PERPETUAL
ENERGY

DECEMBER 31, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

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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 year ended December 31, 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 audited consolidated financial statements and accompanying notes for the years ended December 31, 2014 and 2013. The Corporation's 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"). 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 March 5, 2015.

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 build 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 liquids-rich natural gas ("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 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 calculated by deducting royalties, operating costs, and transportation from total revenue. Operating netbacks are also calculated on a boe basis using average boe production for the period.*

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, but after payments on the gas over bitumen ("GOB") related financial obligation, as 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 December 31*		*Year ended December 31*	
($ thousands, except per share amounts)	***2014***	*2013*	***2014***	*2013*
Cash flow from operating activities	***17,666***	*12,353*	***82,082***	*52,333*
Exploration and evaluation costs (1)	***379***	*(19)*	***644***	*1,279*
Payments on financial obligation (2)	***(1,446)***	*–*	***(2,829)***	*–*
Expenditures on decommissioning obligations	***2,153***	*859*	***6,633***	*2,497*
Changes in long term Crown receivable	***–***	*777*	***(10,997)***	*2,213*
Changes in non-cash operating working capital	***(1,436)***	*(972)*	***5,862***	*146*
Funds flow	***17,316***	*12,998*	***81,395***	*58,468*
Funds flow per share (3)	***0.12***	*0.09*	***0.55***	*0.39*

(1) The Corporation expenses exploratory dry hole costs, geological and geophysical costs, lease rentals on undeveloped properties and the cost of expired leases 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) These payments are indexed to GOB revenue and recorded as a reduction to the Corporation's financial obligation in accordance with IFRS. To present GOB revenue net of these payments, the Corporation has reclassified these payments from financing to operating activities in the calculation of funds flow.

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

Realized revenue: *Realized revenue includes oil and natural gas revenue, realized gains (losses) on financial contracts 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.*

GOB revenue, net of payments: *GOB revenue, net of payments includes GOB revenue less monthly payments on the GOB related financial obligation, This is used by management to calculate the Corporation's net realized GOB revenue to reflect the substantive monetization of the future GOB royalty credits.*

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, current portion of financial obligation, 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:1bbl 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 AND STATEMENTS: *Certain information and statements contained in this MD&A including management's assessment of future plans and operations and including the information contained under the heading "2015 Outlook" may 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 financial contracts 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 compliance with credit facility covenants in 2015 and 2016; 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; 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.

SELECTED ANNUAL INFORMATION

($ thousands, except per share amounts)	**2014**	2013	2012
Financial			
Oil and natural gas revenue	**262,790**	201,294	176,137
Net income (loss)	**3,366**	7,620	(75,986)
Per share[(1)]	**0.02**	0.05	(0.52)
Funds flow	**81,395**	58,468	49,087
Per share[(1)]	**0.55**	0.39	0.33
Total assets	**750,602**	742,288	729,888
Total long term liabilities	**507,296**	513,836	594,342
Net bank debt outstanding	**21,867**	67,201	77,827
Senior notes, at principal amount	**275,000**	150,000	150,000
Convertible debentures, at principal amount	**34,878**	159,779	159,972
Total net debt	**331,745**	376,980	387,799
Capital expenditures			
Exploration and development[(2)]	**116,457**	96,684	79,724
Dispositions, net of acquisitions	**(70,351)**	(70,840)	(164,763)
Interest in Warwick Gas Storage ("WGS LP")	**–**	19,129	–
Other	**614**	120	271
Net capital expenditures	**46,720**	45,093	(84,768)
Shares outstanding (thousands)			
End of period	**150,077**	148,490	147,455
Weighted average	**149,084**	148,144	147,085
Operating			
Average production			
Natural gas (MMcf/d)	**102.7**	88.9	100.2
Oil and NGL (bbl/d)	**3,443**	3,860	3,448
Total average production (boe/d)	**20,554**	18,696	20,142
Average prices			
Natural gas – before derivatives ($/Mcf)	**4.50**	3.26	2.48
Natural gas – including derivatives ($/Mcf)	**4.36**	3.53	3.34
Oil and NGL – before derivatives ($/bbl)	**75.01**	67.65	64.26
Oil and NGL – including derivatives ($/bbl)	**71.82**	66.48	64.13
Wells drilled			
Natural gas – gross (net)	**29 (20.9)**	6 (3.0)	8 (5.5)
Crude oil – gross (net)	**20 (17.8)**	37 (35.7)	36 (34.6)
Total – gross (net)	**49 (38.7)**	43 (38.7)	44 (40.1)

(1) Based on weighted average shares outstanding for the year.
(2) Exploration and development costs include geological and geophysical expenditures.

OVERALL PERFORMANCE

Perpetual focused on five key strategic priorities in 2014:

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

During 2014, Perpetual accelerated the development of its West Central liquid-rich natural gas by maintaining focus on development activities in the Greater Edson area. At West Edson, a facility expansion increased capacity to 60 MMcf/d (30 MMcf/d net), while drilling activity throughout 2014 continues to maintain the new plant at full capacity. During the second half of 2014, Perpetual's capital program focused on East Edson as a result of the East Edson royalty disposition and farm-in agreement ("East Edson Agreements"). The arrangement included the disposition of a 50 percent royalty interest in the current developed producing reserves in the East Edson area (the "Producing Royalty") for net cash proceeds of $47 million. Net cash proceeds consisted of $17 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. Concurrent with the royalty disposition, Perpetual also entered into a farm-in agreement, whereby the partner contributed $70 million to an escrow account to fund the drilling, completion and tie-in of 13 horizontal wells in the Wilrich formation in exchange for a second royalty (the "Drilling Royalty") on new production from the East Edson property. When taking into account both agreements, in exchange for the total acquisition and funding commitment of $120 million net of adjustments, the Drilling and Producing Royalties entitle the partner to receive, on a priority basis, a maximum of 5.6 MMcf/d of natural gas from the East Edson property plus 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 ("East Edson Gross Overriding Royalty") terminate on December 31, 2034. The Producing Royalty also included a 50 percent gross overriding royalty on existing minor oil production.

Pursuant to the East Edson Agreements, Perpetual committed to spend $30 million to drill, complete and tie-in approximately five wells prior to December 31, 2015, substantially following the spending of the $70 million commitment by the partner. The majority of the partner's $70 million commitment and a portion of Perpetual's first $30 million commitment were spent by the end of 2014, with the balance expected to be fully spent by the end of the first quarter of 2015. In addition, Perpetual committed to construct a new gas plant at East Edson to add 30 MMcf/d of processing capacity at an estimated cost of $30 million. Spending on the gas plant began in 2014 with start up expected in the third quarter of 2015. Finally, Perpetual also committed to invest an additional $30 million to drill, complete and tie-in approximately six additional wells prior to December 31, 2022.

The combined capital programs of East and West Edson resulted in 28 (20.6 net) wells drilled in 2014 compared to six (3.0 net) wells drilled in 2013 in the Greater Edson area. Thirteen (13.0 net) East Edson wells were drilled utilizing partner funds from escrow pursuant to the East Edson Agreements.

Perpetual also continued its development of heavy oil assets in the Mannville area during 2014 which included drilling 20 (17.8 net) wells, as well as expenditures related to the initiation of waterflood operations in several larger pools. Capital activities in 2014 also included optimization activities on Perpetual's Eastern Alberta shallow gas assets which mitigated declines and reduced operating costs in these areas.

As a result of Perpetual's 2014 capital initiatives, proved plus probable reserves increased by 70 percent since year end 2013 to 105.5 MMBoe. Oil and natural gas production during 2014 increased ten percent to 20,554 boe/d from 18,696 boe/d in 2013. Higher production, combined with improved year over year commodity prices and lower unit operating costs, drove funds flow up 39 percent to $81.4 million in 2014 from $58.5 million in 2013.

Perpetual reduced year-end net debt by 12 percent to $331.7 million at December 31, 2014 from $377.0 million at the end of 2013, primarily as a result of proceeds received from the monetization of GOB royalty credits, the East Edson royalty disposition, the sale of non-core heavy oil assets and funds flow which more than offset 2014 net capital spending. In addition, Perpetual issued $125 million in senior unsecured notes ("2014 Senior Notes"). The combination of proceeds received from dispositions and the senior notes offering were used to early redeem all the outstanding $99.9 million 7.25 percent convertible debentures ("7.25% Debentures") which were due to mature on January 31, 2015 as well as $25 million of the $59.9 million 7.00 percent convertible debentures ("7.0% Debentures") maturing on December 31, 2015. These transactions supported the positive progress on the Corporation's 2014 strategic priority to reduce debt and manage downside risk. The reduction to total net debt combined with the issuance of senior notes in 2014 bolstered Perpetual's financial flexibility by effectively extending the term for the majority of the Company's debt to 2018 and 2019.

2014 FINANCIAL RESULTS

Capital expenditures

($ thousands)	**2014**	2013
Exploration and development	**115,813**	95,405
Geological and geophysical costs[1]	**644**	1,279
Acquisitions	**998**	8,135
Dispositions	**(71,349)**	(78,975)
Interest in WGS LP	**–**	19,129
Other	**614**	120
Total[2]	**46,720**	45,093

(1) Geological and geophysical expenditures and dry hole costs are expensed directly in the Corporation's statement of income; they are considered by Perpetual to be more closely related to investing activities than operating activities, and therefore are included with capital expenditures.
(2) This table excludes $21.3 million in proceeds related to the monetization of GOB royalty credits.

Exploration and development spending by area

($ thousands)	**2014**	2013
West Central liquids-rich gas [1]	**81,096**	42,360
Mannville heavy oil	**24,559**	49,316
Shallow gas and other	**10,157**	3,729
Total	**115,812**	95,405

(1) Excludes partner spending from the $70 million escrow account in relation to the East Edson Agreements.

Total exploration and development expenditures, including geological and geophysical expenditures, of $116.4 million during 2014 were focused largely on liquids-rich natural gas development activities in the Corporation's West Central district as well as continued heavy oil development at Mannville.

At East Edson, the Corporation commenced its planned drilling program immediately after closing the East Edson Agreements in July 2014, drawing on the majority of the $70 million of farm-in funds established in the partner escrow account before year-end. During 2014, 13 (13.0 net) wells were drilled as part of the East Edson farm-in agreement and financed from the partner's escrow account. These costs are not included as part of Perpetual's reported capital expenditures. In total, 15 (15.0 net) wells were drilled in East Edson during 2014, including the 13 (13.0 net) wells financed from the partner's escrow account and two (2.0 net) additional wells drilled prior to closing of the East Edson Agreements. Nine (9.0 net) of the horizontal wells drilled were within the Northeast development area and six (6.0 net) within the southwest development area. Most of the wells are producing well above their respective proved plus probable independent reserve evaluations type curves. In addition to spending on drilling and completion projects, a 3D seismic survey covering a portion of the East Edson Agreement lands was undertaken and substantially completed during 2014.

In addition to the development spending funded by the partner's capital commitment, Perpetual satisfied $13.3 million of its $30 million exploration and development commitment under the East Edson Agreements and spent an additional $14 million on procurement and site preparation for the new 30 MMcf/d gas plant. The new gas plant is on track to be completed on budget and operational for start-up during the third quarter of 2015.

In West Edson, development of the Corporation's liquids-rich gas was accelerated with drilling after spring breakup targeted to fill the expanded plant capacity of 60 MMcf/d (30 MMcf/d net). During 2014, $44.7 million of expenditures were directed almost exclusively to drilling, completion and tie-in operations at West Edson with the addition of 11 (5.5 net) operated wells and two additional (0.1 net) non-operated wells. The operated wells have performed consistently at or above the proved plus probable independent reserve evaluations type curve. The facility was operating at maximum capacity beginning in early August and is expected to remain at or near capacity through 2020 based on the Corporation's forecast drilling operations.

Exploration and development spending of $24.6 million at Mannville during 2014 included the drilling and completion of 20 (17.8 net) horizontal heavy oil wells down from 37 (35.7 net) in 2013, as well as the conversion of seven wells to waterflood injection wells and expenditures for related pipelines and facilities.

Spending of $10.2 million on Eastern Alberta shallow gas and other assets during the year was primarily related to facility projects, with $3.2 million spent on recompletion and workover programs. These projects were low cost optimizations that generally paid out in less than six months. High capital efficiency recompletion projects, combined with workovers and facility optimization work, arrested the decline in Perpetual's shallow gas assets to five percent in 2014.

During 2014, a farm out commitment well was drilled and completed on Perpetual's behalf, targeting the Duvernay formation in the Waskahigan area. Perpetual retained a 35% working interest in the well and spent $1.2 million toward the equipping and tie-in of this well. The horizontal Duvernay well is expected to commence production in early March 2015.

Acquisitions and dispositions

In addition to the East Edson Agreements, cash proceeds on dispositions, net of acquisitions of $70.4 million during 2014 included the disposition of non-core Mannville heavy oil assets for net proceeds of $21.4 million and the sale of certain undeveloped land for net proceeds of approximately $3.0 million, which included the sale of land acquired through a non-cash swap transaction in the first quarter of 2014. Dispositions net of acquisitions for the same period of 2013 of $70.8 million primarily related to the Elmworth property disposition.

Gas over bitumen monetization

Perpetual receives 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. In 2014, Perpetual closed two transactions which effectively monetized the majority of its future GOB royalty credits associated with certain shut-in properties in northeast Alberta for net proceeds of $21.3 million. In exchange for the proceeds, Perpetual makes monthly payments to the purchaser which are based on the GOB formula set out in the Alberta Gas Royalty Regulations. Under IFRS, this transaction has been accounted for as a hybrid financial obligation, which is adjusted to fair value each reporting period. Monthly payments are recorded as a reduction of the outstanding obligation.

Production

	2014	2013
Natural gas (MMcf/d)		
Eastern – North	**36.4**	38.5
Eastern – South	**23.8**	25.2
West Central	**42.5**	25.2
Total natural gas	**102.7**	88.9
Crude oil (bbl/d)		
Eastern – North	**6**	7
Eastern – South[(1)]	**2,860**	3,150
West Central	**40**	48
Total crude oil	**2,906**	3,205
NGL (bbl/d)		
Eastern – South	**11**	9
West Central	**526**	646
Total NGL	**537**	655
Total production (boe/d)	**20,554**	18,696

(1) Primarily Mannville heavy oil.

Total natural gas, NGL and oil production in 2014 of 20,554 boe/d was ten percent higher than 2013 (18,696 boe/d) due to increased natural gas production from the West Central district. Production from new wells filled the expanded plant capacity with higher heat content sales gas at West Edson. In addition, production increases were also attributable to new East Edson production resulting from an extensive capital program in the third and fourth quarters pursuant to the East Edson Agreements. Production increases from the Greater Edson area more than offset production declines in the Company's other operating areas.

Perpetual's 2014 natural gas production of 102.7 MMcf/d increased 16 percent from 88.9 MMcf/d in 2013. Increased gas production in 2014 was driven by growth in West Edson production, which averaged 25.6 MMcf/d (2013 - 10.8 MMcf/d) and East Edson production, which averaged 17.7 MMcf/d (2013 - 14.3 MMcf/d). Edson processing facilities were operating at full capacity at the end of 2014. Increases in East Edson production and higher heat content deep basin gas production at West Edson more than offset year over year declines in production from Perpetual's shallow gas assets.

Oil production of 2,906 bbl/d in 2014 decreased from 3,205 bbl/d in 2013 as fewer Mannville heavy oil wells were drilled in 2014 with Mannville capital directed to waterflood activities. As a result, production declines offset new production additions as the new drill well count decreased to 20 (17.8 net) in 2014 as compared to 37 (35.7 net) in 2013.

Despite higher gas production in West Central Alberta, NGL production of 537 bbl/d reflected reduced NGL yields in 2014 from the Corporation's Greater Edson area. West Central NGL yields during 2014 dropped to 12.4 bbl/MMcf from 26 bbl/MMcf for the same period in 2013 as high liquids yield wells at East Edson declined and spending continued to be focused at West Edson where liquids yields are lower than at East Edson. In addition, the change in processing arrangements in West Edson, which started up operations on October 1, 2013, reduced the reported liquids recovery. East Edson reported liquids yields were also reduced by changes in processing as economics, turnarounds and capacity considerations resulted in Perpetual processing its gas through its working interest in the Rosevear plant during all of 2014 rather than the third party deep cut plant in which the majority of gas was processed during 2013. A portion of the previously recovered liquids have been included in higher heat content gas sales during all of 2014 versus just the fourth quarter of 2013. The result is a higher realized gas price and, at the same time, higher grade liquids are now recovered and marketed.

Perpetual no longer reports deemed production as Perpetual entered into transactions in 2014 to monetize its future GOB royalty credits for the vast majority of the Corporation's remaining future royalty credit entitlements. These transactions are accounted for as a financial obligation under IFRS.

Commodity prices

	2014	2013
Reference prices		
AECO Monthly Index ($/Mcf) (1)	**4.41**	3.16
AECO Daily Index ($/Mcf) (1)	**4.50**	3.17
Alberta Gas Reference Price ($/Mcf)(2)	**4.21**	2.82
West Texas Intermediate ("WTI") light oil ($USD/bbl)	**93.00**	97.97
Western Canadian Select ("WCS") differential ($USD/bbl)	**(19.40)**	(25.20)
Average Perpetual prices		
Natural gas		
Before derivatives ($/Mcf)(3)(4)	**4.50**	3.26
Percent of AECO Monthly Index	**102**	103
Including derivatives ($/Mcf)	**4.36**	3.53
Percent of AECO Monthly Index	**99**	112
Oil and NGL		
Before derivatives ($/bbl)	**75.01**	67.65
Including derivatives ($/bbl)	**71.82**	66.48
Barrel of oil equivalent		
Average realized price ($/boe)	**33.81**	30.56

(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 2014 natural gas production is 1.10 GJ: 1 Mcf.

AECO Monthly Index prices of $4.41/Mcf in 2014 increased 40 percent from $3.16/Mcf for the same period in 2013. Price appreciation during the first quarter of 2014 was caused by extreme cold weather that led to strong heating demand and significantly depleted natural gas storage levels by the end of the 2014 withdrawal season. The year over year storage deficit was rebuilt as reduced cooling demand in the third quarter allowed strong injections and a warmer than normal fourth quarter contributed to lower early winter storage withdrawals. With gas storage levels back to seasonal norms, continued year over year increases in North American production caused gas prices to decline from the higher prices realized in the first half of 2014.

Increased average AECO Monthly Index prices in 2014 were reflected in Perpetual's natural gas price before derivatives with a year over year increase of 38 percent. 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 in 2014, allowed Perpetual to realize a higher average natural gas price relative to 2013.

Perpetual's average realized gas price, including derivatives, increased 24 percent to $4.36/Mcf in 2014 from $3.53/Mcf for the same period in 2013. Realized losses of $5.1 million on financial natural gas contracts for the year ended December 31, 2014 were partially offset 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 99 percent of the AECO Monthly Index.

Perpetual's oil and NGL price, before derivatives, of $75.01/bbl in 2014 increased 11 percent compared to the same period in 2013 due to strong WTI prices during the first half of 2014 which, along with a narrowing of WCS differentials, offset by the effect of price declines realized in the fourth quarter. In addition, 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 sales from processing changes which affected the liquids recoveries at East and West Edson, contributed to improved pricing.

Perpetual's realized oil and NGL price, including derivatives, was four percent lower than the price before derivatives in 2014, primarily due to economic hedging losses recorded on financial WTI price contracts during the first three quarters of 2014 which more than offset gains realized during the fourth quarter of 2014 as oil prices declined. Losses on financial WTI contracts for the year ended December 31, 2014 were $3.9 million compared to $2.6 million for the same period in 2013.

Commodity price risk management

Perpetual's commodity price 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.

<u>Natural Gas</u>

Perpetual has in place natural gas financial contracts on an estimated 52 percent of forecasted actual natural gas production for the remainder of 2015. The following tables provide a summary of derivative natural gas contracts in place as at December 31, 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 sold (bought) at AECO (GJ/d)	Average price ($/GJ)[1]	Market prices ($/GJ)[2]	Type of contract
January 2015	10,000	4.23	3.19	Financial
January 2015	(10,000)	3.35	3.19	Physical
February 2015	82,065	2.81	2.60	Financial
February 2015	16,500	2.63	2.60	Physical
March 2015	82,500	2.83	2.59	Financial
March 2015	44,500	2.61	2.59	Physical
March 2015	(24,500)	2.48	2.59	Physical
April 2015 – June 2015	102,500	2.57	2.53	Financial
April 2015 – June 2015	(10,000)	2.52	2.53	Financial
July 2015 – October 2015	82,500	2.56	2.61	Financial
November 2015 – December 2015	7,500	2.78	2.90	Financial

(1) Average price calculated using weighted average price for net open contracts.
(2) Market prices for January to March are based on settled AECO Monthly Index prices. Market prices for subsequent months are based on forward AECO prices as of market close on March 4, 2015.

Crude Oil

The following tables provide a summary of derivative crude oil contracts in place as at December 31, 2014, as well as any additional contracts entered into prior to the date of this MD&A.

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 – February 2015	500	87.50	95.25	60.37	Collar
January 2015 – February 2015	500	87.50	95.75	60.37	Collar
March 2015 – December 2015	500	87.50	95.25	71.06	Collar
March 2015 – December 2015	500	87.50	95.75	71.06	Collar

(1) Market prices for January to February are based on settled WTI oil prices at settled foreign exchange rates. Market prices for subsequent months are based on forward WTI oil prices at a forward foreign exchange rate of 1.245 as of market close on March 4 2015.

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

Term	Volumes at WTI (bbl/d)	Call price (US$/bbl WTI)	Market prices (US$/bbl WTI)[1]	Type of contract
January 2016 – December 2016[2]	500	106.00	62.34	Knock out call
January 2016 – December 2016[3]	1,000	104.25	62.34	Knock out call

(1) Market prices are based on forward WTI oil prices as of market close on March 4, 2015.
(2) If WTI index settles above US$106.00/bbl in any month, the contract is settled at US$97.00/bbl for that month.
(3) If WTI index settles above US$104.25/bbl in any month, the contract is settled at US$95.40/bbl for that month.

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
January – March 2015	1,000	(16.88)	(14.73)	Financial
April - December 2015	1,000	(16.88)	(14.90)	Financial

(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 January to March 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 March 4, 2015.

Foreign Exchange

U.S. dollar forward sales arrangements:

Term	Notional US$/month	Exchange rate (Cdn$/US$)	Type of contract
January – June 2015	1,000,000	1.10	Financial

The Corporation receives $1,000 each day during the month that the daily exchange rate is between 1.00 and 1.10. If the average monthly exchange rate is greater than 1.10 the Corporation pays US$1,000,000 multiplied by the difference between the average monthly exchange rate and 1.10. No settlement occurs between the Corporation and the counterparty if the average monthly exchange rate settles below 1.00.

Term	Notional floor US$/month	Notional ceiling US$/month	Exchange rate floor (Cdn$/US$)	Exchange rate ceiling (Cdn$/US$)	Type of contract
January 2015 – December 2016	2,000,000	3,500,000	1.04	1.18	Financial

If the average monthly exchange rate is greater than the exchange rate ceiling, the Corporation pays US$3,500,000 multiplied by the difference between the average monthly exchange rate and 1.127. If the monthly average exchange rate settles below the exchange rate floor, the Corporation receives US$2,000,000 multiplied by the difference between the average monthly exchange rate and the exchange rate floor.

Revenue

($ thousands, except as noted)	**2014**	2013
Petroleum and natural gas revenue		
Natural gas[1]	**168,521**	105,965
Oil and NGL[1]	**94,269**	95,329
Total petroleum and natural gas revenue	**262,790**	201,294
Other revenue		
Unrealized gains (losses) on derivatives	**11,946**	1,783
Realized gains (losses) on derivatives	**(9,127)**	6,275
Total other revenue	**2,819**	8,058
Total revenue	**265,609**	209,352
Per boe	**35.41**	30.68

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

Perpetual's petroleum and natural gas ("P&NG") revenue, before derivatives, increased 31 percent to $262.8 million in 2014 (2013 - $201.3 million) primarily due to improved pricing and increased West Central natural gas production. The impact of new production from capital spending under the East Edson Agreements also began to be realized late in the fourth quarter of 2014.

Natural gas revenue, before derivatives, of $168.5 million in 2014 was 59 percent higher than the prior year. Higher heat content production from West Central deep basin accounted for 37 percent of total natural gas production translating into realized natural gas prices that are ten percent higher compared to dry shallow gas prices.

Oil and NGL revenues, before derivatives, of $94.3 million in 2014 were marginally lower than $95.3 reported in 2013. Decreased oil and NGL revenue was a result of lower oil production as recent capital activity has focused on development of liquids-rich natural gas in West Central Alberta and lower NGL sales related to changes in processing in the Edson area. Production declines were largely offset by higher WTI prices during the majority of 2014. The recent global decline in oil prices affected revenue in the latter part of the fourth quarter of 2014.

Realized losses on derivatives in 2014 totaled $9.1 million compared to gains of $6.3 million in 2013. Losses in 2014 were comprised of $5.1 million and $4.0 million related to natural gas and oil contracts respectively, which were partially offset by $0.4 million of crystallized gains on certain economic hedging contracts.

The Corporation recorded unrealized gains on derivatives of $11.9 million during 2014 compared to a gain of $1.8 million in 2013. Unrealized gains and losses represent the change in mark-to-market values 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)	**2014**	2013
Crown	**15,130**	9,924
Freehold and overriding[(1)]	**16,894**	9,118
Total	**32,024**	19,042
Crown (% of total P&NG sales)	**5.8%**	4.9%
Freehold and overriding (% of total P&NG sales)	**6.4%**	4.5%
Total (% of P&NG sales)	**12.2%**	9.4%
Per boe	**4.27**	2.79

(1) Includes $5.2 million in East Edson Gross Overriding Royalties paid as part of the East Edson Agreements in 2014.

Perpetual recorded royalty expense of $32.0 million in 2014, representing an increase in the combined royalty rate to 12.2 percent compared to 9.4 percent in 2013. The increase in freehold and overriding royalty expense was consistent with Perpetual's East Edson royalty disposition and farm-in agreements which included the sale of Drilling and Producing Royalties which entitle the partner to a maximum of 5.6 MMcf/d of natural gas from the East Edson property plus oil and associated NGL on a monthly basis beginning July 1, 2014. Excluding royalty payments of $5.2 million under the East Edson Agreements, the combined royalty rate for 2014 was 10.2 percent, which was still above the prior year as 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)	**2014**	2013
Production and operating expenses	**78,128**	75,414
Per boe	**10.41**	11.05

With the ten percent increase in production in 2014, total production and operating expenses of $78.1 million were only four percent higher than $75.4 million in 2013 reflecting increased operating efficiencies and cost reductions related to the reclassification of oil trucking fees at Mannville to transportation costs. On a boe basis, operating costs decreased in 2014 to $10.41/boe from $11.05/boe in 2013. Operating cost per boe savings relate primarily to infrastructure expansion and enhancements at West Edson, resulting in decreased processing fees paid to third parties and increased efficiency on a unit-of-production basis. Additional savings were realized by redirecting East Edson volumes from a third party deep cut plant to Perpetual's working interest plant at Rosevear. Further operational efficiencies have been realized as a result of pipeline suspensions in eastern Alberta combined with Perpetual's company-wide cost saving initiatives. Property taxes in eastern Alberta continue to be extremely high relative to operating netbacks for these shallow gas properties. Approximately 88 percent of the property taxes paid in 2014 ($8.9 million) relate to assets in Eastern Alberta. As operating costs are also relatively high for these assets, Eastern Alberta property taxes were 17 percent of operating expenses for Eastern Alberta in 2014 and reduced the Company's operating netbacks in eastern Alberta by close to 27 percent.

Transportation costs

($ thousands except as noted)	**2014**	2013
Transportation costs	**12,684**	10,163
Per boe	**1.69**	1.49

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 2014 increased to $12.7 million from $10.2 million in 2013, primarily due to increased Mannville oil transportation costs and higher natural gas sales volumes. 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). The change to onsite processing has enhanced oil marketing opportunities and improved the overall netback for heavy oil production from the Mannville area.

Operating netbacks

	2014	2013
Operating netback ($ thousands)		
Realized revenue [1]	**253,663**	208,522
Royalties[2]	**(32,024)**	(19,042)
Operating costs	**(78,128)**	(75,414)
Transportation	**(12,684)**	(10,163)
Total operating netback	**130,827**	103,903
Boe operating netback ($/boe)		
Realized revenue [1]	**33.81**	30.56
Royalties	**(4.27)**	(2.79)
Operating costs	**(10.41)**	(11.05)
Transportation	**(1.69)**	(1.49)
Boe operating netback	**17.44**	15.23

(1) See "Non-GAAP measures" in this MD&A.
(2) Includes $5.2 million in East Edson Gross Overriding Royalty payments in relation to the East Edson Agreements in 2014.

Perpetual's 2014 operating netback of $17.44/boe ($130.8 million) increased 15 percent from $15.23/boe ($103.9 million) in 2013, with increased revenue more than offsetting higher transportation costs and increased royalty expenses associated with the East Edson gross overriding royalty beginning on July 1, 2014. Operating netbacks in 2014 excluding royalties paid under the East Edson Agreements were $18.13 /boe ($136.0 million).

Gas over bitumen revenue

($ thousands except as noted)	**2014**	2013
Gas over bitumen revenue	**8,888**	8,905
Payments on financial obligation	**(2,829)**	–
Gas over bitumen revenue, net of payments	**6,059**	8,905
Per boe	**0.81**	1.30

Perpetual records revenue in relation to GOB royalty credits received 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. During 2014, Perpetual recorded $8.9 million in GOB revenue which was consistent with the same period in 2013 as the annual 10 percent decline in deemed production was offset by higher Alberta reference prices.

Gas over bitumen financial obligation

($ thousands except as noted)	**2014**
Balance, beginning of year	**–**
Additions	**21,254**
Payments	**(2,829)**
Change in fair value of financial obligation	**(3,035)**
Balance, end of year	**15,390**

In 2014, Perpetual closed transactions to effectively monetize the majority of its future GOB royalty credits associated with certain shut-in properties in northeast Alberta. After closing adjustments, Perpetual received net proceeds of $21.3 million for these transactions. In exchange for the proceeds, Perpetual makes monthly payments to the purchaser which are based on the GOB 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 the January 1, 2014 price forecast, with the Corporation retaining 35 percent of any excess resulting from Alberta Gas Reference prices exceeding a January 1, 2014 third party evaluators 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, for the purposes of this MD&A, the monthly payments have been included as a reduction to GOB revenue to reflect the substantive monetization of the future GOB royalty credits.

Exploration and evaluation

($ thousands)	**2014**	2013
Lease rentals	**3,165**	3,269
Geological and geophysical costs[1]	**644**	1,279
Lease expiries	**2,135**	2,715
Total exploration and evaluation	**5,944**	7,263

[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 $5.9 million in 2014 were $1.4 million lower than the prior year manly due to reduced spending on seismic data.

General and administrative expenses

($ thousands except as noted)	**2014**	2013
Cash general and administrative expense	**22,371**	24,509
Share based compensation expense (non-cash)	**5,972**	3,974
Total general and administrative expense	**28,343**	28,483
Cash general and administrative expense – per boe	**2.98**	3.59
Share based compensation expense (non-cash) ($/boe)	**0.80**	0.58

Cash general and administrative ("G&A") expense for 2014 decreased nine percent to $22.4 million from $24.5 million in 2013, mainly due to higher overhead recoveries from East Edson capital programs as well as lower consulting and professional fees related to Perpetual's cost savings initiatives. Non-cash compensation expenses in 2014 was $6.0 million, up from $4.0 million in 2013 as a result of performance multiplier adjustments related to performance share units issued and outstanding, along with the initial vesting of units granted in the current year.

Impairment

At December 31, 2014, indicators of potential impairment were identified and Perpetual measured the carrying values of each of its cash generating units ("CGUs"), less the corresponding decommissioning obligations, against the estimated recoverable amount based on value in use which Perpetual deemed to be higher compared to fair value less cost to sell. A net impairment loss of $21.4 million was recorded for 2014 consisting of a $26.4 million impairment loss recorded within the Birchwavy East CGU due to lower forecasted oil prices. This impairment loss was partially offset by the reversal of previous year's impairment charges of $5.0 million within the Birchwavy West CGU due to the underlying assets demonstrating sustainable operational performance since the last calculation of the recoverable amount.

In 2013 Perpetual recorded the reversal of a previous years' impairment charge of $5.2 million on assets geographically located within the West Central CGU. Impairments were reversed primarily due to positive reserve revisions related to the strong performance of Perpetual's wells in West Edson.

Depletion and depreciation

($ thousands except as noted)	**2014**	2013
Depletion and depreciation	**94,736**	92,877
Per boe	**12.63**	13.61

Perpetual recorded $94.7 million ($12.63/boe) of depletion and depreciation expense in 2014, compared to $92.9 million ($13.61/boe) in 2013. The decrease in depletion rates per boe in 2014 is consistent with increased reserves largely due to reserve additions recognized with the committed development of the East Edson assets.

Finance expenses

Interest

($ thousands)	**2014**	2013
Cash interest		
Senior notes	**17,670**	13,125
Convertible debentures	**8,912**	11,423
Bank debt	**3,373**	4,384
Total cash interest	**29,955**	28,932
Non-cash interest		
Amortization of debt issue costs	**3,384**	3,545
Loss on redemption of convertible debentures	**1,512**	5
Total non-cash interest	**4,896**	3,550
Total Interest	**34,851**	32,482

Despite lower overall debt levels, interest expense during 2014 was seven percent higher than 2013, primarily associated with non-cash losses of $1.5 million related to the early redemption of the 7.25% Debentures in August 2014 and partial redemption of the 7.00% Debentures in December 2014. Increased cash interest from the issuance of 8.75% senior notes, which carry a higher interest rate than the 7.25% Debentures, was partially offset by reduced short term borrowing costs due to lower levels of bank debt.

Other finance expenses

($ thousands)	**2014**	2013
Accretion on decommissioning obligations	**5,400**	4,439
Accretion and change in estimate on GOB obligation	**376**	211
Change in fair value of financial obligation	**(3,035)**	–
Loss (gain) on marketable securities	**–**	92
Loss (gain) on call option	**–**	1,274
Other finance expenses	**2,741**	6,016

Other finance expenses in 2014 included accretion on decommissioning obligations of $5.4 million (2013 – $4.4 million), accretion and change in estimate on the GOB Obligation of $0.4 million (2013 – $0.2 million) and an unrealized gain of $3.0 million due to a change in the fair value of the financial obligation, related to the GOB monetization (2013 – nil). In 2013, a loss of $1.3 million was recorded during the first quarter 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").

Gains on dispositions

During 2014, Perpetual recorded gains of $42.9 million primarily related to the East Edson Agreements. Perpetual closed the East Edson Agreements for net cash proceeds of $47.0 million combined with $9.4 million in non-monetary deemed proceeds related to the carried farm-in investment of $70 million. Perpetual also recorded gains on the sale of a non-cash swap of undeveloped lands within West Central Alberta during the first quarter of 2014 and on the disposition of its non-core Mannville heavy oil properties which closed during the fourth quarter of 2014. Property dispositions during the same period in 2013 generated net cash proceeds of $79.0 million, resulting in gains on dispositions of $52.1 million relating to the Elmworth property disposition during the first quarter of 2013.

WGS LP income (loss) and dividends

For the year ended December 31, 2014, Perpetual recorded an expense of $3.2 million representing its share of net loss on its equity investment in WGS LP compared to income of $3.8 million for the same period in 2013. Losses in WGS LP in 2014 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 by or received from WGS LP during 2014 (2013 – $2.4 million).

Funds flow

		2014		2013
	($thousands)	***($/boe)***	*($thousands)*	*($/boe)*
Realized revenue[1]	**253,663**	**33.81**	208,522	30.56
Royalties[2]	**(32,024)**	**(4.27)**	(19,042)	(2.79)
Operating expenses	**(78,128)**	**(10.41)**	(75,414)	(11.05)
Transportation costs	**(12,684)**	**(1.69)**	(10,163)	(1.49)
Operating netback[1]	**130,827**	**17.44**	103,903	15.23
GOB revenue net of payments	**6,059**	**0.81**	8,905	1.30
Exploration and evaluation[3]	**(3,165)**	**(0.42)**	(3,269)	(0.48)
Cash G&A	**(22,371)**	**(2.98)**	(24,509)	(3.59)
Interest[3]	**(29,955)**	**(3.99)**	(28,932)	(4.24)
Dividends from WGS LP	**–**	**–**	2,370	0.35
Funds flow[1]	**81,395**	**10.86**	58,468	8.57

(1) See "Non-GAAP measures" in this MD&A.
(2) Includes $5.2 million in East Edson Gross Overriding Royalty payments in relation to the East Edson Agreements.
(3) Excludes non-cash items.

Funds flow increased 39 percent from 2013 to $81.4 million ($0.55 per share) as a result of increased production, stronger crude oil and natural gas prices, and higher operating netbacks in 2014.

Net income

	2014			2013
	($thousands)	***($/boe)***	*($thousands)*	*($/boe)*
Funds flow[1]	**81,395**	**10.86**	58,468	8.57
Unrealized gains on derivatives	**11,946**	**1.59**	1,783	0.26
Call option premiums received	**–**	**–**	(953)	(0.14)
Payments on financial obligation	**2,829**	**0.38**		
Exploration and evaluation[2]	**(2,779)**	**(0.37)**	(3,994)	(0.59)
Compensation expense, non-cash	**(5,972)**	**(0.80)**	(3,974)	(0.58)
Gain on dispositions	**42,944**	**5.72**	52,143	7.64
Impairment reversal (write-down)	**(21,400)**	**(2.85)**	5,171	0.76
Depletion and depreciation	**(94,736)**	**(12.63)**	(92,877)	(13.61)
Financial items, non-cash	**(7,637)**	**(1.02)**	(9,566)	(1.40)
WGS LP net income (loss) and dividends	**(3,224)**	**(0.43)**	1,419	0.21
Net income	**3,366**	**0.45**	7,620	1.12

(1) See "Non-GAAP measures" in this MD&A.
(2) Includes non-cash exploration and evaluation expense from expired leases and geological and geophysical costs.

The Corporation recorded net income of $3.4 million ($0.45 per boe) for the year ended December 31, 2014 compared to net income of 7.6 million ($1.12 per boe) for the same period in 2013 primarily as a result of the increased funds flow combined with gains on dispositions and unrealized gains on derivatives in 2014.

SUMMARY OF QUARTERLY RESULTS

($ thousands, except where noted)	**Q4 2014**	Q3 2014	Q2 2014	Q1 2014
Financial				
Oil and natural gas revenues	**62,562**	63,126	72,348	64,754
Funds flow[1]	**17,316**	20,831	25,864	17,384
Per share – basic	**0.12**	0.14	0.17	0.12
Net income (loss)	**(18,273)**	36,414	2,549	(17,324)
Per share – basic	**(0.12)**	0.24	0.02	(0.12)
– diluted[2]	**(0.12)**	0.23	0.02	(0.12)
Capital expenditures				
Exploration and development	**25,639**	46,583	12,251	31,340
Geological and geophysical	**379**	34	218	13
Acquisitions	**756**	–	91	151
Dispositions	**(21,351)**	(46,998)	(3,000)	–
Other	**84**	347	108	75
Net capital expenditures	**5,507**	(34)	9,668	31,579
Common shares (thousands)				
Weighted average – basic	**149,462**	149,574	148,835	148,448
Operating				
Daily average production				
Natural gas (MMcf/d)	**122.5**	97.8	97.8	92.1
Oil and NGL (bbl/d)	**3,262**	3,324	3,738	3,451
Total (boe/d)	**23,685**	19,640	20,053	18,794
Average prices				
Natural gas – before derivatives ($/Mcf)	**3.96**	4.35	4.95	4.90
Natural gas – including derivatives ($/Mcf)	**4.16**	4.35	4.66	4.35
Oil and NGL – before derivatives ($/bbl)	**59.77**	78.26	83.08	77.72
Oil and NGL – including derivatives ($/bbl)	**64.39**	75.10	74.65	72.06

(1) See "Non-GAAP measures" in this MD&A.
(2) 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 160.3 million for the second and the third quarters of 2014, respectively.

($ thousands, except where noted)	Q4 2013	Q3 2013	Q2 2013	Q1 2013
Financial				
Oil and natural gas revenues	49,075	52,555	57,187	42,477
Funds flow[1]	12,998	18,650	17,286	9,534
Per share – basic	0.09	0.13	0.12	0.06
Net income (loss)	(13,745)	(6,833)	(4,566)	32,764
Per share – basic	(0.09)	(0.05)	(0.03)	0.22
– diluted[2]	(0.09)	(0.05)	(0.03)	0.21
Capital expenditures				
Exploration and development	24,537	22,325	9,861	38,682
Geological and geophysical	(19)	25	499	774
Acquisitions	418	532	5,433	1,752
Dispositions	(901)	(60)	(84)	(77,930)
Other	2	34	19,162	51
Net capital expenditures	24,037	22,856	34,871	(36,671)
Common shares (thousands)				
Weighted average - basic	148,489	148,382	148,015	147,672
Operating				
Daily average production				
Natural gas (MMcf/d)	90.3	85.3	91.9	88.6
Oil and NGL (bbl/d)	3,509	4,064	4,384	3,483
Total (boe/d)	18,559	18,274	19,708	18,244
Average prices				
Natural gas – before derivatives ($/Mcf)	3.37	2.79	3.68	3.18
Natural gas – including derivatives ($/Mcf)	3.62	3.31	3.90	3.28
Oil and NGL – before derivatives ($/bbl)	65.35	82.03	66.18	54.74
Oil and NGL – including derivatives ($/bbl)	65.88	76.86	64.84	56.82

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

(2) 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 171.7 million for first quarter of 2013.

FOURTH QUARTER FINANCIAL AND OPERATING RESULTS

The Corporation continued its focus on liquids-rich natural gas development in the West Central district by drilling 11 (10.0 net) wells during the fourth quarter of 2014, including two (1.0 net) wells at West Edson and nine (9.0 net) wells at East Edson. The East Edson wells were drilled utilizing partner funds held in escrow pursuant to the East Edson Agreements. All of these new wells have now been brought on production after completion and tie in operations were finished in the first quarter of 2015. Total capital expenditures of $26.0 million were spent on fourth quarter capital projects, including development spending at East Edson and the successful start-up of waterflood projects at Mannville.

Perpetual's fourth quarter 2014 total production of 23,685 boe/d was 28 percent higher than the comparative fourth quarter of 2013 (18,559 boe/d) with new production from the East Edson drilling program more than offsetting natural declines.

Revenue increased 27 percent during the fourth quarter of 2014 compared to the same period in 2013 primarily due to higher natural gas production and increased gas prices offset by lower oil and NGL volumes and prices. Despite increased royalty expenses due to the East Edson GORR, higher operating expenses, and a reduction to GOB revenue, Perpetual's funds flow increased 33 percent to $17.3 million in the fourth quarter of 2014 compared to $13.0 million reported for the same period in 2013. A net loss of $18.3 million ($0.12 per share) was recorded for the fourth quarter of 2014.

LIQUIDITY, CAPITALIZATION AND FINANCIAL RESOURCES

Perpetual targets to maintain a strong capital base to maintain investor, creditor and market confidence, and to sustain the future development of the business. The Corporation strives to manage 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. Perpetual's capital structure includes share capital, bank debt, senior notes, convertible debentures and adjusted working capital. In order to manage its capital structure, the Corporation may from time to time issue shares or debt securities, enter into business transactions including the sale of assets and adjust its capital spending to manage current and projected debt levels.

To strengthen Perpetual's financial position, the following significant transactions were executed in 2014:

- Perpetual completed the monetization of its future GOB credits for net proceeds of $21.3 million. Proceeds were applied to reduce bank indebtedness.

- Perpetual sold a 50 percent royalty interest in current developed producing reserves in the East Edson area which included net cash proceeds of $47 million, consisting of $17 million of unrestricted cash that was applied to reduce bank indebtedness, with the remaining $30 million held in escrow for development spending in East Edson. At the end of 2014, $6.6 million remained in escrow. Concurrent with the royalty disposition, Perpetual also entered into a farm-in agreement, whereby the partner contributed $70 million which was held in a separate escrow account to be used to fund development activities in East Edson. As at December 31, 2014, substantially all the partner escrow cash was spent with the remaining balance spent early in 2015.

- On November 7, 2014, Perpetual divested several non-core heavy oil properties in eastern Alberta for gross proceeds of $21.4 million.

- Perpetual issued $125 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 were used to redeem all of Perpetual's outstanding 7.25% Debentures in cash for approximately $99.9 million on August 25, 2014. The remaining balance was initially applied to further reduce bank indebtedness and then utilized for the early redemption of $25.0 million of Perpetual's $59.9 million outstanding 7.0% Debentures on December 31, 2014. The remaining $34.9 million of the 7.0% Debentures mature on December 31, 2015.

The combined impact of these transactions has alleviated financial liquidity restraints through the repayment of the majority of the Corporation's 2015 debt repayment obligations. In addition, the infusion of cash from both Perpetual's and its partners' East Edson escrow accounts has allowed Perpetual to accelerate its development program which is expected to increase production in 2015. The result of these transactions have provided Perpetual increased flexibility as it reviews repayment options on the remaining outstanding 7.0% Debentures maturing on December 31, 2015.

Capital management

($ thousands, except as noted)	**December 31, 2014**	December 31, 2013
Bank debt	**–**	70,618
Senior notes, measured at principal amount	**275,000**	150,000
Convertible debentures, measured at principal amount	**34,878**	159,779
Adjusted working capital deficiency (surplus)(1) (2)	**21,867**	(3,417)
Net debt	**331,745**	376,980
Shares outstanding at end of period *(thousands)*	**150,077**	148,490
Market price at end of period *($/share)*	**1.14**	1.11
Market value of shares	**171,088**	164,824
Total capitalization(1)	**502,833**	541,804
Net debt as a percentage of total capitalization	**66.0**	69.6
Trailing twelve months funds flow(1)	**81,395**	58,468
Net debt to funds flow ratio(3)	**4.1**	6.4

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

(2) Includes $6.6 million of restricted cash held in escrow but excludes $0.5 million of East Edson partner capital held in escrow at December 31, 2014.

(3) 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 twelve months ("TTM") funds flow. As at December 31, 2014, the Corporation's ratio of net debt to TTM funds flow had improved significantly, decreasing 36 percent from year end 2013, to 4.1 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 December 31, 2014, Perpetual had net debt of $331.7 million, down $45.3 million from December 31, 2013. The reduction in net debt reflected 2014 funds flow, combined with proceeds received from dispositions, Perpetual's escrow funds related to the East Edson Agreements and the monetization of GOB royalty credits, which, in total, exceeded 2014 capital expenditures with the excess funds being applied as an overall reduction to net debt.

Perpetual's adjusted working capital deficiency at December 31, 2014 was $21.9 million compared to a surplus of $3.4 million at December 31, 2013. The Corporation has an adjusted working capital deficiency as a result of increased accounts payables associated with increased capital spending during the fourth quarter of 2014. In addition, accounts payable includes $13.5 million of unapplied cash calls in relation to funds being drawn on the partner's escrow account to fund a portion of 2015 drilling activities in East Edson. The increase in payables is partially offset by increased cash and restricted cash received from the East Edson royalty disposition and additional East Edson partner cash calls.

Reconciliation of net debt ($ millions)	
Net debt, December 31, 2013[(1)]	377.0
Capital expenditures[(2)]	117.0
Dispositions, net of acquisitions	(70.4)
Proceeds on GOB monetization	(21.3)
Funds flow[(1)]	(81.4)
Expenditures on decommissioning obligations	6.6
Issue fees on senior notes	2.7
Other	1.5
Net debt, December 31, 2014[(1)(3)]	**331.7**

(1) See "Non-GAAP measures" in this MD&A.
(2) Capital expenditures consist of exploration and development including geological and geophysical costs and corporate assets.
(3) Excludes $0.5 million of East Edson partner capital held in escrow at December 31, 2014.

Cash and bank indebtedness

At December 31, 2014, Perpetual had cash and cash equivalents of $11.5 million (December 31, 2013 – nil) and restricted cash of $6.6 million (December 31, 2013 – nil) representing Perpetual's escrow funds related to the East Edson Agreements. Perpetual was undrawn on its credit facility with outstanding letters of credit in the amount of $8.8 million. Comparatively, at December 31, 2013, the Corporation had $70.6 million drawn on the credit facility and $5.9 million of outstanding letters of credit.

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. Total availability under the facility was increased to $130 million from $110 million which consisted 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 GOB royalty credits. 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.

On November 5, 2014, the Corporation's lenders completed their next semi-annual review of the borrowing base. Total availability under the facility was increased to $105 million consisting of a demand loan of $90 million and a working capital facility of $15 million. The increase was due to the conversion of undeveloped reserves to developed producing reserves driven by the drilling activities at East Edson despite the monetization of additional GOB royalty credits and the sale of non-core Mannville heavy oil assets. The revolving feature of the facility expires on April 30, 2015 with a 184 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 April 30, 2015.

At December 31, 2014, the Corporation had covenants that require consolidated debt to TTM income before interest, taxes, depletion and depreciation and non-cash items ("Consolidated Debt Ratio") to be less than 4.0 to 1.0. 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. The credit facility also contains covenants that require consolidated senior debt to TTM income before interest, taxes, depletion and depreciation and non-cash items ("Consolidated Senior Debt Ratio") to be less than 3.0 to 1.0. 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 December 31, 2014.

On March 5, 2015, the Corporation's lenders agreed to revise financial covenants based on prevailing low commodity prices at the end of 2014 and uncertainty surrounding forecast commodity prices into 2016. The lenders have agreed to amend the financial covenants contained in the credit facility to:

- Waive the Consolidated Debt Ratio for the quarter ending June 30, 2015 for a period up to and including the quarter ending June 30, 2016.

- Provide for a financial covenant that requires TTM income before interest, taxes, depletion and depreciation and non-cash items to consolidated fixed charges ("Fixed Charges Ratio") of at least 1.45 to 1.0 beginning for the quarter ending June 30, 2015 up to and including the quarter ending June 30, 2016. Fixed charges is defined as the sum of interest on senior notes, convertible debentures, and bank indebtedness less the amortization of debt issuance costs.

- Revise the Consolidated Debt Ratio for the quarter ending September 30, 2016 such that the Corporation will be required to maintain a Consolidated Debt Ratio not exceeding 4.5 to 1.0.

- Reinstate the requirement to maintain a Consolidated Debt ratio not exceeding 4.0 to 1.0 beginning with the quarter ending December 31, 2016.

Advances under the credit facility are made in the form of Banker's Acceptances ("BA"), prime rate loans or letters of credit. 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.

The credit facility bears interest at its lenders' prime rate or BA rates, plus applicable margins and standby fees. The applicable margins range between 1.25 percent and 4.25 percent depending on the form of borrowing and changes in the Corporation's Consolidated Debt Ratio for the most recently completed reporting period.

Convertible debentures

At the beginning of 2014, the Corporation had outstanding $99.9 million of 7.25% Debentures maturing on January 31, 2015, as well as $59.9 million of 7.0% Debentures maturing on December 31, 2015.

The Corporation had the option to settle all or a portion of the outstanding 7.25% Debentures in cash or through the issuance of shares, with no penalty, 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 would be settled in cash with proceeds received from the $125 million senior unsecured notes. Settlement of the 7.25% Debentures occurred on August 25, 2014. Redemption of the total principal amount and accrued interest was funded from proceeds on the issuance of new senior notes.

The outstanding 7.0% Debentures may also be settled in cash or through the issuance of shares, with no penalty, on or after December 31, 2014, 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 December 31, 2014, Perpetual redeemed $25 million of the outstanding principle amount in cash. The redemption and accrued interest was funded primarily from proceeds received on the disposition of non-core heavy oil properties during the fourth quarter of 2014.

At December 31, 2014, $34.9 million of the Corporation's 7.0% Debentures remain outstanding as a short term liability. Management is evaluating repayment options including utilizing excess funds flow and bank indebtedness, asset dispositions, refinancing, or a combination thereof. There is no assurance that the Corporation will be able to raise additional capital to settle all or a portion of the outstanding 7.0% Debentures in cash, in which case, the Corporation would have the option to settle all or a portion with common shares. Additional information on the remaining 7.0% Debentures are as follows:

Principal issued ($ millions)	60.0
Principal outstanding ($ millions)	34.9
Trading symbol on the Toronto Stock Exchange	PMT.DB.E
Maturity date	December 31, 2015
Conversion price ($ per share)	7.00
Fair market value ($ millions)(1)	34.9

(1) Fair values of the 7.0% Debentures are calculated by multiplying the number of debentures outstanding at March 4, 2015 by the quoted market price per debenture at that date.

Senior notes

At December 31, 2014, Perpetual had $275 million of senior notes outstanding, including $125 million of senior notes issued during 2014, proceeds from which were used to redeem certain of the Corporation's outstanding convertible debentures. Additional information on the senior notes is as follows:

	Maturity date	Principal	Interest rate	December 31, 2014	December 31, 2013
2011 senior notes (1)	March 15, 2018	150,000	8.75%	**148,223**	147,719
2014 senior notes (2)	July 23, 2019	125,000	8.75%	**122,467**	–
		275,000		**270,690**	147,719

(1) Issued March 15, 2011, interest payable semi-annually on September 15 and March 15 of each year.
(2) Issued July 23, 2014, interest payable semi-annually on January 23 and July 23 of each year.

The fair market value of the senior notes at March 4, 2015 was $238.3 million.

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 Corporation can redeem up to 35 percent of the principal amount of the senior notes at a premium to face value with proceeds from common share offerings up to three years prior to maturity. Within three years of maturity the Corporation can repay the senior notes at a premium to face value based on the date of repayment.

The senior notes have a cross-default provision with the Corporation's credit facility which require the Consolidated Debt Ratio and the Consolidated Senior Debt Ratio to be less than 4.0 to 1.0 and 3.0 to 1.0, respectively. The Corporation was in compliance with the lenders' covenants at December 31, 2014. The Corporation's lenders have agreed to amend the credit facility agreement for the period beginning with the quarter ended June 30, 2015 up to and including the quarter ended June 30, 2016 to remove the Consolidated Debt Ratio and replace it with the Fixed Charges Ratio. The Consolidated Debt Ratio requirement for the quarter ended September 30, 2016 will be 4.5 to 1.0. Subsequent to this the Consolidated Debt Ratio requirement will return to 4.0 to 1.0 beginning with the quarter ended December 31, 2016.

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 Ratio is less than 3.0 to 1.0, the sum of 50 percent of income before interest, taxes, depletion and depreciation and non-cash items 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; and

ii) To the extent the Corporation's Consolidated Debt 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.

At December 31, 2014 the senior notes are presented net of $4.3 million in issue costs which are amortized using a weighted average effective interest rate of 9.2 percent.

Equity

Perpetual's total capitalization was $502.8 million at December 31, 2014. Net debt as a percentage of total capitalization was 66 percent, down from 70 percent at December 31, 2013. The decrease was driven by lower net debt levels resulting from proceeds on dispositions, GOB monetization and funds flow exceeding capital spending for the period.

Basic weighted average shares outstanding for the year ended December 31, 2014 totaled 149.1 million (2013 – 148.1 million). On March 5, 2015 there were 150.1 million shares outstanding.

2015 OUTLOOK

In 2015, Perpetual is focused on five strategic priorities:

- Grow greater Edson liquids-rich gas production, cash flow, inventory, reserves and value;
- Optimize value of Mannville heavy oil;
- Refine elements of production growth strategy for 2017 to 2020;
- Maximize value of shallow gas; and
- Reduce debt and improve debt/cash flow ratio.

In light of current weakness and uncertainty in commodity prices, Perpetual's Board of Directors has approved a first quarter capital expenditure budget of $45 million. Nearly $42 million will be directed to the drilling of six wells (4.5 net) in west central Alberta, with three (1.5 net) at West Edson and three (3.0 net) at East Edson, coupled with the East Edson plant construction activities. All heavy oil drilling has been deferred until oil prices recover, although $1.3 million will be expended on advancing the Mannville waterflood. Strategic spending at Panny to advance the LEAD pilot project has been reduced to include only capital required to drill two (2.0 net) observation wells associated with the pilot scheme, estimated at $1.2 million.

Capital activity for the remainder of the year will be assessed as the year progresses with the intention that spending will be largely funded from funds flow and available bank indebtedness. The reduction in drilling in first quarter 2015 will not materially impact 2015 gas production as the wells drilled to date have generally exceeded the type curves and provide the same production capability as originally budgeted. Further, variations in capital spending for the final three quarters of 2015 are not expected to materially affect average production or annual funds flow.

Perpetual has commodity price contracts in place for both crude oil and natural gas to protect a base level of cash flow. Natural gas contracts were entered into to provide downside protection on revenue primarily through the summer months with physical and financial contracts in place for 2015 on an average of close to 68,400 GJ/d at an average price of $2.63/GJ. Crude oil contracts for 2015 on 1,000 bbls/d include costless collars protecting a WTI floor price of Cdn$87.50/bbl with an average ceiling of Cdn$95.50/bbl, as well as financial contracts which fix the basis differential between WTI and Western Canadian Select trading hubs at an average of US$16.88/bbl.

Incorporating the assumptions and commodity price contracts outlined above, the following table shows Perpetual's estimated 2015 funds flow using various commodity prices:

Projected 2015 funds flow[(2)] ($millions) **AECO gas price ($/GJ)**[(1)]

		$2.50	**$3.00**	**$3.50**	**$4.00**	**$4.50**
WTI price (US$/bbl)[(1)]	**$45.00**	4.7	13.8	22.9	32.1	41.2
	$50.00	6.8	15.9	25.1	34.2	43.3
	$55.00	8.9	18.0	27.2	36.3	45.4
	$60.00	11.0	20.1	29.3	38.4	47.5
	$65.00	13.1	22.2	31.4	40.5	49.6

(1) The current settled and forward average AECO and WTI prices for 2015 as of March 4, 2015 were $2.69 per GJ and US$55.69 per bbl, respectively.
(2) Funds flow is a non-GAAP measures. Please refer to "Non-GAAP Measures" below.

On March 5, 2015, the Corporation's lenders agreed to revise financial covenants based on prevailing low commodity prices at the end of 2014 and uncertainty surrounding forecast commodity prices into 2016. Based on internal 2015 and 2016 financial and operating forecasts, Perpetual expects to be in compliance with the lender's new covenants.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

Perpetual has contractual agreements comprised of office lease costs and related sublease recoveries, as well as long-term commitments to utilize drilling rigs and pay for gas transportation on certain major pipeline systems in western Canada. As of December 31, 2014, the future minimum payments under these contractual agreements consisted of:

($thousands)	**Drilling Commitments**	**Pipeline commitments**	**Operating lease commitments**
2015	3,533	9,560	1,712
2016	2,712	7,627	1,685
2017	1,416	5,868	1,621
2018	–	3,986	405
2019	–	3,986	–
Total	**$ 7,661**	**$ 31,027**	**$ 5,423**

OFF BALANCE SHEET ARRANGEMENTS

Perpetual has no off balance sheet arrangements.

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.

RISK FACTORS

The business risks the Corporation is exposed to are those inherent in the oil and gas industry as well as those governed by the individual nature of Perpetual's operations. Risks impacting the business which influence controls and management of the Corporation include, but are not limited to, the following:

- geological and engineering risks;
- the uncertainty of discovering commercial quantities of new reserves;
- commodity prices, interest rate and foreign exchange risks;
- competition; and
- changes to government regulations including shut in of GOB assets.

Perpetual manages these risks by:

- attracting and retaining a team of highly qualified and motivated professionals who have a vested interest in the success of the Corporation;
- operating properties in order to maximize opportunities;
- employing risk management instruments and policies to minimize exposure to volatility of commodity prices, interest rates and foreign exchange rates;
- maintaining a strong financial position; and
- maintaining strict environment, safety and health practices.

A complete discussion of risk factors is included in the Corporation's 2014 AIF available on the Corporation's website at www.perpetualenergyinc.com or on sedar at www.sedar.com.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Perpetual's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have designed, or caused to be designed under their supervision, disclosure controls and procedures ("DC&P) and Internal controls over financial reporting ("ICOFR") as defined in National Instrument 52-109 Certification of Disclosure in Issuer's Annual and Interim Filings in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with IFRS.

Disclosure controls and procedures

The DC&P have been designed to provide reasonable assurance that material information relating to Perpetual is made known to the CEO and CFO by others and that information required to be disclosed by Perpetual in its annual filings, interim filing or other reports filed or submitted by Perpetual under securities legislation.

Perpetual's CEO and CFO have concluded, based on their evaluation at December 31, 2014, that DC&P are effective to provide reasonable assurance that material information related to the issuer is made known to them by others within the Corporation, as such information is recorded, processed, summarized and reported in the reports filed or sent to securities regulatory authorities within the time periods specified under Canadian securities laws.

Management's annual report on internal controls over financial reporting

Management is responsible for establishing and maintaining adequate ICOFR, which is a process designed by, or under the supervision of, the CEO and CFO, and effected by the board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

Under the supervision and with the participation of management, including the CEO and CFO, an evaluation of the effectiveness of the internal control over financial reporting was conducted as of December 31, 2014 based on criteria described in "Internal Control – Integrated Framework" issued in 2013 by the Committee of Sponsoring Organization of the Treadway Commission. Based on this assessment, management determined that, as of December 31, 2014, the internal control over financial reporting was effective.

Changes to internal controls over financial reporting

There were no changes in the Corporation's internal control over financial reporting during the period beginning on January 1, 2014 and ended December 31, 2014 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

CEO and CFO certifications

Perpetual's CEO and CFO have filed with the Canadian securities regulators regarding the quality of Perpetual's public disclosures relating to its fiscal 2014 report filed with the Canadian securities regulators.

CRITICAL ACCOUNTING ESTIMATES

Perpetual makes assumptions in applying certain critical accounting estimates that are uncertain at the time the accounting estimate is made and may have a significant effect on the consolidated financial statements. Critical accounting estimates include oil and natural gas reserves, derivative financial instruments, provisions, the amount and likelihood of contingent liabilities and income taxes. Critical accounting estimates are based on variable inputs including:

- Estimation of recoverable oil and natural gas reserves and future cash flows from reserves;
- Forward market price curves;
- Geological interpretations, success or failure of exploration activities, and Perpetual's plans with respect to property and financial ability to hold the property;
- Risk free interest rates;
- Estimation of future abandonment and reclamation costs;
- Facts and circumstances supporting the likelihood and amount of contingent liabilities; and
- Interpretation of income tax laws.

A change in a critical accounting estimate can have a significant effect on net income as a result of their impact on the depletion rate, provisions, impairments, losses and income taxes. A change in a critical accounting estimate can have a significant effect on the value of property, plant, and equipment, provisions, derivative financial instruments and accounts payable. A complete discussion of critical accounting estimates is included in the notes to the consolidated financial statements at December 31, 2014.

Future accounting pronouncements

The International Accounting Standards Board (IASB) and the IFRS Interpretations Committee regularly issue new and revised accounting pronouncements which have future effective dates and therefore are not reflected in Perpetual's financial statements. Once adopted these new and amended pronouncements may have an impact on Perpetual's consolidated financial statements. Perpetual's analysis of recent accounting pronouncements is included in the notes to the consolidated financial statements at December 31, 2014.