Market Value[1]
Trilogy	***19,144*** [2]	**$ 94,062**	**$ 719,253**	*24,144*	$ 125,746	$ 296,975	*23,995*	$ 98,773	$ 206,114
MGM Energy	***43,834***	**1,691**	**10,520**	*43,834*	5,222	8,767	*43,834*	5,844	12,493
Paxton	***1,750***	**4,015**		*1,750*	4,338		*1,750*	4,574	
Other		**1,775**			2,994			4,280	
		$ 101,543			$ 138,300			$ 113,471	

[1] Based on the period-end trading price of publicly traded entities.
[2] Excludes 5 million Trilogy shares classified within assets held for sale.

Income (loss) from equity-accounted investments is composed of the following:

Year ended December 31	**2011**			2010		
	Equity income (loss)	**Dilution gain**	**Total**	Equity income (loss)	Dilution gain	Total
Trilogy	**$ 1,945**	**$ 1,060**	**$ 3,005**	$ 32,415	$ 4,109	$ 36,524
MGM Energy	**(1,481)**	**–**	**(1,481)**	(1,041)	209	(832)
Paxton	**(323)**	**–**	**(323)**	(240)	–	(240)
Other	**–**	**–**	**–**	547	–	547
	$ 141	**$ 1,060**	**$ 1,201**	$ 31,681	$ 4,318	$ 35,999

Paramount recorded a $1.1 million dilution gain (2010 - $4.1 million) in respect of its investment in Trilogy as a result of shares issued by the investee related to stock option exercises.

The following table summarizes the assets, liabilities, revenues and income/loss of Trilogy, MGM Energy and Paxton. The amounts summarized have been derived directly from Trilogy's published financial statements as at and for the years ended December 31, 2011 and 2010 and from MGM Energy's and Paxton's financial statements as at and for the period ended December 31, 2010. The amounts presented do not include Paramount's adjustments in applying the equity method of investment accounting. As a result, these amounts cannot be used directly to derive Paramount's equity income and net investment in these entities.

As at December 31	**2011**	2010		
	Trilogy	Trilogy	MGM Energy[1]	Paxton[1]
Assets	**$ 1,260,364**	$ 1,081,448	$ 236,137	$ 27,527
Liabilities	**$ 729,919**	$ 540,629	$ 5,187	$ 65
Shares outstanding (thousands)	**116,118**	114,741	314,495	17,402
Paramount's equity interest	**21%**	21%	14%	10%

Year ended December 31	**2011**	2010		
Revenue	**$ 342,106**	$ 246,124	$ –	$ –
Net income (loss)	**$ 17,415**	$ 178,242	$ (19,744)	$ (2,876)

Note: Readers are cautioned that Paramount does not have any direct or indirect interest in or right to the investee's assets or revenue, nor does Paramount have any direct or indirect obligation in respect of or liability for the expenses or obligations of such entities.
[1] MGM Energy's and Paxton's 2011 financial statements were not finalized prior to completing these financial statements.

Trilogy had 6.0 million stock options outstanding (1.7 million exercisable) at December 31, 2011 at exercise prices ranging from $4.85 to $38.74 per share.

10. INVESTMENTS IN SECURITIES

	December 31, 2011		December 31, 2010		January 1, 2010	
	Shares (000's)		Shares (000's)		Shares (000's)	
MEG Energy Corp.	3,700	$ 153,809	3,700	$ 168,313	3,700	$ 101,750
NuLoch Resources Inc. ("NuLoch")	–	–	6,579	13,684	6,579	5,921
ProspEx	–	–	5,625	7,369	–	–
Redcliffe	–	–	–	–	19,667	7,210
Other		31		351		502
		$ 153,840		$ 189,717		$ 115,383

In April 2011, Paramount sold 3.3 million of the NuLoch shares it held for cash proceeds of $8.1 million. The Company recognized a gain on the disposition of $5.7 million, which previously had been recorded in other comprehensive income. In May 2011, NuLoch was acquired by Magnum Hunter Resources Corp. ("Magnum Hunter") and each of the remaining 3.3 million NuLoch shares held by Paramount was exchanged for 0.3304 of a common share of Magnum Hunter, resulting in Paramount receiving 1.1 million common shares of Magnum Hunter. An accumulated unrealized gain of $5.3 million that had been recorded in other comprehensive income in respect of the NuLoch shares exchanged by Paramount was recognized in other income. In July 2011, Paramount sold all 1.1 million of the Magnum Hunter shares it held for cash proceeds of $7.7 million. The Company recognized a gain on the disposition of $0.1 million, which previously had been recorded in other comprehensive income.

11. GOODWILL

	December 31, 2011	December 31, 2010	January 1, 2010
Carrying value, beginning of year	$ 8,012	$ –	$ –
Acquisitions	5,477	11,589	–
Adjustment to Redcliffe net assets acquired	978	–	–
Reclassified to assets held for sale	(539)	–	–
Impairment	(10,502)	(3,577)	–
Carrying value, end of year	$ 3,426	$ 8,012	$ –

For the year ended December 31, 2011, there were additions to goodwill of $5.5 million in respect of the ProspEx acquisition and $1.0 million in respect of additional liabilities of Redcliffe that existed at the date of acquisition.

For the purpose of testing goodwill for impairment, the recoverable amount of each CGU was determined on the same basis as used in determining the recoverable amount of that CGU for the purpose of testing its property, plant and equipment assets for impairment.

The carrying amount of goodwill allocated to each of the COUs is as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Grande Prairie	$ –	$ 7,464	$ –
Kaybob	3,124	548	–
Southern	–	–	–
Northern	302	–	–
	$ 3,426	$ 8,012	$ –

12. 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 $7.5 million have been made to December 31, 2011. Unless demanded by the bank, annual scheduled principal repayments are $5.1 million in each of 2012 and 2013, with the remaining outstanding balance of $12.6 million 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 year-long construction period with scheduled principal repayments to commence in 2013. Drilling Rig Loan II is currently undrawn.

Recourse and security for Drilling Rig Loan I and Drilling Rig Loan II is limited to the three existing drilling rigs, the two rigs to be constructed, and drilling contracts guaranteed by Paramount. The carrying value of the three existing rigs is $37.6 million (2010 - $38.0 million). 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 Drilling Rig Loan I for the period ended December 31, 2011 was 4.7 percent (2010 - 4.2 percent).

Cavalier Energy 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 Paramount, 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.

13. LONG-TERM DEBT

	December 31, 2011	December 31, 2010	January 1, 2010
Canadian Dollar Denominated Debt			
Bank credit facility	**$ 61,383**	$ –	$ –
8 ¼ percent Senior Notes due 2017	**370,000**	300,000	–
U.S. Dollar Denominated Debt			
8 ½ percent US Senior Notes due 2013	**–**	–	94,394
	431,383	300,000	94,394
Unamortized financing costs net of premiums	**(4,197)**	(5,795)	(739)
	$ 427,186	$ 294,205	$ 93,655

Bank Credit Facility

In June 2011, Paramount renewed its bank credit facility (the "Facility"), increasing the total credit limit from $160 million to $300 million, which 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 June 30, 2012. 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 June 30, 2012 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 Loan 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, 2011, $61.4 million (December 31, 2010 – nil) was drawn on Tranche A of the Facility. Paramount had undrawn letters of credit outstanding at December 31, 2011 totaling $26.3 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 ("Senior Notes") at par, of which $11.4 million principal amount was purchased by certain directors, associates, officers, and management of the Company.

In February 2011, Paramount completed a public offering of an additional $70 million principal amount of 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 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 Senior Notes are direct senior unsecured obligations of Paramount and rank equally with all other senior unsecured indebtedness of the Company.

The Company may redeem all or any portion of the Senior Notes at any time on or prior to December 13, 2013 at par, plus accrued and unpaid interest, plus a redemption premium equal to the greater of: (i) one percent; and (ii) a make-whole amount based on the then current yield of a Government of Canada bond with a similar maturity. Paramount may also redeem up to an aggregate of 35 percent of the Senior Notes with the net cash proceeds of an equity offering at any time prior to December 13, 2013, at par plus a redemption premium of 8.25 percent. On or after December 13, 2013, the Company may redeem some or all of the Senior Notes at par plus a redemption premium, if applicable, of up to 4.125 percent depending on when redeemed, plus accrued and unpaid interest.

US Senior Notes

During the fourth quarter of 2010, Paramount's obligations under the indenture governing its US$90.2 million principal amount of 8.5 percent US senior notes ("US Senior Notes") were discharged as a result of Paramount: (i) purchasing US$64.2 million principal amount of US Senior Notes pursuant to a tender offer; (ii) delivering all US Senior Notes held by the Company to the trustee for cancellation; (iii) issuing a redemption notice for US$26.0 million principal amount of US Senior Notes not tendered under the tender offer (the "Redeemed Notes"); and (iv) irrevocably depositing sufficient cash with the trustee to pay all amounts due on the Redeemed Notes on the January 31, 2011 redemption date.

14. ASSET RETIREMENT OBLIGATIONS

Year ended December 31	2011	2010
Asset retirement obligations, beginning of year	**$ 241,770**	$ 195,088
Retirement obligations incurred	**23,463**	25,691
Revisions to estimated retirement costs and discount rates	**37,791**	17,819
Obligations settled	**(7,520)**	(3,209)
Disposal of properties	**(2,902)**	(9,638)
Assumed on corporate acquisition	**11,943**	8,541
Accretion expense	**7,374**	7,975
Transfer to liabilities associated with assets held for sale	**(13,040)**	–
Foreign exchange	**323**	(497)
Asset retirement obligations, end of year	**$ 299,202**	$ 241,770

The asset retirement obligation at December 31, 2011 has been determined using a weighted average risk-free rate of 2.25 percent (2010 – 4.0 percent). These obligations will be settled over the useful lives of the assets, which extend up to 42 years.

15. SHARE CAPITAL

Weighted Average Common Shares Outstanding

	2011		2010	
	Shares (000's)		*Shares (000's)*	
Net loss – basic	***78,462***	**$ (231,990)**	*72,705*	$ (90,011)
Dilutive effect of Paramount options	–	–	–	–
Net loss – diluted	***78,462***	**$ (231,990)**	*72,705*	$ (90,011)

Outstanding Paramount Options can be exchanged for the Company's Common Shares in accordance with the terms of the stock option plan. As a result, they are considered potentially dilutive and are included in the calculation of Paramount's diluted net income per share calculation when they are dilutive for the period.

In April 2011, Paramount issued 1,500,000 Common Shares at a price of $32.50 per share for gross proceeds of $48.8 million pursuant to a public offering. In April 2011, Paramount also issued 150,000 Common Shares on a "flow-through" basis in respect of Canadian development expenses at a price of $36.50 per share for gross proceeds of $5.5 million to a company controlled by the Company's Chairman and Chief Executive Officer. In May 2011, the Company issued 2,000,000 Common Shares in connection with the ProspEx acquisition. In October 2011, Paramount issued 1,450,000 Common Shares on a "flow-through" basis in respect of Canadian exploration expenses ("CEE") pursuant to a public offering at a price of $40.50 per share for gross proceeds of $58.7 million. Also in October 2011, the Company issued 100,000 Common Shares on a "flow-through" basis in respect of CEE at a price of $40.50 per share for gross proceeds of $4.1 million to companies controlled by the Company's Chairman and Chief Executive Officer. In November 2011, Paramount issued 4,500,000 Common Shares at a price of $34.75 per share for gross proceeds of $156.4 million through a public offering.

The Company incurred $8.6 million (2010 – $1.0 million) of transaction costs in respect of these equity offerings, net of tax of $2.9 million (2010 – $0.4 million).

16. RESERVES

Reserves at December 31, 2011 include unrealized gains on the Company's investments in available-for-sale securities, foreign exchange differences on the translation of foreign subsidiaries' balances, and contributed surplus amounts in respect of Paramount Options and Cavalier Options. The changes in reserves are as follows:

	Unrealized Gains on Securities	**Translation of Foreign Subsidiaries**	**Contributed Surplus**	**Stock-based compensation – investee options**	**Total Reserves**
Balance, December 31, 2010	$ 71,622	$ (2,028)	$ –	$ 2,402	**$ 71,996**
Other comprehensive income (loss)	(19,913)	1,197	–	–	**(18,716)**
Stock-based compensation liability reclassified	–	–	68,728	–	**68,728**
Stock-based compensation expense	–	–	4,185	–	**4,185**
Stock options exercised	–	–	(7,121)	–	**(7,121)**
Reclassification to equity-accounted investments	–	–	–	(2,402)	**(2,402)**
Balance, December 31, 2011	$ 51,709	$ (831)	$ 65,792	$ –	**$116,670**

	Unrealized Gains on Securities	Translation of Foreign Subsidiaries	Contributed Surplus	Stock-based compensation – investee options	Total Reserves
Balance, January 1, 2010	$ 3,188	$ –	$ –	$ 1,839	$ 5,027
Other comprehensive income (loss)	68,434	(2,028)	–	–	66,406
Stock-based compensation related to equity-accounted investments	–	–	–	563	563
Balance, December 31, 2010	$ 71,622	$ (2,028)	$ –	$ 2,402	$ 71,996

Other Comprehensive Income (Loss)

Year ended December 31	**2011**	2010
Unrealized Gain (Loss) on Securities		
Change in market value of securities	**$ (7,109)**	$ 75,090
Reclassification of other comprehensive income to earnings	**(15,693)**	(3,499)
Deferred tax	**2,889**	(3,157)
	(19,913)	68,434
Translation of Foreign Subsidiaries		
Exchange differences on translation of US subsidiaries	**(1,419)**	(2,749)
Reclassification of other comprehensive loss to earnings	**2,965**	–
Deferred tax	**(349)**	721
	1,197	(2,028)
Other comprehensive income (loss)	**$ (18,716)**	$ 66,406

17. SHARE-BASED PAYMENTS

Paramount Options

Changes in the Company's outstanding options are as follows:

	2011		2010	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		($/share)		($/share)
Balance, beginning of year	**5,006,300**	**$ 13.90**	4,571,500	$ 8.61
Granted	**1,529,000**	**38.95**	1,276,500	28.98
Exercised	**(618,850)**	**10.80**	(683,700)	7.90
Forfeited	**(149,000)**	**17.74**	(158,000)	8.74
Balance, end of year	**5,767,450**	**$ 20.76**	5,006,300	$ 13.90
Options exercisable, end of year	**1,832,218**	**$ 10.66**	1,367,301	$ 8.13

For options exercised in 2011, the weighted average market price of Paramount's Common Shares on the dates exercised was $35.46 (2010 - $21.95).

The weighted average remaining contractual life and exercise prices of Paramount Options outstanding as of December 31, 2011 are as follows:

	Awards Outstanding		
Exercise Prices	**Number**	**Remaining Contractual Life**	**Weighted average exercise price**
$6.87 – $10.00	2,378,200	1.8	$ 7.34
$10.01 – $20.00	751,050	3.3	$ 13.38
$20.01 – $30.00	1,185,200	4.3	$ 29.39
$30.01 – $40.09	1,453,000	5.3	$ 39.51
	5,767,450	**3.4**	**$ 20.76**

The fair value of Paramount Options has been estimated using the Black-Scholes-Merton model incorporating the following weighted average inputs:

	Options re-measured at September 30, 2011	**Options awarded between October 1, 2011 and December 31, 2011**
Weighted average exercise price	$ 14.67	$ 40.02
Expected volatility	49.7 %	47.8 %
Expected life of share options	2.3 years	4.7 years
Pre-vest forfeiture rate	4.6 %	4.9 %
Risk-free interest rate	1.1 %	1.2 %
Expected dividend yield	nil	nil
Weighted average fair value of awards	$ 18.69	$ 16.45

The estimated expected life of the Paramount Options is based on historical exercise patterns. The expected volatility is estimated based on the historical volatility of the trading price of the Company's Common Shares over the most recent period that is generally commensurate with the expected term of the option.

Cavalier Options

In November 2011, 2.5 million Cavalier Options were granted to Cavalier Energy management and directors having a term of seven years and vesting over four to five years. No exercises or cancellations have occurred to date.

Stock Incentive Plan

Year ended December 31	2011		2010	
Stock incentive plan shares held in trust	***Shares (000's)***		*Shares (000's)*	
Balance, beginning of year	***150***	**$ 410**	*178*	$ 312
Shares purchased	***101***	**2,974**	*178*	2,901
Change in vested and unvested shares	***(165)***	**(2,965)**	*(206)*	(2,803)
Balance, end of year	***86***	**$ 419**	*150*	$ 410

Employee Benefit Costs

Year ended December 31	2011	2010
Stock option plan	**$ 18,412**	$ 51,642
Stock incentive plan	**3,050**	3,636
Stock-based compensation expense	**21,462**	55,278
Salaries and benefits, net of recoveries	**10,956**	10,125
	$ 32,418	$ 65,403

18. DEFERRED INCOME TAX

The following table reconciles income taxes calculated at the Canadian statutory rate to Paramount's recorded income tax recovery:

Year ended December 31	2011	2010
Earnings (loss) before tax	**$ (293,771)**	$ (150,744)
Effective Canadian statutory income tax rate	**26.6%**	28.1%
Expected income tax expense (recovery)	**$ (78,143)**	$ (42,359)
Increase (decrease) resulting from:		
Statutory and other rate differences	**8,067**	(17,242)
Gain on investments	**(2,777)**	(983)
Income from equity-accounted investments	**(319)**	(10,116)
Goodwill impairment	**2,792**	1,005
Flow-through share renunciations	**4,625**	6,417
Stock-based compensation	**4,881**	14,494
Non-deductible items and other	**(907)**	(11,949)
Income tax expense (recovery)	**$ (61,781)**	$ (60,733)

Components of Deferred Income Tax Asset (Liability)

As at December 31	2011	2010
Property, plant and equipment	**$ (11,339)**	$ (20,743)
Investments	**(286)**	(3,308)
Asset retirement obligations	**80,105**	62,404
Non-capital and net operating losses	**42,131**	27,523
Other	**6,937**	9,699
	$ 117,548	$ 75,575

Paramount has $152.6 million (2010 - $100.1 million) of unused tax losses expiring between 2014 and 2031. In addition, Paramount has $167.4 million (2010 - $156.9 million) of deductible temporary differences in respect of investments for which no deferred income tax asset has been recognized. Deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences and unutilized tax losses can be applied. A deferred tax asset related to the carry forward of unutilized tax losses has been recorded as the Company expects that future taxable profits, through a combination of future operating results and gains realized on the disposition of assets, will be sufficient to utilize the deferred tax asset.

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.

19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial Instruments

Financial instruments at December 31, 2011 consisted of cash and cash equivalents, accounts receivable, the Deposit, available-for-sale investments, the Drilling Rig Loan, accounts payable and accrued liabilities, risk management assets and liabilities, and long-term debt.

Fair Values of Financial Assets and Liabilities

The fair value of financial assets and liabilities are included in the Consolidated Financial Statements at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced liquidation or sale. The following methods and assumptions were used to estimate the fair values:

- Cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments. The fair value of the Deposit approximates its carrying amount.
- Risk management assets and liabilities are carried at fair values, which are based on forward market curves and compared to quotes provided by financial institutions.
- Publicly traded available-for-sale investments are carried at the period-end trading price.

- The carrying value of the Drilling Rig Loan and long-term debt are measured at amortized cost. The Senior Notes had a market value of 103.1 percent of their principal amount at December 31, 2011.

Risk management financial instruments outstanding at December 31, 2011 are as follows:

Instruments	Notional	Average Fixed Price	Fair Value	Remaining Term
Oil – NYMEX WTI Swap	500 Bbl/d	US $101.01/Bbl	$ 139	January – May 2012
Oil – NYMEX WTI Collar	500 Bbl/d	Floor – US $85.00/Bbl Ceiling – US $116.85/Bbl	45	January – May 2012
Oil – NYMEX WTI Swap	500 Bbl/d	US $101.65/Bbl	223	January – June 2012
Oil – NYMEX WTI Swap	500 Bbl/d	US $97.25/Bbl	(288)	January – December 2012
Oil – NYMEX WTI Swap	1,000 Bbl/d	US $91.50/Bbl	(2,722)	January – December 2012
			$ (2,603)	

Changes in the fair value of risk management assets and liabilities are as follows:

Year ended December 31	2011	2010
Fair value, beginning of year	$ (693)	$ 2,187
Changes in fair value	(1,699)	10,047
Settlements received	(211)	(12,927)
Fair value, end of year	$ (2,603)	$ (693)

Fair Value Hierarchy

Paramount uses a three-level hierarchy for determining the fair value of financial instruments, which is based upon the transparency of inputs used in the valuation of financial instruments recognized at fair value. The three levels are defined as follows:

- Level one – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level two – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level three – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

At December 31, 2011, Paramount's publicly traded available-for-sale investments were classified as level 1 fair values and risk management assets and liabilities were classified as level 2 fair values.

Risk Management

Paramount is exposed to market risks where the fair values or future cash flows of financial instruments fluctuate because of underlying changes in market prices. The principal market risks impacting Paramount are commodity price risk, foreign currency risk, interest rate risk, equity price risk, credit risk and liquidity risk. Paramount periodically uses derivative instruments such as forwards, swaps and options to manage its exposure to fluctuations in crude oil and natural gas prices, foreign exchange rates, and interest rates.

Commodity Price Risk

At December 31, 2011, assuming all other variables are held constant, a 10 percent increase or decrease in the applicable forward market curves would have had the following impact on Paramount's net earnings from changes in the fair value of financial commodity contracts:

	10% increase	**10% decrease**
Crude Oil	$ (5,000)	$ 5,000

Foreign Currency Risk

Paramount is exposed to foreign currency risk on financial instruments denominated in US dollars including cash and cash equivalents, accounts receivable, risk management assets and liabilities, and accounts payable and accrued liabilities.

Sales prices of natural gas, crude oil, and natural gas liquids ("NGLs") are determined with reference to US benchmark prices, therefore a strengthening of the Canadian dollar relative to the US dollar will decrease the revenue received for natural gas, crude oil, and NGLs. Paramount's expenditures are primarily in Canadian dollars but include capital and operating expenditures in US dollars, largely related to the Company's US operations.

Interest Rate Risk

Paramount is exposed to interest rate risk from time to time on outstanding balances on its floating rate bank credit facilities, and on interest bearing cash and cash equivalents. Paramount's Senior Notes bear interest at a fixed rate and are subject to fair value changes as market interest rates change.

Equity Price Risk

Paramount is exposed to equity price risk associated with changes in the market value of its investments.

Credit Risk

Paramount is exposed to credit risk on its financial instruments where a financial loss would be experienced if a counterparty to a financial asset failed to meet its obligations. The Company manages credit risk by endeavoring to enter into contracts with counterparties that possess high credit ratings, employing net settlement agreements, employing letters of credit, and limiting available credit when necessary. The maximum credit risk exposure at December 31, 2011 is limited to the carrying values of cash and cash equivalents, accounts receivable and risk management assets. Accounts receivable include balances due from customers and joint venture partners in the oil and gas industry and are subject to normal industry credit risk. At December 31, 2011, Paramount had balances due from one joint venture partner that represented more than 10 percent of the Company's total accounts receivable.

Liquidity Risk

Liquidity risk is the risk that Paramount will be unable to meet its financial obligations. The Company manages liquidity risk by ensuring that it has sufficient cash and cash equivalents, credit facilities and other financial resources available to meet its obligations.

The Company forecasts cash flows for a period of at least 12 months to identify financial requirements. These requirements are met through a combination of cash flows from operations, credit facilities, dispositions of assets, and accessing capital markets.

In addition to commitments disclosed in Note 23, contractual obligations related to financial liabilities are as follows:

	2012	2013	2014	2015	2016	Thereafter	Total
Drilling Rig Loan I[1]	$ 6,092	$ 5,274	$ 12,983	$ –	$ –	$ –	$ 24,349
Accounts payable and accrued liabilities	136,820	–	–	–	–	–	136,820
Risk management liabilities	2,787	–	–	–	–	–	2,787
Credit Facility[1]	3,253	63,010		–	–	–	66,263
Senior Notes[1]	30,525	30,525	30,525	30,525	30,525	399,354	551,979
	$179,477	$ 98,809	$ 43,508	$ 30,525	$ 30,525	$ 399,354	$782,198

[1]Including interest

Accounts payable and accrued liabilities

	December 31, 2011	December 31, 2010	January 1, 2010
Trade and accrued payables	**$ 119,172**	$ 69,965	$ 31,917
Joint venture and royalties	**2,374**	4,525	10,902
Interest payable	**1,510**	1,288	3,343
Flow-through share renunciation obligations	**5,894**	6,122	2,409
Other	**7,870**	3,028	–
Total accounts payable and accrued liabilities	**$ 136,820**	$ 84,928	$ 48,571

Terms and conditions of the above financial liabilities:

- Trade and accrued payables, joint venture payables and other are non-interest bearing and are normally settled on 60-day terms.
- Interest payable on Senior Notes is payable semi-annually in arrears on June 13 and December 13 in each year.

Accounts receivable

	December 31, 2011	December 31, 2010	January 1, 2010
Revenue receivable	**$ 21,363**	$ 17,907	$ 16,583
Joint venture receivable	**13,600**	11,964	6,407
GST and other	**5,218**	3,409	498
Total accounts receivable	**$ 40,181**	$ 33,280	$ 23,488

Joint venture receivables are non-interest bearing and are generally on 30 day terms.

In determining the recoverability of joint venture receivables, the Company performs a risk analysis considering the type and age of the outstanding receivable and the credit worthiness of the counterparties. As a result of this assessment, the Company determined that there was no impairment required in joint venture receivable. There were no significant non-current joint venture receivables as at December 31, 2011 and 2010.

20. CONSOLIDATED STATEMENTS OF CASH FLOWS – SELECTED INFORMATION

Items not involving cash

Year ended December 31	2011	2010
Financial commodity contracts	$ 1,910	$ 2,880
Stock-based compensation	21,405	55,217
Depletion and depreciation	378,077	160,650
Exploration and evaluation	20,566	34,548
(Gain) on sale of property, plant, and equipment	(42,021)	(380)
Accretion of asset retirement obligations	7,374	7,975
Foreign exchange	933	(568)
(Income) from equity accounted investments	(1,201)	(35,999)
Deferred income tax	(61,793)	(60,946)
Gain on investments	(15,703)	(3,499)
Other	527	1,293
	$ 310,074	$ 161,171

Supplemental cash flow information

Year ended December 31	2011	2010
Interest paid	$ 36,910	$ 15,615
Current tax paid	$ 45	$ 368

Components of cash and cash equivalents

As at December 31	2011	2010
Cash	$ 15,009	$ 29,679
Bankers' acceptances	13,991	44,980
	$ 29,000	$ 74,659

21. CAPITAL STRUCTURE

Paramount's primary objectives in managing its capital structure are to:

(i) maintain a flexible capital structure which optimizes the cost of capital at an acceptable level of risk;

(ii) maintain sufficient liquidity to support ongoing operations, capital expenditure programs, strategic initiatives, and the repayment of debt obligations when due; and

(iii) maximize shareholder returns.

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 monitors metrics such as the Company's debt-to-equity and debt-to-cash flow ratios, among others, to measure the status of its capital structure. The Company has not established fixed quantitative thresholds for such metrics. The capital structure may be adjusted by issuing or repurchasing shares, issuing or repurchasing debt, refinancing existing debt, modifying capital spending programs, and disposing of assets, the availability of any such means being dependent upon market conditions.

Paramount's capital structure consists of the following:

	December 31, 2011	December 31, 2010	January 1, 2010
Working capital deficit (surplus)[1]	**$ 82,036**	$ (4,825)	$ (43,485)
Credit Facility	**61,383**	–	–
Senior Notes[2]	**370,000**	300,000	–
US Senior Notes	–	–	94,394
Net Debt[3]	**513,419**	295,175	50,909
Share capital	**810,781**	481,827	418,191
Accumulated (deficit) earnings	**(103,615)**	128,375	218,386
Reserves	**116,670**	71,966	5,027
Total Capital	**$ 1,337,255**	$ 977,343	$ 692,513

[1] Excludes risk management assets and liabilities, stock-based compensation liabilities, assets and liabilities held for sale and accounts payable and accrued liabilities related to the Company's obligation to renounce qualifying expenditures for flow-through share issuances (December 31, 2011 - $5.9 million, December 31, 2010 - $6.1 million, January 1, 2010 - $2.4 million).
[2] Excludes unamortized financing costs.
[3] Net Debt excludes the deposit on account with the CRA, pending resolution of the Company's Notice of Objection (see Note 18).

Paramount is subject to covenants under its bank Facility and Senior Notes agreements which contain certain restrictions on Paramount's ability to repurchase equity, issue or refinance debt, acquire or dispose of assets, and pay dividends.

22. RELATED PARTY TRANSACTIONS

Service Agreements

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

During 2011, Paramount charged $0.9 million (2010 – $0.5 million) to Trilogy in respect of operational and administrative services. Also, Paramount received $10.1 million (2010: $10.5 million) in annual dividends from Trilogy. As of December 31, 2011, Paramount had a receivable balance due from Trilogy of $0.3 million (2010: $0.3 million).

Compensation of key management personnel

Year ended December 31	**2011**	2010
Salaries and benefits	**$ 2,159**	$ 2,031
Stock-based compensation	**9,173**	29,918
	$ 11,332	$ 31,949

23. COMMITMENTS AND CONTINGENCIES

Commitments

Paramount had the following commitments as at December 31, 2011:

	Within One Year	After one year but not more than 5 years	More than five years
Pipeline transportation commitments [1]	$ 16,353	$ 60,947	$ 55,512
Operating leases	3,569	7,055	10,554
Capital spending commitments[2]	54,174	–	–
Total	$ 74,096	$ 68,002	$ 66,066

[1] Certain of the pipeline transportation commitments are secured by outstanding letters of credit totaling $12.8 million at December 31, 2011 (2010 - $10.4 million).
[2] Relates to contractual obligations for purchases of major equipment.

Operating lease commitment

During the year, the company renewed and extended its head office lease to 2022. The Company incurred office lease costs of $2.8 million in 2011 (2010 - $2.3 million).

Flow-Through Shares

As a result of flow through share issuances in the fourth quarter of 2011, Paramount is required to incur and renounce $29.7 million of Canadian Exploration Expense during 2012.

Contingencies

Paramount is a party to various legal claims associated with the ordinary conduct of its 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.

24. RECONCILIATION TO PREVIOUS GAAP

GAAP in Canada was converted to IFRS as of January 1, 2011, and Paramount's accounting policies have been modified to comply with the new standards. The transition provisions of IFRS require changes to accounting policies to be applied on a retroactive basis, except for certain mandatory and optional exemptions. Paramount has elected to apply the following exemptions:

a) the exemption to measure certain assets at fair value on transition to IFRS and subsequently deem that fair value to be historical cost;

b) the exemption to deem cumulative foreign exchange translation differences related to foreign subsidiaries as of January 1, 2010 to be nil;

c) the exemption that permits amounts recorded in respect of options settled prior to January 1, 2010 not to be retrospectively restated;

d) the exemption that permits business combinations completed prior to January 1, 2010 not to be restated. Paramount's initial business combination recorded in accordance with IFRS 3, "Business Combinations" was the acquisition of Redcliffe in June 2010;

e) the exemption to measure asset retirement obligations at the Transition Date in accordance with IFRS 1;

f) the exemption to assess lease arrangements using the facts and circumstances as of the Transition Date under International Financial Reporting Interpretations Committee Interpretation 4, "Determining whether an Arrangement contains a Lease"; and

g) the exemption that permits borrowing costs directly attributable to the acquisition or construction of qualifying assets not to be capitalized on a retroactive basis prior to January 1, 2010.

The following information reconciles the 2010 comparative amounts included in these Consolidated Financial Statements to the amounts previously published in accordance with Previous GAAP:

The following table summarizes the adjustments to Paramount's December 31, 2009 balance sheet prepared under Previous GAAP to the Company's Transition Date balance sheet prepared in accordance with IFRS:

	December 31, 2009 Previous GAAP	Reclasses (24 a)	PPE (24 b)	ARO (24 c)	FX (24 d)	SBC (24 e)	FTS (24 f)	Equity Accounting (24 g)	Deferred Tax (24 h)	Net Transition Date Adjustments	**January 1, 2010 IFRS**
ASSETS											
Current assets	**$ 121,214**	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	**$ 121,214**
Exploration and evaluation	**–**	152,170	–	–	(887)	–	–	–	–	151,283	**151,283**
Property, plant and equipment, net	**716,235**	(152,170)	(65,412)	8,563	(4,110)	–	–	–	–	(213,129)	**503,106**
Investments	**234,586**	(234,586)	–	–	–	–	–	–	–	(234,586)	**–**
Equity-accounted investments	**–**	119,203	–	–	–	–	–	(7,611)	1,879	113,471	**113,471**
Investments in securities	**–**	115,383	–	–	–	–	–	–	–	115,383	**115,383**
Deferred income tax	**29,940**	–	–	–	–	–	–	–	2,483	2,483	**32,423**
	$ 1,101,975	$ –	$ (65,412)	$ 8,563	$ (4,997)	$ –	$ –	$ (7,611)	$ 4,362	$ (65,095)	**$1,036,880**
LIABILITIES AND SHAREHOLDERS' EQUITY											
Current liabilities											
Drilling rig loan	**$ 29,380**	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	**$ 29,380**
Accounts payable and accrued liabilities	**46,162**	–	–	–	–	–	2,409	–	–	2,409	**48,571**
Stock-based compensation	**11,441**	–	–	–	–	2,386	–	–	–	2,386	**13,827**
	86,983	–	–	–	–	2,386	2,409	–	–	4,795	**91,778**
Long-term debt	**93,655**	–	–	–	–	–	–	–	–	–	**93,655**
Asset retirement obligations	**103,462**	–	–	91,626	–	–	–	–	–	91,626	**195,088**
Stock-based compensation	**3,771**	–	–	–	–	950	–	–	–	950	**4,721**
Deferred income tax	**41,194**	–	–	–	–	–	2,879	–	(34,039)	(31,160)	**10,034**
	329,065	–	–	91,626	–	3,336	5,288	–	(34,039)	66,211	**395,276**
Shareholders' Equity											
Share capital	**393,087**	–	–	–	–	–	25,104	–	–	25,104	**418,191**
Retained earnings	**373,745**	–	(65,412)	(83,063)	(4,997)	(3,336)	(30,392)	(6,560)	38,401	(155,359)	**218,386**
Reserves	**–**	6,078	–	–	–	–	–	(1,051)	–	5,027	**5,027**
Contributed surplus	**2,890**	(2,890)	–	–	–	–	–	–	–	(2,890)	**–**
Accumulated other comprehensive income	**3,188**	(3,188)	–	–	–	–	–	–	–	(3,188)	**–**
	772,910	–	(65,412)	(83,063)	(4,997)	(3,336)	(5,288)	(7,611)	38,401	(131,306)	**641,604**
	$ 1,101,975	$ –	$ (65,412)	$ 8,563	$ (4,997)	$ –	$ –	$ (7,611)	$ 4,362	$ (65,095)	**$1,036,880**

The following table summarizes the adjustments to Paramount's December 31, 2010 balance sheet prepared under Previous GAAP to the Company's balance sheet prepared in accordance with IFRS:

	December 31, 2010 Previous GAAP	Transition Date Adjustments	Reclasses (24 a)	PPE (24 b)	ARO (24 c)	FX (24 d)	SBC (24 e)	FTS (24 f)	Equity Accounting (24 g)	Deferred Tax (24 h)	**December 31, 2010 IFRS**
ASSETS											
Current assets	**$ 110,511**	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	**$ 110,511**
Deposit	**19,788**	–	–	–	–	–	–	–	–	–	**19,788**
Exploration and evaluation	**–**	151,283	118,214	(128)	285	(570)	–	–	–	–	**269,084**
Property, plant and equipment, net	**884,525**	(213,129)	(118,214)	12,889	17,153	(2,890)	–	–	–	–	**580,334**
Investments	**305,288**	(234,586)	(70,702)	–	–	–	–	–	–	–	**–**
Equity-accounted investments	**–**	113,471	(3,632)	–	–	–	–	–	30,340	(1,879)	**138,300**
Investments in securities	**–**	115,383	74,334	–	–	–	–	–	–	–	**189,717**
Deferred income tax	**48,489**	33,643	–	–	995	–	–	(3,803)	–	(3,749)	**75,575**
Goodwill	**8,623**	–	–	(3,577)	2,966	–	–	–	–	–	**8,012**
	$1,377,224	$ (33,935)	$ –	$ 9,184	$ 21,399	$ (3,460)	$ –	$ (3,803)	$ 30,340	$ (5,628)	**$1,391,321**
LIABILITIES AND SHAREHOLDERS' EQUITY											
Current liabilities											
Drilling rig loan	**$ 26,880**	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	**$ 26,880**
Accounts payable and accrued liabilities	**78,806**	2,409	–	–	–	–	–	3,713	–	–	**84,928**
Risk management	**693**	–	–	–	–	–	–	–	–	–	**693**
Stock-based compensation	**45,232**	2,386	–	–	–	–	(1,431)	–	–	–	**46,187**
	151,611	4,795	–	–	–	–	(1,431)	3,713	–	–	**158,688**
Long-term debt	**294,205**	–	–	–	–	–	–	–	–	–	**294,205**
Asset retirement obligations	**130,564**	91,626	–	–	19,580	–	–	–	–	–	**241,770**
Stock-based compensation	**15,110**	950	–	–	–	–	(1,600)	–	–	–	**14,460**
	591,490	97,371	–	–	19,580	–	(3,031)	3,713	–	–	**709,123**
Shareholders' Equity											
Share capital	**458,895**	25,104	–	–	–	–	–	(2,172)	–	–	**481,827**
Retained earnings	**251,277**	(155,359)	(503)	9,184	1,507	–	3,486	(5,344)	30,372	(6,245)	**128,375**
Reserves	**–**	5,027	69,987	–	312	(3,460)	(455)	–	(32)	617	**71,996**
Contributed surplus	**3,940**	(2,890)	(1,050)	–	–	–	–	–	–	–	**–**
Accumulated other comprehensive income	**71,622**	(3,188)	(68,434)	–	–	–	–	–	–	–	**–**
	785,734	(131,306)	–	9,184	1,819	(3,460)	3,031	(7,516)	30,340	(5,628)	**682,198**
	$1,377,224	$ (33,935)	$ –	$ 9,184	$ 21,399	$ (3,460)	$ –	$ (3,803)	$ 30,340	$ (5,628)	**$1,391,321**

The following table summarizes the adjustments to Paramount's comprehensive loss for the year-ended December 31, 2010 prepared under Previous GAAP to the Company's comprehensive loss prepared in accordance with IFRS:

Year ended December 31, 2010	Previous GAAP	Reclasses (24 a)	PPE (24 b)	ARO (24 c)	FX (24 d)	SBC (24 e)	FTS (24 f)	Equity Accounting (24 g)	Deferred Tax (24 h)	IFRS
Petroleum and natural gas sales	$ 184,395	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ 184,395
Royalties	(21,227)	–	–	–	–	–	–	–	–	(21,227)
Revenue	163,168	–	–	–	–	–	–	–	–	163,168
Gain on financial commodity contracts	10,047	–	–	–	–	–	–	–	–	10,047
	173,215	–	–	–	–	–	–	–	–	173,215
Expenses										
Operating expense and production tax	50,892	–	–	–	–	–	–	–	–	50,892
Transportation	17,219	–	–	–	–	–	–	–	–	17,219
General and administrative	15,150	–	–	–	–	–	–	–	–	15,150
Stock-based compensation	58,764	–	–	–	–	(3,486)	–	–	–	55,278
Depletion and depreciation	178,007	(8,022)	(9,335)	–	–	–	–	–	–	160,650
Exploration	8,829	(8,829)	–	–	–	–	–	–	–	–
Dry hole	9,492	(9,492)	–	–	–	–	–	–	–	–
Gain on sale of property, plant and equipment	(3)	–	–	(377)	–	–	–	–	–	(380)
Write-down of petroleum and natural gas assets	25,332	(25,332)	–	–	–	–	–	–	–	–
Interest	13,560	–	–	–	–	–	–	–	–	13,560
Foreign exchange	(801)	503	–	–	–	–	–	–	–	(298)
Debt extinguishment	1,708	–	–	–	–	–	–	–	–	1,708
Exploration and evaluation	–	42,570	151	–	–	–	–	–	–	42,721
Acquisition transaction costs	267	–	–	–	–	–	–	–	–	267
Accretion of asset retirement obligations	–	9,105	–	(1,130)	–	–	–	–	–	7,975
	378,416	503	(9,184)	(1,507)	–	(3,486)	–	–	–	364,742
Income from investments	8,227	(2,600)	–	–	–	–	–	30,372	–	35,999
Other income	2,184	2,600	–	–	–	–	–	–	–	4,784
Loss before tax	(194,790)	(503)	9,184	1,507	–	3,486	–	30,372	–	(150,744)
Income tax expense (recovery)										
Current	213	–	–	–	–	–	–	–	–	213
Deferred	(72,535)	–	–	–	–	–	5,344	–	6,245	(60,946)
	(72,322)	–	–	–	–	–	5,344	–	6,245	(60,733)
Net loss	$ (122,468)	(503)	9,184	1,507	–	3,486	(5,344)	30,372	(6,245)	(90,011)
Other comprehensive income (loss), net of tax										
Change in market value of securities	71,602	–	–	–	–	–	–	–	–	71,602
Exchange differences on translation of US subsidiaries	–	503	–	312	(3,460)	–	–	–	617	(2,028)
Reclass of accumulated (gains) to earnings	(3,168)	–	–	–	–	–	–	–	–	(3,168)
Comprehensive loss	$ (54,034)	$ –	$ 9,184	$ 1,819	$ (3,460)	$ 3,486	$ (5,344)	$ 30,372	$ (5,628)	$ (23,605)

a) Reclassifications ("Reclasses")

i. Balance Sheet

Exploration and Evaluation Assets

At the Transition Date, exploration and evaluation assets having a carrying value of $152.2 million, primarily consisting of costs related to undeveloped land and incomplete exploratory drilling projects, were reclassified from property, plant and equipment to exploration and evaluation. For the twelve months ended December 31, 2010, $118.2 million of net additions were reclassified from property, plant, and equipment to exploration and evaluation.

Equity Accounted Investments

At the Transition Date, equity accounted investments having an aggregate carrying value of $119.2 million, were reclassified from investments to equity accounted investments. For the twelve months ended December 31, 2010, the $3.6 million net change in the carrying value of equity accounted investments was reclassified from investments to equity accounted investments.

Investments in Securities

At the Transition Date, investments in the securities of entities that are accounted for as available-for-sale investments, having an aggregate carrying value of $115.4 million, were reclassified from investments to investments in securities. For the twelve months ended December 31, 2010, the change in the carrying value of investments in securities of $74.3 million was reclassified from investments to investments in securities.

Reserves

At the Transition Date, the contributed surplus balance of $2.9 million and accumulated other comprehensive income balance of $3.2 million that were presented as individual line items on the balance sheet under Previous GAAP were reclassified to reserves under IFRS. For the twelve months ended December 31, 2010, the aggregate $69.5 million change in contributed surplus and accumulated other comprehensive income was reclassified to reserves. Foreign exchange on the translation of US subsidiaries of $0.5 million was reclassified from foreign exchange expense to reserves for the twelve months ended December 31, 2010.

ii. Statement of Comprehensive Income

Exploration Expense

Exploration expense of $8.8 million and dry hole expense of $9.5 million that were presented as individual line items under Previous GAAP are now included in exploration and evaluation expense under IFRS.

Depletion and Depreciation

Write-offs of the cost of expired mineral leases in respect of undeveloped properties of $24.2 million were included in depletion and depreciation expense under Previous GAAP but are included in exploration and evaluation expense under IFRS.

Accretion expense of $9.1 million related to asset retirement obligations was included in depletion, depreciation and accretion under Previous GAAP but is presented separately under IFRS.

The write-down of petroleum and natural gas properties of $25.3 million was presented as an individual item under Previous GAAP but is included in depletion and depreciation under IFRS.

Other Income

The gain on sale of available-for-sale investments of $3.5 million and the write-down of investments of $0.9 million that were included in income (loss) from investments under Previous GAAP are now included in other income under IFRS.

b) Property, Plant, and Equipment ("PPE")

Under IFRS, the type and method of calculating petroleum and natural gas reserves used in determining depletion on a unit-of-production basis is not specifically prescribed. Under Previous GAAP, the Company was required to use a reserve estimate based on average commodity prices of the preceding year. On Transition Date, Paramount changed its reserves estimates for calculating depletion to use proved developed reserves based on forecast commodity prices.

IFRS requires an asset or CGU to be written down when its carrying value exceeds its recoverable amount. The recoverable amount is defined as the greater of value in use and fair value less costs to sell. Under Previous GAAP, a two-step approach was used to determine impairment write-downs: (i) the carrying value of a property was compared to its expected undiscounted before-tax cash flows, and (ii) where the carrying value exceeded the expected undiscounted before-tax cash flows, an impairment write-down was calculated based on the difference between the property's carrying value and its expected discounted before-tax cash flows. The IFRS method of determining impairments resulted in the recognition of additional impairment write-downs of petroleum and natural gas properties of $65.4 million on Transition Date. For the twelve months ended December 31, 2010, additional write-downs of $32.6 million were recognized, including a goodwill impairment charge of $3.6 million. Depletion expense in 2010 was reduced by $41.9 million under IFRS due to reduced carrying values of petroleum and natural gas properties as a result of IFRS impairment adjustments and the change in the reserves used in calculating unit-of-production depletion. The net IFRS adjustments to depletion and impairment write-down amounts resulted in a net increase of $12.9 million in property, plant and equipment during the year ended December 31, 2010.

At Transition Date, the additional impairment write-downs primarily related to the Northern and Kaybob COUs. At December 31, 2010 the additional impairment write-downs related to the Northern, Southern, and Grande Prairie COUs. Write-downs were recognized to the extent that the carrying value of each CGU exceeded its expected recoverable amount. The recoverable amount was estimated on a fair value less costs to sell basis using a discounted cash flow method, which is an approach commonly employed by market participants to value oil and gas properties. Cash flows were projected over the expected productive life of each CGU's reserves, at an after-tax discount rate of eight percent at December 31, 2010 (Transition Date – ten percent).

The $3.6 million write-down of goodwill at December 31, 2010 related to goodwill associated with properties in the Southern COU.

On Transition Date, the fair value of certain CGUs was deemed to be historical cost. The aggregate fair value of such CGUs was $378.7 million compared to an aggregate carrying value under Previous GAAP of $447.7 million.

c) Asset Retirement Obligations ("ARO")

Under IFRS, the Company's policy is to re-measure asset retirement obligations at each reporting date using the period-end risk-free rate. Under Previous GAAP, credit-adjusted risk-free rates were applied to each obligation when initially recognized, and that rate was not adjusted for changes in discount rates in future periods. On Transition Date, the Company recorded a $91.6 million increase in the asset retirement obligation liability due to the decrease in discount rates, from approximately eight percent under Previous GAAP to four percent under IFRS. The increase in the asset retirement obligation liability was recognized as an increase in the carrying value of the related asset where the asset was not part of a CGU for which its fair value had been deemed historical cost, otherwise the increase was recognized in retained earnings. Net additions to the ARO liability in 2010 were increased by $19.6 million primarily due to the change in discount rates, which included a $4.0 million increase to the ARO liability recognized in respect of the Redcliffe acquisition. The change in discount rates decreased 2010 accretion expense by $1.1 million.

d) Foreign Exchange Translation ("FX")

Under IFRS, assets and liabilities of subsidiaries with functional currencies that are not the presentation currency are translated at the exchange rate in effect at the end of the reporting period and the resulting exchange differences are recognized in other comprehensive income. Under Previous GAAP, the assets and liabilities of the Company's integrated foreign operations were translated into Canadian dollars using the temporal method, where non-monetary items were translated at historical exchange rates and monetary assets and liabilities were translated at the exchange rate in effect at the end of the reporting period, with resulting exchange differences recognized in earnings.

On Transition Date, the change of translation method resulted in a decrease in the carrying amount of Paramount's property, plant and equipment assets of $4.1 million and a decrease in exploration and evaluation assets of $0.9 million. For the twelve months ended December 31, 2010, the change in translation methods resulted in a further $2.9 million decrease in the carrying value of the Company's property, plant, and equipment assets and a further $0.6 million decrease in the carrying value of exploration and evaluation assets. The impact on OCI for the twelve months ended December 31, 2010 as a result of the change in translation method was a decrease of $3.5 million.

e) Stock-based Compensation ("SBC")

Until September 30, 2011, Paramount's stock-based compensation liability related to Paramount Options under IFRS was re-measured at the end of each period using the Black-Scholes-Merton fair value option pricing model. Under Previous GAAP, the stock-based compensation liability was re-measured at the end of each period using the intrinsic value method, where the liability was calculated based on the amount by which the market price of the Company's Common Shares exceeded the exercise price of outstanding options. As a result of the change in valuation method, Paramount's stock-based compensation liability increased by $3.3 million on Transition Date. For the twelve months ended December 31, 2010 the stock-based compensation liability increased by $0.3 million, including the increase on Transition Date of $3.3 million and the decrease for 2010 adjustments of $3.0 million compared to Previous GAAP. The impact on 2010 stock-based compensation expense for the year ended December 31, 2010 was a decrease of $3.5 million.

f) Flow-through Shares ("FTS")

Under IFRS, proceeds from the issuance of flow-through shares are allocated between the sale of the shares, which are recorded in share capital, and the sale of the tax benefits, which are initially recorded as an accrued liability. The allocation is made based on the difference between the issue price of flow-

through shares and the market price of the Common Shares on the date the offering is priced. The liability related to the sale of the tax benefits is reversed as qualifying expenditures intended for renunciation to subscribers are incurred, and a deferred tax liability is recorded. The difference between the deferred tax liability recorded and the liability related to the sale of tax benefits is recognized as deferred tax expense. Under Previous GAAP, when flow-through shares were issued, they were recorded in share capital based on proceeds received. Upon filing the renunciation documents with the tax authorities, a future tax liability was recognized and share capital was reduced for the tax effect of expenditures renounced to subscribers. The IFRS adjustment on Transition Date associated with flow-through shares was to increase share capital by $25.1 million, reduce retained earnings by $30.4 million, increase the deferred tax liability by $2.9 million, and increase accrued liabilities by $2.4 million. For the twelve months ended December 31, 2010, additional IFRS adjustments were made to decrease share capital by $2.2 million, reduce retained earnings by $5.3 million, increase accrued liabilities by $3.7 million and decrease the deferred income tax asset balance by $3.8 million.

g) Equity Accounted Investments ("Equity Accounting")

The equity method of accounting requires an investor to adjust the carrying value of its investment in an investee for the investor’s proportionate share of changes in the investee’s net assets. On Transition Date, the carrying value of Paramount’s equity accounted investments was decreased by an aggregate of $7.6 million to reflect Paramount’s proportionate share of the adjustments Trilogy and MGM Energy recorded in respect of their IFRS transitions. For the twelve months ended December 31, 2010, the carrying values of Paramount’s equity accounted investments were increased by $30.3 million due to adjustments recorded by Trilogy and MGM Energy. Income from equity-accounted investments for the year ended 2010 increased by $30.4 million.

h) Deferred Income Tax ("Deferred Tax")

On Transition Date, the Company’s deferred income tax asset balance was increased by $2.5 million, the deferred income tax liability balance was decreased by $34.0 million, and the equity accounted investments balance was increased by $1.9 million to reflect the tax impacts of the IFRS adjustments as described in the preceding discussion. For the twelve months ended December 31, 2010, the deferred income tax asset balance was decreased by $3.7 million, the equity accounted investments balance was decreased by $1.9 million and deferred income tax expense was increased by $6.2 million. The deferred income tax on foreign exchange differences on translation of the US subsidiaries was $0.6 million for the twelve months ended December 31, 2010.

The following table reconciles the Consolidated Statement of Cash Flows prepared under Previous GAAP to the Company's statements of Cash Flows prepared in accordance with IFRS:

Year ended December 31		2010
Cash from operating activities under Previous GAAP	$	63,383
Adjustments under IFRS:		
Exploration costs		(8,172)
Common shares purchased under stock incentive plan		2,901
Foreign exchange on cash and cash equivalents		1,066
Cash from operating activities under IFRS	**$**	**59,178**
Cash from financing activities under Previous GAAP	$	251,905
Adjustment under IFRS:		
Common shares purchased under stock incentive plan		(2,901)
Cash from financing activities under IFRS	**$**	**249,004**
Cash used in investing activities under Previous GAAP	$	(333,867)
Adjustment under IFRS:		
Exploration costs		8,172
Cash used in investing activities under IFRS	**$**	**(325,695)**
Net decrease		**(17,513)**
Foreign exchange on cash and cash equivalents		(1,066)
Cash and cash equivalents, beginning of year	$	93,238
Cash and cash equivalents, end of year	**$**	**74,659**

CORPORATE INFORMATION

OFFICERS

C. H. Riddell
Chairman of the Board and
Chief Executive Officer

J. H. T. Riddell
President and
Chief Operating Officer

B. K. Lee
Chief Financial Officer

E. M. Shier
Corporate Secretary

L. M. Doyle
Corporate Operating Officer

G. W. P. McMillan
Corporate Operating Officer

D. S. Purdy
Corporate Operating Officer

J. Wittenberg
Corporate Operating Officer

P. R. Kinvig
Controller

L. A. Friesen
Assistant Corporate Secretary

DIRECTORS

C. H. Riddell (3)
Chairman of the Board and
Chief Executive Officer
Paramount Resources Ltd.
Calgary, Alberta

J. H. T. Riddell
President and
Chief Operating Officer
Paramount Resources Ltd.
Calgary, Alberta

J. G. M. Bell (1) (4)
General Counsel
Olympia Trust Company
Calgary, Alberta

T. E. Claugus (4)
President, GMT Capital Corp.
Atlanta, Georgia

J. C. Gorman (1) (3) (4)
Retired
Calgary, Alberta

D. Jungé C.F.A. (2) (4)
Chairman of the Board and
Chief Executive Officer
Pitcairn Trust Company
Bryn Athyn, Pennsylvania

D. M. Knott (4)
Managing General Partner
Knott Partners, L.P.
Syosset, New York

S. L. Riddell Rose
President and
Chief Executive Officer
Perpetual Energy Inc.
Calgary, Alberta

V. S. A. Riddell
Business Executive
Calgary, Alberta

J. B. Roy (1) (2) (3) (4)
Independent Businessman
Calgary, Alberta

A. S. Thomson (1) (4)
Retired
Sidney, British Columbia

B. M. Wylie (2)
Business Executive
Calgary, Alberta

(1) Member of Audit Committee
(2) Member of Environmental, Health and Safety Committee
(3) Member of Compensation Committee
(4) Member of Corporate Governance Committee

HEAD OFFICE

4700 Bankers Hall West
888 Third Street S.W.
Calgary, Alberta
Canada T2P 5C5
Telephone: (403) 290-3600
Facsimile: (403) 262-7994
www.paramountres.com

CONSULTING ENGINEERS

McDaniel & Associates Consultants Ltd.
Calgary, Alberta

AUDITORS

Ernst & Young LLP
Calgary, Alberta

BANKERS

Bank of Montreal
Calgary, Alberta

The Bank of Nova Scotia
Calgary, Alberta

Royal Bank of Canada
Calgary, Alberta

Alberta Treasury Branches
Calgary, Alberta

The Royal Bank of Scotland N.V. (Canada) Branch
Calgary, Alberta

The Toronto-Dominion Bank
Calgary, Alberta

HSBC Bank Canada
Calgary, Alberta

REGISTRAR AND TRANSFER AGENT

Computershare Trust Company of Canada
Calgary, Alberta
Toronto, Ontario

STOCK EXCHANGE LISTING

The Toronto Stock Exchange
("POU")

4700 Bankers Hall West
888 Third Street S.W.
Calgary, Alberta
Canada T2P 5C5
Telephone: (403) 290-3600
Facsimile: (403) 262-7994
www.paramountres.com