



## FINANCIAL AND OPERATING HIGHLIGHTS<sup>(1)</sup>

(\$ millions, except as noted)

Three months ended March 31	2011	2010	Change %
<b>Financial<sup>(2)</sup></b>			
Petroleum and natural gas sales	<b>46.8</b>	48.9	(4)
Funds flow from operations <sup>(3)</sup>	<b>13.9</b>	23.5	(41)
Per share – basic and diluted (\$/share)	<b>0.19</b>	0.33	(42)
Net income (loss)	<b>(11.9)</b>	26.9	(144)
Per share – basic and diluted (\$/share)	<b>(0.16)</b>	0.37	(143)
Exploration and development expenditures	<b>160.2</b>	66.8	140
Investments in other entities – market value <sup>(4)</sup>	<b>717.6</b>	341.1	110
Total assets	<b>1,590.9</b>	1,110.1	43
Net debt <sup>(5)</sup>	<b>432.3</b>	117.2	269
Common shares outstanding (thousands)	<b>75,397</b>	72,520	4
<b>Operating</b>			
Sales volumes:			
Natural gas (MMcf/d)	<b>58.7</b>	50.2	17
NGLs (Bbl/d)	<b>968</b>	775	25
Oil (Bbl/d)	<b>2,353</b>	2,739	(14)
Total (Boe/d)	<b>13,097</b>	11,875	10
Average realized price:			
Natural gas (\$/Mcf)	<b>4.26</b>	5.59	(24)
NGLs (\$/Bbl)	<b>79.29</b>	72.22	10
Oil (\$/Bbl)	<b>81.91</b>	75.51	8
Net wells drilled (excluding oil sands evaluation)	<b>12</b>	22	(45)
Net oil sands evaluation wells drilled	<b>26</b>	45	(42)

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

(2) Paramount adopted International Financial Reporting Standards ("IFRS") effective for fiscal years beginning on or after January 1, 2011 and the Company has applied IFRS as of January 1, 2010 for comparative purposes. Certain prior period amounts have been adjusted to reflect the changes in the Company's accounting policies.

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

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

(5) Net debt is a non-GAAP measure, it is calculated and defined in the Liquidity and Capital Resources section of Management's Discussion and Analysis.

# FIRST QUARTER OVERVIEW

## Funds Flow From Operations

- Funds flow from operations in the first quarter of 2011 decreased by \$9.6 million from the first quarter of 2010, primarily due to the impact of lower natural gas prices and higher interest costs.

## Principal Properties

- Average sales volumes of 13,097 Boe/d in the first quarter of 2011 were 10 percent higher than the first quarter of 2010. During the last week of April 2011 average sales volumes exceeded 16,500 Boe/d.
- The Kaybob COU drilled ten (6.5 net) wells. Construction of the 45 MMcf/d processing plant at Musreau is on schedule and on budget for an expected startup in late third quarter 2011.
- First quarter 2011 production in the Grande Prairie COU increased seven percent compared to the first quarter of 2010 despite a month-long unscheduled operational disruption at a third party midstream processing facility at Karr-Gold Creek. A further unscheduled disruption occurred at the same midstream facility in early May, and the operator is working to resolve the issue.
- Construction of the second 20 MMcf/d phase of the compression/dehydration facility at Karr-Gold Creek in the Grande Prairie COU is on schedule and on budget, and is expected to enter service in June 2011.
- Paramount closed the sale of approximately 6,000 net acres of undeveloped 100 percent working interest land in North Dakota for cash proceeds of US\$40 million.
- In April 2011, Paramount entered into an arrangement agreement with ProspEx Resources Ltd. ("ProspEx") which provides for Paramount's acquisition of all of the ProspEx shares not already owned by the Company.

## Strategic Investments

- The market value of Paramount's financial portfolio of investments in other oil and gas entities increased 43 percent in the first quarter of 2011 to \$717.6 million.
- Paramount drilled an additional fifteen oil sands evaluation wells at Hoole and has requested an updated resources evaluation from the Company's independent evaluator.
- At the Saleski carbonate bitumen property, the Company completed a ten well delineation and drilling program in the Grosmont formation to obtain data for a detailed analysis of this resource.

## Corporate

- In February 2011, Paramount closed the public offering of an additional \$70 million principal amount of 8.25% senior unsecured notes.
- In April 2011, Paramount closed a public offering and a private placement of an aggregate 1.7 million Common Shares for gross proceeds of \$54.2 million.
- The revolving feature of the Company's credit facility has been extended to June 30, 2011 to allow for the closing of the ProspEx acquisition prior to establishing a new borrowing base. The Company expects the current \$160 million borrowing base to be increased on renewal.

## REVIEW OF OPERATIONS

Three months ended	March 31, 2011	December 31, 2010	Change
<b>SALES VOLUMES</b>			
Natural gas (MMcf/d)	<b>58.7</b>	60.4	(1.7)
NGLs (Bbl/d)	<b>968</b>	1,030	(62)
Oil (Bbl/d)	<b>2,353</b>	2,357	(4)
Total (Boe/d)	<b>13,097</b>	13,461	(364)
<b>NETBACKS</b>			
(\$/Boe)			
Petroleum and natural gas sales	<b>39.67</b>	37.11	2.56
Royalties	<b>(4.01)</b>	(3.51)	(0.50)
Operating expense and production tax	<b>(13.20)</b>	(10.37)	(2.83)
Transportation	<b>(3.47)</b>	(3.46)	(0.01)
<b>Netback</b>	<b>18.99</b>	19.77	(0.78)
Financial commodity contract settlements	<b>(0.23)</b>	1.45	(1.68)
<b>Netback including financial commodity contract settlements</b>	<b>18.76</b>	21.22	(2.46)

Sales volumes decreased 364 Boe/d in the first quarter of 2011 compared to the fourth quarter of 2010, primarily as a result of natural declines, production interruptions from unscheduled downtime at a third party processing facility in the Grande Prairie COU, scheduled annual maintenance in the Northern COU and the fact that the majority of the wells drilled in the 2010/2011 winter drilling program were not yet on production as of March 31, 2011. A number of these new wells have now been brought on production and Paramount's average sales volumes for the last week of April increased to over 16,500 Boe/d. Additional increases are expected throughout 2011 to achieve the Company's anticipated exit rate of 25,000 Boe/d. The Grande Prairie COU is adding a total of 30 MMcf/d of new compression capacity in the second quarter, and the new 45 MMcf/d processing plant at Musreau in the Kaybob COU is expected to enter service late in the third quarter.

The first quarter netback decreased \$2.46 per Boe compared to the fourth quarter of 2010, primarily because of higher seasonal operating costs and lower financial commodity contract settlements, partially offset by higher commodity prices. The Company's operating costs are normally higher in the first quarter of each year as a result of annual scheduled repair and maintenance programs at winter access locations in the Northern COU.

# KAYBOB

Three months ended	March 31, 2011		December 31, 2010		Change
<b>Sales Volumes</b>					
Natural gas (MMcf/d)	27.7		28.8		(1.1)
NGLs (Bbl/d)	535		614		(79)
Oil (Bbl/d)	95		99		(4)
Total (Boe/d)	5,246		5,506		(260)
<b>Exploration and Development Expenditures<sup>(1)</sup> (\$ millions)</b>					
Exploration, drilling, completions and tie-ins	45.1		26.4		18.7
Facilities and gathering	34.2		11.0		23.2
	79.3		37.4		41.9
	<b>Gross</b>	<b>Net</b>	Gross	Net	
<b>Wells drilled</b>	10	6	5	2	
<b>Wells placed on production</b>	11	7	1	–	

(1) Before deduction of Alberta Drilling Royalty credits

Average daily sales volumes in the Kaybob COU decreased in the first quarter of 2011 as a result of natural declines, and the fact that additions of incremental production from wells drilled in the 2010/2011 winter drilling season occurred towards the end of the quarter. During the first quarter, eleven (6.8 net) wells were completed and tied-in, one (0.5 net) of which remains shut-in and four (3.25 net) of which are producing at restricted rates due to processing and transportation constraints. Notwithstanding these constraints, by the last week of April 2011, incremental production from these wells resulted in the Kaybob COU's sales volumes increasing to approximately 7,700 Boe/d. Once existing capacity restraints are resolved, the Company estimates that incremental liquids rich gas production of up to 30 (25 net) MMcf/d can be obtained from these wells. In addition, the Company has an inventory of an additional 10 (6.8 net) wells that have been drilled and are awaiting completion and tie-in.

Paramount has been actively working on means of increasing its processing and gathering capacity in the Deep Basin by constructing new processing plants and pipelines, securing capacity at third party facilities and securing additional access to sales pipelines. The new 45 MMcf/d processing plant being constructed at Musreau is on schedule to enter service late in the third quarter and is expected to reach its design capacity by the end of the year. The expansion of the third party plant at Smoky, for which Paramount has nominated for an incremental 50 MMcf/d of processing capacity, is currently in the engineering and design phase and is expected to be completed in early 2013.

The Company has drilled a total of 24 horizontal wells in the Deep Basin since the second quarter of 2009, 18 of which were operated by the Company. Ten of these wells targeted the Dunvegan horizon, eleven targeted the Falher horizon, one targeted the Cadotte horizon and more recently two wells have targeted the Montney horizon. The Company has been able to repeat well performance consistently within expected ranges in the Dunvegan and Falher horizons, with test rates for the 15 wells that have been completed averaging 10.3 MMcf/d and with first month sales volumes for the 10 wells that have produced for at least one full month averaging 5.3 MMcf/d of natural gas and 20 Bbls/d of liquids.

Paramount has commenced the development of its 105,000 (100,000 net) acre Montney land base in the Kaybob COU with the drilling of two wells in the first quarter. These wells are expected to be completed in the second quarter and the Company plans to drill additional wells later in 2011.

The Kaybob COU has secured four drilling rigs for its Deep Basin properties and expects to drill up to eleven additional wells during the remainder of 2011.

## GRANDE PRAIRIE

Three months ended	March 31, 2011		December 31, 2010		Change
<b>Sales Volumes</b>					
Natural gas (MMcf/d)	13.0		11.4		1.6
NGLs (Bbl/d)	367		333		34
Oil (Bbl/d)	426		428		(2)
Total (Boe/d)	2,954		2,667		287
<b>Exploration and Development Expenditures<sup>(1)</sup> (\$ millions)</b>					
Exploration, drilling, completions and tie-ins	39.6		24.3		15.3
Facilities and gathering	20.8		14.2		6.6
	60.4		38.5		21.9
	<b>Gross</b>	<b>Net</b>	Gross	Net	
<b>Wells drilled</b>	7	4	4	4	
<b>Wells placed on production</b>	7	4	2	2	

(1) Before deduction of Alberta Drilling Royalty credits

Average daily sales volumes in the Grande Prairie COU increased eleven percent in the first quarter of 2011 compared to the fourth quarter of 2010 as additional wells were brought on production, however the new production was partially offset by an unscheduled processing interruption at a third party facility, which shut-in approximately 1,700 Boe/d of production for most of March 2011. A further unscheduled disruption occurred at the same midstream facility in early May, and the operator is working to resolve the issue.

### KARR-GOLD CREEK

First quarter activities at Karr-Gold Creek included the drilling of three (1.6 net) wells (two of which were completed and tied-in) and the tie-in of three (2.5 net) wells that were drilled in 2010. The completion of an additional five (4.9 net) wells that were scheduled for the first quarter have been delayed until the second quarter.

Construction of the second phase of the compression/dehydration facility is progressing on schedule and on budget and is expected to enter service in June 2011. This will increase the Company's total dehydration and compression capacity at Karr-Gold Creek to 48 MMcf/d.

Of the 18 (15.9 net) wells drilled at Karr-Gold Creek to date, three (1.1 net) are currently producing (as they are sweet wells that are not directed to the third party plant), ten (9.9 net) have been shut-in as a

result of the third party facility disruption and five (4.9 net) are scheduled to be tied-in during the second quarter of 2011. The Grande Prairie COU plans to drill up to three additional wells during the remainder of 2011.

The unscheduled processing interruptions at the third party facility have delayed efforts to restore production from wells previously shut-in and to bring new wells on production. The Company anticipates that production volumes in Karr-Gold Creek will increase during the remainder of 2011 once the third party processing facility resumes service and the Company's inventory of wells can begin to produce on a consistent basis.

## **VALHALLA**

The Grande Prairie COU drilled two (1.2 net) wells at Valhalla in the first quarter and continued the construction of the initial 10 MMcf/d phase of the gathering and compression system. The system is expected to be operational in June 2011 and the Company plans to increase its compression capacity to 20 MMcf/d by the end of the year.

Three Valhalla wells drilled by the Company prior to 2011 have been tied-in to a third party gathering system and have been producing at an aggregate restricted rate of 3.5 MMcf/d. These wells will be redirected through the Company's Valhalla gathering and compression system when it enters service. The Grande Prairie COU has now drilled a total of 10 (6.8 net) wells at Valhalla and an estimated 15 MMcf/d of first month production is currently behind pipe awaiting the start-up of the new compression and gathering system.

## **ANTE CREEK**

Paramount has drilled two (1.5 net) wells at Ante Creek targeting oil from the Montney formation. The first well tested at approximately 1,000 Bbl/d of light sweet oil and 1.4 MMcf/d of natural gas over an 83 hour test period. The well has been equipped and was briefly placed on production but is currently suspended until seasonal road bans are lifted (as oil production volumes need to be trucked from the well site). The second well will be completed after break-up with one (0.5 net) additional well planned to be drilled later in 2011.

# SOUTHERN

Three months ended	March 31, 2011		December 31, 2010		Change
<b>Sales Volumes</b>					
Natural gas (MMcf/d)	8.7		9.1		(0.4)
NGLs (Bbl/d)	51		58		(7)
Oil (Bbl/d)	1,435		1,397		38
Total (Boe/d)	2,939		2,976		(37)
<b>Exploration and Development Expenditures<sup>(1)</sup> (\$ millions)</b>					
Exploration, drilling, completions and tie-ins	3.0		3.0		–
Facilities and gathering	1.8		1.8		–
	4.8		4.8		–
	<b>Gross</b>	<b>Net</b>	Gross	Net	
<b>Wells drilled</b>	3	1	2	1	
<b>Wells placed on production</b>	15	12	–	–	

(1) Before deduction of Alberta Drilling Royalty credits

The Southern COU maintained production levels in the first quarter of 2011 as production additions from new wells offset natural declines.

First quarter 2011 activities in southern Alberta included the tie-in of eight (8.0 net) coal bed methane wells at Chain, with an additional two (2.0 net) wells to be tied-in in the second quarter. At Enchant, the drilling of three oil wells planned for the first quarter was deferred to the second quarter due to rig availability.

The Company plans to drill an initial two (2.0 net) wells on a new area of its Pembina lands in the third quarter. In March 2011, the Company sold certain Pembina area oil and gas properties for cash proceeds of \$4.3 million.

In southern Saskatchewan Paramount's joint development partner has successfully completed three Viking light oil wells drilled in 2010, has licensed six wells to be drilled after breakup and has stated that an additional eight to ten locations will be drilled throughout the remainder of 2011. Paramount's post-payout interest in this development will be 45 percent.

In the United States Paramount participated in the drilling of one (0.2 net) oil well at Beaver Creek that was brought on production in the second quarter with first month gross production of approximately 530 Bbl/d. In February 2011, Paramount closed the sale of approximately 6,000 net acres of undeveloped land in North Dakota for cash proceeds of US\$40 million. In May 2011 the drilling of a fourth well began under the North Dakota joint development project.

## NORTHERN

Three months ended	March 31, 2011		December 31, 2010		Change
<b>Sales Volumes</b>					
Natural gas (MMcf/d)	9.3		11.1		(1.8)
NGLs (Bbl/d)	15		24		(9)
Oil (Bbl/d)	397		434		(37)
Total (Boe/d)	1,958		2,312		(354)
<b>Exploration and Development Expenditures</b> (\$ millions)					
Exploration, drilling, completions and tie-ins	9.9		0.2		9.7
Facilities and gathering	2.9		0.2		2.7
	12.8		0.4		12.4
	<b>Gross</b>	<b>Net</b>	Gross	Net	
<b>Wells drilled</b>	2	2	–	–	
<b>Wells placed on production</b>	2	2	–	–	

First quarter production volumes in the Northern COU were impacted by the annual scheduled turnaround at the Bistcho processing plant. Capital expenditures in the first quarter of 2011 were primarily related to the drilling of two (2.0 net) wells in the Cameron Hills area, one of which was completed and brought on production. A well that had been drilled in 2010 and was subject to a regulatory delay was also brought on production in March 2011.

## PROSPEX ACQUISITION

In April 2011, Paramount announced that it had entered into an arrangement agreement with ProspEx to acquire the remaining outstanding shares of ProspEx not already owned by the Company. The total cost to Paramount is approximately \$180 million (based on the closing price of Paramount's Common Shares on April 7, 2011), and includes the assumption of estimated net debt of approximately \$40 million and the cost of the approximately nine percent of the outstanding ProspEx Shares already held by Paramount. The acquisition is expected to be completed by the end of May 2011, and is subject to approval by ProspEx shareholders and court and regulatory approvals.

Through the transaction, Paramount will acquire a suite of liquids rich natural gas assets with significant multi-zone and horizontal drilling potential in several zones from the Triassic Montney Formations up to the Late Cretaceous Cardium Formations, including the Falher C zone in the Kakwa area. These assets will increase Paramount's already significant Deep Basin land holdings in the Kakwa, Elmworth, and Wapiti areas of Alberta. The transaction also includes considerable assets in the Pembina and Brazeau areas (which have substantial Falher and Notikewin horizontal potential) and numerous drilling locations in the Birch area of northeast British Columbia, a liquids-rich Montney gas opportunity. In addition, the acquisition includes predictable long life reserves and production from the Ricinus and Harmattan areas of Alberta.



## STRATEGIC INVESTMENTS

In the first quarter of 2011 the Company drilled 15 oil sands evaluation wells at Hoole to further delineate the reservoir and bitumen resource. The Company also cased and undertook completion operations on four of these wells in order to quantify the deliverability of prospective water source intervals and the injectivity of potential water disposal intervals and to test cap rock integrity. The Company's independent evaluator will incorporate the data obtained from these new delineation wells in an updated resource evaluation for the property, which is expected to be received in the second quarter of 2011. During the remainder of 2011, the Company expects to complete the engineering design and environmental impact analysis for the project and to communicate with area stakeholders with a view to submitting a regulatory application for thermal development in late 2011.

Paramount has begun the delineation of its carbonate bitumen resource at the Saleski property, completing a ten well drilling and delineation program in April 2011. The wells targeted the Grosmont formation to obtain data for a detailed analysis of this resource. Paramount has commissioned an independent evaluation of its Saleski property.

Paramount is developing plans to begin drilling operations on its shale gas properties in the 2011/2012 winter drilling season, with the first well being planned for the Dunedin area of north-east British Columbia. The Company purchased seismic data in the first quarter of 2011 covering a substantial portion of its shale gas acreage which will be incorporated in further studies and planning for future projects.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

*This Management's Discussion and Analysis ("MD&A"), dated May 17, 2011, should be read in conjunction with the unaudited Interim Consolidated Financial Statements of Paramount Resources Ltd. ("Paramount" or the "Company") for the three months ended March 31, 2011 and Paramount's audited Consolidated Financial Statements for the year ended December 31, 2010.*

*This document contains forward-looking information, non-GAAP measures and disclosures of barrels of oil equivalent volumes. Readers are referred to the "Advisories" section at the end of this document concerning such matters.*

*Additional information concerning Paramount, including its Annual Information Form, can be found on the SEDAR website at [www.sedar.com](http://www.sedar.com).*

Canadian Generally Accepted Accounting Principles ("GAAP"), as issued by the Canadian Institute of Chartered Accountants, were converted to International Financial Reporting Standards ("IFRS") effective for fiscal years beginning on or after January 1, 2011. The Company's unaudited Interim Consolidated Financial Statements for the three months ended March 31, 2011 have been prepared in accordance with IAS 34 - Interim Financial Reporting, IFRS 1 - First-time Adoption of IFRS and the IFRS accounting policies the Company expects to adopt in its initial IFRS annual Consolidated Financial Statements as at and for the year ended December 31, 2011.

In order to prepare comparative information, the Company has applied IFRS as of January 1, 2010 (the "Transition Date") and amounts included in this MD&A related to periods on or after the Transition Date have been adjusted to conform to the Company's IFRS accounting policies. Amounts related to periods prior to the Transition Date included in this MD&A have not been adjusted, and are denoted as being prepared in accordance with Canadian GAAP in effect prior to January 1, 2011 ("Previous GAAP").

The Company's IFRS accounting policies are provided in Note 1 to the unaudited Interim Consolidated Financial Statements. In addition, Note 19 presents reconciliations between the Company's 2010 Previous GAAP results and the 2010 IFRS results. The reconciliations include the Consolidated Balance Sheet as at January 1, 2010 and December 31, 2010, and Consolidated Statement of Comprehensive Income, Changes in Shareholders' Equity and Cash Flows for the three months ended March 31, 2010 and for the twelve months ended December 31, 2010. Readers are referred to the "Change in Accounting Policies" section in this document for further details concerning the impact of the conversion to IFRS.

## About Paramount

Paramount is an independent Canadian energy company involved in the exploration, development, production, processing, transportation and marketing of natural gas, crude oil and natural gas liquids ("NGLs"). Management's strategy is to maintain a balanced portfolio of opportunities, to grow reserves and production in Paramount's Principal Properties while maintaining a large inventory of undeveloped acreage, and to selectively pursue higher risk/higher return prospects.

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

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

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

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

Strategic Investments include: (i) investments in other entities, including affiliates; (ii) investments in development stage assets where there is no near-term expectation of production, but a longer-term value proposition based on spin-outs, dispositions, or future revenue generation; and (iii) three drilling rigs owned by Paramount's wholly owned subsidiaries Fox Drilling Inc. ("Fox Drilling") in Canada and Paramount Drilling U.S., L.L.C. ("Paramount Drilling") in the United States.

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

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

## FIRST QUARTER HIGHLIGHTS<sup>(1)</sup>

Three months ended March 31	2011	2010	Change %
<b>FINANCIAL</b>			
(\$ millions, except as noted)			
Petroleum and natural gas sales	46.8	48.9	(4)
Funds flow from operations <sup>(2)</sup>	13.9	23.5	(41)
per share – basic and diluted (\$/share)	0.19	0.33	(42)
Net income (loss)	(11.9)	26.9	(144)
per share – basic and diluted (\$/share)	(0.16)	0.37	(143)
Exploration and development expenditures	160.2	66.8	140
Investments in other entities – market value <sup>(3)</sup>	717.6	341.1	110
Total assets	1,590.9	1,110.1	43
Long-term debt	365.3	90.9	302
Net debt	432.3	117.2	269
<b>OPERATIONAL</b>			
Sales volumes			
Natural gas (MMcf/d)	58.7	50.2	17
NGLs (Bbl/d)	968	775	25
Oil (Bbl/d)	2,353	2,739	(14)
Total (Boe/d)	13,097	11,875	10
Net wells drilled (excluding oil sands evaluation)	12	22	(45)
Net oil sands evaluation wells drilled	26	45	(42)
<b>FUNDS FLOW FROM OPERATIONS (\$/Boe)</b>			
Petroleum and natural gas sales	39.67	45.75	(13)
Royalties	(4.01)	(6.51)	(38)
Operating expense and production tax	(13.20)	(13.22)	–
Transportation	(3.47)	(3.82)	(9)
<b>Netback</b>	<b>18.99</b>	22.20	(14)
Financial commodity contract settlements	(0.23)	1.16	(120)
<b>Netback including commodity contract settlements</b>	<b>18.76</b>	23.36	(20)
General and administrative	(3.56)	(3.13)	14
Interest	(6.37)	(2.44)	161
Distributions from investments	2.73	3.83	(29)
Other	0.25	0.41	(39)
	<b>11.81</b>	22.03	(46)

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

# FIRST QUARTER 2011 OVERVIEW

## Principal Properties

- Average sales volumes in the first quarter of 2011 increased 10 percent to 13,097 Boe/d in 2011 compared to 11,875 Boe/d in the first quarter of 2010, due primarily to a 46 percent increase in production volumes in the Kaybob COU. During the last week of April 2011 average sales volumes exceeded 16,500 Boe/d.
- Netback decreased five percent to \$22.4 million in 2011 from \$23.7 million in the prior year, primarily due to lower natural gas prices and higher operating costs from higher production, partially offset by lower royalties.
- The Kaybob COU drilled 10 (6.5 net) wells. Construction of the 45 MMcf/d processing plant at Musreau is on schedule and on budget for an expected startup late in the third quarter of the year.
- First quarter 2011 production in the Grande Prairie COU increased seven percent despite a month-long unscheduled operational disruption at a third party midstream processing facility at Karr-Gold Creek. A further unscheduled disruption occurred at the same midstream facility in early May, and the operator is working to resolve the issue.
- The construction of the second 20 MMcf/d phase of the compression/dehydration facility at Karr-Gold Creek in the Grande Prairie COU is progressing on schedule and on budget, and is expected to enter service in June 2011.
- Paramount closed the sale of approximately 6,000 net acres of undeveloped 100 percent working interest land in North Dakota for cash proceeds of US\$40 million.
- In April 2011, Paramount entered into an arrangement agreement with ProspEx Resources Ltd. ("ProspEx") which provides for Paramount's acquisition of all of the ProspEx shares not already owned by the Company. The acquisition is expected to close by the end of May 2011.

## Strategic Investments

- The market value of Paramount's financial portfolio of investments in other oil and gas entities increased 43 percent in the first quarter to \$717.6 million at March 31, 2011 due to increases in the share price of Trilogy and MEG Energy Corp. ("MEG").
- Paramount drilled an additional 15 oil sands evaluation wells at Hoole to further delineate the reservoir and bitumen resource and has requested an updated resources evaluation from the Company's independent evaluator incorporating the new well data.
- At the Saleski carbonate bitumen property, the Company completed a ten well delineation and drilling program in the Grosmont formation to obtain data for a detailed analysis of this resource.

## Corporate

- In February 2011, Paramount closed the public offering of an additional \$70 million principal amount of Senior Notes.
- In April 2011, Paramount closed a public offering and a private placement of an aggregate 1.7 million Common Shares for gross proceeds of \$54.2 million.
- The revolving feature of the Company's credit facility has been extended to June 30, 2011 to allow for the closing of the ProspEx acquisition prior to establishing a new borrowing base. The Company expects the current \$160 million borrowing base to increase on renewal.

## CONSOLIDATED RESULTS

### Net Income (Loss)

Three months ended March 31	2011	2010
Principal Properties	21.6	(2.7)
Strategic Investments	(7.1)	37.7
Corporate	(23.1)	(9.4)
Taxes	(3.3)	1.3
<b>Net Income (Loss)</b>	<b>(11.9)</b>	<b>26.9</b>

The Company recorded a net loss of \$11.9 million in the first quarter of 2011 compared to income of \$26.9 million in the same period of 2010, primarily as a result of:

- A decrease in income from equity investments in 2011, primarily due to \$36.8 million of equity earnings being recorded in 2010 related to Trilogy's conversion from a trust structure to a corporate structure;
- A decrease of \$13.8 million in financial commodity contracts gains;
- An increase of \$6.0 million in depletion and depreciation; and
- An increase in interest of \$5.0 million;

Partially offset by:

- An increase of \$39.5 million in gains recognized on the sale of property, plant and equipment, primarily due to the sale of undeveloped land in North Dakota.

## Funds Flow From Operations<sup>(1)</sup>

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

Three months ended March 31	2011	2010
Cash from operating activities	39.9	15.6
Change in non-cash working capital	(34.1)	3.9
Geological and geophysical expenses	2.8	2.9
Asset retirement obligation settlements	5.3	1.1
<b>Funds flow from operations</b>	<b>13.9</b>	<b>23.5</b>
<b>Funds flow from operations (\$/Boe)</b>	<b>11.81</b>	<b>22.03</b>

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

- Funds flow from operations in the first quarter of 2011 decreased by \$9.6 million from the first quarter of 2010, primarily due to the impact of lower natural gas prices and higher interest costs.

## PRINCIPAL PROPERTIES

### Netback and Segment Earnings (Loss)

Three months ended March 31	2011		2010	
	(\$/Boe)		(\$/Boe)	
Petroleum and natural gas sales	46.8	39.67	48.9	45.75
Royalties	(4.7)	(4.01)	(7.0)	(6.51)
Operating expense and production tax	(15.6)	(13.20)	(14.1)	(13.22)
Transportation	(4.1)	(3.47)	(4.1)	(3.82)
<b>Netback</b>	<b>22.4</b>	<b>18.99</b>	23.7	22.20
Financial commodity contract settlements	(0.3)	(0.23)	1.2	1.16
<b>Netback including financial commodity contract settlements</b>	<b>22.1</b>	<b>18.76</b>	24.9	23.36
Other principal property items (see below)	(0.5)		(27.6)	
<b>Segment earnings (loss)</b>	<b>21.6</b>		(2.7)	

### Petroleum and Natural Gas Sales

Three months ended March 31	2011	2010	% Change
Natural gas	22.5	25.2	(11)
NGLs	6.9	5.1	35
Oil	17.4	18.6	(6)
	<b>46.8</b>	48.9	(4)

Petroleum and natural gas sales in the first quarter of 2011 were \$46.8 million, a decrease of \$2.1 million from the first quarter of 2010, primarily due to the impact of lower natural gas prices and lower oil sales volumes, partially offset by higher natural gas sales volumes.

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

	Natural gas	NGLs	Oil	Total
Three months ended March 31, 2010	25.2	5.1	18.6	48.9
Effect of changes in prices	(7.0)	0.6	1.3	(5.1)
Effect of changes in sales volumes	4.3	1.2	(2.5)	3.0
<b>Three months ended March 31, 2011</b>	<b>22.5</b>	<b>6.9</b>	<b>17.4</b>	<b>46.8</b>

### Sales Volumes

	Three months ended March 31											
	Natural Gas (MMcf/d)			NGLs (Bbl/d)			Oil (Bbl/d)			Total (Boe/d)		
	2011	2010	Change	2011	2010	Change	2011	2010	Change	2011	2010	Change
<b>Kaybob</b>	<b>27.7</b>	18.5	9.2	<b>535</b>	429	106	<b>95</b>	69	26	<b>5,246</b>	3,587	1,659
<b>Grande Prairie</b>	<b>13.0</b>	9.9	3.1	<b>367</b>	279	88	<b>426</b>	823	(397)	<b>2,954</b>	2,751	203
<b>Southern</b>	<b>8.7</b>	9.0	(0.3)	<b>51</b>	44	7	<b>1,435</b>	1,382	53	<b>2,939</b>	2,922	17
<b>Northern</b>	<b>9.3</b>	12.8	(3.5)	<b>15</b>	23	(8)	<b>397</b>	465	(68)	<b>1,958</b>	2,615	(657)
	<b>58.7</b>	50.2	8.5	<b>968</b>	775	193	<b>2,353</b>	2,739	(386)	<b>13,097</b>	11,875	1,222

First quarter natural gas sales volumes increased to 58.7 MMcf/d in 2011 compared to 50.2 MMcf/d in 2010. NGLs sales volumes increased to 968 Bbl/d in 2011 compared to 775 Bbl/d in the same period of the prior year. Oil sales volumes decreased to 2,353 Bbl/d in 2011 compared to 2,739 Bbl/d in 2010.

Total first quarter sales volumes in 2011 increased 1,222 Boe/d to 13,097 Boe/d compared to 11,875 Boe/d in the same quarter of 2010. The increase was primarily a result of new well production in the Deep Basin properties in the Kaybob COU, at Karr-Gold Creek and Valhalla in the Grande Prairie COU, and from wells acquired through the acquisition of Redcliffe Exploration Inc. ("Redcliffe"). The production increases were partially offset by operational issues in the Grande Prairie COU where an unscheduled month-long shut-down of a third party midstream plant affected 1,700 Boe/d of sales volumes at Karr-Gold Creek, and at Crooked Creek where production equipment failures inhibited oil production throughout the quarter. Lower sales volumes in the Northern COU were primarily a result of declines at Bistcho and Cameron Hills.

### Average Realized Prices

Three months ended March 31	2011	2010	% Change
<b>Natural gas (\$/Mcf)</b>	<b>4.26</b>	5.59	(24)
<b>NGLs (\$/Bbl)</b>	<b>79.29</b>	72.22	10
<b>Oil (\$/Bbl)</b>	<b>81.91</b>	75.51	8
<b>Total (\$/Boe)</b>	<b>39.67</b>	45.75	(13)



## Commodity Prices

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

Three months ended March 31	2011	2010	% Change
<b>Natural Gas</b>			
AECO (Cdn\$/GJ)	3.58	5.08	(30)
New York Mercantile Exchange (Henry Hub US\$/MMbtu)	4.13	5.29	(22)
<b>Crude Oil</b>			
Edmonton par (Cdn\$/Bbl)	88.44	80.31	10
West Texas Intermediate (US\$/Bbl)	94.10	78.79	19
<b>Foreign Exchange</b>			
\$Cdn / 1 \$US	0.99	1.04	(5)

## Commodity Price Management

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

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

Three months ended March 31	2011	2010
Natural gas contracts	–	1.2
Oil contracts	(0.3)	–
	(0.3)	1.2

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

Instruments	Total Notional	Average Fixed Price	Fair Value	Remaining Term
Oil – NYMEX Swap	1,000 Bbl/d	USD \$93.73/Bbl	(3.8)	April 2011 – December 2011

## Royalties

Three months ended March 31	2011	Royalty rate (%)	2010	Royalty rate (%)
Natural gas	0.7	3.2	1.9	7.5
NGLs	1.3	19.3	0.9	16.2
Oil	2.7	15.4	4.2	22.8
	4.7	10.1	7.0	14.2

First quarter natural gas royalties decreased by \$1.2 million in 2011 compared to the prior year, primarily due to lower Alberta royalty rates associated with decreased prices. NGLs royalties increased \$0.4 million to \$1.3 million due to increased production volumes. The NGLs royalty rate increased compared to the prior year due to the addition of producing wells from the Redcliffe acquisition which are subject to higher royalty rates. Oil royalties decreased \$1.5 million compared to the prior year due to the reduction of the maximum crown royalty rate from 50 percent to 40 percent in Alberta, and due to lower production in Crooked Creek, which has higher royalty rates.

### **Operating Expense and Production Tax**

<b>Three months ended March 31</b>	<b>2011</b>	2010	% Change
Operating expense	<b>15.1</b>	13.5	12
Production tax	<b>0.5</b>	0.6	(16)
	<b>15.6</b>	14.1	11

Operating expenses in the first quarter of 2011 increased by \$1.6 million or 12 percent compared to the prior year, primarily as a result of increased production from new wells and from the Redcliffe acquisition. First quarter operating expenses were \$13.20 per Boe in 2011, which is consistent with the first quarter of 2010. Paramount's operating expenses are generally higher in the first quarter of the year due to annual scheduled maintenance and repair programs at winter access locations in the Northern COU.

### **Transportation Expense**

<b>Three months ended March 31</b>	<b>2011</b>	2010	% Change
Transportation expense	<b>4.1</b>	4.1	–

First quarter transportation costs remained at \$4.1 million in 2011 although production volumes increased by 10 percent, resulting in decreased per unit costs of \$3.47 per Boe compared to \$3.82 per Boe in 2010. The per unit decrease is due to lower receipt tolls in 2011 and decreased production from properties in the Northern COU which have higher transportation costs, offset by increased production from properties in the Kaybob COU where transportation costs are lower.

### **Other Principal Property Items**

<b>Three months ended March 31</b>	<b>2011</b>	2010
Commodity contracts – net of settlements	<b>(3.1)</b>	9.3
Depletion and depreciation	<b>(27.1)</b>	(21.5)
Exploration and evaluation	<b>(8.6)</b>	(14.2)
Accretion of asset retirement obligations	<b>(2.3)</b>	(1.9)
Gain on sale of property, plant and equipment	<b>39.6</b>	0.1
Other	<b>1.0</b>	0.6
	<b>(0.5)</b>	(27.6)

First quarter depletion and depreciation increased to \$27.1 million or \$23.00 per Boe in 2011 compared to \$21.5 million or \$20.11 per Boe in the prior year. The increase was primarily due to costs related to new wells, facilities and gathering systems and increased production volumes.

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

# STRATEGIC INVESTMENTS

<b>Three months ended March 31</b>	<b>2011</b>	2010
Income (loss) from equity-accounted investments	<b>(1.3)</b>	40.6
Drilling rig revenue	<b>1.5</b>	–
Drilling rig expense	<b>(1.8)</b>	–
General and administrative	<b>(1.0)</b>	(0.6)
Stock-based compensation	<b>(3.0)</b>	(1.8)
Interest	<b>(0.3)</b>	(0.3)
Other (expense) income	<b>(1.2)</b>	(0.2)
<b>Segment Earnings (Loss)</b>	<b>(7.1)</b>	37.7

Strategic Investments at March 31, 2011 include:

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

The first quarter 2011 loss from equity-accounted investments of \$1.3 million compared to \$36.5 million of equity income and a net dilution gain of \$4.1 million in 2010.

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

	<b>Carrying Value</b>		<b>Market Value<sup>(1)</sup></b>	
	<b>March 31, 2011</b>	December 31, 2010	<b>March 31, 2011</b>	December 31, 2010
Trilogy	<b>123.4</b>	125.7	<b>492.1</b>	297.0
MEG	<b>181.5</b>	168.3	<b>181.5</b>	168.3
MGM Energy	<b>4.6</b>	5.2	<b>9.6</b>	8.8
NuLoch	<b>16.3</b>	13.7	<b>16.3</b>	13.7
ProspEx	<b>11.3</b>	7.4	<b>11.3</b>	7.4
Other <sup>(2)</sup>	<b>6.7</b>	7.7	<b>6.8</b>	7.7
<b>Total</b>	<b>343.8</b>	328.0	<b>717.6</b>	502.9

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

<sup>(2)</sup> Includes investments in Paxton Corporation, and other public and private corporations.

In April 2011, Paramount announced that it had entered into an agreement to acquire the remaining outstanding voting shares of ProspEx not already owned by the Company. Under the terms of the agreement, shareholders of ProspEx may elect to receive either: (i) 0.07162 of a Common Share of Paramount; or (ii) \$2.40 cash, for each ProspEx share, provided that Paramount will issue an aggregate of 2,000,000 Common Shares pursuant to the agreement. The total cost to Paramount is approximately \$180 million (based on the closing price of Paramount's Common Shares on April 7, 2011), including the assumption of estimated net debt of approximately \$40 million and the cost of the approximately 9% of the outstanding ProspEx Shares already held by Paramount. The cash portion of the consideration payable for PropEx shares is expected to be funded with available cash and cash equivalents and/or borrowing capacity under the Company's credit facility. The acquisition is expected to be completed by

the end of May 2011. Completion of the transaction is subject to approval by ProspEx shareholders, court approval and regulatory approvals.

In the first quarter of 2011, the Company drilled 15 oil sands evaluation wells at Hoole to further delineate the reservoir and bitumen resource. The Company also cased and undertook completion operations on four of the wells in order to quantify the deliverability of prospective water source intervals, injectivity of potential water disposal intervals, and test cap rock integrity. The Company's independent evaluator will incorporate the data obtained from the new delineation wells in an updated resource evaluation for the property, which is expected to be received in the second quarter of 2011. During the remainder of 2011, the Company expects to complete the engineering design and environmental impact analysis, and to communicate with area stakeholders in order to submit a regulatory application for thermal development in late 2011.

Paramount has also begun the delineation of its carbonate bitumen resource at the Saleski property, completing a ten well drilling and delineation program in April 2011. The wells targeted the Grosmont formation to obtain data for a detailed analysis of the property. Paramount has commissioned an independent resource evaluation of this resource.

Paramount's two Canadian based drilling rigs continue to drill on Company projects in Alberta. The United States based drilling rig has been contracted to the Company's joint development partner for the balance of 2011.

## CORPORATE

<b>Three months ended March 31</b>	<b>2011</b>	2010
General and administrative	<b>3.1</b>	2.7
Stock-based compensation	<b>8.3</b>	4.9
Depletion and depreciation	<b>0.2</b>	0.2
Interest	<b>7.3</b>	2.3
Foreign exchange	<b>4.2</b>	(0.8)
Other (income) expense	-	0.1
	<b>23.1</b>	9.4

First quarter Corporate segment net costs increased to \$23.1 million in 2011 compared to \$9.4 million in 2010, primarily due to the impact of increased interest, changes in foreign exchange rates and higher stock-based compensation. Interest increased in 2011 compared to the prior year as the Company issued \$300 million of new Canadian term debt in late 2010 and an additional \$70 million in February 2011 to replace the outstanding US\$90.2 million of US term debt and provide additional funding for the 2010/2011 exploration and development program.

## EXPLORATION AND CAPITAL EXPENDITURES

Three months ended March 31	2011	2010
Geological and geophysical expenses	2.1	2.9
Drilling, completion and tie-ins	95.0	55.9
Facilities and gathering	63.1	8.0
<b>Exploration and development expenditures</b>	<b>160.2</b>	66.8
Land and property acquisitions	10.8	13.0
<b>Principal Properties</b>	<b>171.0</b>	79.8
<b>Strategic Investments</b>	<b>17.0</b>	11.0
	<b>188.0</b>	90.8

Exploration and development expenditures in the first quarter of 2011 were \$160.2 million compared to \$66.8 million in the same period of 2010. Current year spending focused on drilling and completing wells for the Kaybob COU's Deep Basin development and at Karr-Gold Creek and Valhalla in the Grande Prairie COU. Included in facilities expenditures were \$34.2 million invested at Musreau related to the construction of the 45 MMcf/d processing plant, which is progressing on schedule for an expected startup late in the third quarter, and expansions of gathering systems. Exploration and development expenditures in the first quarter of 2011 were reduced by \$1.3 million (2010 - \$3.0 million) as a result of the Alberta Drilling Royalty Credit program.

Land and property acquisitions include purchases of Deep Basin undeveloped land in the Kaybob COU of \$9.6 million.

Strategic investments capital expenditures in the first quarter of 2011 consist primarily of \$6 million to drill delineation wells for the Hoole Oil Sands Project and \$7 million for delineation wells at the Saleski Carbonate Bitumen Project.

Wells drilled are as follows:

Three months ended March 31	2011		2010	
	Gross <sup>(1)</sup>	Net <sup>(2)</sup>	Gross <sup>(1)</sup>	Net <sup>(2)</sup>
(wells drilled)				
Gas	15	9	19	16
Oil	6	3	2	2
Oil sands evaluation	27	26	45	45
Dry and abandoned	—	—	4	4
	<b>48</b>	<b>38</b>	70	67

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

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

## OUTLOOK

Paramount's 2011 Principal Property exploration and development spending is budgeted at \$425 million, excluding land purchases and acquisitions. The additional \$25 million budgeted for the Hoole oil sands and Saleski carbonate bitumen areas remains unchanged. The Company has flexibility within its current capital plan to increase or decrease spending, depending upon future economic conditions, among other factors. First quarter production of 13,097 Boe/d is consistent with expectations and Paramount continues to forecast annual average production of approximately 20,000 Boe/d with an anticipated exit rate of approximately 25,000 Boe/d, excluding the impact of the ProspEx acquisition.

# LIQUIDITY AND CAPITAL RESOURCES

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

	March 31, 2011	December 31, 2010	Change
Working capital deficit <sup>(1)</sup>	62.3	(4.8)	67.1
Senior Notes <sup>(2)</sup>	370.0	300.0	70.0
<b>Net debt<sup>(3)</sup></b>	<b>432.3</b>	295.2	137.1
Share capital	486.5	481.8	4.7
Retained earnings	116.5	128.4	(11.9)
Reserves	91.1	72.0	19.1
<b>Total Capital</b>	<b>1,126.4</b>	977.4	149.0

(1) Excludes risk management assets and liabilities, stock-based compensation liabilities and \$4.7 million (December 31, 2010 – \$6.1 million) included in accounts payable and accrued liabilities relating to the Company's obligation to renounce qualifying expenditures for flow-through share issuances.

(2) Excludes unamortized issue premiums and financing costs.

(3) Net debt excludes the \$19.8 million deposit on account with the CRA, pending resolution of the Company's notices of objection.

## Working Capital

Paramount's working capital deficit at March 31, 2011 was \$62.3 million compared to a surplus of \$4.8 million at December 31, 2010. The working capital deficit at March 31, 2011 included \$107.0 million of cash and cash equivalents, \$44.1 million of accounts receivable and \$189.6 million of accounts payable and accrued liabilities. The decrease in working capital is primarily a result of the Company's first quarter 2011 capital program, partially offset by proceeds from the Senior Notes offering, proceeds from the undeveloped land sale in the United States and funds flow from operations. A principal payment of \$1.5 million was made on the drilling rig loan in the first quarter of 2011.

Paramount expects to fund its 2011 operations, obligations, acquisitions and capital expenditures with existing cash and cash equivalents, funds flow from operations, proceeds from the April 2011 public offering and private placement equity issuances, drawings under its bank credit facility, and by accessing the capital markets, if required.

## Bank Credit Facility

The borrowing base and lender commitments under the credit facility are \$160 million. The credit facility is secured by a first fixed and floating charge over substantially all of the assets of Paramount, excluding assets securing the drilling rig loan. The maximum amount that Paramount may borrow under the credit facility is subject to semi-annual review, and is dependent upon the Company's reserves and lenders' projections of future commodity prices, among other factors.

The revolving feature of the credit facility has been extended by the syndicate of lenders from April 30, 2011 to June 30, 2011 to allow for the closing of the ProspEx acquisition prior to establishing a new borrowing base. The Company expects the current \$160 million borrowing base to increase on renewal in June 2011, despite the impact of weakening natural gas prices, as a result of reserves added through exploration and development activities, and as a result of the ProspEx acquisition. In the event the revolving period is not extended, the credit facility would be available on a non-revolving basis until April 30, 2012, at which time it would be due and payable.

At March 31, 2011, no balance was drawn on the credit facility. Paramount had undrawn letters of credit outstanding at March 31, 2011 of \$24.4 million that reduce the amount available to the Company.

## Senior Notes

In February 2011, Paramount completed a public offering of an additional \$70 million principal amount of its senior unsecured notes ("Senior Notes") at a price of \$1,030 per \$1,000 principal amount, of which \$1.4 million principal amount was purchased by an entity that is controlled by the Company's Chairman and Chief Executive Officer. As of March 31, 2011, the Company has an aggregate of \$370 million principal amount of Senior Notes outstanding. The Senior Notes bear interest at 8.25 percent per annum, payable semi-annually in arrears on June 13 and December 13 in each year and mature on December 13, 2017. The Senior Notes are direct senior unsecured obligations of Paramount and rank equally with all other senior unsecured indebtedness of the Company. The net proceeds of the 2011 public offering will be used to fund the Company's 2011 capital program and for general corporate purposes.

## Share Capital

In April 2011, Paramount issued 1,500,000 Common Shares at a price of \$32.50 per share for gross proceeds of \$48.8 million through a public offering. In April 2011, Paramount also issued 150,000 Canadian development expense flow-through Common Shares at a price of \$36.50 per share for gross proceeds of \$5.5 million to a company controlled by the Company's Chairman and Chief Executive Officer.

At May 16, 2011, Paramount had 77,051,424 Common Shares and 4,767,300 Stock Options outstanding (1,149,301 exercisable).

# QUARTERLY INFORMATION

(\$ millions, except as noted)	2011	2010				2009 (Previous GAAP)		
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Petroleum and natural gas sales	<b>46.8</b>	46.0	44.9	44.6	48.9	45.0	36.3	40.2
Funds flow from operations	<b>13.9</b>	21.3	24.1	25.2	23.5	18.8	10.2	13.7
per share – basic and diluted (\$/share)	<b>0.19</b>	0.29	0.33	0.35	0.33	0.27	0.15	0.21
Net income (loss)	<b>(11.9)</b>	(113.8)	6.9	(17.5)	26.9	(46.4)	(25.2)	(2.6)
per share – basic and diluted (\$/share)	<b>(0.16)</b>	(1.55)	0.09	(0.24)	0.37	(0.67)	(0.38)	(0.04)
Sales volumes								
Natural gas (MMcf/d)	<b>58.7</b>	60.4	62.9	57.0	50.2	47.0	49.9	59.1
NGLs (Bbl/d)	<b>968</b>	1,030	1,099	821	775	707	564	1,049
Oil (Bbl/d)	<b>2,353</b>	2,357	2,381	2,466	2,739	2,966	3,169	2,463
Total (Boe/d)	<b>13,097</b>	13,461	13,967	12,787	11,875	11,514	12,046	13,362
Average realized price								
Natural gas (\$/Mcf)	<b>4.26</b>	4.04	4.12	4.49	5.59	4.85	3.24	4.03
NGLs (\$/Bbl)	<b>79.29</b>	75.52	59.90	77.26	72.22	67.40	52.01	49.66
Oil (\$/Bbl)	<b>81.91</b>	75.45	68.60	69.34	75.51	71.85	64.16	61.31

## Significant Items Impacting Quarterly Results

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

- First quarter 2011 earnings include gains of \$39.6 million on the sale of property, plant and equipment, partially offset by \$11.3 million of stock-based compensation charges.
- Fourth quarter 2010 earnings include \$33.4 million of stock-based compensation charges, a \$57.9 million write-down of petroleum and natural gas properties and goodwill and \$11.9 million of expired lease costs.
- Third quarter 2010 earnings include a future income tax recovery of \$37.0 million and \$8.1 million of stock-based compensation charges.
- Second quarter 2010 earnings include increased depletion, depreciation and accretion expense and \$6.7 million of stock-based compensation charges.
- First quarter 2010 earnings include \$36.8 million of equity earnings related to Trilogy's conversion from a trust structure to a corporate structure, \$8.2 million of dry hole expenses and \$6.8 million of stock-based compensation charges.
- Fourth quarter 2009 earnings include \$24.3 million of dry hole expenses related to suspended exploratory well costs and a \$14.9 million write-down of petroleum and natural gas properties.<sup>(1)</sup>
- Third quarter 2009 earnings include higher stock-based compensation charges, and lower earnings from Strategic Investments.<sup>(1)</sup>
- Second quarter 2009 earnings include increased future income tax recoveries and lower operating expenses.<sup>(1)</sup>

(1) Financial results prior to the Transition Date were prepared in accordance with Previous GAAP.

## SIGNIFICANT EQUITY INVESTEE

The following table summarizes the assets, liabilities and results of operations of Trilogy. The amounts summarized have been derived directly from Trilogy's financial statements as at and for the periods ended March 31, 2011 and 2010, and do not include Paramount's adjustments in applying the equity method of investment accounting. As a result, the amounts included in the table below cannot be used to derive Paramount's equity income and net investment in Trilogy.

<b>As at March 31</b>	<b>2011</b>	<b>2010</b>
Current assets	<b>48.5</b>	58.9
Long term assets	<b>1,126.6</b>	999.2
Current liabilities	<b>124.9</b>	86.3
Long term liabilities	<b>516.8</b>	380.4
Equity	<b>533.4</b>	591.4
<b>Three months ended March 31</b>	<b>2011</b>	<b>2010</b>
Revenue and other	<b>70.9</b>	88.3
Expenses	<b>70.6</b>	(81.8)
Tax expense (recovery)	<b>0.5</b>	(26.1)
Net earnings (loss)	<b>(0.2)</b>	196.2
Shares/units outstanding, end of period (thousands)	<b>114,925</b>	114,475
Paramount's equity interest in Trilogy, end of period <sup>(1)</sup>	<b>21.0%</b>	21.0%

(1) Readers are cautioned that Paramount does not have any direct or indirect interest in or right to Trilogy's assets or revenue, nor does Paramount have any direct or indirect obligation in respect of or liability for Trilogy's expenses or obligations.

Trilogy had 5.4 million stock options outstanding (1.4 million exercisable) at March 31, 2011 at exercise prices ranging from \$4.85 to \$12.88 per share.



# CHANGE IN ACCOUNTING POLICIES

## **IFRS Transition**

As noted previously, Canadian GAAP was converted to IFRS effective for fiscal years beginning on or after January 1, 2011. Paramount's first quarter 2011 unaudited Interim Consolidated Financial Statements have been prepared in accordance with IAS 34 - Interim Financial Reporting, IFRS 1 - First-time Adoption of IFRS and the IFRS accounting policies the Company expects to adopt in its initial IFRS annual Consolidated Financial Statements as at December 31, 2011. The adoption of IFRS has not had a material impact on the Company's operations, cash flows, capital expenditures or strategic objectives.

The Company's IFRS accounting policies are provided in Note 1 to the unaudited Interim Consolidated Financial Statements. In addition, Note 19 presents reconciliations between the Company's 2010 Previous GAAP results and the 2010 IFRS results. The reconciliations include the Consolidated Balance Sheet as at January 1, 2010 and December 31, 2010, and Consolidated Statement of Comprehensive Income, Changes in Shareholders' Equity and Cash Flows for the three months ended March 31, 2010 and for the twelve months ended December 31, 2010. Summary amounts from these reconciliations are included below.

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

## ***IFRS Transition Exemptions***

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

- a) the exemption to measure certain assets at fair value on transition to IFRS and subsequently deem that fair value to be historical cost;
- b) the exemption to deem cumulative foreign exchange translation differences related to foreign subsidiaries as of January 1, 2010 to be nil;
- c) the exemption that permits amounts recorded in respect of options settled prior to January 1, 2010 not to be retrospectively restated;
- d) the exemption that permits business combinations completed prior to the initial business combination recorded in accordance with IFRS 3 "Business Combinations" ("IFRS 3") not to be restated. Paramount's initial business combination recorded in accordance with IFRS 3 was the June 2010 Redcliffe acquisition;
- e) the exemption to measure asset retirement obligations at the Transition Date in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets";
- f) the exemption to assess lease arrangements using the facts and circumstances as of the Transition Date under International Financial Reporting Interpretations Committee Interpretation 4, "Determining whether an Arrangement contains a Lease"; and
- g) the exemption that permits borrowing costs directly attributable to the acquisition or construction of qualifying assets not to be capitalized on a retroactive basis prior to January 1, 2010.

## ***Significant Accounting Policy Changes***

The IFRS changes to the Company's accounting policies and a description of certain IFRS adjustments to the Company's financial statement balances are described below. Readers are referred to Notes 1 and 19 of the Company's first quarter 2011 unaudited Interim Consolidated Financial Statements regarding Paramount's IFRS accounting policies and IFRS adjustments.

### **a) Property, Plant and Equipment**

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

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

### **b) Asset Retirement Obligations**

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

### **c) Foreign exchange translation**

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

### **d) Stock-based compensation**

Under IFRS, Paramount's stock-based compensation liability is re-measured at the end of each period using the Black-Scholes-Merton fair value option pricing model. Under Previous GAAP, the stock-based compensation liability was re-measured at the end of each period using the intrinsic value method, where the liability was calculated based on the amount by which the market price of the Company's Common Shares exceeded the exercise price of outstanding options. As a result of the change in valuation method, Paramount's stock-based compensation liability increased by \$3.3 million on Transition Date.

### **e) Flow-through shares**

Under IFRS, proceeds from the issuance of flow-through shares are allocated between the sale of the shares, which are recorded in share capital, and the sale of the tax benefits, which are initially recorded as an accrued liability. The allocation is made based on the difference between the issue price of flow-through shares and the market price of the Common Shares on the date the offering is priced. The liability related to the sale of the tax benefits is reversed as qualifying expenditures intended for renunciation to subscribers are incurred, and a deferred tax liability is recorded. The difference between deferred tax liability recorded and the liability related to the sale of tax benefits is recognized as deferred tax expense. Under Previous GAAP, when flow-through shares were issued, they were recorded in share

capital based on proceeds received. Upon filing the renunciation documents with the tax authorities, a future tax liability was recognized and share capital was reduced for the tax effect of expenditures renounced to subscribers. The IFRS adjustment on Transition Date associated with flow-through shares was to increase share capital by \$25.1 million, reduce retained earnings by \$30.4 million and increase accrued liabilities by \$2.4 million.

#### **f) Equity Accounted Investments**

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

#### **g) Deferred Income Tax**

On Transition Date, the Company's deferred income tax asset balance was increased by \$2.5 million and the deferred income tax liability balance was decreased by \$34.0 million to reflect the tax impacts of the IFRS adjustments as described in the preceding discussion. For the twelve months ended December 31, 2010, the deferred income tax asset balance was decreased by \$3.7 million and deferred income tax expense was increased by \$6.2 million.

#### **h) Statement of Cash Flows**

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

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

#### **Balance Sheet**

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

## Comprehensive Income

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

## Cash Flows

	Three months ended March 31, 2010	Year ended December 31, 2010
<b>Cash from operating activities under Previous GAAP</b>	<b>\$ 17.6</b>	<b>\$ 63.4</b>
Adjustments under IFRS:		
Exploration costs	(2.9)	(8.2)
Common shares purchased under stock incentive plan	–	2.9
Foreign exchange on cash	0.9	1.1
<b>Cash from operating activities under IFRS</b>	<b>\$ 15.6</b>	<b>\$ 59.2</b>
<b>Cash from financing activities under Previous GAAP</b>	<b>\$ 1.1</b>	<b>\$ 251.9</b>
Adjustments under IFRS:		
Common shares purchased under stock incentive plan	–	(2.9)
<b>Cash from financing activities under IFRS</b>	<b>\$ 1.1</b>	<b>\$ 249.0</b>
<b>Cash used in investing activities under Previous GAAP</b>	<b>\$ (55.8)</b>	<b>\$ (333.9)</b>
Adjustments under IFRS:		
Exploration costs	2.9	8.2
<b>Cash used in investing activities under IFRS</b>	<b>\$ (52.9)</b>	<b>\$ (325.7)</b>
<b>Net decrease</b>	<b>(36.2)</b>	<b>(17.5)</b>
<b>Foreign exchange on cash and cash equivalents</b>	<b>(0.8)</b>	<b>(1.1)</b>
	<b>\$ (37.0)</b>	<b>\$ (18.6)</b>

## Future Changes in Accounting Policies

Effective January 1, 2013, the current financial instrument standard IAS 39 - Financial Instruments: Recognition and Measurement will be replaced by IFRS 9 - Financial Instruments. The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. The Company is currently evaluating the impact of adopting the new standard.

## CRITICAL ACCOUNTING ESTIMATES

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

### ***Exploration and Evaluation***

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

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

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

### ***Reserves Estimates***

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

Estimates of reserves impact: (i) the assessment of whether or not a new well has found economically recoverable reserves; (ii) depletion rates; and (iii) the determination of the realizable value of petroleum and natural gas properties for impairment tests, all of which could have a material impact on earnings.

### ***Business Combinations***

Business combinations are accounted for using the acquisition method of accounting, where the net identifiable assets acquired are recorded at fair value. Any excess of the purchase price over the fair value of the net assets acquired is recognized as goodwill. Any deficiency of the purchase price below the fair value of the net assets acquired is recorded as a gain in net income. Determinations of fair value often require management to make assumptions and estimates about future events including reserves estimations. Changes in any of the assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the carrying values assigned.

## **Asset Retirement Obligations**

Estimates of expected asset retirement costs are subject to uncertainty associated with the method, timing, economic environment and regulatory standards that will exist at the time when assets are retired in the future. Accordingly, actual payments to settle the obligations may differ materially from estimated amounts.

## **Stock-Based Compensation**

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

## **Income Taxes**

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

# ADVISORIES

## **Forward-looking Information**

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

- Matters related to the proposed acquisition of ProspEx, including, without limitation timing for and receipt of necessary approvals and the anticipated completion of the acquisition;
- expected production volumes and the timing thereof;
- planned exploration and development expenditures and the timing thereof;
- exploration and development plans and strategies;
- budget allocations and capital spending flexibility;
- adequacy of facilities to process natural gas production;
- estimated reserves and resources and the undiscounted and discounted present value of future net revenues from such reserves and resources (including the forecast prices and costs and the timing of expected production volumes and future development capital);
- timing of regulatory applications;
- ability to fulfill future pipeline transportation commitments;
- undeveloped land lease expiries;
- timing and cost of future abandonment and reclamation;
- business strategies and objectives;
- sources of and plans for financing;
- acquisition and disposition plans;
- operating and other costs and royalty rates;
- expected drilling programs, well tie-ins, facility construction and expansions, completions and the timing thereof; and
- the outcome of any legal claims, audits, assessments or other regulatory matters or proceedings.

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

- future oil and gas prices and general economic and business conditions;
- the ability of Paramount to obtain required capital to finance its exploration, development and operations;
- the ability of Paramount to obtain equipment, services, supplies and personnel in a timely manner to carry out its activities;
- the ability of Paramount to market its oil and natural gas successfully to current and new customers;
- the ability of Paramount to secure adequate product transportation and storage;
- the ability of Paramount and its industry partners to obtain drilling success consistent with expectations;
- the timely receipt of required regulatory and shareholder approvals, as applicable; and
- currency exchange and interest rates.

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

- fluctuations in crude oil, natural gas and NGLs prices, foreign currency exchange rates and interest rates;
- the uncertainty of estimates and projections relating to future production, costs and expenses;
- the ability to secure adequate product processing, transportation and storage;
- the uncertainty of exploration, development and drilling;
- operational risks in exploring for, developing and producing crude oil and natural gas, and the timing thereof;
- the ability to obtain equipment, services, supplies and personnel in a timely manner;
- potential disruption or unexpected technical difficulties in designing, developing or operating new or existing facilities;
- risks and uncertainties involving the geology of oil and gas deposits;
- the uncertainty of reserves and resource estimates;
- the ability to generate sufficient cash flow from operations and other sources of financing at an acceptable cost to meet current and future obligations;
- changes to the status or interpretation of laws, regulations or policies;
- changes in environmental laws including emission reduction obligations;
- the timing of governmental or regulatory approvals;
- changes in general business and economic conditions;
- uncertainty regarding aboriginal land claims and co-existing with local populations;
- the effects of weather;
- the ability to fund exploration, development and operational activities and meet current and future obligations;
- the timing and cost of future abandonment and reclamation activities;
- cleanup costs or business interruptions due environmental damage and contamination;
- the ability to enter into or continue leases; existing and potential lawsuits and regulatory actions; and
- other risks and uncertainties described elsewhere in this document and in Paramount's other filings with Canadian securities authorities, including its Annual Information Form.

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

## Non-GAAP Measures

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

The Company has adjusted its funds flow from operations measure for all periods subsequent to the Transition Date to exclude asset retirement obligation settlements, cash outflows related to the purchase of Paramount's Common Shares under the Company's stock incentive plan and the effect of changes in foreign exchange rates in respect of foreign currency cash and cash equivalent balances. Funds flow from operations refers to cash from operating activities before net changes in operating working capital, geological and geophysical expenses and asset retirement obligation settlements. Funds flow from operations is commonly used in the oil and gas industry to assist management and investors in measuring the Company's ability to finance capital programs and meet financial obligations.

Netback equals petroleum and natural gas sales less royalties, operating costs, production taxes and transportation costs. Netback is commonly used by management and investors to compare the results of the Company's oil and gas operations between periods. Net Debt is a measure of the Company's overall debt position after adjusting for certain working capital amounts and is used by management to assess the Company's overall leverage position. Refer to the calculation of Net Debt in the liquidity and capital resources section of this document. Exploration and development expenditures refers to capital expenditures incurred by the Company's COUs (excluding land and property acquisitions). The exploration and development expenditure measure provides management and investors with information regarding the Company's Principal Property spending on drilling and infrastructure projects, separate from land and property acquisition activity.

Investments in other entities – market value reflects the Company's investments in enterprises whose securities trade on a public stock exchange at their period end closing price (e.g. Trilogy, MEG Energy Corp., MGM Energy and others), and all other investments in other entities at book value. Paramount provides this information in its MD&A because the market values of equity-accounted investments, which are significant assets of the Company, are often materially different than their carrying values.

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

## **Oil and Gas Measures and Definitions**

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



**PARAMOUNT RESOURCES LTD.**  
**Consolidated Balance Sheet (Unaudited)**  
(\$ thousands)

As at	Note	March 31 2011	December 31 2010 <small>(note 19)</small>	January 1 2010 <small>(note 19)</small>
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents	17	<b>\$ 107,007</b>	\$ 74,659	\$ 93,238
Accounts receivable		<b>44,091</b>	33,280	23,488
Risk management		–	–	2,187
Prepaid expenses and other		<b>1,597</b>	2,572	2,301
		<b>152,695</b>	110,511	121,214
<b>Deposit</b>	15	<b>19,803</b>	19,788	–
<b>Exploration and evaluation</b>	4	<b>310,254</b>	269,084	151,283
<b>Property, plant and equipment, net</b>	5	<b>687,509</b>	580,334	503,106
<b>Equity accounted investments</b>	7	<b>134,633</b>	138,300	113,471
<b>Investments in securities</b>	8	<b>209,193</b>	189,717	115,383
<b>Deferred income tax</b>		<b>67,628</b>	75,575	32,423
<b>Goodwill</b>	6	<b>9,159</b>	8,012	–
		<b>\$ 1,590,874</b>	\$ 1,391,321	\$ 1,036,880
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>				
<b>Current liabilities</b>				
Drilling rig loan	9	<b>\$ 25,380</b>	\$ 26,880	\$ 29,380
Accounts payable and accrued liabilities		<b>194,264</b>	84,928	48,571
Risk management	16	<b>3,792</b>	693	–
Stock-based compensation	14	<b>47,287</b>	46,187	13,827
		<b>270,723</b>	158,688	91,778
<b>Long-term debt</b>	10	<b>365,343</b>	294,205	93,655
<b>Asset retirement obligations</b>	11	<b>241,685</b>	241,770	195,088
<b>Stock-based compensation</b>	14	<b>19,000</b>	14,460	4,721
<b>Deferred income tax</b>		–	–	10,034
		<b>896,751</b>	709,123	395,276
<b>Shareholders' equity</b>				
Share capital	12	<b>486,533</b>	481,827	418,191
Retained earnings		<b>116,510</b>	128,375	218,386
Reserves	13	<b>91,080</b>	71,996	5,027
		<b>694,123</b>	682,198	641,604
		<b>\$ 1,590,874</b>	\$ 1,391,321	\$ 1,036,880

See the accompanying notes to these Consolidated Financial Statements.

**PARAMOUNT RESOURCES LTD.**  
**Consolidated Statement of Comprehensive Income (Unaudited)**  
(\$ thousands, except as noted)

Three months ended March 31	Note	2011	2010 (note 19)
Petroleum and natural gas sales		\$ 46,755	\$ 48,895
Royalties		(4,731)	(6,956)
<b>Revenue</b>		<b>42,024</b>	41,939
<b>Gain (loss) on financial commodity contracts</b>	16	<b>(3,365)</b>	10,465
		<b>38,659</b>	52,404
<b>Expenses</b>			
Operating expense and production tax		15,555	14,127
Transportation		4,092	4,086
General and administrative		4,202	3,342
Stock-based compensation	14	11,319	6,732
Depletion and depreciation		27,687	21,708
Exploration and evaluation	4	9,383	14,262
Gain on sale of property, plant and equipment		(39,641)	(101)
Accretion of asset retirement obligations		2,326	1,914
Interest		7,627	2,673
Foreign exchange		4,150	(802)
		<b>46,700</b>	67,941
Income (loss) from equity-accounted investments	7	(1,274)	40,571
Other		685	598
<b>Net income (loss) before tax</b>		<b>(8,630)</b>	25,632
<b>Income tax expense (recovery)</b>			
Current		159	3
Deferred		3,076	(1,282)
		<b>3,235</b>	(1,279)
<b>Net income (loss)</b>		<b>\$ (11,865)</b>	\$ 26,911
<b>Other comprehensive income (loss), net of tax</b>	13		
Change in market value of securities		17,417	1,824
Exchange differences on translation of US subsidiaries		(1,478)	(1,689)
Reclassification of other comprehensive loss to earnings		2,326	-
<b>Comprehensive income</b>		<b>\$ 6,400</b>	\$ 27,046
<b>Net income (loss) per common share</b> (\$/share)	12		
Basic and diluted		<b>\$ (0.16)</b>	\$ 0.37

See the accompanying notes to these Consolidated Financial Statements.

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

Three months ended March 31	Note	2011	2010 (note 19)
<b>Operating activities</b>			
Net income (loss)		\$ (11,865)	\$ 26,911
Add (deduct)			
Items not involving cash	17	19,705	(10,360)
Dividends on equity-accounted investments		3,212	4,097
Asset retirement obligations settled	11	(5,331)	(1,143)
Change in non-cash working capital		34,131	(3,940)
Cash from operating activities		39,852	15,565
<b>Financing activities</b>			
Drilling rig loan repayment		(1,500)	(1,000)
Proceeds from Senior Notes, net of issue costs		70,964	–
Common shares issued, net of issue costs		1,813	2,119
Common shares purchased under stock incentive plan		(2,370)	–
Cash from financing activities		68,907	1,119
<b>Investing activities</b>			
Property, plant and equipment and exploration		(185,055)	(87,880)
Proceeds on sale of property, plant and equipment		44,116	–
Proceeds on sale of investment		350	–
Equity accounted investments		–	(1,200)
Investments in securities		–	(1,373)
Change in non-cash working capital		65,146	37,560
Cash used in investing activities		(75,443)	(52,893)
Net increase (decrease)		33,316	(36,209)
Foreign exchange on cash		(968)	(834)
Cash and cash equivalents, beginning of period		74,659	93,238
<b>Cash and cash equivalents, end of period</b>		<b>\$ 107,007</b>	<b>\$ 56,195</b>

**Supplemental cash flow information**

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See the accompanying notes to these Consolidated Financial Statements.

**PARAMOUNT RESOURCES LTD.**  
**Consolidated Statement of Shareholders' Equity (Unaudited)**  
(\$ thousands, except as noted)

<b>Three months ended March 31</b>	<b>2011</b>		<b>2010</b>	
	<i>Shares (000's)</i>		<i>Shares (000's)</i>	
<b>Share Capital</b>				(note 19)
Balance, beginning of period	<b>75,034</b>	<b>\$ 481,827</b>	72,058	\$ 418,191
Issued	<b>214</b>	<b>6,921</b>	284	4,791
Change in unvested common shares for stock incentive plan	<b>(82)</b>	<b>(2,215)</b>	–	138
<b>Balance, end of period</b>	<b>75,166</b>	<b>\$ 486,533</b>	72,342	\$ 423,120
<b>Retained Earnings</b>				
Balance, beginning of period		<b>\$ 128,375</b>		\$ 218,386
Net income (loss)		<b>(11,865)</b>		26,911
<b>Balance, end of period</b>		<b>\$ 116,510</b>		\$ 245,297
<b>Reserves</b>				
Balance, beginning of period		<b>\$ 71,996</b>		\$ 5,027
Other comprehensive income		<b>18,265</b>		135
Stock-based compensation on investees' options		<b>819</b>		217
<b>Balance, end of period</b>		<b>\$ 91,080</b>		\$ 5,379
<b>Total Shareholders' Equity</b>		<b>\$ 694,123</b>		\$ 673,796

See the accompanying notes to these Consolidated Financial Statements.

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

*(\$ thousands, except as noted)*

### **1. SIGNIFICANT ACCOUNTING POLICIES**

Paramount Resources Ltd. ("Paramount" or the "Company") is an independent, publicly traded, Canadian corporation that explores for, develops, processes, transports, and markets petroleum and natural gas. Paramount's principal properties are located in Alberta, the Northwest Territories and British Columbia in Canada, and in North Dakota and Montana in the United States. Paramount is the ultimate parent company of the consolidated group of companies. Paramount has divided its operations into three business segments: Principal Properties, Strategic Investments and Corporate.

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

These unaudited Interim Consolidated Financial Statements were authorized for issuance by the Audit Committee of Paramount Resources Ltd. on May 17, 2011.

#### **a) Basis of Preparation**

These unaudited Interim Consolidated Financial Statements have been prepared on a historical cost basis, except for certain financial instruments and share-based payments that have been measured at fair value, and include the accounts of Paramount and its subsidiaries and partnerships.

Canadian Generally Accepted Accounting Principles ("GAAP"), as issued by the Canadian Institute of Chartered Accountants, were converted to International Financial Reporting Standards ("IFRS") effective for fiscal years beginning on or after January 1, 2011. These financial statements represent Paramount's initial presentation of its results of operations and financial position under IFRS, and have been prepared in accordance with IAS 34 - Interim Financial Reporting ("IAS 34") and IFRS 1 - First-time Adoption of IFRS ("IFRS 1"). Certain information and disclosures normally required to be included in notes to annual consolidated financial statements have been condensed or omitted. Accordingly, these unaudited Interim Consolidated Financial Statements should be read in conjunction with Paramount's audited Consolidated Financial Statements as at and for the year ended December 31, 2010. In order to prepare comparative information, the Company has applied IFRS as of January 1, 2010 (the "Transition Date") and the accounting, estimation and valuation policies adopted on conversion to IFRS, as described below, have been consistently applied to all periods presented herein. A reconciliation of comparative amounts included herein to amounts previously published in accordance with Canadian GAAP in effect prior to January 1, 2011 ("Previous GAAP") has been provided in Note 19.

The IFRS standards that will be effective or available for voluntary early adoption in the financial statements for the year ending December 31, 2011 are subject to change. Accordingly, the Company's accounting policies will be finalized when the first annual IFRS financial statements are prepared for the year ending December 31, 2011.

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

The financial statements of Paramount's subsidiaries and partnerships are prepared for the same reporting periods as the parent in accordance with the Company's accounting principles. All

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

*(\$ thousands, except as noted)*

intercompany balances and transactions have been eliminated. These unaudited Interim Consolidated Financial Statements are stated in Canadian dollars, except where otherwise noted.

### **b) Revenue Recognition**

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

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

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

### **c) Cash and Cash Equivalents**

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

### **d) Trade and Other Receivables**

Accounts receivable are recorded as revenue is recognized. An allowance for doubtful accounts is recorded based on management's best estimate of accounts receivable balances that may not be collectible, and is reviewed quarterly.

### **e) Equity-Accounted Investments**

Investments in entities in which Paramount does not have direct or joint control over the strategic operating, investing, and financing decisions, but over which it has significant influence, are accounted for using the equity method. Under this method, the Company recognizes in earnings, its proportionate share of the earnings of investees. As dividends are received, the carrying value of Paramount's investment in the investee is reduced. The Company is generally considered to have significant influence over an investee where its equity interest exceeds 20 percent, or where Paramount and the investee share common directors and members of management. All other investments are accounted for as financial instruments.

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

### **f) Joint Arrangements**

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

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

*(\$ thousands, except as noted)*

### **g) Exploration and Evaluation**

Costs related to the exploration for and evaluation of hydrocarbon resources, including costs of drilling and completing exploratory wells, acquiring unproved property and estimated asset retirement costs, are initially capitalized, pending determination of technical feasibility and commercial viability. If hydrocarbons are found, but further appraisal activity is required to conclude whether they are economically recoverable, the costs continue to be recognized as an asset. All such costs are subject to technical, commercial, and management review at least annually to confirm the continued intent to develop the discovery. When a project has been determined to be technically feasible and commercially viable, the exploration and evaluation ("E&E") costs are transferred to petroleum and natural gas assets, subject to an impairment assessment. When the Company determines that a project is no longer viable, its accumulated carrying value is charged to earnings.

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

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

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

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

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

### **Depletion and Depreciation**

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

Capitalized costs of gas plants, gathering systems and production equipment are depleted on a unit-of-production basis over the proved developed reserves of the field to which they relate.

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

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

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

*(\$ thousands, except as noted)*

### **Impairment of Non-Financial Assets**

The carrying values of the Company's non-financial assets, excluding goodwill, are reviewed at each reporting date to determine whether any indicators of impairment are present. If an indicator of impairment is identified, the asset's recoverable amount is estimated. For the purpose of impairment testing, assets are tested individually or, in certain circumstances, assets are grouped together into a cash-generating unit ("CGU"), which consists of the smallest group of assets that generate cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The recoverable amount of an asset or CGU is the greater of its fair value less costs to sell and its value in use. In assessing fair value less costs to sell, the Company estimates the value a potential purchaser would ascribe to an asset or CGU, by estimating its expected discounted after-tax future net cash flows. Discounted after-tax future net cash flows are determined using forecast commodity prices and costs over the expected economic life of proved and probable reserves, discounted using market-based rates. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the asset or CGU. If the carrying value of an asset or CGU exceeds its estimated recoverable amount, an impairment charge is recognized.

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

### **Alberta Drilling Royalty Credits**

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

#### ***i) Business Combinations and Goodwill***

Business combinations are accounted for using the acquisition method of accounting. Under this method, the net identifiable assets acquired are measured at fair value on acquisition date. Costs incurred to affect the transaction are expensed. Any excess of the purchase price over the fair value of the net identifiable assets acquired is recognized as goodwill. Any deficiency of the purchase price over the fair value of the net identifiable assets acquired is recognized in earnings.

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

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



## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

(\$ thousands, except as noted)

### **j) Borrowing Costs**

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

### **k) Asset Retirement Obligations**

Asset retirement obligations relate to obligations to retire assets such as well sites, gathering systems, natural gas processing plants and access roads at the end of their productive lives. The Company recognizes the present value of an asset retirement obligation in the period in which it is incurred and when its fair value can be reasonably estimated. The present value of the obligation is determined using the applicable period-end risk free discount rate and is adjusted for the passage of time, which is recognized as accretion expense. Revisions to the timing, amount or applicable discount rate of the estimated liability are accounted for prospectively by recording an adjustment to the asset retirement obligation liability with a corresponding adjustment to the carrying value of the related asset. The fair value of estimated future asset retirement costs are capitalized as part of the related long-lived asset and depreciated on the same basis as the underlying asset.

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

### **l) Foreign Currency Translation**

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

Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at average monthly exchange rates. Monetary assets and liabilities of the Company and its Canadian subsidiaries that are denominated in foreign currencies are translated into Canadian dollars at the period-end exchange rate. Gains or losses are recorded in income in the Consolidated Statement of Comprehensive Income (Loss).

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

### **m) Financial Instruments, Comprehensive Income and Hedges**

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

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

*(\$ thousands, except as noted)*

### **Financial Instruments**

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

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

### **Other Comprehensive Income**

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

### **n) Income Taxes**

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

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

### **o) Flow-Through Shares**

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

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

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

*(\$ thousands, except as noted)*

### **p) Stock-Based Compensation**

#### **Stock Option Plan**

Paramount's stock option plan ("Stock Option Plan") enables the Board of Directors or its Compensation Committee to grant key employees and directors of the Company options to acquire Common Shares. The exercise price of an option is equal to the closing market price of the Common Shares on the day preceding the grant date. Options generally vest over five years and expire within six years of the grant date. Option holders may either exercise their options for Common Shares or, if the Company concurs, surrender their options for a cash payment in an amount equal to the positive difference, if any, between the market price and the exercise price of the number of Common Shares in respect of which the options are surrendered.

Paramount uses the liability method to recognize stock-based compensation expense, where a liability is recognized initially on grant date based on the fair value of the options granted, which is subsequently re-measured each period until the options are exercised, are surrendered or expire. The fair value of options are determined using the Black-Scholes-Merton model. When options are surrendered for cash, the cash settlement is applied against the liability and any difference is recognized as stock-based compensation expense. When options are exercised for Common Shares, the consideration paid by the option holder and the previously recognized liability associated with the options are recorded as an increase to share capital.

#### **Stock Incentive Plan**

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

### **q) Future Changes in Accounting Policies**

Effective January 1, 2013, the current financial instruments standard IAS 39 - Financial Instruments: Recognition and Measurement will be replaced by IFRS 9 - Financial Instruments. The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. The Company is currently evaluating the impact of adopting the new standard.

## **2. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES, AND ASSUMPTIONS**

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

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

*(\$ thousands, except as noted)*

### **Exploration and Evaluation**

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

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

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

### **Reserves Estimates**

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

Estimates of reserves impact: (i) the assessment of whether or not a new well has found economically recoverable reserves; (ii) depletion rates; and (iii) the determination of the realizable value of petroleum and natural gas properties for impairment tests, all of which could have a material impact on earnings.

### **Business Combinations**

Business combinations are accounted for using the acquisition method of accounting, where the net identifiable assets acquired are recorded at fair value. Any excess of the purchase price over the fair value of the net assets acquired is recognized as goodwill. Any deficiency of the purchase price below the fair value of the net assets acquired is recorded as a gain in net income. Determinations of fair value often require management to make assumptions and estimates about future events including reserves estimations. Changes in any of the assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the carrying values assigned.

### **Asset Retirement Obligations**

Estimates of expected asset retirement costs are subject to uncertainty associated with the method, timing, economic environment and regulatory standards that will exist at the time when assets are

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

*(\$ thousands, except as noted)*

retired in the future. Accordingly, actual payments to settle the obligations may differ materially from estimated amounts.

### **Stock-Based Compensation**

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

### **Income Taxes**

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

## **3. SEGMENTED INFORMATION**

Paramount's operations are divided into three business segments established by management to assist in resource allocation, to assess operating performance and to achieve long-term strategic objectives:

- **Principal Properties:** Principal properties consist of: (i) the Kaybob Corporate Operating Unit ("COU"), which includes properties in West Central Alberta; (ii) the Grande Prairie COU, which includes properties in the Peace River Arch area of Alberta; (iii) the Southern COU, which includes properties in Southern Alberta, Saskatchewan, North Dakota, and Montana; and (iv) the Northern COU, which includes properties in Northern Alberta, the Northwest Territories and Northeast British Columbia.
- **Strategic Investments:** Strategic investments include: (i) investments in other entities, including affiliates; (ii) investments in development stage assets where there is no near-term expectation of production or revenue, but a longer-term value proposition based on spin-outs, dispositions, or future revenue generation; and (iii) three Rigs owned by Fox Drilling Inc. and Paramount Drilling U.S., L.L.C., wholly-owned subsidiaries of the Company.
- **Corporate:** Corporate is comprised of income and expense items, including general and administrative expense and interest expense, which have not been specifically allocated to Principal Properties or Strategic Investments.

## Notes to the Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

Three months ended March 31, 2011	Principal Properties	Strategic Investments	Corporate	Inter-segment Eliminations	Total
Petroleum and natural gas sales	\$ 46,755	\$ –	\$ –	\$ –	\$ 46,755
Royalties	(4,731)	–	–	–	(4,731)
<b>Revenue</b>	42,024	–	–	–	42,024
Loss on financial commodity contracts	(3,365)	–	–	–	(3,365)
	38,659	–	–	–	38,659
<b>Expenses</b>					
Operating expense and production tax	15,555	–	–	–	15,555
Transportation	4,092	–	–	–	4,092
General and administrative	–	1,045	3,157	–	4,202
Stock-based compensation	–	3,032	8,287	–	11,319
Depletion and depreciation	27,111	1,409	181	(1,014)	27,687
Exploration and evaluation	8,566	817	–	–	9,383
Gain on sale of property, plant and equipment	(39,641)	–	–	–	(39,641)
Accretion of asset retirement obligations	2,312	14	–	–	2,326
Interest	–	329	7,298	–	7,627
Foreign exchange	–	(30)	4,180	–	4,150
	17,995	6,616	23,103	(1,014)	46,700
Loss from equity-accounted investments	–	(1,274)	–	–	(1,274)
Other	954	–	–	–	954
Drilling rig revenue	–	5,484	–	(3,962)	1,522
Drilling rig expense	–	(3,050)	–	1,259	(1,791)
	21,618	(5,456)	(23,103)	(1,689)	(8,630)
<b>Inter-segment eliminations</b>	–	(1,689)	–	1,689	–
<b>Segment earnings (loss)</b>	\$ 21,618	\$ (7,145)	\$ (23,103)	\$ –	(8,630)
<b>Income tax expense</b>					(3,235)
<b>Net loss</b>					\$ (11,865)

Three months ended March 31, 2010	Principal Properties	Strategic Investments	Corporate	Inter-segment Eliminations	Total
Petroleum and natural gas sales	\$ 48,895	\$ –	\$ –	\$ –	\$ 48,895
Royalties	(6,956)	–	–	–	(6,956)
<b>Revenue</b>	41,939	–	–	–	41,939
Gain on financial commodity contracts	10,465	–	–	–	10,465
	52,404	–	–	–	52,404
<b>Expenses</b>					
Operating expense and production tax	14,127	–	–	–	14,127
Transportation	4,086	–	–	–	4,086
General and administrative	–	631	2,711	–	3,342
Stock-based compensation	–	1,818	4,914	–	6,732
Depletion and depreciation	21,497	997	171	(957)	21,708
Exploration and evaluation	14,210	52	–	–	14,262
Gain on sale of property, plant and equipment	(101)	–	–	–	(101)
Accretion of asset retirement obligations	1,904	10	–	–	1,914
Interest	–	332	2,341	–	2,673
Foreign exchange	–	(34)	(768)	–	(802)
	55,723	3,806	9,369	(957)	67,941
Income from equity-accounted investments	–	40,571	–	–	40,571
Other	662	–	(49)	–	613
Drilling rig revenue	–	3,330	–	(3,330)	–
Drilling rig expense	–	(1,988)	–	1,973	(15)
	(2,657)	38,107	(9,418)	(400)	25,632
<b>Inter-segment eliminations</b>	–	(400)	–	400	–
<b>Segment earnings (loss)</b>	\$ (2,657)	\$ 37,707	\$ (9,418)	\$ –	25,632
<b>Income tax recovery</b>					1,279
<b>Net income</b>					\$ 26,911

## Notes to the Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

### Total Assets

As at	March 31, 2011	December 31, 2010	January 1, 2010
Principal Properties	\$ 960,267	\$ 816,279	\$ 634,860
Strategic Investments	427,010	397,009	286,392
Corporate	203,597	178,033	115,628
	\$ 1,590,874	\$ 1,391,321	\$ 1,036,880

### Geographical Information

March 31, 2011	Property, Plant and Equipment	Goodwill	Petroleum and Natural Gas Sales	Capital Expenditures
Canada	\$ 627,844	\$ 9,159	\$ 39,779	\$ 184,042
United States	59,665	–	6,976	1,013
Total	\$ 687,509	\$ 9,159	\$ 46,755	\$ 185,055

December 31, 2010	Property, Plant and Equipment	Goodwill	Petroleum and Natural Gas Sales	Capital Expenditures
Canada	\$ 513,689	\$ 8,012	\$ 157,292	\$ 279,012
United States	66,645	–	27,103	10,957
Total	\$ 580,334	\$ 8,012	\$ 184,395	\$ 289,969

As at January 1, 2010	Property, Plant and Equipment	Goodwill
Canada	\$ 433,249	\$ –
United States	69,857	–
Total	\$ 503,106	\$ –

## 4. EXPLORATION AND EVALUATION

	Three months ended March 31, 2011	Twelve months ended December 31, 2010
Balance, beginning of period	\$ 269,084	\$ 151,283
Additions	69,989	175,495
Transfers to property, plant and equipment	(18,713)	(22,074)
Impairment	–	(1,739)
Dry hole	–	(8,479)
Expired lease costs	(6,512)	(24,247)
Dispositions	(3,435)	(586)
Foreign exchange	(159)	(569)
<b>Balance, end of period</b>	<b>\$ 310,254</b>	<b>\$ 269,084</b>

### Exploration and Evaluation Expense

Three months ended March 31	2011	2010
Geological and geophysical	\$ 2,871	\$ 3,137
Dry hole	–	8,150
Expired lease costs	6,512	2,975
	\$ 9,383	\$ 14,262

**Notes to the Interim Consolidated Financial Statements (Unaudited)**

(\$ thousands, except as noted)

**5. PROPERTY, PLANT AND EQUIPMENT**

	Petroleum and natural gas assets	Drilling rigs	Other	Total
<b>Cost</b>				
Balance, December 31, 2010	\$ 873,850	\$ 46,146	\$ 19,850	\$ 939,846
Additions	115,405	732	4	116,141
Transfer from exploration and evaluation	19,150	–	–	19,150
Dispositions	(1,537)	–	–	(1,537)
Change in asset retirement provision	3,373	–	–	3,373
Currency translation differences	(1,087)	(337)	(13)	(1,437)
<b>Cost, March 31, 2011</b>	<b>1,009,154</b>	<b>46,541</b>	<b>19,841</b>	<b>1,075,536</b>
<b>Accumulated depletion, depreciation, amortization and write-downs</b>				
Balance, December 31, 2010	\$ (333,483)	\$ (8,157)	\$ (17,872)	\$ (359,512)
Transfer from exploration and evaluation	(437)	–	–	(437)
Depletion, depreciation and amortization	(27,123)	(1,397)	(181)	(28,701)
Dispositions	228	–	–	228
Currency translation differences	281	107	7	395
<b>Accumulated depletion, depreciation, amortization and write-downs, March 31, 2011</b>	<b>(360,534)</b>	<b>(9,447)</b>	<b>(18,046)</b>	<b>(388,027)</b>
Net book value, December 31, 2010	\$ 540,367	\$ 37,989	\$ 1,978	\$ 580,334
<b>Net book value, March 31, 2011</b>	<b>\$ 648,620</b>	<b>\$ 37,094</b>	<b>\$ 1,795</b>	<b>\$ 687,509</b>

	Petroleum and natural gas assets	Drilling rigs	Other	Total
<b>Cost</b>				
Balance, January 1, 2010	\$ 641,265	\$ 46,840	\$ 19,720	\$ 707,825
Additions	185,401	1,208	161	186,770
Transfer from exploration and evaluation	22,620	–	–	22,620
Dispositions	(6,861)	(1,121)	–	(7,982)
Change in asset retirement provision	34,063	–	–	34,063
Currency translation differences	(2,638)	(781)	(31)	(3,450)
Cost, December 31, 2010	873,850	46,146	19,850	939,846
<b>Accumulated depletion, depreciation, amortization and write-downs</b>				
Balance, January 1, 2010	(184,315)	(3,274)	(17,130)	(204,719)
Transfer from exploration and evaluation	(547)	–	–	(547)
Depletion, depreciation and amortization	(100,982)	(5,135)	(751)	(106,868)
Write-downs	(54,350)	–	–	(54,350)
Dispositions	6,415	–	–	6,415
Currency translation differences	296	252	9	557
Accumulated depletion, depreciation, amortization and write-downs, December 31, 2010	(333,483)	(8,157)	(17,872)	(359,512)
Net book value, January 1, 2010	\$ 456,950	\$ 43,566	\$ 2,590	\$ 503,106
Net book value, December 31, 2010	\$ 540,367	\$ 37,989	\$ 1,978	\$ 580,334

At March 31, 2011, \$60.1 million (December 31, 2010 – \$20.0 million) of capitalized costs related to incomplete development wells and infrastructure projects are currently not subject to depletion.



## Notes to the Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

### 6. GOODWILL

As at	March 31, 2011	December 31, 2010	January 1, 2010
<b>Carrying value, beginning of period</b>	<b>\$ 8,012</b>	\$ —	\$ —
Acquisitions	—	11,589	—
Additional accrued liability	<b>1,147</b>	—	—
Impairment	—	(3,577)	—
<b>Carrying value, end of period</b>	<b>\$ 9,159</b>	\$ 8,012	\$ —

For the three months ended March 31, 2011, there were additions to goodwill of \$1.1 million in respect of an additional accrued liability of Redcliffe Exploration Inc. existing at the date of acquisition.

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

As at	March 31, 2011	December 31, 2010	January 1, 2010
Grande Prairie	<b>\$ 8,561</b>	\$ 7,464	\$ —
Kaybob	<b>598</b>	548	—
	<b>\$ 9,159</b>	\$ 8,012	\$ —

### 7. EQUITY ACCOUNTED INVESTMENTS

	March 31, 2011			December 31, 2010			January 1, 2010		
	Shares (000's)	Carrying Value	Market Value <sup>(1)</sup>	Shares (000's)	Carrying Value	Market Value <sup>(1)</sup>	Shares (000's)	Carrying Value	Market Value <sup>(1)</sup>
Trilogy Energy Corp. ("Trilogy")	24,144	\$123,433	\$492,062	24,144	\$125,746	\$296,975	23,995	98,773	\$206,114
MGM Energy Corp. ("MGM Energy")	43,834	4,646	9,643	43,834	5,222	8,767	43,834	5,844	12,493
Paxton Corporation	1,750	4,238		1,750	4,338		1,750	4,574	
Other		2,316			2,994			4,280	
		<b>\$134,633</b>			<b>\$138,300</b>			<b>\$113,471</b>	

(1) Based on the period-end trading price of publicly traded entities.

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

Three months ended March 31	2011			2010		
	Equity income (loss)	Dilution gain	Total	Equity income (loss)	Dilution gain (loss)	Total
Trilogy	\$ (585)	\$ —	\$ (585)	\$ 36,798	\$ 4,109	\$ 40,907
MGM Energy	(589)	—	(589)	(250)	(39)	(289)
Paxton Corporation	(100)	—	(100)	(47)	—	(47)
	<b>\$ (1,274)</b>	<b>\$ —</b>	<b>\$ (1,274)</b>	<b>\$ 36,501</b>	<b>\$ 4,070</b>	<b>\$ 40,571</b>

## Notes to the Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

### 8. INVESTMENTS IN SECURITIES<sup>(1)</sup>

	March 31, 2011		December 31, 2010		January 1, 2010	
	Shares (000's)		Shares (000's)		Shares (000's)	
MEG Energy Corp.	3,700	\$ 181,522	3,700	\$ 168,313	3,700	\$ 101,750
NuLoch Resources Inc.	6,579	16,316	6,579	13,684	6,579	5,921
ProspEx Resources Ltd. ("ProspEx")	5,625	11,250	5,625	7,369	—	—
Redcliffe Exploration Inc.	—	—	—	—	19,667	7,210
Other		105		351		502
		<b>\$ 209,193</b>		<b>\$ 189,717</b>		<b>\$ 115,383</b>

(1) Based on the period-end trading price of publicly traded entities.

### 9. DRILLING RIG LOAN

At March 31, 2011, \$25.4 million (December 31, 2010 - \$26.9 million) was outstanding on the drilling rig loan. Unless demanded by the bank, the remaining scheduled principal repayments are as follows: 2011 - \$2.5 million; 2012 - \$5.1 million; 2013 - \$5.1 million and 2014 - \$12.7 million.

### 10. LONG-TERM DEBT

	March 31, 2011	December 31, 2010	January 1, 2010
Bank credit facility	\$ —	\$ —	\$ —
8 ½ percent US Senior Notes due 2013	—	—	94,394
8 ¼ percent Senior Notes due 2017	370,000	300,000	—
	<b>370,000</b>	300,000	94,394
Unamortized financing costs net of premiums	(4,657)	(5,795)	(739)
	<b>\$ 365,343</b>	<b>\$ 294,205</b>	<b>\$ 93,655</b>

#### Bank Credit Facility

The borrowing base and lender commitments under the credit facility are \$160 million. The credit facility is secured by a first fixed and floating charge over substantially all of the assets of Paramount, excluding assets securing the drilling rig loan. The maximum amount that Paramount may borrow under the credit facility is subject to semi-annual review, and is dependent upon the Company's reserves and lenders' projections of future commodity prices, among other factors.

The revolving feature of the credit facility has been extended by the syndicate of lenders from April 30, 2011 to June 30, 2011 to allow for the closing of the ProspEx acquisition (see note 18 – subsequent events) prior to establishing a new borrowing base. In the event the revolving period is not extended, the credit facility would be available on a non-revolving basis until April 30, 2012, at which time it would be due and payable.

At March 31, 2011, no balance was drawn on the credit facility. Paramount had undrawn letters of credit outstanding at March 31, 2011 of \$24.4 million that reduce the amount available to the Company.

#### Senior Notes

In February 2011, Paramount completed a public offering of an additional \$70 million principal amount of its senior unsecured notes ("Senior Notes") at a price of \$1,030 per \$1,000 principal amount, of which \$1.4 million principal amount was purchased by an entity that is controlled by the Company's Chairman

## Notes to the Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

and Chief Executive Officer. As of March 31, 2011, the Company has an aggregate of \$370 million principal amount of Senior Notes outstanding. The Senior Notes bear interest at 8.25 percent per annum, payable semi-annually in arrears on June 13 and December 13 in each year and mature on December 13, 2017. The Senior Notes are direct senior unsecured obligations of Paramount and rank equally with all other senior unsecured indebtedness of the Company.

### 11. ASSET RETIREMENT OBLIGATIONS

	Three months ended March 31, 2011	Twelve months ended December 31, 2010
<b>Asset retirement obligations, beginning of period</b>	<b>\$ 241,770</b>	\$ 195,088
Retirement obligations incurred	3,434	30,272
Revisions to estimated retirement costs	–	21,779
Obligations settled	(5,331)	(3,209)
Disposal of properties	(269)	(9,638)
Accretion expense	2,326	7,975
Foreign exchange	(245)	(497)
<b>Asset retirement obligations, end of period</b>	<b>\$ 241,685</b>	\$ 241,770

The estimated undiscounted asset retirement obligations at March 31, 2011 were \$288.6 million (December 31, 2010 – \$284.3 million). The period-end present value of the asset retirement obligations was determined using a risk-free rate of four percent (December 31, 2010 – four percent) and an inflation rate of three percent (December 31, 2010 – three percent). These obligations will be settled over the expected useful lives of the assets, which extend up to 43 years.

### 12. SHARE CAPITAL

#### Weighted Average Shares Outstanding

(Thousands of Common Shares)	Three months ended March 31, 2011	Three months ended March 31, 2010
<b>Weighted average Common Shares outstanding – Basic and diluted</b>	<b>75,159</b>	72,225

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

### 13. RESERVES

Reserves include unrealized gains on the Company's investments in securities, foreign exchange differences on translation of foreign subsidiaries balances, and stock-based compensation expense on investees' options ("SBC – Investees' Options"). The changes in reserves are as follows:

**Notes to the Interim Consolidated Financial Statements (Unaudited)**

(\$ thousands, except as noted)

	Unrealized Gains on Securities	Translation of Foreign Subsidiaries	SBC - Investees' Options	Total Reserves
<b>Balance, January 1, 2010</b>	\$ 3,188	\$ –	\$ 1,839	<b>\$ 5,027</b>
Other comprehensive income	75,090	(2,749)	–	<b>72,341</b>
Reclassification to income	(3,499)	–	–	<b>(3,499)</b>
SBC – Investees' Options	–	–	563	<b>563</b>
Deferred tax	(3,157)	721	–	<b>(2,436)</b>
<b>Balance, December 31, 2010</b>	71,622	(2,028)	2,402	<b>71,996</b>
Other comprehensive income	19,775	(879)	–	<b>18,896</b>
Reclassification to earnings	–	2,326	–	<b>2,326</b>
SBC - Investees' Options	–	–	819	<b>819</b>
Deferred tax	(2,358)	(599)	–	<b>(2,957)</b>
<b>Balance, March 31, 2011</b>	\$ 89,039	\$ (1,180)	\$ 3,221	<b>\$ 91,080</b>

	Unrealized Gains on Securities	Translation of Foreign Subsidiaries	SBC - Investees' Options	Total Reserves
<b>Balance, January 1, 2010</b>	\$ 3,188	\$ –	\$ 1,839	<b>\$ 5,027</b>
Other comprehensive income	2,087	(1,574)	–	<b>513</b>
SBC – Investees' Options	–	–	217	<b>217</b>
Deferred tax	(263)	(115)	–	<b>(378)</b>
<b>Balance, March 31, 2010</b>	\$ 5,012	\$ (1,689)	\$ 2,056	<b>\$ 5,379</b>

**14. STOCK-BASED COMPENSATION**

**Stock Option Plan**

	Three months ended March 31, 2011		Year ended December 31, 2010	
	Weighted Average Exercise Price (\$/share)	Number	Weighted Average Exercise Price (\$/share)	Number
Balance, beginning of period	\$ 13.90	5,006,300	\$ 8.61	4,571,500
Granted	34.00	20,000	28.98	1,276,500
Exercised	8.80	(213,500)	7.90	(683,700)
Forfeited	22.65	(47,000)	8.74	(158,000)
Balance, end of period	\$ 14.12	4,765,800	\$ 13.90	5,006,300
Options exercisable, end of period	\$ 8.01	1,153,801	\$ 8.13	1,367,301

Additional information about Paramount Options outstanding at March 31, 2011 is as follows:

Exercise Prices	Number	Weighted Average Remaining Life (years)
\$ 6.87-\$10.00	2,672,800	2.6
\$10.01-\$20.00	875,500	3.7
\$20.01-\$34.00	1,217,500	4.7
<b>Total</b>	<b>4,765,800</b>	<b>3.4</b>

## Notes to the Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

The following key assumptions are incorporated into the period end Black-Scholes-Merton estimates of the fair value of Paramount Options:

	Three months ended March 31, 2011	Year ended December 31, 2010
Option life	<b>1.2 to 5.1 years</b>	1.5 to 5.3 years
Volatility <sup>(1)</sup>	<b>50 %</b>	51%
Forfeiture rate	<b>Nil to 7.9%</b>	Nil to 8.0%
Risk-free rate	<b>1.8% to 2.8%</b>	1.7% to 2.5%
Expected dividends	<b>Nil</b>	Nil

(1) Volatility is calculated on a five year trailing basis based on daily changes in the market value of the Company's Common Shares on the TSX.

The weighted average price of Paramount's Common Shares on the Toronto Stock Exchange during the first quarter of 2011 was \$32.68 (first quarter of 2010 – \$16.53). Options granted during the first quarter of 2011 have a five year term and have a weighted average grant date fair value of \$13.97 per option (first quarter of 2010 – no options granted).

The intrinsic value of vested options at March 31, 2011 was \$29.5 million (December 31, 2010 - \$32.2 million).

### Stock Incentive Plan

	Three months ended March 31, 2011		Twelve months ended December 31, 2010	
<b>Stock incentive plan shares held in trust</b>	<b>Shares (000's)</b>		<b>Shares (000's)</b>	
Balance, beginning of period	150	\$ 410	178	\$ 312
Shares purchased	82	2,370	178	2,901
Change in vested and unvested shares	–	(155)	(206)	(2,803)
<b>Balance, end of period</b>	<b>232</b>	<b>\$ 2,625</b>	<b>150</b>	<b>\$ 410</b>

### Employee Benefit Costs

<b>Three months ended March 31</b>	<b>2011</b>	<b>2010</b>
Stock option plan	\$ 10,750	\$ 6,299
Stock incentive plan	569	433
Stock-based compensation expense	11,319	6,732
Salaries and benefits	5,465	4,793
	<b>\$ 16,784</b>	<b>\$ 11,525</b>

## 15. INCOME TAXES

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

**Notes to the Interim Consolidated Financial Statements (Unaudited)**

(\$ thousands, except as noted)

**16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

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

<b>Instruments</b>	<b>Total Notional</b>	<b>Average Fixed Price</b>	<b>Fair Value</b>	<b>Remaining Term</b>
Oil – NYMEX Swap	1,000 Bbl/d	US \$93.73/Bbl	<b>\$ (3,792)</b>	April 2011 – December 2011

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

	<b>Three months ended March 31, 2011</b>	<b>Year ended December 31, 2010</b>
Fair value, beginning of period	<b>\$ (693)</b>	\$ 2,187
Changes in fair value	<b>(3,365)</b>	10,047
Settlements paid (received)	<b>267</b>	(12,927)
Fair value, end of period	<b>\$ (3,792)</b>	\$ (693)

**17. CONSOLIDATED STATEMENTS OF CASH FLOWS – SELECTED INFORMATION****Items not involving cash**

<b>Three months ended March 31</b>	<b>2011</b>	<b>2010</b>
Financial commodity contracts	<b>\$ 3,098</b>	\$ (9,224)
Stock-based compensation	<b>11,319</b>	6,732
Depletion and depreciation	<b>27,687</b>	21,708
Exploration and evaluation	<b>6,512</b>	11,361
Gain on sale of property, plant, and equipment	<b>(39,641)</b>	(101)
Accretion of asset retirement obligations	<b>2,326</b>	1,914
Foreign exchange	<b>4,121</b>	(967)
Income (loss) from equity accounted investments	<b>1,274</b>	(40,571)
Deferred income tax	<b>3,076</b>	(1,282)
Other	<b>(67)</b>	70
	<b>\$ 19,705</b>	\$ (10,360)

**Supplemental cash flow information**

<b>Three months ended March 31</b>	<b>2011</b>	<b>2010</b>
Interest paid	<b>\$ 190</b>	\$ 4,719
Current tax paid	<b>\$ –</b>	\$ 662

**Components of cash and cash equivalents**

	<b>March 31, 2011</b>	<b>December 31, 2010</b>	<b>January 1, 2010</b>
Cash	<b>\$ 18,014</b>	\$ 29,679	\$ 23,250
Bankers' acceptances	<b>88,993</b>	44,980	69,988
	<b>\$ 107,007</b>	\$ 74,659	\$ 93,238

## **18. SUBSEQUENT EVENTS**

### ***ProspEx Acquisition***

In April 2011, Paramount announced that it had entered into an agreement to acquire the remaining outstanding voting shares of ProspEx not already owned by the Company. Under the terms of the agreement, shareholders of ProspEx may elect to receive either: (i) 0.07162 of a Class A common share of Paramount; or (ii) \$2.40 cash, for each ProspEx share, provided that Paramount will issue an aggregate of 2,000,000 Paramount Shares pursuant to the agreement. The total cost to Paramount is approximately \$180 million (based on the closing price of Paramount's Common Shares on April 7, 2011), including the assumption of estimated net debt of approximately \$40 million and the cost of the approximately nine percent of the outstanding ProspEx Shares already held by Paramount. The acquisition is expected to be completed by the end of May 2011. Completion of the transaction is subject to approval by ProspEx shareholders, court approval and regulatory approvals.

### ***Common Share Issuance***

In April 2011, Paramount issued 1,500,000 Common Shares at a price of \$32.50 per share for gross proceeds of \$48.8 million through a public offering. In April 2011, Paramount also issued 150,000 Canadian development expense ("CDE") flow-through Common Shares at a price of \$36.50 per share for gross proceeds of \$5.5 million to a company controlled by the Company's Chairman and Chief Executive Officer.

## **19. RECONCILIATION TO PREVIOUS GAAP**

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

- a) the exemption to measure certain assets at fair value on transition to IFRS and subsequently deem that fair value to be historical cost;
- b) the exemption to deem cumulative foreign exchange translation differences related to foreign subsidiaries as of January 1, 2010 to be nil;
- c) the exemption that permits amounts recorded in respect of options settled prior to January 1, 2010 not to be retrospectively restated;
- d) the exemption that permits business combinations completed prior to the initial business combination recorded in accordance with IFRS 3 "Business Combinations" ("IFRS 3") not to be restated. Paramount's initial business combination recorded in accordance with IFRS 3 was the June 2010 Redcliffe Exploration Inc. acquisition;
- e) the exemption to measure asset retirement obligations at the Transition Date in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets";
- f) the exemption to assess lease arrangements using the facts and circumstances as of the Transition Date under International Financial Reporting Interpretations Committee Interpretation 4, "Determining whether an Arrangement contains a Lease"; and

**Notes to the Interim Consolidated Financial Statements (Unaudited)**

*(\$ thousands, except as noted)*

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

Paramount has applied IFRS as of the Transition Date, and all amounts presented in these Interim Consolidated Financial Statements have been prepared on a consistent basis in accordance with the Company's expected IFRS accounting policies except where certain IFRS 1 exemptions were utilized. The following information reconciles the 2010 comparative amounts included in these Interim Consolidated Financial Statements to the January 1, 2010, first quarter 2010 and annual amounts that were previously published in accordance with Previous GAAP.



**Notes to the Interim Consolidated Financial Statements (Unaudited)**

(\$ thousands, except as noted)

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

	December 31, 2009 Previous GAAP	Reclasses (19 a)	PPE (19 b)	ARO (19 c)	FX (19 d)	SBC (19 e)	FTS (19 f)	Equity Accounting (19 g)	Deferred Tax (19 h)	Net Transition Date Adjustments	January 1, 2010 IFRS
<b>ASSETS</b>											
<b>Current assets</b>	<b>\$ 121,214</b>	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	<b>\$ 121,214</b>
Exploration and evaluation	—	152,170	—	—	(887)	—	—	—	—	151,283	<b>151,283</b>
Property, plant and equipment, net	<b>716,235</b>	(152,170)	(65,412)	8,563	(4,110)	—	—	—	—	(213,129)	<b>503,106</b>
Investments	<b>234,586</b>	(234,586)	—	—	—	—	—	—	—	(234,586)	—
Equity accounted investments	—	119,203	—	—	—	—	—	(7,611)	1,879	113,471	<b>113,471</b>
Investments in securities	—	115,383	—	—	—	—	—	—	—	115,383	<b>115,383</b>
Deferred income tax	<b>29,940</b>	—	—	—	—	—	—	—	2,483	2,483	<b>32,423</b>
	<b>\$ 1,101,975</b>	\$ —	\$ (65,412)	\$ 8,563	\$ (4,997)	\$ —	\$ —	\$ (7,611)	\$ 4,362	\$ (65,095)	<b>\$1,036,880</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>											
<b>Current liabilities</b>											
Drilling rig loan	<b>\$ 29,380</b>	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	<b>\$ 29,380</b>
Accounts payable and accrued liabilities	<b>46,162</b>	—	—	—	—	—	2,409	—	—	2,409	<b>48,571</b>
Stock-based compensation	<b>11,441</b>	—	—	—	—	2,386	—	—	—	2,386	<b>13,827</b>
	<b>86,983</b>	—	—	—	—	2,386	2,409	—	—	4,795	<b>91,778</b>
<b>Long-term debt</b>	<b>93,655</b>	—	—	—	—	—	—	—	—	—	<b>93,655</b>
<b>Asset retirement obligations</b>	<b>103,462</b>	—	—	91,626	—	—	—	—	—	91,626	<b>195,088</b>
<b>Stock-based compensation</b>	<b>3,771</b>	—	—	—	—	950	—	—	—	950	<b>4,721</b>
<b>Deferred income tax</b>	<b>41,194</b>	—	—	—	—	—	2,879	—	(34,039)	(31,160)	<b>10,034</b>
	<b>329,065</b>	—	—	91,626	—	3,336	5,288	—	(34,039)	66,211	<b>395,276</b>
<b>Shareholders' Equity</b>											
Share capital	<b>393,087</b>	—	—	—	—	—	25,104	—	—	25,104	<b>418,191</b>
Retained earnings	<b>373,745</b>	—	(65,412)	(83,063)	(4,997)	(3,336)	(30,392)	(6,560)	38,401	(155,359)	<b>218,386</b>
Reserves	—	6,078	—	—	—	—	—	(1,051)	—	5,027	<b>5,027</b>
Contributed surplus	<b>2,890</b>	(2,890)	—	—	—	—	—	—	—	(2,890)	—
Accumulated other comprehensive income	<b>3,188</b>	(3,188)	—	—	—	—	—	—	—	(3,188)	—
	<b>772,910</b>	—	(65,412)	(83,063)	(4,997)	(3,336)	(5,288)	(7,611)	38,401	(131,306)	<b>641,604</b>
	<b>\$ 1,101,975</b>	\$ —	\$ (65,412)	\$ 8,563	\$ (4,997)	\$ —	\$ —	\$ (7,611)	\$ 4,362	\$ (65,095)	<b>\$1,036,880</b>

**Notes to the Interim Consolidated Financial Statements (Unaudited)**

(\$ thousands, except as noted)

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

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

**Notes to the Interim Consolidated Financial Statements (Unaudited)**

(\$ thousands, except as noted)

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

<b>Year ended December 31, 2010</b>	<b>Previous GAAP</b>	Reclasses (19 a)	PPE (19 b)	ARO (19 c)	FX (19 d)	SBC (19 e)	FTS (19 f)	Equity Accounting (19 g)	Deferred Tax (19 h)	<b>IFRS</b>
Petroleum and natural gas sales	\$ 184,395	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 184,395
Royalties	(21,227)	—	—	—	—	—	—	—	—	(21,227)
<b>Revenue</b>	<b>163,168</b>	—	—	—	—	—	—	—	—	<b>163,168</b>
<b>Gain on financial commodity contracts</b>	<b>10,047</b>	—	—	—	—	—	—	—	—	<b>10,047</b>
	<b>173,215</b>	—	—	—	—	—	—	—	—	<b>173,215</b>
<b>Expenses</b>										
<b>Operating expense and production tax</b>	<b>50,892</b>	—	—	—	—	—	—	—	—	<b>50,892</b>
<b>Transportation</b>	<b>17,219</b>	—	—	—	—	—	—	—	—	<b>17,219</b>
<b>General and administrative</b>	<b>15,417</b>	—	—	—	—	—	—	—	—	<b>15,417</b>
<b>Stock-based compensation</b>	<b>58,764</b>	—	—	—	—	(3,486)	—	—	—	<b>55,278</b>
<b>Depletion and depreciation</b>	<b>178,007</b>	(8,022)	(9,335)	—	—	—	—	—	—	<b>160,650</b>
Exploration	8,829	(8,829)	—	—	—	—	—	—	—	—
Dry hole	9,492	(9,492)	—	—	—	—	—	—	—	—
<b>Gain on sale of property, plant and equipment</b>	<b>(3)</b>	—	—	(377)	—	—	—	—	—	<b>(380)</b>
Write-down of petroleum and natural gas assets	25,332	(25,332)	—	—	—	—	—	—	—	—
<b>Interest</b>	<b>13,560</b>	—	—	—	—	—	—	—	—	<b>13,560</b>
<b>Foreign exchange</b>	<b>(801)</b>	503	—	—	—	—	—	—	—	<b>(298)</b>
<b>Debt extinguishment</b>	<b>1,708</b>	—	—	—	—	—	—	—	—	<b>1,708</b>
<b>Exploration and evaluation</b>	<b>—</b>	42,570	151	—	—	—	—	—	—	<b>42,721</b>
<b>Accretion of asset retirement obligations</b>	<b>—</b>	9,105	—	(1,130)	—	—	—	—	—	<b>7,975</b>
	<b>378,416</b>	503	(9,184)	(1,507)	—	(3,486)	—	—	—	<b>364,742</b>
<b>Income from investments</b>	<b>8,227</b>	(2,600)	—	—	—	—	—	30,372	—	<b>35,999</b>
<b>Other</b>	<b>2,184</b>	2,600	—	—	—	—	—	—	—	<b>4,784</b>
<b>Loss before tax</b>	<b>(194,790)</b>	(503)	9,184	1,507	—	3,486	—	30,372	—	<b>(150,744)</b>
<b>Income tax expense (recovery)</b>										
Current	213	—	—	—	—	—	—	—	—	213
Deferred	(72,535)	—	—	—	—	—	5,344	—	6,245	(60,946)
	<b>(72,322)</b>	—	—	—	—	—	5,344	—	6,245	<b>(60,733)</b>
<b>Net loss</b>	<b>\$ (122,468)</b>	(503)	9,184	1,507	—	3,486	(5,344)	30,372	(6,245)	<b>(90,011)</b>
<b>Other comprehensive income (loss), net of tax</b>										
Change in market value of securities	71,602	—	—	—	—	—	—	—	—	71,602
Exchange differences on translation of US subsidiaries	—	503	—	312	(3,460)	—	—	—	617	(2,028)
Reclass of accumulated (gains) to earnings	(3,168)	—	—	—	—	—	—	—	—	(3,168)
<b>Comprehensive loss</b>	<b>\$ (54,034)</b>	\$ —	\$ 9,184	\$ 1,819	\$ (3,460)	\$ 3,486	\$ (5,344)	\$ 30,372	\$ (5,628)	<b>\$ (23,605)</b>

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

(\$ thousands, except as noted)

### **a) Reclassifications ("Reclasses")**

#### **i. Balance Sheet**

##### ***Exploration and Evaluation Assets***

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

##### ***Equity Accounted Investments***

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

##### ***Investments in Securities***

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

##### ***Reserves***

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

#### **ii. Statement of Comprehensive Income**

##### ***Exploration Expense***

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

##### ***Depletion and Depreciation***

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

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

*(\$ thousands, except as noted)*

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

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

### **Other Income**

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

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

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

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

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

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

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

*(\$ thousands, except as noted)*

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

### **c) Asset Retirement Obligations ("ARO")**

Under IFRS, the Company's policy is to re-measure asset retirement obligations at each reporting date using the period-end risk-free rate. Under Previous GAAP, credit-adjusted risk-free rates were applied to each obligation when initially recognized, and that rate was not adjusted for changes in discount rates in future periods. On Transition Date, the Company recorded a \$91.6 million increase in the asset retirement obligation liability due to the decrease in discount rates, from approximately eight percent under Previous GAAP to four percent under IFRS. The increase in the asset retirement obligation liability was recognized as an increase in the carrying value of the related asset where the asset was not part of a CGU for which its fair value had been deemed historical cost, otherwise the increase was recognized in retained earnings. Net additions to the ARO liability in 2010 were increased by \$19.6 million primarily due to the change in discount rates, which included a \$3.0 million increase to the ARO liability recognized in respect of the Redcliffe acquisition. The change in discount rates decreased 2010 accretion expense by \$1.1 million.

### **d) Foreign Exchange Translation ("FX")**

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

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

### **e) Stock-based Compensation ("SBC")**

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

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

*(\$ thousands, except as noted)*

### **f) Flow-through Shares ("FTS")**

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

### **g) Equity Accounted Investments ("Equity Accounting")**

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

### **h) Deferred Income Tax ("Deferred Tax")**

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

**Notes to the Interim Consolidated Financial Statements (Unaudited)**

(\$ thousands, except as noted)

The following table summarizes the adjustments to Paramount's comprehensive income for the three months ended March 31, 2010 prepared under Previous GAAP to the Company's comprehensive income prepared in accordance with IFRS:

Three months ended March 31, 2010	Previous GAAP	Reclasses	PPE	ARO	FX	SBC	FTS	Equity Accounting	Deferred Tax	IFRS
Petroleum and natural gas sales	\$ 48,895	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 48,895
Royalties	(6,956)	—	—	—	—	—	—	—	—	(6,956)
<b>Revenue</b>	<b>41,939</b>	—	—	—	—	—	—	—	—	<b>41,939</b>
<b>Gain on financial commodity contracts</b>	<b>10,465</b>	—	—	—	—	—	—	—	—	<b>10,465</b>
	<b>52,404</b>	—	—	—	—	—	—	—	—	<b>52,404</b>
<b>Expenses</b>										
Operating expense and production tax	14,127	—	—	—	—	—	—	—	—	14,127
Transportation	4,086	—	—	—	—	—	—	—	—	4,086
General and administrative	3,342	—	—	—	—	—	—	—	—	3,342
Stock-based compensation	7,747	—	—	—	—	(1,015)	—	—	—	6,732
Depletion and depreciation	39,609	(5,146)	(12,755)	—	—	—	—	—	—	21,708
Exploration	3,054	(3,054)	—	—	—	—	—	—	—	—
Dry hole	8,150	(8,150)	—	—	—	—	—	—	—	—
Gain on sale of property, plant and equipment	—	—	—	(101)	—	—	—	—	—	(101)
Interest	2,673	—	—	—	—	—	—	—	—	2,673
Foreign exchange	(1,187)	385	—	—	—	—	—	—	—	(802)
Exploration and evaluation	—	14,179	83	—	—	—	—	—	—	14,262
Accretion of asset retirement obligations	—	2,171	—	(257)	—	—	—	—	—	1,914
	<b>81,601</b>	385	(12,672)	(358)	—	(1,015)	—	—	—	<b>67,941</b>
<b>Income from investments</b>	<b>8,671</b>	—	—	—	—	—	—	31,900	—	<b>40,571</b>
<b>Other</b>	<b>598</b>	—	—	—	—	—	—	—	—	<b>598</b>
<b>Income (loss) before tax</b>	<b>(19,928)</b>	(385)	12,672	358	—	1,015	—	31,900	—	<b>25,632</b>
<b>Income tax expense (recovery)</b>										
Current	3	—	—	—	—	—	—	—	—	3
Deferred	(5,468)	—	—	—	—	—	1,405	—	2,781	(1,282)
	<b>(5,465)</b>	—	—	—	—	—	1,405	—	2,781	<b>(1,279)</b>
<b>Net income (loss)</b>	<b>(14,463)</b>	(385)	12,672	358	—	1,015	(1,405)	31,900	(2,781)	<b>26,911</b>
<b>Other comprehensive income, net of tax</b>										
Change in market value of securities	1,824	—	—	—	—	—	—	—	—	1,824
Exchange differences on translation of US subsidiaries	—	385	—	170	(2,055)	—	—	—	(189)	(1,689)
<b>Comprehensive income (loss)</b>	<b>\$ (12,639)</b>	\$ —	\$ 12,672	\$ 528	\$ (2,055)	\$ 1,015	\$ (1,405)	\$ 31,900	\$ (2,970)	<b>\$ 27,046</b>



## Notes to the Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

The following table reconciles Shareholders' Equity as at March 31, 2010 under Previous GAAP to Shareholders' Equity prepared in accordance with IFRS:

As at	March 31, 2010
<b>Shareholders' Equity – Previous GAAP</b>	<b>\$ 760,944</b>
IFRS Adjustments:	
Change in asset retirement obligations	(82,535)
Adjustments to PP&E related to impairments and changes in depletion	(52,740)
Change in stock-based compensation liability	(2,438)
Change in currency translation method related to foreign subsidiaries	(7,054)
Adjustments to equity accounted investments - changes in investees' equity due to IFRS	24,384
Adjustment to flow-through shares	(2,196)
Adjustment to deferred tax	35,431
<b>Shareholders' Equity – IFRS</b>	<b>\$ 673,796</b>

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

	Three months ended March 31, 2010	Year ended December 31, 2010
<b>Cash from operating activities under Previous GAAP</b>	<b>\$ 17,632</b>	<b>\$ 63,383</b>
Adjustments under IFRS:		
Exploration costs	(2,901)	(8,172)
Common shares purchased under stock incentive plan	–	2,901
Foreign exchange on cash	834	1,066
<b>Cash from operating activities under IFRS</b>	<b>\$ 15,565</b>	<b>\$ 59,178</b>
<b>Cash from financing activities under Previous GAAP</b>	<b>\$ 1,119</b>	<b>\$ 251,905</b>
Adjustments under IFRS:		
Common shares purchased under stock incentive plan	–	(2,901)
<b>Cash from financing activities under IFRS</b>	<b>\$ 1,119</b>	<b>\$ 249,004</b>
<b>Cash used in investing activities under Previous GAAP</b>	<b>\$ (55,794)</b>	<b>\$ (333,867)</b>
Adjustments under IFRS:		
Exploration costs	2,901	8,172
<b>Cash used in investing activities under IFRS</b>	<b>\$ (52,893)</b>	<b>\$ (325,695)</b>
<b>Net decrease</b>	<b>(36,209)</b>	<b>(17,513)</b>
<b>Foreign exchange on cash and cash equivalents</b>	<b>(834)</b>	<b>(1,066)</b>
	<b>\$ (37,043)</b>	<b>\$ (18,579)</b>

## CORPORATE INFORMATION

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### OFFICERS

**C. H. Riddell**

Chairman of the Board and  
Chief Executive Officer

**J. H.T. Riddell**

President and  
Chief Operating Officer

**B. K. Lee**

Chief Financial Officer

**E. M. Shier**

Corporate Secretary

**L. M. Doyle**

Corporate Operating Officer

**G.W. P. McMillan**

Corporate Operating Officer

**D.S. Purdy**

Corporate Operating Officer

**J. Wittenberg**

Corporate Operating Officer

**P.R. Kinvig**

Controller

**L. A. Friesen**

Assistant Corporate Secretary

### DIRECTORS

**C. H. Riddell**<sup>(3)</sup>

Chairman of the Board and Chief Executive Officer  
Paramount Resources Ltd.  
Calgary, Alberta

**J. H.T. Riddell**

President and Chief Operating Officer  
Paramount Resources Ltd.  
Calgary, Alberta

**T. E. Claugus**<sup>(4)</sup>

President, GMT Capital Corp.  
Atlanta, Georgia

**J. C. Gorman**<sup>(1) (3) (4)</sup>

Retired  
Calgary, Alberta

**D. Jungé C.F.A.**<sup>(4)</sup>

Chairman of the Board and Chief Executive Officer  
Pitcairn Trust Company  
Bryn Athyn, Pennsylvania

**D. M. Knott**<sup>(4)</sup>

Managing General Partner  
Knott Partners, L.P.  
Syosset, New York

**V. S. A. Riddell**

Business Executive  
Calgary, Alberta

**S. L. Riddell Rose**

President and Chief Executive Officer  
Perpetual Energy Inc.  
Calgary, Alberta

**J. B. Roy**<sup>(1) (2) (3) (4)</sup>

Independent Businessman  
Calgary, Alberta

**A. S. Thomson**<sup>(1) (4)</sup>

Retired  
Sidney, British Columbia

**B. M. Wylie**<sup>(2)</sup>

Business Executive  
Calgary, Alberta

### HEAD OFFICE

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

### CONSULTING ENGINEERS

**McDaniel & Associates**

**Consultants Ltd.**  
Calgary, Alberta

### AUDITORS

**Ernst & Young LLP**

Calgary, Alberta

### BANKERS

**Bank of Montreal**

Calgary, Alberta

**The Bank of Nova Scotia**

Calgary, Alberta

**Royal Bank of Canada**

Calgary, Alberta

**ATB Financial**

Calgary, Alberta

**HSBC Bank Canada**

Calgary, Alberta

### REGISTRAR AND TRANSFER AGENT

**Computershare Investor Services**

Calgary, Alberta  
Toronto, Ontario

### STOCK EXCHANGE LISTING

The Toronto Stock Exchange ("POU")

<sup>(1)</sup> Member of Audit Committee

<sup>(2)</sup> Member of Environmental, Health and Safety Committee

<sup>(3)</sup> Member of Compensation Committee

<sup>(4)</sup> Member of Corporate Governance Committee