

COURT FILE NUMBER

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COURT

COURT OF QUEEN'S BENCH OF ALBERTA

JUDICIAL CENTRE

CALGARY

APPLICANT

IN THE MATTER OF THE *COMPANIES'*
CREDITORS ARRANGEMENT ACT, R.S.C.
1985, c. C-36, AS AMENDED

AND IN THE MATTER OF THE *BUSINESS*
CORPORATIONS ACT, R.S.A. 2000, c. B-9

AND IN THE MATTER OF FAIRWEST
ENERGY CORPORATION.

DOCUMENT

**FIRST REPORT OF THE MONITOR
PRICEWATERHOUSECOOPERS INC.**

ADDRESS FOR SERVICE AND
CONTACT INFORMATION OF
PARTY FILING THIS DOCUMENT

BENNETT JONES LLP
Barristers and Solicitors
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INTRODUCTION

- 1) On December 12, 2012 FairWest Energy Corporation (the “Applicant” or “FEC”) applied to this Court for an order under the *Companies’ Creditors Arrangement Act* (the “CCAA”). This Honourable Court made an order on that day granting the relief requested by the Applicant (the “Initial Order”), including:
 - a) an interim stay of proceedings and restraint of certain rights and remedies against the Applicant until and including January 11, 2013, or such later date as this Court may by subsequent order direct (the “Stay Period”);
 - b) a declaration that the Applicant is a company to which the CCAA applies, and authorizing the Applicant to file with the Court, on a date to be set upon further application to this Honourable Court, a Plan of Compromise or Arrangement under the CCAA (the “Plan”); and
 - c) the appointment of PricewaterhouseCoopers Inc. as an officer of the Court to monitor the business and affairs of the Applicant (the “Monitor”).
- 2) Paragraph 24(b) of the Initial Order directs the Monitor to:

“report to this Court at such times and intervals as the Monitor may deem appropriate with respect to matters relating to the Property, the Business, and such other matters as may be relevant to the proceedings herein and immediately report to the Court if in the opinion of the Monitor there is a material adverse change in the financial circumstances of the Applicant.”
- 3) This constitutes the Monitor’s First Report to this Honourable Court contemplated by such provision of the Initial Order. Updates of the proceedings as well as the Monitor’s Report will be posted on the Monitor’s website, www.pwc.com/car-fec.

- 4) Certain information contained in this report is based on information obtained from the Applicant's books and records and discussions with management and staff. The Monitor has not independently verified the accuracy or completeness of such information; accordingly the Monitor does not express an opinion thereon.

MONITORING OF BUSINESS AND FINANCIAL AFFAIRS

- 5) As required by the Initial Order, the Applicant has provided the Monitor with access to its property and to its books, records, data and financial information to enable the Monitor to oversee and assess the Applicant's business and financial affairs.
- 6) The Monitor has, with the cooperation of management, implemented a number of procedures to monitor the Applicant's business and financial affairs and its compliance with the provisions of the Initial Order regarding its property and the carrying on of its business. These procedures include:
- a) review of all disbursements made by the Applicant;
 - b) review of cash receipts; and
 - c) comparison of actual results to the Applicant's financial forecasts.

BACKGROUND INFORMATION

- 7) As set out in the Affidavit of Vernon Fauth dated December 6, 2012 (the "First Fauth Affidavit"), the Applicant is a public corporation, incorporated according to the laws of the Province of Alberta.
- 8) The Applicant is engaged in the exploration for, and the acquisition, development and production of crude oil, natural gas and natural gas liquids (NGL's) reserves in western Canada.

- 9) The primary factor negatively affecting FEC was the downturn in natural gas prices in Alberta. Natural gas prices have been steadily declining from a 2008 high of \$11.35 per mcf to a 2012 low of \$1.66 per mcf. Lower prices resulted in fewer capital expenditures which lead to decreasing production and revenues.
- 10) Due to previous defaults, in December 2012 the Applicant's secured lender at the time sold its debt to Supreme Group Inc. ("SGI"). Prior to the sale, SGI guaranteed the debt owed to the secured lender. SGI is a private company, who is now the largest creditor and shareholder in FEC.
- 11) The Applicant sought CCAA protection to allow it to formally restructure its operations.

CASH FLOWS

- 12) Attached as Exhibit "A" is a copy of the Applicant's cash flow for the period December 12, 2012 to January 4, 2013, compared to the projected cash flow from the First Fauth Affidavit which was filed with this Honourable Court at the time of the CCAA filing ("Initial Cash Flow"). A summary of the variance to the projected cash flow is provided in the following table:

FEC - budget to actual	Forecast	Actual	Difference
Receipts	415,716	303,206	(112,510)
Disbursements	1,093,482	276,871	(816,611)
Net Change in cash	(677,766)	26,335	704,101
Opening Cash	-	94,951	94,951
Ending Cash	(677,766)	121,286	799,052

- 13) During the period December 12, 2012 to January 4, 2013, the Applicant did not receive any DIP Funds due to delays surrounding the DIP debt debenture, which were not resolved until January 3, 2013. A formal request for DIP funds was made on January 7, 2013, however no funds have been received as of January 8, 2013.

14) The actual closing cash balance on January 4, 2013 was \$121,000 as compared to the forecasted negative closing cash balance of (\$678,000).

15) Major reasons for the \$799,000 higher than forecasted cash position include:

a) opening cash balance (positive variance of \$95,000) due to a delay of planned “must-pay” expenditures.

b) receipts (negative variance of \$112,510):

i) BP Energy, a counterparty to FEC, has claimed that FEC is in default of its contract with BP Energy. As a result, BP Energy has claimed damages of \$175,000 and withheld \$94,000 relating to November production (December receipts); and

ii) lower production during November due to unplanned shut-ins and stranded product resulted in lower December receipts.

c) disbursements (positive variance of \$816,000):

i) the initial cash-flow projected payments of \$1.1 million which was comprised of operating costs, G&A costs and reorganization costs. The majority of these costs were not paid as no DIP funds have been received as of January 8, 2013;

ii) a total of \$22,000 was paid to eight operators relating to pre-CCAA services provided to ensure continued operations post-CCAA. Management was of the opinion that these payments were necessary in order to preserve the value of the Company’s assets.

16) As of January 4th 2013, the Applicant estimates that it has incurred approximately \$350,000 of post-CCAA obligations which it intends to pay over the course of the following two weeks. Approximately \$171,000 of the total post-CCAA obligations relate to retainers owed to various consultants and professional firms involved in the Company’s proposed reorganization.

REVISED CASH FLOWS

- 17) Attached as Exhibit "B" is a copy of the Applicant's cash flow for the period January 12, 2013 to February 11, 2013 (the "Revised Cash Flow").
- 18) The collections and disbursements included in the Revised Cash Flow appear to be reasonable estimates based on the discussions with management and the Applicant's current production levels.
- 19) The following table summarizes the Revised Cash Flow for the period from January 12, 2013 to February 11, 2013. Based on this Revised Cash Flow, total draws on the DIP (which is authorized to \$700,000) are expected to be approximately \$502,000.

January 12 to February 11, 2013	TOTALS
OPERATIONS	
Oil & Gas Revenue	336,609
Operating Expenses	(273,760)
CASH FLOW FROM OPERATIONS	62,849
CASH EXPENSES	
G&A	(200,861)
Interest	(7,178)
Reorganization Expenses	(111,000)
TOTAL CASH EXPENSES	(319,040)
Change in Cash	(256,191)
Beginning Cash	(245,776)
ENDING CASH BALANCE	(501,967)

- 20) Opening cash on January 7, 2013 was \$121,000. Planned expenditures of \$367,000 during the week of January 7 – 11, 2013 will result in a projected closing cash balance of (\$246,000) on January 11, 2013.

DIP FINANCING

- 21) The Initial Order authorized the Applicant to borrow under a credit facility from the Supreme Group Inc. (the “DIP Lender”) up to a limit of \$700,000 (the “DIP Funds”).
- 22) As of the date of this report, no DIP Funds have been received or utilized.
- 23) Based on the Company’s Revised Cash Flow, the Applicant will not require an increase to the DIP Funds to fund operations before February 11, 2013.

CREDITOR COMMUNICATIONS

- 24) Pursuant to paragraph 43 (i) of the Initial Order, on December 13, 2013 the Monitor sent a notice containing the information prescribed under the CCAA to the Daily Oil Bulletin. The advertisement ran in the Bulletin on December 14 and 19, 2012.
- 25) Pursuant to paragraph 43 (ii) of the Initial Order, on December 14, 2012, the Monitor sent (by ordinary mail) a copy of the letters attached as Exhibit “C” and “D” to each supplier in the Applicant’s payment history. On December 12, 2012, the Monitor posted the Initial Order and the Creditor Listing to the Monitor’s website (www.pwc.com/car-fec) all in accordance with Section 23(1) of the CCAA.
- 26) The Applicant’s financial records estimate that there are approximately 440 creditors with claims totaling approximately \$16.6 million.

FEC’S REQUEST FOR AN EXTENSION OF THE STAY

- 27) The Initial Order provided the Applicant with a stay until January 11, 2013. FEC has requested an additional 31 day stay to February 11, 2013 (the “Stay Extension”).
- 28) The Stay Extension is necessary to allow FEC sufficient time to;
- a) continue the evaluation of its assets and opportunities; and

b) potentially formulate a plan of arrangement under CCAA; and

29) It is the view of the Monitor that FEC is acting in good faith and with due diligence and the requested Stay Extension is reasonable.

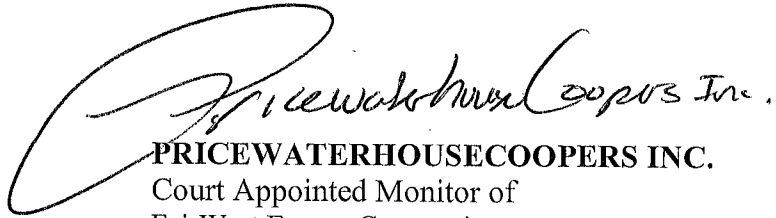
CONCLUSION

30) The Monitor supports the Applicant's request that this Honourable Court:

- a) extend the stay period to February 11, 2013; and
- b) approve the amendment to the commitment letter.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

this 8th day of January, 2013.



PRICEWATERHOUSECOOPERS INC.
Court Appointed Monitor of
FairWest Energy Corporation

EXHIBIT A

FAIRWEST ENERGY CORPORATION
Variance Analysis

December 12 to January 4	Notes	FORECAST	ACTUAL	VARIANCE
OPERATIONS				
Oil & Gas Revenue	1	415,716	303,206	(112,510)
Operating Expenses	1	(341,835)	(105,108)	236,727
CASH FLOW FROM OPERATIONS		73,881	198,098	124,217
CASH EXPENSES				
G&A	2	(278,709)	(171,763)	106,946
Interest	3	(74,937)	-	74,937
Reorganization Expenses	4	(398,000)	-	398,000
TOTAL CASH EXPENSES		(751,647)	(171,763)	579,884
Change in Cash		(677,766)	26,335	704,101
Beginning Cash		-	94,951	94,951
ENDING CASH BALANCE		(677,766)	121,286	799,052

EXHIBIT B

FAIRWEST ENERGY CORPORATION
31 DAY CASH FLOW SUMMARY

	Notes	WEEK 1 JAN 12 - 18	WEEK 2 JAN 19 - 25	WEEK 3 JAN 26 - FEB 1	WEEK 4 FEB 2 - 8	WEEK 5 FEB 9 - 11	Total Jan 12 - Feb 11
OPERATIONS							
Oil & Gas Revenue	1	-	285,536	16,074	35,000	-	336,609
Operating Expenses	1	(1,441)	(224,911)	(31,481)	-	(15,928)	(273,760)
CASH FLOW FROM OPERATIONS		(1,441)	60,625	(15,407)	35,000	(15,928)	62,849
CASH EXPENSES							
G&A	2	(14,559)	-	(186,302)	-	-	(200,861)
Interest	3	-	-	(7,178)	-	-	(7,178)
Reorganization Expenses	4	-	-	(111,000)	-	-	(111,000)
TOTAL CASH EXPENSES		(14,559)	-	(304,481)	-	-	(319,040)
Change in Cash		(16,000)	60,625	(319,887)	35,000	(15,928)	(256,191)
Beginning Cash		(245,776)	(261,776)	(201,151)	(521,039)	(486,039)	(245,776)
ENDING CASH BALANCE		(261,776)	(201,151)	(521,039)	(486,039)	(501,967)	(501,967)

Notes

Management of FEC have prepared this Projected Cash Flow Statement based on probable and hypothetical assumptions detailed in Notes 1-4. Consequently, actual results will likely vary from performance projected and such variations may be material.

The projections have been prepared solely for the Company's CCAA filing. As such, readers are cautioned that it may not be appropriate for other purposes.

1. FEC operates the majority of its interests. Depending on the area, the monthly receipts and operating costs are disclosed as net of partnership interests or on a gross basis.
2. Estimated based on historical trends.
3. Per the DIP financing agreement and the existing credit facility.
4. Estimated based on similar CCAA proceedings.

EXHIBIT C
(See Next Page)



December 14, 2012

NOTICE TO CREDITORS

**In the Matter of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36,
as amended
and in the matter of Fairwest Energy Corporation
(collectively, "FEC" or the "Company")**

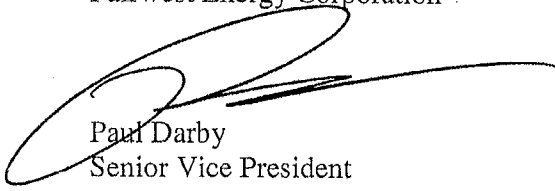
On the 12th day of December, 2012, Fairwest Energy Corporation made an application for protection under the *Companies' Creditors Arrangement Act* ("CCAA") and an Order was granted by the Honourable Justice S.J. Lovecchio of the Court of Queen's Bench of Alberta (the "CCAA Order") and PricewaterhouseCoopers Inc. was appointed Monitor.

The CCAA Order granted the Company various relief, including but not limited to, imposing a stay of proceedings against FEC and its assets, and providing FEC an opportunity to prepare and file a plan of arrangement or compromise under the CCAA for the consideration of its creditors and other stakeholders. Under the CCAA Order, FEC is to continue to carry on business in a manner consistent with the commercially reasonable preservation of its respective businesses and assets. Please be advised that the CCAA Order prohibits the termination of any services currently provided to the Company. Please contact either the Monitor or the Company to discuss any concerns regarding future services.

Copies of the Order are available from the Monitor's website at www.pwc.com/car-fec. Other Court Orders and Reports will be posted to this website during the restructuring and we recommend that creditors who have questions check this website regularly.

If you have any questions or wish to speak to a representative of PricewaterhouseCoopers Inc. please call (403) 509-7382.

PricewaterhouseCoopers Inc.
In its Capacity as Monitor of
Fairwest Energy Corporation



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EXHIBIT D
(See Next Page)



December 13, 2012

To the creditors of FairWest Energy Corporation:

Please be advised that on December 12, 2012, the Court of Queen's Bench of Alberta (the "Court") granted FairWest Energy Corporation ("FairWest" or the "Company") an Initial Order under the *Companies' Creditors Arrangement Act* (the "CCAA") which will allow FairWest time to restructure its affairs.

As most of you are aware, FairWest has faced tremendous challenges over the course of the past year. FairWest's oil and gas production and revenue have continued to decline as a result of the natural depletion of producing wells and the inability of the company to raise sufficient capital to drill its extensive inventory of oil and gas resource prospects.

During this past summer, natural gas prices decreased to levels not seen during the last decade and to date they have not recovered materially. FairWest's producing asset base is predominately natural gas at approximately 70% by volume of production. The Company is faced with significant challenges to generate profits from natural gas production as long as prices remain at current levels. FairWest has been forced to shut in 150 Boe/d of uneconomic natural gas production resulting in a reduction in current production levels to approximately 200 Boe/d or only 60% of the Company's productive capability.

Although FairWest has focused recent efforts on increasing oil production on its lands, the fixed operating costs associated with taxes, surface rentals and third party processing costs have continued to increase. The Company continues to cut costs wherever possible and to pursue opportunities to optimize existing production in order to return to a positive cash flow position.

The Company concluded that the CCAA filing, which provides an opportunity to submit a proposal to our creditors in connection with FairWest's reorganization, was also necessary. The Initial Order provides that until and including January 11, 2013 or such later date as the Court may order, no proceedings may be taken or continued against FairWest or its business or property, except with leave of the Court. This allows time for FairWest to begin to work on restructuring its affairs.

The Company has the support of its principal secured creditor, the Supreme Group Inc., who is also providing debtor-in-possession financing to FairWest while it is operating under the protection of the CCAA. This financing will allow the Company to continue its operations and make payments to its creditors for goods and services provided from and after December 12, 2012.

Thank you for your patience in dealing with FairWest during the past year. We understand that there will be some uncertainty until the Company can announce its restructuring plans. Our goal is to propose a plan, or other restructuring transaction, as quickly as possible that offers a better outcome than would be the case if we were forced to terminate operations and liquidate all of FairWest's assets. We look forward to continuing our relationship with you.

Yours truly,

FAIRWEST ENERGY CORPORATION

Vern Fauth
Chief Executive Officer