

Q3



2010 third quarter report

FINANCIAL AND OPERATING HIGHLIGHTS ⁽¹⁾

(\$ millions, except as noted)

| | Three months ended September 30 | | | Nine months ended September 30 | | |
|---|---------------------------------|--------|----------|--------------------------------|---------|----------|
| | 2010 | 2009 | Change % | 2010 | 2009 | Change % |
| Financial | | | | | | |
| Petroleum and natural gas sales | 44.9 | 36.3 | 24 | 138.4 | 116.7 | 19 |
| Funds flow from operations | 23.2 | 10.2 | 127 | 66.9 | 41.5 | 61 |
| Per share – diluted (\$/share) | 0.32 | 0.15 | 113 | 0.92 | 0.63 | 46 |
| Net loss | (3.7) | (25.2) | (85) | (46.9) | (51.4) | (9) |
| Per share – diluted (\$/share) | (0.05) | (0.38) | (87) | (0.65) | (0.78) | (17) |
| Exploration and development expenditures | 36.4 | 11.0 | 231 | 120.9 | 71.9 | 68 |
| Investments – market value ⁽²⁾ | | | | 443.7 | 303.2 | 46 |
| Total assets | | | | 1,183.0 | 1,047.7 | 13 |
| Net debt ⁽³⁾ | | | | 221.8 | 133.0 | 67 |
| Common shares outstanding (thousands) | | | | 72,598 | 65,959 | 10 |
| Operating | | | | | | |
| Sales volumes: | | | | | | |
| Natural gas (MMcf/d) | 62.9 | 49.9 | 26 | 56.7 | 53.4 | 6 |
| Oil and NGLs (Bbl/d) | 3,480 | 3,733 | (7) | 3,427 | 3,549 | (3) |
| Total (Boe/d) | 13,967 | 12,046 | 16 | 12,884 | 12,440 | 4 |
| Gas weighting | 75% | 69% | 9 | 73% | 71% | 3 |
| Average realized price: | | | | | | |
| Natural gas (\$/Mcf) | 4.12 | 3.24 | 27 | 4.67 | 4.32 | 8 |
| Oil and NGLs (\$/Bbl) | 65.85 | 62.33 | 6 | 70.62 | 55.49 | 27 |
| Net wells drilled | 10 | 2 | 400 | 79 | 18 | 339 |

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

⁽²⁾ Based on the period-end closing prices of publicly traded enterprises and the book value of the remaining investments.

⁽³⁾ 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.

This page intentionally left blank.

THIRD QUARTER OVERVIEW

Principal Properties

- Funds flow from operations increased by 127 percent to \$23.2 million in the third quarter of 2010 compared to \$10.2 million in the third quarter of 2009, primarily due to higher revenue including settlements of financial commodity contracts, partially offset by higher operating expenses and royalties.
- Production increased 16 percent to 13,967 Boe/d in the third quarter of 2010 compared to 12,046 Boe/d in the third quarter of 2009, primarily associated with new well production in the Kaybob and Grande Prairie COUs and the impact of the June 2010 Redcliffe acquisition.
- Operating expenses decreased \$0.36 per Boe to \$9.98 per Boe in the third quarter of 2010 compared to \$10.34 per Boe in the same quarter of 2009.
- Based on recent successful drilling results, the Kaybob COU has commissioned the construction of a processing plant at Musreau with a capacity of up to 50 MMcf/d, anticipated to be operational in the third quarter of 2011, and has also nominated for an additional 50 MMcf/d of processing capacity in a third party facility expansion at Smoky, anticipated to be operational in the third quarter of 2012.
- The Grande Prairie COU continues to make progress in expanding gathering and processing capacity at Karr-Gold Creek, which is expected to be operational before the end of 2010.
- The Northern COU's capital program is substantially complete for 2010. One (1.0 net) well drilled in the first quarter is expected to be brought on in the fourth quarter.
- The Southern COU drilled four (4.0 net) coal bed methane wells and five (1.3 net) oil wells during the quarter.
- The joint development partner under the North Dakota joint development agreement drilled three Bakken oil wells, completing two of them.

Strategic Investments

- The Hoole Oil Sands Project team commenced conceptual design work related to the regulatory application for commercial development. The application is expected to be submitted in 2011.
- Two of Paramount's three drilling rigs are being used to drill on the Company's properties in Alberta. The United States drilling rig continues to be contracted by the North Dakota joint development partner.
- In the third quarter of 2010, MEG Energy Corp. ("MEG") completed its initial public offering on the Toronto Stock Exchange and Paramount's investment in 3.7 million common shares, previously carried at \$27.50 per share, was marked-to-market to the September 30, 2010 closing price of \$35.85 per share.

Corporate

- In July 2010, following the acquisition of Redcliffe, the borrowing base and lender commitments under the Company's credit facility were increased from \$125 million to \$160 million.

REVIEW OF OPERATIONS

Paramount's average daily sales volumes by Corporate Operating Unit ("COU") for the three months ended September 30, 2010 and June 30, 2010 are summarized below:

| | Q3 2010 | | | Q2 2010 | | | Change | | |
|----------------|-------------|--------------|--------|-------------|--------------|--------|-------------|--------------|-------|
| | Natural Gas | Oil and NGLs | Total | Natural Gas | Oil and NGLs | Total | Natural Gas | Oil and NGLs | Total |
| | MMcf/d | Bbl/d | Boe/d | MMcf/d | Bbl/d | Boe/d | MMcf/d | Bbl/d | Boe/d |
| Kaybob | 25.6 | 570 | 4,829 | 21.2 | 510 | 4,035 | 4.4 | 60 | 794 |
| Grande Prairie | 14.7 | 977 | 3,425 | 13.4 | 965 | 3,202 | 1.3 | 12 | 223 |
| Northern | 13.0 | 476 | 2,646 | 13.0 | 461 | 2,624 | – | 15 | 22 |
| Southern | 9.6 | 1,457 | 3,067 | 9.4 | 1,351 | 2,926 | 0.2 | 106 | 141 |
| Total | 62.9 | 3,480 | 13,967 | 57.0 | 3,287 | 12,787 | 5.9 | 193 | 1,180 |

The Company's netbacks for the current and prior quarter are as follows:

| (\$/Boe) | Three months ended | |
|---|--------------------|---------------|
| | September 30, 2010 | June 30, 2010 |
| Petroleum and natural gas sales | 34.96 | 38.34 |
| Royalties | (3.40) | (4.78) |
| Operating expense and production tax | (9.98) | (9.54) |
| Transportation | (3.39) | (3.87) |
| Netback | 18.19 | 20.15 |
| Financial commodity contract settlements | 3.95 | 4.16 |
| Netback including financial commodity contract settlements | 22.14 | 24.31 |

Exploration and development expenditures for the third quarter were \$36.4 million compared to \$17.7 million in the second quarter of 2010.

The majority of the Company's third quarter 2010 capital program focused on horizontal drilling in the Kaybob and Grande Prairie COUs directed at the Dunvegan, Fahler and Montney formations. These high liquids content formations continue to provide attractive rates of return in the current low natural gas price environment. The Alberta Government's decision to maintain the five percent royalty rate on initial production from new oil and gas wells and the Alberta Natural Gas Deep Drilling Program further support the economics of the Company's ongoing development and exploitation of unconventional tight gas reservoirs.

Paramount continues to monitor the financial performance of its properties in the current natural gas price environment to ensure they remain economic. No wells have been shut-in to date for economic reasons.

Kaybob

Third quarter sales volumes for the Kaybob COU increased 794 Boe/d to 4,829 Boe/d, consisting of 25.6 MMcf/d of natural gas and 570 Bbl/d of oil and NGLs. This increase is attributable to one (1.0 net) new well being brought on production in Smoky during the third quarter and a full quarter of production from four (2.0 net) wells brought on production in the second quarter, partially offset by natural production declines.

Capital expenditures for the Kaybob COU during the third quarter were approximately \$11.1 million, excluding land acquisitions and drilling royalty credits. Third quarter activities included completing and equipping one (1.0 net) well at Smoky, which was subsequently brought on production in early October, recompleting a well in Musreau, and starting preparatory work for wells that will be drilled in the fourth quarter.

The Kaybob COU expects to drill up to seven (4.3 net) horizontal wells prior to year end targeting liquids rich natural gas from the Fahler and Dunvegan formations. The majority of the wells planned will be drilled from existing leases or new multiple-well pads, reducing per-well drilling costs by minimizing mobilization and demobilization activities and allowing surface equipment and pipelines to be shared. Where two or more wells are drilled from a single lease, the Company anticipates performing the fracture stimulations back-to-back, increasing equipment and personnel efficiencies and reducing per-well completion costs. Production from these seven (4.3 net) planned wells is not expected until the first quarter of 2011.

Based on the performance of the wells drilled to date, the Company plans to increase processing capacity to ensure sufficient facilities are available for the anticipated increase in production as the Kaybob COU continues to execute its development program. Paramount has commissioned the construction of a processing plant at Musreau with a capacity of up to 50 MMcf/d, anticipated to be operational in the third quarter of 2011, and has nominated for 50 MMcf/d of capacity at a non-operated plant expansion in Smoky, anticipated to be operational in the third quarter of 2012.

Grande Prairie

Grande Prairie COU third quarter sales volumes were 3,425 Boe/d, an increase of seven percent from the prior quarter. The increase is primarily the result of new production from wells drilled and completed in Karr-Gold Creek and Valhalla and the impact of the June 2010 Redcliffe acquisition, partially offset by natural declines.

Total capital expenditures in the Grande Prairie COU for the third quarter were approximately \$26.3 million, excluding land acquisitions and drilling royalty credits. During the quarter, three (2.4 net) horizontal Montney gas wells were drilled at Karr-Gold Creek and one (0.6 net) horizontal Montney gas well was drilled at Valhalla. Two (2.0 net) wells drilled previously were completed and brought on production at Karr-Gold Creek. Due to capacity constraints, wells previously on production were shut-in to allow the newly completed wells to be tied-in and tested.

Construction of the first phase of the compression/dehydration facility at Karr-Gold Creek is nearing completion, with start-up expected in the fourth quarter. The project has been delayed by wet weather which made the site inaccessible to heavy equipment for an extended period. The initial 20 MMcf/d raw gas processing capacity of the facility is planned to be expanded to 40 MMcf/d in the first quarter of 2011. This will allow wells that are currently restricted or shut-in to be brought on stream and for further horizontal drilling to take place in 2011.

At Valhalla, five wells have now been drilled and completed (including the well completed in the third quarter). Construction of the Valhalla gas gathering system is progressing and the system is expected to be operational in early 2011. The Company is evaluating opportunities to target other formations in Valhalla to increase liquids recoveries and enhance returns.

Northern

Third quarter 2010 sales volumes in the Northern COU were 2,646 Boe/d, consistent with the second quarter of the year.

Third quarter capital expenditures for the Northern COU were approximately \$0.4 million and related to seismic work and lease preparation for the forthcoming winter drilling season. A Cameron Hills well drilled earlier in 2010 is expected to be brought on production in the fourth quarter, subject to the receipt of regulatory approvals.

Southern

The Southern COU's third quarter sales volumes were 3,067 Boe/d, an increase of 5 percent from the prior quarter, primarily due to the Redcliffe acquisition.

Total capital expenditures in the Southern COU for the third quarter were approximately \$2.6 million, excluding land acquisitions and drilling royalty credits. The Southern COU drilled four (4.0 net) coal bed methane wells and five (1.3 net) oil wells during the third quarter. Completion and tie-in of the thirteen (13.0 net) coal bed methane wells drilled throughout 2010 is expected to be completed in the fourth quarter.

Paramount has entered into a joint development agreement in southern Saskatchewan with a Canadian exploration and development company. Under the agreement, the partner has committed to carry out a multiple well Viking formation drilling program in order to receive a post-payout interest of 55 percent in certain properties. Three oil wells have been drilled to date under this agreement.

In the United States, Paramount operates through its wholly-owned subsidiary, Summit Resources Inc. ("Summit"). In April 2010, Summit entered into a joint development agreement with a United States focused exploration and development company that has significant operations and experience in the Bakken play in North Dakota. Under the agreement, which covers approximately 39,900 net acres of Summit's undeveloped North Dakota lands, the US company is carrying out a multiple well Bakken horizontal drilling program using multi-stage fracture technology in order to earn an undivided 50 percent of Summit's interest in these lands (19,950 net acres). The North Dakota joint development partner has drilled three horizontal wells to date, two of which have been completed.

Hoole Grand Rapids Oil Sands Project

In the third quarter, Paramount commenced conceptual design work that will be incorporated into the 2011 regulatory application for commercial development of the initial phase of the Hoole Grand Rapids Oil Sands Project. Activities include reservoir modeling to select a depletion strategy, surface design to create drilling and surface templates and water treatment analysis to assess the most effective way to re-use produced water. The preparation of an environmental impact assessment for the area is progressing, and an evaluation of carbon dioxide sequestration technology has been initiated to determine if it is suitable for the project.

In May 2010, Paramount received an updated resource evaluation of its Hoole property, including the results of the Company's 45 well winter drilling and delineation program. The table below summarizes the estimated volumes and net present values attributable to Paramount's 100 percent interest in the contingent bitumen resources within the Grand Rapids formation at the Hoole property, as evaluated by the Company's independent reserves evaluator, as of April 30, 2010:

| Category / Level of Certainty⁽¹⁾ | Contingent Resources⁽²⁾⁽³⁾ (MBbl)⁽⁴⁾ | Fully Developed Production⁽⁵⁾ (Bbl/d) | NPV⁽⁶⁾ of Future Net Revenue Discounted At 10% (\$MM)⁽⁷⁾ |
|--|---|---|---|
| High estimate | 786,394 | 85,000 | 2,934 |
| Best estimate | 634,102 | 70,000 | 1,908 |
| Low estimate | 458,893 | 50,000 | 967 |

⁽¹⁾ A low estimate means high certainty (P90), a best estimate means most likely (P50) and a high estimate means low certainty (P10).

⁽²⁾ Represents the Company's share of recoverable volumes before deduction of royalties.

⁽³⁾ Contingent resources are those quantities of bitumen estimated, as of a given date, to be potentially recoverable from known accumulations using established technology or technology under development, but are classified as a resource rather than a reserve due to one or more contingencies, such as the absence of regulatory approvals, detailed design estimates or near term development plans.

⁽⁴⁾ Thousands of barrels

⁽⁵⁾ These estimates assume that initial production will commence in 2015 and fully developed production will be reached in 2016 for the low estimate, 2017 for the best estimate, and 2018 for the high estimate.

⁽⁶⁾ NPV means net present value and represents the Company's share of future net revenue, before the deduction of income tax and does not represent fair value. The calculation considers such items as revenues, royalties, operating costs, abandonment costs and capital expenditures. Royalties have been calculated based on Alberta's Royalty Framework applicable to oil sands projects in Alberta. The calculation does not consider financing costs and general and administrative costs. All NPVs are calculated assuming natural gas is used as a fuel for steam generation. Revenues and expenditures were calculated based on the reserve evaluator's forecast prices and costs as of April 1, 2010.

⁽⁷⁾ Millions of Canadian dollars

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A"), dated November 2, 2010, should be read in conjunction with the unaudited Interim Consolidated Financial Statements of Paramount Resources Ltd. ("Paramount" or the "Company") for the three and nine months ended September 30, 2010 and Paramount's audited Consolidated Financial Statements and MD&A for the year ended December 31, 2009. Information included in this MD&A is presented in accordance with Generally Accepted Accounting Principles ("GAAP") in Canada. Certain comparative figures have been reclassified to conform to the current year's presentation.

This document contains forward-looking information, non-GAAP measures, disclosures of barrels of oil equivalent volumes and disclosures concerning contingent resources. Readers are referred to the "Advisories" heading in 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.

Paramount is an independent Canadian energy company involved in the exploration, development, production, processing, transportation and marketing of petroleum and natural gas. 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 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 Northern COU, which includes properties in Northern Alberta, the Northwest Territories and Northeast British Columbia; and
- the Southern COU, which includes properties in Southern Alberta, Saskatchewan, Montana and North Dakota.

Strategic Investments include: (i) investments in other entities, including affiliates; and (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.

The Corporate segment is comprised of income and expense items, including general and administrative expense and interest expense, that 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.

THIRD QUARTER HIGHLIGHTS⁽¹⁾

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|------------------------------------|---------|-----------------------------------|---------|
| | 2010 | 2009 | 2010 | 2009 |
| FINANCIAL | | | | |
| Petroleum and natural gas sales | 44.9 | 36.3 | 138.4 | 116.7 |
| Funds flow from operations | 23.2 | 10.2 | 66.9 | 41.5 |
| per share – diluted (\$/share) | 0.32 | 0.15 | 0.92 | 0.63 |
| Net loss | (3.7) | (25.2) | (46.9) | (51.4) |
| per share – basic and diluted (\$/share) | (0.05) | (0.38) | (0.65) | (0.78) |
| Exploration and development expenditures | 36.4 | 11.0 | 120.9 | 71.9 |
| Investments – market value | | | 443.7 | 303.2 |
| Total assets | | | 1,183.0 | 1,047.7 |
| Long-term debt | | | 203.6 | 96.5 |
| Net debt | | | 221.8 | 133.0 |
| OPERATIONAL | | | | |
| Sales volumes | | | | |
| Natural gas (MMcf/d) | 62.9 | 49.9 | 56.7 | 53.4 |
| Oil and NGLs (Bbl/d) | 3,480 | 3,733 | 3,427 | 3,549 |
| Total (Boe/d) | 13,967 | 12,046 | 12,884 | 12,440 |
| Net wells drilled | 10 | 2 | 79 | 18 |
| FUNDS FLOW FROM OPERATIONS (\$/Boe) | | | | |
| Petroleum and natural gas sales | 34.96 | 32.73 | 39.36 | 34.36 |
| Royalties | (3.40) | (3.68) | (4.80) | (3.91) |
| Operating expense and production tax | (9.98) | (10.34) | (10.82) | (13.01) |
| Transportation | (3.39) | (3.01) | (3.68) | (3.07) |
| Netback | 18.19 | 15.70 | 20.06 | 14.37 |
| Financial commodity contract settlements | 3.95 | – | 3.17 | 3.29 |
| Netback including commodity contract settlements | 22.14 | 15.70 | 23.23 | 17.66 |
| General and administrative | (3.48) | (3.82) | (3.13) | (4.03) |
| Interest | (2.66) | (2.28) | (2.52) | (2.48) |
| Distributions from investments | 1.13 | 2.10 | 2.61 | 3.38 |
| Asset retirement obligation expenditures | (0.19) | (0.71) | (0.76) | (0.79) |
| Other | 1.13 | (1.82) | (0.40) | (1.53) |
| | 18.07 | 9.17 | 19.03 | 12.21 |

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

Third Quarter Overview

Principal Properties

- Funds flow from operations increased by 127 percent to \$23.2 million in the third quarter of 2010 compared to \$10.2 million in the third quarter of 2009, primarily due to higher revenue including settlements of financial commodity contracts, partially offset by higher operating expenses and royalties.
- Production increased 16 percent to 13,967 Boe/d in the third quarter of 2010 compared to 12,046 Boe/d in the third quarter of 2009, primarily associated with new well production in the Kaybob and Grande Prairie COUs and the impact of the June 2010 Redcliffe acquisition.
- Operating expenses decreased \$0.36 per Boe to \$9.98 per Boe in the third quarter of 2010 compared to \$10.34 per Boe in the same quarter of 2009.
- Based on recent successful drilling results, the Kaybob COU has commissioned the construction of a processing plant at Musreau with a capacity of up to 50 MMcf/d, anticipated to be operational in the third quarter of 2011, and has also nominated for an additional 50 MMcf/d of processing capacity in a third party facility expansion at Smoky, anticipated to be operational in the third quarter of 2012.
- The Grande Prairie COU continues to make progress in expanding gathering and processing capacity at Karr-Gold Creek, which is expected to be operational before the end of 2010.
- The Northern COU's capital program is substantially complete for 2010. One (1.0 net) well drilled in the first quarter is expected to be brought on in the fourth quarter.
- The Southern COU drilled four (4.0 net) coal bed methane wells and five (1.3 net) oil wells during the quarter.
- The joint development partner under the North Dakota joint development agreement drilled three Bakken oil wells, completing two of them.

Strategic Investments

- The Hoole Oil Sands Project team commenced conceptual design work related to the regulatory application for commercial development. The application is expected to be submitted in 2011.
- Two of Paramount's three drilling rigs are being used to drill on the Company's properties in Alberta. The United States drilling rig continues to be contracted by the North Dakota joint development partner.
- In the third quarter of 2010, MEG Energy Corp. ("MEG") completed its initial public offering on the Toronto Stock Exchange and Paramount's investment in 3.7 million common shares, previously carried at \$27.50 per share, was marked-to-market to the September 30, 2010 closing price of \$35.85 per share.

Corporate

- In July 2010, following the acquisition of Redcliffe, the borrowing base and lender commitments under the Company's credit facility were increased from \$125 million to \$160 million.

Segment Earnings (Loss)

| | Three months ended September 30 | | Nine months ended September 30 | |
|-----------------------|---------------------------------|--------|--------------------------------|--------|
| | 2010 | 2009 | 2010 | 2009 |
| Principal Properties | (25.4) | (14.7) | (64.2) | (50.4) |
| Strategic Investments | (4.5) | (7.2) | 0.2 | (20.2) |
| Corporate | (10.8) | (10.3) | (33.4) | (20.0) |
| Taxes | 37.0 | 7.0 | 50.5 | 39.2 |
| Net Loss | (3.7) | (25.2) | (46.9) | (51.4) |

- The third quarter 2010 net loss of \$3.7 million compared to a net loss of \$25.2 million in the third quarter of 2009. The current year loss includes: (i) a higher Principal Properties loss due to higher depletion, depreciation and accretion, partially offset by higher revenue; (ii) a lower Strategic Investment loss primarily related to the Trilogy investment; (iii) higher Corporate costs primarily due to a lower current year foreign exchange recovery, partially offset by lower stock-based compensation expenses; and (iv) a higher future tax recovery.
- The year-to-date net loss of \$46.9 million in 2010 compared to a net loss of \$51.4 million in the same period in the prior year. The current year loss includes: (i) a higher Principal Properties loss due to higher depletion and dry hole expenses, partially offset by higher revenue and gains on financial commodity contracts; (ii) higher Strategic Investment earnings primarily related to the Trilogy investment; (iii) higher Corporate costs due to higher stock-based compensation and the impact of changes in foreign exchange rates, partially offset by lower general and administrative costs; and (iv) a higher future tax recovery.

Funds Flow From Operations

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

| | Three months ended September 30 | | Nine months ended September 30 | |
|-------------------------------------|---------------------------------|-------|--------------------------------|-------|
| | 2010 | 2009 | 2010 | 2009 |
| Cash from operating activities | 19.7 | 11.1 | 52.3 | 50.8 |
| Change in non-cash working capital | 3.5 | (0.9) | 14.6 | (9.3) |
| Funds flow from operations | 23.2 | 10.2 | 66.9 | 41.5 |
| Funds flow from operations (\$/Boe) | 18.07 | 9.17 | 19.03 | 12.21 |

- Funds flow from operations in the third quarter of 2010 increased by \$13.0 million from the third quarter of 2009, primarily due to higher revenues including settlements of financial commodity contracts, partially offset by higher operating and transportation expenses.
- Year-to-date funds flow from operations in 2010 increased by \$25.4 million from the prior year, primarily due to the impact of higher revenues including settlements of financial commodity contracts and lower operating and general and administrative expenses, partially offset by higher royalties.

Principal Properties

Netback and Segment Loss

| | Three months ended September 30 | | | | Nine months ended September 30 | | | |
|---|---------------------------------|--------------|----------|---------|--------------------------------|--------------|----------|---------|
| | 2010 | | 2009 | | 2010 | | 2009 | |
| | (\$/Boe) | | (\$/Boe) | | (\$/Boe) | | (\$/Boe) | |
| Petroleum and natural gas sales | 44.9 | 34.96 | 36.3 | 32.73 | 138.4 | 39.36 | 116.7 | 34.36 |
| Royalties | (4.4) | (3.40) | (4.1) | (3.68) | (16.9) | (4.80) | (13.3) | (3.91) |
| Operating expense and production tax | (12.8) | (9.98) | (11.5) | (10.34) | (38.1) | (10.82) | (44.2) | (13.01) |
| Transportation | (4.4) | (3.39) | (3.3) | (3.01) | (12.9) | (3.68) | (10.4) | (3.07) |
| Netback | 23.3 | 18.19 | 17.4 | 15.70 | 70.5 | 20.06 | 48.8 | 14.37 |
| Settlements of financial commodity contracts | 5.1 | 3.95 | – | – | 11.2 | 3.17 | 11.2 | 3.29 |
| Netback including settlements of financial commodity contracts | 28.4 | 22.14 | 17.4 | 15.70 | 81.7 | 23.23 | 60.0 | 17.66 |
| Other principal property items (see below) | (53.8) | | (32.1) | | (145.9) | | (110.4) | |
| Segment loss | (25.4) | | (14.7) | | (64.2) | | (50.4) | |

Petroleum and Natural Gas Sales

| | Three months ended September 30 | | | Nine months ended September 30 | | |
|--------------------|---------------------------------|------|----------|--------------------------------|-------|----------|
| | 2010 | 2009 | % Change | 2010 | 2009 | % Change |
| Natural gas sales | 23.8 | 14.9 | 60 | 72.4 | 62.9 | 15 |
| Oil and NGLs sales | 21.1 | 21.4 | (1) | 66.0 | 53.8 | 23 |
| Total | 44.9 | 36.3 | 24 | 138.4 | 116.7 | 19 |

Third quarter revenue from natural gas, oil and NGLs sales in 2010 was \$44.9 million, an increase of \$8.6 million from the third quarter of 2009 due to the impact of higher prices and higher natural gas sales volumes. Year-to-date revenue from natural gas, oil and NGLs sales in 2010 was \$138.4 million, an increase of \$21.7 million from the prior year, due to the impact of higher prices and 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 | Oil and NGLs | Total |
|--|-------------|--------------|-------------|
| Three months ended September 30, 2009 | 14.9 | 21.4 | 36.3 |
| Effect of changes in prices | 5.1 | 1.8 | 6.9 |
| Effect of changes in sales volumes | 3.8 | (2.1) | 1.7 |
| Three months ended September 30, 2010 | 23.8 | 21.1 | 44.9 |

| | Natural gas | Oil and NGLs | Total |
|---|-------------|--------------|--------------|
| Nine months ended September 30, 2009 | 62.9 | 53.8 | 116.7 |
| Effect of changes in prices | 5.5 | 14.5 | 20.0 |
| Effect of changes in sales volumes | 4.0 | (2.3) | 1.7 |
| Nine months ended September 30, 2010 | 72.4 | 66.0 | 138.4 |

Sales Volumes

Three months ended September 30

| | 2010 | | | 2009 | | | Change | | |
|----------------|-------------|--------------|--------|-------------|--------------|--------|-------------|--------------|-------|
| | Natural Gas | Oil and NGLs | Total | Natural Gas | Oil and NGLs | Total | Natural Gas | Oil and NGLs | Total |
| | MMcf/d | Bbl/d | Boe/d | MMcf/d | Bbl/d | Boe/d | MMcf/d | Bbl/d | Boe/d |
| Kaybob | 25.6 | 570 | 4,829 | 17.8 | 460 | 3,432 | 7.8 | 110 | 1,397 |
| Grande Prairie | 14.7 | 977 | 3,425 | 8.0 | 1,125 | 2,454 | 6.7 | (148) | 971 |
| Northern | 13.0 | 476 | 2,646 | 13.6 | 628 | 2,890 | (0.6) | (152) | (244) |
| Southern | 9.6 | 1,457 | 3,067 | 10.5 | 1,520 | 3,270 | (0.9) | (63) | (203) |
| Total | 62.9 | 3,480 | 13,967 | 49.9 | 3,733 | 12,046 | 13.0 | (253) | 1,921 |

Natural gas sales volumes increased to 62.9 MMcf/d in the third quarter of 2010 compared to 49.9 MMcf/d in the third quarter of 2009. Crude oil and NGLs sales volumes decreased to 3,480 Bbl/d in the third quarter of 2010 compared to 3,733 Bbl/d in the third quarter of 2009.

The increases in 2010 sales volumes were primarily a result of production from new wells at Resthaven, Musreau and Smoky in the Kaybob COU and at Karr-Gold Creek in the Grande Prairie COU and the impact of the acquisition of Redcliffe Exploration Inc. ("Redcliffe") in June 2010, partially offset by declines at Bistcho and Cameron Hills in the Northern COU and at Chain in the Southern COU.

The Company's production at Karr-Gold Creek in the Grande Prairie COU is currently constrained because of limitations in compression and dehydration capacity. Work is in progress to expand raw gas compression and dehydration capacity by 20 MMcf/d before the end of 2010.

Nine months ended September 30

| | 2010 | | | 2009 | | | Change | | |
|----------------|-------------|--------------|--------|-------------|--------------|--------|-------------|--------------|-------|
| | Natural Gas | Oil and NGLs | Total | Natural Gas | Oil and NGLs | Total | Natural Gas | Oil and NGLs | Total |
| | MMcf/d | Bbl/d | Boe/d | MMcf/d | Bbl/d | Boe/d | MMcf/d | Bbl/d | Boe/d |
| Kaybob | 21.8 | 526 | 4,155 | 18.8 | 470 | 3,608 | 3.0 | 56 | 547 |
| Grande Prairie | 12.7 | 1,015 | 3,128 | 8.1 | 931 | 2,275 | 4.6 | 84 | 853 |
| Northern | 12.9 | 475 | 2,628 | 15.5 | 533 | 3,113 | (2.6) | (58) | (485) |
| Southern | 9.3 | 1,411 | 2,973 | 11.0 | 1,615 | 3,444 | (1.7) | (204) | (471) |
| Total | 56.7 | 3,427 | 12,884 | 53.4 | 3,549 | 12,440 | 3.3 | (122) | 444 |

Year-to-date natural gas sales volumes increased to 56.7 MMcf/d in 2010 compared to 53.4 MMcf/d in the prior year. Year-to-date crude oil and NGLs sales volumes decreased to 3,427 Bbl/d in 2010 compared to 3,549 Bbl/d in the prior year.

The increases in year-to-date sales volumes were primarily a result of production from new wells at Karr-Gold Creek in the Grande Prairie COU and at Resthaven, Musreau and Smoky in the Kaybob COU, partially offset by declines at Bistcho and Cameron Hills in the Northern COU, at Chain in the Southern COU and at various other properties.

Average Realized Prices

| | Three months ended September 30 | | | Nine months ended September 30 | | |
|-----------------------|---------------------------------|-------|----------|--------------------------------|-------|----------|
| | 2010 | 2009 | % Change | 2010 | 2009 | % Change |
| Natural gas (\$/Mcf) | 4.12 | 3.24 | 27 | 4.67 | 4.32 | 8 |
| Oil and NGLs (\$/Bbl) | 65.85 | 62.33 | 6 | 70.62 | 55.49 | 27 |
| Total (\$/Boe) | 34.96 | 32.73 | 7 | 39.36 | 34.35 | 15 |

Commodity Prices

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

| | Three months ended September 30 | | | Nine months ended September 30 | | |
|--|---------------------------------|-------|----------|--------------------------------|-------|----------|
| | 2010 | 2009 | % Change | 2010 | 2009 | % Change |
| Natural Gas | | | | | | |
| AECO (Cdn\$/GJ) | 3.52 | 2.88 | 22 | 4.09 | 3.90 | 5 |
| New York Mercantile Exchange (Henry Hub Close) (US\$/MMbtu) | 4.38 | 3.41 | 28 | 4.60 | 3.97 | 16 |
| Crude Oil | | | | | | |
| Edmonton par (Cdn\$/Bbl) | 74.76 | 71.72 | 4 | 76.61 | 62.03 | 24 |
| West Texas Intermediate (US\$/Bbl) | 77.81 | 69.25 | 12 | 78.19 | 57.35 | 36 |
| Foreign Exchange | | | | | | |
| Cdn\$/1US\$ | 1.04 | 1.10 | (5) | 1.04 | 1.17 | (11) |

Commodity Price Management

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

Receipts from the settlement of financial commodity contracts are as follows:

| | Three months ended September 30 | | Nine months ended September 30 | |
|---------------|---------------------------------|------|--------------------------------|------|
| | 2010 | 2009 | 2010 | 2009 |
| Gas contracts | 5.1 | – | 11.2 | 11.2 |

At September 30, 2010, Paramount's outstanding natural gas financial contracts are summarized as follows:

| Instruments | Total Notional | Average Fixed Price | Fair Value | Remaining Term |
|----------------------|----------------|---------------------|------------|----------------|
| Gas – AECO Sales | 30,000 GJ/d | CAD\$5.53/GJ | 2.0 | October 2010 |
| Gas – AECO Purchases | (15,000) GJ/d | CAD\$3.87/GJ | (0.2) | October 2010 |
| | | | 1.8 | |

Paramount has a physical contract expiring in January of 2011, to sell 3,400 GJ/d of natural gas at \$2.73/GJ plus an escalation factor. At September 30, 2010 the fair value of the contract was a loss of \$0.2 million.

Royalties

| | Three months ended September 30 | | | Nine months ended September 30 | | |
|--------------|---------------------------------|-------|----------|--------------------------------|-------|----------|
| | 2010 | 2009 | % Change | 2010 | 2009 | % Change |
| Natural gas | 1.2 | (1.1) | 209 | 4.4 | 2.3 | 91 |
| Oil and NGLs | 3.2 | 5.2 | (38) | 12.5 | 11.0 | 14 |
| Total | 4.4 | 4.1 | 7 | 16.9 | 13.3 | 27 |
| Royalty rate | 9.7% | 11.2% | | 12.2% | 11.4% | |

Natural gas royalties in the third quarter of 2010 increased \$2.3 million compared to the third quarter of 2009. Natural gas royalties in the third quarter of 2009 included a recovery of gas cost allowance and custom processing credits and royalty holidays. Third quarter 2010 oil and NGLs royalties decreased \$2.0 million compared to the prior year, primarily due to a higher proportion of liquids production being NGLs, which was subject to a lower royalty rate than oil production.

Year-to-date natural gas royalties increased by \$2.1 million in 2010 compared to the prior year, primarily due lower 2009 royalties associated with prior year recoveries of gas cost allowance and custom processing credits and royalty holidays. Year-to-date oil and NGLs royalties increased \$1.5 million compared to the prior year due to higher oil and NGLs revenue.

Operating Expense and Production Tax

| | Three months ended September 30 | | | Nine months ended September 30 | | |
|-------------------|---------------------------------|------|----------|--------------------------------|------|----------|
| | 2010 | 2009 | % Change | 2010 | 2009 | % Change |
| Operating expense | 12.3 | 10.8 | 14 | 36.3 | 42.6 | (15) |
| Production tax | 0.5 | 0.7 | (29) | 1.8 | 1.6 | 13 |
| Total | 12.8 | 11.5 | 11 | 38.1 | 44.2 | (14) |

Operating expenses increased by \$1.5 million in the third quarter of 2010 compared to the third quarter of 2009, primarily as a result of increased production volumes from newly drilled wells and the June 2010 Redcliffe acquisition.

Year-to-date operating expenses decreased by \$6.3 million compared to the prior year, primarily due to higher prior year costs in the Northern COU related to major maintenance at Cameron Hills, a more extensive plant turnaround at Bistcho and well suspension activities at Liard and Bovie. Operating costs also decreased as a result of improved operating practices in the Kaybob COU and lower production at certain properties. The decreases in operating costs were partially offset by increases due to new wells at Karr-Gold Creek in the Grande Prairie COU and at Smoky, Musreau and Resthaven in the Kaybob COU and wells acquired through the Redcliffe acquisition.

Transportation Expense

| | Three months ended September 30 | | | Nine months ended September 30 | | |
|------------------------|---------------------------------|------|----------|--------------------------------|------|----------|
| | 2010 | 2009 | % Change | 2010 | 2009 | % Change |
| Transportation expense | 4.4 | 3.3 | 33 | 12.9 | 10.4 | 24 |

Transportation expense increased to \$4.4 million in the third quarter of 2010 compared to \$3.3 million in the third quarter of 2009. Year-to-date transportation expense increased to \$12.9 million from \$10.4 million in the prior year. Transportation expense increased primarily because of toll increases in 2010 and increase production volumes. Transportation expenses include the costs of shipping natural gas to sales points in California and the United States east coast.

Other Principal Property Items

| | Three months ended September 30 | | Nine months ended September 30 | |
|--|---------------------------------|-------|--------------------------------|-------|
| | 2010 | 2009 | 2010 | 2009 |
| Depletion, depreciation and accretion | 47.2 | 30.8 | 131.6 | 97.2 |
| Exploration and dry hole expenses | 2.2 | 1.3 | 14.9 | 4.0 |
| Loss on sale of property plant and equipment | 0.4 | 0.2 | – | 0.1 |
| Commodity contracts – net of settlements | 4.3 | 0.3 | 0.3 | 10.1 |
| Other | (0.3) | (0.5) | (0.9) | (1.0) |
| Total | 53.8 | 32.1 | 145.9 | 110.4 |

Depletion, depreciation, and accretion increased to \$47.2 million or \$36.69 per Boe in the third quarter of 2010 compared to \$30.8 million or \$27.76 per Boe in the third quarter of 2009. Year-to-date depletion, depreciation, and accretion increased to \$131.6 million or \$37.41 per Boe in 2010 compared to \$97.2 million or \$28.61 per Boe in the prior year. The increase in the per unit depletion rates is primarily due to a change in the pricing methodology used to estimate proved reserves, which was adopted in the fourth quarter of 2009. The depletion rate has also been impacted by high finding and development costs in recent years.

Year-to-date exploration and dry hole expenses include \$7.8 million of costs related to suspended wells drilled in the first quarter of 2010 at Cameron Hills in the Northern COU.

Strategic Investments

| | Three months ended September 30 | | Nine months ended September 30 | |
|--------------------------------|---------------------------------|-------|--------------------------------|--------|
| | 2010 | 2009 | 2010 | 2009 |
| Income (loss) from investments | (1.0) | (1.3) | 11.0 | (12.2) |
| Drilling revenue | 1.7 | – | 1.7 | – |
| Drilling expense | (1.0) | (1.1) | (1.6) | (1.7) |
| General and administrative | (1.0) | (0.6) | (2.3) | (1.8) |
| Stock-based compensation | (2.5) | (3.9) | (6.6) | (3.9) |
| Interest | (0.3) | (0.2) | (0.9) | (0.2) |
| Other (expense) income | (0.4) | (0.1) | (1.1) | (0.4) |
| Segment Earnings (Loss) | (4.5) | (7.2) | 0.2 | (20.2) |

Strategic Investments at September 30, 2010 include the following:

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

During the third quarter of 2010 Paramount recorded \$1.0 million of equity losses compared to \$1.3 million of equity losses in the prior year.

Year-to-date income from investments in 2010 includes \$3.2 million of equity earnings, dilution gains of \$4.3 million and a gain of \$3.5 million related to the reclassification of gains on the investment in Redcliffe previously

recognized in other comprehensive income. The prior year includes \$13.9 million of equity losses, a dilution loss of \$1.5 million and a \$3.2 million gain realized on the disposition of shares in Nuloch.

Prior to Trilogy's conversion to a corporation in January 2010, Paramount participated in Trilogy's distribution reinvestment plan ("DRIP"), acquiring an additional 0.1 million units for \$1.2 million.

In the third quarter of 2010, MEG completed an initial public offering of its common shares on the Toronto Stock Exchange. As a result, Paramount's investment in 3.7 million common shares of MEG, previously carried at \$27.50 per share, was adjusted to the September 30, 2010 closing price of \$35.85 per share, resulting in an unrealized gain of \$30.9 million being recorded in accumulated other comprehensive income.

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

| | Carrying Value | | Market Value ⁽¹⁾ | |
|----------------------|--------------------|-------------------|-----------------------------|-------------------|
| | September 30, 2010 | December 31, 2009 | September 30, 2010 | December 31, 2009 |
| Trilogy | 106.9 | 104.5 | 277.4 | 206.1 |
| MEG | 132.6 | 101.8 | 132.6 | 101.8 |
| MGM Energy | 5.6 | 5.9 | 9.6 | 12.5 |
| Other ⁽²⁾ | 24.0 | 22.4 | 24.1 | 22.5 |
| Total | 269.1 | 234.6 | 443.7 | 342.9 |

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

⁽²⁾ Includes investments in NuLoch, Paxton, Redcliffe (2009), and other public and private corporations.

In May 2010, Paramount received an updated evaluation of its Grand Rapids resource at Hoole from its independent reserves evaluator, with an evaluation date of April 30, 2010. The report estimated contingent bitumen resources at 634 million barrels (Best Estimate (P50)), having a before-tax net present value of future net revenue of \$1.9 billion, discounted at ten percent (Best Estimate (P50)). In the third quarter, Paramount commenced conceptual design work related to its regulatory application for commercial development. The application is expected to be submitted in 2011.

Corporate

| | Three months ended September 30 | | Nine months ended September 30 | |
|--------------------------------|---------------------------------|-------------|--------------------------------|-------------|
| | 2010 | 2009 | 2010 | 2009 |
| General and administrative | 3.5 | 3.6 | 8.7 | 11.9 |
| Stock-based compensation | 5.5 | 9.7 | 16.5 | 10.1 |
| Depletion and depreciation | 0.2 | 0.2 | 0.5 | 0.6 |
| Interest and financing charges | 3.2 | 2.4 | 8.2 | 8.2 |
| Foreign exchange | (1.7) | (5.5) | (0.7) | (10.6) |
| Other (income) expense | 0.1 | (0.1) | 0.2 | (0.2) |
| Corporate costs | 10.8 | 10.3 | 33.4 | 20.0 |

Third quarter corporate segment net costs increased \$0.5 million to \$10.8 million in 2010, compared to \$10.3 million in the third quarter of 2009, primarily due to the impact of changes in foreign exchange rates and higher interest costs, partially offset by lower stock-based compensation charges.

Corporate segment net costs for the nine months ended September 30, 2010 increased \$13.4 million to \$33.4 million, compared to \$20.0 million in the prior year, primarily due to the impact of changes in foreign exchange rates and higher stock-based compensation charges, partially offset by lower general and administrative expenses. General and administrative expenses decreased primarily due to higher overhead recoveries resulting from higher current year capital spending.

Year-to-date general and administrative expenses include \$0.3 million of costs related to the Redcliffe acquisition.

Capital Expenditures

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|---------------------------------|-------|--------------------------------|-------|
| | 2010 | 2009 | 2010 | 2009 |
| Geological and geophysical | 1.7 | 1.1 | 6.7 | 3.9 |
| Drilling and completions | 31.9 | 8.9 | 90.9 | 47.6 |
| Production equipment and facilities | 2.8 | 1.0 | 23.3 | 20.4 |
| Exploration and development expenditures | 36.4 | 11.0 | 120.9 | 71.9 |
| Land and property acquisitions | 18.9 | 2.9 | 42.0 | 5.6 |
| Acquisition of Redcliffe | – | – | 46.2 | – |
| Proceeds on disposition and other | – | (0.2) | (0.1) | (0.5) |
| Principal Properties | 55.3 | 13.7 | 209.0 | 77.0 |
| Strategic Investments | | | | |
| Capital expenditures | 2.4 | 8.6 | 13.1 | 17.5 |
| Proceeds on disposition | (0.1) | – | (1.0) | – |
| Corporate | – | – | 0.1 | 0.1 |
| Net capital expenditures | 57.6 | 22.3 | 221.2 | 94.6 |

Third quarter exploration and development expenditures were \$36.4 million in 2010 compared to \$11.0 million in 2009. Year-to-date exploration and development expenditures in 2010 were \$120.9 million in 2010 compared to \$71.9 million in 2009. Exploration and development expenditures in 2010 focused on drilling and facility expansion at the Karr-Gold Creek deep gas project in the Grande Prairie COU and drilling Deep Basin wells in the Smoky, Musreau and Resthaven areas in the Kaybob COU.

Year-to-date 2010 exploration and development expenditures were reduced by \$10.9 million as a result of the Alberta Drilling Royalty Credit program.

In the United States Paramount operates through Summit Resources Inc. ("Summit"), a wholly owned subsidiary. In April 2010, Summit entered into a joint development agreement with a United States focused exploration and development company that has significant operations and experience in the Bakken play in North Dakota. Under the agreement, which covers approximately 39,900 net acres of Summit's undeveloped North Dakota lands, the U.S. company is carrying out a multiple well Bakken horizontal drilling program using multi-stage fracture technology in order to earn an undivided 50 percent of Summit's interests in these lands (19,950 net acres). To date, the joint development partner has drilled three wells under the agreement, two of which have been completed.

On June 29, 2010, Paramount acquired, for cash consideration of \$46.2 million, all 109.9 million issued and outstanding Class A shares of Redcliffe that it did not already own, including 340,000 Class A shares owned by certain officers of Paramount. Redcliffe was a Calgary based company with interests in petroleum and natural gas properties primarily at Karr-Gold Creek in the Peace River Arch and at Greater Pembina in southern Alberta. The acquisition was funded with drawings on the Company's credit facility.

Wells drilled are as follows:

| | Three months ended September 30 | | | | Nine months ended September 30 | | | |
|----------------------|---------------------------------|--------------------|----------------------|--------------------|--------------------------------|--------------------|----------------------|--------------------|
| | 2010 | | 2009 | | 2010 | | 2009 | |
| | Gross ⁽¹⁾ | Net ⁽²⁾ | Gross ⁽¹⁾ | Net ⁽²⁾ | Gross ⁽¹⁾ | Net ⁽²⁾ | Gross ⁽¹⁾ | Net ⁽²⁾ |
| Gas | 14 | 8 | 3 | 2 | 37 | 26 | 17 | 10 |
| Oil | 7 | 2 | – | – | 9 | 4 | 1 | 1 |
| Oil sands evaluation | – | – | – | – | 45 | 45 | 7 | 7 |
| Dry and abandoned | – | – | – | – | 4 | 4 | – | – |
| Total | 21 | 10 | 3 | 2 | 95 | 79 | 25 | 18 |

(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.

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, and acquiring or disposing of assets.

| | September 30, 2010 | December 31, 2009 | Change |
|--|--------------------|-------------------|--------|
| Working capital deficit (surplus) ⁽¹⁾ | 17.7 | (43.5) | 61.2 |
| Credit facility | 111.3 | – | 111.3 |
| US Senior Notes (excluding unamortized financing fees) | 92.8 | 94.4 | (1.6) |
| Net debt | 221.8 | 50.9 | 170.9 |
| Share capital | 394.6 | 393.1 | 1.5 |
| Contributed surplus | 3.3 | 2.9 | 0.4 |
| Retained earnings | 327.1 | 373.7 | (46.6) |
| Accumulated other comprehensive income | 33.4 | 3.2 | 30.2 |
| Total Capital | 980.2 | 823.8 | 156.4 |

⁽¹⁾ Excludes risk management assets and stock-based compensation liabilities.

Working Capital

Paramount's working capital deficit at September 30, 2010 was \$17.7 million compared to a surplus of \$43.5 million at December 31, 2009. Working capital at September 30, 2010 includes \$22.7 million of cash and cash equivalents and \$44.2 million of accounts payable and accrued liabilities. The decrease in working capital is primarily due to capital spending, partially offset by funds flow from operations. A principal payment of \$1.0 million was made on the drilling rig loan in March 2010.

Paramount expects to fund its fourth quarter 2010 operations, obligations, and capital expenditures with existing cash and cash equivalents, funds flow from operations, drawings under its bank credit facility and by accessing the capital markets.

Bank Credit Facility

In April 2010, Paramount renewed its credit facility with the borrowing base and lender commitments remaining at \$125 million. The credit facility is available on a revolving basis to April 30, 2011 and can be extended a further 364 days upon request, subject to approval by the lenders. In the event the revolving period is not extended, the credit facility would be available on a non-revolving basis for an additional year, at which time it would be due and payable. In July 2010, following the acquisition of Redcliffe, the borrowing base and lender commitments under the credit facility were increased from \$125 million to \$160 million.

As of September 30, 2010, \$111.3 million was drawn on the credit facility and Paramount had \$16.7 million in outstanding undrawn letters of credit which further reduce the balance available to the Company.

US Senior Notes

As of September 30, 2010 the outstanding balance of Paramount's 8.5% US Senior Notes remains at US\$90.2 million (\$92.9 million).

Share Capital

In April 2010, Paramount received regulatory approval under Canadian securities laws to purchase Common Shares under a normal course issuer bid ("NCIB") commencing April 13, 2010 for a 12-month period. Under the NCIB, Paramount is permitted to purchase for cancellation up to 3,626,476 Common Shares. No shares have been purchased under the NCIB to November 1, 2010.

At November 1, 2010, Paramount had 72,637,724 Common Shares and 4,096,500 Stock Options outstanding (1,605,001 exercisable).

Quarterly Information

| | 2010 | | | | 2009 | | | 2008 |
|--|---------------|--------|--------|--------|--------|--------|--------|---------|
| | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 |
| Petroleum and natural gas sales | 44.9 | 44.6 | 48.9 | 45.0 | 36.3 | 40.2 | 40.2 | 54.7 |
| Funds flow from operations | 23.2 | 22.1 | 21.6 | 18.8 | 10.2 | 13.7 | 17.6 | 68.2 |
| per share – diluted (\$/share) | 0.32 | 0.31 | 0.30 | 0.27 | 0.15 | 0.21 | 0.27 | 1.01 |
| Net earnings (loss) | (3.7) | (28.8) | (14.5) | (46.4) | (25.2) | (2.6) | (23.7) | (150.5) |
| per share – basic & diluted (\$/share) | (0.05) | (0.40) | (0.20) | (0.67) | (0.38) | (0.04) | (0.36) | (2.23) |
| Sales volumes | | | | | | | | |
| Natural gas (MMcf/d) | 62.9 | 57.0 | 50.2 | 47.0 | 49.9 | 59.1 | 51.1 | 53.4 |
| Oil and NGLs (Bbl/d) | 3,480 | 3,287 | 3,514 | 3,673 | 3,733 | 3,512 | 3,398 | 3,298 |
| Total (Boe/d) | 13,967 | 12,787 | 11,875 | 11,514 | 12,046 | 13,362 | 11,912 | 12,202 |
| Average realized price | | | | | | | | |
| Natural gas (\$/Mcf) | 4.12 | 4.49 | 5.59 | 4.85 | 3.24 | 4.03 | 5.73 | 7.43 |
| Oil and NGLs (\$/Bbl) | 65.85 | 71.32 | 74.78 | 71.00 | 62.33 | 57.83 | 45.38 | 60.04 |

Significant Items Impacting Quarterly Results

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

- Third quarter 2010 earnings include a future income tax recovery of \$37.0 million, increased depletion, depreciation and accretion expense and \$8.1 million of stock-based compensation charges.
- Second quarter 2010 earnings include increased depletion, depreciation and accretion expense and \$7.3 million of stock-based compensation charges.
- First quarter 2010 earnings include \$8.2 million of dry hole expenses and \$7.7 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.
- Third quarter 2009 earnings include higher stock-based compensation charges, and lower earnings from Strategic Investments.
- Second quarter 2009 earnings include increased future income tax recoveries and lower operating expenses.
- First quarter 2009 earnings include lower Corporate costs and Strategic Investments losses.
- Fourth quarter 2008 earnings include a \$50.7 million write-down of petroleum and natural gas properties and goodwill and a \$96.9 million investment impairment provision.

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 September 30, 2010 and 2009, and do not include Paramount's adjustments when 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.

| As at September 30 | 2010 | 2009 |
|---------------------------|-------------|-------------|
| Current assets | \$ 42.6 | \$ 41.3 |
| Long term assets | 950.9 | 854.8 |
| Current liabilities | 76.2 | 53.4 |
| Long term liabilities | 467.7 | 475.9 |
| Equity | 449.6 | 366.8 |

| Nine months ended September 30 | 2010 | 2009 |
|--|-------------|-------------|
| Revenue | 203.3 | 156.0 |
| Expenses | 186.3 | 190.2 |
| Tax expense (recovery) | 4.0 | (9.6) |
| Net earnings (loss) | \$ 13.0 | \$ (24.6) |
| Shares/units outstanding at September 30 (thousands) | 115,013 | 99,194 |
| Paramount's equity interest at September 30 ⁽¹⁾ | 21% | 23.7% |

(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 4.6 million stock options outstanding (1.7 million exercisable) at September 30, 2010 at exercise prices ranging from \$4.85 to \$12.88 per share.

Outlook

Based on encouraging drilling and completion results achieved to date, Paramount expects to continue its accelerated development plans in the Kaybob and Grande Prairie COUs during the remainder of 2010. Additional capital spending beyond the Company's \$130 million exploration and development budget is anticipated, the extent of which will depend upon continued strong drilling and completion results and commodity prices.

Year-to-date average production of 12,884 Boe/d is consistent with expectations and the Company's annual 2010 production forecast of 13,425 Boe/d remains unchanged.

Subsequent Event

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

Change in Accounting Policy

Effective January 1, 2010, Paramount early adopted CICA Handbook section 1582 – "Business Combinations", which replaces the previous business combinations standard. The new standard requires that all of the assets

acquired and the liabilities assumed in a business combination be recorded at fair value, which was not the case under the previous standard. The new standard also requires that previously held ownership interests be remeasured to the acquisition date fair value, rather than being restated to cost. In addition, the new standard requires that all acquisition costs associated with the acquisition are expensed, rather than being capitalized as part of the acquisition, that contingent liabilities are recognized at fair value at the acquisition date and subsequently re-measured to fair value with changes recognized in earnings, and that a bargain purchase is recognized in earnings rather than being allocated to non-monetary assets. This new standard has been applied to the acquisition of Redcliffe.

Effective January 1, 2010, Paramount also early adopted CICA Handbook section 1601 – "Consolidations" and 1602 - "Non-controlling Interests", which together replaced section 1600 – "Consolidations". Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 requires non-controlling interests ("NCI") to be presented within equity. There is no impact on the Interim Consolidated Financial Statements from the adoption of these standards.

Future Accounting Changes

International Financial Reporting Standards

The Accounting Standards Board of Canada has announced that accounting standards in Canada, as used by public companies, will be converted to International Financial Reporting Standards ("IFRS") for fiscal years beginning on or after January 1, 2011.

Paramount's IFRS conversion project is proceeding according to plan and the Company expects to be ready for the transition in the first quarter of 2011.

Significant components of Paramount's IFRS conversion project completed to date include:

- compilation of a diagnostic analysis that identified key differences between existing Canadian GAAP and IFRS, as they relate to the Company;
- preparation of Company specific draft accounting position papers;
- implementation of modifications to information systems required to accumulate and process information in order to generate IFRS financial information;
- preparation of draft IFRS financial statement disclosures; and
- Identification of changes to internal controls over financial reporting and disclosure control procedures.

Accounting Policy Changes

The following describes certain changes that Paramount expects to make upon transition to IFRS:

Property, Plant and Equipment

Although Paramount follows the successful efforts method of accounting for oil and gas operations, the transition to IFRS requires certain policy, process and disclosure changes, including exploration phase accounting and impairment testing levels and methodologies.

Exploration and evaluation ("E&E") costs are those expenditures for an area or project for which technical feasibility and commercial viability have not yet been determined. Paramount's E&E asset balance will primarily consist of costs related to undeveloped land and incomplete drilling projects. Under IFRS, Paramount will initially capitalize these costs as E&E assets on the balance sheet. When the area or project is determined to be technically feasible and commercially viable, the costs will be transferred to property, plant and equipment. Costs related to unsuccessful projects will be expensed. Upon transition to IFRS, the Company expects to reclassify approximately \$150 million to E&E assets from property, plant and equipment.

Under Canadian GAAP, impairment of the Company's petroleum and natural gas properties is assessed on a property-by-property basis. Under IFRS, assets are grouped together in cash-generating units ("CGUs"), which consist 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. Paramount expects to group its properties into ten cash generating units which will be used in the impairment assessment upon transition to IFRS.

IFRS requires an impairment to be recognized when the carrying value of a CGU exceeds its recoverable amount. The recoverable amount of a CGU is defined as the greater of its value in use and its fair value less costs to sell. The Company expects to write-down the carrying value of certain CGUs as a result of the IFRS impairment methodology, the extent of which has not yet been determined.

Stock-based Compensation

Under Canadian GAAP, the Company's stock option plan liability is revalued each period using the intrinsic value method, calculated as the amount by which the market price of the Company's shares exceeds the exercise price of the outstanding options. Under IFRS, the stock option plan liability must be remeasured each period using a fair value option pricing model, and Paramount has determined that it will use the Black-Scholes-Merton model. As a result of the change in valuation method, Paramount's stock-based compensation liability is expected to increase by approximately \$3 million on the date of transition to IFRS.

The Company intends to utilize the exemption in IFRS 1 under which amounts recorded in respect of options settled prior to January 1, 2010 will not be retrospectively restated.

Asset Retirement Obligations

Under Canadian GAAP, asset retirement obligations ("ARO") are measured at the estimated fair value of the retirement and decommissioning expenditures expected to be incurred. Existing liabilities are not adjusted for changes in discount rates in future periods. Under IFRS, ARO is measured as the best estimate of the expenditure expected to be incurred and requires the use of current discount rates at each re-measurement date. Generally, the change in discount rates results in a balance being added to or deducted from PP&E. The Company expects to recognize an increase in the ARO liability of approximately \$2 million on the IFRS opening balance sheet upon transition.

Foreign Exchange Translation

Under Canadian GAAP, the assets and liabilities of the Company's integrated foreign operations are translated into the reporting currency of the reporting entity using the temporal method, where non-monetary items are translated at historical exchange rates. Under IFRS, all assets and liabilities of subsidiaries with functional currencies that are different than the reporting currency of the reporting entity are translated at the exchange rate in effect at the end of the reporting period. This change in translation is expected to result in a decrease in the carrying amount of Paramount's property, plant and equipment assets of approximately \$5 million.

Flow-Through Shares

Under Canadian GAAP, when flow-through shares are issued they are recorded based on proceeds received. Upon filing the renouncement documents with the tax authorities, a future tax liability is recognized and

shareholders' equity is reduced for the tax effect of expenditures renounced to subscribers. Under IFRS, the Company expects to allocate the proceeds from the issuance of flow-through shares between the sale of the shares and the sale of the tax benefits. The allocation is made based on the difference between the cost of flow-through shares and the market price of the existing shares. A liability will be recognized for this difference, which will be reversed upon the renunciation of the tax benefit. The difference between this liability and the deferred tax liability will be recorded as income tax expense upon the renunciation of the tax benefit. The IFRS adjustment associated with flow-through shares upon transition is expected to increase share capital by approximately \$25 million, reduce retained earnings by \$21 million and increase accrued liabilities by \$4 million.

Business Combinations

Paramount elected to early adopt CICA handbook section 1582 "Business Combinations" with respect to the acquisition of Redcliffe. This new Canadian standard is substantially converged with IFRS 3 "Business Combinations" and no adjustments are expected on transition to IFRS.

Paramount expects to apply the IFRS 1 exemption not to apply IFRS 3 to past business combinations.

Implementation

The project team is currently focused on the following activities:

- finalizing the opening balance sheet adjustments including future income tax;
- preparing comparative IFRS adjustments to the 2010 quarterly Canadian GAAP financial statement balances; and
- finalizing Paramount's IFRS policy choices, IFRS 1 elections and IFRS disclosures for publication in 2011.

As IFRS accounting policies and processes are being finalized, corresponding changes to internal controls over financial reporting and to disclosure controls and procedures are being identified to ensure controls remain effective.

Business Activities

Paramount is a reserves-based borrower and changes to the carrying value of its assets are not expected to have a significant impact on the Company's debt structure or agreements. Paramount's renewed credit facility agreement incorporates provisions regarding changes in accounting policies, including the adoption of IFRS.

Advisories

Forward-looking Information

Certain statements in this document constitute forward-looking information under applicable securities legislation. Forward looking information in this document includes references to:

- expected production volumes;
- planned exploration and development budget;
- budget allocations and capital spending flexibility;
- expected future plans relating to the COUs;
- capital structure and the flexibility to change future business plans, whether arising from low
- the outcome of any audits, assessments or other regulatory matters or proceedings;
- estimated contingent bitumen resources and the discounted present value of future net revenues from such resources (including the forecast prices and costs and the timing of expected production volumes and future development capital);

- commodity prices or otherwise;
- expected drilling programs, well tie-ins, facility construction and expansions, completions, and the timing thereof;
- expected accounting policies under IFRS and the related impact to the Company's financial statement balances; and
- financing plans.

Forward-looking information is based on a number of assumptions. In addition to any other assumptions identified in this document, assumptions have been made regarding future oil and gas prices remaining economic and provisions for contingencies being adequate. Assumptions have also been made relating to production levels from existing wells and exploration and development plans based on management's experience, historical trends, current conditions and anticipated future developments.

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 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. The material risks and uncertainties include, but are not limited to:

- fluctuations in oil and gas prices, foreign currency exchange rates and interest rates;
- the imprecision of resource estimates;
- the imprecision of estimating the timing, costs and levels of production and drilling;
- 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 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;
- the timing of governmental or regulatory approvals;
- changes in taxation laws and the interpretation thereof;
- uncertainty in amounts and timing of royalty payments and changes to royalty regimes and government regulations regarding royalties;
- changes in general business and economic conditions;
- uncertainty regarding aboriginal land claims and co-existing with local populations; and
- the effects of weather.

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" and "Investments – market value", collectively the "Non-GAAP measures", are used and do not have any standardized meanings as prescribed by GAAP. They are used to assist management in measuring the

Company's ability to finance capital programs and meet financial obligations. Funds flow from operations refers to cash flows from operating activities before net changes in operating working capital. Netback equals petroleum and natural gas sales less royalties, operating costs, production taxes and transportation costs. Refer to the calculation of Net Debt in the liquidity and capital resources section of this document. Investments – market value includes Paramount's publicly traded investments in Trilogy, MGM Energy, Nuloch, Redcliffe and others valued at the period-end closing trading price and the book value of the remaining investments.

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.

This document contains disclosure of the results of an updated evaluation of the Company's contingent bitumen resources from the Grande Rapids formation at Hoole, Alberta. Contingent resources are those quantities of bitumen estimated, as of a given date, to be potentially recoverable from known accumulations using established technology or technology under development, but are classified as a resource rather than a reserve due to one or more contingencies, such as the absence of regulatory approvals, detailed design estimates or near term development plans. A low estimate means high certainty (P90), a best estimate means most likely (P50) and a high estimate means low certainty (P10).

The before tax net present value of contingent bitumen resources disclosed represents the Company's share of future net revenue, before the deduction of income tax and does not represent fair value. The calculation considers such items as revenues, royalties, operating costs, abandonment costs and capital expenditures. Royalties have been calculated based on Alberta's Royalty Framework applicable to oil sands projects in Alberta. The calculation does not consider financing costs and general and administrative costs. The net present value was calculated assuming natural gas is used as a fuel for steam generation. Revenues and expenditures were calculated based on the reserve evaluator's forecast prices and costs as of April 1, 2010.

PARAMOUNT RESOURCES LTD.
Consolidated Balance Sheets (Unaudited)

(\$ thousands)

| | September 30 2010 | December 31 2009 |
|---|----------------------|---------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 22,721 | \$ 93,238 |
| Accounts receivable | 28,713 | 23,488 |
| Risk management assets (Note 11) | 1,781 | 2,187 |
| Prepaid expenses and other | 3,440 | 2,301 |
| | 56,655 | 121,214 |
| Property, plant and equipment, net | 819,648 | 716,235 |
| Investments (Note 5) | 269,125 | 234,586 |
| Future income taxes (Note 12) | 28,959 | 29,940 |
| Goodwill (Note 3) | 8,623 | — |
| | \$ 1,183,010 | \$ 1,101,975 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities | | |
| Drilling rig loan (Note 6) | \$ 28,380 | \$ 29,380 |
| Accounts payable and accrued liabilities | 44,193 | 46,162 |
| Current portion of stock-based compensation liability (Note 10) | 20,320 | 11,441 |
| | 92,893 | 86,983 |
| Long-term debt (Note 7) | 203,598 | 93,655 |
| Asset retirement obligations (Note 8) | 114,809 | 103,462 |
| Stock-based compensation liability (Note 10) | 12,469 | 3,771 |
| Future income taxes (Note 12) | 839 | 41,194 |
| | 424,608 | 329,065 |
| Shareholders' equity | | |
| Share capital (Note 9) | 394,601 | 393,087 |
| Contributed surplus | 3,341 | 2,890 |
| Retained earnings | 327,106 | 373,745 |
| Accumulated other comprehensive income | 33,354 | 3,188 |
| | 758,402 | 772,910 |
| | \$ 1,183,010 | \$ 1,101,975 |

See the accompanying notes to these Interim Consolidated Financial Statements.

PARAMOUNT RESOURCES LTD.
Consolidated Statement of Loss (Unaudited)

(\$ thousands, except as noted)

| | Three months ended September 30 | | Nine months ended September 30 | |
|--|------------------------------------|-------------|-----------------------------------|-------------|
| | 2010 | 2009 | 2010 | 2009 |
| Revenue | | | | |
| Petroleum and natural gas sales | \$ 44,928 | \$ 36,271 | \$ 138,433 | \$ 116,674 |
| Gain (loss) on financial commodity contracts (Note 11) | 662 | (272) | 10,743 | 1,078 |
| Royalties | (4,369) | (4,078) | (16,883) | (13,286) |
| | 41,221 | 31,921 | 132,293 | 104,466 |
| Expenses | | | | |
| Operating expense and production tax | 12,827 | 11,463 | 38,054 | 44,184 |
| Transportation | 4,350 | 3,336 | 12,939 | 10,412 |
| General and administrative | 4,467 | 4,238 | 10,999 | 13,675 |
| Stock-based compensation | 8,061 | 13,582 | 23,104 | 14,025 |
| Depletion, depreciation and accretion | 47,728 | 31,000 | 132,673 | 97,975 |
| Exploration | 2,238 | 1,421 | 7,388 | 4,289 |
| Dry hole | — | — | 7,754 | — |
| Loss on sale of property, plant and equipment | 361 | 165 | 191 | 127 |
| Interest and financing charges | 3,484 | 2,525 | 9,061 | 8,424 |
| Foreign exchange | (1,701) | (5,445) | (692) | (10,607) |
| | 81,815 | 62,285 | 241,471 | 182,504 |
| Income (loss) from investments (Note 5) | (967) | (1,324) | 11,008 | (12,202) |
| Other income (loss) | 909 | (509) | 740 | (411) |
| Loss before tax | (40,652) | (32,197) | (97,430) | (90,651) |
| Income and other tax expense (recovery) (Note 12) | | | | |
| Current and other | 18 | 31 | 12 | (605) |
| Future | (36,999) | (7,068) | (50,500) | (38,620) |
| | (36,981) | (7,037) | (50,488) | (39,225) |
| Net loss | \$ (3,671) | \$ (25,160) | \$ (46,942) | \$ (51,426) |
| Net loss per common share (\$/share) (Note 9) | | | | |
| Basic and diluted | \$ (0.05) | \$ (0.38) | \$ (0.65) | \$ (0.78) |

See the accompanying notes to these Interim Consolidated Financial Statements.

PARAMOUNT RESOURCES LTD.
Consolidated Statement of Cash Flows (Unaudited)

(\$ thousands)

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|------------------------------------|--------------|-----------------------------------|-----------------|
| | 2010 | 2009 | 2010 | 2009 |
| Operating activities | | | | |
| Net loss | \$ (3,671) | \$ (25,160) | \$ (46,942) | \$ (51,426) |
| Add (deduct) | | | | |
| Items not involving cash (Note 13) | 24,892 | 37,885 | 104,271 | 96,255 |
| Asset retirement obligation expenditures (Note 8) | (244) | (792) | (2,657) | (2,681) |
| Gain on sale of available-for-sale investment | – | (3,193) | – | (3,193) |
| Exploration and dry hole expenses | 2,238 | 1,421 | 15,142 | 4,289 |
| Stock incentive plan | – | – | (2,901) | (1,775) |
| | 23,215 | 10,161 | 66,913 | 41,469 |
| Change in non-cash working capital | (3,563) | 977 | (14,620) | 9,284 |
| Cash from operating activities | 19,652 | 11,138 | 52,293 | 50,753 |
| Financing activities | | | | |
| Proceeds from drilling rig loan, net | – | 30,307 | – | 30,307 |
| Drilling rig loan repayment (Note 6) | – | – | (1,000) | – |
| Net draw (repayment) of revolving long-term debt (Note 7) | 50,722 | (31,195) | 111,266 | 557 |
| Repayment of debt assumed on Redcliffe acquisition (Note 3) | – | – | (10,521) | – |
| Settlement of foreign exchange contract | – | – | – | 12,205 |
| Common shares issued | 57 | 84 | 2,832 | 84 |
| Common shares repurchased (Note 9) | – | – | – | (4,219) |
| Cash from (used in) financing activities | 50,779 | (804) | 102,577 | 38,934 |
| Investing activities | | | | |
| Property, plant and equipment and exploration | (57,675) | (22,548) | (176,110) | (95,117) |
| Redcliffe acquisition (Note 3) | – | – | (46,172) | – |
| Proceeds on sale of property, plant and equipment | 102 | – | 1,119 | 449 |
| Proceeds on sale of investment | – | 4,605 | – | 4,605 |
| Purchase of investments | (5,649) | (5,713) | (10,703) | (10,851) |
| Change in non-cash working capital | (8,877) | 633 | 6,479 | (33,537) |
| Cash used in investing activities | (72,099) | (23,023) | (225,387) | (134,451) |
| Net decrease in cash and cash equivalents | (1,668) | (12,689) | (70,517) | (44,764) |
| Cash and cash equivalents, beginning of period | 24,389 | 22,056 | 93,238 | 54,131 |
| Cash and cash equivalents, end of period | \$ 22,721 | 9,367 | \$ 22,721 | \$ 9,367 |

Supplemental cash flow information (Note 13)

See the accompanying notes to these Interim Consolidated Financial Statements.

PARAMOUNT RESOURCES LTD.

Consolidated Statement of Shareholders' Equity (Unaudited)

(\$ thousands, except as noted)

| Nine months ended September 30 | 2010 | | 2009 | |
|--|-------------------|-------------------|-------------------|-------------------|
| | Shares (000's) | | Shares (000's) | |
| Share Capital | | | | |
| Balance, beginning of period | 72,058 | \$ 393,087 | 66,741 | \$ 302,727 |
| Issued on exercise of stock options | 362 | 6,264 | 12 | 165 |
| Tax effect of flow-through share renunciations | – | (4,497) | – | – |
| Common shares repurchased | – | – | (616) | (2,815) |
| Change in unvested common shares for stock incentive plan | 28 | (253) | (178) | 269 |
| Balance, end of period | 72,448 | \$ 394,601 | 65,959 | \$ 300,346 |
| Contributed Surplus | | | | |
| Balance, beginning of period | | \$ 2,890 | | \$ 2,398 |
| Stock-based compensation expense on investees' options | | 451 | | 387 |
| Balance, end of period | | \$ 3,341 | | \$ 2,785 |
| Retained Earnings | | | | |
| Balance, beginning of period | | \$ 373,745 | | \$ 473,362 |
| Common shares repurchased | | – | | (1,404) |
| Change in value of unvested common shares for stock incentive plan | | 303 | | (403) |
| Net loss | | (46,942) | | (51,426) |
| Balance, end of period | | \$ 327,106 | | \$ 420,129 |
| Accumulated Other Comprehensive Income | | | | |
| Balance, beginning of period | | \$ 3,188 | | \$ – |
| Other comprehensive income, net of tax | | 30,166 | | 1,728 |
| Balance, end of period | | \$ 33,354 | | \$ 1,728 |
| Total Shareholders' Equity | | \$ 758,402 | | \$ 724,988 |

See the accompanying notes to these Interim Consolidated Financial Statements.

Consolidated Statement of Comprehensive Income (Loss) (Unaudited)

(\$ thousands)

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|------------------------------------|--------------------|-----------------------------------|--------------------|
| | 2010 | 2009 | 2010 | 2009 |
| Net loss | \$ (3,671) | \$ (25,160) | \$ (46,942) | \$ (51,426) |
| Other comprehensive income, net of tax | | | | |
| Change in unrealized gain on available-for-sale investments | 28,549 | 3,753 | 33,599 | 4,921 |
| Reclassification of accumulated (gains) to earnings, net of \$0.1 million tax | – | (3,193) | (3,433) | (3,193) |
| Comprehensive income (loss) | \$ 24,878 | \$ (24,600) | \$ (16,776) | \$ (49,698) |

See the accompanying notes to these Interim Consolidated Financial Statements.

Notes to Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

1. Basis of Presentation

These unaudited Interim Consolidated Financial Statements include the accounts of Paramount Resources Ltd. and its subsidiaries ("Paramount" or the "Company"), are stated in Canadian dollars, and have been prepared in accordance with Canadian Generally Accepted Accounting Principles using accounting policies and methods of application that are consistent with Paramount's audited Consolidated Financial Statements as at and for the year ended December 31, 2009, except as disclosed in Note 2 below. Paramount has divided its operations into three business segments: Principal Properties, Strategic Investments and Corporate.

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, 2009.

Certain comparative figures have been reclassified to conform to the current year's financial statement presentation.

2. Changes in Accounting Policy

Effective January 1, 2010, Paramount early adopted CICA Handbook section 1582 – "Business Combinations", which replaces the previous business combinations standard. The new standard requires that all of the assets acquired and the liabilities assumed in a business combination be recorded at fair value, which was not the case under the previous standard. The new standard also requires that previously held ownership interests be remeasured to the acquisition date fair value, rather than being restated to cost. In addition, the new standard requires that all acquisition costs associated with the acquisition are expensed, rather than capitalized as part of the acquisition, that contingent liabilities are recognized at fair value at the acquisition date and subsequently remeasured to fair value with changes recognized in earnings, and that a bargain purchase is recognized in earnings rather than being allocated to non-monetary assets. This new standard has been applied to the acquisition of Redcliffe Exploration Inc. ("Redcliffe").

Effective January 1, 2010, Paramount also early adopted CICA Handbook section 1601 – "Consolidations" and 1602 - "Non-controlling Interests", which together replaced section 1600 – "Consolidations". Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 requires non-controlling interests ("NCI") to be presented within equity. There is no impact on the Interim Consolidated Financial Statements from the adoption of these standards.

3. Acquisition of Redcliffe Exploration Inc.

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

The acquisition of Redcliffe has been accounted for using the acquisition method whereby all of the assets acquired and liabilities assumed are recorded at fair value. The following table summarizes the net assets acquired pursuant to the acquisition:

Notes to Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

Net assets acquired

| | |
|--------------------------------|------------------|
| Property, plant, and equipment | \$ 66,943 |
| Goodwill | 8,623 |
| Working capital deficit | (706) |
| Bank debt | (10,521) |
| Asset retirement obligations | (4,581) |
| Future income tax liability | (3,710) |
| Net assets acquired | \$ 56,048 |

| | |
|--|------------------|
| Cash purchase price | \$ 46,172 |
| Fair value of Redcliffe shares previously held | 9,876 |
| Total | \$ 56,048 |

The allocation of the purchase price is provisional, and was estimated by management at the time of the preparation of these interim consolidated financial statements based on information then available. Amendments may be made to these amounts as the estimates are finalized.

Upon the acquisition of Redcliffe, a gain of \$3.5 million previously recorded in Paramount's other comprehensive income ("OCI") related to its investment in Redcliffe was reclassified to income from investments. Goodwill recorded on the acquisition of Redcliffe is primarily related to the Company's recognition of asset retirement obligations and future income tax liabilities. None of the goodwill is deductible for tax purposes. The net assets acquired, including goodwill, have been allocated to the Principal Properties business segment.

Paramount incurred \$0.3 million of transaction costs related to the Redcliffe acquisition, which were recognized in general and administrative expense.

If the acquisition of Redcliffe had been completed on January 1, 2010, Paramount's petroleum and natural gas sales for the nine months ended September 30, 2010 would have been \$144.6 million. From the date of acquisition to September 30, 2010, petroleum and natural gas sales related to properties acquired through the Redcliffe acquisition were \$2.2 million. The impact of the acquisition on net income for the period January 1 to September 30, 2010 and June 29 to September 30, 2010 is impracticable to determine.

4. 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 Northern COU, which includes properties in Northern Alberta, the Northwest Territories and Northeast British Columbia; and (iv) the Southern COU, which includes properties in Southern Alberta, Saskatchewan, Montana and North Dakota.
- **Strategic Investments:** Strategic investments include: (i) investments in other entities, including affiliates; and (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.
- **Corporate:** Corporate is comprised of income and expense items, including general and administrative expense and interest expense, that have not been specifically allocated to Principal Properties or Strategic Investments.

Notes to Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

| Three months ended September 30, 2010 | Principal Properties | Strategic Investments | Corporate | Inter-segment Eliminations | Total |
|--|----------------------|-----------------------|-------------|----------------------------|------------|
| Revenue | | | | | |
| Petroleum and natural gas sales, net of royalties | \$ 40,559 | \$ — | \$ — | \$ — | \$ 40,559 |
| Gain on financial commodity contracts | 662 | — | — | — | 662 |
| | 41,221 | — | — | — | 41,221 |
| Expenses | | | | | |
| Operating expense, production tax and transportation | 17,177 | — | — | — | 17,177 |
| General and administrative | — | 958 | 3,509 | — | 4,467 |
| Stock-based compensation | — | 2,526 | 5,535 | — | 8,061 |
| Depletion, depreciation and accretion | 47,151 | 861 | 184 | (468) | 47,728 |
| Exploration and dry hole | 2,197 | 41 | — | — | 2,238 |
| Loss on sale of property, plant and equipment | 361 | — | — | — | 361 |
| Interest and financing charges | — | 305 | 3,179 | — | 3,484 |
| Foreign exchange | — | — | (1,701) | — | (1,701) |
| | 66,886 | 4,691 | 10,706 | (468) | 81,815 |
| Loss from investments | — | (967) | — | — | (967) |
| Other income (expense) | 290 | — | (43) | — | 247 |
| Drilling rig revenue | — | 3,205 | — | (1,498) | 1,707 |
| Drilling rig expense | — | (2,121) | — | 1,076 | (1,045) |
| | (25,375) | (4,574) | (10,749) | 46 | (40,652) |
| Inter-segment eliminations | — | 46 | — | (46) | — |
| Segment loss | \$ (25,375) | \$ (4,528) | \$ (10,749) | \$ — | (40,652) |
| Income and other tax recovery | | | | | (36,981) |
| Net loss | | | | | \$ (3,671) |

| Three months ended September 30, 2009 | Principal Properties | Strategic Investments | Corporate | Inter-segment Eliminations | Total |
|--|----------------------|-----------------------|-------------|----------------------------|-------------|
| Revenue | | | | | |
| Petroleum and natural gas sales, net of royalties | \$ 32,193 | \$ — | \$ — | \$ — | \$ 32,193 |
| Loss on financial commodity contracts | (272) | — | — | — | (272) |
| | 31,921 | — | — | — | 31,921 |
| Expenses | | | | | |
| Operating expense, production tax and transportation | 14,799 | — | — | — | 14,799 |
| General and administrative | — | 579 | 3,659 | — | 4,238 |
| Stock-based compensation | — | 3,913 | 9,669 | — | 13,582 |
| Depletion, depreciation and accretion | 30,760 | 470 | 160 | (390) | 31,000 |
| Exploration and dry hole | 1,353 | 68 | — | — | 1,421 |
| Loss on sale of property, plant and equipment | 165 | — | — | — | 165 |
| Interest and financing charges | — | 170 | 2,355 | — | 2,525 |
| Foreign exchange | — | — | (5,445) | — | (5,445) |
| | 47,077 | 5,200 | 10,398 | (390) | 62,285 |
| Loss from investments | — | (1,324) | — | — | (1,324) |
| Other income | 506 | — | 49 | — | 555 |
| Drilling rig revenue | — | 1,231 | — | (1,231) | — |
| Drilling rig expense | — | (1,632) | — | 568 | (1,064) |
| | (14,650) | (6,925) | (10,349) | (273) | (32,197) |
| Inter-segment eliminations | — | (273) | — | 273 | — |
| Segment loss | \$ (14,650) | \$ (7,198) | \$ (10,349) | \$ — | (32,197) |
| Income and other tax recovery | | | | | (7,037) |
| Net loss | | | | | \$ (25,160) |

Notes to Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

| Nine months ended September 30, 2010 | Principal Properties | Strategic Investments | Corporate | Inter-segment Eliminations | Total |
|--|----------------------|-----------------------|-------------|----------------------------|-------------|
| Revenue | | | | | |
| Petroleum and natural gas sales, net of royalties | \$ 121,550 | \$ – | \$ – | \$ – | \$ 121,550 |
| Gain on financial commodity contracts | 10,743 | – | – | – | 10,743 |
| | 132,293 | – | – | – | 132,293 |
| Expenses | | | | | |
| Operating expense, production tax and transportation | 50,993 | – | – | – | 50,993 |
| General and administrative | – | 2,282 | 8,717 | – | 10,999 |
| Stock-based compensation | – | 6,636 | 16,468 | – | 23,104 |
| Depletion, depreciation and accretion | 131,570 | 2,472 | 531 | (1,900) | 132,673 |
| Exploration and dry hole | 14,851 | 291 | – | – | 15,142 |
| (Gain) loss on sale of property, plant and equipment | (36) | 227 | – | – | 191 |
| Interest and financing charges | – | 907 | 8,154 | – | 9,061 |
| Foreign exchange | – | – | (692) | – | (692) |
| | 197,378 | 12,815 | 33,178 | (1,900) | 241,471 |
| Income from investments | – | 11,008 | – | – | 11,008 |
| Other income (expense) | 863 | – | (185) | – | 678 |
| Drilling rig revenue | – | 8,130 | – | (6,423) | 1,707 |
| Drilling rig expense | – | (5,777) | – | 4,132 | (1,645) |
| | (64,222) | 546 | (33,363) | (391) | (97,430) |
| Inter-segment eliminations | – | (391) | – | 391 | – |
| Segment earnings (loss) | \$ (64,222) | \$ 155 | \$ (33,363) | \$ – | (97,430) |
| Income and other tax recovery | | | | | (50,488) |
| Net loss | | | | | \$ (46,942) |

| Nine months ended September 30, 2009 | Principal Properties | Strategic Investments | Corporate | Inter-segment Eliminations | Total |
|--|----------------------|-----------------------|-------------|----------------------------|-------------|
| Revenue | | | | | |
| Petroleum and natural gas sales, net of royalties | \$ 103,388 | \$ – | \$ – | \$ – | \$ 103,388 |
| Gain on financial commodity contracts | 1,078 | – | – | – | 1,078 |
| | 104,466 | – | – | – | 104,466 |
| Expenses | | | | | |
| Operating expense, production tax and transportation | 54,596 | – | – | – | 54,596 |
| General and administrative | – | 1,804 | 11,871 | – | 13,675 |
| Stock-based compensation | – | 3,913 | 10,112 | – | 14,025 |
| Depletion, depreciation and accretion | 97,170 | 561 | 634 | (390) | 97,975 |
| Exploration and dry hole | 4,047 | 242 | – | – | 4,289 |
| Loss on sale of property, plant and equipment | 127 | – | – | – | 127 |
| Interest and financing charges | – | 170 | 8,254 | – | 8,424 |
| Foreign exchange | – | – | (10,607) | – | (10,607) |
| | 155,940 | 6,690 | 20,264 | (390) | 182,504 |
| Loss from investments | – | (12,202) | – | – | (12,202) |
| Other income | 1,077 | – | 209 | – | 1,286 |
| Drilling rig revenue | – | 1,608 | – | (1,608) | – |
| Drilling rig expense | – | (2,642) | – | 945 | (1,697) |
| | (50,397) | (19,926) | (20,055) | (273) | (90,651) |
| Inter-segment eliminations | – | (273) | – | 273 | – |
| Segment loss | \$ (50,397) | \$ (20,199) | \$ (20,055) | \$ – | (90,651) |
| Income and other tax recovery | | | | | (39,225) |
| Net loss | | | | | \$ (51,426) |

Notes to Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

5. Investments

| | September 30, 2010 | | December 31, 2009 | |
|----------------------------------|---------------------------|-------------------|---------------------------|-------------------|
| | (Shares/Units) (000's) | | (Shares/Units) (000's) | |
| Equity accounted investments: | | | | |
| Trilogy Energy Corp. ("Trilogy") | 24,144 | \$ 106,893 | 23,995 | \$ 104,472 |
| MGM Energy Corp. ("MGM Energy") | 43,834 | 5,555 | 43,834 | 5,876 |
| Paxton Corporation | 1,750 | 4,399 | 1,750 | 4,574 |
| Other | | 3,744 | | 4,280 |
| | | 120,591 | | 119,202 |
| Available-for-sale investments: | | | | |
| MEG Energy Corp. ("MEG") | 3,700 | 132,645 | 3,700 | 101,750 |
| NuLoch Resources Inc. | 6,579 | 8,224 | 6,579 | 5,921 |
| Other | | 7,665 | | 7,713 |
| | | \$ 269,125 | | \$ 234,586 |

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

| Three months ended September 30 | 2010 | | | 2009 | | |
|---|-------------------------|------------------|-----------------|-------------------------|------------------|-------------------|
| | Equity income (loss) | Dilution gain | Total | Equity income (loss) | Dilution loss | Total |
| Trilogy | \$ (1,261) | \$ – | \$ (1,261) | \$ (4,533) | \$ – | \$ (4,533) |
| MGM Energy | (198) | – | (198) | (246) | – | (246) |
| Paxton Corporation | (55) | – | (55) | (81) | – | (81) |
| Other | 547 | – | 547 | 343 | – | 343 |
| | \$ (967) | \$ – | (967) | \$ (4,517) | \$ – | (4,517) |
| Reclassification of accumulated gains from OCI | | | – | | | 3,193 |
| | | | \$ (967) | | | \$ (1,324) |

| Nine months ended September 30 | 2010 | | | 2009 | | |
|---|-------------------------|------------------|------------------|-------------------------|-------------------|--------------------|
| | Equity income (loss) | Dilution gain | Total | Equity income (loss) | Dilution loss | Total |
| Trilogy | \$ 3,526 | \$ 4,109 | \$ 7,635 | \$ (13,140) | \$ – | \$ (13,140) |
| MGM Energy | (708) | 209 | (499) | (856) | (1,500) | (2,356) |
| Paxton Corporation | (174) | – | (174) | (242) | – | (242) |
| Other | 547 | – | 547 | 343 | – | 343 |
| | \$ 3,191 | \$ 4,318 | 7,509 | \$ (13,895) | \$ (1,500) | (15,395) |
| Reclassification of accumulated gains from OCI | | | 3,499 | | | 3,193 |
| | | | \$ 11,008 | | | \$ (12,202) |

In January 2010, Paramount participated in Trilogy Energy Trust's distribution reinvestment plan ("DRIP"), acquiring an additional 0.1 million units (nine months ended September 30, 2009 – 1.2 million units) for \$1.2 million.

On February 5, 2010, Trilogy Energy Trust converted from an income trust to a corporation, named Trilogy Energy Corp., through a business combination with a private company. Paramount's 24.1 million Trilogy Energy Trust units (as of February 5, 2010) were converted into 12.8 million common shares of Trilogy Energy Corp., which are

Notes to Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

pledged as security for Paramount's US Senior Notes, and 11.3 million non-voting shares of Trilogy Energy Corp. The non-voting shares convert to common shares on a one-for-one basis if: i) beneficial ownership of the non-voting shares are transferred to any person that is not related to or affiliated with Paramount; or ii) Trilogy exercises its right to convert the non-voting shares to common shares. As a result of the conversion, Paramount recognized a dilution gain of \$4.1 million. Following the DRIP and conversion, Paramount owned approximately 21 percent of Trilogy's equity (21.7 percent at December 31, 2009) and approximately 15 percent of its voting shares.

In the third quarter of 2010, MEG completed an initial public offering of its common shares on the Toronto Stock Exchange. As a result, Paramount's investment in 3.7 million common shares of MEG, previously carried at \$27.50 per share, was adjusted to the September 30, 2010 closing price of \$35.85 per share, resulting in an unrealized gain of \$30.9 million being recorded in accumulated other comprehensive income.

6. Drilling Rig Loan

At September 30, 2010, \$28.4 million was outstanding on the drilling rig loan. Unless demanded by the bank, the remaining annual scheduled principal repayments are as follows: December 2010 - \$1.5 million; 2011 - \$4.0 million; 2012 - \$5.1 million; 2013 - \$5.1 million and 2014 - \$12.7 million.

7. Long-Term Debt

| | September 30, 2010 | December 31, 2009 |
|---|--------------------|-------------------|
| Canadian Dollar Denominated Debt | | |
| Bank credit facility | \$ 111,266 | \$ - |
| U.S. Dollar Denominated Debt | | |
| 8 ½ percent US Senior Notes due 2013 (US\$90.2 million) | 92,878 | 94,394 |
| | 204,144 | 94,394 |
| Unamortized debt financing costs | (546) | (739) |
| | \$ 203,598 | \$ 93,655 |

Bank Credit Facility

In April 2010, Paramount renewed its credit facility with the borrowing base and lender commitments remaining at \$125 million. The credit facility is available on a revolving basis to April 30, 2011 and can be extended a further 364 days upon request, subject to approval by the lenders. In the event the revolving period is not extended, the credit facility would be available on a non-revolving basis for an additional year, at which time it would be due and payable. In July 2010, the borrowing base and lender commitments under the credit facility were increased from \$125 million to \$160 million.

Paramount had undrawn letters of credit outstanding totalling \$16.7 million at September 30, 2010 that reduce the amount available under the credit facility.

Notes to Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

8. Asset Retirement Obligations

| | Nine months ended September 30, 2010 | Twelve months ended December 31, 2009 |
|---|---|--|
| Asset retirement obligations, beginning of period | \$ 103,462 | \$ 87,237 |
| Liabilities incurred | 3,097 | 2,693 |
| Liabilities settled | (2,657) | (4,050) |
| Disposal of properties | (327) | (88) |
| Accretion expense | 6,713 | 8,603 |
| Revision in estimated costs of abandonment | – | 9,334 |
| Assumed on Redcliffe acquisition | 4,581 | – |
| Foreign exchange | (60) | (267) |
| Asset retirement obligations, end of period | \$ 114,809 | \$ 103,462 |

9. Share Capital

Normal Course Issuer Bid

In November 2008, Paramount received regulatory approval under Canadian securities laws to purchase Common Shares under a Normal Course Issuer Bid ("NCIB"), commencing November 20, 2008 for a twelve month period. Under the NCIB, Paramount was permitted to purchase for cancellation up to 3,387,456 Common Shares. For the nine months ended September 30, 2009, Paramount purchased 615,600 Common Shares under the NCIB for \$4.2 million, of which \$2.8 million was charged to share capital and \$1.4 million was charged to retained earnings.

In April 2010, Paramount received regulatory approval under Canadian securities laws to purchase Common Shares under a NCIB (the "2010 NCIB") commencing April 13, 2010 for a twelve month period. Under the 2010 NCIB, Paramount is permitted to purchase for cancellation up to 3,626,476 Common Shares. No shares have been purchased to November 1, 2010.

Paramount has incurred sufficient qualifying expenditures to satisfy its commitment associated with the flow-through shares issued in October and November 2009.

Weighted Average Shares Outstanding

| (thousands of common shares) | Three months ended September 30 | | Nine months ended September 30 | |
|--|------------------------------------|--------|-----------------------------------|--------|
| | 2010 | 2009 | 2010 | 2009 |
| Weighted average common shares outstanding – Basic and diluted | 72,439 | 65,947 | 72,355 | 66,103 |

Notes to Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

10. Stock-Based Compensation

Paramount Options

| | Nine months ended September 30, 2010 | | Year ended December 31, 2009 | |
|------------------------------------|--------------------------------------|-----------|---------------------------------|-------------|
| | Weighted Average Exercise Price | Number | Weighted Average Exercise Price | Number |
| | (\$/share) | | (\$/share) | |
| Balance, beginning of period | \$ 8.61 | 4,571,500 | \$ 14.48 | 6,117,700 |
| Granted | 19.85 | 64,000 | 9.73 | 2,344,000 |
| Exercised | 7.88 | (368,500) | 7.89 | (121,500) |
| Cancelled or surrendered | 8.72 | (118,000) | 18.86 | (3,768,700) |
| Balance, end of period | \$ 8.84 | 4,149,000 | \$ 8.61 | 4,571,500 |
| Options exercisable, end of period | \$ 7.34 | 840,334 | \$ 7.51 | 1,208,834 |

11. Financial Instruments and Risk Management

Risk management financial instruments outstanding at September 30, 2010 are as follows:

| Instruments | Total Notional | Average Fixed Price | Fair Value | Remaining Term |
|----------------------|----------------|---------------------|------------|----------------|
| Gas – AECO Sales | 30,000 GJ/d | CAD \$5.53/GJ | \$ 2,016 | October 2010 |
| Gas – AECO Purchases | (15,000) GJ/d | CAD \$3.87/GJ | (235) | October 2010 |
| | | | \$ 1,781 | |

The changes in fair values of risk management assets and liabilities are as follows:

| | Nine months ended September 30, 2010 | | | Year ended December 31, 2009 | | |
|---------------------------------|--------------------------------------|------------------|----------|------------------------------|------------------|-----------|
| | Commodity | Foreign Exchange | Total | Commodity | Foreign Exchange | Total |
| Fair value, beginning of period | \$ 2,187 | \$ – | \$ 2,187 | \$ 9,807 | \$ 9,883 | \$ 19,690 |
| Changes in fair value | 10,743 | – | 10,743 | 5,277 | 2,322 | 7,599 |
| Settlements (received) | (11,149) | – | (11,149) | (12,897) | (12,205) | (25,102) |
| Fair value, end of period | \$ 1,781 | \$ – | \$ 1,781 | \$ 2,187 | \$ – | \$ 2,187 |

Paramount has an outstanding commitment to sell 3,400 GJ/d of natural gas at \$2.73/GJ plus an escalation factor to 2011, which had a fair value loss of \$0.2 million at September 30, 2010 (December 31, 2009 – loss of \$4.1 million). The Company has designated this contract as normal sales exception, and as a result, does not recognize the fair value of the contract in the Consolidated Financial Statements.

Notes to Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

12. Income Taxes

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

| | Nine months ended September 30 | |
|--|--------------------------------|-------------|
| | 2010 | 2009 |
| Loss before tax | \$ (97,430) | \$ (90,651) |
| Effective Canadian statutory income tax rate | 28.12 % | 29.15% |
| Expected income tax recovery | \$ (27,397) | \$ (26,425) |
| Increase (decrease) resulting from: | | |
| Statutory and other rate differences | (12,227) | 642 |
| Non-taxable portion of gain | (467) | (3,906) |
| Income from investments and other | (6,070) | (1,160) |
| De-recognition of future tax assets | 753 | 3,213 |
| Stock-based compensation | 5,907 | 3,918 |
| Change in estimates | (10,973) | (14,292) |
| Other | (14) | (1,215) |
| Income and other tax recovery | \$ (50,488) | \$ (39,225) |

13. Consolidated Statements of Cash Flows – Selected Information

Items not involving cash

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|------------------------------------|-----------|-----------------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Financial commodity contracts | \$ 4,409 | \$ 272 | \$ 406 | \$ 10,079 |
| Stock-based compensation | 8,061 | 13,574 | 23,043 | 13,979 |
| Depletion, depreciation and accretion | 47,728 | 31,000 | 132,673 | 97,975 |
| Gain on sale of property, plant and equipment | 361 | 165 | 191 | 127 |
| Foreign exchange | (2,439) | (6,394) | (1,206) | (14,018) |
| Distributions in excess of equity earnings and dilution | 3,502 | 6,844 | – | 26,879 |
| Equity earnings in excess of distributions | – | – | (757) | – |
| Future income tax | (36,999) | (7,068) | (50,500) | (38,620) |
| Other | 269 | (508) | 421 | (146) |
| | \$ 24,892 | \$ 37,885 | \$ 104,271 | \$ 96,255 |

Supplemental cash flow information

| | Three months ended September 30 | | Nine months ended September 30 | |
|----------------------------|------------------------------------|----------|-----------------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Interest paid | \$ 5,556 | \$ 4,995 | \$ 11,088 | \$ 10,823 |
| Current and other tax paid | \$ – | \$ 69 | \$ 35 | \$ 160 |

Notes to Interim Consolidated Financial Statements (Unaudited)

(\$ thousands, except as noted)

Components of cash and cash equivalents

| | September 30, 2010 | December 31, 2009 |
|------------------|---------------------------|-------------------|
| Cash | \$ 22,721 | \$ 23,250 |
| Cash equivalents | – | 69,988 |
| | \$ 22,721 | \$ 93,238 |

14. Subsequent Event

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

This page intentionally left blank.

CORPORATE INFORMATION

OFFICERS

C. H. Riddell

Chairman of the Board and
Chief Executive Officer

J. H.T. Riddell

President and Chief Operating
Officer

B. K. Lee

Chief Financial Officer

E. M. Shier

Corporate Secretary

G. L. Bunio

Corporate Operating Officer

L. M. Doyle

Corporate Operating Officer

G. W. P. McMillan

Corporate Operating Officer

D. S. Purdy

Corporate Operating Officer

J. Wittenberg

Corporate Operating Officer

P. R. Kinvig

Controller

L. A. Friesen

Assistant Corporate Secretary

DIRECTORS

C. H. Riddell⁽³⁾

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

J. H.T. Riddell⁽²⁾

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

J. C. Gorman⁽¹⁾⁽³⁾⁽⁴⁾

Retired
Calgary, Alberta

D. Jungé C.F.A.⁽⁴⁾

Chairman, Chief Executive Officer and President,
Pitcairn Trust Company
Bryn Athyn, Pennsylvania

D. M. Knott⁽⁴⁾

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

T. E. Clausus⁽⁴⁾

President, GMT Capital Corp.
Atlanta, Georgia

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^{(1) (2) (3) (4)}

Independent Businessman
Calgary, Alberta

A. S. Thomson^{(1) (4)}

Retired
Sidney, British Columbia

B. M. Wylie⁽²⁾

Business Executive
Calgary, Alberta

HEAD OFFICE

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

CONSULTING ENGINEERS

McDaniel & Associates**Consultants Ltd.**

Calgary, Alberta

AUDITORS

Ernst & Young LLP

Calgary, Alberta

BANKERS

Bank of Montreal

Calgary, Alberta

The Bank of Nova Scotia

Calgary, Alberta

Royal Bank of Canada

Calgary, Alberta

HSBC Bank Canada

Calgary, Alberta

ATB Financial

Calgary, Alberta

REGISTRAR AND TRANSFER AGENT

Computershare Investor Services

Calgary, Alberta

Toronto, Ontario

STOCK EXCHANGE LISTING

The Toronto Stock Exchange ("POU")

⁽¹⁾ Member of Audit Committee

⁽²⁾ Member of Environmental, Health and Safety Committee

⁽³⁾ Member of Compensation Committee

⁽⁴⁾ Member of Corporate Governance Committee