



COURT FILE NUMBER

1201 15737

COURT

COURT OF QUEEN'S BENCH OF ALBERTA
CALGARY

APPLICANT

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

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

AND IN THE MATTER OF FAIRWEST
ENERGY CORPORATION.

DOCUMENT

SECOND REPORT OF THE MONITOR
PRICEWATERHOUSECOOPERS INC.

ADDRESS FOR SERVICE AND
CONTACT INFORMATION OF
PARTY FILING THIS DOCUMENT

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INTRODUCTION

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

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

- 4) At the request of the Applicant, on January 11, 2013 this Honourable Court issued an order extending the Stay Period, as defined in Paragraph 13 of the Initial Order, to February 11, 2013.
- 5) It is recommended that this report be read in conjunction with the Monitor's First Report (the "First Report") dated January 8, 2013. Capitalized words in this Second Report not otherwise defined carry the same meaning as in the First Report. A copy of the First Report can be found on the Monitor's website, www.pwc.com/car-fec.
- 6) Certain information contained in this report is based on information obtained from the Applicant's books and records and discussions with management and staff. The Monitor has not independently verified the accuracy or completeness of such information; accordingly the Monitor does not express an opinion thereon.

MONITORING OF BUSINESS AND FINANCIAL AFFAIRS

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

UPDATE ON THE ACTIVITIES OF THE APPLICANT

- 9) Management is in the process of obtaining an updated reserve engineering report from Sproule Petroleum Engineers (“Sproule”). The Applicant advises that the reserve report will be complete by the end of February or early March 2013.
- 10) In addition, management has advised that it intends to enter into a sales process and is seeking out a broker to advise and assist on the sale of the Company or its assets.
- 11) It is anticipated that the combination of the updated reserve report from Sproule and the assistance of a sales broker will have a significant impact on the Company’s strategy within these CCAA proceedings.

ROYALTY INVESTMENT LIMITED PARTNERSHIP

- 12) From 2007 to 2010, FEC sold interests in several of its properties to a series of limited partnerships. In October 2010, these partnerships joined together to form Royalty Investment Limited Partnership (“RILP”). In 2010, FEC and RILP entered into a Joint Operating Agreement (“JOA”) to facilitate the operations of the properties held by RILP.
- 13) Vern Fauth, who is the CEO and Chairman of FEC, is a Director of AFM Management Inc. (“AFM”) which is the Managing Partner of RILP. As of February 6, 2013, it is the Monitor’s understanding that Vern Fauth plans to resign as CEO and Chairman of FEC on February 8, 2013.
- 14) As at December 31, 2012, FEC had an account receivable balance due from RILP of \$505,000. On December 31, 2012, FEC issued a default notice to RILP pursuant to the provisions of the JOA, seeking payment of this receivable.
- 15) On January 31, 2013, FEC received a letter from RILP’s counsel alleging that RILP had a number of claims against FEC.

16) Given the intertwined relationship and history between RILP and FEC, the Monitor will be taking a lead role in the investigation of the claims and allegations between FEC and RILP.

CASH FLOWS

17) The below table summarizes the Applicant's cumulative cash flows from December 12, 2012 to February 1, 2013:

Post- CCAA Cash Flow from Dec 12 - Feb 1	TOTALS
OPERATIONS	\$
Oil & Gas Revenue	541,592
Operating Expenses	(380,794)
CASH FLOW FROM OPERATIONS	160,798
 CASH EXPENSES	
G&A	(426,057)
Interest	(27,242)
Reorganization Expenses	(226,000)
TOTAL CASH EXPENSES	(679,298)
Change in Cash	(518,501)
December 12, 2012 Cash Position	94,951
January 10, 2013 DIP Draw	245,776
January 28, 2013 DIP Draw	295,337
February 1, 2013 Cash Position	117,563

18) During the period December 12, 2012 to January 4, 2013, the Applicant did not receive any DIP Funds due to delays surrounding the DIP debt debenture. A formal request for DIP funds was made on January 7, 2013, and the first tranche of DIP funds was received on January 10, 2013.

19) Attached as Exhibit "A" is a summary of the Applicant's cash flow for the period January 5, 2013 to February 1, 2013, compared to the forecasted cash flows filed with this Honorable

Court. The forecasted cash flows are comprised of week 5 of the Initial Cash Flow and weeks 1 - 3 of the First Revised Cash Flow. These forecasted cash flows were filed as exhibits to the first Affidavit sworn by Vern Fauth dated December 6, 2012 (the "First Fauth Affidavit") and the First Monitor's Report dated January 8, 2013 respectively. A summary of the variance to the forecasted cash flows is provided in the following table:

<u>January 5 - February 1</u>	<u>Actual</u>	<u>Forecast</u>	<u>Variance</u>
	\$	\$	\$
Receipts	238,385	301,609	(63,224)
Disbursements	(783,221)	(593,472)	(189,749)
Net Change in cash	(544,836)	(291,863)	(252,973)
Opening Cash	121,286		
January 10, 2013 DIP Draw	245,776		
January 28, 2013 DIP Draw	295,337		
Ending Cash	117,563		

20) Major reasons for the variance between the forecast and actual cash flows include:

- a) receipts (negative variance of \$63,224):
 - i) BP Energy, a counterparty to FEC, has claimed that FEC is in default of its sales contract with BP Energy. As a result, BP Energy has claimed damages of \$201,000 and withheld \$61,000 relating to December 2012 production (January 2013 receipts). This represents the only real material variance in the forecasted revenues in the above noted table. To date, BP Energy has withheld \$155,000 of its total damage claim, as there was \$94,000 in December 2012 receipts. The sales contract was cancelled in December 2012 and no further volumes have been delivered to BP since the cancellation. The remaining \$46,000 claimed by BP will be dealt with as part of the anticipated claims process. The validity of BP Energy's claims is being investigated by the Monitor and the Company's counsel.
- b) disbursements (negative variance of \$189,749):

- i) the Cash Flow filed with the First Fauth Affidavit, projected payments of \$593,000 which were comprised of operating costs, G&A costs and reorganization costs. A large portion of these costs were not paid during the first Stay Period due to the following reasons: DIP funds were not received until January 11, 2013, management overestimated future expenditures and because of timing differences some of the expenditures were not due until a later period.
- ii) The majority of the negative variance was caused by the delayed payment of professional fee retainers totaling \$125,000 relating to reorganization costs.

CASH FLOW FORECAST

- 21) Attached as Exhibit "B" is a copy of the Applicant's cash flow for the period February 2, 2013 to March 15, 2013 (the "Cash Flow Forecast").
- 22) The collections and disbursements included in the Cash Flow Forecast appear to be reasonable estimates based on the discussions with management and the Applicant's current production levels. The cash flow has been forecasted taking into account timing differences relating to prior post-CCAA stay periods.
- 23) The Applicant is currently in arrears on its post-CCAA surface rental costs. The arrears amount has been estimated at \$128,000 and has been included in the Cash Flow Forecast while the Company works through the process of determining the precise amount.
- 24) A planned disbursement of \$70,000 for a Director's and Officer's trailing insurance policy has been included in the Cash Flow Forecast. This amount is to be held in trust by the Applicant's counsel until a policy is purchased.
- 25) The following table summarizes the Cash Flow Forecast for the period from February 2, 2013 to March 15, 2013. Based on the Cash Flow Forecast, the DIP requirement (which is currently only authorized to \$700,000) is expected to be approximately \$798,000.

<u>February 2 to March 15, 2013</u>	<u>TOTALS</u>
OPERATIONS	\$
Oil & Gas Revenue	403,079
Operating Expenses	(487,853)
CASH FLOW FROM OPERATIONS	<u>(84,774)</u>
CASH EXPENSES	
G&A	(220,567)
Interest	(9,087)
Reorganization Expenses	(60,000)
TOTAL CASH EXPENSES	<u>(289,654)</u>
Change in Cash	(374,428)
Opening Cash	117,563
Ending Cash Balance	<u>(256,865)</u>
January 10th DIP Draw	(245,801)
January 28th, DIP Draw	(295,337)
Current Total DIP Draws	<u>(541,138)</u>
Ending DIP Requirement	<u>(798,003)</u>

DIP FINANCING

26) The Initial Order authorized the Applicant to borrow under a credit facility from the Supreme Group Inc. (the “DIP Lender”) up to a limit of \$700,000 (the “DIP Funds”). Based on the Cash Flow Forecast, the Applicant requires its DIP facility to increase by \$100,000 to \$800,000.

27) As of the date of this report, \$541,000 of DIP funds have been advanced.

CREDITOR COMMUNICATIONS

28) The Monitor continues to respond to various enquiries from creditors and other stakeholders.

FEC'S REQUEST FOR AN EXTENSION OF THE STAY

29) FEC is seeking an extension of the Stay Period up to and including March 15, 2013 (the "Stay Extension").

30) The Stay Extension is necessary to allow FEC sufficient time to;

- a) continue the evaluation of its assets and opportunities; and
- b) formulate a plan of arrangement under CCAA.

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

CONCLUSION

32) The Monitor supports the Applicant's request that this Honourable Court;

- a) extend the stay period to March 15, 2013; and
- b) approve the increase to the DIP facility from \$700,000 to \$800,000.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

this 7th day of February, 2013.



PRICEWATERHOUSECOOPERS INC.
Court Appointed Monitor of
FairWest Energy Corporation

EXHIBIT A

FAIRWEST ENERGY CORPORATION
VARIANCE ANALYSIS: JANUARY 5 - FEBRUARY 1

	ACTUAL JAN 5 - FEB 1	FORECASTED JAN 5 - FEB 1	VARIANCE
OPERATIONS			
Oil & Gas Revenue	238,385	301,609	(63,224)
Operating Expenses	(275,686)	(264,232)	(11,453)
CASH FLOW FROM OPERATIONS	(37,300)	37,377	(74,677)
CASH EXPENSES			
G&A	(254,294)	(211,061)	(43,233)
Interest	(27,242)	(7,178)	(20,063)
Reorganization Expenses	(226,000)	(111,000)	(115,000)
TOTAL CASH EXPENSES	(507,535)	(329,240)	(178,296)
Change in Cash	(544,836)	(291,863)	(252,973)

EXHIBIT B - Cash Flow Forecast

FAIRWEST ENERGY CORPORATION
STAY REQUEST - FEB 12 TO MAR 15 (32 days)
42 DAY CASH FLOW SUMMARY (first 10 days a part of prior CF)

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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 working 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.