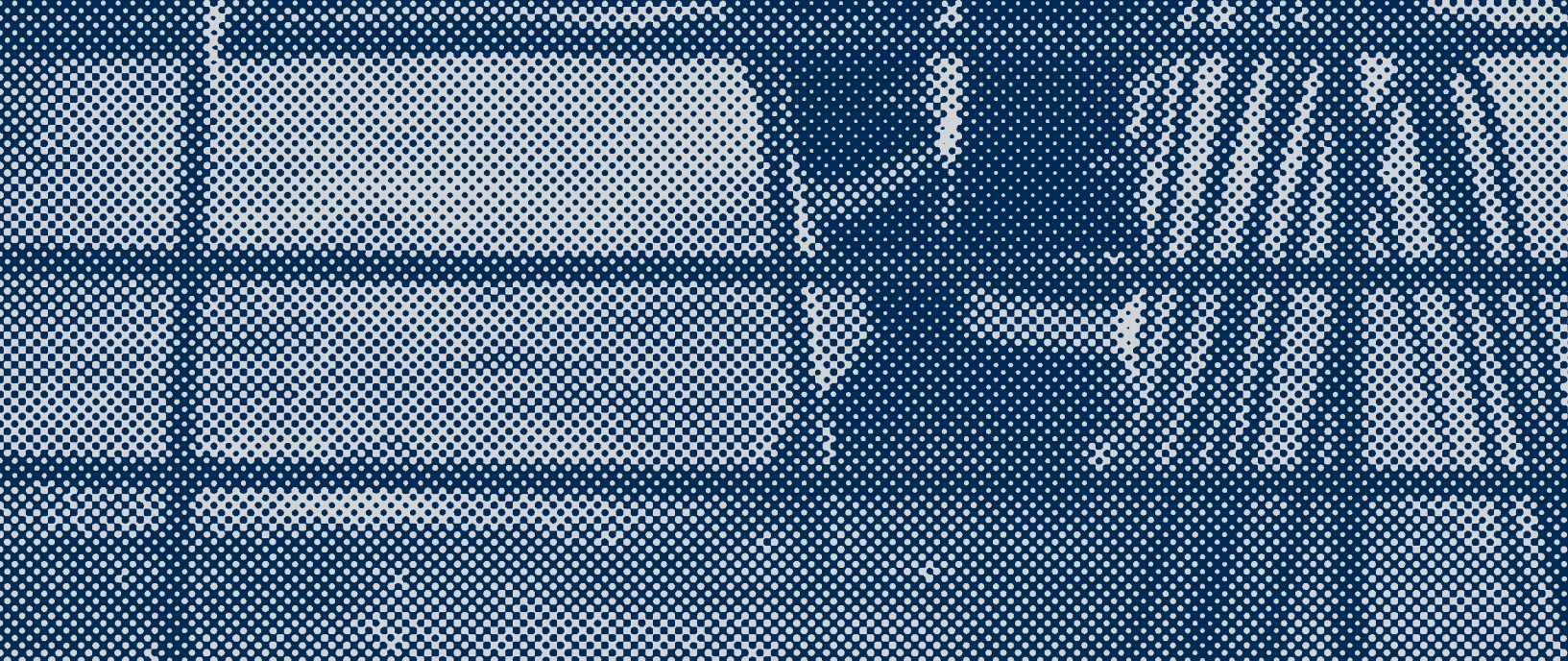
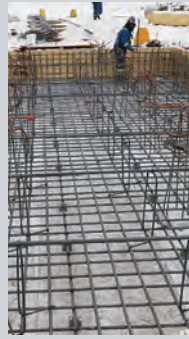


ANNUAL
REPORT
2012



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ANNUAL MEETING OF SHAREHOLDERS

Shareholders are cordially invited to attend the Annual Meeting of Shareholders to be held Wednesday, May 8, 2013 at 10:30 AM MDT at Centrium Place in the Conference Centre, 332 6th Avenue S.W., Calgary, Alberta.

Forward-Looking Statements and Information

This annual report includes forward-looking statements and information that is based on Paramount's current expectations, estimates, projections and assumptions in light of our experience and our perception of historical trends. Actual results may differ materially from those expressed or implied by the forward-looking statements and information. Readers are referred to page 55 for our forward looking statements and other advisories.

FINANCIAL AND OPERATING HIGHLIGHTS⁽¹⁾⁽²⁾

(\$ millions, except as noted)

	2012	2011	% Change
FINANCIAL			
Petroleum and natural gas sales	197.1	241.7	(18)
Funds flow from operations	58.1	96.2	(40)
Per share – basic and diluted (\$/share)	0.67	1.23	(46)
Net loss	(61.9)	(232.0)	73
Per share – basic and diluted (\$/share)	(0.71)	(2.96)	76
Exploration and development expenditures	523.1	465.7	12
Investments in other entities – market value ⁽³⁾	704.8	1,077.3	(35)
Total assets	2,037.0	1,725.7	18
Net debt	701.4	513.4	37
Common shares outstanding (thousands)	89,932	85,500	5
OPERATIONAL			
Sales volumes			
Natural gas (MMcf/d)	98.5	81.6	21
NGLs (Bbl/d)	1,873	1,542	21
Oil (Bbl/d)	1,620	2,291	(29)
Total (Boe/d)	19,917	17,426	14
Gas weighting	82%	78%	
Average realized price			
Natural gas (\$/Mcf)	2.72	4.04	(33)
NGLs (\$/Bbl)	67.10	79.56	(16)
Oil (\$/Bbl)	83.16	87.00	(4)
Total (\$/Boe)	27.04	38.00	(29)
Net wells drilled	35	75	(53)
Net undeveloped land (thousands of acres)	1,190	1,225	(3)
RESERVES			
Proved plus probable			
Natural gas (Bcf)	323.7	244.1	33
NGLs (MBbl)	30,761	5,760	434
Light and medium crude oil (MBbl)	2,128	6,573	(68)
Total Conventional (Mboe)	86,842	53,015	64
Oil sands bitumen (MBbl)	93,091	–	100
Total Company (MBoe)	179,933	53,015	239
Conventional F&D cost before facilities expenditures (proved plus probable) (\$/Boe)	12.18	24.19	(50)
Conventional reserves replacement (proved plus probable)	599%	193%	
NPV ₁₀ future net revenue before tax			
Proved	455.9	611.4	(25)
Proved plus probable	1,259.3	832.2	51

⁽¹⁾ Readers are referred to the advisories concerning non-GAAP measures and oil and gas measures and definitions in the "Advisories" section of this document.

⁽²⁾ Amounts include the results of discontinued operations.

⁽³⁾ Based on the period-end closing prices of publicly traded enterprises and the book value of the remaining investments.

PRESIDENT'S MESSAGE

Paramount continues to make great progress on its large-scale projects in the Kaybob core area. It is difficult not to get excited as our Musreau deep cut plant takes shape and the large inventory of pre-drilled wells that will feed the facility continues to grow. The message we wish to convey is that to date, the wells continue to test positively, the behind-pipe inventory continues to be on track with the Company's schedule and the Musreau deep cut plant remains on-budget and on-schedule for a Q4 2013 start-up.

During 2012, Paramount made further progress on its operational and financial performance. Production increased 14 percent from 17,426 Boe/d in 2011 to 19,917 Boe/d in 2012, despite various significant third party downstream capacity restrictions throughout the second half of the year. Operating costs per Boe decreased 14 percent to \$9.58 in 2012 and corporate G&A costs per Boe decreased 15 percent to \$1.61. Improvements in per unit costs will continue as incremental low cost production is brought on-stream with minimal human resource additions.

Despite these cost improvements, netback per Boe decreased to \$13.04 in 2012 from \$20.13 in 2011 as a result of lower prices for natural gas, oil and natural gas liquids. Cash netback decreased to \$95 million in 2012 from \$128 million in 2011, as the higher production levels and lower per unit costs did not fully compensate for the decline in commodity prices.

Paramount has continued to invest multiples of cash flow as significant drilling and infrastructure spending is occurring on major projects at Musreau and Resthaven in advance of any cash flow from these projects. The Company's exploration and development spending totaled \$523 million in 2012, funded mainly through a combination of equity, debt and asset sales. It is expected that by 2014, after these major projects are on production, Paramount's capital expenditure budget and cash flow will be much more balanced.

Significant progress has been made in rationalizing our asset base in order to focus our technical teams on the opportunities that will create the best return on investment. In 2012, we completed the sale of Paramount's legacy producing assets in North Dakota and Montana, minor non-core properties in Saskatchewan and a non-producing property in the Pembina area of Alberta. In 2013, we have already completed the sale of the remaining properties in the U.S. and the Bistcho - Cameron Hills complex in our Northern operating unit. Gains were realized on both 2013 dispositions, as the proceeds received exceeded the net book costs and remaining abandonment liabilities of the assets sold. All of these transactions have advanced our goals of reducing per unit costs and focusing our time and attention on the projects that are expected to provide the highest rates of return on our future investments.

Paramount was very successful in 2012 in adding reserves at a low cost. Proved reserves increased by 43 percent from 35.7 MMBoe at year end 2011 to 50.9 MMBoe at year end 2012. Conventional proved plus probable reserves increased from 53.0 MMBoe at year end 2011 to 86.8 MMBoe at year end 2012, an increase of 64 percent. The Company achieved conventional reserves replacement ratios of 336 percent for proved reserves and 599 percent for proved plus probable reserves. Excluding capital spending on facilities, which are expected to provide processing capability for several decades, these reserves were added at a very efficient \$16.82/Boe for proved reserves and \$12.18/Boe for proved plus probable reserves.

Paramount's 100 percent owned oil sands subsidiary, Cavalier Energy, had a successful initial year of operations, built a talented and experienced oilsands execution team, and finalized and submitted the initial application for the first 10,000 Bbl/d phase at Hoole. As a result of this application, 93.1 MMBoe of contingent resources were reclassified to probable reserves. Combined with Paramount's conventional reserves, the Company's total proved plus probable reserves were 179.9 MMBoe at year end 2012. Cavalier is evaluating funding alternatives for the initial phase of construction, with the intention of placing advance orders for long-lead time equipment in order to remain on track for completion of construction in late-2015, targeting first oil production from the project in early-2016.

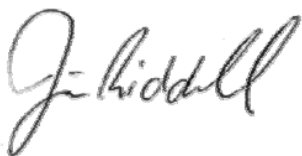
The Company moved forward with its initial Besa River shale gas exploration activities in the Liard Basin in 2012. Drilling and completion operations were completed on the Patry b-40-1 well, with initial test results coming in less than anticipated at 5 to 14 MMcf/d. Drilling of the Dunedin D-57-1 vertical well is nearing completion and a decision to pursue drilling and completing a horizontal leg will be made after the evaluation of petrophysical data obtained from the pilot hole.

Paramount looks forward to the completion and start-up of its 100 percent owned 200 MMcf/d Musreau deep cut plant in Q4 2013 and continued positive drilling results from its core area in the Kaybob operating unit at Musreau, Resthaven, Smoky and Kakwa. Drilling activities over the past few years have substantially de-risked the Company's Deep Basin lands, and Paramount is in the preliminary stages of planning for an additional new 200 MMcf/d plant within the Kaybob operating unit. The Company has also recently achieved positive drilling results extending the middle Montney trend north onto its Karr - Gold Creek acreage. Successful wells in the Karr area will allow us to fill the underutilized wholly-owned Karr facility. We also look forward to the completion of the third-party operated Smoky plant expansion, which will initially provide us an additional 30 MMcf/d of capacity, and will ultimately provide us with a total of 60 MMcf/d of capacity in this 300 MMcf/d deep cut plant.

Progress is slowly being made in North American gas markets, as year-over-year increases in production have essentially ended and signs of declines are starting to appear. Low natural gas prices have also created increased demand for the commodity, which has helped to re-balance supply and demand. Prices for oil have been fairly stable year-over-year, but the differentials between world reference prices and Canadian realized prices have been large and volatile due to localized oversupply as access to world markets is constrained by limited export capacity. Our regulatory system appears to be poorly suited to enable our industry to remedy these issues in a timely manner and, as a result, Canadians will continue to forfeit a significant portion of the full economic benefit of our resource development.

The Company is fortunate to have been able to capture and control some of the best and most economic oil and natural gas prospects available in North America. Paramount is of the view that prices, particularly for natural gas, have dropped to a level that is unsustainable for the full-cycle replacement of reserves, and that we should see appreciably higher commodity prices in the near term. We will continue to allocate capital towards the plays that exceed our economic hurdles at current commodity prices, while balancing risks. Paramount's current capital expenditure program is fully aligned with this and, as a result, approximately 90% of the Company's conventional capital expenditure budget is directed towards the Kaybob play, which provides compelling returns in the current commodity price environment.

Looking forward, Paramount has provided 2013 capital spending guidance of \$500 million on exploration and development activities and an additional \$50 million on its Strategic Investments, mainly on shale gas exploration activities in the Liard Basin. Production is anticipated to range between 21,000 Boe/d and 25,000 Boe/d, depending upon access to third-party downstream NGLs transportation and processing capacity, until our new Musreau deep cut plant comes into service. Corporate production is expected to ramp up to levels that will exceed 50,000 Boe/d at some point in 2014, with the timing dependent on the completion of expansions to downstream de-ethanization and fractionation facilities in which Paramount has secured long-term firm service capacity. It is extremely exciting for the Company to be realizing the results of the many years of hard work on these projects; almost as exciting as the future opportunities for the continued growth of the Company from these plays.



J.H.T. Riddell
President and Chief Operating Officer
March 2013

2012 OVERVIEW

Reserves and Principal Properties

- Total proved and probable reserves increased 239 percent to 179.9 MMBoe, with conventional reserves increasing 64 percent to 86.8 MMBoe (replacement ratio of six times) and probable oil sands bitumen reserves increasing 93.1 MMBoe.
- Conventional proved reserves increased 43 percent year-over-year to 50.9 MMBoe, after production of 7.3 MMBoe and dispositions of 3.4 MMBoe (replacement ratio of three times).
- Conventional proved and probable finding and development costs, excluding facilities and gathering system construction costs, decreased 50 percent to \$12.18 per Boe and for the Kaybob COU decreased 24 percent to \$10.31 per Boe.
- Natural gas and NGLs sales volumes increased approximately 20 percent despite downstream processing and transportation constraints which impacted the Company's operations in the second half of the year.
- The Company's new 45 MMcf/d refrigeration facility at Musreau (the "Musreau Refrig Facility") has been operating near capacity since being re-commissioned in March.
- Operating expenses decreased 14 percent to \$9.58 per Boe in 2012 compared to \$11.20 per Boe in 2011 due to the sale of higher cost US properties and processing cost savings from the Company's Musreau Refrig Facility.
- Construction of the Company's wholly-owned 200 MMcf/d deep cut facility at Musreau (the "Musreau Deep Cut Facility") commenced in the third quarter of 2012 following the receipt of regulatory approval. The project continues to be on-schedule, with commissioning expected to commence by the end of the third quarter of 2013.
- Advance drilling for the deep cut facility expansions at Musreau and Smoky continued. The Company currently has an inventory of 43 (35 net) Kaybob Deep Basin wells with estimated first month deliverability exceeding 225 MMcf/d (185 MMcf/d net) of raw gas.
- In February 2013, the Company closed the sale of substantially all of its remaining US properties for cash proceeds of US\$22.5 million, subject to closing adjustments. Since 2011, the Company has realized aggregate cash proceeds of approximately US\$130 million on the sale of its US properties, significantly in excess of their carrying value.

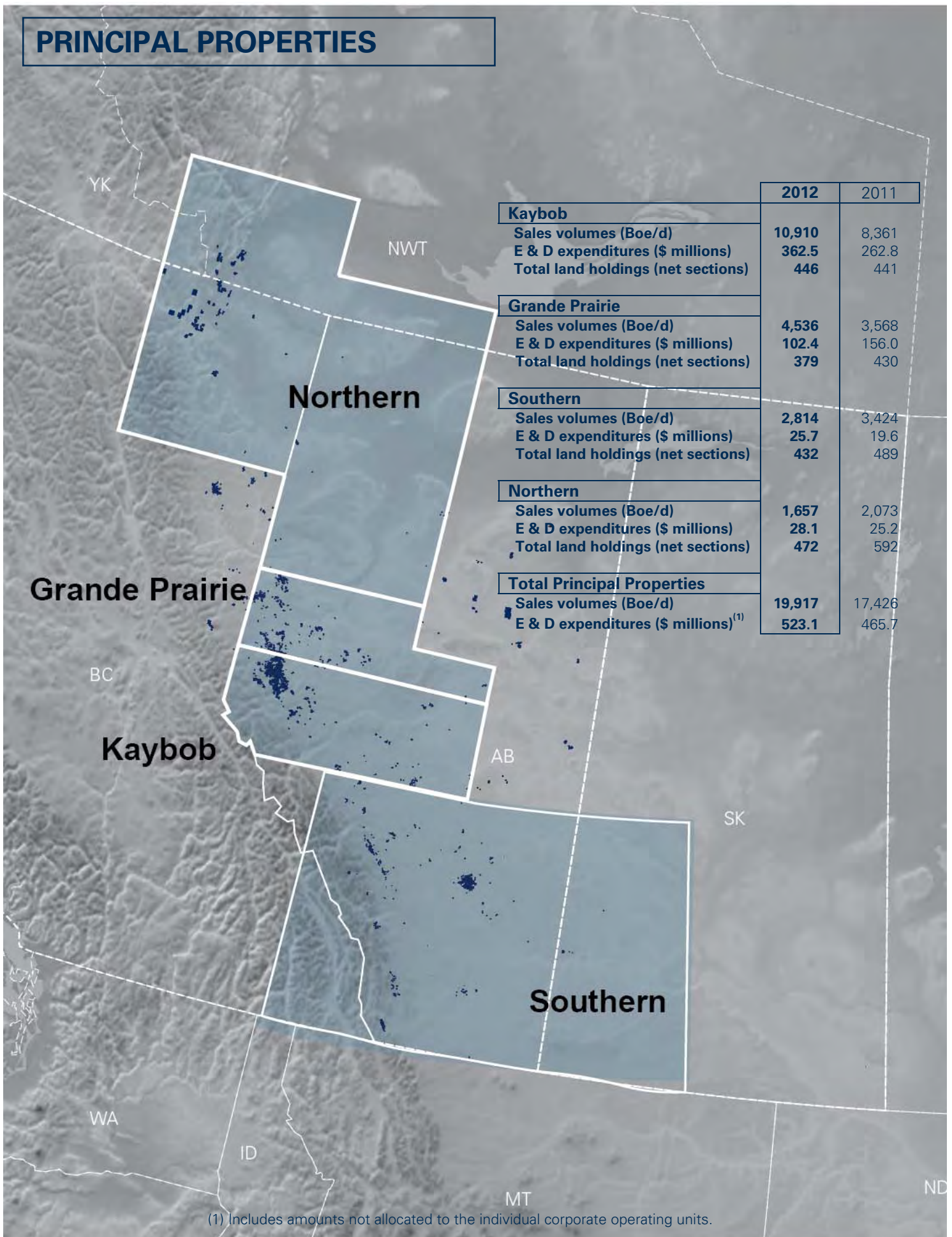
Strategic Investments

- Paramount drilled and completed its first horizontal shale gas exploration well at Patry in Northeast British Columbia in March 2013. In order to further evaluate well performance, the Company plans to bring the well on production by the end of 2013.
- Paramount's wholly-owned subsidiary, Cavalier Energy Inc. ("Cavalier Energy"), recorded 93.1 million barrels of probable bitumen reserves with an NPV₁₀ of \$379 million following its regulatory applications for the initial 10,000 Bbl/d phase of the Hoole Grand Rapids development.
- Fox Drilling completed the construction of two new walking drilling rigs, which will drill on multi-well pad sites in the Kaybob COU.

Corporate

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

PRINCIPAL PROPERTIES



	2012	2011
Kaybob		
Sales volumes (Boe/d)	10,910	8,361
E & D expenditures (\$ millions)	362.5	262.8
Total land holdings (net sections)	446	441
Grande Prairie		
Sales volumes (Boe/d)	4,536	3,568
E & D expenditures (\$ millions)	102.4	156.0
Total land holdings (net sections)	379	430
Southern		
Sales volumes (Boe/d)	2,814	3,424
E & D expenditures (\$ millions)	25.7	19.6
Total land holdings (net sections)	432	489
Northern		
Sales volumes (Boe/d)	1,657	2,073
E & D expenditures (\$ millions)	28.1	25.2
Total land holdings (net sections)	472	592
Total Principal Properties		
Sales volumes (Boe/d)	19,917	17,426
E & D expenditures (\$ millions) ⁽¹⁾	523.1	465.7

(1) Includes amounts not allocated to the individual corporate operating units.

REVIEW OF OPERATIONS⁽¹⁾

	2012		2011		% Change
Sales Volumes					
Natural gas (MMcf/d)	98.5		81.6		21
NGLs (Bbl/d)	1,873		1,542		21
Oil (Bbl/d)	1,620		2,291		(29)
Total (Boe/d)	19,917		17,426		14
Netbacks (\$ millions) ⁽²⁾	(\$/Boe) ⁽³⁾		(\$/Boe) ⁽³⁾		% Change in \$/Boe
Natural gas revenue	98.2	2.72	120.2	4.04	(33)
NGLs revenue	46.0	67.10	44.8	79.56	(16)
Oil revenue	49.3	83.16	72.7	87.00	(4)
Royalty and sulphur revenue	3.6	—	4.0	—	
Petroleum and natural gas sales	197.1	27.04	241.7	38.00	(29)
Royalties	(16.5)	(2.27)	(22.1)	(3.47)	(35)
Operating expense and production tax	(69.9)	(9.58)	(71.3)	(11.20)	(14)
Transportation	(21.8)	(2.98)	(20.5)	(3.23)	(8)
Netback	88.9	12.21	127.8	20.10	(39)
Financial commodity contract settlements	(0.1)	(0.02)	0.2	0.03	(167)
Insurance settlement	6.2	0.85	—	—	100
Netback including commodity & insurance settlements	95.0	13.04	128.0	20.13	(35)

(1) Amounts include the results of discontinued operations. Refer to page seven of Paramount's Management's Discussion and Analysis for the year ended December 31, 2012.

(2) Readers are referred to the advisories concerning non-GAAP measures and oil and gas definitions in the Advisories section of this document.

(3) Natural gas revenue shown per Mcf.

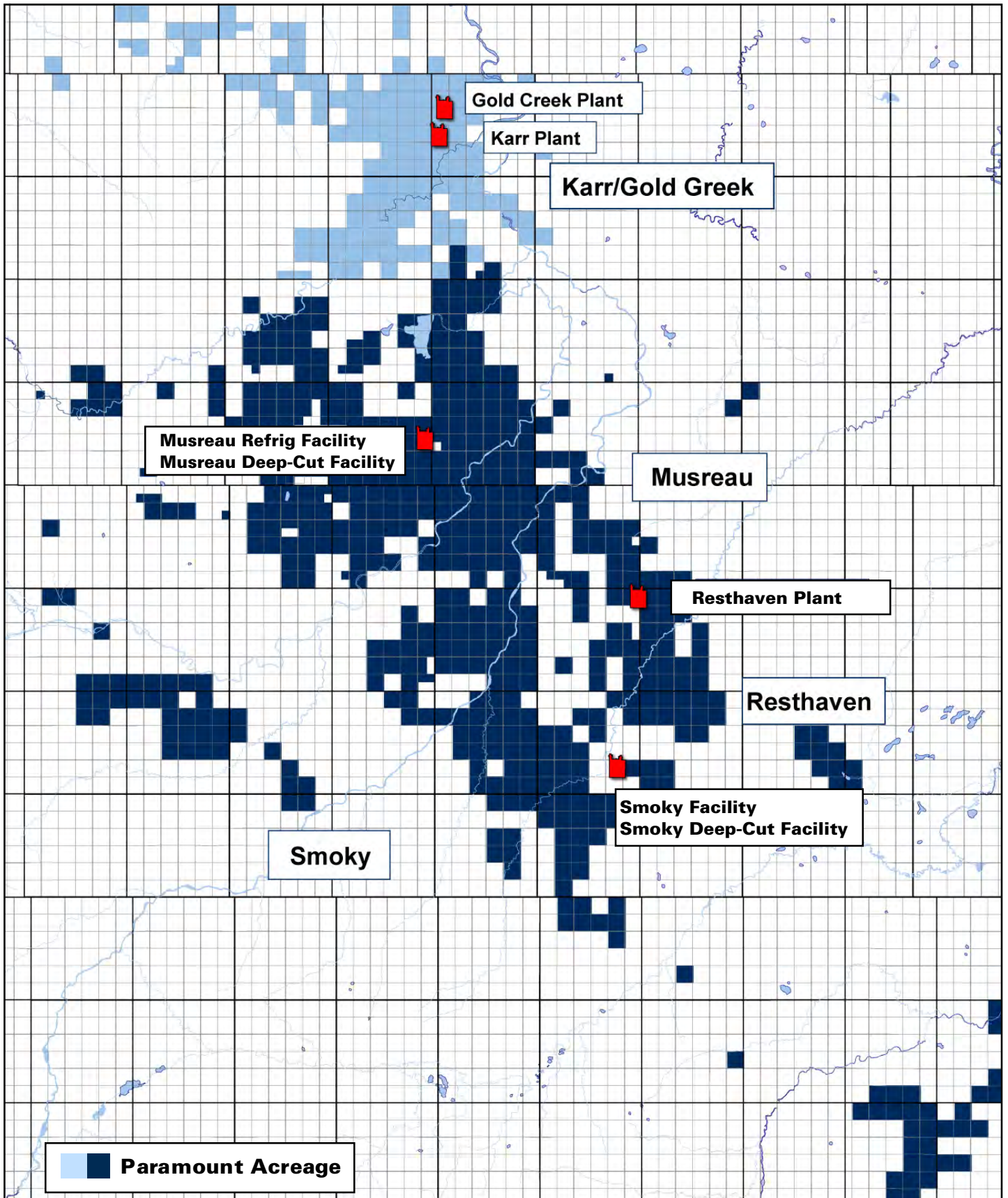
Paramount's natural gas and NGLs sales volumes increased 21 percent in 2012 as the Company completed the first phase of its Kaybob Deep Basin expansion with the re-commissioning of the Musreau Refrig Facility at the end of the first quarter. New production was also added at Valhalla in the Grande Prairie COU, where the gathering and compression system was expanded.

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

Oil sales volumes decreased 29 percent to 1,620 Bbl/d in 2012 compared to 2,291 Bbl/d in 2011, primarily because of the second quarter US property disposition and natural declines in other areas.

Petroleum and natural gas sales revenue in 2012 decreased \$44.6 million compared to 2011 as a result of lower realized prices and the US property disposition. Operating costs decreased \$1.4 million compared to 2011 primarily due to the disposition of the US properties, partially offset by higher operating expenses from continuing operations.

KAYBOB



Kaybob

	2012		2011		% Change
Sales Volumes					
Natural gas (MMcf/d)	59.5		44.5		34
NGLs (Bbl/d)	924		868		6
Oil (Bbl/d)	62		72		(14)
Total (Boe/d)	10,910		8,361		30
Exploration and Development Expenditures (\$ millions)					
Exploration, drilling, completions and tie-ins	200.7		171.2		17
Facilities and gathering	161.8		91.6		77
	362.5		262.8		38
	Gross	Net	Gross	Net	
Total Land Holdings (sections)	788	446	792	441	
Wells Drilled	27	21.2	28	18.3	

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. Paramount has assembled extensive multi-zone mineral rights to 788 (446 net) sections, with the primary formations of interest being the Montney and various Cretaceous horizons. Depending on the formation, well densities of eight or more wells per section per formation are anticipated to be required to recover the resources in place, representing a multi-decade inventory of drilling locations.

Paramount continues to execute the large-scale development of its Deep Basin lands that will materially increase production volumes and cash flow. The Company's drilling activities are currently focused on the Montney, Dunvegan, and Falher formations, which are high pressure, liquids rich, tight gas formations with large reserves potential. These plays continue to generate robust rates of return in the current low natural gas price environment because of the high liquids content in these formations.

The Company achieved significant reserves growth in 2012 as a result of its development activities in the Kaybob Deep Basin. Further increases in reserves are expected as facilities expansions are completed and development drilling continues.

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

Operations

Average daily sales volumes in the Kaybob COU during 2012 were 10,910 Boe/d, an increase of 30 percent compared to 2011. Sales volumes in the first quarter of 2012 were impacted by the fourth quarter 2011 electrical component failure at the Musreau Refrig Facility. The re-commissioning of the facility was completed in March 2012, and average sales volumes increased to 12,236 Boe/d in the second quarter. Sales volumes in the second half of the year were reduced as a result of the previously described Third Party Disruptions. By the middle of September, production across the Kaybob COU was curtailed to less than 6,500 Boe/d, including a temporary reduction in throughput at the Musreau Refrig

Facility to 10 MMcf/d. Sales volumes reached 13,500 Boe/d in November following the partial resolution of Third Party Disruptions.

Between December 2012 and February 2013, Kaybob COU sales volumes have ranged between 11,500 Boe/d and 13,500 Boe/d as operations continue to be impacted by Third Party Disruptions. Based on the current NGLs constraints and projections of capacity for the remainder of 2013, production is expected to be within the current range until the expansion of a third-party NGLs pipeline is completed, Paramount secures additional fractionation capacity and the Musreau Deep Cut Facility is brought on-stream. The Kaybob COU has approximately 28,000 Boe/d of first year production behind pipe which will be brought on-stream when the Musreau and Smoky deep cut expansions are on-stream.

After the start-up of the Musreau Refrig Facility, operating costs for the Kaybob COU were reduced to approximately \$5.00 per Boe, before deducting processing income. The Musreau Refrig Facility provides significant savings to the Company through the elimination of third-party processing fees. The Kaybob COU's per unit operating costs are expected to further decrease with the commissioning of the Musreau Deep Cut Facility, as fixed costs will be applied over significantly larger production volumes. In the third quarter, Paramount received a \$6.2 million settlement in respect of a business interruption insurance claim related to the electrical equipment failure at the Musreau Refrig Facility in December 2011.

Paramount has completed the first phase of its Deep Basin expansion with the re-commissioning of the Musreau Refrig Facility. The next major milestone will be the start-up of the Musreau and Smoky deep cut facilities, which will represent a major step change for Paramount, as Kaybob COU sales volumes are expected to increase more than four times 2012 levels by the end of 2014.

Musreau Deep Cut Facility

Paramount's wholly-owned Musreau Deep Cut Facility is designed to capture incremental volumes of NGLs from the Company's Deep Basin liquids rich gas production that would otherwise be sold as slightly higher heat content natural gas. The incremental liquids are captured by cooling the natural gas stream sufficiently to change the phase of the components from a gas to a liquid and then separating these streams using gravity. Liquids yields from the facility will vary depending on the liquids content of the gas being processed and the temperature to which Paramount cools the gas stream, among other factors.

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

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

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

Kaybob COU sales volumes are expected to increase to approximately 30,000 Boe/d over the first few months after startup, as the operations team optimizes the facility's equipment and processes. Volumes initially processed through the Musreau Deep Cut Facility will be primarily from leaner Cretaceous wells in which Paramount's working interest generally ranges from 50 percent to 100 percent. Ethane is expected to remain in the gas stream until the midstream company completes an expansion of its de-ethanization facilities, which is scheduled to be operational in the second half of 2014. By late-2014, Kaybob COU sales volumes are expected to increase by over four times 2012 levels once a greater proportion of liquids-rich, 100 percent working interest Montney wells are flowing through the Musreau Deep Cut Facility, the expansion of the third party de-ethanization facility is completed and the Smoky Deep Cut Facility is on-stream.

The Company continues to advance its project to construct an amine processing train at the Musreau Deep Cut Facility, which will provide the capability to treat sour gas production at the facility instead of at well sites. This enhancement is expected to cost approximately \$50 million, and will decrease equipping costs by over \$1 million per well and reduce ongoing well operating costs. Design work for the amine facility has been completed and long lead-time components have been ordered. The amine processing train is scheduled to be on-stream in the first half of 2014, and will not impact the start-up of the Musreau Deep Cut Facility.

Smoky Deep Cut Facility

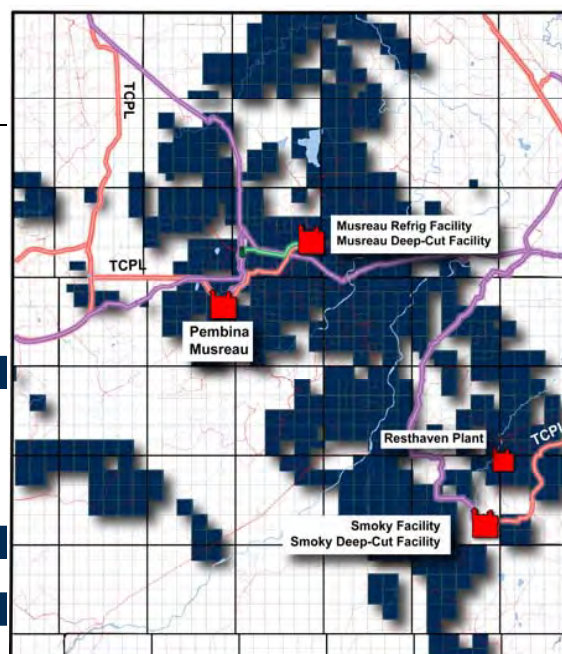
Paramount continues to participate in the deep cut expansion of the non-operated processing facility at Smoky (the "Smoky Deep Cut Facility"). The Company will have a 20 percent interest in the expanded facility, an increase from its 10 percent interest in the existing 100 MMcf/d dew point facility. The Smoky Deep Cut Facility will initially have 200 MMcf/d of capacity upon start-up, increasing to 300 MMcf/d through the later installation of an incremental 100 MMcf/d of compression. As a plant owner, Paramount has the option at any time to request installation of the additional compression, which would bring the Company's total owned capacity in the facility to 60 MMcf/d. Construction work commenced at the site in the third quarter of 2012 with the installation of pilings and foundations. NGLs bullets and compressors have been delivered and a significant portion of the major equipment is expected to be delivered prior to break-up, with the remaining components to be delivered later this year. The expansion is scheduled to be commissioned in the third quarter of 2014. Paramount's share of the Smoky Deep Cut Facility expansion costs is expected to total \$65 million, of which approximately \$30 million has been incurred to December 31, 2012.

Kaybob Processing Capacity

Upon completion of the Musreau Deep Cut Facility and the Smoky Deep Cut Facility, Paramount expects to have over 300 MMcf/d of net owned and third party firm-service processing capacity in the Deep Basin, estimated to be capable of yielding over 73,000 Boe/d of sales volumes when fully utilized. This capacity will be used to process Paramount's production as well as third-party unavoidably commingled volumes for a fee. Paramount currently has access to an incremental 10 to 12 MMcf/d of interruptible processing capacity and will continue to utilize such capacity in addition to its owned and firm-service capacity where available. The Company's current and future owned and firm-service processing capacity in the Deep Basin is as follows:

	Gross Raw Gas Capacity (MMcf/d)	Net Paramount Raw Gas Capacity (MMcf/d)	Net Paramount Sales Capacity⁽¹⁾ (Boe/d)
Current Processing Capacity			
Musreau Refrig Facility	45	45	8,600
Resthaven Facility	20	10	2,000
Smoky Facility	100	10	2,500
Kakwa Facility	40	4	720
Firm Contracted Capacity	10	10	1,800
Subtotal – Current Capacity	215	79	15,620
Future Processing Capacity			
Musreau Deep-Cut Facility	200	200	50,000
Smoky Deep-Cut Facility	200	30	7,500
Subtotal – Future Capacity	400	230	57,500
Projected Total	615	309	73,120

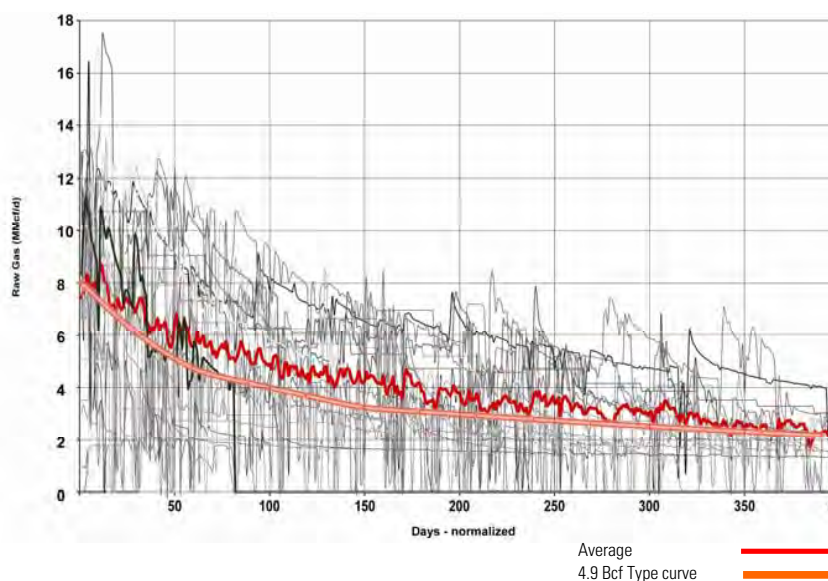
(1) Estimated



Keybob Drilling Activity

During 2012, Paramount was active drilling and completing wells in the Deep Basin, continuing to build production deliverability in preparation for the start-up of the new Musreau and Smoky deep cut facilities. The Company drilled 27 (21.2 net) wells in 2012, including 7 (6.0 net) horizontal Montney formation wells and completed 17 (13.1 net) wells, including 9 (8.0 net) Montney formation wells. The initial flow rates and NGLs content continue to be consistent with expectations, further confirming well performance profiles.

The Company's producing Falher formation wells have on average performed in accordance with the anticipated type curve below:



NGLs transportation and fractionation capacity constraints have temporarily limited Paramount's ability to bring on Montney formation wells due to their higher liquids content. The Company has continued to drill and complete Montney wells in advance of the Musreau and Smoky deep cut facilities expansions and test results from the latest wells continue to be consistent with earlier wells, further confirming

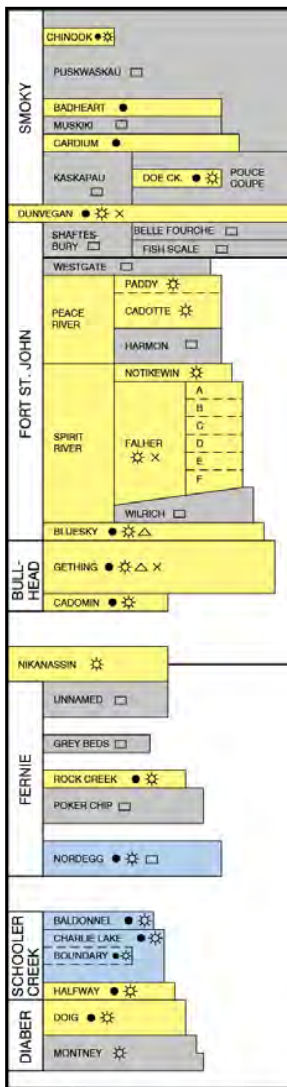
expected recoveries from this formation. The following table summarizes test results for Montney formation wells rig released in 2011 and 2012:

Location	Test Results ⁽¹⁾		
	Avg. Rate	Pressure ⁽²⁾	Duration
	(MMcf/d)	(PSI)	(Hrs)
Musreau	11.6	2,029	6
Musreau	8.6	1,006	20
Musreau	6.1	1,159	2
Musreau	6.6	2,068	64
Musreau	12.4	2,067	1
Smoky	4.1	584	4
Smoky	10.9	3,454	56
Musreau	9.0	2,455	1
Musreau	11.0	2,248	31
Musreau	6.5	2,373	36

(1) Test rates represent the average rate of gas-flow during post clean-up production tests up the largest choke setting. All wells were stimulated using frac oil and substantially all fluids recovered during the test periods were load fluids. As a result, fluid volumes recovered during the tests have not been disclosed. Pressure transient analyses and well-test interpretations have not been carried out for these wells 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.

(2) Average flow-back casing pressure for the duration of the test.

The Company has varying rights to multiple formations within its 788 (446 net) section Kaybob COU land position, including 391 (240 net) sections of Cretaceous rights and 229 (195 net) sections of Montney rights. Having rights to multiple formations allows the Company to evaluate shallower formations while drilling deeper wellbores targeting deeper rights. Prospective shallower zones can be completed in addition to the deeper reservoirs to increase total recoveries from individual locations. The Company has received approval to drill up to five Montney formation wells per section on six sections and is preparing to file applications on additional lands. It is anticipated that well densities of eight or more wells per section per formation will be required to fully recover the resources.



Paramount's experience over the past few years in the Deep Basin has allowed the Company to achieve cost reductions in drilling and completion operations through improved drilling and fracturing techniques and improved logistics with multi-well pad sites. The Company has been successful in reducing drilling time for Falher formation wells to approximately 30 days from 40 days in 2010. Drilling time for the deeper Montney formation wells has been reduced to approximately 45 days from over 80 days in the early part of 2011. With the cost of each drilling day averaging approximately \$75,000, the reduction in drilling days alone has resulted in significant cost savings. The Company has also reduced completion costs by improving pumping techniques, optimizing frac sizing and spacing, recycling the frac oil, and negotiating lower rates for services, equipment and completion fluids.

During the fourth quarter of 2012, the Company finished equipping the wells on its first five-well pad at Musreau. Three (2.5 net) Montney formation wells and two (1.5 net) Falher formation wells were drilled, completed, equipped and tied-in for aggregate gross costs of approximately \$45 million, including the cost of site sweetening packages for the Montney wells. Average gross raw gas test rates for the five wells totaled approximately 55 MMcf/d over the final 24 hours of their test periods, with flowing pressures averaging 2,500 PSI.

Multi-well pad sites will increasingly be used to develop Paramount's Deep Basin lands, where drilling and completion operations are performed on

multiple wells thereby minimizing mobilization and de-mobilization costs and reducing equipping and tie-in costs by using common facilities. The Company plans to utilize its two new built-for-purpose walking rigs to drill on its multi-well pad sites beginning in the second quarter of 2013. These rigs have the ability to move across the lease with drill pipe standing in the derrick so that pad wells are drilled in sequence with minimal downtime between wells. Completion operations on pad sites allow the Company to produce back energized oil from a fracture stimulation, recycle the fluid and re-inject it into the next well, saving the cost of transporting and purchasing new frac oil.

Paramount currently has five drilling rigs working in the Deep Basin, which continue to add to the Company's inventory of wells that will feed the Musreau and Smoky deep cut facilities. The Company plans to drill up to an additional 40 wells during 2013, approximately 50 percent of which will target the Montney formation. The 2013 drilling program includes eight pad sites that are expected to account for 32 of the planned 40 wells.

The following table summarizes the status of Kaybob Deep Basin wells that have been drilled and are awaiting production as of February 28, 2013, the estimated remaining capital required to complete these wells, and their anticipated production and sales volumes:

	Wells		Total Remaining Capital (net)	Estimated Net Raw Gas Production ⁽¹⁾		Estimated Net Sales Volumes ⁽²⁾	
	Gross	Net		First Month	First Year	First Month	First Year
			(\$ millions)	(MMcf/d)	(MMcf/d)	(Boe/d)	(Boe/d)
Shut-in due to capacity constraints	9	8	–	23	11	6,400	3,100
Tied-in, capable of producing	10	7	–	54	25	14,900	7,000
Completed, awaiting tie-in	14	12	20	59	29	19,000	9,200
Drilled, awaiting completion	10	8	51	52	28	17,000	9,100
	43	35	71	188	93	57,300	28,400

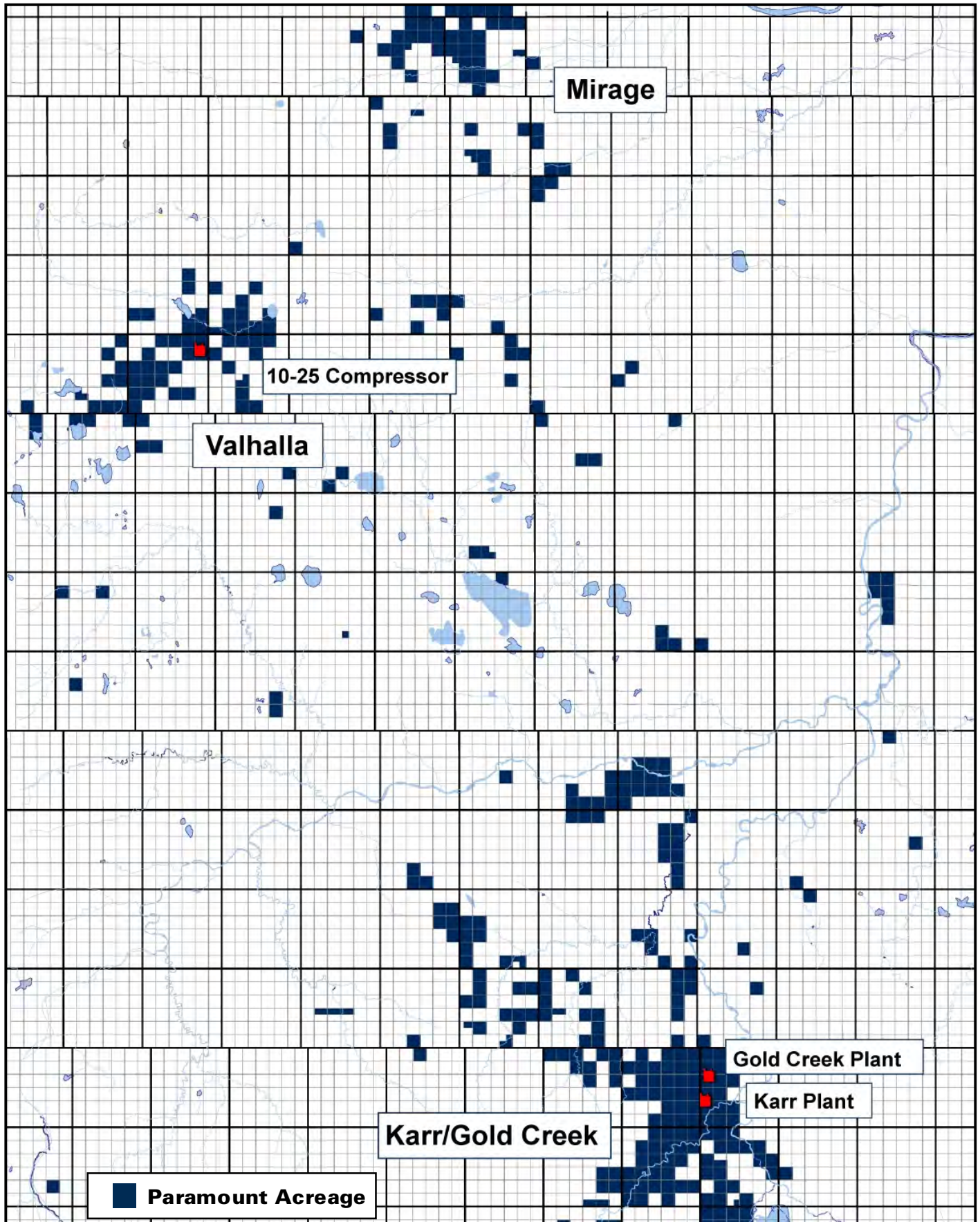
(1) Based on the Company's 4.9 Bcf type curve for Falher wells and 3.7 Bcf type curve for Montney wells.

(2) Based on processing through a deep cut facility.

Once the Musreau Deep Cut Facility is fully operational and the ramp-up of production volumes is complete, the Company estimates that approximately 20 new wells will be required each year to keep the facility operating at capacity.

The Kaybob COU's focus in 2013 is to complete the construction of the Musreau Deep Cut Facility and maximize production volumes through available capacity. The Company is ready for significant growth. With production volumes ramping-up as the Musreau and Smoky deep cut facilities are brought on-stream, Paramount will begin to realize returns on its Deep Basin drilling and infrastructure investments.

GRANDE PRAIRIE



Grande Prairie

	2012		2011		% Change
Sales Volumes					
Natural gas (MMcf/d)	20.9		16.0		31
NGLs (Bbl/d)	749		505		48
Oil (Bbl/d)	307		393		(22)
Total (Boe/d)	4,536		3,568		27
Exploration and Development Expenditures (\$ millions)					
Exploration, drilling, completions and tie-ins	69.5		106.4		(35)
Facilities and gathering	32.9		49.6		(34)
	102.4		156.0		(35)
	Gross	Net	Gross	Net	
Total Land Holdings (sections)	577	379	629	430	
Wells Drilled	10	6.7	22	15.0	

The Grande Prairie COU operates in the Peace River Arch area of Alberta. Core producing areas include Valhalla and Karr-Gold Creek. Average daily sales volumes in the Grande Prairie COU during 2012 were 4,536 Boe/d, an increase of 27 percent compared to 2011. Fourth quarter 2012 sales volumes averaged 5,243 Boe/d, after being curtailed as a result of the Third Party Disruptions between August and October.

Increases in 2012 sales volumes were primarily from Valhalla. The Company's gathering and compression system was expanded to 24 MMcf/d in the second quarter and additional wells were brought on-stream. The Company drilled six (4.3 net) wells in Valhalla in 2012 targeting the Montney and Doig formations. These wells were completed and tied-in during the year, along with wells drilled in 2011.

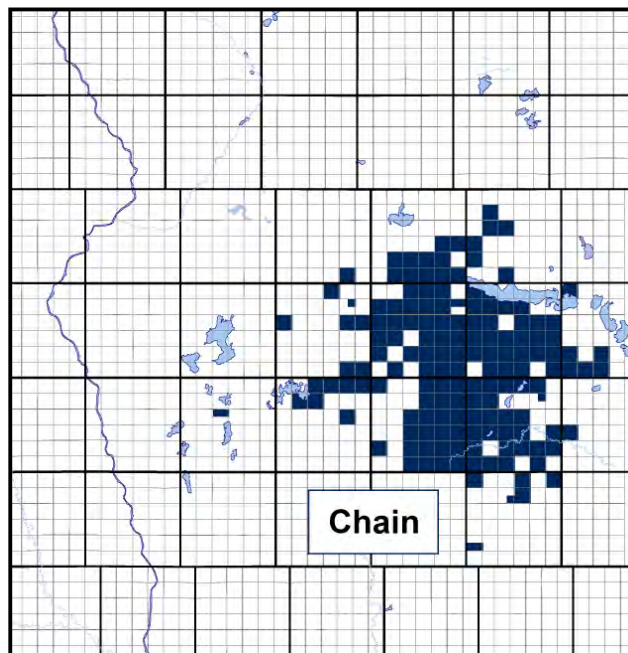
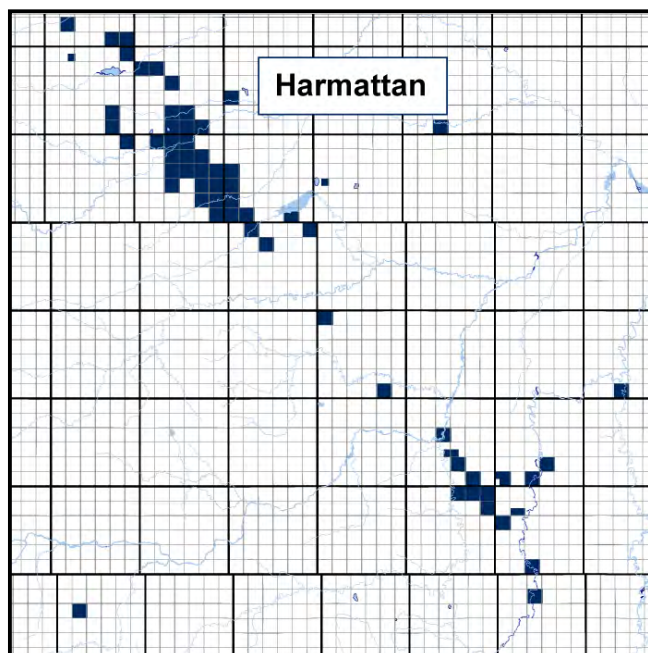
Karr-Gold Creek is located approximately 20 kilometers north of the Kaybob COU's Musreau development. Activities in 2012 focused on exploration of the middle and upper Montney reservoirs and continued efforts to improve the performance of the Company's previously completed lower Montney formation wells. Paramount's land position at Karr-Gold Creek of approximately 180 (148 net) sections exhibits similar geological reservoir and fluid characteristics to competitors' offsetting lands, and the Company's Montney holdings in the Musreau / Resthaven area.

In the third quarter of 2012, the Company completed a previously drilled middle Montney well at Karr-Gold Creek, which was brought-on production during the first quarter of 2013. A new well targeting the middle Montney formation was drilled in the fourth quarter of 2012, was completed in the first quarter of 2013 and will be tied-in during the third quarter. Test results from these wells have exceeded forecasts, confirming Paramount's interpretation that the Kaybob middle/upper Montney play extends northwest onto the Karr lands, adding significant resources to Paramount's future development base in the Deep Basin.

Results of the performance enhancement program for the Company's lower Montney wells at Karr-Gold Creek have not been consistent with expectations. While recoveries from some wells improved modestly, others wells are unchanged and Third Party Disruptions impacted the project for a significant portion of the year. This program will not be continued in 2013.

Exploration and development activities in the Grande Prairie COU will include the drilling, completion and tie-in of middle Montney wells at Karr-Gold Creek. The Company anticipates the existing inventory of producing and behind pipe wells at Valhalla will be sufficient to maintain production volumes at the current level throughout 2013, subject to the availability of NGLs transportation and fractionation capacity.

Southern⁽¹⁾



	2012		2011		% Change
Sales Volumes					
Natural gas (MMcf/d)	9.8		10.8		(9)
NGLs (Bbl/d)	171		150		14
Oil (Bbl/d)	1,016		1,483		(31)
Total (Boe/d)	2,814		3,424		(18)
Exploration and Development Expenditures (\$ millions)					
Exploration, drilling, completions and tie-ins	23.0		14.9		51
Facilities and gathering	2.7		4.7		(43)
	25.7		19.6		29
	Gross	Net	Gross	Net	
Total Land Holdings (sections)	627	432	708	489	
Wells Drilled	4	2.2	22	12.0	

(1) Amounts include the results of discontinued operations. Refer to page seven of Paramount's Management's Discussion and Analysis for the year ended December 31, 2012.

In May 2012, Summit closed the sale of all of its operated properties in North Dakota and all of its Montana properties for cash proceeds of approximately US\$70 million. This disposition included approximately 900 Boe/d of production and 42 net sections of land. During the first quarter of 2013, Summit closed the sale of its non-operated joint venture operations and lands in North Dakota for aggregate gross proceeds of US\$22.5 million, subject to closing adjustments. This disposition included approximately 200 Boe/d of production and undeveloped land. With the closing of these transactions, substantially all of Paramount's US assets and operations have been sold.

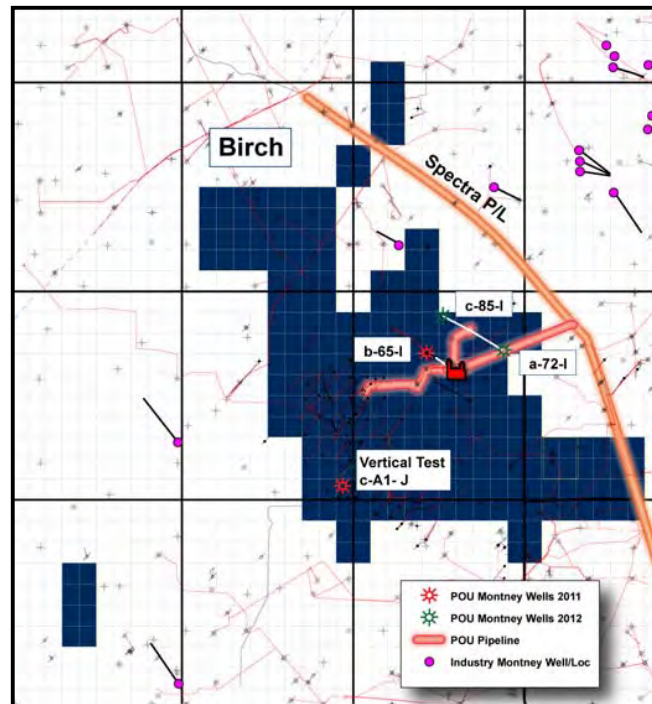
Combined with the 2011 sale of undeveloped land in the United States for US\$40 million, approximately US\$130 million in cash proceeds has been realized from the sale of US properties, significantly in excess of the book value of these assets.

Southern COU sales volumes decreased 18 percent to 2,814 Boe/d in 2012 compared to 3,424 Boe/d in 2011, mainly as a result of the disposition of the operated US properties in May. Wells drilled in 2012

include three (2.2 net) wells in Harmattan in southern Alberta, one of which was completed and is scheduled to be brought-on production in the second quarter of 2013.

Plans for the Southern COU's properties in 2013 consist primarily of routine maintenance and production optimization programs.

Northern



	2012		2011		% Change
Sales Volumes					
Natural gas (MMcf/d)	8.3		10.3		(19)
NGLs (Bbl/d)	29		19		53
Oil (Bbl/d)	235		343		(31)
Total (Boe/d)	1,657		2,073		(20)
Exploration and Development Expenditures (\$ millions)					
Exploration, drilling, completions and tie-ins	21.2		21.8		(3)
Facilities and gathering	6.9		3.4		103
	28.1		25.2		9
	Gross	Net	Gross	Net	
Total Land Holdings (sections)	705	472	959	592	
Wells Drilled	3	3.0	2	2.0	

Sales volumes in the Northern COU were 1,657 Boe/d in 2012, 20 percent lower than 2011, as a result of natural declines at Cameron Hills and Bistcho and second quarter processing disruptions at the Bistcho plant.

Paramount's initial well at Birch in Northeast British Columbia was brought on-stream in December 2012 following the completion of modifications to surface facilities. Two additional wells drilled in 2012 have been completed and tied-in. The Company has 3 MMcf/d of raw gas processing capacity at Birch, and is currently working to optimize production from these wells. In the third quarter, Paramount drilled a

vertical evaluation well at Birch to evaluate the lower Montney formation and preserve surrounding mineral rights.

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

RESERVES

Conventional

Paramount achieved strong conventional reserves additions in 2012, driven by the Company's Deep Basin development in the Kaybob COU. The Company's conventional proved and probable reserves at December 31, 2012 increased 64 percent to 86.8 MMBoe compared to 53.0 MMBoe at December 31, 2011, after production of 7.3 MMBoe and dispositions of 4.4 MMBoe, with a proved and probable reserves replacement ratio of 599 percent. Proved reserves increased 43 percent to 50.9 MMBoe at December 31, 2012 from 35.7 MMBoe at December 31, 2011, with a proved reserves replacement ratio of 336 percent.

Hoole Oil Sands Bitumen

Incremental to the conventional reserves additions, the Company recorded 93.1 MMBbl of probable bitumen reserves additions related to Cavalier Energy's 10,000 barrel per day oil sands development planned for the Hoole Grand Rapids. These reserves volumes were recognized following Cavalier Energy's November 2012 regulatory applications for project approval to the ERCB and AESRD.

Reserves Summary

Paramount's reserves for the year ended December 31, 2012 were evaluated by McDaniel & Associates Consultants Ltd., the Company's independent reserves evaluator, 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 as of December 31, 2012 using forecast prices and costs are as follows:

Reserves Category	Gross Proved and Probable Reserves ⁽¹⁾					Before Tax Net Present Value ⁽¹⁾⁽³⁾		
	Natural Gas	Light & Medium Crude Oil	Natural Gas Liquids	Bitumen	Total	(\$ millions)		
						Discount Rate		
	(Bcf)	(MBbl)	(MBbl)	(MBbl)	(MBoe) ⁽²⁾	0%	10%	15%
Conventional								
Proved								
Developed Producing	143.3	1,416	4,198	–	29,501	472	382	349
Developed Non-producing	37.6	123	3,695	–	10,090	122	72	57
Undeveloped	21.0	–	7,769	–	11,266	55	2	(14)
Total Proved	201.9	1,540	15,662	–	50,857	649	456	392
Total Probable	121.8	588	15,099	–	35,985	774	424	334
Total Proved and Probable Conventional	323.7	2,128	30,761	–	86,842	1,422	880	726
Oil Sands Bitumen								
Total Proved	–	–	–	–	–	–	–	–
Total Probable	–	–	–	93,091	93,091	2,065	379	140
Total Proved and Probable Bitumen	–	–	–	93,091	93,091	2,065	379	140
Total Company								
Total Proved	201.9	1,540	15,662	–	50,857	649	456	392
Total Probable	121.8	588	15,099	93,091	129,076	2,839	803	474
Total Proved and Probable	323.7	2,128	30,761	93,091	179,933	3,487	1,259	866

(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.

(3) The estimated net present values disclosed in this document do not represent fair market value. Revenues and expenditures were calculated based on McDaniel's forecast prices and costs as of January 1, 2013.

December 31, 2012 reserves include 10.1 MMBoe of proved developed non-producing ("PDNP") reserves, mainly related to wells in the Kaybob COU that have been drilled and are expected to come on-stream once the deep cut facilities expansions are completed. Proved undeveloped ("PUD") reserves totalling 11.3 MMBoe are mainly related to certain of the locations that the Kaybob COU expects to drill over the next year. PDNP and PUD reserves are expected to be reclassified to proved developed producing reserves once the Musreau Deep Cut Facility is substantially complete and the undeveloped locations are drilled.

Future development costs totalling \$110 million in respect of estimated costs to complete the Musreau Deep Cut Facility and Smoky Deep Cut Facility were deducted in determining the future net revenue of Paramount's total proved reserves; \$56 million of which was deducted from PDNP reserves values and \$54 million of which was deducted from PUD reserves values.

Conventional Reserves

The following table summarizes future development costs deducted in the calculation of future net revenue from conventional reserves:

	Future Development Costs – Undiscounted				
	Total	Before Tax NPV10 ⁽¹⁾	Wells & Other		
			Plants	Other	Total
	(Mboe)	(\$MM)	(\$MM)	(\$MM)	(\$MM)
Proved Developed Producing	29,501	382	–	–	–
Proved Developed Non-Producing	10,090	72	56	21	77
Proved Undeveloped	11,266	2	54	118	172
Total Proved	50,857	456	110	139	249
Total Probable	35,985	424	–	158	158
Total Proved and Probable	86,842	880	110	297	407

(1) The estimated net present values disclosed in this document do not represent fair market value. Revenues and expenditures were calculated based on McDaniel's forecast prices and costs as of January 1, 2013.

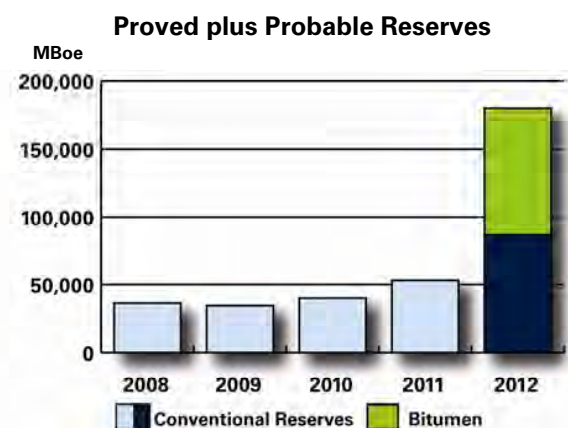
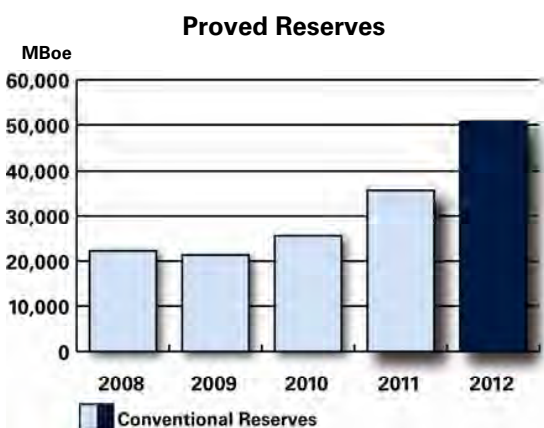
Reserves Reconciliation

	Proved Reserves ⁽¹⁾				Proved and Probable Reserves ⁽¹⁾			
	Natural Gas	Oil and NGLs ⁽²⁾	Bitumen	Total	Natural Gas	Oil and NGLs ⁽²⁾	Bitumen	Total
	(Bcf)	(MBbl)	(MBbl)	(MBoe) ⁽³⁾	(Bcf)	(MBbl)	(MBbl)	(MBoe) ⁽³⁾
January 1, 2012	162.0	8,673	–	35,666	244.1	12,333	–	53,015
Extensions & discoveries	74.4	9,058	–	21,464	148.8	21,167	93,091	139,058
Technical revisions	(1.3)	3,205	–	2,997	(31.9)	3,801	–	(1,517)
Economic factors	–	–	–	–	(4.5)	(2)	–	(749)
Acquisitions	6.9	242	–	1,395	9.0	318	–	1,820
Dispositions	(4.1)	(2,700)	–	(3,376)	(5.7)	(3,450)	–	(4,406)
Production	(36.1)	(1,278)	–	(7,290)	(36.1)	(1,278)	–	(7,290)
December 31, 2012	201.9	17,202	–	50,857	323.7	32,889	93,091	179,933

(1) Columns and rows may not add due to rounding.

(2) Light and medium crude oil and natural gas liquids.

(3) Refer to the oil and gas measures and definitions in the Advisories section of this document.



Finding and Development Costs

Paramount's finding and development ("F&D") costs per barrel are summarized below. The total F&D capital includes costs and changes in future development costs relating to major facilities and gathering system projects.

	2012 F&D Cost					3-Year Average F&D		
	Including Major Facilities & Gathering							
	Costs ⁽¹⁾ \$MM	FDC Change ⁽¹⁾ \$MM	Total F&D Capital ⁽¹⁾ \$MM	Reserves Additions ⁽²⁾ MMBoe	F&D \$/Boe	2011 \$/Boe	2010 \$/Boe	3-Year Average \$/Boe
PROVED								
Total Company	526.0	211.2	737.1	24.5	30.14	42.29	29.10	33.15
Kaybob	362.5	223.0	585.5	21.4	27.35	27.06	19.63	26.41
Total Conventional	523.1	211.2	734.2	24.5	30.02	41.57	27.45	32.61
PROVED & PROBABLE								
Total Company	526.0	1,871.5	2,397.4	136.8	17.53	37.58	28.50	19.63
Kaybob	362.5	378.5	740.9	45.5	16.29	21.56	16.30	17.27
Total Conventional	523.1	331.9	854.9	43.7	19.56	36.92	26.91	23.80
<i>Oil Sands Bitumen</i>	<i>2.9</i>	<i>1,539.6</i>	<i>1,542.5</i>	<i>93.1</i>	<i>16.57</i>	<i>—</i>	<i>—</i>	<i>16.71</i>

⁽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.

Paramount's F&D costs per barrel, excluding costs and changes in future development costs related to major facilities and gathering system projects are summarized below.

	2012 F&D Cost					3-Year Average F&D		
	Excluding Major Facilities & Gathering							
	Costs ⁽¹⁾ \$MM	FDC Change ⁽¹⁾ \$MM	Total F&D Capital ⁽¹⁾ \$MM	Reserves Additions ⁽²⁾ MMBoe	F&D \$/Boe	2011 \$/Boe	2010 \$/Boe	3-Year Average \$/Boe
PROVED								
Kaybob	200.7	112.7	313.4	21.4	14.64	17.85	15.79	15.67
Total Conventional	310.6	100.9	411.5	24.5	16.82	27.70	21.04	20.39
PROVED & PROBABLE								
Kaybob	200.7	268.2	468.9	45.5	10.31	13.57	13.18	11.14
Total Conventional	310.6	221.6	532.2	43.7	12.18	24.19	20.76	15.53

⁽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.

Capital Expenditures

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

(1) Strategic Investments includes \$7.0 million of undeveloped land purchases.

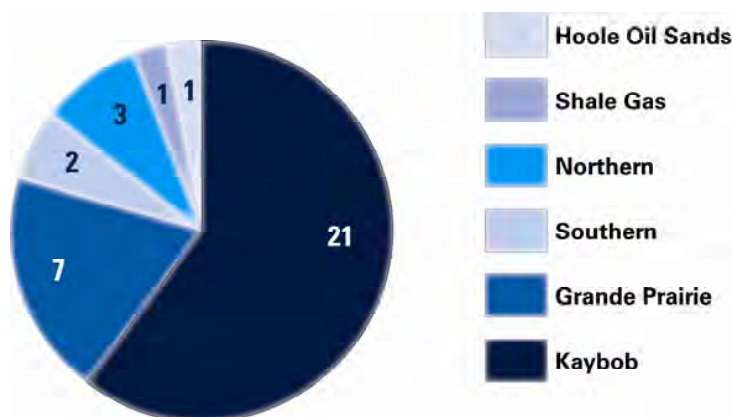
DRILLING AND LAND

As at December 31	2012			2011		
(000's of acres)	Gross ⁽¹⁾	Net ⁽²⁾	Average Working Interest	Gross ⁽¹⁾	Net ⁽²⁾	Average Working Interest
Undeveloped land	1,685	1,190	71%	1,736	1,225	71%
Acreage assigned reserves	523	289	55%	574	334	58%
Total	2,208	1,479	67%	2,310	1,559	67%

(1) "Gross" acres means the total acreage in which Paramount has an interest.

(2) "Net" acres means gross acres multiplied by Paramount's working interest therein.

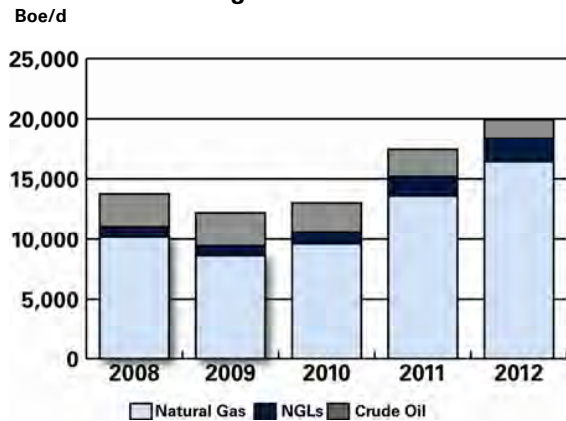
Wells Drilled (net)



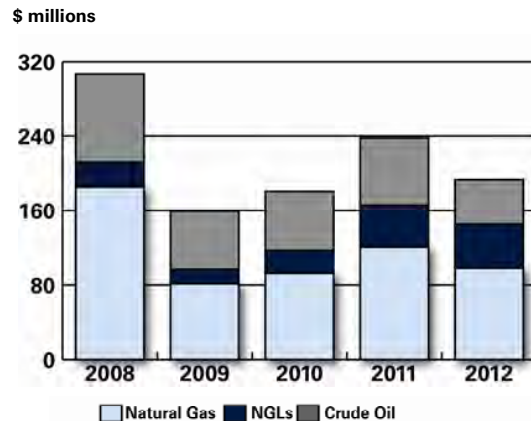
OPERATING RESULTS

Paramount's natural gas and NGLs sales volumes increased approximately 20 percent in 2012 compared to the prior year, despite downstream processing and transportation constraints which impacted the Company's operations in the second half of the year. Production levels have increased each year since 2009, and are expected to increase to over 50,000 Boe/d by late-2014 when new facilities are brought on-stream. 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.

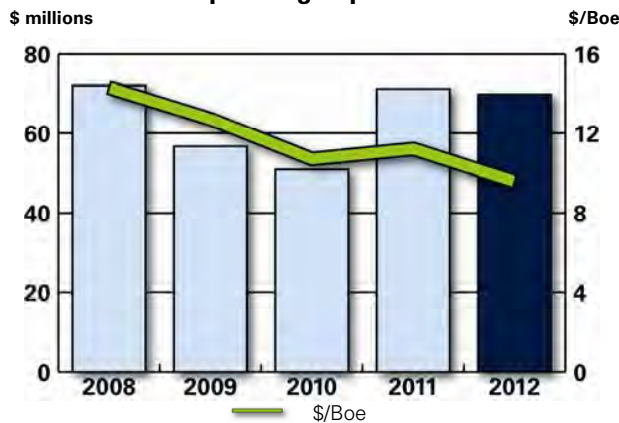
Average Sales Volumes



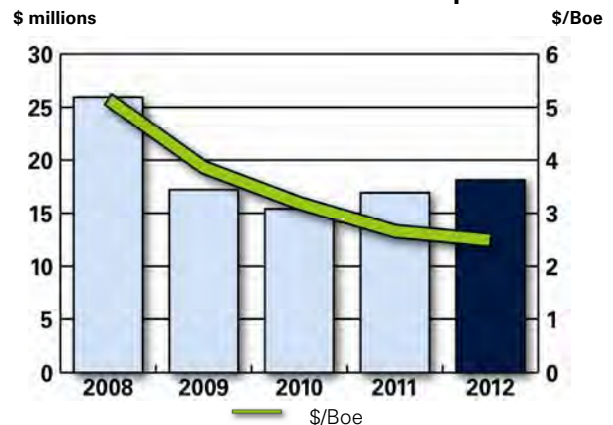
Sales Revenue



Operating Expenses



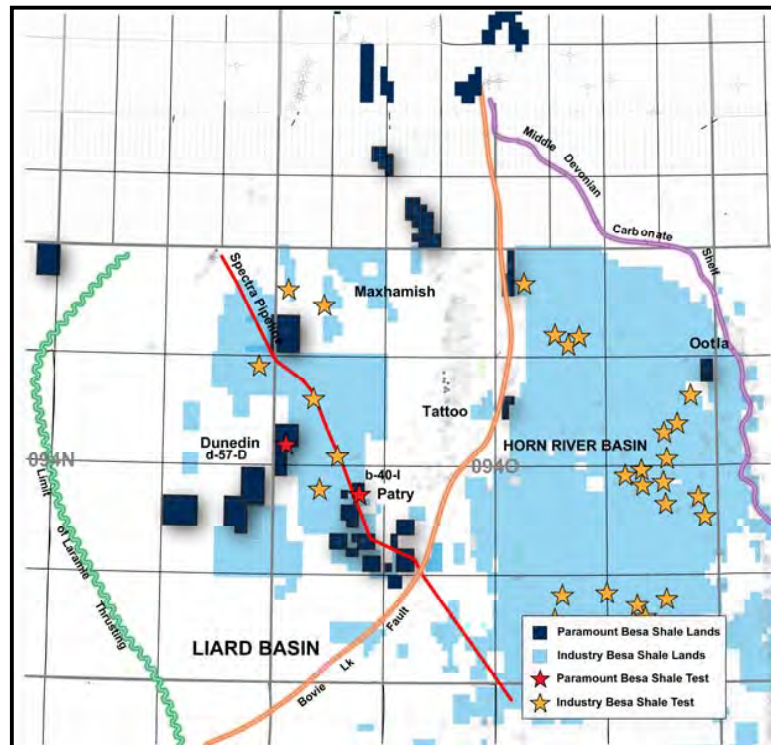
General and Administrative Expenses



STRATEGIC INVESTMENTS

SHALE GAS

Paramount's shale gas holdings encompass approximately 260 (220 net) sections in the Liard Basin and the Horn River Basin in Northeast British Columbia and the Northwest Territories, including approximately 180 net sections with potential from the Besa River shale gas formation.



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

The well commenced flowing on clean-up in the first week of March 2013 and continues to recover the completion fluids. Over the first 69 hours of metered gas flow, natural gas rates ranged between 5 MMcf/d and 14 MMcf/d on clean-up and completion fluid recoveries averaged approximately 4,000 Bbl/d at flowing tubing pressures of 11,000 to 35,000 kPa up 114.3 mm tubing. During the last 24 hours of that period, natural gas rates averaged 7 MMcf/d at an average flowing tubing pressure of approximately 11,500 kPa and completion fluid recovery was approximately 2,800 Bbl/d. As a pressure transient analysis or well test interpretation has not been carried out at this time, the flow-back data provided should be considered preliminary. In addition, this data is not necessarily indicative of long-term performance or ultimate recovery.

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

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



Cavalier Energy is designed to be a focused, self-funding entity, which was created in 2011 as a wholly-owned subsidiary of Paramount to execute the development of the Company's oil sands and carbonate bitumen assets. Cavalier Energy holds over 300 sections, representing approximately 200,000 net acres of Crown leases in the Western Athabasca region of Alberta.

Hoole Grand Rapids

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

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

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

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

In January 2013, Cavalier Energy received an updated independent evaluation of the Hoole Project, effective December 31, 2012, from the Company's independent reserves evaluators. The evaluation ascribed 93 million barrels of probable reserves with a net present value (discounted at 10 percent) of \$379 million to Hoole Grand Rapids Phase 1, which covers approximately two sections of the Hoole Project. Over and above the aforementioned reserves, the evaluation ascribed 719 million barrels of economic contingent resources (best estimate) with a net present value (discounted at 10 percent) of \$1.949 billion to the remaining approximate 54 sections of the Hoole Project (the "Remaining Hoole Leases") within the Grand Rapids formation. The updated estimates and reclassification of Hoole Project volumes from economic contingent resources to probable reserves follows Cavalier Energy's November 2012 regulatory applications.

The reserves assigned to Hoole Grand Rapids Phase 1 are summarized in the Reserves section of this document. Results of the evaluation of the Remaining Hoole Leases are as follows:

Classification/Level of Certainty⁽¹⁾	DEBIP⁽¹⁾ (MMBbl) ⁽²⁾	Economic Contingent Resources⁽¹⁾ (MMBbl) ⁽²⁾	NPV of Future Net Revenue⁽¹⁾ (discounted at 10%) (\$MM)
High Estimate	1,656	903	2,982
Best Estimate	1,469	719	1,949
Low Estimate	1,167	511	946

(1) See Oil Sands Resource Notes in the Advisories section of this document.

(2) MMBbl means millions of barrels.

Future Exploration Portfolio

Cavalier Energy holds 128,000 acres of mineral rights located on the Grosmont Carbonate Trend. Industry peers have begun to explore this resource and have constructed pilot projects to refine extraction technologies. Cavalier Energy is monitoring industry developments and will develop future plans for its holdings based on the results of these pilot projects.

Cavalier Energy acquired 36 sections of land at Eagles Nest in early 2012. The property is prospective for oil sands bitumen in the McMurray and Wabiskaw formations and seismic data is currently being evaluated to validate mapping and plan additional seismic and drilling activities.



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



INVESTMENTS IN OTHER ENTITIES

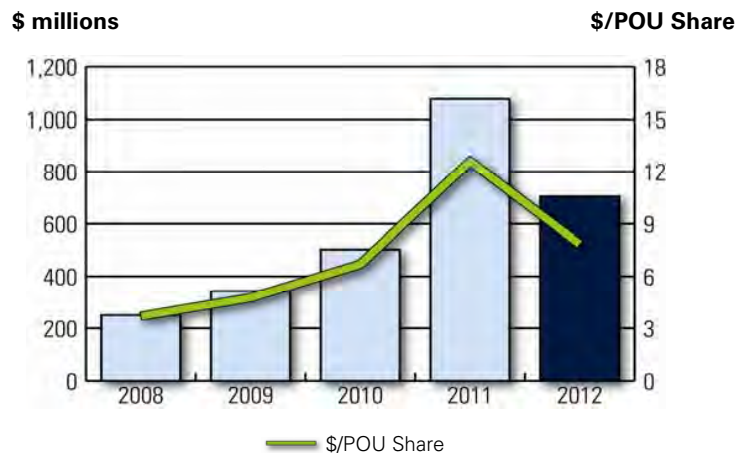
Market Value⁽¹⁾						
As at December 31	2012			2011		
	<i>Shares (000's)</i>	<i>(\$ millions)</i>	<i>(\$/share)</i>	<i>Shares (000's)</i>	<i>(\$ millions)</i>	<i>(\$/share)</i>
Trilogy Energy Corp. ("Trilogy")	19,144	\$ 557.3	29.11	24,144	\$ 907.1	37.57
MEG Energy Corp.	3,700	112.6	30.44	3,700	153.8	41.57
MGM Energy Corp.	54,147	13.5	0.25	43,834	10.6	0.24
Other ⁽²⁾		21.4			5.8	
Total		\$ 704.8			\$ 1,077.3	

(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.

In January 2012, Paramount closed the sale of 5.0 million of its non-voting Trilogy shares for net cash proceeds of \$181.7 million, recognizing a gain of \$157.2 million.

Market Value of Investments



MANAGEMENT'S DISCUSSION & ANALYSIS

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

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

About Paramount

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

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

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

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

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

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

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

2012 OVERVIEW

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

Principal Properties

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

Strategic Investments

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

Corporate

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

Highlights⁽¹⁾

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

⁽¹⁾ Readers are referred to the advisories concerning non-GAAP measures and oil and gas measures and definitions in the Advisories section of this document.

⁽²⁾ Amounts include the results of discontinued operations.

⁽³⁾ Based on the period-end closing prices of publicly traded enterprises and the book value of the remaining investments.

Consolidated Results

Net Income (Loss)

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

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

	Year ended December 31
Loss from continuing operations – 2011	(256.3)
<ul style="list-style-type: none"> • Higher income from equity-accounted investments mainly due to a \$157.2 million gain on the sale of 5.0 million non-voting shares of Trilogy in January 2012 • Lower depletion, depreciation and impairment mainly due to lower write-downs of petroleum and natural gas properties and goodwill • Higher gains on the sale of property, plant and equipment related to continuing operations • Lower income tax recovery compared to 2011 • Lower netback primarily due to a 27 percent decrease in average realized prices • Lower other income, mainly because 2011 included gains related to previous investments in NuLoch Resources Inc. and ProspEx Resources Ltd. • Higher stock-based compensation expense • Higher exploration and evaluation expense mainly due to higher dry hole expense • Other 	<p style="text-align: right;">152.1</p> <p style="text-align: right;">85.8</p> <p style="text-align: right;">21.6</p> <p style="text-align: right;">(46.0)</p> <p style="text-align: right;">(30.2)</p> <p style="text-align: right;">(10.1)</p> <p style="text-align: right;">(7.6)</p> <p style="text-align: right;">(6.4)</p> <p style="text-align: right;">5.0</p>
Loss from continuing operations – 2012	(92.1)

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

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

	Year ended December 31
Loss from continuing operations – 2010	(93.0)
<ul style="list-style-type: none"> • Higher depletion, depreciation and impairment mainly due to an increase of \$167.7 million in write-downs of petroleum and natural gas properties and goodwill and \$49.0 million of higher Principal Properties depletion expense due to higher production • Lower income from equity-accounted investments, as 2010 included \$36.8 million of earnings related to Trilogy's conversion from a trust structure to a corporate structure • Higher interest expense due to higher 2011 debt levels • Loss on financial commodity contracts compared to a gain in 2010 • Lower stock-based compensation expense • Higher netback mainly due to a 34 percent increase in sales volumes • Higher other income primarily due to the recognition of \$11.1 million in gains on the sale of the shares of NuLoch and its successor, Magnum Hunter Resources Corporation • Higher income tax recovery compared to 2010 • Lower exploration and evaluation expense • Higher gains on the sale of property plant and equipment related to continuing operations • Other 	(215.3) (34.8) (20.5) (11.7) 33.8 31.7 19.8 16.1 13.9 4.5 (0.8)
Loss from continuing operations – 2011	(256.3)

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

Funds Flow From Operations ⁽¹⁾⁽²⁾

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

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

⁽¹⁾ Refer to the advisories concerning non-GAAP measures in the Advisories section of this document.

⁽²⁾ Includes the results of discontinued operations.

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

Funds flow from operations attributable to continuing operations in 2012 was \$51.6 million, \$29.2 million lower than 2011, primarily because of the impact of a 27 percent decrease in average realized prices, partially offset by higher other income, primarily due to \$6.2 million in cash proceeds from a business interruption insurance settlement. Funds flow from operations attributable to discontinued operations in 2012 decreased by \$8.9 million compared to the prior year because 2012 includes a partial year of operations from the sold properties as a result of their May 2012 sale.

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

Discontinued Operations

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

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

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

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

⁽¹⁾Natural gas revenue shown per Mcf.

Principal Properties

Netback and Segment Loss – Continuing Operations

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

Petroleum and Natural Gas Sales – Continuing Operations

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

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

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

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

Sales Volumes

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

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

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

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

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

Average Realized Prices – Continuing Operations

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

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

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

Commodity Prices

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

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

Commodity Price Management

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

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

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

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

Royalties – Continuing Operations

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

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

Operating Expense – Continuing Operations

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

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

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

Transportation Expense – Continuing Operations

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

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

Insurance Settlement

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

Other Principal Property Items – Continuing Operations

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

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

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

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

The gain on sale of property, plant and equipment recorded for 2012 is primarily related to the sale of non-core properties at West Pembina, Alberta and at Kindersley, Saskatchewan in the Southern COU and

at East Negus in the Northern COU for aggregate proceeds of approximately \$49.2 million. These properties did not have significant associated production.

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

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

Strategic Investments

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

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

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

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

Strategic Investments at December 31, 2012 include:

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

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

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

⁽¹⁾ Based on the period-end closing price of publicly-traded investments and book value of remaining investments.

⁽²⁾ December 31, 2011 balances include five million shares that were sold in January 2012, having a December 31, 2011 carrying value of \$24.2 million and a December 31, 2011 market value of \$187.9 million.

⁽³⁾ Includes investments in Paxton Corporation and other public and private corporations.

Shale Gas

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

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

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

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

Cavalier Energy

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

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

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

In November 2012, Cavalier Energy submitted regulatory applications for the initial 10,000 Bbl/d phase of the Hoole Grand Rapids development ("Hoole Grand Rapids Phase 1") to the Energy Resources Conservation Board and Alberta Environment and Sustainable Resource Development. Cavalier Energy

anticipates regulatory approvals to be received in the first half of 2014. Construction of Hoole Grand Rapids Phase 1 is dependent upon the receipt of regulatory approvals, sanctioning by the Board of Directors, and securing funding.

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

Fox Drilling

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

Corporate

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

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

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

Exploration and Capital Expenditures

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

(1) Exploration and development expenditures include \$4.6 million (2011 - \$3.2 million) of capitalized interest.

(2) Strategic Investments includes \$7.0 million of undeveloped land purchases in 2012.

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

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

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

Wells drilled are as follows:

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

(1) Gross is the number of wells in which Paramount has a working interest or a royalty interest that may be converted to a working interest.

(2) Net is the aggregate number of wells obtained by multiplying each gross well by Paramount's percentage of working interest.

Kaybob Deep Basin Natural Gas Development

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

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

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

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

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

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

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

Outlook

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

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

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

Sales volumes for the first three quarters of 2013 are expected to range between 21,000 Boe/d and 25,000 Boe/d, after giving effect to the first quarter property dispositions, depending upon the availability

of downstream NGLs transportation and processing capacity. Sales volumes are expected to increase in the fourth quarter once the expansion of a third-party NGLs pipeline is completed, additional fractionation capacity is secured and the Musreau Deep Cut Facility is on-stream.

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

Liquidity and Capital Resources

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

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

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

⁽²⁾ Excludes unamortized issue premiums and financing costs.

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

Adjusted Working Capital

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

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

Proceeds from these offerings and asset sales were used, and are expected to be used, to further the development and exploration of the Company's properties, including drilling and completion work and facilities construction at Musreau and Smoky in the Kaybob COU and at Valhalla in the Grande Prairie

COU and drilling and completion work in Northeast British Columbia. Proceeds from Common Shares issued on a flow-through basis in respect of Canadian Development Expenses ("CDE") were used to incur eligible CDE. Proceeds from Common Shares issued on a flow-through basis in respect of Canadian Exploration Expenses ("CEE") were used and are expected to be used to incur eligible CEE. Proceeds from the offerings and asset sales were also used for the non-permanent repayment of indebtedness under the Company's credit facility.

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

Demand Facilities

Drilling Rig Loans

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

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

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

Cavalier Facility

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

Bank Credit Facility

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

assets securing the Drilling Rig Loans and the Cavalier Facility. Balances drawn under Tranche B are secured by the pledge of certain of the Company's equity investments.

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

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

Senior Notes

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

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

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

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

Share Capital

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

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

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

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

Deposit

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

Quarterly Information

Operating Results – Continuing Operations

Sales Volumes

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

Netback – Continuing Operations

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

(1) Natural gas revenue shown per Mcf.

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

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

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

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

Net Loss

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

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

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

	Three months ended December 31
Loss from continuing operations – 2011	(210.8)
<ul style="list-style-type: none"> • Lower depletion, depreciation and impairment mainly due to lower write-downs of petroleum and natural gas properties and goodwill • Gain on financial commodity contracts compared to a loss in 2011 • Lower income tax recovery in 2012 • Higher exploration and evaluation expense • Loss on sale of property, plant and equipment compared to a gain in 2011 • Higher interest in 2012 due to higher debt levels • Other 	88.6 8.3 (23.0) (6.6) (4.8) (3.0) (0.5)
Loss from continuing operations – 2012	(151.8)

Funds Flow from Operations⁽¹⁾

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

⁽¹⁾ Refer to the advisories concerning non-GAAP measures in the Advisories section of this document.

⁽²⁾ Includes the results of discontinued operations.

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

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

Significant Items Impacting Quarterly Results

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

- Fourth quarter 2012 earnings include a \$135.6 million write-down of petroleum and natural gas properties and goodwill, and \$6.5 million in dry hole charges.
- Third quarter 2012 earnings includes \$6.2 million in respect of a business interruption insurance settlement related to an electrical equipment failure at the Musreau Refrig Facility in the fourth quarter of 2011.
- Second quarter 2012 earnings include a \$50.7 million pre-tax gain recognized on the disposition of United States properties.
- First quarter 2012 earnings include a \$157.2 million pre-tax gain on the sale of 5.0 million Trilogy shares and a \$28.3 million gain on the sale of property, plant and equipment, partially offset by higher tax expense, operating expenses and depletion and depreciation.

- Fourth quarter 2011 earnings include a \$225.7 million write-down of petroleum and natural gas properties and goodwill, and \$7.6 million of losses on financial commodity contracts, partially offset by an \$8.4 million decrease in stock-based compensation expense and a \$3.1 million gain on the sale of property, plant and equipment.
- Third quarter 2011 earnings include \$14.6 million of stock-based compensation expense, a decrease of \$15.4 million in gains on the sale of securities and an increase of \$8.3 million in depletion and depreciation.
- Second quarter 2011 earnings include the recognition of \$15.4 million of gains on investments in securities and a \$10.6 million stock-based compensation recovery, partially offset by higher depletion and depreciation and interest.
- First quarter 2011 earnings include gains of \$39.6 million on the sale of property, plant and equipment, partially offset by \$11.3 million of stock-based compensation charges.

Other Information

Related Party Transactions

Service Agreements

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

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

Contractual Obligations

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

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

(1) Including interest and principal repayments.

(2) Certain pipeline transportation and NGLs processing commitments are secured by outstanding letters of credit totalling \$27.3 million at December 31, 2012 (2011 - \$12.8 million).

(3) Relates to contractual obligations for purchases of major equipment.

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

Operating Lease Commitment

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

Contingencies

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

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

Change In Accounting Policies

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

- **IFRS 10, "Consolidated Financial Statements"** is the result of the IASB's project to replace Standing Interpretations Committee 12, "Consolidation – Special Purpose Entities" and the consolidation requirements of IAS 27, "Consolidated and Separate Financial Statements". The new standard eliminates the current risk and rewards approach and establishes control as the single basis for determining the consolidation of an entity.
- **IFRS 11, "Joint Arrangements"** is the result of the IASB's project to replace IAS 31, "Interests in Joint Ventures". The new standard redefines "joint operations" and "joint ventures" and requires joint operations to be proportionately consolidated and joint ventures to be equity accounted. Under IAS 31, joint ventures could be proportionately accounted. The Company expects its joint venture arrangements will continue to meet the definition of "joint operations" and that proportionate consolidation of such arrangements will continue under the new standard.
- **IFRS 12, "Disclosure of Interests in Other Entities"** outlines the required disclosures for interests in subsidiaries and joint arrangements. The new standard requires disclosure of information that will assist financial statement users to evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries and joint arrangements.
- **IFRS 13, "Fair Value Measurement"** provides a common definition of fair value, establishes a framework for measuring fair value under IFRS and enhances the disclosures required for fair value measurements. The standard applies where fair value measurements are required and does not require new fair value measurements.

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

Disclosure Controls and Procedures

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

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

Internal Controls Over Financial Reporting

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

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

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

Changes in Internal Controls Over Financial Reporting

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

Critical Accounting Estimates

The timely preparation of financial statements requires management to make certain estimates that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to

be reasonable under the circumstances. Changes in estimates and assumptions based on new information could result in a material change to the carrying amount of assets or liabilities and have a material impact on revenue and expenses in future periods. The following is a discussion of the accounting estimates that are considered significant:

Reserves Estimates

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

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

Business Combinations

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

Asset Retirement Obligations

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

Share-Based Payments

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

Paramount previously accounted for Paramount Options as cash-settled awards due to its past practice of accepting requests to settle Paramount Options with a cash payment. In recent years, the Company has not been granting requests to settle Paramount Options in cash, and does not expect to do so in the future. As a result, Paramount has accounted for Paramount Options as equity-settled stock-based

compensation transactions from of October 1, 2011. The change in accounting method resulted in the reclassification of the September 30, 2011 stock-based compensation liability of \$68.7 million to Contributed Surplus.

Income Taxes

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

Advisories

FORWARD-LOOKING INFORMATION

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

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

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

- future oil, gas, NGLs, and bitumen prices and general economic, business, and market conditions;
- the ability to obtain required capital, through access to capital markets and other means, to finance exploration and development activities and new and expanded facilities;
- the ability to obtain equipment, services, supplies and personnel in a timely manner and at an acceptable cost to carry out activities;
- the ability of Paramount and its industry partners to obtain drilling success and production levels consistent with expectations, including with respect to anticipated reserves additions and NGLs yields;
- the timely receipt of required regulatory approvals;
- expected timelines and budgets being met and anticipated results achieved, in respect of facilities and infrastructure development;
- anticipated rates of return from existing and planned

- the ability to market oil, natural gas, NGLs and bitumen successfully to current and new customers;
- the ability to secure adequate product processing, fractionation, transportation and storage;
- projects relative to other opportunities;
- estimates of input and labour costs; and
- currency exchange and interest rates.

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

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

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

NON-GAAP MEASURES

In this document "Funds flow from operations", "Funds flow from operations - per Boe", "Funds flow from operations per share - diluted", "Netback", "Netback including commodity & insurance 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 Generally Accepted Accounting Principles in Canada ("GAAP").

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 Paramount's Management's Discussion and Analysis. **Exploration and development expenditures** refer to capital expenditures and geological and geophysical costs incurred by the Company's COUs (excluding land and acquisitions). The exploration and development expenditure measure provides management and investors with information regarding the Company's Principal Property spending on drilling and infrastructure projects, separate from land acquisition activity. **Investments in other entities – market value** reflects the Company's investments in enterprises whose securities trade on a public stock exchange at their period end closing price (e.g. Trilogy, MEG Energy, MGM Energy and others), and investments in all other entities at book value. Paramount provides this information because the market values of equity-accounted investments, which are significant assets of the Company, are often materially different than their carrying values.

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

OIL AND GAS MEASURES AND DEFINITIONS

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

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

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.

Oil Sands Resource Notes:

High Estimate is considered to be an optimistic estimate of the quantity of resource that will actually be recovered. It is unlikely that the actual remaining quantities of resources recovered will meet or exceed the high estimate. Those resources at the high end for the estimate range have a lower degree of certainty (a 10 percent confidence level) that the actual quantities recovered will equal or exceed the estimate.

Best Estimate is considered to be the best estimate of the quantity that will be actually 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.

Low Estimate is considered to be a conservative estimate of the quantity of resources that will actually be recovered. It is likely that the actual remaining quantities recovered will exceed the low estimate. Those resources at the low end of the estimate range have the highest degree of certainty (a 90 percent confidence level) that the actual quantities recovered will equal or exceed the estimate.

Discovered Exploitable Bitumen In Place ("DEBIP") 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 Remaining Hoole Leases, the presence of these characteristics is considered necessary for the commercial application of known recovery technologies. There is no certainty that it will be commercially viable to produce any portion of the resources from the Remaining Hoole Leases.

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 applications, 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 Remaining Hoole Leases, contingencies which must be overcome to enable the reclassification of bitumen contingent resources as reserves include the finalization of plans for the development, submission of a regulatory application 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 January 1, 2013). Volumes presented are working interest, before the deduction of royalties.

NPV means net present value and represents Cavalier Energy's share of future net revenue, before the deduction of income tax, from the economic contingent resources in the Grand Rapids formation within the Remaining Hoole Leases. 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. 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 January 1, 2013. The estimated net present values disclosed in this press release do not represent fair market value.

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 independent 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 7, 2013

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, 2012 and 2011 and the consolidated statements of comprehensive loss, shareholders' equity and cash flows for the years ended December 31, 2012 and 2011, 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.

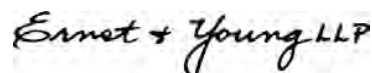
We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

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, 2012 and 2011 and its financial performance and its cash flows for the years ended December 31, 2012 and 2011 in accordance with International Financial Reporting Standards.

Calgary, Canada

7 March 2013

The logo for Ernst & Young LLP, featuring the company name in a stylized, cursive script font.

Chartered accountants

PARAMOUNT RESOURCES LTD.

Consolidated Balance Sheet

(\$ thousands)

As at December 31	Note	2012	2011
ASSETS			
Current assets			
Cash and cash equivalents	21	\$ 146,684	\$ 29,000
Accounts receivable	20	32,790	40,181
Risk management	20	–	184
Prepaid expenses and other		2,504	2,551
Assets held for sale	6	12,433	58,038
		194,411	129,954
Deposit	19	20,234	20,043
Exploration and evaluation	8	405,090	390,742
Property, plant and equipment, net	9	1,078,451	808,617
Equity-accounted investments	10	90,977	101,543
Investments in securities	11	127,767	153,840
Deferred income tax	19	116,901	117,548
Goodwill	12	3,124	3,426
		\$ 2,036,955	\$ 1,725,713
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Demand facilities	13	\$ 40,703	\$ 22,842
Accounts payable and accrued liabilities	20	183,512	136,820
Risk management	20	–	2,787
Liabilities associated with assets held for sale	6	470	13,040
		224,685	175,489
Long-term debt	14	660,702	427,186
Asset retirement obligations	15	300,468	299,202
		1,185,855	901,877
Commitments and contingencies	24		
Shareholders' equity			
Share capital	16	921,680	810,781
Accumulated deficit		(165,527)	(103,615)
Reserves	17	94,947	116,670
		851,100	823,836
		\$ 2,036,955	\$ 1,725,713

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	2012	2011
Petroleum and natural gas sales		\$ 185,662	(restated see note 4) \$ 213,356
Royalties		(14,585)	(17,400)
Revenue		171,077	195,956
Gain (loss) on financial commodity contracts	20	2,487	(1,699)
		173,564	194,257
Expenses			
Operating expense		66,396	62,443
Transportation		21,774	20,519
General and administrative		18,140	16,934
Stock-based compensation	1,18	29,082	21,462
Depletion and depreciation	9	284,155	369,997
Exploration and evaluation	8	33,516	27,156
Gain on sale of property, plant and equipment		(26,432)	(4,863)
Interest		35,324	34,109
Accretion of asset retirement obligations		3,332	7,887
Acquisition transaction costs		–	1,044
Foreign exchange		1,583	(949)
		466,870	555,739
Income from equity-accounted investments	10	153,333	1,201
Other income	5	14,290	24,392
Loss from continuing operations before tax		(125,683)	(335,889)
Income tax expense (recovery)	19		
Current		789	12
Deferred		(34,339)	(79,599)
		(33,550)	(79,587)
Loss from continuing operations		(92,133)	(256,302)
Income from discontinued operations, net of tax	4	30,221	24,312
Net loss		\$ (61,912)	\$ (231,990)
Other comprehensive income (loss), net of tax			
Change in market value of securities	17	(42,830)	(19,913)
Exchange differences on translation of US subsidiaries		438	1,197
		(42,392)	(18,716)
Comprehensive loss		\$ (104,304)	\$ (250,706)
Net income (loss) per common share (\$/share)			
Basic – continuing operations	16	(1.06)	(3.27)
Basic – discontinued operations		0.35	0.31
Basic		(0.71)	(2.96)
Diluted – continuing operations		(1.06)	(3.27)
Diluted – discontinued operations		0.35	0.31
Diluted		(0.71)	(2.96)

See the accompanying notes to these Consolidated Financial Statements.

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

Year ended December 31	Note	2012	2011
Operating activities			
Net loss		\$ (61,912)	\$ (231,990)
Add (deduct):			
Items not involving cash	21	101,013	310,074
Dividends from equity-accounted investments		8,040	11,360
Asset retirement obligations settled	15	(8,002)	(7,520)
Current tax related to the sale of U.S. properties		3,931	–
Change in non-cash working capital		12,150	3,036
Cash from operating activities		55,220	84,960
Financing activities			
Net draw (repayment) of demand loans		17,861	(4,038)
Proceeds from Senior Notes, net of issue costs		294,135	70,899
Repayment of debt assumed on acquisitions	7	–	(37,824)
Net draw (repayment) of revolving long-term debt	14	(61,383)	61,383
Common shares issued, net of issue costs		124,465	268,627
Common shares purchased under stock incentive plan		(3,052)	(2,974)
Cash from financing activities		372,026	356,073
Investing activities			
Property, plant and equipment and exploration		(623,631)	(525,239)
Proceeds on sale of property, plant and equipment		45,231	45,385
Proceeds on sale of discontinued operations, net		66,498	–
Proceeds on sale of investment, net		181,718	16,129
Corporate acquisitions	7	–	(64,759)
Investments in securities		(13,023)	–
Investments in equity accounted investees		(1,650)	–
Change in non-cash working capital		36,008	41,769
Cash used in investing activities		(308,849)	(486,715)
Net increase (decrease)		118,397	(45,682)
Foreign exchange on cash and cash equivalents		(713)	23
Cash and cash equivalents, beginning of year		29,000	74,659
Cash and cash equivalents, end of year		\$ 146,684	\$ 29,000

Supplemental cash flow information 21

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	2012		2011	
		<i>Shares (000's)</i>		<i>Shares (000's)</i>	
Share Capital					
Balance, beginning of year		85,414	\$ 810,781	75,034	\$ 481,827
Issued		4,432	110,896	8,316	271,683
Issued on acquisition of ProspEx	7	–	–	2,000	57,280
Change in unvested common shares for stock incentive plan	18	11	3	64	(9)
Balance, end of year		89,857	\$ 921,680	85,414	\$ 810,781
Accumulated (Deficit) Earnings					
Balance, beginning of year			\$ (103,615)		\$ 128,375
Net loss			(61,912)		(231,990)
Balance, end of year			\$ (165,527)		\$ (103,615)
Reserves					
Balance, beginning of year	17		\$ 116,670		\$ 71,996
Other comprehensive loss			(42,392)		(18,716)
Contributed surplus			20,669		65,792
Stock-based compensation – investee options			–		(2,402)
Balance, end of year			\$ 94,947		\$ 116,670
Total Shareholders' Equity			\$ 851,100		\$ 823,836

See the accompanying notes to these Consolidated Financial Statements.

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

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 properties are primarily located in Alberta, the Northwest Territories and British Columbia. 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 is the ultimate parent company of the consolidated group of companies and 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 of the Company, as at December 31, 2012 and December 31, 2011 and for the years then ended (the "Consolidated Financial Statements"), were authorized for issuance by Paramount's Board of Directors on March 7, 2013.

a) Basis of Preparation

These Consolidated Financial Statements comply in all material respects 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. The Company's accounting policies have been applied consistently to all years presented.

These Consolidated Financial Statements include the accounts of Paramount and its subsidiaries and partnerships, including Cavalier Energy Inc. ("Cavalier Energy"), Fox Drilling Inc. ("Fox Drilling"), Summit Resources, Inc. ("Summit") and Paramount Drilling U.S. LLC. All intercompany balances and transactions have been eliminated.

In May 2012, Paramount's wholly-owned subsidiary, Summit, closed the sale of all of its operated properties in North Dakota and all of its properties in Montana (the "Sold Properties"). Results of the Sold Properties have been presented as discontinued operations and prior year comparative results have been adjusted to conform to the current year's basis of presentation, refer to note 4.

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 Consolidated Financial Statements are described in Note 2.

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.

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

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 corresponding amounts of revenue are 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 Trilogy Energy Corp. ("Trilogy"), 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 Trilogy, MGM Energy and Paxton share common directors and/or members of management. The Company's remaining investments in other entities are accounted for as available-for-sale investments.

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 and pre-production 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.

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

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 the costs of materials, machinery, labour, and directly attributable overhead in connection with their construction. 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, which extend up to 20 years.

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, which vary 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, 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. For oil and gas properties, the fair value less costs to sell is estimated based on expected after-tax future net cash flows 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

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

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.

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. 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. Costs incurred to affect the transaction are expensed.

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 (or group of CGUs), including goodwill, exceeds its estimated recoverable amount. Impairment charges relating to goodwill are not reversed in future periods.

For the purpose of testing goodwill for impairment, recoverable amounts for a CGU or group of CGUs are estimated on the same basis as used in testing the assets of that CGU for impairment.

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, after applying an estimated cost inflation factor, and is adjusted for the passage of time, which is recognized as accretion expense. Revisions to the timing, amount, and applicable discount and inflation rates 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.

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

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 purpose 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. The measurement of a financial instrument in subsequent periods is dependent upon whether it 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. All of the Company's financial instruments have been classified as fair value through profit or loss except available-for-sale investments and long-term debt.

Fair value through profit or loss financial assets and financial liabilities are measured at fair value, and changes in fair values 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 are accumulated in other comprehensive income ("OCI") until the asset is realized, at which time the cumulative gain or loss is recognized net income. Held-to-maturity financial assets, loans and receivables and other financial liabilities, including related transaction costs, are measured at amortized cost using the effective interest method.

Other Comprehensive Income

For Paramount, 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 in the Consolidated Balance Sheet.

n) Income Taxes

Paramount follows the liability method of accounting for income taxes. Under this method, a deferred income tax asset or liability is recognized in respect of any temporary difference between the carrying

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

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 the underlying 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 was 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

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

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

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 the 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.

2. SIGNIFICANT ACCOUNTING ESTIMATES, ASSUMPTIONS AND JUDGMENTS

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

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

Exploration and Evaluation Assets

The accounting for exploration and evaluation assets requires management to make judgments as to whether wells are classified as exploratory or development. Management must also determine whether exploratory wells have discovered economically recoverable quantities of reserves, which requires the quantity and value such reserves to be estimated. 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.

Determination of CGUs

The recoverability of the carrying value of oil and gas properties is assessed at the CGU level. Determination of the properties and other assets to be included within a particular CGU is based on management's judgment with respect to the integration between assets, shared infrastructure and cashflows. Changes in the assets comprising each CGU impacts recoverable amounts used in impairment assessments and 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

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

consideration transferred versus the fair value of the net identifiable assets acquired is recognized in earnings. The fair value of individual assets is often required to be estimated, which may involve estimating the fair values of reserves and resources, tangible assets, undeveloped land, intangible assets and other assets acquired. These estimates incorporate assumptions using appropriate indicators of fair value, as determined by management. Changes in any of the estimates or assumptions used in determining the fair value of the net identifiable assets acquired may impact the carrying values assigned and net income.

Asset Retirement Obligations

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

Share-Based Payments

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

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

- **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. DISCONTINUED OPERATIONS

In May 2012, Paramount's wholly-owned subsidiary, Summit, closed the sale of all of its operated properties in North Dakota and all of its properties in Montana for after-tax cash proceeds of \$66.5 million. These properties were included in the Company's Principal Properties business segment.

Details of income from discontinued operations are presented below:

Year ended December 31	2012	2011
Petroleum and natural gas sales	\$ 11,481	\$ 28,357
Royalties	(1,945)	(4,656)
Revenue	9,536	23,701
Expenses		
Operating expense and production tax	3,455	8,810
Depletion and depreciation	1,398	8,080
Exploration and evaluation	(341)	174
Gain on sale of property, plant and equipment	–	(37,158)
Accretion of asset retirement obligations	51	(513)
Foreign exchange	–	2,326
	4,563	(18,281)
Other income (expense)	(13)	136
Income from ordinary activities of discontinued operations before tax	4,960	42,118
Gain on sale of discontinued operations	50,721	–
Income from discontinued operations before tax	55,681	42,118
Income tax expense – discontinued operations		
Current	3,931	–
Deferred	21,529	17,806
	25,460	17,806
Income from discontinued operations	\$ 30,221	\$ 24,312

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

The cash flows from discontinued operations, including changes in related non-cash working capital items are as follows:

Year ended December 31	2012	2011
Operating	\$ 11,450	\$ 15,567
Investing	65,501	37,221
Cash flow from discontinued operations	\$ 76,951	\$ 52,788

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; 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 Paramount's wholly-owned subsidiary, Fox Drilling.
- **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.

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

Year ended December 31, 2012	Principal Properties	Strategic Investments	Corporate	Inter-segment Eliminations	Total
Revenue	\$ 171,077	\$ –	\$ –	\$ –	\$ 171,077
Gain on financial commodity contracts	2,487	–	–	–	2,487
	173,564	–	–	–	173,564
Expenses					
Operating expense	66,396	–	–	–	66,396
Transportation	21,774	–	–	–	21,774
General and administrative	–	6,438	11,702	–	18,140
Stock-based compensation	–	10,879	18,203	–	29,082
Depletion and depreciation	282,101	4,657	338	(2,941)	284,155
Exploration and evaluation	32,038	1,478	–	–	33,516
Gain on sale of property, plant and equipment	(26,432)	–	–	–	(26,432)
Interest	–	1,499	33,825	–	35,324
Accretion of asset retirement obligations	3,310	22	–	–	3,332
Foreign exchange	–	18	1,565	–	1,583
	379,187	24,991	65,633	(2,941)	466,870
Income from equity-accounted investments	–	153,333	–	–	153,333
Other	11,483	–	–	–	11,483
Drilling rig revenue	–	20,884	–	(13,422)	7,462
Drilling rig expense	–	(10,841)	–	6,186	(4,655)
	(194,140)	138,385	(65,633)	(4,295)	(125,683)
Inter-segment eliminations	–	(4,295)	–	4,295	–
Segment income (loss)	\$ (194,140)	\$ 134,090	\$ (65,633)	\$ –	(125,683)
Income tax recovery					33,550
Income from discontinued operations					30,221
Net loss					\$ (61,912)
Year ended December 31, 2011 (restated see note 4)	Principal Properties	Strategic Investments	Corporate	Inter-segment Eliminations	Total
Revenue	\$ 195,956	\$ –	\$ –	\$ –	\$ 195,956
Loss on financial commodity contracts	(1,699)	–	–	–	(1,699)
	194,257	–	–	–	194,257
Expenses					
Operating expense	62,443	–	–	–	62,443
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	367,614	5,639	454	(3,710)	369,997
Exploration and evaluation	25,552	1,604	–	–	27,156
Gain on sale of property, plant and equipment	(4,863)	–	–	–	(4,863)
Interest	–	1,195	32,914	–	34,109
Accretion of asset retirement obligations	7,837	50	–	–	7,887
Acquisition transaction costs	–	–	1,044	–	1,044
Foreign exchange	–	(30)	(919)	–	(949)
	479,102	19,180	61,167	(3,710)	555,739
Income from equity-accounted investments	–	1,201	–	–	1,201
Other	4,995	15,703	–	–	20,698
Drilling rig revenue	–	22,376	–	(14,039)	8,337
Drilling rig expense	–	(11,072)	–	6,429	(4,643)
	(279,850)	9,028	(61,167)	(3,900)	(335,889)
Inter-segment eliminations	–	(3,900)	–	3,900	–
Segment income (loss)	\$ (279,850)	\$ 5,128	\$ (61,167)	\$ –	(335,889)
Income tax recovery					79,587
Income from discontinued operations					24,312
Net loss					\$ (231,990)

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

Total Assets	December 31, 2012		December 31, 2011	
Principal Properties	\$	1,410,129	\$	1,216,808
Strategic Investments		342,967		361,909
Corporate		283,859		146,996
	\$	2,036,955	\$	1,725,713

Geographical Information	2012			2011		
	Canada	United States	Total	Canada	United States	Total
Revenue	\$ 165,661	\$ 5,416	\$ 171,077	\$ 183,344	\$ 12,612	\$ 195,956
Exploration and evaluation assets	405,056	34	405,090	374,364	16,378	390,742
Property, plant and equipment, net	1,077,116	1,335	1,078,451	753,167	55,450	808,617
Goodwill	3,124	–	3,124	3,426	–	3,426

For the year ended December 31, 2012, the Company had sales to one customer which exceeded \$30 million and to another customer which exceeded \$21 million.

Other Income

Year ended December 31	2012		2011	
Gain on investments	\$	–	\$	15,703
Drilling rig revenue		7,462		8,337
Drilling rig expense		(4,655)		(4,643)
Other		11,483		4,995
	\$	14,290	\$	24,392

Other income for the year ended December 31, 2012 includes \$6.2 million in respect of a business interruption insurance settlement related to an electrical equipment failure at one of the Company's facilities in the fourth quarter of 2011.

6. ASSETS HELD FOR SALE

	December 31, 2012		December 31, 2011		
	Principal Properties		Principal Properties	Trilogy	Total
Exploration and evaluation	\$ 12,270		\$ 5,052	\$ –	\$ 5,052
Property, plant and equipment, net	163		28,251	–	28,251
Equity-accounted investments	–		–	24,196	24,196
Goodwill	–		539	–	539
Asset retirement obligations	\$ (470)		\$ (13,040)	\$ –	\$ (13,040)

Assets Held For Sale – December 31, 2012

During the first quarter of 2013, Summit closed the sale of its non-operated joint venture operations and lands in North Dakota for \$22.5 million, subject to closing adjustments. The carrying value of the properties and associated liabilities have been presented as assets held for sale as at December 31, 2012.

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

Assets Held For Sale – December 31, 2011

During the first quarter of 2012, Paramount closed sales of certain Canadian oil and gas properties within the Southern and Northern COUs for aggregate gross proceeds of \$49.2 million, including a \$4.0 million convertible debenture due February 2014. A \$28.3 million before-tax gain on sale of property, plant and equipment was recorded in respect of these transactions.

In January 2012, the Company closed the sale of 5.0 million non-voting shares of Trilogy for net cash proceeds of \$181.7 million, resulting in the recognition of a before-tax gain of \$157.2 million which has been included in income from equity-accounted investments.

7. ACQUISITION

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
<hr/>		
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.

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

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 in 2011 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 was 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, were 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 for the year ended December 31, 2011.

Between May 31, 2011 and December 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.

8. EXPLORATION AND EVALUATION

Year ended December 31	2012	2011
Balance, beginning of year	\$ 390,742	\$ 269,084
Additions	166,214	229,347
Transfer to assets held for sale	(12,270)	(5,052)
Corporate acquisitions	—	82,100
Transfers to property, plant and equipment	(111,416)	(161,853)
Dry hole	(6,842)	(2,371)
Expired lease costs	(18,550)	(18,195)
Dispositions	(2,548)	(3,052)
Foreign exchange	(240)	734
Balance, end of year	\$ 405,090	\$ 390,742

Additions to exploration and evaluation assets totaled \$119.0 million (2011 - \$207.5 million) for Principal Properties and \$47.2 million (2011 - \$21.8 million) for Strategic Investments.

Exploration and Evaluation Expense

Year ended December 31	2012	2011
Geological and geophysical	\$ 7,923	\$ 7,297
Dry hole	6,880	2,371
Expired lease costs	18,713	17,488
	\$ 33,516	\$ 27,156

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

9. PROPERTY, PLANT AND EQUIPMENT

Year ended December 31, 2012	Petroleum and natural gas assets	Drilling rigs	Other	Total
Cost				
Balance, December 31, 2011	\$ 1,466,107	\$ 51,471	\$ 19,943	\$ 1,537,521
Additions	426,808	32,889	446	460,143
Transfers to assets held for sale	(1,284)	–	–	(1,284)
Transfers from exploration and evaluation	111,416	–	–	111,416
Dispositions	(58,305)	–	–	(58,305)
Change in asset retirement provision	15,697	–	–	15,697
Currency translation differences	394	(260)	(15)	119
Cost, December 31, 2012	1,960,833	84,100	20,374	2,065,307
Accumulated depletion, depreciation and write-downs				
Balance, December 31, 2011	\$ (696,630)	\$ (13,899)	\$ (18,375)	\$ (728,904)
Transfer to assets held for sale	1,121	–	–	1,121
Depletion and depreciation	(148,174)	(4,630)	(367)	(153,171)
Write-downs	(135,278)	–	–	(135,278)
Dispositions	29,504	–	–	29,504
Currency translation differences	(242)	109	5	(128)
Accumulated depletion, depreciation and write-downs, December 31, 2012	(949,699)	(18,420)	(18,737)	(986,856)
Net book value, December 31, 2011	769,477	37,572	1,568	808,617
Net book value, December 31, 2012	\$ 1,011,134	\$ 65,680	\$ 1,637	\$ 1,078,451

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)
Transfers 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	(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

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

Depletion and Depreciation

Year ended December 31	2012	2011
Depletion and depreciation	\$ 151,772	\$ 148,385
Write-down of property, plant and equipment	135,278	215,156
Goodwill impairment	302	10,502
Inter-segment eliminations	(3,197)	(4,046)
	\$ 284,155	\$ 369,997

At December 31, 2012, \$267.7 million (December 31, 2011 – \$111.4 million) of capitalized costs related to incomplete development wells and infrastructure projects are currently not subject to depletion.

Additions to property, plant and equipment in 2012 were \$426.8 million (2011 - \$295.7 million) for Principal Properties, \$32.9 million (2011 - \$5.0 million) for Strategic Investments and \$0.5 million (2011 – \$0.1 million) for Corporate. Additions to property, plant and equipment include \$4.6 million (2011 – \$3.2 million) of capitalized interest for qualifying assets in the construction phase at a weighted average interest rate of eight percent (2011 – eight percent).

The Company recorded an impairment write-down related to its petroleum and natural gas assets of \$135.3 million (2011 – \$215.2 million) within the Principal Properties business segment. The impairment write-down was primarily related to the Bistcho/Cameron Hills and Clarke Lake CGUs in the Northern COU, the Elmworth CGU in the Grande Prairie COU and the Southern CGU (Chain), 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 the decline in forecast oil, natural gas, and natural gas liquids prices, higher well costs than reserves values assigned, and declines in reserves assigned due to well performance.

The 2011 impairment write-down was primarily related to the Elmworth CGU in the Grande Prairie COU, the Southern CGU (Chain) in Canada, and the Bistcho/Cameron CGU 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, 2012 (December 31, 2011 – 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)	2013	2014	2015	2016	2017	2018-2027	Thereafter
Natural Gas							
AECO (\$/MMBtu)	3.35	3.85	4.35	4.70	5.10	5.45 - 6.50	+2%/yr
Henry Hub (US\$/MMBtu)	3.75	4.30	4.85	5.25	5.70	6.10 - 7.25	+2%/yr
Crude Oil							
Edmonton Light (\$/Bbl)	87.50	90.50	92.60	94.50	96.40	98.30 - 117.50	+2%/yr
WTI (US\$/Bbl)	92.50	92.50	93.60	95.50	97.40	99.40 - 118.80	+2%/yr

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The following benchmark prices were used in determining the 2011 impairment write-down:

(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 (\$/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

10. EQUITY ACCOUNTED INVESTMENTS

As at December 31	2012			2011		
	Shares (000's)	Carrying Value	Market Value ⁽¹⁾	Shares (000's)	Carrying Value	Market Value ⁽¹⁾
Trilogy ⁽²⁾	19,144	\$ 82,419	\$ 557,292	19,144	\$ 94,062	\$ 719,253
MGM Energy	54,147	2,299	13,537	43,834	1,691	10,520
Paxton	1,750	3,687		1,750	4,015	
Other		2,572			1,775	
		\$ 90,977			\$ 101,543	

(1) Based on the year-end trading price.

(2) December 31, 2011 balances exclude 5.0 million non-voting shares of Trilogy classified within assets held for sale.

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

Year ended December 31	2012				2011		
	Equity income (loss)	Dilution gain	Gain on sale	Total	Equity income (loss)	Dilution gain	Total
Trilogy	\$ (3,725)	\$ 416	\$ 157,215	\$ 153,906	\$ 1,945	\$ 1,060	\$ 3,005
MGM Energy	(1,043)	–	–	(1,043)	(1,481)	–	(1,481)
Paxton	(328)	–	–	(328)	(323)	–	(323)
Other	798	–	–	798	–	–	–
	\$ (4,298)	\$ 416	\$ 157,215	\$ 153,333	\$ 141	\$ 1,060	\$ 1,201

Paramount recorded a \$0.4 million dilution gain (2011 - \$1.1 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, revenue and income of Trilogy, MGM Energy and Paxton. These amounts have been derived directly from Trilogy's published financial statements as at and for the years ended December 31, 2012 and 2011. 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 Trilogy.

Notes to the Consolidated Financial Statements

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As at December 31	2012		2011	
	Trilogy	Trilogy	MGM Energy ⁽¹⁾	Paxton ⁽¹⁾
Assets	\$ 1,395,111	\$ 1,260,364	\$ 76,708	\$ 24,557
Liabilities	\$ 908,712	\$ 729,919	\$ 5,845	\$ 62
Shares outstanding (thousands)	116,674	116,118	314,495	17,402
Paramount's equity interest	16%	21%	14%	10%

Year ended December 31	2012		2011	
Revenue	\$ 399,098	\$ 342,106	\$ —	\$ 103
Net income (loss)	\$ (12,133)	\$ 17,415	\$ (160,859)	\$ (3,103)

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 2012 financial statements were not finalized prior to completing these financial statements.

Trilogy had 7.3 million stock options outstanding (2.7 million exercisable) at December 31, 2012 at exercise prices ranging from \$4.85 to \$38.74 per share.

11. INVESTMENTS IN SECURITIES

As at December 31	2012		2011	
	Shares (000's)	Market Value	Shares (000's)	Market Value
MEG Energy Corp.	3,700	\$ 112,628	3,700	\$ 153,809
Other		15,139		31
		\$ 127,767		\$ 153,840

Paramount sold its investment in NuLoch Resources Inc., and shares in the successor company by acquisition, Magnum Hunter Resources Corp., through transactions in 2011 for aggregate gross proceeds of \$15.8 million. The Company recognized aggregate gains of \$11.1 million in other income, which previously had been recorded in OCI.

12. GOODWILL

As at December 31	2012	2011
Carrying value, beginning of year	\$ 3,426	\$ 8,012
Acquisitions	—	5,477
Adjustment to Redcliffe Exploration Inc. net assets acquired	—	978
Reclassified to assets held for sale	—	(539)
Impairment	(302)	(10,502)
Carrying value, end of year	\$ 3,124	\$ 3,426

The carrying amount of goodwill by COU is as follows:

As at December 31	2012	2011
Kaybob	\$ 3,124	\$ 3,124
Northern	—	302
	\$ 3,124	\$ 3,426

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

13. DEMAND FACILITIES

As at December 31	2012	2011
Drilling Rig Loan I	\$ 17,766	\$ 22,842
Drilling Rig Loan II	21,000	–
Cavalier Facility	1,937	–
	\$ 40,703	\$ 22,842

Drilling Rig Loans

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

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

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

Cavalier Facility

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

14. LONG-TERM DEBT

As at December 31	2012	2011
Bank credit facility	\$ –	\$ 61,383
8.25% Senior Notes due 2017	370,000	370,000
7.625% Senior Notes due 2019	300,000	–
	670,000	431,383
Unamortized financing costs net of premiums	(9,298)	(4,197)
	\$ 660,702	\$ 427,186

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Bank Credit Facility

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

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

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

Senior Notes

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

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

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

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

Notes to the Consolidated Financial Statements

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15. ASSET RETIREMENT OBLIGATIONS

Year ended December 31	2012	2011
Asset retirement obligations, beginning of year	\$ 299,202	\$ 241,770
Retirement obligations incurred	14,626	23,463
Revisions to estimated retirement costs and discount rates	441	37,791
Obligations settled	(8,002)	(7,520)
Disposal of properties	(8,500)	(2,902)
Assumed on corporate acquisition	–	11,943
Accretion expense – continuing operations	3,332	7,887
Accretion expense – discontinued operations	51	(513)
Transfer to liabilities associated with assets held for sale	(470)	(13,040)
Transfer to current liabilities	(280)	–
Foreign exchange	68	323
Asset retirement obligations, end of year	\$ 300,468	\$ 299,202

Asset retirement obligations at December 31, 2012 were determined using a weighted average risk-free rate of 2.00 percent (December 31, 2011 – 2.25 percent) and an inflation rate of 2.00 percent (December 31, 2011 – 2.00 percent). These obligations will be settled over the useful lives of the assets, which extend up to 39 years.

16. SHARE CAPITAL

Paramount's authorized share capital consists of an unlimited number of Class A common shares ("Common Shares") without par value and an unlimited number of preferred shares issuable in series. At December 31, 2012, 89,857,478 Common Shares were outstanding, net of 74,396 Common Shares held in trust under the stock incentive plan, and no Preferred Shares were outstanding.

In September 2012 Paramount issued, to a company controlled by the Company's Chairman and Chief Executive Officer, 646,000 Common Shares on a "flow-through" basis in respect of Canadian exploration expenses ("CEE") at a price of \$31.00 per share and 1,244,000 Common Shares on a "flow-through" basis in respect of Canadian development expenses ("CDE") at a price of \$28.15 per share for aggregate proceeds of \$55 million.

In October 2012 Paramount issued, pursuant to a public offering, 1,936,000 Common Shares on a "flow-through" basis in respect of CEE at a price of \$31.00 per share and 356,000 Common Shares on a "flow-through" basis in respect of CDE at a price of \$28.15 per share for aggregate gross proceeds of \$70 million. Certain officers and management of the Company participated in this offering.

A liability of \$19.8 million was recognized in accounts payable and accrued liabilities on the issuance of such flow-through shares in respect of the Company's obligation to renounce qualifying expenditures, of which \$9.0 million has been reclassified as a deferred tax liability upon the incurrence of qualifying expenditures.

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 CDE 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

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respect of 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 \$2.4 million (2011 – \$8.6 million) of transaction costs in respect of these equity offerings, net of tax benefits of \$0.8 million (2011 – \$2.9 million).

Weighted Average Common Shares Outstanding

Year Ended December 31	2012		2011	
	Shares (000's)	Loss from continuing operations	Shares (000's)	Loss from continuing operations
Loss from continuing operations – basic	86,607	\$ (92,133)	78,462	\$ (256,302)
Dilutive effect of Paramount Options	–	–	–	–
Loss from continuing operations - diluted	86,607	\$ (92,133)	78,462	\$ (256,302)

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 per share calculations when they are dilutive to income from continuing operations.

17. RESERVES

Reserves at December 31, 2012 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	Total Reserves
Balance, December 31, 2011	\$ 51,709	\$ (831)	\$ 65,792	\$ 116,670
Other comprehensive income (loss)	(42,830)	438	–	(42,392)
Stock-based compensation expense	–	–	26,072	26,072
Stock options exercised	–	–	(5,403)	(5,403)
Balance, December 31, 2012	\$ 8,879	\$ (393)	\$ 86,461	\$ 94,947

	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

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Other Comprehensive Income

Year ended December 31	2012	2011
Unrealized Loss on Securities		
Change in market value of securities	\$ (43,096)	\$ (7,109)
Reclassification of other comprehensive income to earnings	–	(15,693)
Deferred tax	266	2,889
	(42,830)	(19,913)
Translation of Foreign Subsidiaries		
Exchange differences on translation of US subsidiaries	89	(1,419)
Reclassification of other comprehensive income to earnings	349	2,965
Deferred tax	–	(349)
	438	1,197
Other Comprehensive Loss	\$ (42,392)	\$ (18,716)

18. SHARE-BASED PAYMENTS

Paramount Options

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

	2012		2011	
	Number	Weighted average exercise price (\$/share)	Number	Weighted average exercise price (\$/share)
Balance, beginning of year	5,767,450	\$ 20.76	5,006,300	\$ 13.90
Granted	1,340,000	34.01	1,529,000	38.95
Exercised	(258,600)	11.13	(618,850)	10.80
Forfeited	(171,000)	28.15	(149,000)	17.74
Expired	(10,000)	40.09	–	–
Balance, end of year	6,667,850	\$ 23.58	5,767,450	\$ 20.76
Options exercisable, end of year	2,862,134	\$ 14.42	1,832,218	\$ 10.66

For options exercised in 2012, the weighted average market price of Paramount's Common Shares on the dates exercised was \$34.46 (2011 - \$35.46).

The weighted average remaining contractual life and exercise prices of Paramount Options outstanding as of December 31, 2012 are as follows:

Exercise Prices	Awards Outstanding		
	Number	Remaining contractual life	Weighted average exercise price
\$6.87 - \$10.00	2,170,300	0.7 years	\$ 7.34
\$10.01 - \$20.00	689,050	2.3 years	\$ 13.37
\$20.01 - \$30.00	1,119,500	3.3 years	\$ 29.38
\$30.01 - \$40.09	2,689,000	4.8 years	\$ 36.89
	6,667,850	3.0 years	\$ 23.58

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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	Options awarded in 2012
Weighted average exercise price per share	\$ 14.67	\$ 40.02	\$ 34.01
Expected volatility	49.7%	47.8%	45.3%
Expected life of share options	2.3 years	4.7 years	4.7 years
Pre-vest forfeiture rate	4.6%	4.9%	5.0%
Risk-free interest rate	1.1%	1.2%	1.3%
Expected dividend yield	—	—	—
Weighted average fair value of awards	\$ 18.69	\$ 16.45	\$ 13.47

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

Cavalier Energy granted 2.2 million Cavalier Options in 2012 (2011 – 2.5 million) which vest over three to five years. No exercises or cancellations have occurred to date.

The grant date fair value of Cavalier Options awarded was estimated using the Black-Scholes-Merton model, incorporating the following inputs: expected volatility 62.4% (2011 – 63.0%), expected life 6.5 years (2011 – 6.9 years), risk-free interest rate 1.5% (2011 – 1.6%), pre-vest forfeiture rate of nil (2011 – nil), and expected dividend yield of nil (2011 – nil).

The estimated expected life of the Cavalier Options is the term of the option. As Cavalier is a private entity, expected volatility is estimated based on the average historical volatility of the trading price of a group publicly traded oil sands companies which are comparable to Cavalier Energy over the most recent period that is generally commensurate with the expected term of the option.

Stock Incentive Plan – Shares Held in Trust

Year ended December 31	2012		2011	
	Shares (000's)	\$	Shares (000's)	\$
Balance, beginning of year	86	419	150	410
Shares purchased	124	3,052	101	2,974
Change in vested and unvested shares	(135)	(3,055)	(165)	(2,965)
Balance, end of year	75	416	86	419

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Employee Benefit Costs

Year ended December 31	2012	2011
Stock option plan	\$ 26,072	\$ 18,412
Stock incentive plan	3,010	3,050
Stock-based compensation expense	29,082	21,462
Salaries and benefits, net of recoveries	11,951	10,956
	\$ 41,033	\$ 32,418

19. INCOME TAX

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

Year ended December 31	2012	2011
Loss from continuing operations before tax	\$ (125,683)	\$ (335,889)
Effective Canadian statutory income tax rate	25.1%	26.6%
Expected income tax expense (recovery)	\$ (31,546)	\$ (89,346)
Change resulting from:		
Statutory and other rate differences	(2,469)	1,469
Income from equity-accounted investments	(22,441)	(3,096)
Investment in subsidiaries	2,643	—
Goodwill impairment	76	2,792
Flow-through share renunciations	8,759	4,625
Stock-based compensation	6,534	4,881
Non-deductible items and other	4,894	(912)
Income tax recovery	\$ (33,550)	\$ (79,587)

Components of Deferred Income Tax Asset (Liability)

As at December 31	2012	2011
Property, plant and equipment	\$ (9,373)	\$ (11,339)
Investments	(2,761)	(286)
Asset retirement obligations	75,515	80,105
Non-capital and net operating losses	50,466	42,131
Other	3,054	6,937
	\$ 116,901	\$ 117,548

Paramount has \$208.6 million (2011 - \$152.6 million) of unused tax losses expiring between 2014 and 2032. In addition, Paramount has \$190.6 million (2011 - \$167.4 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

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(\$ thousands, except as noted)

with its objection to the Reassessments, the Company was required to deposit approximately \$20 million with the CRA, which will remain on account until the dispute is resolved.

20. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial Instruments

Financial instruments at December 31, 2012 consisted of cash and cash equivalents, accounts receivable, the Deposit, available-for-sale investments, the demand facilities, accounts payable and accrued 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.
- Publicly traded available-for-sale investments are carried at the period-end trading price.
- The carrying value of the demand facilities and long-term debt are measured at amortized cost.
- The 2017 Senior Notes had a market value of 104.1 percent of their principal amount at December 31, 2012 (December 31, 2011 – 103.1 percent).
- The 2019 Senior Notes had a market value of 100.3 percent of their principal amount at December 31, 2012.

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

Year ended December 31	2012	2011
Fair value, beginning of year	\$ (2,603)	\$ (693)
Changes in fair value	2,487	(1,699)
Settlements paid (received)	116	(211)
Fair value, end of year	\$ –	\$ (2,603)

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.

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- 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, 2012, Paramount's publicly traded available-for-sale investments were classified as level one 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, 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.

Foreign Currency Risk

Paramount is exposed to foreign currency risk on financial instruments denominated in US dollars including cash and cash equivalents, accounts receivable, 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 expenditures in US dollars.

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 2017 Senior Notes and 2019 Senior Notes bear interest at fixed rates 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, 2012 is limited to the carrying values of cash and cash equivalents and accounts receivable. 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, 2012, Paramount had balances due from one joint venture partner that represented approximately 10 percent of the Company's total accounts receivable.

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(\$ thousands, except as noted)

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 24, contractual obligations related to financial liabilities are as follows:

	2013	2014	2015	2016	2017	Thereafter	Total
Drilling Rig Loans ⁽¹⁾	\$ 10,458	\$ 20,051	\$ 6,798	\$ 5,050	\$ –	\$ –	\$ 42,357
Cavalier Facility ⁽²⁾	1,937	–	–	–	–	–	1,937
Accounts payable and accrued liabilities ⁽³⁾	172,705	–	–	–	–	–	172,705
Senior Notes ⁽¹⁾	53,400	53,400	53,400	53,400	421,895	344,058	979,553
	\$ 238,500	\$ 73,451	\$ 60,198	\$ 58,450	\$ 421,895	\$ 344,058	\$1,196,552

⁽¹⁾Including interest

⁽²⁾Excluding interest

⁽³⁾Excluding \$10.8 million related to the Company's obligation to renounce qualifying expenditures for flow-through share issuances.

Accounts payable and accrued liabilities

As at December 31	2012	2011
Trade and accrued payables	\$ 163,891	\$ 127,042
Joint venture and royalties	5,618	2,374
Interest payable	3,197	1,510
Flow-through share renunciation obligations	10,806	5,894
	\$ 183,512	\$ 136,820

Terms and conditions of the above financial liabilities:

- Trade and accrued payables and joint venture payables are non-interest bearing and are normally settled within 30 – 60 days.
- Interest on the 2017 Senior Notes is payable semi-annually in arrears on June 13 and December 13 in each year.
- Interest on the 2019 Senior Notes is payable semi-annually in arrears on June 4 and December 4 in each year.

Accounts receivable

As at December 31	2012	2011
Revenue receivable	\$ 19,412	\$ 21,543
Joint venture receivable	10,790	13,420
GST and other	2,588	5,218
	\$ 32,790	\$ 40,181

Notes to the Consolidated Financial Statements

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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 receivables and the credit worthiness of the counterparties. As a result of this assessment, the Company determined that there was no impairment of joint venture receivables required. There were no significant non-current joint venture receivables as at December 31, 2012 and 2011.

21. CONSOLIDATED STATEMENTS OF CASH FLOWS – SELECTED INFORMATION

Items not involving cash

Year ended December 31	2012	2011
Financial commodity contracts	\$ (2,603)	\$ 1,910
Stock-based compensation	29,082	21,405
Depletion and depreciation	284,155	369,997
Exploration and evaluation	26,077	19,858
Gain on sale of property, plant, and equipment	(26,432)	(4,863)
Accretion of asset retirement obligations	3,332	7,887
Foreign exchange	1,497	(1,393)
Income from equity-accounted investments	(153,333)	(1,201)
Deferred income tax	(34,339)	(79,599)
Gain on sale of investments	–	(15,703)
Discontinued operations	(27,681)	(8,751)
Other	1,258	527
	\$ 101,013	\$ 310,074

Supplemental cash flow information

Year ended December 31	2012	2011
Interest paid	\$ 36,424	\$ 36,910
Current tax paid	\$ 1,598	\$ 45

Components of cash and cash equivalents

Year ended December 31	2012	2011
Cash	\$ 4,575	\$ 15,009
Cash equivalents	142,109	13,991
	\$ 146,684	\$ 29,000

22. 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

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

- (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:

As at December 31	2012	2011
Working capital deficit (surplus) ⁽¹⁾	\$ 31,432	\$ 82,036
Credit Facility	–	61,383
Senior Notes ⁽²⁾	670,000	370,000
Net Debt ⁽³⁾	701,432	513,419
Share capital	921,680	810,781
Accumulated deficit	(165,527)	(103,615)
Reserves	94,947	116,670
Total Capital	\$ 1,552,532	\$ 1,337,255

(1) Excludes risk management assets and 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, 2012 - \$10.8 million, December 31, 2011 - \$5.9 million).

(2) Excludes unamortized issue premiums and financing costs.

(3) Net Debt excludes the deposit on account with the CRA, pending resolution of the Company's Notice of Objection (see Note 19).

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.

23. 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 2012, Paramount charged \$0.4 million (2011 – \$0.9 million) to Trilogy in respect of operational and administrative services. Also, Paramount received \$8.0 million (2011 - \$10.1 million) in dividends from Trilogy. As of December 31, 2012, Paramount had a receivable balance due from Trilogy of \$0.9 million (2011 - \$0.3 million).

Compensation of key management personnel

Year ended December 31	2012	2011
Salaries and benefits	\$ 1,914	\$ 2,159
Stock-based compensation	11,039	9,173
	\$ 12,953	\$ 11,332

Notes to the Consolidated Financial Statements

(\$ thousands, except as noted)

24. COMMITMENTS AND CONTINGENCIES

Commitments

Paramount had the following commitments as at December 31, 2012:

	Within One Year	After one year but not more than 5 years	More than five years
Petroleum and natural gas transportation and processing commitments ⁽¹⁾	\$ 17,142	\$ 173,381	\$ 217,210
Operating leases	2,786	7,414	8,753
Capital spending commitments ⁽²⁾	12,789	—	—
	\$ 32,717	\$ 180,795	\$ 225,963

(1) Certain of the transportation and processing commitments are secured by outstanding letters of credit totaling \$27.3 million at December 31, 2012 (2011 - \$12.8 million).

(2) Relates to contractual obligations for purchases of major equipment.

Operating lease commitment

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

Flow-Through Shares

As a result of flow through share issuances in 2012, Paramount is required to incur and renounce \$57.5 million of CEE during 2013. Paramount has incurred sufficient qualifying expenditures to satisfy commitments associated with CDE flow-through shares issued in 2012 and the CEE and CDE flow-through shares issued in 2011.

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.

25. SUBSEQUENT EVENTS

In March 2013, Paramount sold its properties in the Bistcho area of Alberta and the Cameron Hills area of the Northwest Territories for approximately \$9 million, subject to closing adjustments.

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

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) (3) (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

J. B. Roy ^{(1) (2) (3) (4)}

Independent Businessman
Calgary, Alberta

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

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