Q2 | 2014

Perpetual's focused capital expenditure program combined with stronger commodity prices resulted in reported increases in production, revenue and funds flow compared to both the preceding first quarter of 2014 and the second quarter of 2013. In addition, several transactions were announced in the second quarter to reduce the Company's overall debt levels while, at the same time, increasing reserves and accelerating future funds flow growth.

Perpetual remains focused on its top five strategic priorities for 2014:

1. Reduce debt and manage downside risk;
2. Grow Edson liquids-rich gas production, reserves, cash flow, inventory and value;
3. Maximize value of Mannville heavy oil;
4. Maximize cash flow from shallow gas; and
5. Advance and broaden the portfolio of high impact opportunities with risk-management investment.

A focus on these strategic priorities has led to increases in production, reserves, revenues and funds flow for Perpetual and at the same time resulted in significant improvement in liquidity during the second quarter of 2014. A summary of the significant progress with respect to these priorities is highlighted below.

Production and operating highlights

- Second quarter average production of 20,053 boe/d increased seven percent from the preceding first quarter of 2014 (18,794 boe/d) and was two percent higher than the prior year (Q2 2013 – 19,708 boe/d). Gas over bitumen ("GOB") deemed production decreased 20 percent to 19.3 MMcf/d from 24.1 MMcf/d in the second quarter of 2013 as a result of annual 10 percent reductions combined with the expiration of the 10 year deemed production period for multiple wells.
- Oil and natural gas liquids ("NGL" or "liquids") production of 3,738 bbl/d increased eight percent from the first quarter of 2014 (3,451 boe/d) reflecting production from new Mannville heavy oil wells drilled during the first quarter. Compared to the prior year, oil and NGL production decreased 15 percent, primarily due to lower reported liquids production from Edson wells related to changes in plant and liquids recovery operations.
- Natural gas production of 97.8 MMcf/d was up six percent from both the preceding first quarter as well as the second quarter of 2013, reflecting production from new wells drilled at West Edson which more than offset natural declines on Perpetual's shallow gas assets. Higher heat content deep basin gas represented 38 percent of natural gas production in the second quarter of 2014 compared to 29 percent in 2013, increasing the average heating value of total gas production to 1.11 GJ/Mcf from 1.09 GJ/Mcf.
- Exploration and development expenditures of $12.3 million were primarily related to completion of the plant expansion at West Edson and start-up of drilling programs for heavy oil at Mannville and liquids-rich gas at West Edson.
- Drilling activities in the second quarter included two (2.0 net) horizontal heavy oil wells at Mannville and one (0.5 net) horizontal well at West Edson. Modest capital was also allocated to optimize production operations on shallow gas assets.
- Disposition proceeds of $3.0 million were realized during the quarter on the sale of a portion of the Company's interest in certain undeveloped lands.
- Perpetual monetized its interest in remaining GOB royalty credits for proceeds of $20.5 million, subject to adjustments.

PERPETUAL ENERGY INC. IS A CANADIAN ENERGY COMPANY FOCUSED ON LONG-TERM VALUE CREATION THROUGH OIL AND GAS BASED EXPLORATION, DEVELOPMENT, PRODUCTION AND MARKETING. PERPETUAL HAS BUILT A SPECTRUM OF RESOURCE-STYLE OPPORTUNITIES SPANNING HEAVY OIL, LIQUIDS-RICH NATURAL GAS AND BITUMEN. THESE BALANCE A BASE OF LEGACY SHALLOW GAS ASSETS. WITH A TRACK RECORD OF INNOVATION AND OPERATIONAL EXCELLENCE, PERPETUAL IS POSITIONED TO GROW AND PROSPER THROUGHOUT THE DYNAMIC CYCLES OF THE ENERGY BUSINESS.

A SPECTRUM OF OPPORTUNITY

Financial highlights

- Funds flow of $25.9 million ($0.17 per share) was 50 percent higher than both the comparative second quarter of 2013 ($17.3 million) and the preceding first quarter of 2014 ($17.4 million), reflecting increased commodity prices, higher average production and higher average heat content gas with an increased proportion of gas produced from West Central Alberta.
- Production and operating costs declined 18 percent to $9.99/boe in the second quarter of 2014 compared to $12.15/boe in 2013 through cost savings initiatives and reduced processing fees from changes to infrastructure at West Edson.
- The second quarter operating netback of $19.97/boe was 35 percent higher than the $14.81/boe recorded in the prior year, an increase driven by production growth, higher quality sales products, improved realized commodity prices and enhanced operating efficiencies.
- Net income of $2.5 million in the second quarter (2013 – loss of $14.8 million) reflected higher revenue and reduced operating expenses.
- Increased AECO monthly index prices and higher heat content gas sales were reflected in Perpetual's average natural gas price, before derivatives, of $4.95/Mcf, up 35 percent from $3.68/Mcf in the second quarter of 2013. Losses on financial natural gas contracts reduced Perpetual's realized gas revenue by $2.7 million resulting in a realized price of $4.66/Mcf for the second quarter.
- Perpetual's second quarter oil and NGL price, before derivatives, of $83.08/bbl increased 26 percent compared to the same period in 2013 ($66.18/bbl) due to the combination of higher crude oil reference prices and an increase in the overall quality of both oil and NGL sales products. Price improvements were realized from the delivery of higher grade oil resulting from new drying operations at the majority of the Company's Mannville heavy oil locations, as well as higher grade NGL as a result of the change in liquid recoveries at West Edson. Perpetual's realized oil and NGL price, including derivatives, was impacted by net losses of $2.9 million recorded on financial WTI fixed price contracts, resulting in a realized price of $74.65/bbl.
- Total net debt of $360.0 million at June 30, 2014 was reduced by $33.8 million from $393.8 million at March 31, 2014. The reduction was driven by funds flow exceeding capital expenditures for the second quarter, combined with proceeds from dispositions and the monetization of GOB royalty credits.

Debt reduction and downside risk management

- On June 25, 2014, Perpetual entered into a joint venture arrangement for the accelerated development of the Company's East Edson property. The arrangement, which closed on July 16, 2014, included the disposition of a royalty interest in developed producing reserves, as well as granting an additional gross overriding royalty on undeveloped reserves pursuant to a farm-in agreement. Upon closing of the arrangement, Perpetual received $20 million of unrestricted funds which was initially applied against outstanding bank debt. Additional proceeds of $100 million were placed in escrow to be utilized to fund drilling commitments, $70 million of which represents funding commitments of the joint venture partner with the remaining $30 million attributed to Perpetual's commitments.
- During the second quarter, Perpetual closed a transaction with a third party to effectively monetize the vast majority of its remaining future GOB royalty credits for net proceeds of $18.5 million.
- On July 23, 2014, the Company closed an 8.75 percent senior notes offering for gross proceeds of $125 million. Net proceeds from the issue of the senior notes will be used to redeem Perpetual's $100 million 7.25 percent convertible debentures ("7.25% Debentures"), due to mature on January 31, 2015. Concurrent with the closing of the offering, Perpetual provided notice for the early redemption of all of the outstanding 7.25% Debentures on August 25, 2014. The excess $25 million of proceeds will be used to repay bank indebtedness, assist in the future repayment of its 7.00 percent convertible debentures ("7.00% Debentures") and for general corporate purposes.
- In conjunction with the monetization of future GOB credits, the Company's lenders reduced the borrowing base under the credit facility to $120 million from $130 million at June 26, 2014, with a further reduction on July 23, 2014 to $100 million to adjust for future interest payments that will be required by the issue of the senior notes.
- Perpetual did not enter into any significant commodity price management contracts during the second quarter of 2014; however, Perpetual has commodity price contracts in place for the remainder of 2014 to protect a base level of funds flow. Perpetual has in place natural gas hedges on an estimated 48 percent of forecast production from September to December of 2014 at an average price of $4.19/GJ. Perpetual also has financial contracts in place for September to October 2014 to fix the basis differential between the NYMEX and AECO for an average of 7,500 MMBtu/d at US$(0.48)/MMBtu.
- Perpetual has oil sales arrangements for 1,500 bbl/d in place from September through December 2014 protecting an average WTI index floor price of US$86.67/bbl with an average ceiling price of US$95.15/bbl. In addition, the Corporation has fixed WTI oil sales contracts for 250 bbl/d for the period September through December at US$90.00/bbl as a result of the trigger of a swaption call on December 31, 2013. The Corporation also has financial contracts in place for 1,000 bbl/d to fix the basis differential between the West Texas Intermediate and Western Canadian Select ("WTI"-"WCS") trading hubs at an average of US($22.63)/bbl.

Edson Wilrich liquids-rich gas and East Edson joint venture

- Capital spending in the West Central district during the second quarter totaled $6.9 million, which included drilling operations for one (0.5 net) liquids-rich wells in West Edson as well as completion of the West Edson facility expansion. In addition, approximately $1.0 million of the accounted expenditures in the Eastern Alberta shallow gas business unit related directly to the overhauls of sales compressor units to restore them to new condition to be put into service as part of the West Edson facility expansion. Wells drilled in 2014 continue to perform at or above the type curve for the area.
- Completion of the West Edson facility expansion during the second quarter increased processing capacity to 60 MMcf/d (30 MMcf/d net) through the addition of condensate stabilization equipment and additional compression, which was brought online beginning June 3, 2014.
- Perpetual plans to spend an additional $28 million at West Edson during the second half of 2014 for the drilling of up to nine (4.5 net) wells. Currently two drilling rigs are active at West Edson to grow production to the fully expanded plant capacity early in the third quarter and maintain the production level for the remainder of the year and into 2015. Perpetual is also participating in two (0.1 net) wells operated by a third party.
- On July 16, 2014, Perpetual closed an arrangement for the accelerated development of the Corporation's East Edson property. The arrangement included the disposition of a 50 percent royalty interest in current developed producing reserves in the East Edson area (the "Producing Royalty") for $50 million. In addition, the joint venture partner contributed $70 million for the drilling, completion and tie-in of approximately 14 horizontal wells in the Wilrich formation pursuant to a farm-in agreement to earn a second royalty (the "Drilling Royalty"). In combination, the Drilling and Producing Royalties entitle the joint venture partner to receive, on a priority basis, 5.6 MMcf/d of natural gas from the East Edson property plus oil and associated NGL from July 1, 2014 to December 31, 2022 and declining thereafter at 10 percent per year until the Drilling Royalty and the Producing Royalty terminate on December 31, 2034.
- As part of the East Edson transaction, Perpetual committed to spend $30 million to drill, complete and tie-in approximately five additional wells prior to December 31, 2015, substantially following the spending of the partner's $70 million farm-in investment. In addition, Perpetual will construct a new gas plant at East Edson to add 30 MMcf/d of processing capacity to the East Edson area at an estimated cost of $30 million. The new plant is expected to be operational by September 1, 2015. Further to this, prior to December 31, 2022, Perpetual committed to invest another $30 million to drill, complete and tie-in approximately six more wells.
- Planned capital spending on the East Edson property of $81 million includes drilling 13 (13.0 net) wells in the last half of 2014, as well as initial spending on equipment for the new 30 MMcf/d East Edson plant to be constructed in 2015 pursuant to the terms of the East Edson royalty agreements. Funding for the remaining 2014 capital program includes $70 million from amounts held in escrow accounts.
- The Company's independent reserve auditors, McDaniel and Associates Consultants Ltd., ("McDaniel") re-assessed the reserves related to the East Edson property, giving effect to the East Edson transaction, and also mechanically-adjusted Perpetual's year-end 2013 reserves to an effective date of May 1, 2014. The capital injected by the East Edson transaction is expected to increase the operating cash flow from the East Edson property to a level where the full development can be self-funded and Perpetual has committed to a significant capital program in the area thereby allowing McDaniel to substantially increase the reserve bookings to the technical level warranted. Upon closing of the East Edson transaction, Perpetual's Company-interest recognized booked reserves increased by 60 percent, adding an estimated 36.3 MMboe of additional proved and probable reserves to Perpetual's corporate reserves, effective May 1, 2014. Perpetual's total proved and probable reserves are estimated at 96.5 MMboe, an increase of 34.1 MMboe (55 percent) from 62.4 MMboe at year-end 2013.
- Reserve additions also included an increase in future development capital of $412 million, $70 million of which will be funded through the East Edson farm-in commitment. McDaniel's estimate of net present value (discounted at eight percent) of Perpetual's total proved and probable reserves at May 1, 2014, giving effect to the East Edson transaction and mechanical adjustments, increased 21 percent ($144 million) from year-end 2013. This increase in net present value was recorded with only a modest increase in McDaniel's commodity price forecasts effective April 1, 2014.
- Given the significant increased reserve bookings, the East Edson transactions translated into an estimated 56 percent increase in Perpetual's reserve-based net asset value ("NAV") to $4.80 per share as compared to the reserve-based NAV of $3.07 per share calculated at year-end 2013.

Mannville heavy oil

- Perpetual drilled two (2.0 net) wells during the second quarter of 2014, both of which were development locations in a new pool that was brought on-stream during the first quarter of 2014.
- Operations are continuing in the third quarter of 2014 with $15 million in capital spending to include drilling of seven (6.1 net) horizontal wells, including additional development locations in new pool discoveries made in the fourth quarter of 2013 and the first quarter of 2014.

- Capital will also be directed to water handling and injection projects to expand the waterflood pilot in the Mannville I2I pool and begin pressure maintenance through waterflood on two additional pools in the Mannville area.

Shallow gas

- Second quarter capital expenditures included $2.4 million on shallow gas assets, primarily to reactivate shut-in shallow gas wells, work over existing wells, recomplete additional zones and reduce operating costs, as well as overhaul compressors for re-purposing at West Edson. Based on production additions achieved to date, Perpetual expects an average recovery payout of less than six months for the shallow gas optimization projects.
- The remaining 2014 capital budget includes an additional $2 million of spending to continue operations to maximize value and mitigate production declines on the Corporation's legacy shallow gas assets through facility optimization projects, workovers and uphole recompletions.

High impact opportunities

- Project planning and full scale development scoping continued on Perpetual's bitumen recovery pilot project in the Bluesky formation at Panny during the quarter. Regulatory approval of the pilot project to assess the proprietary LEAD (Low-Pressure Electro-Thermal Assisted Drive) technology was received on July 24, 2014.
- Completion activities are expected to commence on the Company's non-operated Waskahigan Duvernay horizontal well during the third quarter to evaluate the future development potential of Perpetual's Duvernay acreage.

2014 Outlook

The recent transactions that closed subsequent to the end of the second quarter provide a foundation for accelerated growth in production and funds flow, as well as improved liquidity in the coming quarters and 2015. In addition, the issuance of $125 million of new high yield notes provides certainty with respect to the repayment of the 7.25% Debentures, and terms out debt capacity through to July 2019.

Closing of the East Edson arrangement in July 2014 is accelerating the development of the Corporation's East Edson asset. Activities are underway to execute close to $70 million in capital projects utilizing the escrowed funds prior to the end of 2014, with the remaining funds from escrow expected to be spent in 2015. Excluding the East Edson capital program, Perpetual continues to target other capital spending in 2014 to be fully funded by 2014 funds flow. The table below summarizes expected capital spending and planned drilling activities in accordance with Perpetual's 2014 strategic priorities for the remainder of 2014.

Capital expenditures for second half of 2014	$ millions	# of Wells
West Central liquids-rich gas	28	9 (4.5 net)
East Edson joint venture (1)	81	13 (13.0 net)
Mannville heavy oil	15	7 (6.1 net)
Shallow gas	2	–
Abandonment and reclamation	2	–
	128	29 (23.6 net)

(1) Includes $70 million to be funded through the East Edson partner from funds held in escrow.

Perpetual estimates full year 2014 production will average approximately 20,100 boe/d. The enhanced heat content of Perpetual's liquids-rich gas in West Central Alberta results in premium pricing to AECO market prices. Perpetual expects to average 41 to 43 MMcf/d of gas production in the greater Edson area, where the average heat content is estimated at 1.18 GJ/Mcf. Based on these assumptions and the current forward market for commodity prices, Perpetual expects 2014 funds flow of close to $85 million. Furthermore, Perpetual is well positioned to deliver strong results for continued growth in 2015.

Susan Riddell Rose
President and Chief Executive Officer
August 7, 2014

FINANCIAL AND OPERATING HIGHLIGHTS

	Three Months Ended June 30,			Six Months Ended June 30,		
(Cdn$ thousands, except as noted)	**2014**	2013	% Change	**2014**	2013	% Change
Financial						
Oil and natural gas revenue	**72,348**	57,187	27	**137,102**	99,664	38
Funds flow [(1)]	**25,864**	17,286	50	**43,248**	26,820	61
Per share [(1)(2)]	**0.17**	0.12	49	**0.29**	0.18	61
Net earnings (loss)	**2,549**	(4,566)	156	**(14,775)**	28,198	(152)
Per share – basic and diluted [(2)]	**0.02**	(0.03)	167	**(0.10)**	0.19	(153)
Total assets	**747,708**	718,544	4	**747,708**	718,544	4
Net bank debt outstanding [(1)]	**50,020**	50,297	(1)	**50,020**	50,297	(1)
Senior notes, at principal amount	**150,000**	150,000	–	**150,000**	150,000	–
Convertible debentures, at principal amount	**159,779**	159,867	–	**159,779**	159,867	–
Total net debt [(1)]	**359,799**	360,164	–	**359,799**	360,164	–
Capital expenditures						
Exploration and development	**12,251**	9,861	24	**43,591**	48,543	(10)
Interest in WGS LP	**–**	19,129	(100)	**–**	19,129	(100)
Dispositions, net of acquisitions	**(2,909)**	5,349	(154)	**(2,758)**	(70,829)	(96)
Other [(3)]	**326**	532	(39)	**414**	1,357	(69)
Net capital expenditures	**9,668**	34,871	(72)	**41,247**	(1,800)	2,392
Common shares outstanding (thousands)						
End of period	**149,636**	148,274	1	**149,636**	148,274	1
Weighted average - basic	**148,835**	148,015	1	**148,835**	147,853	1
Operating						
Average production						
Natural gas (MMcf/d) [(4)]	**97.8**	91.9	6	**95.0**	90.2	5
Oil and NGL (bbl/d) [(4)]	**3,738**	4,384	(15)	**3,596**	3,937	(9)
Total (boe/d) [(5)]	**20,053**	19,708	2	**19,428**	18,980	2
Gas over bitumen deemed production (MMcf/d) [(5)]	**19.3**	24.1	(20)	**19.4**	24.5	(21)
Average daily (actual and deemed – boe/d) [(4)(5)]	**23,270**	23,725	(2)	**22,661**	23,063	(2)
Average prices						
Natural gas, before derivatives ($/Mcf)	**4.95**	3.68	35	**4.93**	3.43	44
Natural gas, including derivatives ($/Mcf)	**4.66**	3.90	19	**4.51**	3.60	25
Oil and NGL, before derivatives ($/bbl)	**83.08**	66.18	26	**80.52**	61.15	32
Oil and NGL, including derivatives ($/bbl)	**74.65**	64.84	15	**73.29**	61.31	20
Barrel of oil equivalent, including derivatives ($/boe)	**36.64**	32.60	12	**35.62**	29.82	19
Drilling (wells drilled gross/net)						
Gas	**1/0.5**	-/-		**4/2.5**	-/-	
Oil	**2/2.0**	2/2.0		**13/11.7**	29/27.7	
Total	**3/2.5**	2/2.0		**17/14.2**	29/27.7	
Success rate (%)	**100/100**	100/100		**100/100**	100/100	

1. These are non-GAAP measures. Please refer to "Non-GAAP Measures" below.
2. Based on weighted average basic or diluted common shares outstanding for the period.
3. Other costs include geological and geophysical expenditures.
4. Production amounts are based on the Corporation's interest before royalty expense.
5. The deemed production volume describes all gas shut-in or denied production pursuant to a decision report, corresponding order or general bulletin of the Alberta Energy and Utilities Board ("AEUB"), or through correspondence in relation to an AEUB ID 99-1 application. This deemed production volume is not actual gas sales but represents shut-in gas that is the basis of the gas over bitumen financial solution which is received monthly from the Alberta Crown as a reduction against other royalties payable.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is management's discussion and analysis ("MD&A") of Perpetual Energy Inc.'s ("Perpetual" or the "Corporation") operating and financial results for the three and six months ended June 30, 2014 as well as information and estimates concerning the Corporation's future outlook based on currently available information. This discussion should be read in conjunction with the Corporation's condensed interim consolidated financial statements and accompanying notes for the three and six months ended June 30, 2014 as well as the audited consolidated financial statements and accompanying notes for the years ended December 31, 2013 and 2012. The MD&A should be read in conjunction with the Corporation's MD&A for the year ended December 31, 2013 as disclosure that is unchanged from the December 31, 2013 MD&A has not been duplicated herein. The Corporation's annual consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), which require publicly accountable enterprises to prepare their financial statements using International Financial Reporting Standards ("IFRS"). The Corporation's condensed interim consolidated financial statements are prepared in accordance with International Accounting Standard No. 34, Interim Financial Reporting. Readers are referred to the advisories for additional information regarding forecasts, assumptions and other forward-looking information contained in the "Forward-Looking Information" section of this MD&A. The date of this MD&A is August 7, 2014.

NATURE OF BUSINESS: Perpetual is an oil and natural gas based energy company headquartered in Calgary, Alberta. Over the past five years, Perpetual has transitioned its business from a shallow gas focused cash flow distributing energy trust to a diversified, growth-oriented, exploration, production and marketing company. Perpetual has a spectrum of opportunities in its resource-style portfolio of assets to support its growth strategy, including natural gas rich in natural gas liquids ("NGL" or "liquids-rich") assets in the deep basin of West Central Alberta, heavy oil in eastern Alberta, oil sands leases in northern Alberta and an interest in a natural gas storage business, which all complement its legacy shallow gas production and resource base. Additional information on Perpetual, including the most recent filed Annual Information Form ("AIF"), can be accessed at www.sedar.com or from the Corporation's website at www.perpetualenergyinc.com.

ADVISORIES

NON-GAAP MEASURES: This document contains the following non-GAAP financial measures which do not have any standardized meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. Non-GAAP measures presented in this document should not be viewed as alternatives to measures of financial performance calculated in accordance with GAAP.

Operating netback: Perpetual considers operating netback a key performance measure as it demonstrates its profitability relative to current commodity prices. Operating netbacks are also calculated on a boe basis by deducting royalties, operating costs and transportation from total revenue.

Funds flow: Management uses cash flow from operating activities before changes in non-cash working capital, changes in long term Crown receivable, settlement of decommissioning obligations and certain Exploration and Evaluation ("E&E") costs described below ("funds flow"), funds flow per share and annualized funds flow to analyze operating performance and leverage. Funds flow is reconciled to its closest GAAP measure, cash flow from operating activities, as follows.

Funds flow GAAP reconciliation	Three months ended June 30,		Six months ended June 30,	
($ thousands, except per share amounts)	**2014**	2013	**2014**	2013
Cash flow from operating activities	**22,605**	16,579	**37,137**	22,163
Exploration and evaluation costs [(1)]	**218**	499	**231**	1,273
Expenditures on decommissioning obligations	**628**	62	**3,029**	464
Changes in long term Crown receivable	**(8,225)**	730	**(10,997)**	1,144
Changes in non-cash operating working capital	**10,638**	(584)	**13,848**	1,776
Funds flow	**25,864**	17,286	**43,248**	26,820
Funds flow per share [(2)]	**0.17**	0.12	**0.29**	0.18

(1) The Corporation charges exploratory dry hole costs, geological and geophysical costs, and lease rentals on undeveloped properties and the cost of expired leases to income or loss in the period incurred. To make reported funds flow in this MD&A more comparable to industry practice the Corporation reclassifies dry hole costs, geological and geophysical costs and expired leases from operating to investing activities in the funds flow reconciliation.

(2) Based on weighted average shares outstanding for the period.

Realized revenue: Realized revenue includes oil and natural gas revenue, realized gains (losses) on economic hedges and call option premiums received and is used by management to calculate the Corporation's net realized commodity prices taking into account monthly settlements on financial forward sales, collars and foreign exchange contracts. These contracts are put in place to protect Perpetual's funds flows from potential volatility in commodity prices, and as such any related realized gains or losses are considered part of the Corporation's realized price.

Adjusted working capital deficiency (surplus): Adjusted working capital deficiency (surplus) includes total current assets, current liabilities and long term Crown receivables excluding short-term derivative assets and liabilities related to the Corporation's economic hedging activities, assets and liabilities held for sale, share-based payment liabilities, current portion of convertible debentures, and current bank indebtedness.

Net debt and net bank debt: Net bank debt is measured as current and long term bank indebtedness including adjusted working capital deficiency (surplus). Net debt includes the carrying value of net bank debt and the principle amount of senior notes and convertible debentures. Net bank debt and net debt are used by management to analyze leverage.

Total capitalization: Total capitalization is equal to net debt plus market value of issued equity and is used by management to analyze leverage. Total capitalization is not intended to represent the total funds from equity and debt received by the Corporation upon issuance.

Volume conversions: Barrel of oil equivalent ("boe") may be misleading, particularly if used in isolation. In accordance with National Instrument 51-101 ("NI 51-101"), a conversion ratio for natural gas of 6 Mcf:1 bbl has been used, which is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. In addition, utilizing a conversion on a 6 Mcf:1 bbl basis may be misleading as an indicator of value as the value ratio between natural gas and crude oil, based on the current prices of natural gas and crude oil, differ significantly from the energy equivalency of 6 Mcf:1 bbl.

FORWARD-LOOKING INFORMATION: Certain statements contained in this MD&A constitute forward-looking information and statements within the meaning of applicable securities laws. This information and these statements relate to future events or to future performance. All statements other than statements of historical fact may be forward-looking information and statements. The use of any of the words "anticipate", "continue", "estimate", "expect", "may", "will", "project", "should", "believe", "outlook", "guidance", "objective", "plans", "intends", "targeting", "could", "potential", "strategy" and any similar expressions are intended to identify forward-looking information and statements.

In particular, but without limiting the foregoing, this MD&A contains forward-looking information and statements pertaining to the following: the quantity and recoverability of Perpetual's reserves; the timing and amount of future production; future prices as well as supply and demand for natural gas, natural gas liquids ("NGL") and oil; the existence, operations and strategy of the commodity price risk management program; the approximate amount of forward sales and economic hedges to be employed, and the value of financial forward natural gas, oil and other risk management contracts; funds flow sensitivities to commodity price, production, foreign exchange and interest rate changes; operating, general and administrative ("G&A"), and other expenses; the costs and timing of future abandonment and reclamation, asset retirement and environmental obligations; the use of exploration and development activity, prudent asset management, and acquisitions to sustain, replace or add to reserves and production or expand the Corporation's asset base; the Corporation's acquisition and disposition strategy and the existence of acquisition and disposition opportunities, the criteria to be considered in connection therewith and the benefits to be derived therefrom; Perpetual's ability to benefit from the combination of growth opportunities and the ability to grow through the capital expenditure program; expected book value and related tax value of the Corporation's assets and prospect inventory and estimates of net asset value; funds flow; ability to fund exploration and development; the corporate strategy; expectations regarding Perpetual's access to capital to fund its acquisition, exploration and development activities; the effect of future accounting pronouncements and their impact on the Corporation's financial results; expected realization of gas over bitumen ("GOB") royalty adjustments; future income tax and its effect on funds flow; intentions with respect to preservation of tax pools and taxes payable by the Corporation; funding of and anticipated results from capital expenditure programs; renewal of and borrowing costs associated with the credit facility; future debt levels, financial capacity, liquidity and capital resources; future contractual commitments; drilling, completion, facilities, construction and waterflood plans, and the effect thereof; the impact of Canadian federal and provincial governmental regulation on the Corporation relative to other issuers; Crown royalty rates; Perpetual's treatment under governmental regulatory regimes; business strategies and plans of management including future changes in the structure of business operations and debt reduction initiatives; and the reliance on third parties in the industry to develop and expand Perpetual's assets and operations.

The forward-looking information and statements contained in this MD&A reflect several material factors and expectations and assumptions of the Corporation including, without limitation, that Perpetual will conduct its operations in a manner consistent with its expectations and, where applicable, consistent with past practice; the general continuance of current or, where applicable, assumed industry conditions; the continuance of existing, and in certain circumstances, the implementation of proposed tax, royalty and regulatory regimes; the ability of Perpetual to obtain equipment, services, and supplies in a timely manner to carry out its activities; the accuracy of the estimates of Perpetual's reserve and resource volumes; the timely receipt of required regulatory approvals; certain commodity price and other cost assumptions; the timing and costs of storage facility and pipeline construction and expansion and the ability to secure adequate product transportation; the continued availability of adequate debt and/or equity financing and funds flow to fund the Corporation's capital and operating requirements as needed; and the extent of Perpetual's liabilities.

The Corporation believes the material factors, expectations and assumptions reflected in the forward-looking information and statements are reasonable but no assurance can be given that these factors, expectations and assumptions will prove to be correct. The forward-looking information and statements included in this MD&A are not guarantees of future performance and should not be unduly relied upon. Such information and statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information or statements including, without limitation: volatility in market prices for oil and natural gas products; supply and demand regarding Perpetual's products; risks inherent in Perpetual's operations, such as production declines, unexpected results, geological, technical, or drilling and process problems; unanticipated operating events that can reduce production or cause production to be shut-in or delayed; changes in exploration or development plans by Perpetual or by third party operators of Perpetual's properties; reliance on industry partners; uncertainties or inaccuracies associated with estimating reserves volumes; competition for, among other things; capital, acquisitions of reserves, undeveloped lands, skilled personnel, equipment for drilling, completions, facilities and pipeline construction and maintenance; increased costs; incorrect assessments of the value of acquisitions; increased debt levels or debt service requirements; industry conditions including fluctuations in the price of natural gas and related commodities; royalties payable in respect of Perpetual's production; governmental regulation of the oil and gas industry, including environmental regulation; fluctuation in foreign exchange or interest rates; the need to obtain required approvals from regulatory authorities; changes in laws applicable to the Corporation, royalty rates, or other regulatory matters; general economic conditions in Canada, the United States and globally; stock market volatility and market valuations; limited, unfavorable, or a lack of access to capital markets, and certain other risks detailed from time to time in Perpetual's public disclosure documents. The foregoing list of risk factors should not be considered exhaustive.

The forward-looking information and statements contained in this MD&A speak only as of the date of this MD&A, and none of the Corporation or its subsidiaries assumes any obligation to publicly update or revise them to reflect new events or circumstances, unless expressly required to do so by applicable securities laws.

RECENT DEVELOPMENTS

East Edson royalty disposition and farmout agreement

On July 16, 2014, Perpetual entered into an arrangement for the accelerated development of the Corporation's East Edson property. The arrangement included the disposition of a 50 percent royalty interest in current developed producing reserves in the East Edson area (the "Producing Royalty") for $50 million, consisting of $20 million of unrestricted cash that was applied to reduce bank indebtedness with the remaining $30 million held in escrow to be used for development spending in East Edson. In addition, the joint venture partner contributed $70 million to an escrow account for the drilling, completion and tie-in of approximately 14 horizontal wells in the Wilrich formation pursuant to a farm-in agreement to earn a second royalty (the "Drilling Royalty"). In combination, in exchange for the total acquisition and funding commitment of $120 million, the Drilling and Producing Royalties entitle the joint venture partner to receive, on a priority basis, 5.6 MMcf/d of natural gas from the East Edson property plus oil and associated NGL from July 1, 2014 to December 31, 2022 and declining thereafter at 10 percent per year until the Drilling Royalty and the Producing Royalty terminate on December 31, 2034.

As part of the East Edson arrangement, Perpetual committed to spend $30 million to drill, complete and tie-in approximately five additional wells prior to December 31, 2015, substantially following the spending of the $70 million farm-in investment. In addition, Perpetual will construct a new gas plant at East Edson to add 30 MMcf/d of processing capacity at an estimated cost of $30 million. The new plant is expected to be operational by September 1, 2015. Further to this, prior to December 31, 2022, Perpetual committed to invest another $30 million to drill, complete and tie-in approximately six more wells. Perpetual will operate all East Edson joint venture operations and expects to execute the farm-in operations related to approximately 14 wells prior to year-end 2014.

The capital injected by the transaction is expected to materially grow liquids-rich gas production and operating cash flow from the East Edson property.

Reserve update

The Corporation's independent reserve auditors, McDaniel and Associates Consultants Ltd. ("McDaniel"), have re-assessed the reserves related to the East Edson property, giving effect to the East Edson transaction, and also mechanically-adjusted Perpetual's year-end 2013 reserves to an effective date of May 1, 2014. The capital injected by the East Edson transaction is expected to increase the operating cash flow from the East Edson property to a level where the full development can be self-funded and Perpetual has committed to a significant capital program in the area thereby allowing McDaniel to substantially increase the reserve bookings to the technical level warranted. Upon closing, Perpetual's Company-interest recognized booked reserves increased by 60 percent, adding an estimated 36.3 MMboe of proved and probable reserves to Perpetual's corporate reserves, effective May 1, 2014 as mechanically-updated by McDaniel. Perpetual's total proved and probable reserves are estimated at 96.5 MMboe, an increase of 34.1 MMboe (55 percent) from 62.4 MMboe at year-end 2013.

Reserve additions also included an increase in future development capital of $412 million, $70 million of which will be funded through the East Edson farm-in commitment. McDaniel's estimate of net present value (discounted at eight percent) of Perpetual's total proved and probable reserves at May 1, 2014, giving effect to the East Edson transaction and mechanical adjustments, increased 21 percent ($144 million) from year-end 2013. This increase in net present value was recorded with only a modest increase in McDaniel's commodity price forecasts effective April 1, 2014.

Senior notes financing & redemption of convertible debentures

On July 23, 2014, Perpetual issued $125.0 million in senior unsecured notes ("2014 Senior Notes"), which bear interest at 8.75 percent annually and mature on July 23, 2019. The net proceeds from this issuance will be used to redeem all of Perpetual's outstanding 7.25 percent convertible debentures ("7.25% Debentures") due to mature in January 2015, repay bank indebtedness, assist in the future repayment of its 7.00% convertible debentures ("7.00% Debentures") and for general corporate purposes. Concurrent with the closing of the offering, Perpetual provided notice for the early redemption of all of the outstanding 7.25% Debentures for total cash payments of $99.9 million on August 25, 2014.

SECOND QUARTER 2014 RESULTS

Capital expenditures

	Three months ended June 30,		Six months ended June 30,	
($ thousands)	**2014**	2013	**2014**	2013
Exploration and development	**12,251**	9,861	**43,591**	48,543
Geological and geophysical costs [(1)]	**218**	499	**231**	1,273
Interest in gas storage "WGS LP"	**–**	19,129	**–**	19,129
Acquisitions	**91**	5,433	**242**	7,185
Dispositions	**(3,000)**	(84)	**(3,000)**	(78,014)
Other	**108**	33	**183**	84
Total	**9,668**	34,871	**41,247**	(1,800)

(1) Geological and geophysical expenditures and dry hole costs are expensed directly in the Corporation's statement of income (loss); however, they are considered by Perpetual to be more closely related to investing activities than operating activities and therefore, are included with capital expenditures.

Exploration and development spending

($ thousands)	Three months ended June 30, **2014**	2013	Six months ended June 30, **2014**	2013
West Central liquids-rich gas	**6,955**	3,212	**26,011**	13,601
Mannville heavy oil	**2,850**	5,682	**13,757**	32,283
Eastern Alberta shallow gas and other	**2,446**	967	**3,823**	2,659
Total	**12,251**	9,861	**43,591**	48,543

During the second quarter of 2014, exploration and development expenditures of $12.3 million continued to be focused on the Corporation's proven diversifying assets at Mannville for heavy oil and in West Central Alberta for liquids-rich gas, bringing the total year to date spending to $43.6 million.

Exploration and development spending of $7.0 million during the second quarter related to the continued development of the liquids-rich Wilrich play in the West Edson area with drilling of one (0.5 net) horizontal well and completion of the West Edson facility expansion, including condensate stabilization equipment and compression. The facility expansion increased capacity to 60 MMcf/d (30 MMcf/d net) with the new components of the West Edson facility online beginning June 3, 2014. Perpetual's ongoing drilling operations in West Edson are projected to fill the plant to capacity early in the third quarter of 2014.

Exploration and development spending at Mannville of $2.9 million during the second quarter of 2014 included the drilling and completion of two (2.0 net) horizontal heavy oil wells. These wells were the start of a nine (8.1 net) well drilling program which will continue into the third quarter. Both wells are development locations in a new pool that was brought on-stream during the first quarter of 2014.

Spending of $2.4 million on Eastern Alberta shallow gas and other assets during the second quarter was primarily related to compressor overhauls as well as abandonments and reclamation work. Approximately $1 million of the accounted expenditures related directly to overhauls on sales compressor units to restore them to new condition to be put into service as part of the West Edson facility expansion. Additionally, facilities projects designed to reduce operating costs and recompletions continued the shallow gas program, which began in the first quarter and carried into the second quarter of 2014.

Acquisitions and dispositions

During the second quarter of 2014, Perpetual sold a portion of its interest in undeveloped land acquired through a non-cash swap transaction in the prior quarter for net proceeds of approximately $3.0 million. Net dispositions of $2.6 million for the six months ended June 30, 2014 compared with $70.8 million, net of acquisitions, during the same period in 2013 relating primarily to the Elmworth property disposition during the first quarter of 2013.

Gas over bitumen monetization

Perpetual receives gas over bitumen ("GOB") royalty credits under the Natural Gas Royalty Regulation as a result of its working interests in a number of natural gas wells which have been shut-in pursuant to shut-in orders issued by the Government of Alberta. On June 26, 2014, Perpetual closed a transaction to effectively monetize its future GOB royalty credits associated with certain shut-in properties in northeast Alberta for gross proceeds of $20.5 million, subject to closing adjustments. In exchange for the proceeds, Perpetual will make a monthly payment to the purchaser, which is based on the gas over bitumen formula set out in the Alberta Gas Royalty Regulations. After expiries on July 1, 2014 related to a group of wells reaching the end of their 10 year deemed production period, the future GOB royalty credits included in the monetization agreement represent the vast majority of the Corporation's remaining royalty credit entitlements. Under IFRS, this transaction has been accounted for as a hybrid financial obligation, which will be restated to fair value at each reporting period. Future monthly payments will be recorded as a reduction of the outstanding obligation.

Production

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	**2014**	2013
Natural gas (MMcf/d)				
Eastern – North	**37.8**	39.2	**36.4**	39.2
Eastern – South	**22.9**	26.3	**22.8**	26.8
West Central	**37.1**	26.4	**35.8**	24.2
Total natural gas	**97.8**	91.9	**95.0**	90.2
Crude oil (bbl/d)				
Eastern – North	**12**	17	**9**	10
Eastern – South [(1)]	**3,121**	3,575	**2,992**	3,167
West Central	**52**	68	**49**	49
Total crude oil	**3,185**	3,660	**3,050**	3,226
NGL (bbl/d)				
Eastern – North	**1**	1	**–**	1
Eastern – South	**13**	5	**12**	6
West Central	**539**	718	**534**	704
Total NGL	**553**	724	**546**	711
Total actual production (boe/d)	**20,053**	19,708	**19,428**	18,980
Deemed natural gas production (MMcf/d)	**19.3**	24.1	**19.4**	24.5
Total actual plus deemed production (boe/d)	**23,270**	23,725	**22,661**	23,063

(1) Primarily Mannville heavy oil.

Total oil, NGL and natural gas production for the three months ended June 30, 2014 of 20,053 boe/d was up two percent from the same period in 2013. Similarly, year to date production was up two percent to 19,428 boe/d from 18,980 boe/d in 2013 as production increases from Perpetual's capital investments continued to more than offset production declines.

Perpetual's gas production of 97.8 MMcf/d increased six percent from 91.9 MMcf/d from the first quarter of 2014, and similar increases were recorded for the three and six months ended June 30, 2014 compared to the same periods last year. Increased gas production in 2014 comes from an increase in higher heat content deep basin gas production at West Edson which more than offset the seven percent year over year decline in production from Perpetual's shallow gas assets.

Second quarter oil production of 3,185 bbl/d increased nine percent from 2,911 in the first quarter of 2014 as new Mannville heavy oil wells drilled during the first quarter were brought on production during the second quarter. Second quarter volumes included production from two new heavy oil pools discovered in the prior quarter as well as increased production through new infill wells. Production for the first six months of 2014 of 3,050 bbl/d decreased five percent from 3,226 bbl/d in 2013 as production declines offset new production additions and the new drill well count decreased to 13 (11.7 net) as compared to 29 (27.7 net) in the first six months of 2013.

NGL production for the second quarter of 553 bbl/d reflected reduced NGL yields in 2014 from the Corporation's West Central area. Reported West Central NGL yields during the six months ended 2014 dropped to 14.9 bbl/MMcf from 29.1 bbl/MMcf for the same period in 2013 as the higher liquids yield wells at Edson declined and spending for liquids-rich gas continued to be focused at West Edson where liquids yields are lower than at Edson proper. In addition, the change in processing arrangements in West Edson, which started up operations on October 1, 2013, reduced the reported liquids recovery. A portion of the previously recovered liquids are now included in higher heat content gas sales resulting in a higher realized gas price and, at the same time, higher grade condensate liquids are now recovered through the new plant.

Deemed production for the second quarter of 2014 of 19.3 MMcf/d decreased 20 percent from 24.1 MMcf/d in 2013. The decrease reflects the annual 10 percent reduction assessed on deemed production volumes combined with wells reaching the end of their 10 year deemed production period. Wells are only eligible for deemed production and the associated GOB royalty adjustment for 10 years following shut-in. Beginning July 1, 2014, deemed production was reduced by 6.1 MMcf/d as a group of wells reached the end of their 10 year deemed production period. Furthermore, Perpetual entered into a transaction to monetize its future GOB royalty credits for the vast majority of the Corporation's remaining royalty credit entitlements. Although this transaction has been accounted for as a financial obligation under IFRS, Perpetual ceased to report deemed production beginning June 26, 2014 upon closing of the monetization transaction.

Commodity prices

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	**2014**	2013
Reference prices				
AECO Monthly Index ($/Mcf) [1]	**4.68**	3.59	**4.72**	3.33
AECO Daily Index ($/Mcf) [1]	**4.69**	3.53	**5.20**	3.36
Alberta Gas Reference Price ($/Mcf) [2]	**4.40**	3.33	**4.61**	3.12
West Texas Intermediate ("WTI") light oil (US$/bbl)	**102.99**	94.22	**100.84**	94.30
Western Canadian Select ("WCS") differential (US$/bbl)	**(20.04)**	(19.16)	**(21.30)**	(25.56)
Average Perpetual prices				
Natural gas				
Before derivatives ($/Mcf) [3] [4]	**4.95**	3.68	**4.93**	3.43
Percent of AECO Monthly Index	**106**	103	**104**	103
Including derivatives ($/Mcf)	**4.66**	3.90	**4.51**	3.60
Percent of AECO Monthly Index	**100**	109	**96**	108
Oil and NGL				
Before derivatives ($/bbl)	**83.08**	66.18	**80.52**	61.15
Including derivatives ($/bbl)	**74.65**	64.84	**73.29**	61.31
Barrel of oil equivalent				
Average realized price ($/boe)	**36.64**	32.60	**35.62**	29.82

(1) AECO Index prices are reported in $/GJ and have been converted at a ratio of 1.05 GJ: 1 Mcf.

(2) Alberta Gas Reference Price is the price used to calculate Alberta Crown royalties.

(3) Natural gas price before derivatives includes physical forward sales contracts for which delivery was made during the reporting period but excludes realized gains and losses on financial derivatives.

(4) The average conversion ratio for Perpetual's natural gas production is 1.10 GJ: 1 Mcf.

AECO Monthly Index prices of $4.68/Mcf for the quarter ended June 30, 2014 increased 30 percent from $3.59/Mcf for the same period in 2013. For the six months ended June 30th, year over year AECO Monthly Index prices increased 42 percent to $4.72/Mcf from $3.33/Mcf in 2013. Extreme cold weather during the first quarter of 2014 caused strong heating demand, contributing to natural gas storage facilities being depleted to significantly below five-year average levels and by the end of the 2014 withdrawal season, a deficit of 865 Bcf in U.S. natural gas storage facilities existed year over year. The large storage deficit and continued colder weather in April kept gas prices relatively strong early in the second quarter of 2014. A lack of cooling demand in June and July has now reduced the year over year storage deficit, causing gas prices to pull back in recent weeks.

Increased AECO Monthly Index prices were reflected in Perpetual's natural gas price before derivatives with year over year increases of 35 percent and 44 percent, respectively, for the three and six months ended June 30. In addition, an increased volume of higher heat content natural gas associated with West Central production, combined with the Aux Sable and Alliance Pipeline marketing and transportation agreements, allowed Perpetual to realize a higher average natural gas price relative to the same periods in 2013.

Perpetual's average realized gas price, including derivatives, increased 19 percent to $4.66/Mcf for the three month period ended June 30, 2014 from $3.90/Mcf for the same period in 2013. The Corporation's realized 2014 second quarter natural gas price was reduced by $2.8 million in realized losses on natural gas derivatives with close to 60 percent of Perpetual's production being economically hedged below settled market prices during the second quarter. Realized losses of $7.6 million on financial natural gas contracts for the six month period ended June 30, 2014 were partially mitigated by $0.4 million realized on the monetization of gains on natural gas contracts during the first quarter of 2014. Realized losses led to an average 2014 gas price that was 96 percent of the AECO Monthly Index.

Perpetual's oil and NGL price, before derivatives, of $83.08/bbl in the second quarter of 2014 increased 26 percent compared to the same period in 2013 due to increased WTI prices. Perpetual realized further price improvements through the delivery of higher grade oil resulting from new drying operations at the majority of the Mannville heavy oil production pads as well as higher grade NGL from the change in liquid recoveries at West Edson.

Perpetual's realized oil and NGL price, including derivatives, was lower than the price before derivatives for both 2014 periods due to losses recorded on financial WTI fixed price contracts. Losses on financial WTI contracts for the six months ended June 30, 2014 were $4.7 million compared to $0.8 million for the same period in 2013.

Risk management

Perpetual's risk management strategy is focused on using both physical and financial derivatives to provide increased certainty in funds flow by mitigating the effect of commodity price volatility, to lock in economics on capital programs and acquisitions, and to take advantage of perceived anomalies in commodity markets. Perpetual also utilizes foreign exchange swaps and physical or financial swaps related to the differential between natural gas prices at the AECO and NYMEX trading hubs and oil basis differentials between WTI and WCS in order to mitigate the effects of fluctuations in foreign exchange rates and basis differentials on the Corporation's realized commodity prices.

Natural Gas

Perpetual has in place natural gas hedges on an estimated 48 percent of forecast actual natural gas production for September to December of 2014. The following tables provide a summary of derivative natural gas contracts in place as at June 30, 2014, as well as any additional contracts entered into prior to the date of this MD&A.

Fixed price natural gas forward sales arrangements (net of related financial fixed-price natural gas purchase contracts) at the AECO trading hub:

Term	Volumes at AECO (GJ/d)	Average price ($/GJ) (1)	Market prices ($/GJ) (2)	Type of contract
July 2014	5,275	4.06	4.38	Physical
July 2014	66,514	4.09	4.38	Financial
August 2014	7,775	3.97	3.79	Physical
August 2014	58,600	4.05	3.79	Financial
September 2014	5,275	4.06	3.83	Physical
September 2014	66,100	4.01	3.83	Financial
October 2014	5,275	4.06	3.84	Physical
October 2014	58,600	4.05	3.84	Financial
November 2014 – December 2014	52,500	4.38	3.95	Financial

(1) Average price calculated using weighted average price for net open contracts.

(2) Market prices for July and August are based on settled AECO Monthly Index prices. Market prices for subsequent months are based on forward AECO prices as of market close on August 7, 2014.

Sold natural gas call with monthly expiry over the contract term:

Term	Volumes at AECO (GJ/d)	Strike price ($/GJ)	Market prices ($/GJ) (1)	Type of contract
July 2014 (2)	10,000	4.25	4.38	Call
August 2014 (2)	10,000	4.25	3.79	Call
September 2014 – December 2014	10,000	4.25	3.90	Call

(1) Market prices for July and August are based on settled AECO Monthly Index prices. Market prices for subsequent months are based on forward AECO prices as of market close on August 7, 2014.

(2) This call was triggered in July but was not triggered in August due to the settled market price falling below the strike price.

Financial forward gas sales arrangements to fix the basis differentials between NYMEX and AECO trading hubs:

Term	Volumes at NYMEX-AECO (MMBtu/d)	Average price ($/MMBtu) (1)	Market prices ($/MMBtu) (2)	Type of contract
August 2014	7,500	(0.48)	(0.13)	Financial
September 2014 – October 2014	7,500	(0.48)	(0.21)	Financial

(1) Average price is in US$ and calculated using weighted average price for net open contracts; the price at which these contracts settle is equal to the NYMEX index less a fixed basis amount.

(2) Market prices for August are based on settled NYMEX-AECO differential prices. Market prices for subsequent months are based on forward NYMEX-AECO differential prices as of market close on August 7, 2014.

Crude Oil

The following tables provide a summary of derivative crude oil contracts in place as at June 30, 2014 as well as any additional contracts entered into prior to the date of this MD&A:

Fixed price oil sales arrangements in US$:

Term	Volumes at WTI (bbl/d)	Price (US$/bbl) (1)	Market prices (US$/bbl) (2)	Type of contract
July 2014	250	90.00	102.39	Financial
August 2014 – December 2014	250	90.00	97.80	Financial

(1) Average price calculated using weighted average price for net open contracts.

(2) Market prices for July are based on settled WTI oil prices. Market prices for subsequent months are based on forward WTI oil prices as of market close on August 7, 2014.

Costless collar oil sales arrangements in US$:

Term	Volumes at WTI (bbl/d)	Floor price (US$/bbl)	Ceiling price (US$/bbl)	Market prices (US$/bbl) (1)	Type of contract
July 2014	500	85.00	91.10	102.39	Collar
July 2014	500	85.00	91.20	102.39	Collar
July 2014	500	90.00	103.15	102.39	Asian Collar (2)
August 2014 – December 2014	500	85.00	91.10	97.80	Collar
August 2014 – December 2014	500	85.00	91.20	97.80	Collar
August 2014 – December 2014	500	90.00	103.15	97.80	Asian Collar (2)
January 2015 – December 2015	500	90.00	103.20	93.56	Asian Collar (3)

(1) Market prices for July are based on settled WTI oil prices. Market prices for subsequent months are based on forward WTI oil prices as of market close on August 7, 2014.

(2) If WTI index settles above US$103.15/bbl in any month, the contract is settled at US$93.00/bbl for that month.

(3) If WTI index settles above US$103.20/bbl in any month, the contract is settled at US$90.00/bbl for that month.

Costless collar oil sales arrangements in Cdn$:

Term	Volumes (bbl/d)	Floor price (Cdn$/bbl)	Ceiling price (Cdn$/bbl)	Market prices (Cdn$/bbl) (1)	Type of contract
January 2015 – December 2015	500	87.50	95.25	100.39	Collar
January 2015 – December 2015	500	87.50	95.75	100.39	Collar

(1) Market prices are based on forward WTI oil prices at a forward foreign exchange rate of 1.073 as of market close on August 7, 2014.

Sold oil call options with monthly expiry over the contract term:

Term	Volumes at WTI (bbl/d)	Strike price (US$/bbl WTI)	Market prices (US$/bbl WTI) (1)	Type of contract
January 2015 – December 2015	1,500	100.00	93.56	Call

(1) Market prices are based on forward WTI oil prices as of market close on August 7, 2014.

Basis differential contracts between WTI and WCS trading:

Term	Volumes (bbl/d)	WTI-WCS differential (US$/bbl) (1)	Market prices (US$/bbl) (2)	Type of contract
July 2014	1,000	(22.63)	(19.66)	Financial
July 2014	1,000	(20.66)	(19.66)	Physical
August 2014	1,000	(22.63)	(22.19)	Financial
August 2014	1,000	(20.66)	(22.19)	Physical
September 2014 – December 2014	1,000	(22.63)	(21.55)	Financial
September 2014 – December 2014	1,000	(20.66)	(21.55)	Physical

(1) Average price calculated using weighted average price for net open contracts; contracts settle at WTI index less a fixed basis amount.

(2) Market prices for July and August are based on settled WTI-WCS differential prices. Market prices for subsequent months are based on forward WTI-WCS differential prices as of market close on August 7, 2014.

Foreign Exchange

U.S. dollar forward sales arrangements:

Term	Notional US$/month	Exchange rate (Cdn$/US$)	Type of contract
July 2014 – June 2015	1,000,000	1.1000	Financial

The Corporation receives $1,000 each day during the month that the daily exchange rate is between $1.0000 and $1.1000. If the average monthly exchange rate is greater than $1.1000 the Corporation pays US$1,000,000 multiplied by the difference between the average monthly exchange rate and $1.1000. No settlement occurs between the Corporation and the counterparty if the average monthly exchange rate settles below $1.0000.

Term	Notional floor US$/month	Notional ceiling US$/month	Exchange rate floor (Cdn$/US$)	Exchange rate ceiling (Cdn$/US$)	Type of contract
July 2014 – December 2015	2,500,000	5,000,000	1.0400	1.1410	Financial

If the average monthly exchange rate is greater than the exchange rate ceiling, the Corporation pays US$5,000,000 multiplied by the difference between the average monthly exchange rate and $1.1000. If the monthly average exchange rate settles below the exchange rate floor, the Corporation receives US$2,500,000 multiplied by the difference between the average monthly exchange rate and the exchange rate floor.

Revenue

	Three months ended June 30,		Six months ended June 30,	
($ thousands, except as noted)	**2014**	2013	**2014**	2013
Petroleum and natural gas ("P&NG") revenue				
Natural gas [(1)]	**44,085**	30,784	**84,701**	56,102
Oil and NGL [(1)]	**28,263**	26,403	**52,401**	43,562
Total P&NG revenue	**72,348**	57,187	**137,102**	99,664
Other revenue				
Unrealized gains (losses) on derivatives	**6,994**	6,536	**(5,737)**	5,594
Realized gains (losses) on derivatives	**(5,478)**	1,273	**(11,852)**	1,810
Total other revenue	**1,516**	7,809	**(17,589)**	7,404
Total revenue	**73,864**	64,996	**119,513**	107,068
Per boe	**40.47**	36.25	**33.99**	31.17

(1) Includes revenues related to physical forward sales contracts that settled during the period

Perpetual's P&NG revenue, before derivatives, for the quarter ended June 30, 2014 of $72.3 million increased 12 percent from the first quarter of 2014 and 27 percent from the second quarter of 2013 mainly due to improved natural gas, oil and NGL prices.

Natural gas revenue, before derivatives, of $44.1 million for the second quarter of 2014 increased 43 percent from $30.8 million for the same period of 2013 with increased natural gas production, higher natural gas prices and increased higher heat content natural gas production associated with development spending in West Edson. On a year to date basis, natural gas revenues of $84.7 million were 51 percent higher than the first six months of 2013. The higher heat content West Central deep basin accounted for 38 percent of total natural gas production for the six months, up from 27 percent in 2013.

Oil and NGL revenues of $28.3 million in the second quarter of 2014 increased 17 percent from $24.1 million in the first quarter of 2014 and were seven percent higher than the $26.4 million reported in the second quarter of 2013. These increases were primarily as a result of increased commodity prices and higher grade oil and condensate production which Perpetual now markets as a result of operational changes at Mannville and West Edson.

Realized losses on derivatives for the six months ended June 30, 2014 totaled $11.9 million compared to gains of $1.8 million for the same period in 2013. Losses in 2014 were comprised of $7.6 million and $4.7 million related to natural gas and oil contracts respectively which were partially offset by $0.4 million of crystallized gains on certain hedging contracts.

The Corporation recorded unrealized gains on derivatives of $7.0 million during the second quarter of 2014 compared to a $12.7 million loss during the first quarter of 2014 resulting in a net unrealized loss of $5.7 million for the six months ended June 30, 2014 compared to a gain of $5.6 million for the same period in 2013. Unrealized losses represent the change in mark-to-market value of derivative contracts as forward commodity prices change. Unrealized gains and losses on derivatives are excluded from the Corporation's calculation of funds flow as they are non-cash. Derivative gains and losses vary depending on the nature and extent of economic hedging contracts in place, which in turn, vary with the Corporation's assessment of commodity price risk, committed capital spending and other factors.

Royalties

($ thousands, except as noted)	Three months ended June 30, 2014	2013	Six months ended June 30, 2014	2013
Crown	**4,675**	3,959	**9,054**	5,226
Freehold and overriding	**4,609**	3,429	**6,404**	4,638
Total	**9,284**	7,388	**15,458**	9,864
Crown (% of total P&NG sales)	**6.5**	6.9	**6.6**	5.2
Freehold and overriding (% of total P&NG sales)	**6.4**	6.0	**4.7**	4.7
Total (% of P&NG sales)	**12.9**	12.9	**11.3**	9.9
Per boe	**5.09**	4.12	**4.40**	2.87

Perpetual recorded royalty expense of $9.3 million in the second quarter of 2014, representing a combined royalty rate of 12.9 percent. Although the combined royalty rate was consistent with the prior year, second quarter 2013 royalties were impacted by annual Crown royalty adjustments of $2.6 million, evidencing an overall increase in royalty rates in 2014. Similarly, for the six months ended June 30, 2014 Perpetual's combined average royalty rate on P&NG revenues increased to 11.3 percent from 9.9 percent in 2013. Increased royalty rates in 2014 are a result of increases to Crown royalty rates associated with higher Alberta gas reference prices. In addition, certain of the Corporation's Mannville heavy oil wells continue to transition to higher royalty rates after reaching maximum volume recoveries under initial low royalty rate incentive periods.

Production and operating expenses

($ thousands, except as noted)	Three months ended June 30, 2014	2013	Six months ended June 30, 2014	2013
Production and operating expenses	**18,234**	21,776	**40,001**	39,929
Per boe	**9.99**	12.15	**11.38**	11.62

Production and operating expenses of $18.2 million in the second quarter of 2014 decreased 16 percent from $21.8 million in 2013 and similarly decreased on a boe basis to $9.99/boe from $12.15/boe. Operating cost savings related to changes in infrastructure at West Edson during 2013, which resulted in decreased processing fees and increased efficiency on a unit-of-production basis. Further operational efficiencies have been realized as a result of pipeline suspensions combined with Perpetual's corporate cost saving initiatives.

Transportation costs

($ thousands, except as noted)	Three months ended June 30, 2014	2013	Six months ended June 30, 2014	2013
Transportation costs	**2,905**	2,733	**5,903**	5,088
Per boe	**1.59**	1.52	**1.68**	1.48

Transportation costs include clean oil trucking and transportation as well as costs to transport natural gas from the plant gate to a commercial sales point. Transportation costs in the second quarter of 2014 increased to $2.9 million from $2.7 million for the same period in 2013, primarily due to increased Mannville oil transportation costs. In addition, Perpetual has increased its onsite processing of oil at Mannville to meet sales point specifications, primarily to allow increased volumes to be transported by rail. This resulted in a change in classification from operating costs (emulsion trucking) to transportation costs (clean oil trucking). This change to onsite processing has enhanced oil marketing opportunities and improved the overall netback for heavy oil production from the Mannville area.

Operating netbacks

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	**2014**	2013
Operating netback ($ thousands)				
Realized revenue [1]	**66,870**	58,460	**125,250**	102,427
Royalties	**(9,284)**	(7,388)	**(15,458)**	(9,864)
Operating costs	**(18,234)**	(21,776)	**(40,001)**	(39,929)
Transportation	**(2,905)**	(2,733)	**(5,903)**	(5,088)
Total operating netback	**36,447**	26,563	**63,888**	47,546
Boe operating netback ($/boe)				
Realized revenue [1]	**36.64**	32.60	**35.62**	29.81
Royalties	**(5.09)**	(4.12)	**(4.40)**	(2.87)
Operating costs	**(9.99)**	(12.15)	**(11.38)**	(11.62)
Transportation	**(1.59)**	(1.52)	**(1.68)**	(1.48)
Boe operating netback	**19.97**	14.81	**18.16**	13.84

(1) See "Non-GAAP measures" in this MD&A.

Perpetual's second quarter 2014 operating netback of $19.97/boe ($36.4 million) increased 35 percent from $14.81/boe ($26.6 million) in 2013, primarily reflecting increased revenue and reduced operating expenses partially offset by increased royalties due to higher commodity prices, and increased transportation expenses.

GOB revenue

	Three months ended June 30,		Six months ended June 30,	
($ thousands, except as noted)	**2014**	2013	**2014**	2013
GOB revenue [1]	**3,018**	3,696	**5,643**	5,248
Per boe	**1.65**	2.06	**1.60**	1.53

(1) Prior period amounts have been corrected as a result of the GOB Obligation being overstated and GOB revenue being understated. See note 2 of the condensed interim consolidated financial statements for the six months ended June 30, 2014.

Perpetual recorded $3.0 million in GOB revenue in the second quarter of 2014 compared to $3.7 million in 2013. The decrease was primarily as a result of the annual 10 percent deemed production decline on remaining wells, partially offset by higher Alberta reference prices. GOB revenue will be further reduced in the third quarter of 2014 as deemed production declined by approximately 6.1 MMcf/d in conjunction with a group of wells reaching the end of their 10 year deemed production period in July 2014.

Monetization of future GOB revenue

On June 26, 2014, the Corporation closed a transaction to effectively monetize its future GOB royalty credits associated with certain shut-in properties in northeast Alberta for proceeds of $20.5 million, subject to adjustments. The future GOB royalty credits included under the monetization agreement represent the vast majority of the Corporation's remaining royalty credit entitlements following July 1, 2014 expiries. In exchange for the net proceeds, Perpetual will make a monthly payment to the purchaser, which is based on the gas over bitumen formula set out in the Alberta Gas Royalty Regulations.

Pursuant to the terms of the agreement, in the event that the annual average Alberta Gas Reference Price is higher than a price based on the January 1, 2014 price forecast defined in the agreement, the payment will be adjusted for differences between the actual Alberta Gas Reference price and January 1, 2014 price forecast, with the Corporation retaining 35 percent of any excess resulting from Alberta Gas References prices exceeding the January 1, 2014 price forecast. The monthly payment commitment expires concurrent with the GOB Royalty Adjustment entitlements, with final expiries expected to occur in June 2021. Further, none of the GOB credits included under the monetization transaction have repayment obligations as the underlying shut-in wells were sold in 2010, at which time the liability for future repayment was assumed by the purchasers. As such, the monetization transaction had no impact on the Corporation's recorded GOB Obligation.

Under IFRS this transaction is accounted for as a hybrid financial instrument including a financial host contract obligation with an embedded derivative related to the indexation of the future cash payments to changes in the future Alberta gas reference price. The financial obligation will be restated to fair value each reporting period with monthly payments applied against the obligation. GOB revenue will continue to be recognized separately as revenue in accordance with Perpetual's accounting policies; however, the Corporation will no longer report deemed production beginning June 26, 2014.

Correction of prior period amounts

GOB Royalty Adjustments are paid to operators through a credit against their Crown royalty invoice, and are subject to repayment provisions should a well return to production (the "GOB Obligation"). The repayment of the GOB Obligation is structured as a gross overriding royalty ("GORR") with a maximum GOB Obligation equal to the GOB Royalty Adjustments received for the well. The GOB Obligation is measured at the discounted amount of the Corporation's best estimate of expected repayments of the GOB Royalty Adjustments.

Prior to the year ended December 31, 2013, Perpetual recognized the full amount of the GOB Royalty Adjustments received as a GOB Obligation, rather than the discounted amount of the expected GORR, as management initially expected that the full amount of the GOB Royalty Adjustments received would be fully repayable. Since the full amount of the GOB Royalty Adjustments received was recorded as a GOB Obligation, Perpetual did not recognize any of the GOB Royalty Adjustments as GOB revenue in earnings unless the GOB Royalty Adjustments related to shut-in wells that had been sold, where the related GOB Obligation was transferred to the purchaser under the respective purchase and sale agreement.

During preparation of the consolidated financial statements for the year ended December 31, 2013, Perpetual determined that:

- The GOB Obligation at January 1 and December 31, 2012 was overstated when compared to the discounted amount of expected repayments of the GOB Royalty Adjustments through the GORR. Accordingly, management determined that the previous GOB Obligation was not being accounted for correctly, and was overstated given that the full undiscounted amount of the GOB Royalty Adjustments was recognized as a provision (GOB Obligation) even though the full amount was unlikely to be repaid based on the discounted amount of the future GORR.
- As a result of recording the GOB Royalty Adjustments received or due as an obligation, the GOB revenue was understated for the three and six months ended June 30, 2013 and prior years. Previously, no GOB revenue was recognized unless it related to shut-in wells that had been sold, where entitlement to the GOB Royalty Adjustments were retained but the obligation for repayment had been transferred to the purchaser.

The comparative financial information as at January 1 and December 31, 2012 and for the year ended December 31, 2012 in the Corporation's consolidated financial statements as at and for the year ended December 31, 2013 was previously restated. The effect of the correction in the consolidated statement of loss and comprehensive loss for the three and six months ended June 30, 2013 is as follows:

	Three months ended June 30, 2013			Six months ended June 30, 2013		
($ thousands)	Reported	Adjustments	Adjusted	Reported	Adjustments	Adjusted
Gas over bitumen revenue	2,935	761	3,696	4,055	1,193	5,248
Net income (loss) and comprehensive income (loss)	(5,327)	761	(4,566)	27,005	1,193	28,198
Net income per share – basic	(0.04)	0.01	(0.03)	0.18	0.01	0.19
Net income per share – diluted	(0.04)	0.01	(0.03)	0.18	0.01	0.19

Collection of GOB Royalty Adjustments is limited by the Alberta government to deductions from the Corporation's monthly natural gas royalty invoices. Beginning in 2014, royalty adjustments are collected on behalf of Perpetual by one of its partners in the GOB wells with Perpetual's share being received in cash on a monthly basis. As of June 30, 2014, the Corporation had accumulated $10.4 million (December 31, 2013 – $18.1 million) of GOB adjustments receivable from the Crown of which nil (December 31, 2013 – $11.0 million) has been classified as long term. Perpetual will recover this receivable by applying its monthly future gas Crown royalties against the accumulated receivable.

Perpetual has recorded a GOB Obligation at June 30, 2014 of $3.2 million (December 31, 2013 - $2.9 million). Each quarter, the GOB Obligation is measured as the estimated discounted value of a gross overriding royalty on future gas production from shut-in wells that will be repayable to the Crown should the wells resume production within the GOB area.

Exploration and evaluation ("E&E") expenses

	Three months ended June 30,		Six months ended June 30,	
($ thousands)	**2014**	2013	**2014**	2013
Lease rentals	**661**	753	**1,313**	1,396
Geological and geophysical costs [(1)]	**218**	499	**231**	1,273
Lease expiries	**401**	592	**752**	592
Total E&E expense	**1,280**	1,844	**2,296**	3,261

(1) Geological and geophysical expenditures and dry hole costs are expensed directly in the Corporation's statement of income (loss); they are considered by Perpetual to be more closely related to investing activities than operating activities, and therefore are included with capital expenditures.

E&E costs include lease rentals on undeveloped acreage, geological and geophysical costs and lease expiries. E&E costs of $1.3 million for the three months ended June 30, 2014 were $0.5 million lower than the prior year as a result of fewer seismic purchases and lease expiries.

General and administrative ("G&A") expenses

	Three months ended June 30,		Six months ended June 30,	
($ thousands, except as noted)	**2014**	2013	**2014**	2013
Cash G&A expense	**5,379**	4,933	**10,141**	10,165
Compensation expense (non-cash)	**1,528**	715	**2,669**	1,359
Total G&A expense	**6,907**	5,648	**12,810**	11,524
Cash G&A expense – per boe	**2.95**	2.75	**2.88**	2.96
Compensation expense (non-cash) ($/boe)	**0.84**	0.40	**0.76**	0.40

Cash G&A expense for the second quarter of 2014 increased nine percent to $5.4 million from $4.9 million in 2013, mainly due to increased professional fees and consulting costs. Non-cash compensation expenses in the second quarter increased to $1.5 million from $0.7 million for the same period in 2013 as a result of performance multiplier adjustments related to performance share units issued and outstanding.

Depletion and depreciation

	Three months ended June 30,		Six months ended June 30,	
($ thousands, except as noted)	**2014**	2013	**2014**	2013
Depletion and depreciation	**24,492**	24,517	**47,229**	46,209
Per boe	**13.42**	13.67	**13.43**	13.45

Perpetual recorded $24.5 million ($13.42/boe) of depletion and depreciation expense in the second quarter of 2014 which is consistent with $24.5 million ($13.67/boe) for the same period in 2013.

Finance expenses

Interest

	Three months ended June 30,		Six months ended June 30,	
($ thousands)	**2014**	2013	**2014**	2013
Interest	**7,561**	7,287	**14,829**	14,413
Amortization of debt issue costs	**954**	880	**1,885**	1,739
Interest	**8,515**	8,167	**16,714**	16,152

Interest expense during the second quarter of 2014 remained relatively consistent with the comparative period as debt levels remained consistent. Interest expense for the six months ended June 30, 2014 included interest on the Corporation's senior notes of $6.8 million (2013 - $6.8 million), interest on convertible debentures of $7.3 million (2013 - $7.2 million) and interest on bank debt of $2.6 million (2013 - $2.2 million).

Gain on dispositions

During the six months ended June 30, 2014, Perpetual recorded gains of $5.6 million primarily related to a non-cash swap of undeveloped lands within West Central Alberta during the first quarter of 2014. During the second quarter, Perpetual sold a portion of these undeveloped lands for net proceeds of approximately $3.0 million. Property dispositions during the same period in 2013 generated net cash proceeds of $78.0 million, resulting in gains on dispositions of $51.2 million relating to the Elmworth property disposition during the first quarter of 2013.

Other finance expenses

	Three months ended June 30,		Six months ended June 30,	
($ thousands)	**2014**	2013	**2014**	2013
Accretion on decommissioning obligations	**1,344**	982	**2,684**	1,965
Accretion on GOB Obligation	**219**	–	**219**	–
Loss on marketable securities	**–**	506	**–**	545
Loss on call option	**–**	–	**–**	1,274
Other finance expenses	**1,563**	1,488	**2,903**	3,784

Other finance expenses for 2014 included accretion on decommissioning obligations of $1.3 million (2013 - $1.0 million) and accretion on the GOB Obligation of $0.2 million (2013 – nil). For the six months ended June 30, 2013, a loss of $1.3 million was recorded during the first quarter of 2013 in relation to the expiry and partial exercise of Perpetual's option to repurchase up to a 30 percent interest in Warwick Gas Storage LP ("WGS LP").

WGS LP income (loss) and dividends

For the six months ended June 30, 2014, Perpetual recorded a loss of $2.2 million on its equity investment in WGS LP compared to a gain of $0.5 million for the same period in 2013. Losses in WGS LP were primarily due to non-cash unrealized losses in relation to fair value adjustments recognized on WGS LP's gas storage obligation due to increased forward prices. There were no dividends declared or received during the six months ended June 30, 2014 or 2013.

Funds flow

	Three months ended June 30,			
		2014		2013
	($ thousands)	**($/boe)**	($ thousands)	($/boe)
Realized revenue (1)	**66,870**	**36.64**	58,460	32.60
Royalties	**(9,284)**	**(5.09)**	(7,388)	(4.12)
Operating expenses	**(18,234)**	**(9.99)**	(21,776)	(12.15)
Transportation costs	**(2,905)**	**(1.59)**	(2,733)	(1.52)
Operating netback (1)	**36,447**	**19.97**	26,563	14.81
GOB revenue (2)	**3,018**	**1.65**	3,696	2.06
Exploration and evaluation (3)	**(661)**	**(0.36)**	(753)	(0.42)
Cash G&A	**(5,379)**	**(2.95)**	(4,933)	(2.75)
Interest (3)	**(7,561)**	**(4.14)**	(7,287)	(4.06)
Funds flow (1)	**25,864**	**14.17**	17,286	9.64

	Six months ended June 30,			
		2014		2013
	($ thousands)	**($/boe)**	($ thousands)	($/boe)
Realized revenue (1)	**125,250**	**35.62**	102,427	29.81
Royalties	**(15,458)**	**(4.40)**	(9,864)	(2.87)
Operating expenses	**(40,001)**	**(11.38)**	(39,929)	(11.62)
Transportation costs	**(5,903)**	**(1.68)**	(5,088)	(1.48)
Operating netback (1)	**63,888**	**18.16**	47,546	13.84
GOB revenue (2)	**5,643**	**1.60**	5,248	1.53
Exploration and evaluation (3)	**(1,313)**	**(0.37)**	(1,396)	(0.41)
Cash G&A	**(10,141)**	**(2.88)**	(10,165)	(2.96)
Interest (3)	**(14,829)**	**(4.22)**	(14,413)	(4.20)
Funds flow (1)	**43,248**	**12.29**	26,820	7.80

(1) See "Non-GAAP measures" in this MD&A.

(2) Prior period amounts have been corrected as a result of the GOB Obligation being overstated and GOB revenue being understated. See note 2 of the Corporation's annual audited consolidated financial statements.

(3) Excludes non-cash items.

Funds flow increased 49 percent from the preceding first quarter to $25.9 million ($0.17 per share) for the quarter ended June 30, 2014. Similarly, funds flow increased 50 percent compared to $17.3 million ($0.12 per share) for the same period in 2013, both of which reflect the increase in operating netbacks.

Net income (loss)

	Three months ended June 30,			
		2014		2013
	($ thousands)	**($/boe)**	($ thousands)	($/boe)
Funds flow [1]	**25,864**	**14.17**	17,286	9.64
Unrealized gains (losses) on derivatives	**6,994**	**3.83**	6,536	3.65
Exploration and evaluation [3]	**(619)**	**(0.34)**	(1,091)	(0.61)
Compensation expense, non-cash	**(1,528)**	**(0.84)**	(715)	(0.40)
Gain on dispositions	**–**	**–**	84	0.05
Depletion and depreciation	**(24,492)**	**(13.42)**	(24,517)	(13.67)
Financial items, non-cash [2]	**(2,517)**	**(1.38)**	(2,368)	(1.32)
WGS LP net income (loss) and dividends	**(1,153)**	**(0.63)**	219	0.12
Net income (loss)	**2,549**	**1.39**	(4,566)	(2.54)

	Six months ended June 30,			
		2014		2013
	($ thousands)	**($/boe)**	($ thousands)	($/boe)
Funds flow [1]	**43,248**	**12.29**	26,820	7.80
Unrealized gains (losses) on derivatives	**(5,737)**	**(1.63)**	5,594	1.63
Call option premiums received	**–**	**–**	(953)	(0.28)
Exploration and evaluation [3]	**(983)**	**(0.28)**	(1,865)	(0.54)
Compensation expense, non-cash	**(2,669)**	**(0.76)**	(1,359)	(0.40)
Gain on dispositions	**5,622**	**1.60**	51,183	14.90
Depletion and depreciation	**(47,229)**	**(13.43)**	(46,209)	(13.45)
Financial items, non-cash [2]	**(4,788)**	**(1.36)**	(5,523)	(1.61)
WGS LP net income (loss) and dividends	**(2,239)**	**(0.64)**	510	0.15
Net income (loss)	**(14,775)**	**(4.21)**	28,198	8.20

(1) See "Non-GAAP measures" in this MD&A.

(2) Prior period amounts have been corrected as a result of the GOB Obligation being overstated and GOB revenue being understated. See note 2 of the Corporation's annual audited consolidated financial statements.

(3) Includes non-cash exploration and evaluation expense from expired leases and geological and geophysical costs.

The Corporation recorded net income of $2.5 million ($1.39 per boe) for the quarter ended June 30, 2014 compared to a net loss of $4.6 million ($2.54 per boe) for the same period in 2013 primarily as a result of higher funds flow in 2014. For the six months ended June 30, 2014, the Corporation recorded a net loss of 14.8 million ($4.21 per boe) compared to net income of $28.2 million ($8.20 per boe) in the same period in 2013, which included a large gain on the Elmworth property disposition and unrealized gains on financial derivatives.

SUMMARY OF QUARTERLY RESULTS

($ thousands, except as noted)	**Q2 2014**	Q1 2014	Q4 2013	Q3 2013
Financial				
Oil and natural gas revenues	**72,348**	64,754	49,075	52,555
Funds flow [(1)]	**25,864**	17,384	12,998	18,650
Per share – basic	**0.17**	0.12	0.09	0.13
Net income (loss) [(2)]	**2,549**	(17,324)	(13,745)	(6,833)
Per share – basic and diluted [(2) (3)]	**0.02**	(0.12)	(0.09)	(0.05)
Capital expenditures				
Exploration and development	**12,251**	31,340	24,537	22,325
Geological and geophysical	**218**	13	(19)	25
Acquisitions	**91**	151	418	532
Dispositions	**(3,000)**	–	(901)	(60)
Other	**108**	75	2	34
Net capital expenditures	**9,668**	31,579	24,037	22,856
Common shares (thousands)				
Weighted average – basic	**148,835**	148,448	148,489	148,382
Operating				
Daily average production				
Natural gas (MMcf/d)	**97.8**	92.1	90.3	85.3
Oil and NGL (bbl/d)	**3,738**	3,451	3,509	4,064
Total (boe/d)	**20,053**	18,794	18,559	18,274
Average prices				
Natural gas – before derivatives ($/Mcf)	**4.95**	4.90	3.37	2.79
Natural gas – including derivatives ($/Mcf)	**4.66**	4.35	3.62	3.31
Oil and NGL – before derivatives ($/bbl)	**83.08**	77.72	65.35	82.03
Oil and NGL – including derivatives ($/bbl)	**74.65**	72.06	65.88	76.86

(1) See "Non-GAAP measures" in this MD&A.

(2) Prior period amounts have been corrected as a result of the GOB Obligation being overstated and GOB revenue being understated. See note 2 of the Corporation's annual audited consolidated financial statements for the year ended December 31, 2013.

(3) Periods in which Perpetual has reported a net loss have an anti-dilutive impact on per share calculations resulting in per share amounts for basic and diluted reported as the same. Diluted per share amounts for periods where Perpetual has reported net income have been calculated based on the weighted average diluted shares of 157.6 million and 171.7 million for the second quarter of 2014 and the first quarter of 2013 respectively.

continued on next page

SUMMARY OF QUARTERLY RESULTS *continued*

($ thousands, except as noted)	Q2 2013	Q1 2013	Q4 2012	Q3 2012
Financial				
Oil and natural gas revenues	57,187	42,477	44,468	40,028
Funds flow [(1)]	17,286	9,534	11,158	10,760
Per share – basic	0.12	0.06	0.08	0.07
Net income (loss) [(2)]	(4,566)	32,764	(56,400)	(34,117)
Per share – basic [(2)]	(0.03)	0.22	(0.38)	(0.22)
– diluted [(2) (3)]	(0.03)	0.21	(0.38)	(0.22)
Capital expenditures				
Exploration and development	9,861	38,682	21,426	17,913
Geological and geophysical	499	774	(241)	9
Acquisitions	5,433	1,752	–	1,709
Dispositions	(84)	(77,930)	(6,923)	(16,207)
Other	19,162	51	23	44
Net capital expenditures	34,871	(36,671)	14,285	3,468
Common shares (thousands)				
Weighted average – basic	148,015	147,672	147,184	147,123
Operating				
Daily average production				
Natural gas (MMcf/d)	91.9	88.6	88.3	93.7
Oil and NGL (bbl/d)	4,384	3,483	3,536	3,336
Total (boe/d)	19,708	18,244	18,250	18,955
Average prices				
Natural gas – before derivatives ($/Mcf)	3.68	3.18	2.99	2.36
Natural gas – including derivatives ($/Mcf)	3.90	3.28	3.56	3.44
Oil and NGL – before derivatives ($/bbl)	66.18	54.74	62.02	64.24
Oil and NGL – including derivatives ($/bbl)	64.84	56.82	71.29	59.63

(1) See "Non-GAAP measures" in this MD&A.

(2) Prior period amounts have been corrected as a result of the GOB Obligation being overstated and GOB revenue being understated. See note 2 of the Corporation's annual audited consolidated financial statements for the year ended December 31, 2013.

(3) Periods in which Perpetual has reported a net loss have an anti-dilutive impact on per share calculations resulting in per share amounts for basic and diluted reported as the same. Diluted per share amounts for periods where Perpetual has reported net income have been calculated based on the weighted average diluted shares of 157.6 million and 171.7 million for the second quarter of 2014 and the first quarter of 2013 respectively.

LIQUIDITY, CAPITALIZATION AND FINANCIAL RESOURCES

The Corporation targets to maintain a strong capital base to retain investor, creditor and market confidence, and to sustain the future development of the business. The Corporation manages its capital structure and makes adjustments in light of changes in economic conditions and the risk characteristics of its underlying oil and natural gas assets. The Corporation considers its capital structure to include share capital, bank debt, senior notes, convertible debentures and adjusted working capital. In order to maintain or adjust the capital structure, the Corporation may from time to time issue shares or debt securities and adjust its capital spending to manage current and projected debt levels.

To strengthen the Corporation's financial position and address Perpetual's upcoming capital commitment to repay the 7.25% convertible debentures on January 31, 2015, the following transactions were executed at the end in the second quarter and beginning of the third quarter of 2014:

- On June 26, 2014, Perpetual completed the monetization of its future GOB credits for net proceeds of $18.5 million. Proceeds were applied to reduce bank indebtedness.
- On July 16, 2014, Perpetual sold a 50 percent royalty interest to a joint venture partner in current developed producing reserves in the East Edson area for $50.0 million consisting of $20 million of unrestricted cash that was applied to reduce bank indebtedness, with the remaining $30 million held in escrow to be used for development spending in East Edson. Concurrently, the joint venture partner will farm-in on the Wilrich formation in certain undeveloped lands restricted to the East Edson area, contributing $70.0 million to be held in escrow on behalf of the joint venture partner to be used toward drilling activities in East Edson.
- On July 23, 2014, Perpetual issued $125.0 million in senior unsecured notes, which bear interest at 8.75 percent annually and mature on July 23, 2019. The net proceeds from this issuance will be used to redeem with cash all of Perpetual's outstanding 7.25% Debentures, repay bank indebtedness, assist in the future repayment of its 7.00% Debentures and for general corporate purposes.

Capital management

($ thousands, except as noted)	**June 30, 2014**	December 31, 2013
Bank debt	**60,135**	70,618
Senior notes, measured at principal amount	**150,000**	150,000
Convertible debentures, measured at principal amount	**159,779**	159,779
Adjusted working capital deficiency (surplus) (1)	**(10,115)**	(3,417)
Net debt	**359,799**	376,980
Shares outstanding at end of period (thousands)	**149,636**	148,490
Market price at end of period	**2.21**	1.11
Market value of shares	**330,696**	164,824
Total capitalization (1)	**690,495**	541,804
Net debt as a percentage of total capitalization	**52.1**	69.6
Twelve months trailing funds flow (1)	**74,897**	58,468
Net debt to funds flow ratio (times) (2)	**4.8**	6.4

(1) See "Non-GAAP measures" in this MD&A.

(2) Net debt to funds flow is calculated based on trailing funds flow for the most recent four quarters.

The Corporation monitors capital based on the ratio of net debt to trailing 12 months ("TTM") funds flow. As at June 30, 2014, the Corporation's ratio of net debt to TTM funds flow decreased 25 percent to 4.8 to 1 (December 31, 2013 – 6.4 to 1). This ratio is monitored continuously by the Corporation and the targeted range of net debt to TTM funds flow varies based on such factors as acquisitions or dispositions, commodity prices, forecasts of future commodity prices, price management contracts, projected cash flows, dividends, capital expenditure programs and timing of such programs. As part of the management of this ratio, the Corporation prepares annual capital expenditure budgets and monthly funds flow forecasts, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment, acquisition and development activities and general industry conditions. Capital spending budgets are approved by the Board of Directors.

At June 30, 2014, Perpetual had net debt of $359.8 million, down $17.2 million from December 31, 2013. The reduction in net debt during the first six months of 2014 resulted from funds flow exceeding capital expenditures, combined with proceeds received from the monetization of GOB royalty credits and dispositions.

Perpetual's adjusted working capital surplus at June 30, 2014 was $10.1 million compared to a surplus of $3.4 million at December 31, 2013. The Corporation has an adjusted working capital surplus primarily due to declining accounts payable and accrued liabilities as a result of reduced capital spending from spring break up combined with lower operating and corporate costs and increased receivables from increased oil and gas revenues. From time to time the Corporation will have working capital deficiencies, in which case they are funded from future sales revenues and by additional credit facility borrowings as required.

Reconciliation of net debt ($ millions)	
Net debt, December 31, 2013 [(1)]	377.0
Capital expenditures [(2)]	44.0
Acquisitions, net of dispositions	(2.8)
Proceeds on GOB monetization	(18.5)
Funds flow [(1)]	(43.2)
Expenditures on decommissioning obligations	3.0
Other	0.3
Net debt, June 30, 2014 [(1)]	**359.8**

(1) See "Non-GAAP measures" in this MD&A.

(2) Capital expenditures consist of exploration and development including geological and geophysical costs.

Bank indebtedness

At June 30, 2014, Perpetual had $60.1 million outstanding on its credit facility, down $10.5 million from December 31, 2014 ($70.6 million). In addition to amounts outstanding under the credit facility, the Corporation has outstanding letters of credit in the amount of $6.9 million (December 31, 2013 – $5.9 million).

The Corporation's credit facility is with a syndicate of Canadian chartered banks. On May 6, 2014, the Corporation's lenders completed their semi-annual review of the borrowing base under the credit facility. The lenders advised that total availability under the facility will be increased to $130 million from $110 million, which consists of a demand loan of $115 million and a working capital facility of $15 million. On June 26, 2014, total availability under the credit facility was reduced to $120 million in conjunction with the monetization of GOB royalty credits. On July 23, 2014, the borrowing base was reduced by an additional $20 million to $100 million as a result of the issuance of $125 million senior unsecured notes. In conjunction with the issuance of new senior notes and redemption of the 7.25% Debentures, the Corporation's lenders approved an extension of the revolving feature to April 29, 2015 with a 182-day term to maturity should it not be extended. The next semi-annual redetermination of the Corporation's borrowing base will occur on or before October 30, 2014.

The Corporation has covenants that require consolidated debt and consolidated senior debt to TTM income before interest, taxes, depletion and depreciation and non-cash items to be less than 4 to 1 and 3 to 1, respectively. Consolidated debt is defined as the sum of the Corporation's period end balance of the credit facility, senior notes and outstanding letters of credit. Consolidated senior debt is defined as the sum of consolidated debt less the period end balance of the senior notes. The Corporation was in compliance with the lenders' covenants at June 30, 2014. Collateral for the credit facility is provided by a floating-charge debenture covering all existing and acquired property of the Corporation, as well as unconditional full liability guarantees from all subsidiaries in respect of amounts borrowed under the credit facility.

Advances under the credit facility are made in the form of Banker's Acceptances ("BA"), prime rate loans or letters of credit. In the case of BA advances, interest is a function of the BA rate plus a margin based on the Corporation's ratio of debt to TTM cash flow for the most recently completed reporting period. In the case of prime rate loans, interest is charged at the lenders' prime rate plus a margin. The effective interest rate on outstanding amounts at June 30, 2014 was 5.5 percent (December 31, 2013 – 5.5 percent).

Convertible debentures

At June 30, 2014, the Corporation had outstanding 7.25 percent convertible debentures (7.25% Debentures) that mature on January 31, 2015, as well as 7.0 percent convertible debentures (7.0% Debentures) that mature on December 31, 2015. While the 7.0% Debentures remain a long term liability, the 7.25% Debentures have been classified as a current liability at June 30, 2014.

All series of convertible debentures are repayable on the maturity date in cash or in shares, at the option of Perpetual. Additional information on convertible debentures is as follows:

Convertible debentures	7.25%	7.00%
Principal issued ($ millions)	100.0	60.0
Principal outstanding ($ millions)	99.9	59.9
Trading symbol on the Toronto Stock Exchange	PMT.DB.D	PMT.DB.E
Maturity date	January 31, 2015	December 31, 2015
Conversion price ($ per share)	7.50	7.00
Fair market value ($ millions) [(1)]	100.1	60.4

(1) Fair values of debentures are calculated by multiplying the number of debentures outstanding at August 7, 2014 by the quoted market price per debenture at that date.

The Corporation has the option to settle all or a portion of the outstanding 7.25% Debentures and 7.00% Debentures through the issuance of shares by giving notice of such intent to debenture holders not more than 60 and not less than 30 days prior to the maturity date. On July 23, 2014, Perpetual gave notice to debenture holders that the 7.25% Debentures will be settled in cash with proceeds received from the $125 million senior unsecured notes. Settlement of the 7.25% Debentures is expected to occur on or about August 25, 2014. Redemption of the total principal amount of $99.9 million and accrued interest of $0.5 million will be funded from proceeds on the issuance of new senior notes.

Management is evaluating repayment options for the 7.00% Debentures including utilizing excess funds flow and bank indebtedness, asset dispositions, refinancing, or a combination thereof. The issue of senior unsecured notes in July 2014 resulted in proceeds of $125 million, leaving $25 million of excess proceeds after redemption of the 7.25% Debentures. The excess $25 million of proceeds will assist in the repayment of the 7.25% Debentures. There is no assurance that the Corporation will be able to raise additional capital to settle all or a portion of the outstanding 7.00% Debentures in cash, in which case, the Corporation would have the option to settle all or a portion of the debentures with common shares.

Senior notes

At June 30 2014, Perpetual had $150 million of senior notes outstanding which mature on March 15, 2018 and bear interest at 8.75 percent, payable semi-annually ("2011 Senior Notes"). The senior notes are direct senior unsecured obligations of Perpetual ranking pari passu with all other present and future unsecured and unsubordinated indebtedness of the Corporation. The senior notes are carried on the statement of financial position at the par value less unamortized debt issue costs. The fair market value of the senior notes at August 7, 2014 was $151.9 million.

As part of the senior notes indenture and the credit facility, the Corporation has covenants that require the ratios of consolidated debt and consolidated senior debt to 12-month trailing income before interest, taxes, depletion and depreciation and non-cash items to be less than 4 to 1 and 3 to 1, respectively. Consolidated debt is defined as the sum of the balance on the credit facility, senior notes and outstanding letters of credit. Consolidated senior debt is defined as consolidated debt less the senior notes. Perpetual was in compliance with these covenants at June 30, 2014. The senior notes indenture also contains restrictions on certain payments including dividends, retirement of subordinated debt and stock repurchases. The permitted amount of any restricted payment is limited to:

- The extent the Corporation's consolidated debt to cash flow ratio is less than 3 to 1 pro forma for the proposed restricted payment, the sum of 50 percent of cash flow from operating activities from January 1, 2011 to the end of the most recently completed fiscal quarter plus 100 percent of the fair market value of any equity contributions made to the Corporation during that period less the sum of all restricted payments during that period.
- The extent the Corporation's consolidated debt to cash flow ratio is greater than or equal to 3 to 1 pro forma for the proposed restricted payment, $50 million plus 100 percent of the fair market value of any equity contributions made to the Corporation.

On July 23, 2014, the Corporation issued $125.0 million in new senior notes ("2014 Senior Notes"). The 2014 Senior Notes mature on July 23, 2019 and bear interest at 8.75 percent, payable semi-annually on January 23 and July 23 of each year beginning on January 23, 2015. Covenants related to the 2014 Senior Notes are the same as the existing 2011 Senior Notes.

Equity

Perpetual's total capitalization was $690.5 million at June 30, 2014. Net debt to total capitalization decreased to 52 percent from 70 percent at December 31, 2013. The decrease was driven by a 99 percent increase in market value of Perpetual's common shares combined with lower net debt levels from an increase in funds flow over capital spending and proceeds received from the monetization of GOB credits.

Basic weighted average shares outstanding for the six months ended June 30, 2014 totaled 148.6 million (2013 – 147.9 million). On August 7, 2014 there were 149.8 million shares outstanding.

2014 OUTLOOK

Perpetual's top five strategic priorities for 2014 are:

1. Reduce debt and manage downside risks;
2. Grow Edson liquids-rich gas production, reserves, cash flow, inventory and value;
3. Maximize value of Mannville heavy oil;
4. Maximize cash flow from shallow gas; and
5. Advance and broaden portfolio of high impact opportunities with risk-managed investment.

The Corporation's focus on these five strategic priorities in the first half of 2014 has led to increases in production, reserves, revenues and funds flow and, at the same time, significantly improved liquidity compared to the prior year. The recent transactions that closed subsequent to the second quarter, the East Edson royalty sale and farmout arrangement, provide a foundation for further rapid growth. In addition, the issuance of new high yield notes provides certainty with respect to the repayment of the 7.25% Debentures, terming out debt capacity through to July 2019.

Closing of the East Edson arrangement in July 2014 is accelerating the development of the Corporation's East Edson asset. Activities are underway to execute close to $70 million in capital projects utilizing the funds from escrow accounts established at the closing of the East Edson royalty sale and farmout transaction on July 16, 2014 prior to the end of 2014, with the remaining funds from escrow expected to be spent in 2015. Excluding the East Edson capital program, Perpetual continues to target other capital spending in 2014 to be fully funded by 2014 funds flow. The table below summarizes expected capital spending and planned drilling activities in accordance with Perpetual's 2014 strategic priorities for the remainder of 2014.

Capital expenditures for second half of 2014	$ millions	# of Wells
West Central liquids-rich gas	28	9 (4.5 net)
East Edson joint venture [(1)]	81	13 (13.0 net)
Mannville heavy oil	15	7 (6.1 net)
Shallow gas	2	–
Abandonment and reclamation	2	–
	128	29 (23.6 net)

(1) Includes $70 million to be funded through the East Edson partner from funds held in escrow.

Planned capital spending on the East Edson property of $81 million is underway and includes drilling 13 (13.0 net) wells in the last half of 2014 as well as initial facility spending on equipment for a new 30 MMcf/d East Edson plant to be constructed in 2015. At West Edson, Perpetual plans to spend $28 million during the second half of 2014 for the drilling of up to 9 (4.5 net) wells. Currently two drilling rigs are active at West Edson to grow production to the fully expanded plant capacity of 60 MMcf/d (30 MMcf/d net) early in the third quarter and maintain these production levels for the remainder of the year and into 2015. Perpetual is also participating in two (0.1 net) wells operated by a third party which are not included in the numbers above.

Execution of the Mannville heavy oil drilling program is underway with seven (6.1 net) horizontal wells to be drilled early in the third quarter of 2014, including development locations in two recent new pool discoveries. Capital will also be directed to water handling and injection projects to expand the waterflood pilot in the Mannville I2I pool and begin pressure maintenance through waterflood on two additional pools in the Mannville area.

The capital program also includes continued activities focused on maximizing value and mitigating production declines on the Corporation's legacy shallow gas assets through facility optimization projects, workovers and uphole recompletions.

Based on these forecast activities, Perpetual estimates full year 2014 production will average approximately 20,100 boe/d. The enhanced heat content of Perpetual's liquids-rich gas in West Central Alberta results in premium pricing to AECO market prices. Perpetual expects to average 41 to 43 MMcf/d of gas production in the greater Edson area, where the average heat content is estimated at 1.18 GJ/Mcf.

Funds flow sensitivities

The following table shows Perpetual's estimated 2014 funds flow at various second half 2014 commodity prices:

Projected 2014 funds flow (2) ($ millions)		**AECO gas price ($/GJ)** (1)				
		$3.00	**$3.50**	**$4.00**	**$4.50**	**$5.00**
WTI price (US$/bbl) (1)	**$85.00**	73	76	80	83	87
	$95.00	76	79	83	86	90
	$100.00	77	80	84	87	91
	$105.00	77	80	84	87	91
	$115.00	78	81	85	88	92

(1) The current settled and forward average AECO and WTI prices for July to December 2014 as of August 7, 2014 were $3.96 per GJ and US$98.57 per bbl, respectively.

(2) See "Non-GAAP measures" in this MD&A.

CORPORATE GOVERNANCE

The Corporation is committed to maintaining high standards of corporate governance. Each regulatory body, including the Toronto Stock Exchange and the Canadian provincial securities commissions, has a different set of rules pertaining to corporate governance. The Corporation fully conforms to the rules of the governing bodies under which it operates.

FUTURE ACCOUNTING PRONOUNCEMENTS

Perpetual will be required to adopt IFRS 9, "Financial Instruments" which establishes principles for the disclosure of financial assets and financial liabilities that will present information that is useful for the assessment of the amounts, timing and uncertainty of an entity's future cash flows. The IFRS is applicable to all items that fall within the scope of IAS 39, "Financial Instruments: Recognition and Measurement". This IFRS is effective for annual periods commencing on or after January 1, 2018 and is to be applied retrospectively. The Corporation intends to adopt IFRS 9 in its financial statements for the annual period beginning January 1, 2018.

Perpetual has not applied this standard as of June 30, 2014. The Corporation is currently evaluating the impact that adoption will have on the consolidated financial statements.

INTERNAL CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures

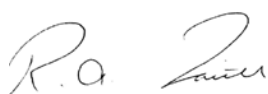
The Corporation's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of disclosure controls and procedures and internal control over financial reporting defined in Canada under National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings. There were no changes in the Corporation's internal control over financial reporting during the period beginning on January 1, 2014 and ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

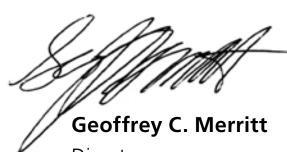
As at	June 30, 2014	December 31, 2013
(Cdn$ thousands, unaudited)		
Assets		
Current assets		
Restricted cash (note 4)	**$ 12,000**	$ –
Accounts receivable	**43,278**	36,099
Prepaid expenses and deposits	**1,759**	1,369
Derivatives (notes 11 and 12)	**-**	326
Assets held for sale (note 4)	**19,168**	-
	76,205	37,794
Long term Crown receivable	**-**	10,997
Derivatives (notes 11 and 12)	**-**	19
Property, plant and equipment (note 5)	**555,961**	576,954
Exploration and evaluation (note 6)	**89,434**	88,177
Equity-method investment	**26,108**	28,347
Total assets	**$ 747,708**	$ 742,288
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**$ 46,933**	$ 45,059
Derivatives (notes 11 and 12)	**10,868**	6,468
Bank indebtedness (note 7)	**60,135**	70,618
Convertible debentures (note 8)	**98,914**	-
Financial obligation (note 10)	**5,367**	-
	222,217	122,145
Derivatives (notes 11 and 12)	**3,770**	2,778
Senior notes (note 9)	**147,991**	147,719
Convertible debentures	**57,195**	154,496
Financial obligation (note 10)	**13,087**	-
Gas over bitumen obligation	**3,167**	2,948
Decommissioning obligation	**214,336**	213,906
Total liabilities	**661,763**	643,992
Equity		
Share capital	**1,258,403**	1,257,315
Shares held in trust (note 14)	**(251)**	-
Equity component of convertible debentures	**13,971**	13,971
Contributed surplus	**23,061**	21,474
Deficit	**(1,209,239)**	(1,194,464)
Total equity	**85,945**	98,296
Total liabilities and equity	**$ 747,708**	$ 742,288

Subsequent events (notes 4, 7, 8 and 9)

See accompanying notes. The notes are an integral part of the Corporation's condensed interim consolidated financial statements.



Robert A. Maitland
Director



Geoffrey C. Merritt
Director

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	**2014**	2013
(Cdn$ thousands, except per share amounts, unaudited)		(note 2)		(note 2)
Revenue				
Oil and natural gas	**$ 72,348**	$ 57,187	**$ 137,102**	$ 99,664
Royalties	**(9,284)**	(7,388)	**(15,458)**	(9,864)
	63,064	49,799	**121,644**	89,800
Change in fair value of commodity price derivatives (note 12)	**1,516**	7,809	**(17,589)**	7,404
Gas over bitumen	**3,018**	3,696	**5,643**	5,248
	67,598	61,304	**109,698**	102,452
Expenses				
Production and operating	**18,234**	21,776	**40,001**	39,929
Transportation	**2,905**	2,733	**5,903**	5,088
Exploration and evaluation (note 6)	**1,280**	1,844	**2,296**	3,261
General and administrative	**6,907**	5,648	**12,810**	11,524
Gain on dispositions	**-**	(84)	**(5,622)**	(51,183)
Depletion and depreciation (note 5)	**24,492**	24,517	**47,229**	46,209
Income from operating activities	**13,780**	4,870	**7,081**	47,624
Finance expenses (note 13)	**(10,078)**	(9,655)	**(19,617)**	(19,936)
Share of net income (loss) of equity-method investment	**(1,153)**	219	**(2,239)**	510
Net income (loss) and comprehensive income (loss)	**$ 2,549**	$ (4,566)	**$ (14,775)**	$ 28,198
Income (loss) per share (note 15)				
Basic	**$ 0.02**	$ (0.03)	**$ (0.10)**	$ 0.19
Diluted	**$ 0.02**	$ (0.03)	**$ (0.10)**	$ 0.19

See accompanying notes. The notes are an integral part of the Corporation's condensed interim consolidated financial statements.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Cdn$ thousands, unaudited)	Share capital	Shares held in trust	Equity component of convertible debentures	Contributed surplus	Deficit	Total equity
Balance at December 31, 2013	$ 1,257,315	–	$ 13,971	$ 21,474	$ (1,194,464)	$ 98,926
Net loss	–	–	–	–	(14,775)	(14,775)
Common shares issued pursuant to share based compensation plans	1,088	–	–	(1,082)	–	6
Share based compensation expense	–	–	–	2,669	–	2,669
Shares purchased and held in trust (note 14)	–	(251)	–	–	–	(251)
Balance at June 30, 2014	**$ 1,258,403**	**$ (251)**	**$ 13,971**	**$ 23,061**	**$(1,209,239)**	**$ 85,945**

(Cdn$ thousands, unaudited)	Share capital	Shares held in trust	Equity component of convertible debentures	Contributed surplus	Deficit	Total equity
Balance at December 31, 2012	$ 1,255,450	–	$ 13,988	$ 19,308	$ (1,202,084)	86,662
Net income	–	–	–	–	28,198	28,198
Common shares issued pursuant to share based compensation plans	1,549	–	–	(1,529)	–	20
Share based compensation expense	–	–	–	1,359	–	1,359
Share based payment liability	–	–	–	12	–	12
Redemption of convertible debentures	–	–	(9)	9	–	–
Balance at June 30, 2013	$ 1,256,999	–	$ 13,979	$ 19,159	$ (1,173,886)	$ 116,251

See accompanying notes. The notes are an integral part of the Corporation's condensed interim consolidated financial statements.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	**2014**	2013
(Cdn$ thousands, unaudited)				
Cash flows from operating activities				
Net income (loss)	**$ 2,549**	$ (4,566)	**$ (14,775)**	$ 28,198
Adjustments to add (deduct) non-cash items:				
Depletion and depreciation	**24,492**	24,517	**47,229**	46,209
Exploration and evaluation (note 6)	**401**	592	**752**	592
Share based compensation expense	**1,528**	715	**2,669**	1,359
Change in fair value of commodity price derivatives	**(6,994)**	(6,536)	**5,737**	(5,594)
Finance expenses	**2,517**	2,368	**4,788**	5,523
Share of net (income) loss of equity-method investment	**1,153**	(219)	**2,239**	(510)
Gain on dispositions	**–**	(84)	**(5,622)**	(51,183)
Call option premiums received	**–**	–	**–**	953
Long term Crown receivable adjustments	**8,225**	(730)	**10,997**	(1,144)
Expenditures on decommissioning obligations	**(628)**	(62)	**(3,029)**	(464)
Change in non-cash working capital	**(10,638)**	584	**(13,848)**	(1,776)
Net cash from operating activities	**22,605**	16,579	**37,137**	22,163
Cash flows from (used in) financing activities				
Change in bank indebtedness	**(15,162)**	(5,181)	**(10,483)**	(19,113)
Transactions with trustee	**–**	–	**(251)**	–
Redemption of convertible debentures	**–**	(102)	**–**	(102)
Common shares issued	**6**	20	**6**	20
Proceeds on financial obligation (note 10)	**18,454**	–	**18,454**	–
Change in non-cash working capital	**4,035**	6,135	**(54)**	2,029
Net cash from (used in) financing activities	**7,333**	872	**7,672**	(17,166)
Cash flows used in investing activities				
Acquisitions	**(91)**	(5,466)	**(242)**	(7,269)
Capital expenditures	**(12,359)**	(9,861)	**(43,774)**	(48,543)
Proceeds on dispositions	**3,000**	84	**3,000**	78,014
Increased interest in equity method investment	**–**	(19,129)	**–**	(19,129)
Change in non-cash working capital	**(20,488)**	(13,072)	**(3,793)**	(8,070)
Net cash used in investing activities	**(29,938)**	(47,444)	**(44,809)**	(4,997)
Change in cash	**–**	(29,993)	**–**	–
Cash, beginning of period	**–**	29,993	**–**	–
Cash, end of period	**$ –**	$ –	**$ –**	$ –
Interest paid	**$ 3,409**	$ 3,319	**$ 14,903**	$ 14,656

See accompanying notes. The notes are an integral part of the Corporation's condensed interim consolidated financial statements.

SELECTED NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2014

(All tabular amounts are in Cdn$ thousands, except where otherwise noted)

1. REPORTING ENTITY

Perpetual Energy Inc. ("Perpetual" or the "Corporation") is a Canadian corporation engaged in the exploration, development, and marketing of oil and gas based energy in Alberta, Canada. The Corporation operates a diversified asset portfolio that includes conventional heavy oil, resource-style tight gas, liquids-rich gas in the Alberta deep basin, and several long-term bitumen resource properties.

The address of the Corporation's registered office is 3200, 605 – 5 Avenue S.W., Calgary, Alberta, T2P 3H5.

The condensed interim financial statements of the Corporation as at and for the three and six months ended June 30, 2014 are comprised of the accounts of Perpetual and its wholly owned subsidiaries, Perpetual Energy Operating Corp. and Perpetual Operating Trust, which are incorporated in Canada.

2. CORRECTION OF PRIOR PERIOD AMOUNTS

Perpetual receives temporary assistance under the Natural Gas Royalty Regulation as a result of its working interest in a number of natural gas wells which have been shut-in pursuant to shut-in orders issued by the Government of Alberta. The gas over bitumen Royalty Adjustments ("GOB Royalty Adjustments") are paid to operators through a credit against their crown royalty invoice, and are subject to repayment provisions should a well return to production (the "GOB Obligation"). The repayment of the GOB Obligation is structured as a gross overriding royalty ("GORR") with a maximum GOB Obligation equal to the GOB Royalty Adjustments received for the well. The GOB Obligation is measured at the discounted amount of the Corporation's best estimate of the expected repayments of the GOB Royalty Adjustments.

Prior to the year ended December 31, 2013, Perpetual had recognized the full amount of the GOB Royalty Adjustments received as a GOB Obligation, rather than the discounted amount of the expected GORR, as management initially expected that the full amount of the GOB Royalty Adjustments received would be fully repayable. Since the full amount of the GOB Royalty Adjustments received were recorded as a GOB Obligation, Perpetual did not recognize any of the GOB Royalty Adjustments as GOB revenue in earnings unless the GOB Royalty Adjustments related to shut-in wells that had been sold, where the related GOB Obligation was transferred to the purchaser under the respective purchase and sale agreement.

During preparation of the consolidated financial statements for the year ended December 31, 2013, Perpetual determined that:

i) The GOB Obligation at January 1 and December 31, 2012 was overstated when compared to the discounted amount of expected repayments of the GOB Royalty Adjustments through the GORR. Accordingly, management determined that the previous GOB Obligation was not being accounted for correctly, and was overstated given that the full undiscounted amount of the GOB Royalty Adjustments were recognized as a provision (GOB Obligation) even though the full amount was unlikely to be repaid based on the discounted amount of the future GORR.

ii) As a result of recording the GOB Royalty Adjustments received or due as an obligation, the gas over bitumen revenue was understated for the period ended June 30, 2013 and prior years. Previously, no gas over bitumen revenue was recognized unless it related to shut-in wells that had been sold, where entitlement to the royalty adjustment was retained but the obligation for repayment had been transferred to the purchaser.

The comparative financial information as at January 1 and December 31, 2012 and for the year ended December 31, 2012 in the Corporation's consolidated financial statements as at and for the year ended December 31, 2013 was previously restated. The effect of the correction in the consolidated statement of loss and comprehensive loss for the three and six months ended June 30, 2013 is as follows:

	Three months ended June 30, 2013			Six months ended June 30, 2013		
	As reported	Adjustments	Adjusted	As reported	Adjustments	Adjusted
Gas over bitumen revenue	2,935	761	3,696	4,055	1,193	5,248
Net income and comprehensive income	(5,327)	761	(4,566)	27,005	1,193	28,198
Net income per share – basic	(0.04)	0.01	(0.03)	0.18	0.01	0.19
Net income per share – diluted	(0.04)	0.01	(0.03)	0.18	0.01	0.19

3. BASIS OF PREPARATION

These condensed interim consolidated financial statements are unaudited and have been prepared in accordance with IAS 34 Interim Financial Reporting and do not include all of the information required for full annual financial statements. These condensed interim consolidated financial statements should be read in conjunction with the Corporation's consolidated financial statements as at and for the year ended December 31, 2013 which were prepared in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Except for the newly adopted policies described below, the accounting policies, basis of measurement, and critical accounting judgments and significant estimates used to prepare the annual consolidated financial statements as at and for the year ended December 31, 2013 have been applied in the preparation of these interim consolidated financial statements.

These condensed interim consolidated financial statements of the Corporation were approved and authorized for issue by the Board of Directors on August 7, 2014.

Newly adopted accounting policies

The accounting policies applied by the Corporation in these condensed interim consolidated financial statements are the same as those applied in preparation of the consolidated annual financial statements as at and for the year ended December 31, 2013 with the exception of the following new policies adopted on January 1, 2014:

i) Shares held in trust

The Corporation has a compensation program whereby employees may be entitled to receive shares of the Corporation purchased on the open market by a trustee controlled by Perpetual. Shares acquired and held by the trustee for the benefit of employees that have not yet been issued to employees are presented as a separate category of equity. The balance of shares held in trust represents the cumulative cost of shares held by the trustee. Upon the issuance of shares to the employee, the amount attributable to an employee is deducted from the balance of shares held in trust and transferred to share capital along with the associated compensation benefit recognized in contributed surplus.

ii) New pronouncements

a) IFRIC 21, "Levies" provides guidance on accounting for levies in accordance with the requirements of IAS 37, *Provisions, Contingent Liabilities and Contingent Assets.* The interpretation defines a levy as an outflow from an entity imposed by a government in accordance with legislation and states that levies do not arise from executory contracts or other contractual arrangements. The interpretation also confirms that an entity recognizes a liability for a levy only when the triggering event specified in the legislation occurs. This IFRIC is effective for annual periods commencing on or after January 1, 2014 and is to be applied retrospectively. The Corporation has adopted IFRIC 21 in its financial statements for the annual period beginning January 1, 2014.

b) IAS 32, "Financial Instruments: Presentation" was amended to provide further criteria on the legal right and intention to offset financial assets and financial liabilities. The Corporation has adopted the amended IAS 32 in its financial statements for the annual period beginning January 1, 2014.

Adoption of these standards and amendments has had no measurement or disclosure impact on the Corporation's interim consolidated financial statements.

4. ASSETS HELD FOR SALE

As at	June 30, 2014
Property, plant and equipment (note 5)	**18,013**
Exploration and evaluation (note 6)	**1,155**
	19,168

During the second quarter of 2014 the Corporation executed definitive agreements with a partner for a portion of lands in the East Edson area of the Corporation's West Central CGU which have been presented as assets held for sale measured at the lower of cost and fair value less costs to sell, as at June 30, 2014. An arrangement was established which provides Perpetual with additional capital to accelerate the development of the East Edson property in exchange for the disposition of a portion of Perpetual's interest by granting gross overriding royalties to the partner.

On July 16, 2014, the Corporation closed the East Edson arrangement. The agreements establish a 50 percent royalty interest in current developed producing reserves in the East Edson area for cash consideration of $50 million. On June 25, 2014 Perpetual received a $12 million non-refundable deposit which was placed in escrow. Upon closing the balance of the proceeds were received. Total proceeds consist of $20 million of unrestricted cash with the remaining $30 million held in escrow to be used to drill, complete and tie-in approximately five wells in the East Edson property prior to December 31, 2015. The partner also contributed $70 million to an escrow account for the drilling, completion and tie-in of approximately 14 wells pursuant to a farm-in agreement.

In conjunction with the arrangement the Corporation has additional capital commitments totaling $60 million following spending of the $70 million farm-in investment by the partner. Including $30 million to drill, complete and tie-in approximately six more wells prior to December 31, 2022 and an estimated $30 million for the construction of a new gas plant expected to be completed by September 1, 2015.

5. PROPERTY, PLANT AND EQUIPMENT

	Oil and gas properties	Corporate assets	Total
Cost			
December 31, 2012	2,473,440	6,287	2,479,727
Additions	93,180	120	93,300
Change in decommissioning obligations estimates	2,182	–	2,182
Transferred from exploration and evaluation	1,426	–	1,426
Acquisitions	808	–	808
Dispositions	(8,952)	–	(8,952)
Reclassification to assets held for sale	(1,581)	–	(1,581)
December 31, 2013	2,560,503	6,407	2,566,910
Additions	43,367	183	43,550
Transferred from exploration and evaluation	675	–	675
Acquisitions	54	–	54
Dispositions	(30)	–	(30)
Reclassification to assets held for sale (note 4)	(28,040)	–	(28,040)
June 30, 2014	**2,576,529**	**6,590**	**2,583,119**
Accumulated depletion, depreciation and impairment losses			
December 31, 2012	(1,903,831)	(5,481)	(1,909,312)
Depletion and depreciation	(92,380)	(497)	(92,877)
Dispositions	7,062	–	7,062
Impairment reversal	5,171	–	5,171
December 31, 2013	(1,983,978)	(5,978)	(1,989,956)
Depletion and depreciation	(47,079)	(150)	(47,229)
Reclassification to assets held for sale (note 4)	10,027	–	10,027
June 30, 2014	**(2,021,030)**	**(6,128)**	**(2,027,158)**
Carrying amount			
December 31, 2013	576,525	. 429	576,954
June 30, 2014	**555,499**	**462**	**555,961**

At June 30, 2014, property, plant and equipment included $6.1 million (December 31, 2013 – $7.9 million) of costs currently not subject to depletion and $19.6 million (December 31, 2013 – $19.6 million) of costs related to shut-in gas over bitumen reserves which are not being depleted due to the non-producing status of the wells in the affected properties.

6. EXPLORATION AND EVALUATION

	June 30, 2014	December 31, 2013
Balance, beginning of period	**88,177**	80,494
Additions	**999**	5,617
Acquisitions	**6,188**	7,400
Dispositions	**(3,348)**	–
Non-cash exploration and evaluation expense	**(752)**	(2,715)
Transferred to property, plant and equipment	**(675)**	(1,426)
Reclassification to assets held for sale (note 4)	**(1,155)**	(1,193)
Balance, end of period	**89,434**	88,177

During the six months ended June 30, 2014, $1.5 million (2013 - $2.7 million) in costs were charged directly to exploration and evaluation expense in net income.

7. BANK INDEBTEDNESS

The Corporation's credit facility is with a syndicate of Canadian chartered banks. On May 6, 2014, the Corporation's lenders completed their semi-annual review of the borrowing base under the credit facility. The lenders advised that total availability under the facility will be increased to $130 million from $110 million which consists of a demand loan of $115 million and a working capital facility of $15 million. On June 26, 2014, total availability under the credit facility was reduced to $120 million in conjunction with the monetization of the Corporation's gas over bitumen royalty credits (see note 10). On July 23, 2014, in conjunction with the issuance of new senior notes, the Corporation's credit facility was further reduced from $120 million to $100 million to adjust for future interest payments that will be required pursuant to terms of the senior notes (see note 9). At June 30, expiration of the revolving feature of the credit facility was set to expire on October 31, 2014. In conjunction with the issuance of new senior notes and redemption of the 7.25% convertible debentures (see note 8), the Corporation's lenders approved an extension of the revolving feature to April 29, 2015 with a 182 day term to maturity should it not be extended. The next semi-annual redetermination of the Corporation's borrowing base will occur on or before October 30, 2014.

The Corporation has covenants that require consolidated debt and consolidated senior debt to twelve month trailing income before interest, taxes, depletion and depreciation and non-cash items to be less than 4.0 to 1.0 and 3.0 to 1.0, respectively. Consolidated debt is defined as the sum of the Corporation's period end balance of the credit facility, senior notes and outstanding letters of credit. Consolidated senior debt is defined as the sum of consolidated debt less the period end balance of the senior notes. The Corporation was in compliance with the lender's covenants at June 30, 2014. In addition to amounts outstanding under the credit facility, the Corporation has outstanding letters of credit in the amount of $6.9 million (December 31, 2013 – $5.9 million). Collateral for the credit facility is provided by a floating-charge debenture covering all existing and acquired property of the Corporation, as well as unconditional full liability guarantees from all subsidiaries in respect of amounts borrowed under the credit facility.

Advances under the credit facility are made in the form of Banker's Acceptances ("BA"), prime rate loans or letters of credit. In the case of BA advances, interest is a function of the BA rate plus a margin based on the Corporation's ratio of debt to twelve months trailing cash flow for the most recently complete reporting period. In the case of prime rate loans, interest is charged at the lenders' prime rate plus a margin. The effective interest rate on outstanding amounts at June 30, 2014 was 5.5 percent (December 31, 2013 – 5.5 percent).

8. CONVERTIBLE DEBENTURES

The Corporation's 7.25% Convertible Debentures amended on December 17, 2009, which trade under the symbol PMT.DB.D, mature on January 31, 2015, bear interest at 7.25 percent per annum paid semi-annually on January 31 and July 31 of each year and are subordinated to substantially all other liabilities of the Corporation including the credit facility and senior notes. The 7.25% Convertible Debentures are convertible at the option of the holder into common shares at any time prior to the maturity date at a conversion price of $7.50 per common share. This series of debentures was re-classified to current in the first quarter of 2014.

On July 23, 2014, the Corporation provided notice for redemption of all of the outstanding 7.25% Convertible Debentures on August 25, 2014. Redemption of the total principal amount of $99.9 million and accrued interest of $0.5 million will be funded from proceeds on the issuance of new senior notes (see note 9).

9. SENIOR NOTES

On March 15, 2011, the Corporation issued $150.0 million in senior notes. The senior notes are direct senior unsecured obligations of Perpetual, ranking pari passu with all other present and future unsecured and unsubordinated indebtedness of the Corporation. The senior notes have a cross-default provision with the Corporation's credit facility which require consolidated debt and consolidated senior debt to twelve month trailing income before interest, taxes and depletion and depreciation to be less than 4.0 to 1.0 and 3.0 to 1.0, respectively (see note 7).

The senior notes indenture also contains restrictions on certain payments including dividends, retirement of subordinated debt and stock repurchases. The permitted amount of any restricted payment is limited to:

i) To the extent the Corporation's consolidated debt to cash flow ratio is less than 3.0 to 1.0 pro forma for the proposed restricted payment, the sum of 50 percent of cash flow from operating activities from January 1, 2011 to the end of the most recently completed fiscal quarter plus 100 percent of the fair market value of any equity contributions made to the Corporation during that period less the sum of all restricted payments during that period.

ii) To the extent the Corporation's consolidated debt to cash flow ratio is greater than or equal to 3.0 to 1.0 pro forma for the proposed restricted payment, $50 million plus 100 percent of the fair market value of any equity contributions made to the Corporation.

The Corporation was in compliance with the lenders' covenants at June 30, 2014.

The senior notes mature on March 15, 2018 and bear interest at 8.75 percent, payable semi-annually on September 15 and March 15 of each year beginning on September 15, 2011. The Corporation can redeem at a premium to face value, with equity proceeds from common share offerings, up to 35 percent of the principal amount of the senior notes prior to March 15, 2015. The Corporation can repay the senior notes at any time on or after March 15, 2015 to maturity date at a premium to face value based on date of repayment. At June 30, 2014 the senior notes are presented net of $2.0 million in issue costs which are amortized using an effective interest rate of 9.1 percent.

On July 23, 2014, the Corporation issued $125.0 million in senior notes. The senior notes mature on July 23, 2019 and bear interest at 8.75 percent, payable semi-annually on January 23 and July 23 of each year beginning on January 23, 2015. Covenants related to the new senior notes are the same as the existing 2011 senior notes.

10. FINANCIAL OBLIGATION

On June 26, 2014, the Corporation entered into an agreement to whereby the Corporation received cash proceeds of $18.5 million in exchange for an obligation to make a monthly cash payment equivalent to substantially all of the Corporation's monthly GOB Royalty Adjustment entitlements until final expiries in June 2021. Monthly payments under the arrangement are due on the 25th day following the entitlement month.

At the inception of the arrangement, the estimated future payments were determined using the same formula as the Corporation's monthly GOB Royalty Adjustment entitlements under the Alberta Natural Gas Royalty Regulation based on a January 1, 2014 forecast for the Alberta gas reference price ("base cash payment"). In the event that the actual Alberta gas reference price for a month results in the actual monthly cash payment under the arrangement to differ from the base cash payment, the Corporation is required to (a) pay 65 percent of any increase from the base cash payment, or (b) deduct 100 percent of any decrease from the base cash payment. This financial obligation is a hybrid financial instrument comprising a debt host with an embedded derivative related to indexation of the future cash payments to changes in the future Alberta gas reference price. The Corporation has designated the financial obligation as a financial liability which is measured at fair value through profit and loss. There has been no change in the fair value of the financial obligation since the inception of the agreement.

Security for the financial obligation is provided by an interest in certain lands of the Corporation and by the Corporation's entitlement to future GOB Royalty Adjustments.

11. COMMODITY AND FOREIGN EXCHANGE CONTRACTS

Realized losses on commodity price derivatives recognized in net income for the six months ended June 30, 2014 were $11.9 million (2013 – gains of $1.8 million). The realized losses on commodity price derivatives for the six months ended June 30, 2014, included gains of $0.4 million in respect of the settlement of contracts prior to maturity (2013 – nil).

Natural gas contracts

At June 30, 2014, the Corporation had entered into financial and forward natural gas sales arrangements at AECO as follows:

Term	Perpetual sold/bought	Volumes at AECO (GJ/d)	Average price ($/GJ)	Type of contract
July 2014	Sold	7,914	4.32	Financial
July 2014 – October 2014	Sold	26,100	4.02	Financial
July 2014 – October 2014	Sold	5,275	4.06	Physical
July 2014 – December 2014	Sold	32,500	4.09	Financial
November 2014 – December 2014	Bought	(5,000)	4.57	Financial
November 2014 – December 2014	Sold	25,000	4.80	Financial

At June 30, 2014, the Corporation had entered into the following financial call option gas sales arrangements, whereby the Corporation's counterparty has the right to settle the specified volumes of natural gas at the specified prices in the future periods.

Term	Perpetual sold/bought	Volumes at AECO (GJ/d)	Strike price ($/GJ)	Type of contract
July 2014 – December 2014	Sold	10,000	4.25	Call

At June 30, 2014, the Corporation had entered into financial natural gas sales arrangements to fix the basis differential between the New York Mercantile Exchange ("NYMEX") and AECO trading hubs. The price at which these contracts settle is equal to the NYMEX index less a fixed basis amount.

Term	Perpetual sold/bought	Volumes at NYMEX-AECO (MMBtu/d)	Average price (US$/MMBtu)	Type of contract
August 2014 – October 2014	Sold	7,500	(0.48)	Financial

Oil contracts

At June 30, 2014, the Corporation has entered into the following fixed price oil sales arrangements:

Term	Perpetual sold/bought	Volumes at WTI (bbl/d)	Average price (US$/bbl)	Type of contract
July 2014 – December 2014	Sold	250	90.00	Financial

At June 30, 2014, the Corporation had entered into financial and forward physical oil sales arrangements to fix the basis differential between the West Texas Intermediate ("WTI") and Western Canadian Select ("WCS") trading hubs. The price at which these contracts settle is equal to the WTI index less a fixed basis amount.

Term	Perpetual sold/bought	Volumes at WTI-WCS (bbl/d)	Average differential (US$/bbl)	Type of contract
July 2014 – December 2014	Sold	1,000	(22.63)	Financial
July 2014 – December 2014	Sold	1,000	(20.66)	Physical

At June 30, 2014, the Corporation had entered into the following costless collar oil sales arrangements which settle in US$:

Term	Volumes at WTI (bbl/d)	Floor price (US$/bbl)	Ceiling price (US$/bbl)	Type of contract
July 2014 – December 2014 (1)	500	90.00	103.15	Asian collar
July 2014 – December 2014	500	85.00	91.10	Collar
July 2014 – December 2014	500	85.00	91.20	Collar
January 2015 – December 2015 (2)	500	90.00	103.20	Asian collar

(1) In this collar arrangement Perpetual received a ceiling price above the market price for such collars, and in exchange should the WTI index settle above US$103.15 per bbl in any month during the contract period Perpetual will receive a price of US$93.00 per bbl.

(2) In this collar arrangement Perpetual received a premium strike price on a purchased call option, and in exchange should the WTI settle above $US103.20 in any month during the contract period Perpetual will receive a price of US$90.00 per bbl.

At June 30, 2014, the Corporation had entered into the following costless collar oil sales arrangements which settle in Cdn$:

Term	Volumes at WTI (bbl/d)	Floor price (Cdn$/bbl)	Ceiling price (Cdn$/bbl)	Type of contract
January 2015 – December 2015	500	87.50	95.25	Collar
January 2015 – December 2015	500	87.50	95.75	Collar

At June 30, 2014, the Corporation has entered into the following fixed price oil sales arrangements:

Term	Perpetual sold/bought	Volumes at WTI (bbl/d)	Average price (US$/bbl)	Type of contract
July 2014 – December 2014	Sold	250	90.00	Financial

At June 30, 2014, the Corporation had entered into the following financial call option oil sales arrangements, whereby the Corporation's counterparty has the right to settle specified volumes of oil at specified prices in the future periods.

Term	Perpetual sold/bought	Volumes at WTI (bbl/d)	Average price (US$/bbl)	Type of contract
January 2015 – December 2015	Sold	1,500	100.00	Financial

Foreign exchange contracts

At June 30, 2014, the Corporation had entered into the following US$ forward sales arrangement:

Term	Perpetual sold/bought	Notional US$/month	Exchange rate (Cdn$/US$)	Type of contract
July 2014 – June 2015 (1)	Sold	1,000,000	1.1000	Financial

(1) The Corporation receives $1,000 each day during the month that the daily exchange rate is between $1.0000 and $1.1000. If the average monthly exchange rate is greater than $1.1000 the Corporation pays US$1,000,000 multiplied by the difference between the average monthly exchange rate and $1.1000. No settlement occurs between the Corporation and the counterparty if the average monthly exchange rate settles below $1.0000.

At June 30, 2014, the Corporation had entered into the following US$ forward sales arrangement:

Term	Perpetual sold/bought	Notional floor US$/month	Notional ceiling US$/month	Exchange rate floor (Cdn$/US$)	Exchange rate ceiling (Cdn$/US$)	Type of contract
July 2014 – December 2015 (1)	Sold	2,500,000	5,000,000	1.0400	1.1410	Financial

(1) If the monthly average exchange rate is greater than $1.1410 the Corporation pays US$5,000,000 multiplied by the difference between the average monthly exchange rate and $1.1000. If the monthly average exchange rate settles below $1.0400 the Corporation receives US$2,500,000 multiplied by the difference between the average monthly exchange rate and $1.0400. No settlement occurs between the Corporation and the counterparty if the average monthly exchange rate settles between $1.0400 and $1.1410.

12. FINANCIAL INSTRUMENTS

The following table reconciles the Corporation's change in fair value of commodity derivatives:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	**2014**	2013
Realized loss on financial oil contracts	**(3,235)**	(535)	**(4,628)**	(835)
Realized gain (loss) on financial natural gas contracts	**(2,361)**	1,499	**(7,410)**	2,295
Realized gain on forward foreign exchange contracts	**118**	309	**186**	350
Unrealized gain (loss) on financial oil contracts	**(1,294)**	4,219	**(4,167)**	6,098
Unrealized gain (loss) on physical oil contracts	**69**	(341)	**249**	(1,586)
Unrealized gain (loss) on financial natural gas contracts	**5,002**	3,547	**(2,011)**	1,187
Unrealized gain (loss) on physical natural gas contracts	**204**	(110)	**(204)**	–
Unrealized gain (loss) on forward foreign exchange contracts	**3,013**	(779)	**396**	(105)
Change in fair value of commodity price derivatives	**1,516**	7,809	**(17,589)**	7,404

Natural gas sensitivity analysis

As at June 30, 2014, if future natural gas prices increased by $0.25 per GJ with all other variables held constant, the fair value of commodity price derivatives and after tax net income for the period would change by $2.7 million. If future natural gas prices decrease by $0.25 per GJ with all other variables held constant, the fair value of commodity price derivatives and after tax net income for the period would change by $3.9 million. The fair value sensitivity is based on published forward AECO and NYMEX prices.

Oil sensitivity analysis

As at June 30, 2014, if future oil prices changed by $5.00 per boe with all other variables held constant, the fair value of commodity price derivative and after tax net income for the period would have changed by $0.1 million. The fair value sensitivity is based on published forward WTI and WCS prices.

Fair value of financial assets and liabilities

Perpetual's fair value measurements are classified as one of the following levels of the fair value hierarchy:

Level 1 – inputs represent unadjusted quoted prices in active markets for identical assets and liabilities. An active market is characterized by a high volume of transactions that provides pricing information on an ongoing basis.

Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These valuations are based on inputs that can be observed or corroborated in the marketplace, such as market interest rates or forward prices for commodities.

Level 3 – inputs for the asset or liability are not based on observable market data.

The Corporation aims to maximize the use of highly observable inputs when preparing calculations of fair value. Classification of each measurement into the fair value hierarchy is based on the lowest level of input that is significant to the fair value calculation.

The fair value of accounts receivable, accounts payable and accrued liabilities approximate their carrying amounts due to their short terms to maturity. The fair value of the long term Crown receivable approximates the carrying value as the Corporation expects to recover the full carrying amount by way of future gas Crown royalties. Bank debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying amount.

The fair value of the financial obligation is estimated by discounting future cash payments based on the forecasted Alberta gas reference price (see note 10) multiplied by the contracted deemed volume. This fair value measurement is classified as level 3 as significant unobservable inputs, including the discount rate and forecasted Alberta gas references prices, are used in determination of the carrying amount. The discount rate of 12.2% was determined on inception of the agreement based on the characteristics of the instrument. The forecasted Alberta gas reference prices for the remaining term are based on NGX forward market pricing with adjustments for historical differences between the Alberta reference price and market prices. As of June 30, 2014 there has been no change in the fair value of the financial obligation since the inception of the agreement on June 26, 2014.

The fair value of financial assets and liabilities, excluding working capital, is attributable to the following fair value hierarchy levels:

As at June 30, 2014	Gross	Netting [1]	Carrying amount	Level 1	Fair value Level 2	Level 3
Financial assets						
Fair value through profit and loss						
Derivatives – current	**1,920**	**(1,920)**	**–**	**–**	**–**	**–**
Derivatives – non-current	**158**	**(158)**	**–**	**–**	**–**	**–**
Financial liabilities						
Financial liabilities at amortized cost						
Senior notes	**147,991**	**–**	**147,991**	**–**	**150,750**	**–**
Convertible debentures – current	**98,914**	**–**	**98,914**	**101,150**	**–**	**–**
Convertible debentures – non-current	**57,195**	**–**	**57,195**	**60,626**	**–**	**–**
Fair value through profit and loss						
Derivatives – current	**12,788**	**(1,920)**	**10,868**	**–**	**10,868**	**–**
Derivatives – non-current	**3,928**	**(158)**	**3,770**	**–**	**3,770**	**–**
Financial obligation – current	**5,367**	**–**	**5,367**	**–**	**–**	**5,367**
Financial obligation – non-current	**13,087**	**–**	**13,087**	**–**	**–**	**13,087**

(1) Derivative assets and liabilities presented in the statement of financial position are shown net of offsetting assets or liabilities where the arrangement provides, or the legal right and intention for net settlement exists.

13. FINANCE EXPENSE

Finance expense for the three and six months ended June 30, 2014, is comprised of the following:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	**2014**	2013
Interest on senior notes	**3,410**	3,407	**6,779**	6,776
Interest on convertible debentures	**3,675**	3,612	**7,330**	7,181
Interest on bank indebtedness	**1,430**	1,148	**2,605**	2,195
Accretion on decommissioning obligations	**1,344**	982	**2,684**	1,965
Accretion on GOB obligation	**219**	–	**219**	–
Loss on marketable securities	**–**	506	**–**	545
Loss on call option	**–**	–	**–**	1,274
	10,078	9,655	**19,617**	19,936

14. SHARES HELD IN TRUST

The Corporation has compensation agreements in place with employees whereby they may be entitled to receive shares of the Corporation purchased on the open market by a trustee.

The balance of shares held in trust represents the cumulative cost of shares held by the trustee for the benefit of employees that have not yet been issued to employees. The number of shares held by the trustee as at June 30, 2014 is 194,361.

	June 30, 2014
Balance, beginning of period	**–**
Shares purchased and held in trust	**251**
Balance, end of period	**251**

15. PER SHARE INFORMATION

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	**2014**	2013
(thousands, except per share amounts)				
Net income (loss) – basic	**2,549**	(4,566)	**(14,775)**	28,198
Effect of dilutive securities	**–**	–	**–**	–
Net income (loss) – diluted	**2,549**	(4,566)	**(14,775)**	28,198
Issued common shares	**149,029**	148,015	**148,791**	147,853
Effect of shares held in trust	**(194)**	–	**(149)**	–
Weighted average common shares outstanding – basic	**148,835**	148,015	**148,642**	147,853
Effective of dilutive securities	**8,720**	–	**–**	2,139
Weighted average common shares outstanding – diluted	**157,555**	148,015	**148,642**	149,992
Income (loss) per share – basic	**0.02**	(0.03)	**(0.10)**	0.19
Income (loss) per share – diluted	**0.02**	(0.03)	**(0.10)**	0.19

In computing per share amounts for the three months ended June 30, 2014, 21,901,026 potentially issuable common shares through the convertible debentures were excluded as they had an anti-dilutive effect on calculated per share amounts.

In computing per share amounts for the six months ended June 30, 2014, 2,372,954 Share Options, 1,266,173 Restricted Rights, 1,682,068 Performance Shares Rights, 112,450 deferred options, 990,992 deferred shares, and 21,901,026 potentially issuable common shares through the convertible debentures were excluded as the Corporation had a net loss.

DIRECTORS

Clayton H. Riddell
Executive Chairman

Susan L. Riddell Rose
President, Chief Executive Officer and Director (4)

Karen A. Genoway
Independent Director (2) (3)

Randall E. (Randy) Johnson
Independent Director (1) (3)

Robert A. Maitland
Independent Director (1) (3)

Geoffrey C. Merritt
Independent Director (1) (2) (4)

Donald J. Nelson
Independent Director (2) (4)

Howard R. Ward
Independent Director (3) (4)

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

OFFICERS

Susan L. Riddell Rose
President, Chief Executive Officer and Director

Cameron R. Sebastian
Vice President, Finance and Chief Financial Officer

Vicki L. Benoit
Vice President, Production Operations

Jeffrey R. Green
Vice President, Corporate and Engineering Services

Gary C. Jackson
Vice President, Land, Acquisitions and Divestitures

Linda L. McKean
Vice President, Exploitation

Marcello M. Rapini
Vice President, Marketing

HEAD OFFICE

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STOCK EXCHANGE LISTING | TSX | PMT

CONVERTIBLE DEBENTURES | PMT.DB.D
PMT.DB.E

AUDITORS

KPMG LLP

BANKERS

Bank of Montreal
Canadian Imperial Bank of Commerce
The Bank of Nova Scotia
The Toronto-Dominion Bank
National Bank of Canada
ATB Financial

RESERVE EVALUATION CONSULTANTS

McDaniel & Associates Consultants Ltd.

REGISTRAR AND TRANSFER AGENT

Computershare Trust Company of Canada

FORWARD-LOOKING INFORMATION

Certain information regarding Perpetual in this report including management's assessment of future plans and operations and including the information contained under the heading "2014 Outlook" may constitute forward-looking statements under applicable securities laws. The forward-looking information includes, without limitation, statements regarding capital expenditure levels for 2014, prospective drilling and operational activities; forecast production and production type, operations, forecast and realized commodity prices; expected funding, allocation and timing of capital expenditures; projected use of funds flow and anticipated funds flow; planned drilling and development and the results thereof; expected dispositions, anticipated proceeds therefrom and the use of proceeds therefrom; and commodity prices. Various assumptions were used in drawing the conclusions or making the forecasts and projections contained in the forward-looking information contained in this report which assumptions are based on management analysis of historical trends, experience, current conditions, and expected future developments pertaining to Perpetual and the industry in which it operates as well as certain assumptions regarding the matters outlined above. Forward-looking information is based on current expectations, estimates and projections that involve a number of risks, which could cause actual results to vary and in some instances to differ materially from those anticipated by Perpetual and described in the forward looking information contained in this report. Undue reliance should not be placed on forward-looking information, which is not a guarantee of performance and is subject to a number of risks or uncertainties, including without limitation those described under "Risk Factors" in Perpetual's Annual Information Form and MD&A for the year ended December 31, 2013 and those included in other reports on file with Canadian securities regulatory authorities which may be accessed through the SEDAR website (www.sedar.com) and at Perpetual's website (www.perpetualenergyinc.com). Readers are cautioned that the foregoing list of risk factors is not exhaustive. Forward-looking information is based on the estimates and opinions of Perpetual's management at the time the information is released and Perpetual disclaims any intent or obligation to update publicly any such forward-looking information, whether as a result of new information, future events or otherwise, other than as expressly required by applicable securities laws. For more information, please refer to "Forward-Looking Information" on page 7 of this report.

STOCK EXCHANGE LISTING | TSX | **PMT**

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