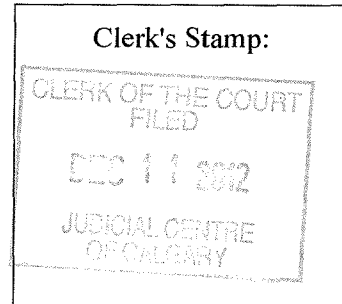


COURT FILE NUMBER 1201-15737
COURT COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE CALGARY
APPLICANT IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED
AND IN THE MATTER OF FAIRWEST ENERGY CORPORATION
DOCUMENT AFFIDAVIT OF VERNON R. FAUTH
SWORN DECEMBER 10, 2012



Burnet, Duckworth & Palmer LLP
2400, 525 – 8 Avenue SW
Calgary, Alberta T2P 1G1

ADDRESS FOR SERVICE AND
CONTACT INFORMATION OF
PARTY FILING THIS DOCUMENT

Lawyer: Carole J. Hunter
Phone Number: (403) 260-0368
Fax Number: (403) 260-0332
Email Address: chunter@bdplaw.com

File No. 71301-1

AFFIDAVIT OF VERNON R. FAUTH
(Sworn December 6, 2012)

I, VERNON R. FAUTH of the City of Calgary, in the Province of Alberta, MAKE
OATH AND SAY:

1. I am the Chairman and Chief Executive Officer of FairWest Energy Corporation ("FairWest" or the "Company"). As such, I have knowledge of the matters hereinafter deposed to, except where stated to be based on information and belief, in which case I have stated the source of the information and believe it to be true.
2. This affidavit is made in support of an application by FairWest for an Order (the "Initial Order") pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c.C-36, as amended (the "CCAA"), among other things:

- (a) Declaring that the Company is one to which the CCAA applies;
- (b) Staying all proceedings and remedies taken or that might be taken in respect of the Company or any of its property, except as otherwise set forth in the Initial Order;
- (c) Authorizing the Company to carry on business in a manner consistent with the preservation of its property and business;
- (d) Appointing PricewaterhouseCoopers Inc. as monitor ("**PWC**" or the "**Monitor**") of the Company in these proceedings;
- (e) Approving the debtor-in-possession commitment letter between the Company and Supreme Group Inc. ("**Supreme**");
- (f) Approving certain charges as set out herein; and
- (g) Deeming service of the Application for the Initial Order to be good and sufficient.

Overview and Corporate Structure

3. FairWest is a corporation formed by the amalgamation of Fairstar Exploration Inc. and Western Energy Corporation under the *Canada Business Corporations Act* on August 18, 2005. FairWest is a reporting issuer in Alberta, British Columbia, Saskatchewan, Ontario and Quebec and is engaged in the exploration for, and the acquisition, development and production of crude oil, natural gas and natural gas liquids ("**NGLs**") reserves in western Canada.

4. FairWest's shares trade on the TSX Venture Exchange under the symbol "**FEC**". The head office of FairWest is located at Suite 800, Canada Place, 407 – 2nd Street S.W., Calgary, Alberta T2P 2Y3. A copy of the Corporate Registry search for FairWest is attached hereto as **Exhibit "A"**.

(a) Oil and Gas Reserves

5. An independent evaluation of FairWest's oil and gas reserves was completed by Sproule & Associates Limited ("**Sproule**") for the year ended December 31, 2011 (the "**Sproule Report**"). The following table sets out a summary of FairWest's oil and gas reserves as at December 31, 2011¹.

¹ The Company has no heavy oil or coalbed methane. Numbers may not add due to rounding.

RESERVE CATEGORY	RESERVES ⁽¹⁾							
	LIGHT AND MEDIUM OIL		NATURAL GAS (non-associated & associated)		NATURAL GAS (solution)		NATURAL GAS LIQUIDS	
	Gross (Mbbbl)	Net (Mbbbl)	Gross (MMcf)	Net (MMcf)	Gross (MMcf)	Net (MMcf)	Gross (Mbbbl)	Net (Mbbbl)
Proved								
Developed Producing	102.0	93.8	1,085	971	136	124	6.7	4.7
Developed Non-Producing	10.2	9.5	448	409	28	27	2.8	1.8
Undeveloped	15.7	15.0	85	77	55	52	1.9	1.3
Total Proved	127.9	118.3	1,619	1,457	219	203	11.4	7.8
Probable	277.7	241.7	1,738	1,577	823	751	25.7	18.2
Total Proved Plus Probable	405.6	360.0	3,357	3,034	1,042	953	37.1	26.0

6. The following table sets out a summary of the value of FairWest's oil and gas reserves as at December 31, 2011 based on forecast prices and costs.

RESERVES CATEGORY	BEFORE INCOME TAXES, DISCOUNTED AT (% /year)				
	0% (M\$)	5% (M\$)	10% (M\$)	15% (M\$)	20% (M\$)
Proved Developed Producing	5,137.7	4,610.3	4,183.5	3,837.5	3,553.8
Proved Developed Non-Producing	1,207.8	981.6	816.9	690.7	590.8
Proved Undeveloped	368.0	228.3	119.0	32.1	(37.6)
Total Proved	6,713.5	5,820.2	5,119.4	4,560.4	4,107.0
Probable Additional	16,431.9	11,917.6	8,805.9	6,583.8	4,946.1
Total Proved Plus Probable Additional	23,145.4	17,737.8	13,925.2	11,144.1	9,053.1

7. As at December 31, 2011, the Sproule Report contained a value for the Company's proved plus probable oil, natural gas and NGLs reserves of \$13.9 million, before income taxes and discounted at 10%. The carrying value of the Company's developed and producing petroleum and natural gas assets as at September 30, 2012 was \$10.3 million based on management's update of the Sproule Report's discounted cash flows using before tax net cash flows based on proved plus probable reserves. The Company is in discussions with Sproule regarding their engagement to commence preparing an updated evaluation of the oil and gas reserves of the Company effective December 31, 2012. This is expected to commence during the first week of January 2013.

(b) *Landholdings*

8. As at December 31, 2011, the Company had 102,470 gross acres (57,431 net) of land, of which 70,779 gross acres (39,061 net) are developed. Undeveloped land encompasses 31,691 gross acres (18,370 net), of which approximately 90% are unproved with no attributed reserves. The following table sets out the Company's consolidated land holdings by area as at December 31, 2011.

PROPERTY	AVERAGE WORKING INTEREST	GROSS ACRES	NET ACRES
Alberta			
Kirkpatrick/Youngstown	69.6	32,014	22,286
Provost/Neutral Hills	39.8	31,628	12,585
Berry Creek	37.0	10,400	3,849
Antelope	56.8	13,920	7,905
Other	67.8	4,795	3,249
Total Alberta	53.8	92,757	49,874
Saskatchewan			
Burstall	81.6	9,066	7,396
Other	24.9	647	161
Total Saskatchewan	77.8	9,713	7,557
Total	56.1	102,470	57,431

(c) *Properties*

(i) Kirkpatrick Lake/Youngstown, Alberta

9. The Company owns various working interests in approximately 32,014 acres (22,286 net) of land located north of Youngstown, Alberta. As at December 31, 2011, total proved plus probable reserves valued at \$0.83 million have been estimated for this property. The property produced 143,577 Mcf of gas and 1,692 barrels of oil and NGLs for a total of 25,622 barrels of oil equivalent during the nine months ended September 30, 2012, representing 34.6% of the Company's total production.

(ii) Provost/Neutral Hills, Alberta

10. Provost/Neutral Hills is located north of Veteran, Alberta. FairWest's Provost area covers 31,628 gross acres (12,585 net) of land and includes properties at Ribstone, Neutral Hills and various properties in the Provost Field. As at December 31, 2011, total proved plus probable reserves of \$5.1 million have been estimated for this area. Approximately \$3.5 million of this value is attributed to the Neutral Hills property. Production from this area totaled 81,962 Mcf of gas and 10,849 barrels of oil and NGLs for a total of 24,509 barrels of oil equivalent during the nine months ended September 30, 2012, representing 33.1% of total production.

(iii) Berry Creek, Alberta

11. Berry Creek is located near the town of Cessford, Alberta. The Company owns various working interests in 10,400 gross acres (3,849 net) of land in this area, which contains several producing oil and gas wells and a number of identified drilling locations. The Company owns a 60% working interest in the Berry Creek gas plant with processing capacity of 8.5 MMscf/day of natural gas. The plant process includes refrigeration and the Company extracts approximately 18 barrels of NGLs per million cubic feet of natural gas throughput. Ownership of this gas plant provides for third party processing fee

revenue. As at December 31, 2011, total proved plus probable reserves valued at \$5.8 million have been estimated for this area. Production from this area totaled 41,288 Mcf of gas and 3,620 barrels of oil and NGLs for a total of 10,501 barrels of oil equivalent during the nine months ended September 30, 2012, representing 14.2% of total production.

Employees and Senior Management

12. FairWest currently employs 15 full-time employees and its senior management is currently made up of the following individuals:

- (a) Vernon Fauth - Chief Executive Officer;
- (b) Douglas McNichol - President and Chief Operating Officer;
- (c) Marion Mackie - Chief Financial Officer;
- (d) Michael Lambros - Vice President, Land;
- (e) Darlene Zeck - Vice President, Administration; and
- (f) Philip Rodd - General Manager, Exploration.

Indebtedness

(a) *Bank of Montreal*

13. On February 24, 2012, FairWest entered into an agreement with Bank of Montreal ("BMO"), pursuant to which BMO provided FairWest with a \$7,000,000 demand revolving credit facility, including a \$30,000 corporate Mastercard sublimit and a \$250,000 letter of credit/letter of guarantee sublimit (the "**Credit Agreement**"). The Credit Agreement is secured by, among other things, (i) a general security agreement which creates a security interest over all of the present and after-acquired property of FairWest, and (ii) a \$7,000,000 guarantee from Supreme.

14. Pursuant to a Debt and Security Assignment Agreement dated as of December 10, 2012, BMO (with the consent of FairWest) sold and assigned to Supreme all of BMO's right, title and interest in and to, the Credit Agreement, all of the indebtedness and liability owing by FairWest to BMO pursuant to or in respect of the Credit Agreement (the "**Indebtedness**") and the security and other documents delivered to BMO by and at the request of FairWest in connection with the Indebtedness.

15. As at December 9, 2012, the amount outstanding under the Credit Agreement was \$7,040,221.86, including a zero balance on the corporate Mastercard and \$367,717.19 in respect of outstanding letters of credit.

(b) Debenture Holders

16. On November 27, 2007, FairWest entered into a debenture agreement for the issuance of \$2.0 million of Series 1, 14% secured subordinated convertible debentures with certain debenture holders (the "**Series 1 Debentures**"). In 2009, \$0.25 million of Series 1 Debentures were paid out and the initial maturity date of October 31, 2009 for the remaining outstanding \$1.75 million of Series 1 Debentures was extended on two occasions to a current maturity date of November 27, 2012. In 2011, holders of \$0.58 million of Series 1 Debentures elected to convert to FairWest common shares. The remaining outstanding \$1.17 million of Series 1 Debentures matured on November 27, 2012 and FairWest was unable to repay the principal and accrued interest in the amount of \$13,000 owing to the debenture holders.

17. On December 31, 2009, FairWest entered into a trust indenture for the issuance of Series 2, 14% secured subordinated convertible redeemable debentures with Olympia Trust Company (the "**Series 2 Debentures**"). FairWest issued 5,500 debenture units for total proceeds of \$5.5 million in 2009 and 2010. The initial December 31, 2011 maturity date of the Series 2 Debentures was extended on two occasions to the final maturity date of December 31, 2012. In 2011, holders of \$2.0 million of Series 2 Debentures elected to convert to common shares, reducing the outstanding amount to \$3.5 million. FairWest was unable to pay the interest in the amount of \$41,000 due to the outstanding Series 2 Debentures on December 7, 2012. The outstanding Series 2 Debentures mature on December 31, 2012 and FairWest anticipates it will be unable to repay the \$3.5 million of principal and accrued interest in the amount of \$41,000 owing to the debenture holders on that date.

(c) Trade Payables and Statutory Remittances

18. In addition to the secured indebtedness, FairWest has approximately \$6.7 million in trade debt. A number of the trade creditors have registered liens against FairWest's property interests, threatened to cut off supply and some have refused to supply as a result of outstanding obligations owing to such creditors by FairWest.

19. As of the date hereof, all obligations owing by FairWest to Canada Revenue Agency (for payroll deductions and goods, services taxes and corporate taxes), employees (other than accrued holiday pay and banked overtime), Workers' Compensation and Alberta and Saskatchewan provincial taxes are current.

Financial Position

(a) Assets

20. Attached hereto and marked as **Exhibits "B"** and **"C"** respectively are the unaudited financial statements for the nine month period ended September 30, 2012 and the audited financial statements for the twelve month period ended December 31, 2011.

21. In general, the Company's assets as at September 30, 2012 were comprised of \$2.8 million of current assets and \$14.2 million of non-current assets, as follows:

- (a) Cash and cash equivalents of \$32,000;
- (b) Accounts receivable of \$2.6 million;
- (c) Prepaid expenses of \$192,000;
- (d) Property, plant and equipment of \$10.6 million;
- (e) Exploration and evaluation assets of \$3.6 million; and
- (f) Investments in associates of \$24,000.

22. The approximate balance owing to creditors of the Company as at September 30, 2012 was approximately \$23.6 million, comprised of:

- (a) Accounts payable and accrued liabilities of \$6.0 million;
- (b) Amounts owing under the bank loan of \$6.4 million;
- (c) Amounts owing under a finance lease and loan of \$365,000;
- (d) Amounts owing under the Series 1 Debentures and Series 2 Debentures of \$4.7 million;
- (e) Decommissioning liabilities of \$5.8 million (non-cash); and
- (f) Flow-through share premium liabilities of \$377,000 (non-cash).

23. The Company is currently in a position that it is unable to pay its obligations generally as they become due and is therefore insolvent. The proposed CCAA proceedings are intended to allow the Company an opportunity to pursue a sale or recapitalization in order to maximize the recovery for all stakeholders.

Events Leading to this Application

24. On May 23, 2007, in an attempt to grow its oil and gas operations, FairWest acquired 100% of the issued and outstanding shares of Strike Petroleum Ltd. ("**Strike**"), a corporation incorporated under the *Business Corporations Act* (Alberta) and engaged in the exploration for, and the acquisition, development and production of crude oil, natural gas and NGLs reserves in western Canada. The acquisition of Strike was effected through a plan of arrangement involving Strike and the shareholders and option holders of Strike and certain creditors of Strike and FairWest (the "**Strike Arrangement**"). Strike was listed on the TSX Venture Exchange under the symbol "SPP". Strike's properties were located in east central Alberta at Kirkpatrick Lake and Youngstown; areas which were a focus for FairWest.

25. The \$23.0 million Strike Arrangement included the assumption of \$16 million of debt and working capital deficiency and \$2.0 million of abandonment liabilities by FairWest. The Strike properties required significant capital expenditures to restore production to the levels that existed in January 2007 when FairWest entered into its purchase agreement with Strike. During 2007, FairWest spent \$11.0 million (net of \$4.7 million of asset sales) by way of capital expenditures, in addition to the Strike Arrangement. As at December 31, 2007, FairWest had a consolidated working capital deficiency of \$23.2 million, not including \$2.0 million of outstanding Series 1 Debentures. Of the total \$23.2 million of consolidated working capital deficiency, \$11.1 million related to Strike of which Strike's secured lender held \$10.6 million and arranged creditors held \$0.5 million.

26. Following the closing of the Strike Arrangement, FairWest realized that the expectations contained in Strike's independent engineering report were not realistic and the expected reserves and production were not capable of being realized. FairWest expected to add 500 Boe/d of production from the Strike properties and with the additional expenditure of \$1.43 million expected to increase production from the properties to 850 Boe/d by the end of 2007. In contrast, actual production from the Strike properties averaged only 275 Boe/d during the second quarter of 2007, declining to only 229 Boe/d at year end and averaging only 184 Boe/d in 2008. The value of Strike's oil and gas assets was less than the amount of its outstanding secured debt. On August 19, 2008, FairWest acquired Strike's secured indebtedness from its lender for \$4.25 million and 5.0 million FairWest units (each unit was comprised of one common share issued at \$0.15 and one warrant exercisable at \$0.20). On December 31, 2009, Strike was dissolved and the assets and results of operations were distributed to FairWest. The Strike Arrangement had a significant negative impact on FairWest's financial position and the impact of the transaction is still being felt today.

27. In 2008, FairWest spent \$5.0 million (net of a \$4.8 million sale of assets) and achieved production of 856 Boe/d during its first quarter. Production decreased over the remainder of 2008 ending the year at 694 Boe/d. Poor performance from the properties acquired in the Strike Arrangement, marginal drilling results, a steep decline in natural gas prices and a high administrative and operating cost structure along with a secured lender exerting pressure on FairWest to reduce its debt levels, left FairWest in a precarious financial position. As at December 31, 2008, FairWest's obligations totaled \$21.1 million, (including \$11.6 of bank debt and \$2.0 million of outstanding Series 1 Debentures), \$2.1 million of outstanding preferred shares and \$0.3 million of leases and loans payable. FairWest incurred a net loss of \$8.9 million for the year.

28. The financial position of FairWest resulted in a financial covenant default in early 2009 with its secured lender and the lender requested a significant reduction of its outstanding credit facility. FairWest entered into a forbearance agreement with its lender and commenced restructuring efforts through the sale of \$8.6 million of assets, including sales of assets to related party limited partnerships, further sales of Series 2 Debentures in the amount of \$1.4 million, the issuance of \$1.7 million of equity and a restriction of capital expenditures. FairWest drilled only one well (0.9 net) in 2009. As at December 31, 2009, FairWest had decreased its obligations to \$15 million including \$6.6 million of bank debt, \$3.2 million of working capital deficiency (excluding bank debt), \$3.1 million of Series 1 Debentures and Series 2 Debentures and \$2.1 million of preferred shares. FairWest incurred a net loss of \$10.3 million for the year.

29. Through to July 2010, FairWest operated under forbearance agreements which saw its indebtedness to its secured lender paid off and it entered into loan agreements with a new lender partially secured by a guarantee from a significant shareholder. The Company continued its efforts to raise funds through the sale of equity, further sales of Series 2 Debentures and the sale of assets. Overall capital spending in 2010 was limited to \$2.0 million (net of \$2.0 million of property dispositions) and only three (1.4 net) wells were drilled late in the year. As a result of the on-going natural depletion of producing wells, production declined to 412 Boe/d at year end. As at December 31, 2010, FairWest had total obligations of \$15.45 million including \$2.5 million of bank debt, \$3.6 million of working capital deficiency (excluding bank debt and preferred shares), \$7.25 million of outstanding Series 1 Debentures and Series 2 Debentures and \$2.1 million of preferred shares. In addition, FairWest incurred a net loss of \$15.5 million and negative cash flow from operations of \$4.0 million for the year.

30. During 2011, holders of \$2.5 million of the Series 1 Debentures and Series 2 Debentures elected to convert to common shares, reducing the Company's long term debt. On March 11, 2011,

FairWest converted all of its preferred shares to common equity as per amended terms of conversion. FairWest also raised funds required for its continued operations through flow-through share equity and common equity for net proceeds of \$5.2 million. In 2011, FairWest entered into two farm-out agreements in the Provost and Kirkpatrick Lake areas of Alberta which resulted in three successful horizontal Viking wells drilled at Provost and five unsuccessful horizontal Viking wells drilled at Kirkpatrick Lake. The eight wells were drilled at no cost to the company however, only the three wells (0.96 net) drilled at Provost provided incremental production for the Company. Total Company production at year-end 2011 was 311 Boe/d. As at December 31, 2011, FairWest's obligations totaled \$11.5 million including \$4.8 million of bank debt, \$2.0 million of working capital deficiency (excluding bank debt and debentures payable) and \$4.7 million of Series 1 Debentures and Series 2 Debentures. In addition, FairWest incurred a net loss of \$2.9 million and negative cash flow from operations of \$4.1 million for the year.

31. In December 2011, the Company's lender gave a verbal indication that the Company would be required to repay all amounts outstanding on its \$7.5 million demand loan facility in early 2012. In January 2012, the Company received formal notice from its lender of the requirement to repay its credit facility. The Company had recently closed the sale of \$2.3 million of flow-through shares in December 2011 and representatives of the lender verbally agreed to allow these funds to be directed towards drilling activity. FairWest commenced drilling a horizontal well at Berry Creek in January 2012. As of January 17, 2012, the lender reduced the availability under the loan facility by \$1.35 million to \$6.15 million.

32. In February 2012, FairWest entered into a new credit facility with BMO in the amount of \$7.0 million. As set out above, the new credit facility is secured by a general security agreement and a \$7.0 million guarantee from Supreme, an affiliate of a significant shareholder. The new credit facility was used to payout in full the credit facility with the previous lender. The Company raised \$2.1 million of common and flow-through equity for general working capital purposes and various development projects. Efforts to raise capital in a poor market for junior companies proved to be extremely difficult. 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. Only one well (0.75 net) was drilled by the Company in early 2012. Initial encouragement that the well would be a commercial producer was met with disappointment and the decision was subsequently made to abandon the well.

33. 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 operating costs continue to increase. For example, processing and transportation fees levied by a third party processor for the

Company's gas at Kirkpatrick Lake have more than doubled over the past year as a result of their increased maintenance costs and reduced throughput volumes. FairWest also generates small levels of production volumes from a large number of wells on its legacy properties. This has the effect of increasing per unit operating costs due to the cost of maintaining many wells located over a widespread area. In the summer of 2012, spot 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 with approximately 70% natural gas by volume of production. FairWest is faced with significant challenges to generate profits from natural gas production as long as natural gas prices remain at their current levels.

34. The Company's production rate in 2012 has averaged 271 Boe/d as at September 30, 2012. FairWest has been forced to shut in an additional 70 Boe/d of uneconomic natural gas production at Kirkpatrick Lake, Alberta at the end of November 2012 increasing its total shut in natural gas production to 150 Boe/d. This has resulted in a reduction in current production levels to approximately 200 Boe/d or only 60% of the Company's productive capability. As at September 30, 2012, FairWest's obligations totaled \$14.4 million including \$6.4 million of bank debt, \$3.4 million of working capital deficiency and \$4.6 million of Series 1 Debentures and Series 2 Debentures. In addition, FairWest incurred a net loss of \$15.2 million and negative cash flow from operations of \$4.1 million for the nine month period.

Cash Flow Projections and the Restructuring

35. Attached as **Exhibit "D"** hereto as the cash flow projections for FairWest (the "**Cash Flow Projections**") for the 30 day period ending January 11, 2013. Based on my knowledge of the financial position of the Company, and based on the assumptions set out in the Cash Flow Projections, I verily believe that they are fair and reasonable.

36. FairWest's management has worked with the proposed Monitor to prepare the Cash Flow Projections. The proposed Monitor has made certain suggestions about the Cash Flow Projections, which have been incorporated therein, and the proposed Monitor has not expressed any concern over the reasonableness of the Cash Flow Projections.

37. The Cash Flow Projections highlight FairWest's need for debtor-in-possession ("**DIP**") financing based on a projected shortfall of approximately **\$694,366.00**. To address this matter, FairWest has negotiated a commitment letter dated December 10, 2012 with Supreme for a demand DIP facility in

the maximum amount of \$700,000.00 (the "**Commitment Letter**"). The Commitment Letter also includes the following terms:

- (a) interest calculated at the BMO prime rate plus 10% per annum;
- (b) a maturity date of January 11, 2013; and
- (c) security to include a charge ranking in priority to all charges set out in the Initial Order except the Administration Charge (as hereinafter defined).

A copy of the Commitment Letter is attached hereto as **Exhibit "E"**

38. FairWest requires that the DIP facility contemplated under the Commitment Letter in order to continue its operations and meet its post-filing obligations in the ordinary course.

39. FairWest has the confidence and support of its major lender, Supreme. It is also FairWest's position that none of its creditors will be materially prejudiced as a result of the granting of a DIP charge against FairWest's assets. Rather, the provision of the DIP facility will enable FairWest to continue its operations and meet its post-filing obligations and will enhance the prospects of a viable compromise or arrangement being made in respect of FairWest.

40. Based on the Cash Flow Projections and other financial information set out herein, I believe that given a reasonable period of time to reorganize the financial affairs of the Company that there is a reasonable prospect that the Company will be able to file a viable Plan of Arrangement.

The Proposed Monitor

41. I believe that PWC is qualified and competent to act as Monitor of FairWest in these CCAA proceedings. PWC is not the auditor of FairWest. Attached hereto as **Exhibit "F"** is a copy of the Consent to Act as Monitor signed by PWC.

Administration Charge and Directors' & Officers' Charge

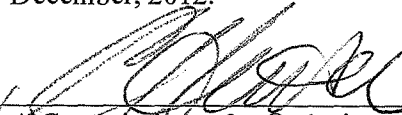
42. The Initial Order contemplates that an Administration Charge be granted in the sum of \$200,000 as a first priority charge against the assets of FairWest as security for the professional fees and disbursements incurred by the Monitor, legal counsel to the Monitor and FairWest's legal counsel, both prior to and after the making of any Initial Order (the "**Administration Charge**"). These professional advisors require the Administration Charge as security for their fees and without their continued involvement FairWest would not be able to restructure its affairs.

43. Similarly, in response to concerns that directors and officers may be exposed to liability during the restructuring for which they would otherwise be entitled to indemnification from the Applicants and which may not be covered by Directors' and Officers' insurance, the proposed Initial Order contains a charge in favour of directors, officers, and people of a similar position with FairWest in the amount of \$200,000 (the "**Directors' Charge**"). FairWest requires these individuals to continue as directors and officers to ensure continuity and preserve value for the stakeholders.

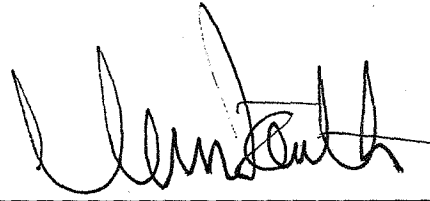
Relief Requested

44. I swear this affidavit in support of the Company's application for an Initial Order under the CCAA, and for no other or improper purpose.

SWORN BEFORE ME at the City of Calgary, in
the Province of Alberta, this 10th day of
December, 2012.



A Commissioner for Oaths in and for the Province
of Alberta

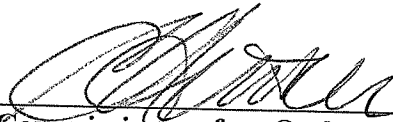


VERNON R. FAUTH

CAROLE J. HUNTER
Barrister & Solicitor

**THIS IS EXHIBIT "A" REFERRED TO IN
THE AFFIDAVIT OF VERNON R. FAUTH**

**SWORN BEFORE ME THIS 10TH DAY OF
DECEMBER, 2012.**



**As Commissioner for Oaths in and for the
Province of Alberta**

CAROLE J. HUNTER
Barrister & Solicitor



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Corporation Number

4321812

Business Number (BN)

869206755RC0003

Governing Legislation

Canada Business Corporations Act - 2005-08-18

Corporate Name

FairWest Energy Corporation

Status

Active

Registered Office Address

407 - 2 Street SW
Suite 800
CALGARY AB T2P 2Y3
Canada

Active CBCA corporations are required to [update this information](#) within 15 days of any change.

Directors

Minimum	Maximum
3	15

Directors

VERN FAUTH
SEAN CONRAD FAUTH
DOUGLAS O. MCNICHOL
CARL M. RAVINSKY
DAVID STEWART KELCHER

To obtain addresses of directors, [contact Corporations Canada](#) by email or fax.

Active CBCA corporations are required to [update this information](#) within 15 days of any change.

Annual Filings**Anniversary Date (MM-DD)**

08-18

Date of Last Annual Meeting

2012-07-04

Annual Filing Period (MM-DD)

08-18 to 10-17

Type of Corporation

Distributing corporation

Status of Annual Filings

2012 - Filed

2011 - Filed

2010 - Filed

Corporate History

Corporate Name History

2005-08-18 to Present FairWest Energy Corporation

Certificates and Filings

Certificate of Amalgamation

2005-08-18 Corporations amalgamated:

- 4321804 WESTERN ENERGY CORPORATION
- 1888846 FAIRSTAR EXPLORATIONS INC. / EXPLORATIONS FAIRSTAR INC.

Certificate of Amendment *


2008-12-23 Amendment details: Other

Certificate of Amendment *

2011-01-20 Amendment details: Other

* Amendment details are only available for amendments effected after 2010-03-20. Some certificates issued prior to 2000 may not be listed. For more information, [contact Corporations Canada](#).

Date Modified: 2012-10-24


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[Terms and conditions](#)

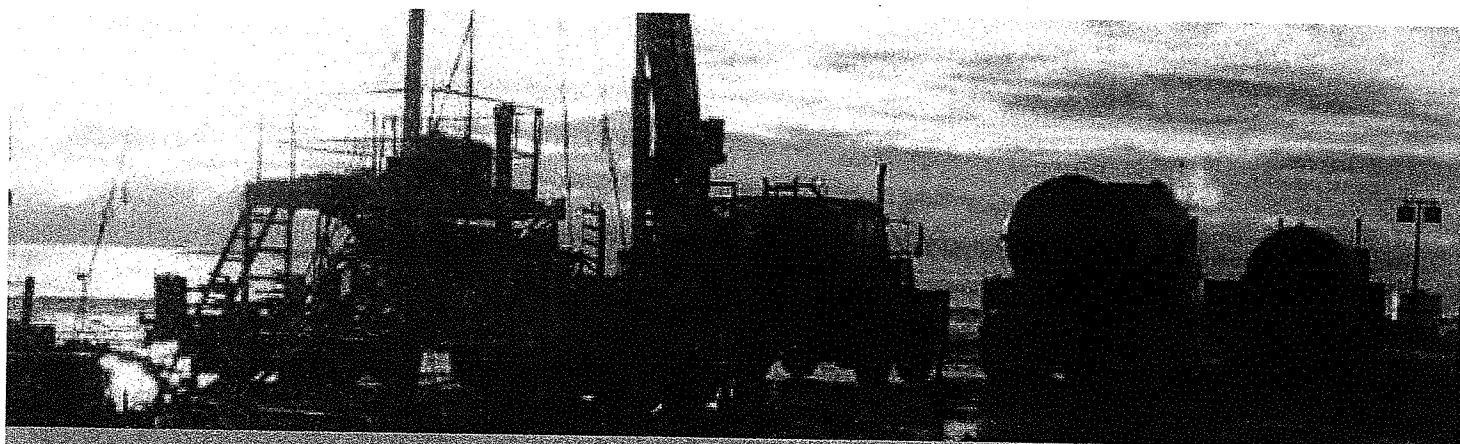
**THIS IS EXHIBIT "B" REFERRED TO IN
THE AFFIDAVIT OF VERNON R. FAUTH**

**SWORN BEFORE ME THIS 10TH DAY OF
DECEMBER, 2012.**

A handwritten signature in dark ink, appearing to read "Carol J. Hunter", is written over a horizontal line.

**A Commissioner for Oaths in and for the
Province of Alberta**

CAROLE J. HUNTER
Barrister & Solicitor



FairWest Energy Corporation

Q3 Financial Report

For the three and nine months ended September 30, 2012

Condensed Statements of Financial Position

As at,
Unaudited

(Thousands of Canadian Dollars)

	Note	September 30, 2012	December 31, 2011
Assets			
Current assets			
Cash		32	500
Marketable securities		1	-
Accounts receivable	5, 14	2,557	3,319
Prepaid expenses		192	155
		2,782	3,974
Non-current assets			
Property, plant and equipment	6	10,555	12,764
Exploration and evaluation assets	7	3,629	5,721
Investments in associates		24	81
Deferred tax assets		-	5,258
		14,208	23,824
Total assets		16,990	27,798
Equity and liabilities			
Current liabilities			
Accounts payable and accrued liabilities	5, 14	6,034	5,611
Bank loan payable	9	6,364	4,799
Current portion of finance lease	13	165	156
Current portion of loans payable	13	6	29
Debentures payable	16	4,634	4,553
		17,203	15,148
Non-current liabilities			
Finance lease	13	194	320
Decommissioning liabilities	10	5,823	5,410
Flow-through share premium liability	8	377	590
		6,394	6,320
Total liabilities		23,597	21,468
Equity			
Share capital	8	68,059	66,015
Warrants	8	-	23
Contributed surplus		3,067	2,781
Deficit		(77,733)	(62,489)
Total equity		(6,607)	6,330
Total equity and liabilities		16,990	27,798

Going Concern (note 1)

Contingent liabilities (note 12)

Commitments (note 13)

Subsequent events (note 16)

The accompanying notes are an integral part of these financial statements.

FairWest Energy Corporation

Financial Statements

Condensed Statements of Loss and Comprehensive Loss

Unaudited

(Thousands of Canadian Dollars)

Note	Sept. 30, 2012 (3 months)	Sept. 30, 2011 (3 months)	Sept. 30, 2012 (9 months)	Sept. 30, 2011 (9 months)
Revenue				
Petroleum and natural gas	751	1,042	2,362	3,208
Royalties	(75)	(189)	(208)	(390)
	676	853	2,154	2,818
Processing fee income	55	86	190	226
Royalty income	15	7	21	20
Gain (loss) on disposal of assets	-	(13)	8	1,036
Gain on flow-through share premium	225	108	283	527
Total Revenue	971	1,041	2,656	4,627
Expenses				
Operating	660	959	2,248	2,688
Transportation and marketing	47	58	144	178
Depletion and depreciation	422	397	1,489	1,253
General and administration	449	512	1,213	1,687
Share-based payments	34	114	223	488
Part XII.6 tax	-	-	16	5
Exploration and evaluation expense	-	-	51	-
Impairment (reversal) of property, plant and equipment	-	(2,538)	3,738	(1,137)
Impairment of exploration and evaluation assets	2,326	5	2,423	59
Equity loss (gain) on investment	57	(1)	57	(2)
Total expenses	3,995	(494)	11,602	5,219
Operating loss (income) before finance and taxes	3,024	(1,535)	8,946	592
Finance income	(1)	(6)	(1)	(19)
Finance expenses	363	536	1,042	1,370
Loss (gain) on modification of compound financial instruments	-	(220)	-	353
Loss (income) before taxes	3,386	(1,225)	9,987	2,296
Income tax	(1)	(46)	(1)	(46)
Deferred tax expense (recovery)	4,927	(947)	5,258	(840)
Net (income) loss and comprehensive (income) loss	8,312	(2,218)	15,244	1,410
Basic and diluted (earnings) loss per share	0.027	(0.010)	0.052	0.006
Basic and diluted weighted average number of shares outstanding	310,850,427	232,895,491	291,377,385	218,214,426

The accompanying notes are an integral part of these financial statements.

Condensed Statements of Changes in Equity

For the nine months ended September 30,

Unaudited

(Thousands of Canadian dollars)

	Note	Number of common Shares	Share capital	Convertible debentures equity component	Preferred shares	Total share capital	Warrants	Contributed surplus	Retained earnings/ deficit	Total equity
Balance at January 1, 2012		276,815,693	65,591	424	-	66,015	23	2,781	(62,489)	6,330
Issuance of common shares	8	35,800,000	1,790	-	-	1,790	-	-	-	1,790
Issuance of flow-through shares	8	7,039,082	352	-	-	352	-	-	-	352
Share issue costs		-	(98)	-	-	(98)	-	-	-	(98)
Warrants expired	8	-	-	-	-	-	(23)	23	-	-
Share-based payments	8	-	-	-	-	-	-	263	-	263
Net loss and comprehensive loss		-	-	-	-	-	-	-	(15,244)	(15,244)
Balance at September 30, 2012		319,654,775	67,635	424	-	68,059	-	3,067	(77,733)	(6,607)
Balance at January 1, 2011		192,301,620	54,802	645	157	55,604	24	2,107	(59,562)	(1,827)
Issuance of common shares	8	6,060,000	1,212	-	-	1,212	-	-	-	1,212
Issuance of flow-through shares	8	8,242,000	1,686	-	-	1,686	-	-	-	1,686
Preferred share modification		-	-	-	493	493	-	-	-	493
Share issue costs net of tax of \$36 thousand		-	(294)	-	-	(294)	-	-	-	(294)
Preferred shares converted to common shares		14,082,524	2,743	-	(650)	2,093	-	-	-	2,093
Debentures converted to common shares		13,893,340	2,225	(201)	-	2,024	-	-	-	2,024
Warrants exercised		6,273,147	629	-	-	629	(1)	-	-	628
Options exercised		200,000	29	-	-	29	-	-	-	29
Shares cancelled		(195,979)	-	-	-	-	-	-	-	-
Share-based payments		-	-	-	-	-	-	547	-	547
Net loss and comprehensive loss		-	-	-	-	-	-	-	(1,410)	(1,410)
Balance at September 30, 2011		240,856,652	63,032	444	-	63,476	23	2,654	(60,972)	5,181

The accompanying notes are an integral part of these financial statements.

FairWest Energy Corporation

Financial Statements

Condensed Statements of Cash Flows

Unaudited

(Thousands of Canadian Dollars)

	Sept. 30, 2012 (3 months)	Sept. 30, 2011 (3 months)	Sept. 30, 2012 (9 months)	Sept. 30, 2011 (9 months)
Cash flows from (used in) operating activities				
Net income (loss)	(8,312)	2,218	(15,244)	(1,410)
Adjustments for:				
Depletion and depreciation	422	397	1,489	1,253
Impairment of property, plant and equipment	-	(2,538)	3,738	(1,137)
Impairment of exploration and evaluation assets	2,326	5	2,423	59
Accretion	76	67	202	248
Share-based payments	34	114	223	488
Gain (loss) on disposal of assets	-	13	(14)	(1,036)
Non-cash general and administrative	15	-	15	-
Deferred tax expense (recovery)	4,927	(947)	5,258	(840)
Gain on flow-through share premium	(225)	(108)	(283)	(527)
Loss (gain) on modification of compound instruments	-	(220)	-	353
Equity loss on investment	57	-	57	-
Funds flow from operations	(680)	(999)	(2,136)	(2,549)
Change in non-cash working capital	277	255	499	(518)
Abandonment costs incurred	-	-	-	-
	(403)	(744)	(1,637)	(3,067)
Cash flows from (used in) financing activities				
Issuance of share capital, net of issuance costs	489	(5)	2,114	2,942
Change in bank loan payable	770	1,117	1,565	1,718
Payments on loans payable	(6)	(11)	(24)	(33)
Payments on finance lease	(39)	(55)	(115)	(159)
Change in note payable	-	(625)	-	-
Cash on option exercise	-	20	-	20
Cash on warrant exercise	-	625	-	628
	1,214	1,066	3,540	5,116
Cash flows from (used in) investing activities				
Expenditures on exploration and evaluation assets	(102)	(126)	(338)	(411)
Expenditures on property, plant and equipment	(480)	(550)	(2,710)	(2,118)
Proceeds from sale of property, plant and equipment	-	(12)	45	1,115
Distributions from equity investments	-	1	-	1
Changes in non-cash working capital	(239)	365	632	(636)
	(821)	(322)	(2,371)	(2,049)
Change in cash	(10)	-	(468)	-
Cash, beginning of period	42	-	500	-
Cash, end of period	32	-	32	-

The accompanying notes are an integral part of these financial statements.

FairWest Energy Corporation

Notes to the condensed interim (unaudited) Financial Statements

(Tabular amounts in thousands of Canadian dollars, unless otherwise stated)

1. Reporting Entity, Nature of Operations and Going Concern

Reporting entity and nature of operations

FairWest Energy Corporation (the "Company") is incorporated in Canada under the Canada Business Corporations Act, with registered offices at suite 800, 407 – 2nd Street SW, Calgary, Alberta, T2P 2Y3. The Company is engaged in the acquisition, exploration, development and production of petroleum and natural gas in western Canada. Its common shares trade on the TSX Venture Exchange ("TSXV") under the symbol "FEC".

Going concern

These financials have been prepared on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The financial statements do not include any adjustments to the amounts and classifications of assets and liabilities that may be necessary should the Company be unable to continue as a going concern and these adjustments and classifications may be material.

As at and for the nine months ended September 30, 2012, the Company had a working capital deficiency of \$14.4 million, an equity deficiency of \$6.6 million, net loss of \$15.2 million and negative funds flow from operations of \$2.1 million.

Series 1 debentures with a face value of \$1.2 million matured November 27, 2012 and Series 2 debentures with a face value of \$3.5 million mature December 31, 2012. The Company has sent default notices to the Series 1 debenture holders for non-payment of the principal and accrued interest in the amount of \$1.2 million at maturity of the Series 1 debentures on November 27, 2012. The Company anticipates that it will also be in default of the interest payable to the Series 2 debenture holders for interest due December 7, 2012 in the amount of \$41 thousand. In addition, the Company does not anticipate it will be in a position to pay the principal and accrued interest in the amount of \$3.5 million to the holders of Series 2 debentures at December 31, 2012. The Company has also decided to terminate the previously announced Series 3 debenture offering.

Included in the working capital deficiency is \$6.4 million of bank debt. The Company's credit facility in the amount of \$7.0 million is secured by a general security agreement and a \$7.0 million guarantee from the significant shareholder. The guarantee from the significant shareholder can be cancelled with 90 days' notice. The credit facility does not have any financial covenants and the Company is in breach of one non-financial covenant. The Company has allowed liens in the amount of \$14 thousand to be registered against its assets. As security for the guarantee, the Company has granted the significant shareholder a general security agreement which has been postponed to the bank. As at November 29, 2012, the credit facility has been substantially drawn down.

Future development costs of \$9.0 million are required to fully realize the proved plus probable reserves and the related future cash flows determined by the Company, based on management's update of the 2011 year end independently prepared reserve report prepared by Sproule Associates Limited (the "Sproule Report"). Management's update allocates \$8.7 million of these expenditures to be incurred in 2012. Management no longer expects these expenditures to be incurred in 2012, and as a result, the future capital required to develop the proved and probable undeveloped reserves will need to be adjusted in the next annual independent evaluation. If the Company cannot raise funds to finance these development costs, estimated future cash flows will be significantly impacted.

Approximately \$2.2 million of eligible capital expenditures are required by December 31, 2012 to meet the Company's flow-through share commitments. The Company anticipates it will incur approximately \$250 thousand Canadian Exploration Expense ("CEE") expenditures by December 31, 2012, leaving approximately \$1.95 million of previously renounced CEE expenditures unexpended. The working capital deficiency limits the Company's ability to fund capital expenditures. Failure to incur these eligible capital expenditures will result in significant additional Part XII.6 tax.

During the nine month period ended September 30, 2012, the Company raised approximately \$357 thousand net proceeds from a flow-through share offering and approximately \$1.27 million net proceeds from a common share offering. On November 16, 2012, the Company terminated the common share offering announced October 1, 2012 with no proceeds raised.

The continuation of the Company as a going concern is dependant on the continued support of the guarantor under the credit facility, completing short term financing to maintain operations, the continued support of the Company's suppliers to which are owed payment, a reduction of operating and general and administrative expenses, dispositions of non-core assets and the Company's ability to manage its debt. There is significant doubt as to the ability of the Company to continue as a going concern. The Company has retained advisors to assist in assessing strategic alternatives. If the Company cannot achieve the above, it will not have sufficient cash flow to meet its ongoing operations without the sale of a substantial portion of its core property, plant and equipment. Should the Company not be able to continue as a going concern, it will be necessary to restate the Company's assets and liabilities on a liquidation basis resulting in further impairments and write-downs which could be material.

The information contained herein is current as of November 29, 2012.

2. Basis of Preparation

Statement of compliance

These interim condensed financial statements are unaudited and prepared in accordance with International Accounting Standard ("IAS") 34, *Interim Financial Reporting* as issued by the International Accounting Standards Board ("IASB"). Certain information and disclosures required to be included in notes to Annual Financial Statements prepared in accordance with International Financial Reporting Standards ("IFRS") and interpretations of the International Financial Interpretations Committee ("IFRIC"), as issued by the IASB, have been condensed or omitted.

FairWest Energy Corporation

Notes to the condensed interim (unaudited) Financial Statements

(Tabular amounts in thousands of Canadian dollars, unless otherwise stated)

2. Basis of Preparation (continued)

Statement of compliance (continued)

The interim condensed Financial Statements should be read in conjunction with the audited annual financial statements as at and for the year ended December 31, 2011 and the notes thereto ("2011 Annual Financial Statements") included in the annual report and the interim financial statements for the periods ended March 31, 2012 and June 30, 2012.

These financial statements were authorized for issue by the board of Directors on November 29, 2012.

Basis of measurement

The financial statements have been prepared on a historical cost basis, except for the following:

- Measurement of financial contracts
- Measurement of financial instruments at fair value through profit or loss
- Measurement of share-based payments
- Decommissioning liabilities

Functional and presentation currency

These financial statements are presented in Canadian dollars, which is the Company's functional currency.

BOE presentation

The term barrels of oil equivalent ("boe") may be misleading particularly if used in isolation. All boe conversions in this report are derived by converting gas to oil in the ratio of six thousand cubic feet of gas to one barrel of oil. A boe conversion ratio of 6 mcf : 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All amounts of boe/d, bbl/d, mcf/d, \$/boe, \$/bbl and \$/mcf are not expressed in thousands.

Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be material. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future years affected.

Significant areas of estimation uncertainty and critical judgments in applying accounting policies that impact the amounts recognized in the financial statements were the same as those applied in the 2011 Annual Financial Statements.

3. Significant Accounting Policies

a) Accounting policies used

The interim condensed financial statements have been prepared following the same accounting policies and methods of computation as the 2011 Annual Financial Statements.

b) New standards and interpretations

The Company continues to assess the impact of adopting new pronouncements from the IASB as described in the 2011 Annual Financial Statements.

4. Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the same methods as described in the 2011 Annual Financial Statements.

5. Financial risk management and capital management

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities:

- Credit risk
- Liquidity risk
- Market risk

FairWest Energy Corporation

Notes to the condensed interim (unaudited) Financial Statements

(Tabular amounts in thousands of Canadian dollars, unless otherwise stated)

5. Financial risk management and capital management (continued)

This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing risk. Further quantitative disclosures are included throughout these financial statements.

Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and petroleum and natural gas marketers. The Company has practices in place that assess the credit quality of its marketers and suppliers.

(\$000's)	September 30, 2012	December 31, 2011
Oil and natural gas marketing companies	390	532
Joint venture partners and other trade receivables	2,167	2,787
Total	2,557	3,319

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected in one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to the expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, a further risk exists with joint venture partners, such as disagreements, that increase the potential for non-collection. There is a time lag, sometimes significant, from the receipt of joint venture invoices, through the billing process to partners and receipt of payment that can affect the Company's cash flows. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however, the Company has the ability to withhold production from joint venture partners in the event of non-payment where it is the operator.

The carrying amount of accounts receivable represents the maximum credit exposure. The Company does not have an allowance for doubtful accounts as at September 30, 2012 and December 31, 2011.

The Company's receivables are aged as follows:

(\$000's)	September 30, 2012	December 31, 2011
Not past due (less than 90 days)	910	1,911
Past due (90 days and over)	1,208	676
Over 1 year	439	732
Total	2,557	3,319

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due.

As at and for the nine months ended September 30, 2012, the Company had a working capital deficiency of \$14.4 million and negative funds flow from operations of \$2.1 million and is experiencing significant cash flow constraints. The credit facility is substantially drawn down. The Company is in default of its Series 1 debentures and anticipates being in default of its Series 2 debentures. The Company does not have the financial resources to fund further needed development costs on its property, plant and equipment and it is anticipated that it will be unable to fulfill its requirement to incur eligible capital expenditures on a flow-through share offering (see notes 1, 9 and 16).

The Company has reduced its capital expenditures, is working on reducing general and administrative costs and pursuing the sale of non-core assets and is working on a solution to manage its debt.

The Company attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month. In addition, the Company utilizes letters of credit pursuant to a letter of credit facility with its lender. At September 30, 2012, approximately \$206 thousand has been issued under these facilities of which \$158 thousand relates to security for the cost of decommissioning liabilities of oil and gas facilities and other operator responsibilities. The remaining \$48 thousand relates to a security granted to a gas processor.

FairWest Energy Corporation

Notes to the condensed interim (unaudited) Financial Statements

(Tabular amounts in thousands of Canadian dollars, unless otherwise stated)

5. Financial risk management and capital management (continued)

Liquidity risk

The following is a maturity analysis of the Company's financial obligations:

(\$000's)	Less than 1 month	1-3 months	3 months to 1 year	Beyond 1 year	Total
Accounts payable	960	587	3,153	1,334	6,034
Bank loan payable	-	6,364	-	-	6,364
Debentures payable	-	4,679	-	-	4,679
Finance lease	15	31	93	249	388
Loans payable	2	4	-	-	6
	977	11,665	3,246	1,583	17,471

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Company's income or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company may utilize financial or physical contracts to manage market risks.

Commodity price risk

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Based on production levels, for the nine month period ended September 30, 2012, a \$1.00/mcf change in gas prices received would change gross revenue from sales of gas by 40% or approximately \$328 thousand and a \$10.00/bbl change in oil and gas liquids prices received would change gross revenue from sales of oil by 13% or approximately \$195 thousand for the nine month period ended September 30, 2012.

The Company had two physical contracts, each for 50 bbl/d of oil production. The first contract was for the period November 2011 to April 2012, had a floor price of \$90.00/bbl and a ceiling price of \$94.00/bbl, based on West Texas Intermediate ("WTI"), and adjusted to the delivery point. The second contract is for the period May 1, 2012 to October 31, 2012 for a fixed price of \$101.10/bbl, base on WTI, adjusted to the delivery point. The contract ending April 1, 2012 resulted in a \$27 thousand net loss for the first quarter of 2012. The contract beginning April 1, 2012 resulted in an \$11 thousand gain during the second quarter of 2012 and a \$26 thousand gain during the third quarter of 2012. Subsequent to September 30, 2012, this contract resulted in additional gains of approximately \$15 thousand.

During 2012, the Company also entered into several physical contracts for gas. The first is for the period April 1 to October 31, 2012, for 1,000 GJ/d whereby if the AECO monthly index gas price goes below \$2.00/GJ the Company will be paid that price plus an additional \$1.00/GJ. The second is for the period November 1, 2012 to November 30, 2012 and is based on the AECO monthly index gas price with a floor of \$2.00/GJ and a ceiling of \$3.00/GJ for 1,000 GJ/d. A third contract is for the period December 1, 2012 to October 2014 with a floor of \$2.38/GJ and a ceiling of \$3.37/GJ for 1,000 GJ/d. If the monthly average price goes above \$5.00/GJ, the Company participates fully. Currently the Company's gas production is approximately 1,000 GJ/d. The contract in place for the nine month period ended September 30, 2012 increased revenue from gas sales by approximately \$86 thousand. Subsequent to September 30, 2012, this contract resulted in a loss of approximately \$15 thousand.

The Company did not have any long term contracts in place for oil and gas for the nine month period ended September 30, 2011. The Company may enter into monthly gas physical contracts to help mitigate commodity price risk as a normal part of its operations.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears a floating rate of interest. A change of 1.0% in the floating rate would have a \$64 thousand annual impact on income before income taxes, based on the amount of the bank debt at September 30, 2012. The Company had no interest rate swap or financial contracts in place as at or during the periods ended September 30, 2012 and December 31, 2011.

Capital Management

The Company considers its capital structure to include shareholders' equity, bank debt and working capital.

(\$000's)	September 30, 2012	December 31, 2011
Equity	(6,607)	6,330
Bank loan payable	6,364	4,799
Working capital (deficiency)(excluding bank debt)	(8,057)	(6,375)
Total	(8,300)	4,754

FairWest Energy Corporation

Notes to the condensed interim (unaudited) Financial Statements

(Tabular amounts in thousands of Canadian dollars, unless otherwise stated)

5. Financial risk management and capital management (continued)

Capital Management (continued)

The Company manages its capital structure, and makes adjustments to it, in light of changes in economic conditions and the Company's planned requirements, and the risk characteristics of the underlying petroleum and natural gas assets. In order to maintain or adjust capital structure, the Company may from time to time issue new shares or debt instruments, adjust its capital spending and sell assets to manage current and projected debt levels. The Company has not met its objective of obtaining a strong capital base.

The Company monitors capital based on the ratio of net debt to quarterly annualized funds flow from operations. In this ratio, net debt is defined as all outstanding debt, plus or minus working capital, divided by funds flow from operations for the most recent calendar quarter, annualized (multiplied by four). Funds flow from operations is defined as cash flow from operating activities before changes in non-cash working capital. The Company's goal is to achieve a ratio of less than 2 to 1 has been adversely affected by it not meeting its budgeted targets for raising of additional equity. Achieving positive cash flow from operating has been negatively affected due to capital restraints.

For the nine month period ended September 30, 2012, the Company's ratio of net debt to quarterly annualized funds flow from operations was negative (December 31, 2011 - negative). The September 30, 2012 ratio is not within the range set by management as a result of low natural gas prices, declining production and capital expenditures to increase production being delayed. During 2012, average production was approximately 271 boe/d (2011 average — 318 boe/d). This decrease is a result of natural declines, shut in production due to economics and curtailed capital expenditures. Current production is approximately 200 boe/d. There is approximately 150 boe/d shut in due to economics. Drilling activities have not added to cash flow.

During the nine month period ended September 30, 2012, the Company raised approximately \$357 thousand net proceeds from the flow-through share offering and approximately \$1.27 million net proceeds from a common share offering. The equity raised was used to fund the Company's capital expenditure program and for general working capital requirements.

There were no changes in the Company's approach to capital management during the quarter.

The net debt to annual funds flow from operations has been calculated as follows:

(\$000's)	September 30, 2012	December 31, 2011
Working capital deficiency (excluding bank debt and debentures payable)	3,423	6,375
Bank loan payable	6,364	4,799
Long term finance lease and loans payable	194	320
Debentures payable	4,634	4,553
	14,615	16,047
Quarterly funds flow from operations	(680)	(1,430)
Annualizing factor	4	4
Annualized funds flow from operations	(2,720)	(5,720)
Ratio	-	-

FairWest Energy Corporation

Notes to the condensed interim (unaudited) Financial Statements

(Tabular amounts in thousands of Canadian dollars, unless otherwise stated)

6. Property, plant and equipment

(\$000's)	Petroleum and natural gas PP&E	Office & automotive equipment	Total
Cost or deemed cost			
Balance at December 31, 2011	25,010	333	25,343
Additions	3,041	-	3,041
Transferred from E&E	8	-	8
Disposals and derecognition	(31)	-	(31)
Balance at September 30, 2012	28,028	333	28,361
Accumulated depletion, depreciation and impairment losses			
Balance at December 31, 2011	12,458	121	12,579
Depletion and depreciation for the period	1,453	36	1,489
Impairment loss	3,781	-	3,781
Impairment reversals	(43)	-	(43)
Disposals and derecognition	-	-	-
Balance at September 30, 2012	17,649	157	17,806
Carrying amounts			
At December 31, 2011	12,552	212	12,764
At September 30, 2012	10,379	176	10,555

Included in the calculation of depletion are future development costs in the amount of \$8.7 million (December 31, 2011 - \$9.1 million). During the nine month period ended September 30, 2012, the Company capitalized general and administrative expenditures directly related to development activity of \$124 thousand (December 31, 2011 - \$136 thousand).

D&P assets are assessed for impairment by comparing fair value less cost to sell to net book value ("NBV"). Fair value less cost to sell is based on management's update of the Sproule Report discounted cash flows using before tax net cash flows based on proved plus probable reserves. Cash flows are discounted at 10.0% for oil weighted CGUs and 15.0% for gas weighted CGUs. The resulting value is compared to the NBV of the Company's D&P assets. During the three month period ended September 30, 2012, there were no indications of impairment and the Company took no further write downs than those taken in the first six months. A \$3.7 million net impairment has been recorded for the nine month period ended September 30, 2012 (December 31, 2011 - \$709 thousand).

At September 30, 2012 liens have been filed against the Company's PP&E assets in the amount of \$14 thousand.

Included in PP&E is equipment under capital lease with a net book value as shown in the table below:

(\$000's)	September 30, 2012	December 31, 2011
Cost	500	500
Accumulated depletion	(92)	(26)
Net book value	408	474

7. Intangible Exploration and Evaluation assets

Intangible exploration and evaluation ("E&E") assets consist of the Company's exploration projects which are pending the determination of proved and probable reserves. Additions represent the Company's share of costs incurred on E&E assets during the year.

(\$000's)	Intangible E&E assets
Cost or deemed cost:	
Balance at December 31, 2011	5,721
Additions	358
Expiries	-
Impairment	(2,423)
Transferred to D&P	(8)
Disposals and derecognition	(19)
Balance at September 30, 2012	3,629

During the nine month period ended September 30, 2012, the Company capitalized general and administrative expenditures directly related to E&E assets of \$338 thousand (December 31, 2011 - \$523 thousand).

FairWest Energy Corporation

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(Tabular amounts in thousands of Canadian dollars, unless otherwise stated)

7. Intangible Exploration and Evaluation assets (continued)

E&E assets are assessed for impairment at least annually based on data to determine technical feasibility and commercial viability as well as at any time that facts and circumstances that suggest the carrying amount exceeds the recoverable amount. At September 30, 2012, the Company does not have sufficient cash flow to utilize the E&E assets in exploration activities and has written down the E&E assets by \$2.4 million to their estimated recoverable amount using fair value less cost to sell.

8. Share capital

The Company is authorized to issue an unlimited number of common voting shares and an unlimited number of preferred shares. During the nine month period ended September 30, 2012, the Company issued 35,800,000 common shares for gross proceeds of \$1.79 million. In addition, during the nine month period ended September 30, 2012, the Company issued 7,039,082 flow-through units for gross proceeds of \$422 thousand. Each unit consisted of one CDE flow-through share and one common share warrant. A flow-through share premium liability was recorded of \$70 thousand. This resulted in an addition to share capital of \$352 thousand for flow-through equity.

During 2012, the Company issued 7,039,082 common share warrants, as part of the unit offering above, with an exercise price of \$0.10 per share. These warrants expired September 30, 2012. The value of these warrants was \$nil as calculated using the residual method.

During the nine month period ended September 30, 2012, 48,533 broker warrants expired with an exercise price of \$0.15 and a value of \$1 thousand. This amount has been transferred to contributed surplus.

During the nine month period ended September 30, 2012, 528,424 creditor warrants expired with an exercise price of \$0.15 and a value of \$22 thousand. This amount was transferred to contributed surplus.

Stock options

The Company has a stock option plan that governs the granting of options to employees, directors and consultants to provide incentive to those persons to promote the best interests of the Company.

During the nine month period ended September 30, 2012, the Company issued 650,000 options with an exercise price of \$0.10. The assumptions used to calculate the fair value of the options granted were as follows: risk-free interest rate 1.50%, forfeiture rate of 5%, expected stock price volatility 119% - 136%, expected option life (weighted average) 5 years, grant date fair value \$0.04 and the exercise price of \$0.10. During the nine month period ended September 30, 2012, the Company also cancelled 2,325,000 options with an average exercise price of \$0.15. Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options.

As at September 30, 2012, the following options are outstanding:

Number of common shares under option	Exercisable Options	Exercise price per option (\$)	Weighted average life remaining (years)
3,275,000	3,275,000	0.15	2.25
6,650,000	6,650,000	0.10	2.47
50,000	50,000	0.10	2.47
500,000	500,000	0.10	2.90
200,000	133,333	0.10	3.21
6,925,000	4,616,667	0.20	3.67
500,000	166,667	0.10	4.60
150,000	50,000	0.10	4.62
18,250,000	15,441,667	0.15	2.98

Flow-through shares

The following table summarizes information about flow-through shares outstanding:

Qualifying Expenditures				
(\$000's)	Total flow-through proceeds	Cumulative amount incurred to December 31, 2011	Cumulative amount incurred to September 30, 2012	Expenditures remaining at September 30, 2012
Year Issued				
2011 ⁽¹⁾	4,351	228	2,194	2,157
2012 ⁽²⁾	422	-	6	416
	4,773	228	2,200	2,573

FairWest Energy Corporation

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(Tabular amounts in thousands of Canadian dollars, unless otherwise stated)

8. Share capital (continued)

Flow-through shares (continued)

(1) The Company renounced proceeds to investors as at December 31, 2011 and has until December 31, 2012 to incur the qualifying expenditures.

(2) The Company has until December 31, 2013 to incur the qualifying expenditures.

During the third quarter of 2012, \$1.3 million in qualifying expenditures were reclassified from Canadian Development Expenditures to Canadian Exploration Expenses as a decision to abandon the well during the period. This reclassification increased the eligible qualifying expenditures relating to the 2011 issuance and resulted in a reduced amount of expenditures being allocated to the 2012 flow-through share issuance.

During 2008, the Canada Revenue Agency ("CRA") initiated an audit of the Company's (including a previous subsidiary) flow-through share offerings for the 2004, 2005 and 2006 taxation years. On February 26, 2009, the Company received a letter from CRA indicating they believed the Company had a shortfall of \$3.3 million of flow-through eligible expenditures. These findings were summarized in a subsequent letter dated March 20, 2009. CRA subsequently issued a notice of reassessment. The Company did not believe that the reassessment was valid and filed a notice of objection on July 29, 2009. The CRA acknowledged receipt of the objection in a letter dated December 20, 2009 and indicated that a review would be completed by the appeals division of the CRA. To date the Company has not received any correspondence from the appeal division of CRA, but has received verbal confirmation that CRA is reviewing the notice of objection. Management's assessment is that any amounts that may be payable by the Company to CRA and/or investors resulting from the above will not be material.

Flow-through share premium liability

(\$000's)	September 30, 2012	December 31, 2011
Balance beginning of period	590	924
Premium attributed to flow-through shares issued	70	622
Reduction of liability due to expenditures incurred	(283)	(956)
Balance end of period	377	590

Earnings per share

The following sets forth the computed basic and diluted earnings per share:

	September 30, 2012	December 31, 2011
Numerator		
Net loss (\$000's)	15,244	2,927
Denominator		
Weighted average number of common shares	291,377,385	224,800,279
Effect of dilutive securities		
preferred shares	-	-
stock options	-	-
debentures	-	-
warrants	-	-
	291,377,385	224,800,279
Basic and diluted loss per share (\$)	0.052	0.013

All outstanding stock options and debentures are potentially dilutive but were not included in the calculation of diluted earnings per share for the periods ended September 30, 2012 and December 31, 2011 because to do so would be anti-dilutive.

9. Bank loan payable

The Company has a credit facility in the amount of \$7.0 million which is secured by a general security agreement and a guarantee in the amount of \$7.0 million from a significant shareholder. The guarantor is secured by a general security agreement which is postponed to the bank. The guarantee can be cancelled with 90 days notice. The credit facility does not have any financial covenants and the Company is in breach of one non-financial covenant. The Company has allowed liens in the amount of \$14 thousand to be registered against its assets. Interest on the credit facility with the lender is prime plus 2.5%. At September 30, 2012, the bank prime rate was 3.0%. As at November 29, 2012, the credit facility has been substantially drawn down. The secured creditors would be within their rights to enforce their security. The Company is working on potential solutions to manage its debt.

FairWest Energy Corporation

Notes to the condensed interim (unaudited) Financial Statements

(Tabular amounts in thousands of Canadian dollars, unless otherwise stated)

10. Decommissioning liabilities

(\$000's)	September 30, 2012	December 31, 2011
Balance, beginning of period	5,410	5,772
Change in estimates	2	(321)
Change in rate	217	109
Increase on acquisitions	91	226
Decrease on dispositions	(19)	(569)
Adjustment	-	-
Accretion expense	122	193
Balance, end of period	5,823	5,410

The Company has estimated the net present value of its total decommissioning obligation to be \$5.8 million at September 30, 2012 (December 31, 2011 - \$5.4 million) based on an undiscounted total future liability of \$7.4 million (December 31, 2011 - \$7.3 million). The discount factor, being the risk-free rate related to the liability, is 2.75% (December 31, 2011 - 3.25%).

11. Deferred Taxes

Management no longer considers it probable future profits will be available against which tax benefits can be utilized and has derecognized its deferred tax asset of \$5.3 million (December 31, 2011 - \$5.3 million). The main factor that influenced this decision is the uncertainty associated with forecasted cash flow.

12. Contingent liabilities

- In 2005, the Company received a statement of claim in the amount of \$136 thousand from Aero Drilling & Consulting Ltd., in respect of services provided to a subcontractor of Supreme Energy Inc. The Company has reviewed the claim and considers it without merit and no provision has been made with respect to the claim. The Company is defending the claim.
- In November 2006, the Company received a notice of reassessment from Revenu Quebec for the period ended February 28, 2003, in the amount of \$211 thousand including interest. With additional interest and penalties the amount of the assessment is currently \$306 thousand. This relates to Fairstar Explorations Inc. ("Fairstar"). Fairstar and Western Energy Corporation amalgamated August 18, 2005 to form the Company. The Company has filed a notice of objection, does not believe that the reassessment is valid and has made no provision with respect to the claim in the financial statements.

13. Commitments

The Company leases its corporate office. Non-cancellable operating lease rentals excluding operating costs, are payable as follows:

(\$000's)	Gross
2012	65
2013	173
Beyond 2013	-
Total	238

The future obligations under capital lease and loans payable are:

(\$000's)	2012	2013	2014	Total
Capital Lease				
Principal	40	168	151	359
Imputed interest	7	18	4	29
	47	186	155	388
Loan Payable				
Principal	6	-	-	6
Interest	-	-	-	-
	6	-	-	6
Total				
Principal	46	168	151	365
Imputed interest	7	18	4	29
	53	186	155	394

FairWest Energy Corporation

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(Tabular amounts in thousands of Canadian dollars, unless otherwise stated)

13. Commitments (continued)

The Company's future commitments to the Saskatchewan Ministry of Energy and Resources are as follows:

(\$000's)	Gross
2012	161
2013	90
2014	90
2015	90
2016	90
Beyond 2016	325
Total	846

The Company has committed to put up a letter of credit with the Saskatchewan Ministry of Energy and Resources over the next several years. These letters of credit are to be held in case the Company has unsatisfied abandonment liabilities in the province. At September 30, 2012, the Company has a total future commitment of \$846 thousand and subsequent to September 30, 2012 has put up a letter of credit of approximately \$108 thousand. The Company expects to recover approximately 20% of the total future commitment from its partners.

14. Related parties

Key management personnel compensation

(\$000's)	September 30, 2012	September 30, 2011
Salaries	360	360
Directors fees	8	11
Short-term employee benefits	32	39
Termination benefits	-	57
Share-based payments	157	215
	557	682

Key personnel includes the Chief Executive Officer, President and Chief Operating Officer, Chief Financial Officer and directors.

Short-term benefits comprise bonuses and other benefits.

Termination benefits comprise amounts paid and accrued.

The share-based payment amounts reported represents the cost to the Company of key management's participation in share-based payment plans, as measured by the amortization of share-based payments associated with options granted, net of amounts capitalized to PP&E.

Executive officers and directors participate in the Company's stock option plan (note 9).

Other related party transactions

Trade and other receivables from related parties – included in accounts receivable (\$000's)	September 30, 2012	December 31, 2011
Royalty Investments Limited Partnership	783	553
Significant Shareholder and Controlled Associated Companies	532	196
Western Royalty Holdings Corporation	-	1
	1,315	750

The trade and other receivables from related parties in the above table are unsecured, are on terms similar to trade receivables, have no fixed terms of repayment and bear no interest.

Trade and other payables to related parties – included in accounts payable (\$000's)	September 30, 2012	December 31, 2011
Royalty Investments Limited Partnership	265	186
Significant Shareholder and Controlled Associated Companies	438	163
Western Royalty Holdings Corporation	3	4
Total	706	353

- The trade and other payables to related parties are unsecured and have no fixed terms of repayment.
- AFM Management Inc. ("AFM") is controlled by the CEO of the Company. AFM is the general partner of Royalty Investments Limited Partnership ("RILP").
- A member of management of the Company is a director of Western Royalty Holdings Corporation ("Western").

FairWest Energy Corporation

Notes to the condensed interim (unaudited) Financial Statements

(Tabular amounts in thousands of Canadian dollars, unless otherwise stated)

14. Related parties (continued)

The following transactions were in the normal course of operations and have been recorded at the exchange amounts, which is the amount of consideration established and agreed to by the related parties and in management's opinion is approximate fair value:

- During 2012, the Company charged RILP \$41 thousand (September 30, 2011 - \$56 thousand) in management fees at a rate of \$2.00/boe of sales and interest of \$nil (September 30, 2011 - \$19 thousand).
- During the third quarter of 2012, the Company paid interest on a short term loan to management and associated companies in the amount of \$140 dollars (September 30, 2011 - \$nil).
- During 2012, the Company paid debenture interest to management and associated companies in the amount of \$5 thousand (September 30, 2011 - \$46 thousand).
- During 2012, the Company paid debenture interest to a significant shareholder and controlled associated companies in the amount of \$210 thousand (September 30, 2011 - \$210 thousand).
- During 2011, a significant shareholder and controlled associated companies provided a guarantee to a lender to secure a credit facility for the Company. The Company incurred \$275 thousand for a guarantee fee related to this transaction and paid \$20 thousand in additional banking fees related to this guarantee. In the first quarter of 2012, this shareholder provided a guarantee to the lender to secure a credit facility for the Company. A guarantee fee is being negotiated with the guarantor, but has not been finalized to date. During 2012, interest fees in the amount of \$53 thousand (September 30, 2011 - \$nil) were incurred on the guarantee.

The following transactions were not in the normal course of operations:

- During 2012, the Company sold a property in the Berry Creek area to a significant shareholder and associated companies for cash proceeds of \$11 thousand. There was no gain recorded on the transaction. The sale closed on January 16, 2012 and was recognized for accounting purposes on that date.

15. Finance income and costs

Recognized in profit or loss

(\$000's)	Note	September 30, 2012	September 30, 2011
Interest income		(1)	(19)
Finance income		(1)	(19)
Interest on bank indebtedness	10	306	267
Interest on convertible debentures		491	689
Accretion on convertible debentures		80	91
Accretion on decommissioning liabilities		122	146
Preferred share dividends		-	34
Accretion on preferred shares		-	11
Other interest		43	132
Finance costs		1,042	1,370
Net finance costs recognized in profit or loss		1,041	1,351

16. Subsequent events

- Series 1 debentures matured on November 27, 2012 and the Company defaulted on the principal and accrued interest due as of that date.
- The Company anticipates that it will also be in default of the interest payable to the Series 2 debenture holders for interest due December 7, 2012 in the amount of \$41 thousand. In addition, the Company does not anticipate it will be in a position to pay the principal and accrued interest in the amount of \$3.5 million to the holders of Series 2 debentures at December 31, 2012.
- The Company has terminated the previously announced Series 3 debenture offering.

Management's Discussion & Analysis

The following Management's Discussion and Analysis ("MD&A") of FairWest Energy Corporation (the "Company") is management's explanation of the operating and financial results for the period ended September 30, 2012, as well as estimates of future operating and financial performance based on information currently available. It should be read in conjunction with the annual MD&A and audited financial statements of the Company for the year ended December 31, 2011 and the interim MD&A and financial statements for the periods ended March 31, 2012 and June 30, 2012.

Basis of Presentation

The financial statements, MD&A and comparative information have been prepared in Canadian dollars unless otherwise indicated and in accordance with International Financial Reporting Standards ("IFRS") representing generally accepted accounting principles ("GAAP") for publicly accountable enterprises in Canada.

The term barrels of oil equivalent ("boe") may be misleading particularly if used in isolation. All boe conversions in this report are derived by converting gas to oil in the ratio of six thousand cubic feet of gas to one barrel of oil. A boe conversion ratio of 6 mcf : 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Given that the current ratio based on the current price of crude oil as compared to natural gas is significantly different from the energy equivalency of 6:1, utilizing a conversion ratio of 6:1 may be misleading as an indication of value. All amounts of boe/d, bbl/d, mcf/d, \$/boe, \$/bbl and \$/mcf are not expressed in thousands.

Unless otherwise stated and other than per unit items, all figures are presented in thousands.

Description of Business

The Company is a junior oil and gas company engaged in the acquisition, exploration, development and production of crude oil, natural gas and natural gas liquids in the provinces of Alberta and Saskatchewan. The common shares of the Company trade on the TSX Venture Exchange under the symbol "FEC".

Outlook

These financials have been prepared on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

As at and for the nine months ended September 30, 2012, the Company had a working capital deficiency of \$14.4 million, an equity deficiency of \$6.6 million, net loss of \$15.2 million and negative funds flow from operations of \$2.1 million.

Series 1 debentures with a face value of \$1.2 million matured November 27, 2012 and Series 2 debentures with a face value of \$3.5 million mature December 31, 2012. The Company has sent default notices to the Series 1 debenture holders for non-payment of the principal and accrued interest in the amount of \$1.2 million at maturity of the Series 1 debentures on November 27, 2012. The Company anticipates that it will also be in default of the interest payable to the Series 2 debenture holders for interest due December 7, 2012 in the amount of \$41 thousand. In addition, the Company does not anticipate it will be in a position to pay the principal and accrued interest in the amount of \$3.5 million to the holders of Series 2 debentures at December 31, 2012. The Company has also decided to terminate the previously announced Series 3 debenture offering.

Included in the working capital deficiency is \$6.4 million of bank debt. The Company's credit facility in the amount of \$7.0 million is secured by a general security agreement and a \$7.0 million guarantee from the significant shareholder. The guarantee from the significant shareholder can be cancelled with 90 days notice. The credit facility does not have any financial covenants and the Company is in breach of one non-financial covenant. The Company has allowed liens in the amount of \$14 thousand to be registered against its assets. As security for the guarantee, the Company has granted the significant shareholder a general security agreement which has been postponed to the bank. As at November 29, 2012, the credit facility has been substantially drawn down.

Future development costs of \$9.0 million are required to fully realize the proved plus probable reserves and the related future cash flows determined by the Company, based on management's update of the 2011 year end independently prepared reserve report prepared by Sproule Associates Limited (the "Sproule Report"). Management's update allocates \$8.7 million of these expenditures to be incurred in 2012. Management no longer expects these expenditures to be incurred in 2012, and as a result, the future capital required to develop the proved and probable undeveloped reserves will need to be adjusted in the next annual independent evaluation. If the Company cannot raise funds to finance these development costs, estimated future cash flows will be significantly impacted.

Approximately \$2.2 million of eligible capital expenditures are required by December 31, 2012 to meet the Company's flow-through share commitments. The Company anticipates it will incur approximately \$250 thousand Canadian Exploration Expense ("CEE") expenditures by December 31, 2012, leaving approximately \$1.95 million of previously renounced CEE expenditures unexpended. The working capital deficiency limits the Company's ability to fund capital expenditures. Failure to incur these eligible capital expenditures will result in significant additional Part XII.6 tax.

During the nine month period ended September 30, 2012, the Company raised approximately \$357 thousand net proceeds from a flow-through share offering and approximately \$1.27 million net proceeds from a common share offering. On November 16, 2012, the Company terminated the common share offering announced October 1, 2012 with no proceeds raised.

FairWest Energy Corporation

Management's Discussion and Analysis

The Company recently made a decision to shut in its natural gas production at Kirkpatrick Lake at the end of November 2012. Processing and transportation fees levied by a third party processor have more than doubled over the past year to approximately \$1.75 per Mcf as a result of increased maintenance activities and reduced throughput volumes. The property will remain shut in until natural gas prices improve to a level where production is economic. The Company is also investigating alternatives for processing its gas at a lower cost. The Company recently reactivated two Viking natural gas wells at Provost that have somewhat offset the loss of production at Kirkpatrick Lake. However, the Company has not had sufficient capital available to perform maintenance work on a number of wells. As a result, overall corporate volumes are currently approximately 200 Boe/d (35% oil and NGLs, 65% gas) with the Kirkpatrick Lake shut in and overall declines.

The continuation of the Company as a going concern is dependant on the continued support of the guarantor under the credit facility, completing short term financing to maintain operations, the continued support of the Company's suppliers to which are owed payment, a reduction of operating and general and administrative expenses, dispositions of non-core assets and the Company's ability to manage its debt. There is significant doubt as to the ability of the Company to continue as a going concern. The Company has retained advisors to assist in assessing strategic alternatives. If the Company cannot achieve the above, it will not have sufficient cash flow to meet its ongoing operations without the sale of a substantial portion of its core property, plant and equipment. Should the Company not be able to continue as a going concern, it will be necessary to restate the Company's assets and liabilities on a liquidation basis resulting in further impairments and write-downs which could be material.

The information contained herein is current as of November 29, 2012.

Non-GAAP and Additional GAAP Measurements - This MD&A contain the term funds flow from operations which is an additional GAAP measure. Funds flow from operations represents net earnings adjusted for non-cash items including, but not limited to, depletion and depreciation, accretion, share-based payments, deferred income taxes, loss on compound instrument, impairment, equity gain on investment and gain on flow-through share premium liability. The Company evaluates its performance on earnings and funds flow from operations. The Company's determination of funds flow from operations may not be comparable to that reported by other companies, especially those in other industries. This MD&A also contains the term 'netback' and 'operating netback' which are a non-GAAP financial measures used to represent profit margins on the sale of petroleum and natural gas. These terms are non-GAAP measurements that are calculated on a BOE basis by deducting royalties, operating costs, and transportation from petroleum and natural gas sales. These non-GAAP financial measures do not have any standardized meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. The Company considers funds flow from operations and operating netbacks key measures that demonstrate profitability from operations and the Company's ability to generate the funds flow necessary to repay debt and fund future capital investment.

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Cash flow from operating activities (\$)	(403)	(744)	(1,637)	(3,067)
Changes in non-cash working capital (\$)	(277)	(255)	(499)	518
Decommissioning liability expenditures (\$)	-	-	-	-
Funds flow from operations (\$)	(680)	(999)	(2,136)	(2,549)

Forward-Looking Statements

Certain statements contained in this MD&A and in certain documents incorporated by reference into this MD&A, constitute forward-looking statements. These statements relate to future events or future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as seek, anticipate, budget, plan, continue, estimate, expect, forecast, may, will, project, predict, potential, targeting, intend, could, might, should, believe and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. Management believes the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in, or incorporated by reference into, this MD&A or as of the date specified in the documents incorporated by reference into this MD&A, as the case may be.

In particular, this MD&A and the documents incorporated by reference, contain forward-looking statements pertaining to the following:

- the performance characteristics of the Company's oil and natural gas properties;
- the Company's oil and natural gas production levels;
- expectations regarding the Company's payment obligations under the Series 1 and Series 2 debentures;
- the amount of the Company's eligible expenses qualifying as Canadian exploration expenses;
- the ability of the Company to meet its flow-through obligations;
- the size of the Company's oil and natural gas reserves;
- projections of market prices and costs;
- expectations regarding the ability to raise capital and to continually add to reserves through acquisitions and development;
- treatment under governmental regulatory regimes and tax laws; and
- capital expenditures programs.

FairWest Energy Corporation

Management's Discussion and Analysis

The actual results could differ materially from those anticipated in these forward-looking statements as a result of risk factors set forth below and elsewhere in this MD&A:

- volatility in market prices for oil and natural gas;
- changes in supply and demand for oil, natural gas and natural gas liquids;
- liabilities inherent in oil and natural gas operations;
- uncertainties associated with estimating oil and natural gas reserves;
- competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel;
- incorrect assessments of the value of acquisitions;
- geological, technical, drilling and processing problems; and
- changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry.

Statements relating to reserves or resources are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future. Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward-looking statements contained in this MD&A and the documents incorporated by reference herein are expressly qualified by this cautionary statement. Except as required by applicable securities law, the Company does not undertake any obligation to publicly update or revise any forward-looking statements.

Current Economic Environment

The price of natural gas remains at near record lows and it is not expected to increase significantly over the next year due to oversupply, reduced demand and pipeline capacity. Pipeline capacity in the United States is increasing the differential between the prices realized in Canada versus those realized at the southern US refineries for oil, as well. Current oil prices have been relatively stable, but can fluctuate as economic outlooks change in other parts of the world. The firmer oil prices are positive for the Company as the ratio of oil and NGL production to natural gas production has increased to 26% for the nine month period ended September 30, 2012, from 21% for the period ended December 31, 2011. Revenue from oil and NGL production represents 65% of gross revenue at September 30, 2012, up from 53% at December 31, 2011.

Quarterly Performance

Quarterly performance is as follows:

Financial Highlights ('\$000's), except volumes and share amounts	Sept. 30, 2012 (3 Months)	June 30, 2012 (3 Months)	Mar. 31, 2012 (3 Months)	Dec. 31, 2011 (3 Months)	Sept. 30, 2011 (3 Months)	June 30, 2011 (3 Months)	Mar. 31, 2011 (3 Months)	Dec. 31, 2010 (3 Months)
Revenue								
Petroleum and natural gas sales, net of royalties	676	710	768	964	853	1,007	958	1,121
Net (income) loss	8,312	4,848	2,085	1,518	(2,218)	2,287	1,340	5,414
Funds flow from operations	(680)	(823)	(634)	(1,430)	(999)	(827)	(721)	(826)
Basic and diluted (earnings) loss per share	0.027	0.017	0.008	0.007	(0.010)	0.010	0.006	0.037
Share Data:								
Common shares outstanding	319,654,775	309,654,775	283,854,775	276,815,693	240,856,652	225,669,291	222,701,144	192,301,620
Weighted shares outstanding	310,850,427	285,555,874	277,511,866	224,800,279	232,895,491	224,760,592	196,588,214	145,415,353
Preferred shares	-	-	-	-	-	-	-	211,259
Common share warrants	-	7,567,506	7,567,506	576,957	576,957	576,957	600,104	600,104
Flow-through share warrants	-	-	-	-	-	6,250,000	6,250,000	6,250,000
Options	18,250,000	19,100,000	19,850,000	19,925,000	19,925,000	20,275,000	12,775,000	12,875,000
Highlights of Operations	Sept. 30, 2012 (3 Months)	June 30, 2012 (3 Months)	Mar. 31, 2012 (3 Months)	Dec. 31, 2011 (3 Months)	Sept. 30, 2011 (3 Months)	June 30, 2011 (3 Months)	Mar. 31, 2011 (3 Months)	Dec. 31, 2010 (3 Months)
Natural gas								
Volume – mcf/d	1,140	1,189	1,260	1,414	1,401	1,446	1,554	2,141
\$/mcf	2.54	2.55	2.39	3.41	3.38	4.32	3.83	4.18
Oil and NGLs								
Volume – bbl/d	67	72	75	76	76	71	73	55
\$/bbl	78.01	77.74	81.10	86.60	86.17	84.28	78.32	72.10
Barrel of oil equivalent								
Volume – boe/d	257	270	285	311	310	312	332	412

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Petroleum and Natural Gas Sales

The following table represents revenue, sales volumes and average prices received from the sale of petroleum and natural gas for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Revenue				
Natural gas revenue	266	436	816	1,541
Oil and natural gas liquids revenue	485	606	1,546	1,667
Petroleum and natural gas sales	751	1,042	2,362	3,208
Royalty	(75)	(189)	(208)	(390)
Petroleum and natural gas sales, net of royalty expense	676	853	2,154	2,818
Petroleum and natural gas sales (\$/boe)	31.80	36.55	31.87	36.96
Sales Volumes				
Natural gas (mmcf)	105	129	328	400
Oil and natural gas liquids (mbbls)	6	7	19	20
MBoe	24	29	74	87
Boe/d	257	310	271	318
Average Sales Price				
Natural gas (\$/mcf)	2.54	3.38	2.49	3.85
Oil and natural gas liquids (\$/bbl)	79.01	86.17	79.31	83.01

Production declined to an average of 271 boe/d during the nine month period ended September 30, 2012 compared to 318 boe/d during the same period in 2011. This is a result of natural declines, the sale of interests in several areas, the temporary shut-in of a number of natural gas wells due to low prices and curtailed capital expenditures. Current production is approximately 200 boe/d. The Company has approximately 150 boe/d production (primarily gas) shut-in due to economics.

Natural gas prices averaged \$2.54/mcf during the third quarter of 2012 compared to \$3.38/mcf during the corresponding period in 2011. These prices are not expected to increase significantly in 2012. Natural gas prices have increased somewhat from lows experienced in 2012. The Company has several physical contracts for gas. The first is for the period April 1 to October 31, 2012, for 1,000 GJ/d whereby if the AECO monthly index gas price goes below \$2.00/GJ the Company will be paid that price plus an additional \$1.00/GJ. The second is for the period November 1, 2012 to November 30, 2012 and is based on the AECO monthly index gas price with a floor of \$2.00/GJ and a ceiling of \$3.00/GJ for 1,000 GJ/d. A third contract is for the period December 1, 2012 to October 2014 with a floor of \$2.38/GJ and a ceiling of \$3.37/GJ. If the monthly average price goes above \$5.00/GJ, the Company participates fully. The contract in place for the nine month period ended September 30, 2012 increased revenue from gas sales by approximately \$86 thousand. The Company expects a \$15 thousand loss from this contract during the fourth quarter of 2012.

Oil and natural gas liquids prices averaged \$79.01/bbl during the third quarter of 2012 versus \$86.17/bbl during the same period of 2011. On a relative basis oil and natural gas liquids still commands a significantly higher price over natural gas and this has continued into 2012. Oil prices continue to provide healthy profits from oil production. The Company is focusing on oil projects in 2012 to capture the higher netbacks. The Company has two physical contracts, each for 50 bbl/d of oil production. The first contract was for the period November 2011 to April 2012, had a floor price of \$90.00/bbl and a ceiling price of \$94.00/bbl, based on West Texas Intermediate ("WTI"), and adjusted to the delivery point. The second contract is for the period May 1, 2012 to October 31, 2012 for a fixed price of \$101.10/bbl, base on WTI, adjusted to the delivery point. The contract ending April 1, 2012 resulted in a \$27 thousand net loss for the first quarter of 2012. The contract beginning April 1, 2012 resulted in an \$11 thousand gain during the second quarter of 2012 and a \$26 thousand gain during the third quarter of 2012. Subsequent to September 30, 2012, this contract resulted in additional gains of \$15 thousand. For the nine months ended September 30, 2012, revenue from oil and natural gas liquids represented 65% of total petroleum and natural gas revenue even though it only accounted for 26% of total production volumes.

The Company's revenue is not only affected by the commodity prices for its products, but by production rates as well. Operational risk is the risk that the Company's production profile cannot be maintained at current levels. The Company has field personnel who constantly monitor production through daily attendance at well site locations, as well as alarm systems that notify them of facility failures. Office staff monitor production daily to identify problems and consult with field staff to correct any production problems on a timely basis. Capital expenditures are necessary to maintain production levels at current levels. Due to capital constraints, the Company's production is declining as optimization cannot be performed in a timely manner. The economic viability of certain reserves is dependant on commodity price, regulatory framework (ie. royalties) and operating costs. In general, at this particular time, oil production is economic, liquids rich gas production is economic and dry natural gas is marginally economic. The oil and gas business continues to experience inflationary related cost pressures such as higher landowner rental costs, increased third party service company charges, higher municipal tax rates and increasing environmental compliance costs.

Royalties

The following table shows royalty expense for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Royalties	75	189	208	390
% of sales	10.0	18.1	8.8	12.2
\$/boe	3.18	6.63	2.81	4.49

Royalties are expected to increase as the Company focuses more on oil production. Royalties on natural gas are relatively low due to the low commodity price, low production and increased gas cost allowance deducted from crown royalty. Oil royalties are higher on a percentage basis as compared to natural gas under the current economic environment. Royalties for the three month period ended September 30, 2011 include a royalty adjustment of approximately \$100 thousand.

Royalty Income

The following table shows royalty income for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Royalty income	15	7	21	20
\$/boe	0.64	0.25	0.28	0.23

Royalty income increased in the third quarter of 2012 due to an adjustment for prior periods.

Operating

The following table shows operating costs for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Operating	660	959	2,248	2,688
Transportation and marketing	47	58	144	178
Processing fee income	(55)	(86)	(190)	(226)
Total	652	931	2,202	2,640
\$/boe	27.57	32.65	29.71	30.42

For the nine month period ended September 30, 2012, per unit operating costs decreased to \$29.71/boe as compared to the same period in 2011. For the three month period ended September 30, 2012, per unit operating costs decreased by \$5.08/boe due to a processing fee equalization adjustment in the third quarter of 2011 in the amount of \$168 thousand. The Company continues to emphasize overall cost reductions through efficiencies and has shut in uneconomical wells to reduce operating costs. Fixed costs which do not decrease with lower production volumes continue to have a negative impact on per unit operating costs.

Operating expenses are analyzed by the Company net of processing income which represents the recovery of processing costs incurred by third parties at the Company's facilities. The amount of processing income is completely variable with the volume of third-party gas being flowed through the Company's facilities. There are no long term fixed contracts with respect to this throughput.

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Netbacks

The following table shows operating netbacks for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Petroleum and natural gas sales	751	1,042	2,362	3,208
Processing fee income	55	86	190	226
Royalties ⁽¹⁾	(75)	(189)	(208)	(390)
Operating expense ⁽²⁾	(660)	(959)	(2,248)	(2,688)
Transportation and marketing	(47)	(58)	(144)	(178)
Operating netback	24	(78)	(48)	178
Petroleum and natural gas sales (\$/boe)	31.80	36.55	31.87	36.96
Processing fee income (\$/boe)	2.33	3.02	2.56	2.60
Royalties (\$/boe) ⁽³⁾	(3.18)	(6.63)	(2.81)	(4.49)
Operating expense (\$/boe) ⁽⁴⁾	(27.91)	(35.67)	(30.33)	(30.97)
Transportation and marketing (\$/boe)	(1.99)	(1.94)	(1.94)	(2.05)
Operating netback (\$/boe)	1.05	(2.73)	(0.65)	2.05

(1) Three and nine month periods in 2011, include a \$100 thousand adjustment that relates to a prior period.

(2) Three and nine month periods in 2011, include a \$168 thousand adjustment that relates to a prior period.

(3) Three and nine month periods in 2011, include an adjustment for a prior period of \$3.51/boe and \$1.15/boe respectively.

(4) Three and nine month periods in 2011, include an adjustment for a prior period of \$5.89/boe and \$1.94/boe respectively.

The Company has positive operating netbacks, improving from the three months ended September 30, 2011 (negative \$2.73) and December 31, 2011 (negative \$7.44) as the Company emphasized oil production and shut in uneconomical wells.

General and Administrative

The following table shows general and administrative expense for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Gross general and administrative	574	644	1,635	2,133
Capitalized general and administrative	(125)	(132)	(422)	(446)
Net general and administrative	449	512	1,213	1,687
Gross general and administrative (\$/boe)	24.31	22.59	22.07	24.57
Capitalized general and administrative (\$/boe)	(5.29)	(4.63)	(5.70)	(5.13)
Net general and administrative (\$/boe)	19.02	17.96	16.37	19.44

For the nine month period ended September 30, 2012, gross G&A expense has decreased by \$498 thousand or 23% over the same period in 2011. The decrease was accomplished primarily through a reduced staffing complement and resulting decreases in salaries and benefits.

Funds Flow from Operations

The following table shows funds flow from operations for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Funds flow from operations	(680)	(999)	(2,136)	(2,549)
\$/boe	(28.76)	(35.04)	(28.82)	(29.36)

Low natural gas prices is the largest factor contributing to negative funds flow from operations. The price for gas was \$2.49/mcf for the nine month period ended September 30, 2012, compared to \$3.85/mcf for the same period in 2011. The price for oil and natural gas liquids was \$79.31/bbl for the nine month period ended September 30, 2012, compared to \$83.01/bbl for the same period in 2011. At September 30, 2012, the Company was weighted 74% gas and 26% oil and NGL production, however oil and NGL accounts for 65% of revenue.

Lower production is a significant factor affecting funds flow from operations. Production for the nine month period ended September 30, 2012 was 271 boe/d compared to 318 boe/d in 2011. The decrease in production is attributed to sale of assets, delays in capital expenditures and shutting in of uneconomic wells. Current production is approximately 200 boe/d with 150 boe/d shut in due to economics.

Share-based Compensation

The following table shows the share-based compensation expense for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Share-based compensation	34	114	223	488
\$/boe	1.44	4.00	3.01	5.62

Share-based compensation for the nine month period ended September 30, 2012 was \$263 thousand (2011 - \$555 thousand). Of this total, \$223 thousand (2011 - \$488 thousand) was expensed and \$40 thousand (2011 - \$67 thousand) was capitalized. Share-based payments are used to provide incentive to employees, officers and directors on a cost effective basis to the Company as they are not cash based. The Company uses the Black-Scholes option pricing model to calculate share-based compensation.

Depletion, Depreciation and Impairment

The following table shows depletion, depreciation and impairment expense for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Depletion and depreciation	422	397	1,489	1,253
Exploration and Evaluation Impairment	2,326	5	2,423	59
Property, Plant and Equipment Impairment (reversal)	-	(2,538)	3,738	(1,137)
Total	2,748	(2,136)	7,650	175
\$/boe	116.38	(74.93)	103.21	2.02

Future development costs on proved reserves of \$8.7 million are included in the calculation of depletion and depreciation (2011 - \$2.9 million).

D&P assets are assessed for impairment by comparing fair value less cost to sell to net book value ("NBV"). Fair value less cost to sell is based on management's update of the Sproule Report discounted cash flows using before tax net cash flows based on proved plus probable reserves. Cash flows are discounted at 10.0% for oil weighted CGUs and 15.0% for gas weighted CGUs. The resulting value is compared to the NBV of the Company's D&P assets. A \$3.7 million net impairment has been recorded for the nine month period ended September 30, 2012 (December 31, 2011 - \$709 thousand), based on management's update of the Sproule Report. The impairment is a result of declining commodity prices.

E&E assets are assessed for impairment at least annually based on data to determine technical feasibility and commercial viability as well as any facts and circumstances that suggest the carrying amount exceeds the recoverable amount. For the nine month period ended September 30, 2012, the Company has written down the E&E assets by \$2.4 million to their estimated fair value as the Company does not have sufficient cash flow to utilize the E&E assets in exploration activities and to adjust for lease expiries.

Gain on Flow-through Share Premium

The following table shows gain on flow-through share premium for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Gain on flow-through share premium	225	108	283	527
\$/boe	9.53	3.79	3.82	6.07

Eligible expenditures incurred that result in tax pools that can be flowed-through to investors in flow-through equity result in a decrease to the flow-through share premium liability and an offsetting gain to income.

Gain (loss) on Modification of Compound Financial Instruments

The following table shows loss on compound financial instrument for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Gain (loss) on modification of compound financial instruments	-	220	-	(353)
\$/boe	-	7.72	-	(4.07)

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Modification of the terms of the preferred shares and Series 2 debentures resulted in an addition to preferred share equity in the amount of \$493 thousand and debenture payable in the amount of \$80 thousand, with an offsetting loss to income in the amount of \$573 thousand in the nine month period ended September 30, 2011.

Gain (loss) on Disposal of Assets

The following table shows gain (loss) on disposal of assets for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Gain (loss) on disposal of assets	-	(13)	8	1,036
\$/boe	-	(0.46)	0.11	11.93

During the nine month period ended September 30, 2012, the Company quit claim an interest in two wells which resulted in a loss of \$20 thousand. The Company recorded a \$34 thousand gain resulting from an adjustment to a sale of assets originally recorded in 2011. The Company also recorded several other small sale adjustments resulting in a cumulative net loss of approximately \$6 thousand. The total of these sales and adjustments make up the gain of \$8 thousand for the nine month period ended September 30, 2012. During the nine month period ended September 30, 2011, the most significant gain on disposal of assets was the sale of a 20% interest in undeveloped land which resulted in a gain of \$972 thousand.

Finance Income

The following table shows finance income for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Finance income	1	6	1	19
\$/boe	0.04	0.21	0.01	0.22

The interest charged in 2011 relates to notes receivable from related parties. The amount of notes receivable was fully repaid at December 31, 2011. The Company does not anticipate having significant interest income during 2012.

Finance Expense

The following table shows finance expenses for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Finance expense	287	469	840	1,122
Accretion	76	67	202	248
Total	363	536	1,042	1,370
\$/boe	15.37	18.80	14.06	15.79

The Company has a credit facility in the amount of \$7.0 million which is secured by a general security agreement and a guarantee in the amount of \$7.0 million from a significant shareholder. The guarantee can be cancelled with 90 days notice, however the Company anticipates the support of the significant shareholder to continue. The Company is currently in breach of one non financial covenant by allowing liens to be resisted in the amount of \$14 thousand. The Company is working on potential solutions to managing its debt issues. The secured creditors would be within their rights to enforce security. Interest on the credit facility with the New Lender is prime plus 2.5%. At September 30, 2012, there was \$6.4 million drawn on this facility. At September 30, 2012, the bank prime rate was 3.0%.

At September 30, 2012, the Company had total debenture financing of \$4.7 million. The interest rate on these debentures is 14.0%. The Series 1 debentures matured on November 27, 2012 in the amount of \$1.2 million and the Company defaulted on the principal and accrued interest. The Series 2 debentures mature on December 31, 2012 in the amount of \$3.5 million. The Company anticipates it will be in default of the interest due on December 7, 2012 and the principal and accrued interest due at December 31, 2012.

Included in finance expenses is accretion relating to the liability component of debentures and decommissioning liability.

Part XII.6 Tax

Part XII.6 tax is levied when a company allocates income tax expenditures to a flow-through shareholder prior to the date the actual expenditures are incurred. A total of \$2.2 million of qualified expenditures were incurred during the nine month period ended September 30, 2012 (2011 - \$1.2 million). Proceeds from sales of flow-through shares sold by the Company in 2011 require that a further \$2.2 million of qualified CEE expenditures be spent by December 31, 2012. Proceeds from sales of flow-through shares sold by the Company in 2012 require that a further \$416 thousand of qualified Canadian Development Expense ("CDE") expenditures be spent by December 31, 2013. The Company does not anticipate it will incur the required CEE qualified expenditures by December 31, 2012.

During 2008, the Canada Revenue Agency ("CRA") initiated an audit of the Company's (including a previous subsidiary) flow-through share offerings for the 2004, 2005 and 2006 taxation years. On February 26, 2009, the Company received a letter from CRA indicating they believed the Company had a shortfall of \$3,295 thousand of flow-through eligible expenditures. These findings were summarized in a subsequent letter dated March 20, 2009. CRA subsequently issued a notice of reassessment. The Company does not believe the reassessment is valid and filed a notice of objection on July 29, 2009. The CRA acknowledged receipt of the objection in a letter dated December 20, 2009. To date, the Company has not received any correspondence from the appeal division of the CRA, but has received verbal confirmation that the CRA is reviewing the notice of objection. Management's assessment is that any amounts that may be payable by the Company to CRA and/or investors resulting from the above will not be material.

The following table shows Part XII.6 tax for the periods indicated:

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Part XII.6 tax (recovery)	-	-	16	5
\$/boe	-	-	0.22	0.06

Deferred Taxes

Management no longer considers it probable future profits will be available against which tax benefits can be utilized and has derecognized its deferred tax asset of \$5.3 million (December 31, 2011 - \$5.3 million). The main factor that influenced this decision is the uncertainty associated with forecasted cash flow.

Net (Income) Loss

The net loss for the nine month period ended September 30, 2012 is \$15.2 million (September 30, 2011 - \$1.4 million). A net impairment in the amount of \$6.2 million [September 30, 2011 - (\$1.1 million)] was a significant factor contributing to the net loss at September 30, 2012. In addition, during 2012, the Company derecognized its future tax assets as it is uncertain whether the Company will be in a position to utilize its tax pools. Another significant factor affecting net loss for the nine month period ended September 30, 2011, was a \$972 thousand gain on sale of assets this relates to the sale of undeveloped land. During the nine month period ended September 30, 2012 gain on sale of assets was \$8 thousand.

(\$000's)	September 30, 2012 (3 months)	September 30, 2011 (3 months)	September 30, 2012 (9 months)	September 30, 2011 (9 months)
Net (income) loss	8,312	(2,218)	15,244	1,410
\$/boe	351.97	(77.80)	205.66	16.24

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Capital Expenditures

The following table sets out capital expenditures of the Company:

(\$000's)	September 30, 2012	September 30, 2011
D&P		
Acquisitions	55	350
Drilling and completions	1,550	788
Facilities and equipment	814	819
Lease rentals	187	173
Capitalized G&A	103	105
Total Cash D&P Expenditures	2,709	2,235
Transferred from E&E – Non-cash	8	-
Dispositions - cost	(31)	(89)
Decommissioning liabilities	311	(122)
Capitalized share-based payments	21	-
Total D&P Expenditures	3,018	2,024
Automotive and Office Equipment		
Cash expenditures	-	-
Dispositions – non-cash	-	-
Total Auto and Office Equipment	-	-
Total D&P	3,018	2,024
E&E		
Acquisitions	-	44
Seismic	20	-
Capitalized G&A	319	408
Total Cash E&E Expenditures	339	452
Transferred to D&P	(8)	-
Dispositions - cost	(19)	(81)
Capitalized share-based payments	19	-
Total E&E Expenditures	331	371
Total Capital Expenditures	3,349	2,395

Liquidity and Capital Resources

The Company's credit facility in the amount of \$7.0 million is secured by a general security agreement and a \$7.0 million guarantee from the significant shareholder. The guarantee from the significant shareholder can be cancelled with 90 days notice. The credit facility does not have any financial covenants and the Company is in breach of one non-financial covenant. The Company has allowed liens in the amount of \$14 thousand to be registered against its assets, which have been paid and are in the process of being removed. As security for the guarantee, the Company has granted the significant shareholder a general security agreement which has been postponed to the bank. As at November 29, 2012, the credit facility has been substantially drawn down. The Company is working on potential solutions to manage its debt.

Series 1 debentures with a face value of \$1.2 million matured November 27, 2012 and Series 2 debentures with a face value of \$3.5 million mature December 31, 2012. The Company has sent default notices to the Series 1 debenture holders for non-payment of the principal and accrued interest in the amount of \$1.2 million at maturity of the Series 1 debentures on November 27, 2012. The Company anticipates that it will also be in default of the interest payable to the Series 2 debenture holders for interest due December 7, 2012 in the amount of \$41 thousand. In addition, the Company does not anticipate it will be in a position to pay the principal and accrued interest in the amount of \$3.5 million to the holders of Series 2 debentures at December 31, 2012. The Company has also decided to terminate the previously announced Series 3 debenture offering.

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At September 30, 2012, approximately \$2.2 million in eligible capital expenditures are required by December 31, 2012 for the Company to meet its CEE and CDE flow-through commitments. The Company does not anticipate it will incur the required expenditures and will have approximately \$1.95 million of unexpended previously renounced CEE expenditures. During 2012, the Company raised \$422 thousand in CDE flow-through share equity and has raised gross \$1.79 million in common equity. On November 16, 2012, the Company terminated the common share offering announced October 1, 2012 with no proceeds raised. The Company is also continuing to pursue the sale of non-core assets along with continuing to monitor all expenses for any cost saving opportunities.

During the nine month period ended September 30, 2012, the Company issued 650,000 options with an exercise price of \$0.10. The assumptions used to calculate the fair value of the options granted were as follows: risk-free interest rate 1.50%, expected stock price volatility 119% - 136%, expected option life (weighted average) 5 years, grant date fair value \$0.04 and the exercise price of \$0.10. During the nine month period ended September 30, 2012, the Company also cancelled 2,325,000 options with an average exercise price of \$0.15. Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options.

As at September 30, 2012, the following options are outstanding:

Number of common shares under option	Exercisable Options	Exercise price per option (\$)	Weighted average life remaining (years)
3,275,000	3,275,000	0.15	2.25
6,650,000	6,650,000	0.10	2.47
50,000	50,000	0.10	2.47
500,000	500,000	0.10	2.90
200,000	133,333	0.10	3.21
6,925,000	4,616,667	0.20	3.67
500,000	166,667	0.10	4.60
150,000	50,000	0.10	4.62
18,250,000	15,441,667	0.15	2.98

The Company is authorized to issue an unlimited number of common voting shares and an unlimited number of preferred shares. During the nine month period ended September 30, 2012, the Company issued 35,800,000 common shares for gross proceeds of \$1.79 million. In addition, during the nine month period ended September 30, 2012, the Company issued 7,039,082 flow-through units for gross proceeds of \$422 thousand. Each unit consisted of one CDE flow-through share and one common share warrant.

During 2012, the Company issued 7,039,082 common share warrants, as part of the unit offering above, with an exercise price of \$0.10 per share. These warrants expired September 30, 2012. The value of these warrants was \$nil as calculated using the residual method.

During the nine month period ended September 30, 2012, 48,533 broker warrants expired with an exercise price of \$0.15 and a value of \$1 thousand. This amount has been transferred to contributed surplus.

During the nine month period ended September 30, 2012, 528,424 creditor warrants expired with an exercise price of \$0.15 and a value of \$22 thousand. This amount was transferred to contributed surplus.

Related Party Transactions

Key management personnel compensation

(\$000's)	September 30, 2012	September 30, 2011
Salaries	360	360
Directors fees	8	11
Short-term employee benefits	32	39
Termination benefits	-	57
Share-based payments	157	215
	557	682

Key personnel includes the Chief Executive Officer, President and Chief Operating Officer, Chief Financial Officer and directors.

Short-term benefits comprise bonuses and other benefits.

Termination benefits comprise amounts paid and accrued.

The share-based payment amounts reported represents the cost to the Company of key management's participation in share-based payment plans, as measured by the amortization of share-based payments associated with options granted, net of amounts capitalized to PP&E.

Executive officers and directors participate in the Company's stock option plan.

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Other related party transactions

Trade and other receivables from related parties – included in accounts receivable (\$000's)	September 30, 2012	December 31, 2011
Royalty Investments Limited Partnership	783	553
Significant Shareholder and Controlled Associated Companies	532	196
Western Royalty Holdings Corporation	-	1
	1,315	750

The trade and other receivables from related parties in the above table are unsecured, are on terms similar to trade receivables, have no fixed terms of repayment and bear no interest.

Trade and other payables to related parties – Included in accounts payable (\$000's)	September 30, 2012	December 31, 2011
Royalty Investments Limited Partnership	265	186
Significant Shareholder and Controlled Associated Companies	438	163
Western Royalty Holdings Corporation	3	4
Total	706	353

(a) Management and Associated Companies

During 2012, the Company paid debenture interest to management and associated companies in the amount of \$5 thousand (September 30, 2012 - \$46 thousand).

(b) Royalty Investments Limited Partnership

AFM Management Inc. ("AFM") is the general partner of Royalty Investments Limited Partnership ("RILP"). The Chief Executive Officer ("CEO") of the Company is a director of AFM. During 2012, the Company charged \$41 thousand (September 30, 2011 - \$56) in management fees at a rate of \$2.00/boe of sales. During the nine month period ended 2011, the Company charged RILP \$19 thousand in interest related to a promissory note that was paid in full on December 30, 2011. No interest was charged by the Company in the first half of 2012.

(c) Significant Shareholder and Controlled Associated Companies

During 2011, a significant shareholder and controlled associated companies provided a guarantee to a lender to secure a credit facility for the Company. The Company was billed \$275 thousand for a guarantee fee related to this transaction and paid \$20 thousand in additional banking fees related to this guarantee. In the first quarter of 2012, this shareholder provided a guarantee to the New Lender to secure a credit facility for the Company. A guarantee fee is being negotiated with the guarantor, but has not been finalized to date. During 2012, interest fees in the amount of \$53 thousand (September 30, 2011 - \$nil) were incurred on the guarantee.

During 2012, the Company paid debenture interest to a significant shareholder and controlled associated companies in the amount of \$210 thousand (September 30, 2011 - \$210 thousand).

(d) Western Royalty Holdings Corporation

A member of management is a director of Western Royalty Holdings Corporation ("Western"). All transactions with Western are in the normal course of business.

Financial instruments

The Company has exposure to the following risks from its use of financial instruments:

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities:

- Credit risk
- Liquidity risk
- Market risk

This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing risk. Further quantitative disclosures are included throughout these financial statements.

Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and petroleum and natural gas marketers. The Company has practices in place that assess the credit quality of its marketers and suppliers.

(\$000's)	September 30, 2012	September 30, 2011
Oil and natural gas marketing companies	390	532
Joint venture partners and other trade receivables	2,167	2,787
Total	2,557	3,319

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected in one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to the expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, a further risk exists with joint venture partners, such as disagreements, that increase the potential for non-collection. There is a time lag, sometimes significant, from the receipt of joint venture invoices, through the billing process to partners and receipt of payment that can affect the Company's cash flows. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however, the Company has the ability to withhold production from joint venture partners in the event of non-payment where it is the operator.

The carrying amount of accounts receivable represents the maximum credit exposure. The Company does not have an allowance for doubtful accounts as at September 30, 2012 and December 31, 2011.

The Company's receivables are aged as follows:

(\$000's)	September 30, 2012	December 31, 2011
Not past due (less than 90 days)	910	1,911
Past due (90 days and over)	1,208	676
Over 1 year	439	732
Total	2,557	3,319

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due.

As at and for the nine months ended September 30, 2012, the Company had a working capital deficiency of \$14.4 million and negative funds flow from operations of \$2.1 million and is experiencing significant cash flow constraints. The credit facility is substantially drawn down. The Company is in default of its Series 1 debentures and anticipates being in default of its Series 2 debentures. The Company does not have the financial resources to fund needed further development costs on its property, plant and equipment and is unable to fulfill its requirement to incur eligible capital expenditures on a flow-through share offering, which will result in significant additional part XII.6 tax.

The Company has reduced its capital expenditures, is working on reducing general and administrative costs and pursuing the sale of non-core assets. The Company is working towards a solution to manage its debt.

The Company attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month. In addition, the Company utilizes letters of credit pursuant to a letter of credit facility with its lender. At September 30, 2012, approximately \$206 thousand has been issued under these facilities of which \$158 thousand relates to security for the cost of decommissioning liabilities of oil and gas facilities and other operator responsibilities. The remaining \$48 thousand relates to a security granted to a gas processor.

The following is a maturity analysis of the Company's financial obligations:

(\$000's)	Less than 1 month	1-3 months	3 months to 1 year	Beyond 1 year	Total
Accounts payable	960	587	3,153	1,334	6,034
Bank loan payable	-	6,364	-	-	6,364
Debentures payable	-	4,679	-	-	4,679
Finance leases	15	31	93	249	388
Loans payable	2	4	-	-	6
	977	11,665	3,246	1,583	17,471

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Company's income or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company may utilize financial or physical contracts to manage market risks.

FairWest Energy Corporation

Management's Discussion and Analysis

Commodity price risk

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Based on production levels, for the nine month period ended September 30, 2012, a \$1.00/mcf change in gas prices received would change gross revenue from sales of gas by 40% or approximately \$328 thousand and a \$10.00/bbl change in oil and gas liquids prices received would change gross revenue from sales of oil by 13% or approximately \$195 thousand for the nine month period ended September 30, 2012.

The Company had two physical contracts, each for 50 bbl/d of oil production. The first contract was for the period November 2011 to April 2012, had a floor price of \$90.00/bbl and a ceiling price of \$94.00/bbl, based on West Texas Intermediate ("WTI"), and adjusted to the delivery point. The second contract is for the period May 1, 2012 to October 31, 2012 for a fixed price of \$101.10/bbl, base on WTI, adjusted to the delivery point. The contract ending April 1, 2012 resulted in a \$27 thousand net loss for the first quarter of 2012. The contract beginning April 1, 2012 resulted in an \$11 thousand gain during the second quarter of 2012 and a \$26 thousand gain during the third quarter of 2012. Subsequent to September 30, 2012, this contract resulted in additional gains of approximately \$15 thousand.

During 2012, the Company also entered into several physical contracts for gas. The first is for the period April 1 to October 31, 2012, for 1,000 GJ/d whereby if the AECO monthly index gas price goes below \$2.00/GJ the Company will be paid that price plus an additional \$1.00/GJ. The second is for the period November 1, 2012 to November 30, 2012 and is based on the AECO monthly index gas price with a floor of \$2.00/GJ and a ceiling of \$3.00/GJ for 1,000 GJ/d. A third contract is for the period December 1, 2012 to October 2014 with a floor of \$2.38/GJ and a ceiling of \$3.37/GJ for 1,000 GJ/d. If the monthly average price goes above \$5.00/GJ, the Company participates fully. Currently, the Company's production of gas is approximately 1,000 GJ/d. The contract in place for the nine month period ended September 30, 2012 increased revenue from gas sales by approximately \$86 thousand. Subsequent to September 30, 2012, this contract resulted in a loss of approximately \$15 thousand.

The Company did not have any long term contracts in place for oil and gas for the nine month period ended September 30, 2011. The Company may enter into monthly gas physical contracts to help mitigate commodity price risk as a normal part of its operations.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears a floating rate of interest. A change of 1.0% in the floating rate would have a \$64 thousand annual impact on income before income taxes, based on the amount of the bank debt at September 30, 2012. The Company had no interest rate swap or financial contracts in place as at or during the periods ended September 30, 2012 and December 31, 2011.

Fair value of financial instruments

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the same methods as described in the 2011 Annual Financial Statements.

Critical Accounting Estimates

The reader is advised that the critical accounting estimates, policies and practices as described in this MD&A continue to be critical in determining the Company's financial results.

The reader is further cautioned that the preparation of financial statements in accordance with GAAP requires management to make certain judgments and estimates that affect the reported amount of assets, liabilities, revenues and expenses. Estimating reserves is also critical to several accounting estimates and requires judgments and decisions based upon available geological, geophysical, engineering and economic data. These estimates may change, having either a negative or positive effect on net earnings as further information becomes available and as the economic environment changes. Changes in these judgments and estimates could have a material impact on the financial results and financial condition. Further information on the Company's critical accounting estimates can be found in the notes to the consolidated financial statements and annual MD&A for the year ended December 31, 2011. There have been no changes to the Company's critical accounting estimates as of September 30, 2012.

Claims and Litigation

In 2005, the Company received a statement of claim in the amount of \$136 thousand from Aero Drilling & Consulting Ltd., in respect of services provided to a subcontractor of Supreme Energy Inc. The Company has reviewed the claim and considers it without merit and no provision has been made with respect to the claim. The Company is defending the claim.

In November 2006, the Company received a notice of reassessment from Revenu Quebec for the period ended February 28, 2003, in the amount of \$211 thousand including interest. With additional interest and penalties the amount of the assessment is currently \$306 thousand. This relates to Fairstar Explorations Inc. ("Fairstar"). Fairstar and Western Energy Corporation amalgamated August 18, 2005 to form the Company. The Company has filed a notice of objection, does not believe that the reassessment is valid and has made no provision with respect to the claim in the financial statements.

Commitments

(a) The Company's total obligations, under a property lease agreement, exclusive of occupancy costs are as follows:

(\$000's)	Gross
2012	65
2013	173
Beyond 2013	-
Total	238

(b) The future obligations under capital lease and loans payable are:

(\$000's)	2012	2013	2014	Total
Capital Lease				
Principal	40	168	151	359
Imputed interest	7	18	4	29
	47	186	155	388
Loan Payable				
Principal	6	-	-	6
Interest	-	-	-	-
	6	-	-	6
Total				
Principal	46	168	151	365
Imputed interest	7	18	4	29
	53	186	155	394

(c) The Company's future commitments to the Saskatchewan Ministry of Energy and Resources are as follows:

(\$000's)	Gross
2012	161
2013	90
2014	90
2015	90
2016	90
Beyond 2016	325
Total	846

The Company has committed to put up a letter of credit with the Saskatchewan Ministry of Energy and Resources over the next several years. These letters of credit are to be held in case the Company has unsatisfied abandonment liabilities in the province. At September 30, 2012, the Company has a total future commitment of \$846 thousand and subsequent to September 30, 2012 has put up a letter of credit of approximately \$108 thousand. The Company expects to recover approximately 20% of the total future commitment from its partners.

Additional information can be found regarding the Company at www.SEDAR.com.

Corporate Information

Management

Vern Fauth
Chief Executive Officer
Douglas O. McNichol
President and Chief Operating Officer
Marion D. Mackie
Chief Financial Officer
Michael Lambros
Vice President, Land
Darlene Zeck
Vice President, Administration
Philip Rodd
General Manager, Exploration

Directors

Vern Fauth ⁽⁴⁾
Calgary, Alberta
Sean Fauth ^{(1) (2) (3)}
Calgary, Alberta
David Kelcher ^{(1) (2)}
Calgary, Alberta
Douglas O. McNichol ⁽³⁾
Calgary, Alberta
Carl M. Ravinsky ^{(1) (2)}
Montreal, Quebec

- (1) Audit Committee
- (2) Compensation and Governance Committee
- (3) Environment and Safety Committee
- (4) Executive Chairman

Stock Exchange Listing

TSX Venture Exchange
Trading Symbol: FEC

Auditors

Kenway Mack Slusarchuk Stewart LLP
Calgary, Alberta

Registrar and Transfer Agent

Olympia Trust Company
Suite 2300, 125 – 9 Avenue SE
Calgary, Alberta T2G 0P6
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Contact

Vern Fauth
Chief Executive Officer
Douglas O. McNichol
President and Chief Operating Officer
Marion D. Mackie
Chief Financial Officer

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FairWest Energy Corporation

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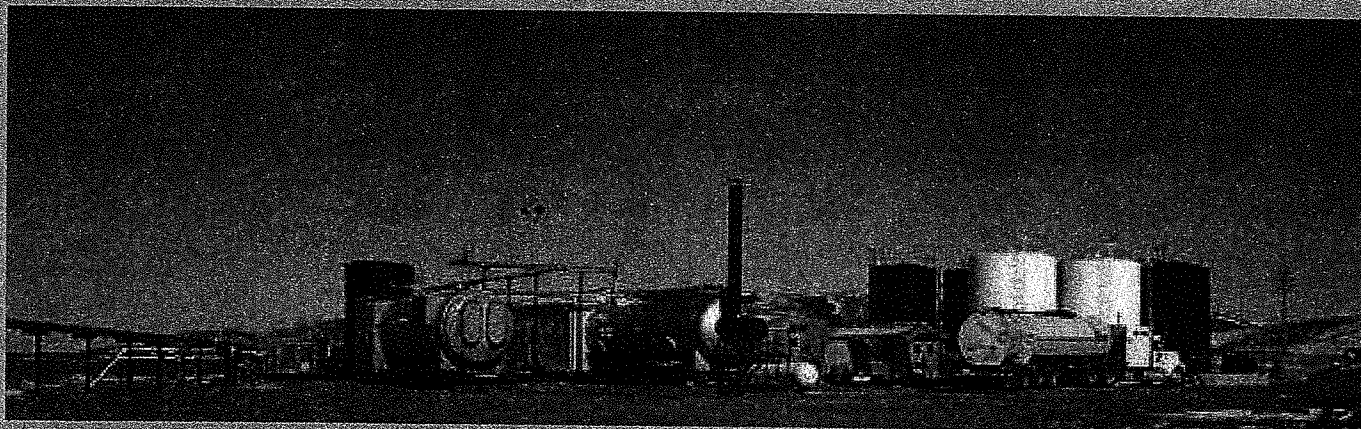
Calgary, Alberta

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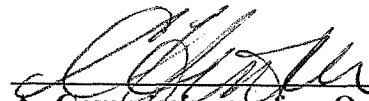
Facsimile: 403-269-1761

Email: info@fairwestenergy.com



**THIS IS EXHIBIT "C" REFERRED TO IN
THE AFFIDAVIT OF VERNON R. FAUTH**

**SWORN BEFORE ME THIS 10TH DAY OF
DECEMBER, 2012.**



**A Commissioner for Oaths in and for the
Province of Alberta**

**CAROLE J. HUNTER
Barrister & Solicitor**

FairWest Energy Corporation

Financial Statements

Statements of Financial Position

December 31, 2011

(Canadian dollars)

(\$000's)	Note	December 31, 2011	December 31, 2010	January 1, 2010
Assets				
Current assets				
Cash		500	-	5
Accounts receivable	5, 19	3,319	3,176	3,292
Notes receivable	19	-	516	2,656
Prepaid expenses		155	213	330
		<u>3,974</u>	<u>3,905</u>	<u>6,283</u>
Non-current assets				
Property, plant and equipment	6	12,764	12,640	22,770
Exploration and evaluation assets	7	5,721	5,029	4,661
Investments in associates	8	81	229	56
Deferred tax assets	11	5,258	2,293	3,715
		<u>23,824</u>	<u>20,191</u>	<u>31,202</u>
Total assets		<u>27,798</u>	<u>24,096</u>	<u>37,485</u>
Equity and liabilities				
Current liabilities				
Accounts payable and accrued liabilities	5, 19	5,611	7,294	9,040
Bank loan payable	12	4,799	2,490	6,641
Financial contracts		-	-	133
Current portion of finance leases	14	156	187	203
Current portion of loans payable	15	29	43	41
Debentures payable	13	4,553	-	-
Preferred shares	9	-	2,082	-
		<u>15,148</u>	<u>12,096</u>	<u>16,058</u>
Non-current liabilities				
Finance leases	14	320	28	65
Loans payable	15	-	29	72
Decommissioning liabilities	16	5,410	5,772	5,142
Flow-through share premium liability	10	590	924	296
Debentures payable	13	-	7,074	3,060
Preferred shares	9	-	-	2,019
		<u>6,320</u>	<u>13,827</u>	<u>10,654</u>
Total liabilities		<u>21,468</u>	<u>25,923</u>	<u>26,712</u>
Equity				
Share capital	10	66,015	55,604	52,081
Warrants	10	23	24	187
Contributed surplus		2,781	2,107	1,675
Deficit		(62,489)	(59,562)	(43,170)
Total equity		<u>6,330</u>	<u>(1,827)</u>	<u>10,773</u>
Total equity and liabilities		<u>27,798</u>	<u>24,096</u>	<u>37,485</u>

Going Concern (note 1)

Contingent liabilities (note 17)

Commitments (note 18)

Subsequent events (note 22)

Approved on behalf of the Board

"Allen Cameron" (signed)

Allen Cameron, Director

"David Kelcher" (signed)

David Kelcher, Director

The accompanying notes are an integral part of these financial statements.

FairWest Energy Corporation

Financial Statements

Statements of Loss and Comprehensive Loss

Years ended December 31,

(Canadian dollars)

(\$000's)

	Note	2011	2010
Revenue			
Petroleum and natural gas		4,255	4,946
Royalties		(473)	(238)
		3,782	4,708
Processing fee income		314	346
Royalty income		30	56
Gain (loss) on disposal of assets		1,480	(700)
Gain on flow-through share premium		956	662
Unrealized gain on financial contract		-	133
Total Revenue		6,562	5,205
Expenses			
Operating		3,892	3,407
Transportation and marketing		239	333
Depletion and depreciation	6	1,940	2,197
General and administration		2,388	2,771
Share-based payments	10	600	244
Part XII.6 tax (recovery)		8	(7)
Exploration and evaluation expense		105	-
Loss on settlement of debt		-	135
Impairment of property, plant and equipment	6	709	8,920
Impairment of exploration and evaluation assets	7	221	-
Share of loss - associates	8	142	61
Total expenses		10,244	18,061
Operating loss before finance and taxes		3,682	12,856
Finance income	21	(36)	(291)
Finance expenses	21	1,846	2,296
Loss on modification of compound financial instruments	9, 13	353	-
Loss before taxes		5,845	14,861
Income tax	11	(41)	34
Deferred tax (recovery)	11	(2,877)	1,497
Net loss and comprehensive loss		2,927	16,392
Basic and diluted loss per share	10	0.013	0.113
Basic and diluted weighted average number of shares outstanding		224,800,279	145,415,353

The accompanying notes are an integral part of these financial statements.

FairWest Energy Corporation

Financial Statements

Statements of Changes in Equity

Years ended December 31, 2011

(Canadian dollars)

	Note	Number of common Shares	Share capital (\$000's)	Convertible debentures equity component (\$000's)	Preferred shares (\$000's)	Total share capital (\$000's)	Warrants (\$000's)	Contributed surplus (\$000's)	Retained earnings/ deficit (\$000's)	Total equity (\$000's)
Balance at January 1, 2011		192,301,620	54,802	645	157	55,604	24	2,107	(59,562)	(1,827)
Issuance of common shares	10	6,060,000	1,212	-	-	1,212	-	-	-	1,212
Issuance of flow-through shares	10	40,956,330	3,729	-	-	3,729	-	-	-	3,729
Preferred share modification	9	-	-	-	493	493	-	-	-	493
Share issue costs net of tax of \$88 thousand		-	(264)	-	-	(264)	-	-	-	(264)
Preferred shares converted to common shares	9	14,082,524	2,743	-	(650)	2,093	-	-	-	2,093
Debentures converted to common shares	13	17,140,008	2,711	(221)	-	2,490	-	-	-	2,490
Warrants exercised	10	6,273,147	629	-	-	629	(1)	-	-	628
Options exercised	10	200,000	29	-	-	29	-	(9)	-	20
Shares cancelled	10	(197,936)	-	-	-	-	-	-	-	-
Share-based payments	10	-	-	-	-	-	-	683	-	683
Net loss and comprehensive loss		-	-	-	-	-	-	-	(2,927)	(2,927)
Balance at December 31, 2011		276,815,693	65,591	424	-	66,015	23	2,781	(62,489)	6,330
Balance at January 1, 2010		129,839,879	51,441	483	157	52,081	187	1,675	(43,170)	10,773
Issuance of common shares	10	12,930,000	1,293	-	-	1,293	-	-	-	1,293
Issuance of flow-through shares	10	43,021,684	1,721	-	-	1,721	-	-	-	1,721
Issuance of debentures	13	-	-	165	-	165	-	-	-	165
Transaction costs net of tax of \$75 thousand	13	-	(222)	(3)	-	(225)	-	-	-	(225)
Issuance costs reclassified from share capital to convertible debentures		-	113	-	-	113	-	-	-	113
Creditor settlements		6,510,057	456	-	-	456	22	-	-	478
Warrants issued	10	-	-	-	-	-	43	-	-	43
Warrants cancelled		-	-	-	-	-	(228)	187	-	(41)
Share-based payments	10	-	-	-	-	-	-	245	-	245
Net loss and comprehensive loss		-	-	-	-	-	-	-	(16,392)	(16,392)
Balance at December 31, 2010		192,301,620	54,802	645	157	55,604	24	2,107	(59,562)	(1,827)

The accompanying notes are an integral part of these financial statements.

FairWest Energy Corporation

Financial Statements

Statements of Cash Flows

Years ended December 31,

(Canadian dollars)

(\$000's)

	2011	2010
Cash flows from (used in) operating activities		
Net loss	(2,927)	(16,392)
Adjustments for:		
Depletion and depreciation	1,940	2,197
Impairment of property, plant and equipment	709	8,920
Impairment of exploration and evaluation assets	221	-
Accretion	315	418
Share-based payments	600	244
Loss (gain) on disposal of assets	(1,497)	830
Deferred tax (recovery)	(2,877)	1,497
Gain on flow-through share premium	(956)	(662)
Share of loss - associates	142	61
Loss on settlement of debt	-	135
Loss on modification of compound instruments	353	-
Unrealized gain on financial contract	-	(133)
Non-cash expenses	-	114
	(3,977)	(2,771)
Change in non-cash working capital	(101)	(1,682)
Abandonment costs incurred	-	(92)
	(4,078)	(4,545)
Cash flows from (used in) financing activities		
Issuance of share capital, net of issuance costs	5,211	4,006
Issuance of convertible debt, net of issuance costs	-	4,053
Change in bank loan payable	2,309	(4,151)
Payments on loans payable	(43)	(41)
Payments on finance leases	(241)	(197)
Proceeds from finance leases	500	144
Exercise of stock options	20	-
Exercise of warrants	629	-
	8,385	3,814
Cash flows from (used in) investing activities		
Expenditures on exploration and evaluation assets	(994)	(651)
Expenditures on property, plant and equipment	(2,843)	(2,604)
Proceeds on sale of property, plant and equipment	1,171	1,852
Proceeds on sale of exploration and evaluation assets	4	-
Investment in associates	-	(511)
Distributions from associates	5	-
Changes in non-cash working capital	(1,150)	2,640
	(3,807)	726
Change in cash and cash equivalents	500	(5)
Cash, beginning of year	-	5
Cash, end of year	500	-

Supplementary Cash Flow Information (note 19)

The accompanying notes are an integral part of these financial statements.

1. Reporting Entity, Nature of Operations and Going Concern

Reporting entity and nature of operations

FairWest Energy Corporation (the "Company") is incorporated in Canada under the Canada Business Corporations Act, with registered offices at suite 800, 407 – 2nd Street SW, Calgary, Alberta, T2P 2Y3. The Company is engaged in the acquisition, exploration, development and production of petroleum and natural gas in western Canada. Its common shares trade on the TSX Venture Exchange under the symbol "FEC".

Going concern

These financials have been prepared on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

As at December 31, 2011, the Company has a working capital deficiency of \$11.2 million, net loss of \$2.9 million and negative cash flow from operations of \$4.0 million. Included in the working capital deficiency of \$11.2 million is \$4.8 million of bank debt, guaranteed by a significant shareholder. At December 31, 2011, the bank debt was in breach of a working capital covenant.

During the first quarter of 2012, the Company arranged a credit facility with another Canadian Chartered Bank (the "New Lender") in the amount of \$7.0 million. The new credit facility is secured by a general security agreement and a \$7.0 million guarantee from a significant shareholder. The new credit facility was used to payout in full the credit facility with the previous lender. The new credit facility does not have any financial covenants and the Company is not in breach of any non-financial covenants. The guarantee from the significant shareholder can be cancelled with 90 days notice, but the Company anticipates the support of the significant shareholder to continue. As at April 19, 2012, approximately \$6.5 million has been drawn on the new credit facility.

During 2011, holders of Series 1 and Series 2 debentures in the amount of \$2.5 million elected to convert to common shares, reducing the Company's long term debt. Series 1 and 2 debentures pay 14% interest and conversion has eliminated the obligation to pay interest in the amount of \$350 thousand. Also during 2011, the holders of the Series 2 debentures agreed to extend the maturity date to December 31, 2012. Series 1 and Series 2 debentures in the amount of \$4.7 million mature in the last quarter of 2012. As well, all of the preferred shares outstanding which were redeemable at the option of the holders after June 15, 2011, were converted to common shares.

The Company expects to improve its cash flow from operations and reduce its working capital deficiency during 2012 by increasing its production levels through drilling, farmouts, optimization and possibly from further acquisitions. An acquisition made in the first quarter of 2011 and wells drilled on farmout lands have yielded promising results and have resulted in numerous potential additional locations and additions to proved plus probable reserves. The Company has drilled one well so far in 2012 on the acquired lands which will add to cash flow and increase working capital. Current production is approximately 275 boe/d and is expected to increase during 2012 as the Company optimizes existing facilities and wells and continues its drilling program as additional capital is raised. Current production is 30% oil, a 40% increase from 2011 levels. The Company will continue to focus on oil production due to the stronger oil price, as compared to gas.

As indicated in Note 6, the Company must incur future development costs of \$9.1 million to fully realize the proved plus probable reserves and the related future cash flows determined by the Company's independent engineers. The Company's year end, independently prepared reserve report prepared by Sproule Associates Limited (the "Sproule Report") anticipates \$8.8 million of these expenditures to be incurred in 2012.

The Company anticipates raising additional equity in 2012 to cover a portion of the required 2012 development costs with the balance provided from expected 2012 operating cash flows. To date the Company has raised \$422 thousand of flow-through equity in 2012. As well the Company will continue to market non-core assets during 2012.

The inability of the Company to raise the additional equity discussed above could result in a further impairment of the carrying value of the Company's property, plant and equipment ("PP&E") and exploration and evaluation ("E&E") assets, and a reduction in the Company's deferred tax assets.

The Company's ability to continue as a going concern and to fully exploit and carry out its planned exploration and development program is contingent upon positive cash flows from operating activities, favourable commodity prices, the maintenance of its existing reserve and production base, successful drilling activities, the availability of financing from its secured lender, the continued support of its creditors and the ability to raise additional equity. The financials do not include any adjustments to the amounts and classifications of assets and liabilities that may be necessary should the Company be unable to continue as a going concern and these adjustments and classifications may be material.

The information contained herein is current as of April 19, 2012.

FairWest Energy Corporation

Notes to the Financial Statements

2. Basis of Preparation

Statement of compliance

The financial statements of the Company represent the first annual financial statements prepared in accordance with the International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). Previously, the Company prepared its annual financial statements in accordance with Canadian Generally Accepted Accounting Principles then applicable to publically accountable enterprises ("Previous GAAP"). Statements of financial position, results of operations and cash flows under IFRS, have been prepared in accordance with IFRS 1 *First-Time Adoption of IFRS*.

The comparative figures for 2010 and the Company's financial position as at January 1, 2010 have been restated from Previous GAAP to IFRS. The reconciliations to IFRS from Previous GAAP are summarized in note 23 and disclose the impact of the transition to IFRS on the Company's reported financial position and financial performance, including the nature and effect of significant changes in accounting policies from those used in the Company's financial statements for the year ended December 31, 2010. Subject to certain transition elections disclosed in note 23, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect.

These financial statements were authorized for issue by the board of Directors on April 19, 2012.

Basis of measurement

The financial statements have been prepared on a historical cost basis, except for the following:

- Measurement of financial contracts
- Measurement of financial instruments at fair value through profit or loss
- Measurement of share-based payments
- Decommissioning liabilities

Functional and presentation currency

These financial statements are presented in Canadian dollars, which is the Company's functional currency.

BOE presentation

The term barrels of oil equivalent ("boe") may be misleading particularly if used in isolation. All boe conversions in this report are derived by converting gas to oil in the ratio of six thousand cubic feet of gas to one barrel of oil. A boe conversion ratio of 6 mcf : 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All amounts of boe/d, bbl/d, mcf/d, \$/boe, \$/bbl and \$/mcf are not expressed in thousands.

Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Significant areas of estimation uncertainty and critical judgments in applying accounting policies that impact the amounts recognized in the financial statements include:

- Compound financial instruments – estimate of the fair value of the liability instruments without conversion features.
- Impairment testing – estimates of oil and natural gas reserves, future commodity prices, future costs, production profiles and discount rates.
- Depletion and depreciation – estimates of oil and natural gas reserves to use in calculations of depletion.
- Decommissioning liabilities – estimates related to amounts, timing, inflation and discount rates.
- Share-based payments – estimates of forfeiture rates, volatility and expected life of options
- Deferred tax – estimates of reversal of temporary differences, tax rates substantially enacted, and probability of assets being realized.
- Accounts receivable and allowance for doubtful accounts – estimates related to timing and collection of accounts receivable.

3. Significant Accounting Policies

a) Principles of consolidation

Subsidiaries

The Company does not have any subsidiary companies.

Associates

Associates are those entities in which the Company has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Company holds between 20 and 50 percent of the voting power of another entity. Investments in associates are accounted for using the equity method (equity accounted investees) and are recognized initially at cost. When applicable, the financial statements include the Company's share of the income and expenses and equity movements of the equity accounted investees, after adjustments to align the accounting policies with those of the Company from the date that significant influence commences, until the date that significant influence ceases. When the Company's share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest, including any long-term investments, is reduced to nil, and the recognition of further losses is discontinued, except to the extent that the Company has an obligation, or has made payments on behalf of the investee.

Jointly controlled operations and jointly controlled assets

Many of the Company's oil and natural gas activities involve jointly controlled assets. The financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

b) Financial instruments

i. Non-derivative financial instruments

Non-derivative financial instruments comprise accounts receivable, notes receivable, cash and cash equivalents, bank loan payable, accounts payable and loans payable. Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Financial assets at fair value through profit or loss

An instrument is classified at fair value through profit or loss if it is held for trading or designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's risk management or investment strategy. Upon initial recognition, attributable transaction costs are recognized in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss. The Company has designated cash and cash equivalents at fair value through profit or loss.

Other

Non-derivative financial instruments, such as accounts receivable, notes receivable, bank loan payable, accounts payable and loans payable are measured at amortized cost using the effective interest method, less any impairment losses.

ii. Derivative financial instruments

The Company may enter into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices. The Company has not designated its financial derivative contracts as effective accounting hedges, and thus not applied hedge accounting, even though the Company considers all commodity contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded on the statement of financial position at fair value. Transaction costs are recognized in profit or loss when incurred.

The Company accounts for its forward physical delivery sales contracts, which may be entered into and are held for the purpose of receipt or delivery of non-financial items in accordance with its expected purchase, sale or usage requirements as executory contracts. As such, these contracts are not considered to be derivative financial instruments and have not been recorded at fair value on the statement of financial position. Settlements on these physical sales contracts are recognized in oil and natural gas revenue.

iii. Compound financial instruments

Compound financial instruments issued by the Company comprise convertible debentures and preferred shares, that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

The liability component of compound financial instruments is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component, if any, is recognized initially at the difference between the fair value of the compound financial instrument and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

FairWest Energy Corporation

Notes to the Financial Statements

3. Significant Accounting Policies (continued)

b) Financial instruments (continued)

iii. Compound financial instruments (continued)

Subsequent to initial recognition, the liability component of compound financial instruments is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not measured again subsequent to initial recognition.

Interest, dividends, losses and gains relating to financial liabilities are recognized in profit or loss.

iv. Share Capital

Common shares

Common share capital is classified as equity. Costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of the tax effect.

Preferred shares

Preferred share capital is classified as equity if it is non-redeemable, or redeemable only at the Company's option. Dividends thereon are recognized as distributions within equity. Preferred share capital is classified as a liability if it is retractable on a specific date or at the option of the shareholder. Dividends thereon are recognized as interest expense in profit or loss as accrued. Shares that have both a liability component and an equity component are split between liability and equity.

c) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, term deposits held with banks and other short-term highly liquid investments with original maturities of three months or less.

d) Exploration and evaluation ("E&E") assets and property, plant and equipment ("PP&E")

i. Recognition and Measurement

Pre-license costs

Costs that are incurred prior to obtaining the legal right to explore, develop or extract resources are expensed in the period they are incurred.

Exploration and evaluation expenditures

E&E costs, including the costs of acquiring licenses, technical services and studies, exploration drilling and testing, and directly attributed general and administrative costs, initially are capitalized as either tangible or intangible E&E assets according to the nature of the assets acquired. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability.

E&E assets are assessed for impairment if:

1. Sufficient data exists to determine technical feasibility and commercial viability, and
2. Facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For purposes of impairment testing, E&E assets are allocated to cash generating units ("CGU").

Technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proved or probable reserves are determined to exist. A review of each field or exploration area is carried out, at least annually, to ascertain whether proved or probable reserves have been discovered. Upon determination of proved or probable reserves, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from E&E assets to PP&E.

E&E assets are reduced for the amount of cash received from farm-outs. No gain or loss is recognized.

Gains and losses on disposal of an item of E&E are determined by comparing the proceeds from disposal with the carrying amount of E&E and are recognized net within "gain (loss) on disposal of assets."

Property, plant and equipment

Items of PP&E, which include oil and natural gas development and production ("D&P") assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. PP&E is grouped into CGUs for impairment testing. IFRS 1 provides an exemption whereby PP&E is valued at deemed cost upon transition to IFRS. Deemed cost is equivalent to the carrying value of PP&E under Previous GAAP and the Company allocated its deemed cost to three CGUs under IFRS. The allocation of deemed cost to the CGUs was made based on proved plus probable reserve values.

3. Significant Accounting Policies (continued)

d) E&E assets and PP&E (continued)

i. Recognition and Measurement (continued)

When significant parts of an item of PP&E, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of PP&E, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of PP&E and are recognized net within "gain (loss) on disposal of assets." Farmouts of oil and gas interests included in PP&E are accounted for as a disposition of an interest in the asset in exchange for the fair value of goods and services received pertaining to the Company's retained interest in the asset.

ii. Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of PP&E are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such costs generally represent amounts incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of PP&E are recognized in profit or loss as incurred.

iii. Depletion and Depreciation

E&E assets are not depleted.

The net carrying value of PP&E is depleted using the unit of production method by reference to the ratio of production in the period to the related proved and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

Proved and probable reserves are estimated by independent, qualified reserve engineer evaluations and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs which are considered commercially producible.

Such reserves may be considered commercially producible if management has the intention of developing and producing them and such intention is based upon:

- a reasonable assessment of the future economics of such production;
- a reasonable expectation that there is a market for all or substantially all the expected oil and natural gas production; and
- evidence that the necessary production, transmission and transportation facilities are available or can be made available.

iv. Determination of cash generating units ("CGU")

PP&E assets are grouped by major producing area into CGUs for purposes of impairment testing. Management has evaluated the oil and natural gas properties of the Company, and grouped the properties into CGUs on the basis of how operations are managed, the ability of these properties to generate independent cash flows, similar reserve characteristics, geographical location, and shared infrastructure. The Company's three CGUs are Provost, Berry Creek and Antelope.

e) Leased assets

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset. Lease payments made under finance leases are apportioned between the finance expenses and the reduction of the outstanding liability. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Other leases are operating leases, which are not recognized on the Company's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

FairWest Energy Corporation

Notes to the Financial Statements

3. Significant Accounting Policies (continued)

f) Impairment

i. Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset. An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. Significant financial assets are tested for impairment on an individual basis. All impairment losses are recognized in profit or loss. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in profit or loss.

ii. Non-financial assets

The carrying amounts of the Company's non-financial assets, other than E&E assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and other intangible assets that have indefinite lives or that are not yet available for use, the recoverable amount is estimated each year at the same time. E&E assets are assessed for impairment when they are reclassified to PP&E assets and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, PP&E assets are grouped together into CGUs. The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their net present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proved and probable reserves.

The goodwill acquired in a business combination, for the purposes of impairment testing, is allocated to CGUs that are expected to benefit from the synergies of the combination. An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment loss had been recognized.

g) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

h) Decommissioning liabilities

The Company provides for dismantling, decommissioning and site disturbance remediation activities based on current legislation and industry operating practices. Provision is made for the estimated cost of decommissioning obligations and capitalized in the respective asset category unless it arises from the normal course of production activities, in which case it is recognized in profit or loss. Decommissioning obligations are measured at the present value of management's best estimate of expenditures required to settle the present obligation at the date of the statement of financial position. Subsequent to initial measurement, the obligation is adjusted at the end of each reporting period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as a finance cost and increases/decreases due to changes in the estimated future cash flows to decommission the asset are capitalized. Actual costs incurred upon settlement of the site restoration obligations are charged against the provision to the extent the provision was established.

i) Revenue recognition

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer. Processing fee income is recognized on a fee for service basis when the service has been performed in accordance with applicable third party agreements.

j) Finance expense

Finance expense comprises interest expense on borrowings, unwinding of the discount on provisions, accretion of compound financial instruments, negative changes in the fair value of financial assets or liabilities at fair value through profit or loss and impairment losses recognized on financial assets. IAS-23 requires capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (an asset that necessarily takes a substantial period of time to get ready for its intended use or sale). Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in profit or loss using the effective interest method. The Company does not have any qualifying assets.

3. Significant Accounting Policies (continued)**k) Income tax**

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous years.

Deferred income tax is recognized using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred income tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination, and at the time of the transaction, affects neither accounting income nor taxable income. Deferred income tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. A deferred income tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred income tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

l) Flow-through common shares

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. When flow-through shares are issued, share capital is recorded at the trading value of a common share. The difference between the proceeds and the common share value is recorded as a flow-through share premium liability. When the flow-through expenditures are incurred, the share premium liability is recognized as other income and the deferred income tax liability on the expenditures is recognized in profit or loss.

m) Share-based payments

The Company has a stock option plan that allows certain officers, directors, consultants and related company employees to acquire shares of the Company. The fair value of the options granted is recognized as an expense or capitalized in the same manner in which the salaries for the related employees are treated, with a corresponding increase in equity.

Share-based payments to employees and others providing similar services are measured at the grant date at the fair value of the instruments issued. Fair value is determined using the Black-Scholes option pricing model taking into account the terms and conditions upon which the options were granted. The amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest. Each tranche in an award with graded vesting is considered a separate grant with a different vesting date and fair value. Each grant is accounted for on that basis. Share-based payments to non-employees are measured at the fair value of the goods or services received, unless that fair value cannot be estimated reliably, in which case the fair value of the equity instruments issued is used. The value of the goods or services is recorded at the earlier of the vesting date, or the date the goods or services are received.

The offset to the recorded cost is to contributed surplus. Consideration received on the exercise of stock options is recorded as share capital and the related share-based payments originally recorded as contributed surplus are transferred to share capital.

n) Earnings per share

The Company presents basic and diluted earnings per share ("EPS") data for its common shares. Basic EPS is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the year. Diluted EPS is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all dilutive potential common shares, which comprise convertible debentures, stock options, warrants and preferred shares.

o) Foreign currency

Foreign currency transactions are recorded at the rate of exchange prevailing at the date of the transaction. Monetary assets and liabilities in foreign currencies are translated at period-end rates. Non-monetary items are translated at historic rates, unless such items are carried at market value, in which case they are translated using the exchange rates that existed when the values were determined. Any resulting exchange rate differences are recognized in profit or loss.

p) New standards and interpretations not yet adopted

Standards issued but not yet effective up to the date of issuance of the Company's financial statements are listed below. This listing is of standards and interpretations issued which the Company reasonably expects to be applicable at a future date.

IFRS 9 *Financial Instruments*— as part of its project to replace IAS 39, the IASB issued the first phase of IFRS 9 implementation dealing with the classification and measurement of financial assets. In October 2010, the IASB updated IFRS 9 by incorporating requirements for the accounting for financial liabilities. The effective date for the application of this standard has been deferred to January 1, 2015.

IFRS 10 *Consolidated Financial Statements*— establishes the accounting principles for consolidated financial statements when one entity controls other entities and replaces IAS 27 Consolidated and Separate Financial Statements and the related provisions of SIC-12 Consolidation— Special Purpose Entities. This standard establishes a new control model that applies to all entities.

FairWest Energy Corporation

Notes to the Financial Statements

3. Significant Accounting Policies (continued)

p) New standards and interpretations not yet adopted (continued)

IFRS 11 *Joint Arrangements* – establishes the accounting principles for parties to a joint venture arrangement and replaces IAS 31 *Interest in Joint Ventures* and SIC-13 *Jointly Controlled Entities: Non-Monetary Contributions by Venturers*. This standard requires a party to assess its rights and obligations from the arrangement in order to determine the type of joint venture arrangement. The choice of proportionate consolidation accounting is removed from joint ventures (currently jointly controlled entities under IAS 31) as equity accounting is required.

IFRS 12 *Disclosure of Interests in Other Entities* – establishes comprehensive disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities and replaces existing disclosures in related standards.

IFRS 13 *Fair Value Measurement* – establishes a single framework for fair value measurement and disclosures when fair value is required or permitted under IFRS. This standard is applied prospectively from the beginning of the period in which the standard is adopted.

IAS 1 *Presentation of Financial Statements* – amendment requires companies to group items presented within comprehensive income based on whether they may be subsequently reclassified to profit and loss. This amendment is effective for annual periods beginning on or after July 1, 2012.

IAS 27 *Separate Financial Statements* – amendments made are designed to focus this standard on the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The standards relating to consolidated financial statements have been provided for in the new IFRS 10.

IAS 28 *Investments in Associates and Joint Ventures* – amendments made to this standard to conform to the changes made in IFRS 10 and IFRS 11.

In December 2011, the ISAB issued amendments to IFRS 7 *Financial Instruments: Disclosures* and IAS 32 *Financial Instruments: Presentation* to clarify the current offsetting model and develop common disclosure requirements. Amendments to IFRS 7 are effective for annual periods on or after January 1, 2013. Amendments to IAS 32 are effective for annual periods beginning on or after January 1, 2014.

Except as noted above, all of the above pronouncements are effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. The Company is currently assessing the impact of adopting these pronouncements.

4. Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable further information about the assumptions made in determining fair values is disclosed in the note specific to the asset or liability.

PP&E assets and E&E assets

The fair value of PP&E assets and E&E assets is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on the Sproule Report. The market value of PP&E is the estimated amount for which PP&E could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction wherein the parties had each acted knowledgeably, prudently and willingly. The market value of oil and natural gas interests (included in PP&E) is estimated with reference to the discounted cash flows expected to be derived for oil and natural gas production based on the Sproule Report. The risk adjusted discount rate is specific to the asset with reference to general market conditions. The fair value of items of plant, equipment, fixtures and fittings is based on market approach and cost approaches using quoted market prices for similar items when available and replacement cost when appropriate.

Accounts receivable, notes receivable, accounts payable, accrued liabilities and bank loan payable

The fair value of accounts receivable, accounts payable, accrued liabilities and bank loan payable approximate their carrying amounts due to their short-term to maturity. The fair value of trade and other receivables with a maturity of more than one year is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

Non-derivative financial liabilities and compound financial instruments

Fair value which is determined for disclosure purposes is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date. In respect of the liability component of convertible debentures and preferred shares, the market rate of interest is determined by reference to similar liabilities that do not have a conversion option. For loans payable, the market rate of interest is determined by reference to similar agreements.

Share-based payments

The fair value of employee stock options is measured using the Black-Scholes model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility, weighted average expected life of the instruments, expected dividends, expected forfeiture rate and the risk-free interest rate. Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value.

FairWest Energy Corporation

Notes to the Financial Statements

5. Financial risk management and capital management

a) Financial Instruments

Set out below is a comparison by category of carrying amounts and fair values of all the Company's financial instruments that are carried in the financial statements:

Financial Assets

	December 31, 2011		December 31, 2010		January 1, 2010	
(\$000's)	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Loans and Receivables						
Accounts receivable	3,319	3,319	3,176	3,176	3,292	3,292
Note receivable	-	-	516	516	2,656	2,656
	3,319	3,319	3,692	3,692	5,948	5,948
Held for Trading						
Cash	500	500	-	-	5	5
Total Financial Assets	3,819	3,819	3,692	3,692	5,953	5,953

Financial Liabilities

	December 31, 2011		December 31, 2010		January 1, 2010	
(\$000's)	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Measured at Amortized Cost						
Accounts payable and accrued liabilities	5,611	5,611	7,294	7,294	9,040	9,040
Bank loan payable	4,799	4,799	2,490	2,490	6,641	6,641
Finance leases	476	476	215	215	268	268
Loans payable	29	29	72	72	113	113
Debentures payable	4,553	4,553	7,074	7,074	3,060	3,060
Preferred shares	-	-	2,082	2,082	2,019	2,019
	15,468	15,468	19,227	19,227	21,141	21,141
Held for Trading						
Financial contracts	-	-	-	-	133	133
Total Financial Liabilities	15,468	15,468	19,227	19,227	21,274	21,274

The fair value of the financial assets and liabilities are included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

The fair values of the debentures payable and the finance lease approximate the carrying values as they have been calculated using rates not significantly different from quoted market rates as at December 31, 2011. The fair value of the bank loan approximates carrying value as the bank loan bears floating market rates. Due to the short-term maturities of accounts receivable and accounts payable and accrued liabilities, their carrying values approximate their fair values. The Financial Contract was classified as "held for trading" and was measured at fair value.

The Company's financial assets and liabilities recorded at fair value have been classified according to the following hierarchy based on the significance of observable inputs employed in the measurement:

Level 1: fair value measurements are based on quoted (unadjusted) prices in active markets for identical assets or liabilities. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis. At December 31, 2011, the Company's cash is classified as level 1.

Level 2: fair value measurements are based on valuation models and techniques where the significant inputs are observable, either directly or indirectly. The Financial Contract held at January 1, 2010 is classified as level 2.

Level 3: fair value measurements are based on unobservable market data. The Company has no financial instruments measured at fair value in the statement of financial position classified as level 3.

FairWest Energy Corporation

Notes to the Financial Statements

5. Financial risk management and capital management (continued)

b) Risks Associated with Financial Instruments

The Board of Directors has overall responsibility for the establishment of the Company's risk management framework. The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities:

- Credit risk
- Liquidity risk
- Market risk

This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing risk. Further quantitative disclosures are included throughout these financial statements.

Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint venture partners and petroleum and natural gas marketers. The Company has practices in place that assess the credit quality of its marketers and suppliers.

(\$000's)	December 31, 2011	December 31, 2010
Oil and natural gas marketing companies	532	664
Joint venture partners and other trade receivables	2,787	2,512
Total	3,319	3,176

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected in one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining partner approval of significant capital expenditures prior to the expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, a further risk exists with joint venture partners, such as disagreements, that increase the potential for non-collection. There is a time lag, sometimes significant, from the receipt of joint venture invoices, through the billing process to partners and receipt of payment that can affect the Company's cash flows. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venture partners; however, the Company has the ability to withhold production from joint venture partners in the event of non-payment where it is the operator.

The carrying amount of accounts receivable represents the maximum credit exposure. The Company does not have an allowance for doubtful accounts as at December 31, 2011 and December 31, 2010.

The Company's receivables are aged as follows:

(\$000's)	December 31, 2011	December 31, 2010
Not past due (less than 90 days)	1,911	1,897
Past due (90 days and over)	676	555
Over 1 year	732	724
Total	3,319	3,176

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company has several strategies to address this risk.

The Company prepares annual capital expenditure budgets which are regularly monitored through a comparison to actual results. If necessary, adjustments are made to the timing of capital expenditures. The Company also utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. To facilitate the capital expenditures program, the Company has a credit facility (note 12). The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month. In addition, the Company utilizes letters of credit pursuant to a letter of credit facility with its lender. At December 31, 2011, approximately \$152 thousand has been issued under these facilities of which \$104 thousand relates to security for the cost of decommissioning liabilities of oil and gas facilities and other operator responsibilities. The remaining \$48 thousand relates to a security granted to a gas processor.

FairWest Energy Corporation

Notes to the Financial Statements

5. Financial risk management (continued)

Liquidity risk (continued)

The following is a maturity analysis of the Company's financial obligations:

(\$000's)	Less than 1 month	1-3 months	3 months to 1 year	Beyond 1 year	Total
Accounts payable	1,555	1,410	947	1,699	5,611
Bank loan payable	-	-	4,799	-	4,799
Debentures payable	-	-	4,679	-	4,679
Finance leases	15	31	141	342	529
Loans payable	4	7	18	-	29
	1,574	1,448	10,584	2,041	15,647

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Company's income or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company may utilize financial or physical contracts to manage market risks.

Commodity price risk

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted not only by the relationship between the Canadian and United States dollar, but also by world economic events that dictate the levels of supply and demand. Based on December 31, 2011 production levels, a \$1.00/mcf change in gas prices received would change gross revenue from sales of gas by 27% or approximately \$530 thousand and a \$10.00/bbl change in oil and gas liquids prices received would change gross revenue from sales of oil by 12% or approximately \$269 thousand for the year ended December 31, 2011.

As at December 2011, the Company had entered into two physical contracts, each for 50 bbl/d of oil production. The first contract is for the period November 2011 to April 2012, has a floor price of \$90.00/bbl and a ceiling price of \$94.00/bbl, based on West Texas Intermediate ("WTI"), and adjusted to the delivery point. The second contract is for the period May 1, 2012 to October 31, 2012 for a fixed price of \$101.10/bbl, base on WTI, adjusted to the delivery point.

Subsequent to year end, the Company has also entered into two physical contracts for gas. The first is for the period April 1 to October 31, 2012, for 1,000 GJ/d whereby if the AECO monthly index gas price goes below \$2.00/GJ the Company will be paid that price plus an additional \$1.00/GJ. The second is for the period November 1, 2012 to October 31, 2013 and is based on the AECO monthly index gas price with a floor of \$2.00/GJ and a ceiling of \$3.00/GJ for 1,000 GJ/d. At December 31, 2010, the Company had no long-term forward averaging contracts.

The Company enters into monthly gas physical contracts to help mitigate commodity price risk as a normal part of its operations.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears a floating rate of interest. A change of 1.0% in the floating rate would have a \$48 thousand impact on income before income taxes in the year, based on the amount of the bank debt at December 31, 2011. The Company had no interest rate swap or financial contracts in place as at or during the years ended December 31, 2011 and December 31, 2010.

Capital Management

The Company's objective is to attain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Company considers its capital structure to include shareholders' equity, bank debt and working capital.

(\$000's)	December 31, 2011	December 31, 2010
Equity	6,330	(1,827)
Bank loan payable	4,799	2,490
Working capital (deficiency)(excluding bank debt)	(6,375)	(5,701)
Total	4,754	(5,038)

FairWest Energy Corporation

Notes to the Financial Statements

5. Financial risk management (continued)

Capital Management (continued)

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the Company's planned requirements, and the risk characteristics of the underlying petroleum and natural gas assets. In order to maintain or adjust capital structure, the Company may from time to time issue new shares or debt instruments, adjust its capital spending and sell assets to manage current and projected debt levels.

The Company monitors capital based on the ratio of net debt to quarterly annualized funds flow from operations. In this ratio, net debt is defined as all outstanding debt, excluding the liability component of preferred shares, plus or minus working capital, divided by funds flow from operations for the most recent calendar quarter, annualized (multiplied by four). Funds flow from operations is defined as cash flow from operating activities before changes in non-cash working capital. The Company's goal is to achieve a ratio of less than 2 to 1. This ratio may increase at certain times as a result of acquisitions. In order to facilitate the management of this ratio, the Company prepares annual capital expenditures budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. The annual budgets are approved by the Board of Directors.

For the year ended December 31, 2011, the Company's ratio of net debt to quarterly annualized funds flow from operations was negative (December 31, 2010 - negative). The December 31, 2011 ratio is not within the range set by management as a result of low natural gas prices, declining production and capital expenditures to increase production being delayed. Management's plan to lower this ratio in 2012, includes increasing production volumes and associated cash flow in particular oil production through drilling, farmout arrangements, optimization and purchase of oil and gas assets. The Company also plans to raise additional equity and sell non-core assets. During 2011, average production is approximately 316 boe/d (2010 average – 408 boe/d). This decrease is a result of natural declines, the sale of interests in several areas and curtailed capital expenditures to accommodate restructuring efforts. Current production is approximately 275 boe/d and is expected to increase as new production comes on stream.

The net debt to annual funds flow from operations has been calculated as follows:

(\$000's)	December 31, 2011	December 31, 2010
Working capital deficiency (excluding bank debt)	6,375	5,701
Bank loan payable	4,799	2,490
Debentures payable	4,553	7,074
Long term finance leases and loans payable	320	57
	16,047	15,322
Quarterly funds flow from operations	(1,430)	(826)
Annualizing factor	4	4
Annualized funds flow from operations	(5,720)	(3,304)
Ratio	-	-

The Company's share capital is not subject to external restrictions, however, the bank debt facility in place at December 31, 2011 was based on petroleum and natural gas reserves and certain covenants imposed by the bank. The credit facility was secured by a \$35.0 million debenture against the Company's assets and a \$5.0 million guarantee from a significant shareholder which was extended into 2012. During the first quarter of 2012, the Company changed its banking relationship to the New Lender. The Company has a credit facility with the New Lender in the amount of \$7.0 million (note 12). This credit facility is secured by a General Security Agreement and \$7.0 million guarantee from a significant shareholder. This guarantee can be cancelled with 90 days notice, but the Company anticipates continued support from the significant shareholder.

At December 31, 2011, \$2.5 million of Series 1 and 2 debentures were converted to common equity. The effect of all these conversions will be to decrease annual interest payments in the amount of \$350 thousand per annum.

There were no changes in the Company's approach to capital management during the year.

FairWest Energy Corporation

Notes to the Financial Statements

6. Property, plant and equipment

(\$000's)	Petroleum and natural gas PP&E	Office & automotive equipment	Total
Cost or deemed cost			
Balance at January 1, 2010	22,412	358	22,770
Additions	3,532	13	3,545
Disposals and derecognition	(2,945)	-	(2,945)
Balance at December 31, 2010	22,999	371	23,370
Additions	3,297	-	3,297
Transferred from E&E	8	-	8
Disposals and derecognition	(1,294)	(38)	(1,332)
Balance at December 31, 2011	25,010	333	25,343
Accumulated depletion, depreciation and impairment losses			
Balance at January 1, 2010	-	-	-
Depletion and depreciation for the period	2,110	87	2,197
Impairment loss	8,932	-	8,932
Impairment reversal	(12)	-	(12)
Disposals and derecognition	(387)	-	(387)
Balance at December 31, 2010	10,643	87	10,730
Depletion and depreciation for the period	1,874	66	1,940
Impairment loss	5,346	-	5,346
Impairment reversals	(4,637)	-	(4,637)
Disposals and derecognition	(768)	(32)	(800)
Balance at December 31, 2011	12,458	121	12,579
Carrying amounts			
At January 1, 2010	22,412	358	22,770
At December 31, 2010	12,356	284	12,640
At December 31, 2011	12,552	212	12,764

Due to significant fluctuations in commodity prices during 2011, the Company determined there were indicators of impairment for its predominantly gas CGUs and possible impairment reversals for its predominantly oil CGUs. During the year ended December 31, 2011, the Company recognized a net impairment of \$709 thousand (December 31, 2010 – \$8.9 million). Included in the calculation of depletion are future development costs in the amount of \$9.1 million (December 31, 2010 - \$3.5 million). During the year ended December 31, 2011, the Company capitalized general and administrative expenditures directly related to development activity of \$136 thousand (December 31, 2010 - \$84 thousand).

D&P assets are assessed for impairment by comparing fair value less cost to sell to net book value ("NBV"). Fair value less cost to sell are based on the Sproule Report discounted cash flows using before tax net cash flows based on proved plus probable reserves. Cash flows are discounted at 10.0% for oil weighted CGUs and 15.0% for gas weighted CGUs. The resulting value is compared to the NBV of the Company's D&P assets.

The price forecasts used in the Sproule Report calculation of future cash flows are as follows:

	Oil Alberta Par Price Cdn.\$/bbl	Natural Gas AECO – C Spot Cdn.\$/ MMBTU
2012	96.81	3.16
2013	93.75	3.78
2014	90.89	4.13
2015	96.23	5.53
2016	98.16	5.65
% increase thereafter	2.0%	2.0%

Included in PP&E is equipment under capital lease with a net book value as shown in the table below:

(\$000's)	December 31, 2011	December 31, 2010
Cost	500	1,035
Accumulated depletion	(26)	(591)
Net book value	474	444

If the forecasted price of natural gas were to decrease by 10%, we would have an additional impairment of \$1.1 million, at a 15% discount rate, for the year ended December 31, 2011. If the forecasted price of oil were to decrease by 10%, we would have an additional impairment of \$2.3 million, at a 10% discount rate, for the year ended December 31, 2011. If the discount rate was to change by 1%, we would have an additional impairment of \$600 thousand for the year ended December 31, 2011.

FairWest Energy Corporation

Notes to the Financial Statements

7. Intangible Exploration and Evaluation assets

Intangible exploration and evaluation ("E&E") assets consist of the Company's exploration projects which are pending the determination of proved and probable reserves. Additions represent the Company's share of costs incurred on E&E assets during the year.

(\$000's)	
E&E Assets	
Cost or deemed cost:	
Balance at January 1, 2010	4,661
Expiries	-
Transferred to D&P	-
Disposals	(299)
Additions	667
Balance at December 31, 2010	5,029
Additions	1,046
Expiries	(221)
Transferred to D&P	(8)
Disposals	(125)
Balance at December 31, 2011	5,721

During the year ended December 31, 2011, the Company capitalized general and administrative expenditures directly related to E&E assets of \$523 thousand (December 31, 2010 - \$656 thousand)

8. Investments in associates

(\$000's)	December 31, 2011	December 31, 2010
Petrovest Exploration & Production Corporation ("Petrovest")	-	-
Royalty Investments Limited Partnership ("RILP")	81	229
Total	81	229

The investments in each of the associates is less than 20%, however, the Company exerts significant influence over these entities through representation on the board of directors.

Petrovest Exploration & Production Corporation

(\$000's)	December 31, 2011	December 31, 2010
Balance beginning of year	-	56
Share of net loss for year	-	(56)
Balance end of year	-	-

The Company's share of Petrovest's cumulative net losses exceeds its original investment which has been adjusted to \$nil (December 31, 2010 - \$nil). The Company received dividends in the amount of \$3 thousand during 2011 (2010 - \$nil)

Royalty Investments Limited Partnership

(\$000's)	December 31, 2011	December 31, 2010
Balance beginning of year	229	-
Investment during year	-	522
Distributions	(3)	-
Share of net loss for year	(75)	(5)
Impairment	(70)	-
Loss on disposal of units	-	(288)
Balance end of year	81	229

The Company's share of RILP's net loss at December 31, 2011 was \$75 thousand (December 31, 2010 - \$5 thousand) and the carrying value has been reduced by that amount. In addition, the Company has recorded an impairment of \$70 thousand. The Company received distributions in the amount of \$3 thousand during 2011 (2010 - \$nil).

FairWest Energy Corporation

Notes to the Financial Statements

9. Preferred shares

Issued Preferred shares	Number of shares	Amount (\$000's)
Balance Preferred shares January 1, 2010	211,259	2,019
Accretion	-	63
Balance Preferred shares December 31, 2010	211,259	2,082
Accretion	-	11
Converted to common shares	(211,259)	(2,093)
Balance Preferred shares December 31, 2011	-	-

On December 29, 2008, the Company issued 211,259 7% Cumulative Convertible Redeemable Preferred shares, Series 1, with a stated value of \$10.00 per preferred share. Each Series 1 Preferred Share was convertible into 33.33 of the Company's common shares ("Conversion Basis") at any time from the date of issuance and such conversion would result in the issuance of up to 7,041,296 of the Company's common shares. Each Series 1 Preferred Share was redeemable at any time on or after December 15, 2010 at the option of the Company at a price equal to \$10.00 per Series 1 Preferred Share with accrued and unpaid cumulative dividends thereon and were retractable at any time on or after June 15, 2011 at the option of the holder of the Series 1 Preferred Share at a price equal to \$10.00 per Series 1 Preferred Share with accrued and unpaid cumulative dividends thereon. If at any time the Company's common shares trade at or above \$0.30 per share for a consecutive period of 10 trading days, the Company may, at its option, convert all of the outstanding Series 1 Preferred Shares into common shares on the Conversion Basis. The holders of the preferred shares are entitled to receive a cumulative dividend of 7% per annum payable quarterly on March 31, June 30, September 30 and December 31 of each year commencing on March 31, 2009. Dividends in the amount of \$34 thousand were paid in 2011 prior to the conversion (December 31, 2010 - \$148 thousand) and recorded in finance expense.

Effective December 15, 2010, the holders of the preferred shares agreed to amend the date of retraction of the preferred shares from June 15, 2011 to December 31, 2012 and the conversion rate of the preferred shares from 33.33 to 66.66 and received regulatory approval in the first quarter of 2011. This modification resulted in a \$493 thousand addition to equity and an offsetting amount recognized in income as a cost of modification. On March 7, 2011, the Company converted the preferred shares to common equity and issued 14,082,524 common shares. Conversion of the preferred shares resulted in extinguishment of the liability component and equity component of the preferred shares in the amount of \$2.1 million and \$650 thousand respectively and an addition to share capital for common equity in the amount of \$2.7 million.

The preferred shares have a liability component because of the retraction feature and an equity component because of the conversion feature. The fair value of the equity component was calculated using the net residual method.

10. Share capital

The Company is authorized to issue an unlimited number of common voting shares and an unlimited number of preferred shares. During the year ended December 31, 2011, the Company issued 6,060,000 common shares for gross proceeds of \$1.2 million and 40,956,330 flow-through shares for gross proceeds of \$4.4 million. A flow-through share premium liability was recorded of \$622 thousand with an offset to share capital. These adjustments resulted in addition to share capital of \$1.2 million for common equity and \$3.7 million for flow-through equity. During the year ended December 31, 2010, the Company issued 12,930,000 common shares for gross proceeds of \$1.3 million and 43,021,684 flow-through shares for gross proceeds of \$3.0 million. A flow-through premium liability was recorded of \$1.3 million with an offset to share capital. These adjustments resulted in additions to share capital of \$1.3 million for common equity and \$1.7 million for flow-through equity.

During 2011, \$2.5 million debentures were converted to 17,140,008 common shares. These conversions resulted in an increase in common share capital of \$2.7 million and a decrease of \$221 thousand in the equity component of share capital, for a net increase in share capital of \$2.5 million (note 13).

During 2011, 197,936 shares were cancelled. When Fairstar Explorations Inc. (Fairstar") and Western Energy Corporation amalgamated to form the Company in 2005, shareholders of Fairstar had six years to submit their Fairstar share certificates for conversion to the Company shares. The cancelled shares relate to those shares which were held for conversion, but not submitted and have now been returned to treasury.

Warrants	December 31, 2011		December 31, 2010	
(\$000's), except number of warrants	Number of Warrants	Amount	Number of Warrants	Amount
Balance, beginning of year	600,104	24	5,000,000	187
Issued	-	-	2,600,238	65
Cancelled	-	-	(2,000,134)	(41)
Exercised	(23,147)	(1)	-	-
Expired	-	-	(5,000,000)	(187)
Balance, end of year	576,957	23	600,104	24

During the year ended December 31, 2011, 23,147 warrants with an exercise price of \$0.15 were converted and resulted in the Company issuing 23,147 common shares for proceeds of \$3 thousand. This warrant exercise increased share capital by \$4 thousand and decreased warrants issued value by \$1 thousand.

FairWest Energy Corporation

Notes to the Financial Statements

10. Share capital (continued)

As part of the settlement with a former subsidiary of the Company's secured lender, 5.0 million warrants were issued with an exercise price of \$0.20 per warrant. The fair value of the warrants was calculated using the Black-Scholes option pricing model with the following assumptions: expected life – 2 years; risk free rate – 2%; expected volatility 74%; exercise price \$0.20. The warrants expired August 19, 2010. The equity portion of these warrants has been transferred to contributed surplus.

During 2010, 2,048,667 were brokers' warrants issued as payment of commissions relating to Series 2 debenture issuances. The warrants have an exercise price of \$0.15 per warrant and expire on March 31, 2012. The fair value of the warrants of \$0.02 per warrant was calculated using the Black-Scholes option pricing model with the following assumptions: expected life – 2 years; risk free rate – 1.34% to 1.73%; expected volatility 103.20% to 106.8% and exercise price - \$0.15. At December 31, 2010, 2,000,134 commission warrants valued at \$41 thousand were cancelled. In addition, during 2010, the Company settled \$831 thousand of unsecured trade debt with \$180 thousand cash, 6,510,057 common shares and 551,571 common share purchase warrants. The deemed price of the common shares issued was \$0.10 per share. The fair value assigned to each common share was \$0.07 per share. The warrants are exercisable into common shares at a price of \$0.15 per share until September 30, 2012. The fair value of the warrants of \$0.04 per warrant was calculated using the Black-Scholes option pricing model with the following assumptions: expected life – 2.5 years; risk free rate – 1.19% to 1.63%; expected volatility 128.55% to 130.42% and exercise price - \$0.15.

Flow-through Share Warrants	December 31, 2011		December 31, 2010	
(\$000's), except number of warrants	Number of Warrants	Amount (\$)	Number of Warrants	Amount (\$)
Balance, beginning of year	6,250,000	-	6,250,000	-
Exercised	(6,250,000)	-	-	-
Balance, end of year	-	-	6,250,000	-

Flow-through share units were issued in 2009 at \$0.20 per unit. Each unit consisted of two flow-through shares and one warrant. The warrants had an exercise price of \$0.10 and upon exercise the holder can acquire one flow-through share per warrant. The warrants had an original expiry date of December 18, 2010. The residual value method was used to value the warrants. During 2010, the Company applied for and received regulatory approval during 2010 to amend the expiry date to September 14, 2011. As a result of the extension of the expiry date of the warrants, the ability of the warrant-holder to convert the warrants to flow-through shares was no longer available. All other terms and conditions of the warrants remain unchanged. This modification did not result in a revaluation of the warrants. The warrants were exercised during the third quarter of 2011 resulting in a \$625 thousand increase in share capital and 6,250,000 common shares issued.

Stock options

The Stock Option Plan ("the Plan") was adopted in order to offer directors, officers and employees of the Company and persons and companies providing ongoing services to the Company, the opportunity, through share options, to acquire a proprietary interest in the Company, thereby providing an additional incentive to the persons and companies contemplated above to promote the best interests of the Company and to provide the means to the Company to attract qualified persons. In accordance with the Option Policy, rolling option plans must receive approval of the shareholders yearly at the Company's annual meeting. The Plan was given shareholder approval at the annual and special shareholder meeting held June 29, 2011. Pursuant to TSX Venture Exchange Policy 4.4 ("the Option Policy") the Company is permitted to maintain a rolling stock option plan. The total number of shares that may be issued pursuant to the Plan shall not exceed 10% of the aggregate number of issued and outstanding shares of the Company. The maximum number of shares that may be reserved for issuance to any one person under the Plan is 5% of the shares outstanding at the time of the grant.

Changes in the number of options, with weighted average exercise prices are summarized as follows:

	December 31, 2011		December 31, 2010	
	Number of Options	Weighted Average Exercise Price (\$)	Number of Options	Weighted Average Exercise Price (\$)
Balance, beginning of year	12,875,000	0.119	6,725,000	0.212
Granted	7,700,000	0.197	7,950,000	0.100
Cancelled	(450,000)	0.150	(1,800,000)	0.385
Exercised	(200,000)	0.100	-	-
Balance, end of year	19,925,000	0.149	12,875,000	0.119
Exercisable	12,141,691	0.139	7,574,998	0.133

10. Share capital (continued)

Stock options (continued)

As at December 31, 2011, the following options are outstanding:

Number of common shares under option	Exercisable Options	Exercise price per option (\$)	Weighted average life remaining (years)
4,475,000	4,475,000	0.15	3.00
7,200,000	4,733,359	0.10	3.22
50,000	33,333	0.10	3.22
500,000	333,334	0.10	3.65
200,000	66,667	0.10	4.08
7,500,000	2,499,998	0.20	4.42
19,925,000	12,141,691		3.64

Share-based payments

The assumptions and resulting fair values for stock options granted during the years ended December 31, 2011 and December 31, 2010 were as follows:

	December 31, 2011	December 31, 2010
Risk-free interest rate (%)	2.00 – 2.56	2.08 – 2.90
Expected dividend yield (years)	-	-
Expected stock price volatility (%)	112 – 140	105 – 108
Expected option life (weighted average) (years)	3 – 5	3 – 5
Exercise price (\$)	0.10 – 0.20	0.10
Grant date fair value (\$)	0.06 – 0.13	0.03 – 0.05

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options.

Flow-through shares

The following table summarizes information about flow-through shares outstanding:

(\$000's)	Qualifying Expenditures			
	Total flow-through proceeds	Cumulative amount incurred to December 31, 2010	Cumulative amount incurred to December 31, 2011	Expenditures remaining at December 31, 2011
Year Issued				
2010 ⁽¹⁾	3,012	1,017	3,012	-
2011 ⁽²⁾	4,351	-	228	4,123
	7,363	1,017	3,240	4,123

(1) The Company renounced proceeds to investors as at December 31, 2010 and had until December 31, 2011 to incur the qualifying expenditures.

(2) The Company renounced proceeds to investors as at December 31, 2011 and has until December 31, 2012 to incur the qualifying expenditures.

During 2008, the Canada Revenue Agency ("CRA") initiated an audit of the Company's (including a previous subsidiary) flow-through share offerings for the 2004, 2005 and 2006 taxation years. On February 26, 2009, the Company received a letter from CRA indicating they believed the Company had a shortfall of \$3.3 million of flow-through eligible expenditures. These findings were summarized in a subsequent letter dated March 20, 2009. CRA subsequently issued a notice of reassessment. The Company did not believe that the reassessment was valid and filed a notice of objection on July 29, 2009. The CRA acknowledged receipt of the objection in a letter dated December 20, 2009 and indicated that a review would be completed by the appeals division of the CRA. To date the Company has not received any correspondence from the appeal division of CRA, but has received verbal confirmation that CRA is reviewing the notice of objection. Management's assessment is that any amounts that may be payable by the Company to CRA and/or investors resulting from the above will not be material.

FairWest Energy Corporation

Notes to the Financial Statements

10. Share capital (continued)

Flow-through share premium liability

(\$000's)	December 31, 2011	December 31, 2010
Balance beginning of year	924	296
Premium attributed to flow-through shares issued	622	1,290
Reduction of liability due to expenditures incurred	(956)	(662)
Balance end of year	590	924

Expenditures during the year ended December 31, 2011 resulted in a reduction of the flow-through share premium liability of \$956 thousand.

Earnings per share

The following sets forth the computed basic and diluted earnings per share:

	December 31, 2011	December 31, 2010
Numerator		
Net loss (\$000's)	2,927	16,392
Denominator		
Weighted average number of common shares	224,800,279	145,415,353
Effect of dilutive securities		
preferred shares	-	-
stock options	-	-
debentures	-	-
warrants	-	-
	224,800,279	145,415,353
Basic and diluted loss per share (\$)	0.013	0.113

All of the above preferred shares, stock options, warrants and debentures are potentially dilutive but were not included in the calculation of diluted earnings per share for the years ended December 31, 2011 and December 31, 2010 because to do so would be anti-dilutive.

11. Income taxes

- (a) The provision for income taxes recorded in the financial statements differs from the amount which would be obtained by applying the statutory income tax rate of 26.5% (December 31, 2010 – 28.0%) to the loss for the years as follows:

(\$000's)	December 31, 2011	December 31, 2010
Loss for the year before income taxes	(5,845)	(14,861)
Statutory rate	26.5%	28.0%
Expected income tax	(1,549)	(4,161)
Increase (decrease) resulting from:		
Change in rates	74	446
Share-based payments	159	68
Non taxable gain on flow-through share premium	(253)	(185)
Flow-through share expenditures	589	561
Recognition of previously unrecognized tax assets	(2,668)	-
Unrecognized deferred tax assets	-	5,093
Other	771	(325)
Provision for income taxes (recovery)	(2,877)	1,497

- (b) The components of the Company's deferred income tax assets are as follows:

(\$000's)	December 31, 2011	December 31, 2010	January 1, 2010
Share issuance costs	159	162	200
Non capital loss carry forwards	3,912	2,077	1,203
Decommissioning liabilities	-	-	1,286
Exploration and evaluation and property, plant and equipment	1,068	-	926
Risk management asset	-	-	33
Finance leases	119	54	67
Net deferred income tax asset	5,258	2,293	3,715

11. Income taxes (continued)

At December 31, 2011 a deferred tax asset of \$5.3 million (December 31, 2010 - \$2.3 million) has been recognized in the financial statements. Management considers it probable that future taxable profits will be available against which the tax benefits will be utilized. The main factor that influenced the decision to increase the deferred tax asset was the increase in proved and probable reserves and the associated forecast cash flows.

The Company has non-capital losses available to reduce future taxable income in the amount of \$15.6 million between 2014 and 2030.

c) Deferred tax assets have not been recognized in respect of the following items:

(\$000's)	December 31, 2011	December 31, 2010	January 1, 2010
Exploration and evaluation and property, plant and equipment	16,108	23,541	12,158
Non capital loss carry forwards	-	3,212	-
Decommissioning liabilities	5,410	5,772	-
Capital losses	5,790	5,445	5,445
Total unrecognized deferred tax assets	27,308	37,970	17,603

Deferred tax assets have not been recognized in respect to these items because it is not probable that future taxable profit will be available against which the benefits can be utilized. A portion of these tax assets relate to certain resource pools that are restricted through the successor tax rules and foreign exploration and development pools.

12. Bank loan payable

During 2010, the Company changed its banking relationship to a new bank. The previous credit facility was paid out from the proceeds of the new credit facility with the new bank and a short term loan from a significant shareholder in the amount of \$1.7 million. The short term loan was paid in full with accrued interest on December 31, 2010. The new credit facility was a revolving, operating demand bank loan facility of \$3.6 million that bore interest at the bank's prime lending rate plus 1%. At December 31, 2010 there was \$2.5 million drawn on this credit facility. The Company was in breach of the working capital covenant at December 31, 2010 and received a waiver of this covenant from the bank for this breach.

During 2011, the Company's revolving, operating demand loan facility was increased to \$7.5 million and bore interest at the lender's prime lending rate plus 2.5% on the first \$3.0 million of advances and the lender's prime lending rate on the balance of advances. The loan facility was secured by a \$35.0 million debenture over the Company assets and a \$5.0 million guarantee from a significant shareholder. A guarantee fee of \$275 thousand was paid to the guarantor. The guarantee was to expire on December 31, 2011, but was extended into the first quarter of 2012. At December 31, 2011, there was \$4.8 million drawn on the facility. At December 31, 2011, the Company was in breach of its working capital covenant.

During the first quarter of 2012, the Company changed its banking relationship to another Canadian Chartered Bank (the "New Lender"). The Company has a credit facility with the New Lender in the amount of \$7.0 million which is secured by a general security agreement and a guarantee in the amount of \$7.0 million from a significant shareholder. The guarantee can be cancelled with 90 days notice, however the Company anticipates the support of the significant shareholder to continue. The Company is not currently in breach of any covenants with regards to the new lending facility. Interest on the credit facility with the New Lender is prime plus 2.5%. At December 31, 2011, the bank prime rate was 3.0%.

13. Debentures payable

Series 1

In 2007, the Company issued 2,000 Series 1 debentures, each with a principal amount of \$1 thousand, for total proceeds of \$2.0 million.

On October 31, 2009, debenture holders representing 1,750 Series 1 debentures agreed to extend the term of the debentures for a further 24 months, to October 31, 2011. The interest rate remained unchanged at 14% per annum. The conversion rate was changed to \$0.15. The debentures are convertible to common shares at \$0.15 per common share at the option of the holder at any time. The Company reserved 11,666,667 common shares for the conversion. One debenture holder representing 250 debentures (\$250 thousand) did not agree to extend the debenture and was repaid over several months with the balance outstanding included in accounts payable bearing interest at 14% per annum. The balance at December 31, 2010 of \$75 thousand has been fully repaid. At December 31, 2010 and effective December 15, 2010, the Company received approval from all Series 1 debenture holders, and subsequently received regulatory approval in the first quarter of 2011 to extend the maturity date from October 31, 2011 to November 27, 2012. The interest rate on the Series 1 debentures remains unchanged at 14%. The total interest paid on the Series 1 debentures at December 31, 2011 was \$185 thousand (December 31, 2010 - \$249 thousand).

During the year ended December 31, 2011, debenture holders representing 580 debentures converted to common shares as per the conversion feature and the Company issued 3,866,666 common shares. This resulted in a reduction in debentures payable of \$580 thousand, reduction in debenture equity of \$142 thousand and an increase in common share equity of \$722 thousand.

FairWest Energy Corporation

Notes to the Financial Statements

13. Debentures payable (continued)

Series 2

During 2010, the Company issued a total of 4,135 Series 2 debentures, each with a principal amount of \$1 thousand, for total proceeds of \$4.1 million. The debentures bear interest at 14% per annum and were set to mature on March 31, 2012. Regulatory approval for this issuance was received during the second quarter of 2011. Interest is paid monthly. The Series 2 debentures have an equity component because of the conversion feature. The total interest paid at December 31, 2011 was \$671 thousand (December 31, 2010 - \$652 thousand). As of July 1, 2010, the debentures were redeemable by the Company. The debentures are convertible to common shares at \$0.15 per common share at the option of the holder at any time.

Effective December 15, 2010, the holders of the series 2 debentures agreed to amend the terms of the debentures by extending the maturity date of the debentures to December 31, 2012 and during the second quarter of 2011, approval was received from regulatory authorities. No other terms were changed. This modification resulted in a decrease to the Series 2 debentures of \$140 thousand and a corresponding gain on compound instrument for the year ended December 31, 2011. During the year ended December 31, 2011, Series 2 debenture holders representing 1,991 debentures converted their debentures to 13,273,342 common shares. This resulted in a reduction in debentures payable of \$1.9 million, reduction in debenture equity of \$79 thousand and an increase in common share equity of \$2.0 million.

The following table shows the liability and equity components of the debentures:

Series 1 Debentures	Number of debentures	Liability component (\$000's)	Equity component (\$000's)	Total (\$000's)
Balance January 1, 2010 and December 31, 2010	1,750	1,750	428	2,178
Converted	(580)	(580)	(142)	(722)
Balance December 31, 2011	1,170	1,170	286	1,456
Series 2 Debentures	Number of debentures	Liability component (\$000's)	Equity component (\$000's)	Total (\$000's)
Balance January 1, 2010	1,365	1,310	55	1,365
Issuance of convertible debentures	4,135	3,970	165	4,135
Issuance costs	-	(79)	(3)	(82)
Amortization of issuance costs	-	37	-	37
Accretion of liability	-	86	-	86
Balance December 31, 2010	5,500	5,324	217	5,541
Converted	(1,991)	(1,912)	(79)	(1,991)
Modification of terms	-	(140)	-	(140)
Amortization of issuance costs	-	26	-	26
Accretion of liability	-	85	-	85
Balance December 31, 2011	3,509	3,383	138	3,521
Total Series 1 and Series 2 Debentures	Number of debentures	Liability component (\$000's)	Equity component (\$000's)	Total (\$000's)
January 1, 2010	3,115	3,060	483	3,543
December 31, 2010	7,250	7,074	645	7,719
December 31, 2011	4,679	4,553	424	4,977

14. Finance leases

The Company previously entered into two finance leases for the purchase of compression equipment. One lease was to expire November 30, 2010. This lease was extended to September 30, 2011 and bore interest at 12.9%. At the end of the lease, the Company purchased the asset for one dollar. Initially, the second lease was to expire July 31, 2011, but was extended to March 31, 2012 and bore interest at 12.9%. At the end of the lease, the Company had the option to purchase the asset for one dollar. During 2011, the Company paid out the lease early under the terms of the agreement and acquired the asset.

Subsequent to the purchase of the two compressors, the Company entered into a sale and leaseback arrangement whereby the two compressors were sold for proceeds of \$500 thousand and leased back. The Company recognized a gain on the sale of the compressors of \$2 thousand. The lease expires on October 2014 and bears interest at 8.0%. At the end of the lease, the Company has the option to purchase the assets for one dollar.

The future obligations under the capital leases are:

(\$000's)	2012	2013	2014	Total
Principal	156	169	151	476
Imputed interest	31	18	4	53
	187	187	155	529

FairWest Energy Corporation

Notes to the Financial Statements

15. Loans payable

The Company entered into two financing arrangements for service field trucks. One arrangement expires April 30, 2012 and bears interest at 5.4%. The current portion of this debt is \$7 thousand (December 2010 - \$22 thousand). The second arrangement expires December 31, 2012 and bears interest at 1.99%. The Current portion of this debt is \$22 thousand (December 31, 2010 - \$21 thousand).

Payments required under the loans are:

(\$000's)	2012	Total
Principal	29	29
Interest	-	-
	29	29

16. Decommissioning liabilities

(\$000's)	December 31, 2011	December 31, 2010
Balance, beginning of year	5,772	5,142
Change in estimates	(321)	715
Change in rate	109	259
Increase on acquisitions	226	41
Decrease on dispositions	(569)	(476)
Costs incurred	-	(93)
Accretion expense	193	184
Balance, end of year	5,410	5,772

The Company's decommissioning obligations result from its ownership interest in oil and natural gas assets including well sites and gathering systems. The total future decommissioning obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The Company has estimated the net present value of its total decommissioning obligation to be \$5.4 million at December 31, 2011 (December 31, 2010 - \$5.8 million) based on an undiscounted total future liability of \$7.3 million (December 31, 2010 - \$7.5 million). These payments are expected to be made over the next 25-30 years. The provision is the discounted present value of the estimated cost, using existing technology at current prices, of decommissioning the Company's oil and natural gas fields and production facilities. The discount factor, being the risk-free rate related to the liability, is 3.25% (December 31, 2010 - 3.42%).

17. Contingent liabilities

- In 2005, the Company received a statement of claim in the amount of \$136 thousand from Aero Drilling & Consulting Ltd., in respect of services provided to a subcontractor of Supreme Energy Inc. The Company has reviewed the claim and considers it without merit and no provision has been made with respect to the claim. The Company is defending the claim.
- In November 2006, the Company received a notice of reassessment from Revenu Quebec for the period ended February 28, 2003, in the amount of \$211 thousand including interest. This relates to Fairstar Explorations Inc. ("Fairstar"). Fairstar and Western Energy Corporation amalgamated August 18, 2005 to form the Company. The Company has filed a notice of objection, does not believe that the reassessment is valid and has made no provision with respect to the claim in the financial statements.
- In January 2012, the Company received a statement of claim from EOG Resources Canada Inc. ("EOG") in the amount of \$126 thousand in regard to disputed joint venture billings. The Company is defending the claim.

18. Commitments

The Company leases its corporate office. Non-cancellable operating lease rentals excluding operating costs, are payable as follows:

(\$000's)	Gross
2012	259
2013	172
Beyond 2013	-
Total	431

FairWest Energy Corporation

Notes to the Financial Statements

18. Commitments (continued)

The Company's future commitments to the Saskatchewan Ministry of Energy and Resources are as follows:

(\$000's)	Gross
2012	180
2013	90
2014	90
2015	90
2016	90
Beyond 2016	360
Total	900

The Company has committed to put up a letter of credit with the Saskatchewan Ministry of Energy and Resources over the next several years. These letters of credit are to be held in case the Company has unsatisfied abandonment liabilities in the province. The Company has a total commitment of \$900 thousand and has to date put up a letter of credit of approximately \$83 thousand.

19. Related parties

Key management personnel compensation

(\$000's)	December 31, 2011	December 31, 2010
Salaries, bonuses and directors fees	494	1,060
Short-term employee benefits	46	31
Termination benefits	57	114
Share-based payments	499	212
	1,096	1,417

Key personnel includes the Chief Executive Officer, President and Chief Operating Officer, Chief Financial Officer and directors.

Short-term benefits comprise bonuses and other benefits.

Termination benefits comprise amounts paid and accrued.

The share-based payment amounts reported represents the cost to the Company of key management's participation in share-based payment plans, as measured by the amortization of share-based payments associated with options granted, net of amounts capitalized to PP&E.

Executive officers and directors participate in the Company's stock option plan (note 10).

Other related party transactions

In the fourth quarter 2010, the net assets of AltaEast Production Limited Partnership ("AEPLP"), Battle River Production Limited Partnership ("BRPLP"), Garrington Limited Partnership ("GLP"), Neutral Creek Limited Partnership ("NCLP"), Strategic Production Limited partnership ("SPLP") and Petrovest, together (the "Parties"), were acquired by RILP (the "Transaction"). Subsequent to the Transaction, the Company negotiated, with the Parties and RILP, the cancellation of the Company's requirement to make an offer to purchase the Parties' oil and natural gas assets pursuant to an option agreement between the Company and the Parties. The total amount of this contractual obligation was, in aggregate, estimated by the Company to be approximately \$9.5 million. Amounts due to and from the Parties were consolidated under RILP and certain adjustments to the amounts due were agreed to between RILP and the Parties.

Trade and other receivables from related parties – included in accounts receivable (\$000's)	December 31, 2011	December 31, 2010	January 1, 2010
AltaEast Production Limited Partnership	-	-	6
Battle River Production Limited Partnership	-	-	40
Garrington Limited Partnership	-	-	167
Neuberry Energy (2007) Ltd. ("Neuberry")	-	-	1
Petrovest Exploration & Production Corporation	-	-	388
Royalty Investments Limited Partnership	553	177	-
Significant Shareholder and Controlled Associated Companies	196	21	-
Strategic Production Limited Partnership	-	-	16
Western Royalty Holding Corporations	1	-	-
	750	198	618

The trade and other receivables from related parties in the above table are unsecured, are on terms similar to trade receivables, have no fixed terms of repayment and bear no interest.

FairWest Energy Corporation

Notes to the Financial Statements

19. Related parties (continued)

Notes receivable from related parties – short term – included in note receivable (\$000's)	December 31, 2011	December 31, 2010	January 1, 2010
AltaEast Production Limited Partnership	-	-	653
Garrington Limited Partnership	-	-	308
Royalty Investments Limited Partnership	-	500	-
Strategic Production Limited Partnership	-	-	1,595
Total	-	500	2,556

The notes receivable from AEPLP and SPLP at January 1, 2010 were collected during 2010. The note receivable from GLP was forgiven to facilitate the transfer of net assets of Petrovest, GLP, BRPLP, AEPLP, SPLP and NCLP into RILP and a net loss on settlement of debt in the amount of \$308 thousand was recorded in 2010. The note receivable from RILP bore interest at 5%, was unsecured and was due upon demand. The note receivable from RILP was paid in full on December 30, 2011.

Trade and other payables to related parties – included in accounts payable (\$000's)	December 31, 2011	December 31, 2010	January 1, 2010
Espoir Capital Corporation	-	-	45
Lavery, de Billy, LLP	-	-	8
Neutral Creek Limited Partnership	-	-	105
Royalty Investments Limited Partnership	186	-	-
Significant Shareholder and Controlled Associated Companies	163	9	-
Western Royalty Holdings Corporation	4	18	21
Total	353	27	179

- The trade and other payables to related parties are unsecured and have no fixed terms of repayment.
- AltaEast Oil & Gas Inc. ("AEOG") is controlled by the CEO of the Company. AEOG is the general partner of AEPLP.
- Battle River Oil and Gas Inc. ("BRO&G") is controlled by the CEO of the Company. BRO&G is the general partner of BRPLP.
- Garrington Production Corporation ("GPC") is controlled by the Chief Executive Officer ("CEO") of the Company and is the general partner of GLP.
- Neutral Creek Corporation ("NCC") is controlled by the CEO of the Company and is the general partner of NCLP.
- Petrovest Exploration & Production Corporation is controlled by the CEO of the Company.
- Strategic Oil & Gas Production Inc. ("SOGP") is controlled by the CEO of the Company. SOGP is the general partner of SPLP.
- AFM Management Inc. ("AFM") is controlled by the CEO of the Company. AFM is the general partner of RILP.
- The CEO of the Company is a director of Espoir Capital Corporation ("Espoir").
- A director of the Company is a partner in Lavery, de Billy, LLP ("Lavery").
- A key management personnel of the Company is a director of Western Royalty Holdings Corporation ("Western").

The following transactions were in the normal course of operations and have been recorded at the exchange amounts, which is the amount of consideration established and agreed to by the related parties and in management's opinion is approximate fair value:

- During 2010, the CEO provided security to a lender to secure a credit facility for the Company and billed the Company \$30 thousand as a guarantee fee.
- During 2011, the Company was billed \$nil (2010 - \$2 thousand) by Lavery for legal services.
- During 2011, the Company charged various related party limited partnerships that it provides management services \$72 thousand (2010 - \$153 thousand) in management fees at a rate of \$2.00 to \$2.50/boe of sales and interest of \$25 thousand (2010 - \$113 thousand).
- During 2011, the Company received dividends from Petrovest in the amount of \$3 thousand (2010 - \$nil).
- During 2011, a significant shareholder and controlled associated companies provided a guarantee to a lender to secure a credit facility for the Company. The Company incurred \$275 thousand for a guarantee fee related to this transaction and paid \$5 thousand in additional banking fees related to this guarantee. In the first quarter of 2012, this shareholder provided a guarantee to the New Lender to secure a credit facility for the Company. A guarantee fee is being negotiated with the guarantor, but has not been finalized to date.
- During 2009, the Company received a \$50 thousand loan from Espoir which was fully repaid on March 1, 2010. The loan bore interest at 12% and interest paid in 2010 was \$1 thousand.

FairWest Energy Corporation

Notes to the Financial Statements

19. Related parties (continued)

The following transactions were not in the normal course of operations:

- The Company sold wellbores in the Provost and Berry areas to AEPLP for cash proceeds of \$50. The sale closed on September 30, 2010 and was recognized for accounting purposes at this date. A gain of \$65 thousand was recorded on the sale.
- The Company sold wellbores in the Provost and Berry areas to SPLP for cash proceeds of \$50. The sale closed on September 30, 2010 and was recognized for accounting purposes at this date. A gain of \$65 thousand was recorded on the sale.
- During 2011, the Company sold undeveloped land and wellbores in the provost area to a significant shareholder and controlled associated companies for cash proceeds of \$996 thousand. The Company recorded a gain of \$972 thousand on the sale. The sale closed on February 28, 2011 and was recognized for accounting purposes on this date.
- In two separate transactions in 2011, the Company sold properties in the Berry Creek area to a significant shareholder and controlled associated companies for cash proceeds of \$100 thousand and \$31 thousand respectively. The Company recorded a gain of \$13 thousand on the first sale and \$33 thousand on the second sale. These sales both closed on May 31, 2011 and were recognized for accounting purposes on this date.

20. Supplemental cash flow information

Changes in working capital (\$000's)	December 31, 2011	December 31, 2010
Change in accounts receivable	(142)	116
Change in accounts receivable – non cash	-	(12)
Change in prepaid expenses and deposits	58	117
Change in notes receivable	516	2,140
Change in notes receivable – non cash	-	(308)
Change in accounts payable and accrued liabilities	(1,683)	(1,746)
Change in accounts payable and accrued liabilities – non cash	-	651
	(1,251)	958
Relating to		
Operating activities	(101)	(1,682)
Financing activities	-	-
Investing activities	(1,150)	2,640
	(1,251)	958
Cash interest received in the year	5	3
Cash interest paid in the year	1,516	1,878
Cash taxes paid (recovered) in the year	-	(27)

21. Finance income and costs

Recognized in profit or loss

(\$000's)	Note	December 31, 2011	December 31, 2010
Interest income		36	291
Finance income		36	291
Interest on bank indebtedness		473	535
Interest on convertible debentures	13	856	876
Accretion on convertible debentures	13	111	123
Accretion on decommissioning liabilities	16	193	231
Preferred share dividends	9	34	148
Accretion on preferred shares	9	11	63
Other interest		168	320
Finance costs		1,846	2,296
Net finance costs recognized in profit or loss		1,810	2,005

22. Subsequent events

- On March 23, 2012 the Company issued 7,039,082 flow-through share units for gross proceeds of \$422 thousand. Each unit consisted of one common share of the Company at \$0.06 issued on a Canadian development expense flow-through ("CDE") basis and one common share purchase warrant, exercisable into one common share at a price of \$0.10 per common share on or before September 30, 2012.
- During the first quarter of 2012, the Company changed its banking relationship to a New Lender (note 12).

23. Transition to IFRS

The accounting policies set out in note 3 have been applied in preparing the financial statements for year ended December 31, 2011, the comparative information presented in these financial statements for the year ended December 31, 2010 and in the preparation of an opening IFRS statement of financial position at January 1, 2010.

In preparing its opening IFRS statement of financial position, the Company has adjusted amounts reported previously in financial statements prepared in accordance with Previous GAAP. An explanation of how the transition from Previous GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

The Company has applied the following transition exemptions to full retrospective application of IFRS:

- Deemed cost exemption for full cost oil and gas entities as further described in note 23(a).
- Decommissioning obligation exemption that allows any changes in decommissioning liabilities on transition to IFRS to be adjusted through opening retained earnings as further described in note 23(e).
- Business combinations exemption that allows a company to not have to restate any business combinations that occurred prior to the date of transition.
- Share-based payments exemption that allows a company to only have to evaluate share-based payments awards that were unvested as of the date of transition and that were issued subsequent to November 7, 2002.

FairWest Energy Corporation

Notes to the Financial Statements

23. Transition to IFRS (continued)

Reconciliation of statement of financial position - January 1, 2010

	Note	Previous GAAP	Effect of transition to IFRS	IFRS Reclassification	IFRS
		\$	\$	\$	\$
Assets					
Current assets					
Cash		5	-	-	5
Accounts receivable	(l)	2,674	-	618	3,292
Notes receivable	(l)	100	-	2,556	2,656
Due from related parties	(l)	618	-	(618)	-
Notes receivable from related parties	(l)	2,556	-	(2,556)	-
Prepaid expenses		330	-	-	330
		<u>6,283</u>	<u>-</u>	<u>-</u>	<u>6,283</u>
Non-current assets					
Property plant and equipment	(a)	34,729	(11,959)	-	22,770
Exploration and evaluation assets	(b)	-	4,661	-	4,661
Investment in associates		56	-	-	56
Deferred tax assets	(c)	1,442	2,273	-	3,715
		<u>36,227</u>	<u>(5,025)</u>	<u>-</u>	<u>31,202</u>
Total assets		<u>42,510</u>	<u>(5,025)</u>	<u>-</u>	<u>37,485</u>
Equity and liabilities					
Current liabilities					
Accounts payable and accrued liabilities	(l)	8,768	-	272	9,040
Bank loan payable		6,641	-	-	6,641
Due to related parties	(l)	272	-	(272)	-
Financial contracts		133	-	-	133
Current portion of finance leases		203	-	-	203
Current portion of loans payable		41	-	-	41
		<u>16,058</u>	<u>-</u>	<u>-</u>	<u>16,058</u>
Non-current liabilities					
Debentures payable	(d)	3,060	-	-	3,060
Finance leases		65	-	-	65
Loans payable		72	-	-	72
Decommissioning liabilities	(e)	4,326	816	-	5,142
Flow-through shares premium liability	(f)	-	296	-	296
Preferred shares	(g)	2,056	(37)	-	2,019
		<u>9,579</u>	<u>1,075</u>	<u>-</u>	<u>10,654</u>
Total liabilities		<u>25,637</u>	<u>1,075</u>	<u>-</u>	<u>26,712</u>
Equity					
Share capital	(h)	49,795	2,286	-	52,081
Warrants		187	-	-	187
Contributed surplus	(i)	1,675	-	-	1,675
Deficit	(j)	(34,784)	(8,386)	-	(43,170)
Total equity		<u>16,873</u>	<u>(6,100)</u>	<u>-</u>	<u>10,773</u>
Total equity and liabilities		<u>42,510</u>	<u>(5,025)</u>	<u>-</u>	<u>37,485</u>

FairWest Energy Corporation

Notes to the Financial Statements

23. Transition to IFRS (continued)

Reconciliation of statement of financial position – December 31, 2010

	Note	Previous GAAP	Effect of transition to IFRS	IFRS Reclassification	IFRS
(\$000's)					
Assets					
Current assets					
Cash		-	-	-	-
Accounts receivable	(l)	2,999	-	177	3,176
Notes receivable	(l)	16	-	500	516
Due from related parties	(l)	177	-	(177)	-
Notes receivable from related parties	(l)	500	-	(500)	-
Prepaid expenses		213	-	-	213
		<u>3,905</u>	<u>-</u>	<u>-</u>	<u>3,905</u>
Non-current assets					
Property plant and equipment	(a)	23,204	(10,564)	-	12,640
Exploration and evaluation assets	(b)	-	5,029	-	5,029
Investment in associates		229	-	-	229
Deferred tax assets	(c)	2,293	-	-	2,293
		<u>25,726</u>	<u>(5,535)</u>	<u>-</u>	<u>20,191</u>
Total assets		<u>29,631</u>	<u>(5,535)</u>	<u>-</u>	<u>24,096</u>
Equity and liabilities					
Current liabilities					
Accounts payable and accrued liabilities	(l)	7,269	-	25	7,294
Bank loan payable		2,490	-	-	2,490
Due to related parties	(l)	25	-	(25)	-
Current portion of finance leases		187	-	-	187
Current portion of loans payable		43	-	-	43
Preferred shares	(g)	2,056	26	-	2,082
		<u>12,070</u>	<u>26</u>	<u>-</u>	<u>12,096</u>
Non-current liabilities					
Debentures payable	(d)	7,074	-	-	7,074
Finance leases		28	-	-	28
Loans payable		29	-	-	29
Decommissioning liabilities	(e)	4,613	1,159	-	5,772
Flow-through share premium liability	(f)	-	924	-	924
		<u>11,744</u>	<u>2,083</u>	<u>-</u>	<u>13,827</u>
Total liabilities		<u>23,814</u>	<u>2,109</u>	<u>-</u>	<u>25,923</u>
Equity					
Share capital	(h)	54,190	1,414	-	55,604
Warrants		24	-	-	24
Contributed surplus	(i)	2,053	54	-	2,107
Deficit	(j)	(50,450)	(9,112)	-	(59,562)
Total equity		<u>5,817</u>	<u>(7,644)</u>	<u>-</u>	<u>(1,827)</u>
Total equity and liabilities		<u>29,631</u>	<u>(5,535)</u>	<u>-</u>	<u>24,096</u>

FairWest Energy Corporation

Notes to the Financial Statements

23. Transition to IFRS (continued)

Reconciliation of statement of comprehensive loss for the year ended December 31, 2010

	Note	Previous GAAP	Effect of transition to IFRS	IFRS Reclassification	IFRS
(\$000's)					
Revenue					
Petroleum and natural gas		4,946	-		4,946
Royalties		(238)	-		(238)
		4,708	-		4,708
Processing fee income		346	-		346
Other income		347	-	(347)	-
Royalty income	(l)	-	-	56	56
Gain (loss) on disposal of assets	(a)	(259)	(441)		(700)
Gain on flow-through share premium	(f)	-	662		662
Unrealized gain on financial contract		133	-		133
Total revenue		5,275	221	(291)	5,205
Expenses					
Operating	(l)	3,740	-	(333)	3,407
Transportation and marketing	(l)	-	-	333	333
Depletion and depreciation	(a, o)	13,761	(3,911)	(7,653)	2,197
General and administration	(n)	2,115	656	-	2,771
Share-based payments	(p)	144	100	-	244
Part XII.6 tax (recovery)		(7)	-	-	(7)
Share of loss — associates		61	-	-	61
Loss on settlement of debt		135	-	-	135
Impairment of property, plant and equipment	(a)	-	1,267	7,653	8,920
Total expenses		19,949	(1,888)	-	18,061
Operating loss before finance and taxes		14,674	(2,109)	291	12,856
Finance income		-	-	(291)	(291)
Finance expenses	(g, o)	1,973	323	-	2,296
Loss before taxes		16,647	(1,786)	-	14,861
Current taxes		34	-	-	34
Deferred tax expense (recovery)		(1,157)	2,654	-	1,497
Net loss and comprehensive loss		15,524	868	-	16,392

23. Transition to IFRS (continued)

a. IFRS 1 election for full cost oil and gas entities

(\$000's)	Note	January 1, 2010	December 31, 2010
Balance as per Previous GAAP		34,729	23,204
Transfer to E&E assets on transition		(4,966)	(4,966)
Impairment on transition		(6,993)	(6,993)
Sale of assets		-	(473)
Capitalized G&A	(n)	-	(1,359)
Decommissioning liability adjustment		-	842
Impairment		-	(1,267)
Depletion		-	3,662
Reclassification to E&E		-	(10)
Balance as per IFRS		22,770	12,640

IFRS 1 election for full cost oil and gas entities

The Company elected an IFRS 1 exemption whereby the Previous GAAP full cost pool was measured upon transition to IFRS as follows:

- i. E&E assets were reclassified from the full cost pool to E&E assets at the amount that was recorded under Previous GAAP. On transition \$5.0 million was reclassified to intangible E&E assets and an impairment of \$305 thousand was recorded for a net of \$4.7 million.
- ii. The remaining full cost pool was allocated to PP&E assets and the respective CGUs pro-rata using reserve values.

Depletion

Upon transition to IFRS, the Company adopted a policy of depleting oil and gas interests on an area by area basis on a unit of production basis over proved plus probable reserves. The depletion policy under Previous GAAP was based on units of production over proved reserves of the entire full cost pool. Overall the impact of this adoption was a decrease to depletion expense as a result of using proved and probable reserves and associated future capital in the IFRS depletion calculation compared to using only proved reserves and associated future capital under Previous GAAP. There was a decrease in depletion expense of \$3.7 million for the year ended December 31, 2010.

Impairment

Under Previous GAAP, an impairment of oil and gas assets was recognized and measured on the entire full cost pool and was not reversed. Under IFRS, impairments of PP&E are recognized and measured at a CGU level and impairments are reversed. The Company recognized impairment at January 1, 2010 of \$7.0 million and a total change in impairment of \$1.3 million for the year ended December 31, 2010. The impairments are related to the Company's natural gas CGUs and arose primarily due to declining forward natural gas prices. The impairments were based on the difference between each period's respective PP&E net book values and their recoverable amounts. The recoverable amounts were determined using fair value less costs to sell based on discounted future cash flows of proved and probable reserves using forecast prices and costs discounted at 10% for reserves that were primarily oil and 15% for reserves that were primarily natural gas.

Loss on disposal of assets

During the year ended December 31, 2010 the Company sold oil and gas assets which resulted in a loss of \$484 thousand which was not recorded under Previous GAAP because under the full cost method of accounting for oil and gas properties, a loss is not recognized on disposal of assets if the loss did not result in a change to the depletion rate of more than 20% for the cost centre.

During the year ended December 31, 2010 the Company sold oil and gas assets which resulted in a loss of \$473 thousand from that recorded under Previous GAAP due to changes to the carrying amounts of PP&E and decommissioning liabilities under IFRS. Under Previous GAAP, a gain or loss was not recorded unless the transaction resulted in a change of more than 20% in the depletion note.

b. Exploration & evaluation assets

(\$000's)	Note	January 1, 2010	December 31, 2010
Balance as per Previous GAAP		-	-
Transfer from PP&E on transition	(a)	4,966	4,966
Impairment on transition		(305)	(305)
Sale of assets		-	(300)
Reclassification from PP&E		-	10
Capitalized G&A	(n)	-	658
Balance as per IFRS		4,661	5,029

FairWest Energy Corporation

Notes to the Financial Statements

23. Transition to IFRS (continued)

Impairment

Reclassified E&E assets were reviewed for impairment. Impairment of E&E assets of \$305 thousand was recognized on transition at January 1, 2010.

c. Deferred tax assets

(\$000's)	Note	January 1, 2010	December 31, 2010
Balance as per Previous GAAP		1,442	2,293
Adjustment for flow-through shares issued in 2009	(f)	246	246
Deferred tax on IFRS adjustments on transition		2,027	2,027
Sale adjustment		-	(38)
Flow-through share premium tax effect		-	(42)
Deferred tax calculation adjustments		-	(2,193)
Balance as per IFRS		3,715	2,293

d. Debentures payable

(\$000's)	Note	January 1, 2010	December 31, 2010
Balance as per Previous GAAP and IFRS		3,060	7,074

In October 2009, the Company modified the terms of conversion of the Series 1 debentures payable. Under IFRS, this modification required recognition of costs of modifying the conversion ratio resulting in a charge to deficit of \$428 thousand and a corresponding increase to the equity component.

e. Decommissioning liabilities

(\$000's)	Note	January 1, 2010	December 31, 2010
Balance as per Previous GAAP		4,326	4,613
Adjustment on transition		816	816
Adjustment of obligations on acquisitions/ dispositions		-	(158)
Change in estimate and rates		-	548
Accretion adjustments		-	(47)
Balance as per IFRS		5,142	5,772

IFRS 1 provides an exemption that the Company has elected which allows an entity to measure decommissioning liabilities as at the date of transition to IFRS in accordance with IAS-37 and recognize any differences between that amount and the carrying amount of the liabilities determined under Previous GAAP directly in retained earnings. Under Previous GAAP, asset retirement obligations were discounted at a credit adjusted risk free rate of 5.75%. Under IFRS the estimated cash flow to abandon and remediate the wells and facilities has been risk adjusted therefore the provision is discounted at risk free rates that coincide with the expected time frame of the abandonments which will vary over time.

As at January 1, 2010, decommissioning liabilities increased by \$816 thousand with a corresponding increase in deficit.

Decommissioning liabilities increased by \$630 thousand for the year ended December 31, 2010 as a result of the effect of change in discount rates used under IFRS, changes in accretion expense and adjustments due to acquisitions and disposals.

f. Flow-through share premium liability

(\$000's)	Note	January 1, 2010	December 31, 2010
Balance as per Previous GAAP		-	-
Adjustment on transition		296	296
Adjustment for issuances of flow-through shares		-	1,290
Transfer to profit or loss		-	(662)
Balance as per IFRS		296	924

Under Previous GAAP, proceeds received from flow-through shares were included in their entirety in share capital and the estimated tax cost of issuing flow-through shares was reflected in share capital and deferred taxes when the expenditures were renounced. Under IFRS, the premium received on the flow-through shares, being the difference in price over a common share with no tax attributes, is not included in share capital, but rather is included on the balance sheet as a flow-through share premium liability. In addition, as the flow-through expenditures are incurred the deferred tax liability associated with the renounced tax deductions are recognized through profit or loss along with a pro-rata portion of the deferred premium.

On transition, the Company increased share capital by \$1.9 million reflecting the impact of eliminating the deferred income tax and the premiums on flow-through shares issued between 2005 and 2008 with a corresponding increase in deficit.

23 Transition to IFRS (continued)

On transition, the Company also increased share capital by \$142 thousand reflecting the net impact of eliminating the premiums on flow-through shares issued in 2009 and the related deferred income tax in 2009. The corresponding effect was to increase deferred tax asset by \$246 thousand, deficit by \$92 thousand and increased flow-through share premium liability by \$296 thousand on January 1, 2010.

For the year ended December 31, 2010, the Company reclassified the premium for flow-through shares issued of \$1.3 million from share capital. Expenditures incurred were reclassified to profit or loss.

g. Preferred shares

(\$000's)	Note	January 1, 2010	December 31, 2010
Balance as per Previous GAAP		2,056	2,056
Adjustment for equity component		(37)	(37)
Accretion on liability component		-	63
Balance as per IFRS		2,019	2,082

Under Previous GAAP, the Company valued the equity component of the preferred shares and used the residual method to value the debt component of the preferred shares. Under IFRS, the Company is required to initially value the liability component of the preferred shares and value the equity component as the difference between the fair value of the preferred shares and the fair value of the liability component. As at January 1, 2010, the liability component of the preferred shares decreased by \$37 thousand with a corresponding increase in the equity component of preferred shares of \$100 thousand and an increase in deficit of \$63 thousand.

The liability component of preferred shares increased by \$63 thousand as at December 31, 2010 as a result of changes in accretion with a corresponding increase in finance expenses.

h. Share capital

(\$000's)	Note	January 1, 2010	December 31, 2010
Balance as per Previous GAAP		49,795	54,190
Adjustment for flow-through shares issued between 2005 and 2008	(f)	1,900	1,900
Adjustment for flow-through shares issued in 2009	(f)	(142)	(142)
Debenture series 1 modification	(d)	428	428
Preferred shares equity component	(g)	100	100
Flow-through share premium liability	(f)	-	(872)
Balance as per IFRS		52,081	55,604

i. Contributed surplus

(\$000's)	Note	January 1, 2010	December 31, 2010
Balance as per Previous GAAP		1,675	2,053
Share-based payment adjustments	(p)	-	54
Balance as per IFRS		1,675	2,107

j. Deficit

(\$000's)	Note	January 1, 2010	December 31, 2010
Balance as per Previous GAAP		(34,785)	(50,450)
Exploration and evaluation impairment	(a)	(305)	(305)
Property, plant & equipment impairment	(a)	(6,993)	(8,260)
Depletion and depreciation		-	3,661
Deferred tax	(c)	2,026	(627)
Decommissioning liabilities	(e)	(816)	(798)
Sale of assets		-	(329)
Flow-through shares	(f)	(1,806)	(1,145)
Preferred shares	(g)	(63)	(126)
Debentures	(n)	(428)	(428)
Share-based payments		-	(100)
General and administrative expense		-	(656)
Rounding		-	1
Balance as per IFRS		(43,170)	(59,562)

FairWest Energy Corporation

Notes to the Financial Statements

23. Transition to IFRS (continued)

k. Provisions

Amounts disclosed as contingent liabilities under Previous GAAP were examined to determine the extent to which the contingent liabilities should be recognized as provisions. No additional provisions were considered necessary for such items.

l. Reclassifications

Certain amounts have been reclassified to conform with IFRS presentation.

m. Cash flow statements

Upon transition to IFRS, the only significant changes to operating and investing cash flows for the year ended December 31, 2010 were related to the changes in capitalization of G&A expenses. There were no significant changes to financing cash flows for the year ended December 31, 2010.

n. Directly attributable general and administration expenses

Certain general and administration (G&A) expenses were capitalized under Previous GAAP which are not directly attributable to PP&E and therefore cannot be capitalized under IFRS. G&A expenses increased by \$656 thousand for the year ended December 31, 2010. G&A expenses of \$657 thousand for the year ended December 31, 2010 were allocated to E&E assets.

o. Finance expenses

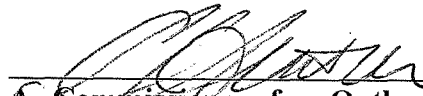
Under Previous GAAP, accretion expense was included as part of depletion, depreciation and accretion in the statement of comprehensive loss. This item is presented as finance expenses under IFRS. The Company reclassified accretion expense of \$231 thousand for the year ended December 31, 2010 to finance expenses. The Company also increased finance expense by the amount of accretion of the equity component of its preferred shares. The Company increased finance expense by \$29 thousand relating to amounts reported as dividend payments under Previous GAAP for the year ended December 31, 2010 respectively.

p. Share-based payments

Under Previous GAAP, share-based payments calculations did not consider each tranche in a stock option granted with graded vesting as a separate grant with a different vesting date and fair value. For stock options granted in 2010 additional share-based payments of \$100 thousand for the year ended December 31, 2010 have been recognized with a corresponding increase in contributed surplus.

**THIS IS EXHIBIT "D" REFERRED TO IN
THE AFFIDAVIT OF VERNON R. FAUTH**

**SWORN BEFORE ME THIS 10TH DAY OF
DECEMBER, 2012.**



**A Commissioner for Oaths in and for the
Province of Alberta**

CAROLE J. HUNTER
Barrister & Solicitor

FAIRWEST ENERGY CORPORATION
30 DAY CASH FLOW SUMMARY

	Notes	WEEK 1 DEC. 12-16	WEEK 2 DEC. 17-23	WEEK 3 DEC. 24-30	WEEK 4 DEC. 31-JAN. 6	WEEK 5 JAN 7- 11
OPERATIONS						
Oil & Gas Revenue	1	-	13,976	356,945	44,795	-
Operating Expenses	1	(61,800)	(47,245)	(168,325)	(64,466)	(6,400)
CASH FLOW FROM OPERATIONS		(61,800)	(33,269)	188,621	(19,671)	(6,400)
CASH EXPENSES						
G&A	2	(22,855)	-	(53,966)	(201,888)	(10,200)
Interest	3	(25,000)	-	-	(49,937)	-
Reorganization Expenses	4	(107,000)	(58,500)	-	(232,500)	-
TOTAL CASH EXPENSES		(154,855)	(58,500)	(53,966)	(484,326)	(10,200)
Change in Cash		(216,655)	(91,769)	134,654	(503,996)	(16,600)
Beginning Cash		-	(216,655)	(308,424)	(173,769)	(677,766)
ENDING CASH BALANCE		(216,655)	(308,424)	(173,769)	(677,766)	(694,366)

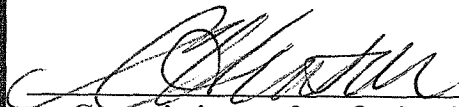
Notes

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.

**THIS IS EXHIBIT "E" REFERRED TO IN
THE AFFIDAVIT OF VERNON R. FAUTH**

**SWORN BEFORE ME THIS 10TH DAY OF
DECEMBER, 2012.**

A handwritten signature in dark ink, appearing to be "C. Hunter", written over a horizontal line.

**A Commissioner for Oaths in and for the
Province of Alberta**

CAROLE J. HUNTER
Barrister & Solicitor

December 10, 2012

FairWest Energy Corporation
800, 407 – 2nd Street S.W.
Calgary, Alberta T2P 2Y3
Attention: Chairman and Chief Executive Officer

Dear Sirs:

Re: Credit Facility to be Provided by Supreme Group Inc.

We understand that FairWest Energy Corporation (the “**Borrower**”) intends to apply to the Court of Queen’s Bench of Alberta (the “**Court**”) for an Initial Order (the “**Initial Order**”) pursuant to the *Companies’ Creditors Arrangement Act* (the “**CCAA**”). We are pleased to advise that Supreme Group Inc. (the “**Lender**”) has approved the following revolving super-priority debtor-in-possession credit facility pursuant to terms and conditions of this Commitment Letter.

BORROWER:	FairWest Energy Corporation.
LENDER:	Supreme Group Inc. (or its assigns).
CREDIT FACILITY:	Super-Priority Debtor-in-Possession Revolving Loan (the “ Facility ”).
LOAN AMOUNT:	Maximum of \$700,000, as more specifically set out in the Cash Flow Forecast, as attached hereto in Schedule A.
PURPOSE:	General working capital purposes and restructuring costs.
MATURITY:	January 11, 2013 (the “ Term ” or “ Maturity Date ”).
AVAILABILITY:	Canadian dollars.
REPAYMENT:	Interest monthly. Outstanding advances under the Facility are due to be repaid no later than the Maturity Date and from excess cash flow from operations, equity offering, refinancing and/or asset sale.

All payments shall be applied as follows:

- Firstly to any outstanding costs and fees;
- Secondly to all accrued and unpaid interest; and
- Then to repay the principal outstanding.

All overdue costs and expenses and interest shall at the option of the Lender, be added to outstanding principal amount and bear interest at the Default Rate until paid.

PREPAYMENT: Prepayment of the Facility in whole or in part shall be allowed at anytime without penalty.

EVIDENCE OF DEBT: Demand Promissory Note.

INTEREST RATE: The Borrower shall pay interest on the outstanding principal, interest and other amounts from time to time at a rate of BMO Bank of Montreal Prime + 10% per annum. Interest at the aforesaid rate shall be calculated daily and payable on the last business day of each month beginning December 31, 2012. Overdue interest shall be compounded monthly.

COMMITMENT FEE: \$25,000 payable in cash out of initial advance.

DRAWDOWN NOTICE / EXCESS CASH: The Borrower shall deliver to the Lender weekly reports every Friday on its current cash balance, cash requirements for the immediately following week, variance of the projected cash requirements for such week from the cash flow forecast for the same week and an explanation for any such variance.

The Lender agrees to lend to the Borrower by not later than Monday of the following week in accordance with the terms hereof the amount specified in the Cash Flow Forecast for such week or such greater amount as may be agreed by the Lender in its discretion.

In the event that the report referred to above indicates that the Borrower will have on hand cash in an amount that is more than \$100,000 greater than the amount of cash than projected as being required for the following week, then the Borrower shall pay to the Lender on the following Monday an amount equal to such excess cash, which payment shall be applied against the outstanding loan balance under the Facility.

DRAWDOWNS: Funds under each draw to be advanced only upon satisfaction of all Conditions Precedent.

SECURITY: To be Obtained:

The following security shall be completed, duly executed, delivered and registered, where necessary, to the entire satisfaction of the Lender and its counsel. All security (the “**Security**”) and the terms thereof shall be held by the Lender as continuing security for the present and future indebtedness to the Lender under the Commitment Letter and the Security as the same may be amended, replaced, restated or supplemented.

1. Demand Promissory Grid Note(s);
2. Revolving Credit Agreement;
3. Evidence of Insurance coverage in accordance with industry standards with the Lender listed as first loss payee;
4. \$10,000,000 Fixed and Floating Demand Debenture providing a second floating charge security interest over all personal and real property assets of the Borrower and a Negative Pledge and Undertaking to provide fixed charges on the Borrower's oil and gas reserves as selected by the Lender in their discretion, at the request of the Lender;
5. Court Ordered Charge (as defined below);
6. Director's Resolution from the Borrower authorizing the Facility; and
7. Such other security, documents and agreements the Lender or their legal counsel may reasonably request.

The Security may be registered in the Province of Alberta and the Province of Saskatchewan by the Lender's counsel.

**COURT ORDERED
CHARGE:**

A first ranking charge (subject only to an administration charge in an amount acceptable to the Lender) on all of the Borrower's personal and real property granted pursuant to the Initial Order, which Order shall be in form and substance satisfactory to the Lender.

**REPRESENTATIONS
AND WARRANTIES:**

The Borrower represents and warrants to the Lender that:

1. It is in good standing under the legislation governing it, and it has the powers, permits, and licenses required to operate its business or enterprise and to own, manage, and administer its property;
2. Subject to the making of the Initial Order, this Commitment Letter constitutes, and the Security and related agreements will constitute, legal, valid, and binding obligations of the Borrower, enforceable in accordance with their terms, subject to applicable bankruptcy, insolvency, or similar laws affecting creditors' rights generally and to the availability of equitable remedies;

3. Subject to the making of the Initial Order, the Borrower has the right to pledge, charge, mortgage, or lien its assets in accordance with the Security contemplated by this Agreement;
4. Except as disclosed to the Lender in writing, the Borrower is presently in good standing under, and shall duly perform and observe, all material terms of all documents, agreements, and instruments affecting or relating to the petroleum and natural gas assets of the Borrower;
5. There has been no "Material Adverse Change" (as defined below) in the financial position of the Borrower since the date of its most recent unaudited financial statements for the period ended September 30, 2012. The Borrower does not foresee incurring any major liability which it has not already disclosed in writing to the Lender;

"Material Adverse Change" means a material adverse change on

- (a) the business, financial condition, operations, assets or capitalization of the Borrower taken as a whole;
- (b) the ability of the Borrower to pay or perform the obligations under this Commitment Letter or the ability of the Borrower to pay or perform any of its obligations or contingent obligations under any Security or any underlying agreements or document delivered pursuant to this Commitment Letter or the Security;
- (c) the ability of the Borrower to perform its obligations under any material contract, if it would also have a material adverse change on the ability of the Borrower to pay or perform its obligations under this Commitment Letter, the Security, or any underlying agreements or documents delivered pursuant to this Commitment Letter or the Security;
- (d) the validity or enforceability of this Commitment Letter, the Security or any underlying agreements or documents delivered pursuant to this Commitment Letter or the Security; and
- (e) the priority ranking of any security interests granted by this Commitment Letter, the Security, or any underlying agreements or documents delivered pursuant to this Commitment Letter or the Security,

or the rights or remedies intended or purported to be granted to the Lender under or pursuant to this Commitment Letter, the Security or any underlying agreements or documents delivered pursuant to this Commitment Letter or the Security.

6. Except as disclosed in Schedule "B" hereto, other than various invoices which are past due and for which no legal action has been taken to enforce, it is not in default under the contracts to which it is a party or under the applicable legislation and regulations governing the operation of its business or its property, including, without limitation, all Environmental Requirements subsequently stated in Environmental Obligations.

**CONDITIONS
PRECEDENT:**

Prior to any drawdown under the Facility, the Borrower shall have provided to the Lender:

1. This Commitment Letter and all Security denoted under the Security heading of this Commitment Letter shall have been duly completed, authorized, executed and delivered by the parties thereto and all such Security shall be on terms and conditions satisfactory to the Lender;
2. All Security that is required to be registered in order to protect or perfect the security interest granted thereby or which is required to be registered in order to obtain a priority over another creditor shall have been duly registered to the satisfaction of counsel to the Lender;
3. The Lender shall be satisfied in its discretion with the Existing Hedge Arrangements;
4. The Initial Order shall have been made, shall be in form and substance satisfactory to the Lender, and shall not have been stayed, varied or vacated;
5. All representations and warranties of the Borrower to the Lender shall be true and correct in all material aspects;
6. No default or event of default shall have occurred and be continuing on the date of such drawdown after giving effect to such drawdown; and
7. The first drawdown shall have been advanced by not later than December 14, 2012.

**REPORTING
REQUIREMENTS:**

The Borrower shall submit to the Lender:

1. Weekly production and revenue reports in the form and substance satisfactory to the Lender within five business days of each week end;
2. Monthly unaudited consolidated financial statements including balance sheet, income statement, and cash flow statement and compliance certificate (in the form and substance satisfactory to the Lender) within 32 calendar days of each month end;
3. An independent engineering report in form and substance satisfactory to the Lender on the petroleum and natural gas reserves of the Borrower on or before March 1, 2013; and
4. Any other information the Lender may reasonably require from time to time.

Paragraph 3 of this section to survive Maturity or termination of the Facility.

**AFFIRMATIVE
COVENANTS:**

The Borrower shall:

1. Carry on business and operate its petroleum and natural gas reserves in accordance with good practices consistent with accepted industry standards and pursuant to applicable agreements, regulations, and laws;
2. Maintain its corporate existence and comply with all applicable laws, including the Initial Order;
3. Comply with all provisions of this Commitment Letter, the Security and related agreements;
4. Pay, when due, all taxes, assessments, deductions at source, crown royalties, income tax or levies for which the payment is guaranteed by legal privilege or ranks senior in priority to the Court Ordered Charge without subrogation or consolidations;
5. Comply with all regulatory bodies and provisions regarding environmental procedures and controls;
6. Allow the Lender unfettered access to its books and records and to visit and inspect the Borrower's assets and place of business during ordinary business hours;

7. Maintain adequate and appropriate insurance on the Borrower's assets including protection against public liability, blow-outs, and "all-risk" perils; and
8. Inform the Lender of any event or action which would have a material adverse impact on the Borrower's operational or financial affairs, including but not limited to the sale of assets, guarantees, or alteration of type of business; keep and maintain books of account and other accounting records in accordance with generally accepted accounting principles.

**NEGATIVE
COVENANTS:**

The Borrower shall not without the prior approval of the Lender:

1. Allow a Change of Control;
2. Merge, amalgamate, consolidate, wind up or sell any of its assets out of the ordinary course of business;
3. Reduce or distribute capital or pay dividends or redeem or repurchase equity or debt securities;
4. Incur further secured indebtedness, pledge or encumber assets, or guarantee the obligations of others;
5. Make loans or investments to any shareholders, employees, subsidiaries or affiliates;
6. The Borrower shall not sell or dispose of any assets except as expressly permitted by the floating charge provisions of the Fixed and Floating Demand Debenture;
7. Hedge or contract crude oil, natural gas liquids, or natural gas, on a fixed price basis, with the exception of hedges or contracts that exist as of the date hereof (the "**Existing Hedge Arrangements**"); or
8. Monetize or settle any fixed price financial hedge or contract.

**ENVIRONMENTAL
OBLIGATIONS:**

1. The Borrower shall comply with the requirements of all legislative and regulatory environmental provisions ("Environmental Requirements") and shall at all times maintain the authorizations, permits, and certificates required under these provisions;
2. The Borrower shall immediately notify the Lender in the event a contaminant spill or emission occurs or is discovered with

respect to its property, operations, or those of any neighboring property. In addition, it shall report to the Lender forthwith any notice, order, decree, or fine that it may receive or be ordered to pay with respect to the Environmental Requirements relating to its business or property;

3. At the request of and in accordance with the conditions set forth by the Lender, the Borrower shall, at its own cost, provide any information or document, which the Lender may reasonably require, with respect to its environmental situation, including any study or report prepared by a firm acceptable to the Lender. In the event that such studies or reports reveal that any Environmental Requirements are not being respected, the Borrower shall effect the necessary work to ensure that its business and property comply with the Environmental Requirements within a period acceptable to the Lender acting reasonably; and
4. The provisions, undertakings, and indemnification set out in this section shall survive the satisfaction and release of the Security and payment and satisfaction of the indebtedness and liability of the Borrower to the Lender pursuant to the terms hereof.

EVENTS OF DEFAULT: The following shall be considered Events of Default, upon the occurrence of any one of which the Lender may choose, in its sole discretion, to cancel all credit availability and to demand repayment of the Facility in full, together with outstanding accrued interest and fees and, without prejudice to the Lender's other rights and remedies, the Lender's Security shall become enforceable:

1. Default in payment of any interest, fee, principal payment or any other monies when due by the Borrower;
2. Any Representation or Warranty proves to be untrue in any material respect;
3. Failure to observe or comply with any covenant, agreement, condition, or term as outlined herein or in any Security document or underlying agreements delivered pursuant hereto, including without limitation, the Affirmative and Negative Covenants;
4. In the opinion of the Lender, acting reasonably, a Material Adverse Change in the financial condition of the Borrower or to the operation of its assets has occurred;
5. If an application for a bankruptcy order is made, the Borrower

makes an assignment in bankruptcy or a resolution passed, or any other proceeding is taken for the winding up, dissolution, or liquidation of the Borrower;

6. If proceedings are taken to enforce any encumbrance on the assets of the Borrower;
7. The Initial Order is stayed, vacated or varied in a manner not satisfactory to the Lender;
8. If the Borrower ceases or threatens to cease to carry on its business, or if proceedings are commenced for the suspension of the business of the Borrower;
9. If proceedings are commenced to appoint a receiver, receiver/manager, or trustee in respect of the assets of the Borrower by a court or pursuant to any other agreement;
10. A default or an Event of Default shall have occurred under the Security;
11. If a "Change of Control" has occurred. A "Change of Control" means any "Person" or "Persons" (as defined below) acting jointly or in concert (within the meaning of the *Securities Act* (Alberta)), shall beneficially, directly or indirectly, hold or exercise control or direction over and/or has the right to acquire or control or exercise direction over (whether such right is exercisable immediately or only after the passage of time) more than 20% of the issued and outstanding voting shares of the Borrower;

"Person" or "persons" means and includes an individual, a partnership, a corporation, a joint stock company, a trust, an unincorporated association, a joint venture or other entity or a government or any agency or political subdivision thereof.

DEFAULT RATE OF INTEREST:

In the event of a default or Event of Default, the Borrower shall pay on demand interest at a rate of 2% greater than the interest rate provided above on all amounts unpaid, from the date the default occurred until such time as the default is remedied or such time as the unpaid amounts are fully repaid.

COSTS:

All reasonable expenses incurred by the Lender in connection with the Facility being made available hereunder including, without limitation, (i) the negotiation and settling of the terms of this Commitment Letter and any of the Security and other agreements contemplated hereby, (ii) the enforcement of any of the Security,

including but not limited to third party Agents that have been engaged by the Borrower for the disposition of any or all of the oil and gas properties of the Borrower (iii) obtaining repayment of any monies outstanding hereunder, (iv) any reasonable legal fees on a solicitor and his own client basis, and (v) engineering fees, in each case are for the account of the Borrower unless otherwise stipulated.

GENERAL:

Time is of the essence. The Borrower shall do all things and execute all documents deemed necessary or appropriate by the Lender's for the purposes of giving full force and effect to the terms, conditions, undertakings, and security granted or to be granted hereunder.

When a contradiction or conflict exists between an express term of any of the Security and an express term of this Commitment Letter, the term of this Commitment Letter shall govern and prevail. For better certainty, a term contained in the Security and not contained in the Commitment Letter and vice versa is not a contradiction or conflict with the other, nor shall the formal expression in the Security of a term in this Commitment Letter constitute a contradiction or conflict. Further, if there is any right or remedy of the Lender set out in any of the Security or any part of which is not set out or provided for in this Commitment Letter, such additional right shall not constitute a conflict or inconsistency.

**PERSONAL PROPERTY
SECURITY ACT ("PPSA")
REQUIREMENTS:**

The Borrower hereby waives the requirement for the Lender to provide copies of PPSA registrations, verification statements, or financing statements undertaken by the Lender.

The Borrower hereby agrees to provide to the Lender written notice of a change in name or address immediately.

ASSIGNMENT:

No rights or obligations of the Borrower hereunder and no amount of the Facility may be transferred or assigned by the Borrower, any such transfer or assignment being null and void insofar as the Lender is concerned and rendering any balance then outstanding of the loan immediately due and payable at the option of the Lender and releasing the Lender from any and all obligations of making any advances hereunder.

The Lender may at any time (whether before or after default) assign in whole or in part any of its rights and obligations hereunder without the consent of the Borrower.

**ACCESS TO
INFORMATION:**

The Borrower hereby authorizes any personal information agent, financial institution, creditor, tax authority, employer, or any other person including any public entity, having information concerning the Borrower or its property, including any financial information or information with respect to any undertaking, guarantee, or

[Remainder of page left intentionally blank]

suretyship given by the Borrower, to supply such information to the Lender in order to verify the accuracy of all information furnished or to be furnished from time to time to the Lender and to confirm the solvency of the Borrower at all times.

**ANTI-MONEY LAUNDERING
LEGISLATION:**

Borrower acknowledges that, pursuant to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (Canada) and other applicable anti-money laundering, anti-terrorist financing, government sanction and "know your client" laws (collectively, including any guidelines or orders thereunder, "AML Legislation"), the Lender may be required to obtain, verify and record information regarding the Borrower and its respective subsidiaries, directors, authorized signing officers, direct or indirect shareholders or other persons in control of the Borrower and the transactions contemplated hereby. The Borrower shall promptly provide all such information, including supporting documentation and other evidence, as may be reasonably requested by the Lender, or any prospective assignee or participant of the Lender, in order to comply with the applicable AML Legislation, whether now or hereafter in existence.

BINDING AGREEMENT: The terms and conditions of this Commitment Letter are binding and legal obligations and shall constitute a commitment on each party hereto.

GOVERNING LAW: This Commitment Letter shall be construed and governed in accordance with the laws of the Province of Alberta.

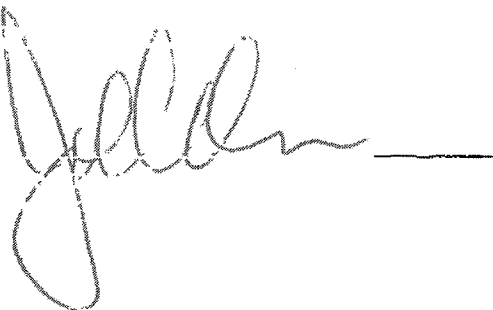
EXPIRY DATE: This Commitment Letter is open for acceptance until 5:00 p.m. on December 10, 2012 at which time, at the option of the Lender, it will expire unless extended by mutual consent.

If the foregoing terms and conditions are acceptable, please sign both copies of this Commitment Letter and return one copy to the Lender by the expiry date.

Yours truly,

SUI

By:
Name
Title



AGREED AND ACCEPTED this ____ day of December, 2012.

FAIRWEST ENERGY CORPORATION

By: _____

Name:

Title:

SCHEDULE "A"

**CASH FLOW FORECAST
(SEE ATTACHED)**

SCHEDULE "B"

Indian Oil & Gas Canada	\$320,704.65
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Freehold royalties

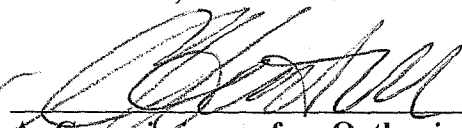
Apache Canada Ltd.	\$24,789.00
Range Royalty LP	\$12,247.00
Canpar Holdings Ltd.	\$3,450.00
ConocoPhillips Canada	\$1,125.00
Verna V. Kienlen	\$32.00
Edna J. Clay	\$16.00

Municipal Taxes

County of Paint Earth	\$188,095.00
Special Areas Board	\$175,000
Special Areas Board	\$174,023
RM of Deer Forks No. 23	\$80,845
Red Deer County	\$24,279
Vulcan County	\$12,689
RM of Reno No. 51	\$423
County of Newall No. 4	\$186

**THIS IS EXHIBIT "F" REFERRED TO IN
THE AFFIDAVIT OF VERNON R. FAUTH**

**SWORN BEFORE ME THIS 10TH DAY OF
DECEMBER, 2012.**



**A Commissioner for Oaths in and for the
Province of Alberta**

**CAROLE J. HUNTER
Barrister & Solicitor**

Clerk's Stamp:

COURT FILE NUMBER _____

COURT COURT OF QUEEN'S BENCH OF ALBERTA

JUDICIAL CENTRE CALGARY

APPLICANTS 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.

DOCUMENT CONSENT

ADDRESS FOR SERVICE AND
CONTACT INFORMATION OF
PARTY FILING THIS DOCUMENT

Burnet, Duckworth & Palmer LLP
2400, 525 – 8th Avenue SW
Calgary, Alberta T2P 1G1
Lawyer: Carole Hunter
Phone Number: 403-260-0368
Fax Number: 403-260-0332
Email Address: chunter@bdplaw.com

File No.: 71301-1

CONSENT TO ACT AS MONITOR

PricewaterhouseCoopers Inc. hereby consents to act as monitor in these proceedings if so appointed by this Honourable Court.

DATED at Calgary, Alberta this 4th day of December, 2012.

PRICEWATERHOUSECOOPERS INC.

Per: 