COURT FILE NUMBER	1201-01367	Clerk's Stamp
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 COUGAR OIL AND GAS CANADA, INC.	
DOCUMENT	**FIRST REPORT OF THE MONITOR** **FEBRUARY 17, 2012**	
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	**<u>MONITOR</u>** ERNST & YOUNG 1000, 440 - 2nd Avenue SW Calgary, Alberta T2P 5E9 Attention: Neil Narfason / Peter Chisholm Telephone: 403-206-5067 / 403-206-5061 Fax: 403-206-5075 Email: neil.narfason@ca.ey.com peter.chisholm@ca.ey.com	

TABLE OF CONTENTS OF THE FIRST REPORT

INTRODUCTION

1. On February 3, 2012, Cougar Oil and Gas Canada Inc. ("Cougar Oil and Gas" or the "Company") sought and obtained protection from their creditors under the Companies' Creditors Arrangement Act, R.S.C. 1985 c. C-36, as amended, (the "CCAA") pursuant to an order of this Honourable Court (the "Initial Order").

2. Pursuant to the Initial Order, Ernst & Young Inc. was appointed monitor of the Cougar Oil and Gas (the "Monitor").

3. The purpose of this first report (the "First Report") of the Monitor is to provide this Honourable Court with the Monitor's comments in respect of the following:

    a) the notices issued to creditors regarding the granting of the Initial Order;

    b) the Alberta Energy Resources Conservation Board ("ERCB") Closure Orders (defined below);

    c) the request for approval of debtor-in-possession financing;

    d) the budget to actual cash flow results for the period for February 3, 2012 to February 16, 2012 (the "Reporting Period");

    e) the revised cash flow projections (the "Revised Cash Flow Projection") from February 17, 2012 to July 31, 2012 (the "Forecast Period");

    f) the Monitor's comments regarding the Company's request for an extension of the stay period; and

    g) the Monitor's recommendations.

4. Capitalized terms not defined in this First Report are as defined in the Initial Order.

BACKGROUND

5. Cougar Oil and Gas is a publicly traded oil and gas exploration and production company focussing on the exploration and development of Canadian based onshore oil and gas properties.

6. Cougar Oil and Gas has experienced three significant setbacks in the last year which have caused it to experience serious financial difficulties and file for protection under the CCAA, as follows:

   a) Cougar Oil and Gas had reduced production from its main property for five months as a result of the pipeline to the property being shut down. The reduction in volume of production negatively affected the ERCB's calculation of Cougar Oil and Gas Canada's Licensee Liability Rating ("LLR"), as described in further detail below; and during this period, Cougar Oil and Gas also experienced substantially higher operating costs due to extensive trucking requirements to get the oil to market;

   b) Cougar Oil and Gas drilled a new well at the cost of $3 million however the well was unsuccessful; and

   c) as a result of certain orders ("Closure Orders") issued by the ERCB, production from the Trout Property was shut in on January 23, 2012.

TERMS OF REFERENCE

7. In preparing this First Report, the Monitor has relied upon unaudited financial information, company records and discussions with management of the Company. The Monitor has not performed an audit, review or other verification of such information. An examination of the financial forecast as outlined in the Canadian Institute of Chartered Accountants Handbook has not been performed. Future orientated financial information relied upon in this report is based on

management's assumptions regarding future events and actual results achieved will vary from this information and the variations may be material.

NOTICE TO CREDITORS (THE "NOTICE")

8. Pursuant to the terms of the Initial Order, the Monitor:

   a) made the Initial Order publicly available on the Monitor's website effective February 6, 2012;

   b) on February 9, 2012 mailed the Notice to every known creditor identified to it by the Company (the "Known Creditors") as having a claim;

   c) prepared a list showing the names and addresses of the Known Creditors and made the list publicly available on the Monitor's web site on February 9, 2012; and

   d) is in the process of placing newspaper advertisements in the Nickel Daily Oil Bulletin and the Peace River Record Gazette providing notice of these CCAA proceedings.

9. The Notice also advised that if a creditor was unable to obtain a copy of this Order from the Monitor's website, it could request a copy be delivered.

ERCB CLOSURE ORDERS

10. The ERCB applies a Licensee Liability Rating ("LLR") to all upstream oil and gas wells, facilities, and pipeline. The purpose of the LLR is to prevent the costs to suspend abandon, remediate and reclaim a well, facility or pipeline from being borne by the public of Alberta should a licensee become defunct and minimize the risk that fund administered by the ERCB for these costs would be insufficient due to unfunded liability of licences in the program.

11. The Liability Management Rating ("LMR") is the ratio of a licensee's eligible deemed assets in the LLR and other programs administered by the ERCB as

compared to the licensee's deemed liabilities in those programs. The ERCB performs its LMR calculation on the first Saturday of each month for each licensee.

12. The deemed assets (the "Deemed Assets") under the LLR program are calculated by the ERCB based upon the average of the monthly volumes of production for the trailing 12 months from the licensee's oil and gas properties multiplied by an industry standard price and an assumed three year period.

13. The deemed liabilities (the "Deemed Liabilities") under the LLR program are calculated by the ERCB based upon the sum of the costs to suspend, abandon, remediate and reclaim all wells and facilities for which it is the licensee, adjusted for status and present value and salvage factor.

14. Licensees with a LMR ratio of less than 1.0 are required to post a security deposit (the "LMR Deposit") with the ERCB for the shortfall between the values of the licensee's deemed assets and deemed liabilities.

15. In the fall of 2011, Cougar Oil and Gas was contacted by the ERCB to post a LMR Security Deposit of $620,074.93, the LMR Security Deposit was required as a result of the following:

    a) Cougar Oil and Gas had no production from its main property for several months as a result of the pipeline to the property being shut down. These reduction in volumes of production significantly reduced the ERCB's calculation of Cougar Oil and Gas Canada's deemed assets under the LLR Program; and

    b) In January 2011, Cougar Oil and Gas purchased properties (the "PetroReal Properties") with little production and significant abandonment liabilities. Cougar Oil and Gas's Deemed Liabilities increased significant as a result of acquiring the PetroReal Properties abandonment liabilities however the Deemed Assets did not increase as the PetroReal Properties had little production.

16. As Cougar Oil and Gas did not have sufficient cash to post the LMR Deposit and a sale of the PetroReal Properties was unsuccessful the ERCB issued the Closure Orders. Cougar Oil and Gas will receive revenue for the production between January 1, 2012 and January 23, 2012 on February 25, 2012 however as a result of its wells being shut in, Cougar Oil and Gas Inc. will not receive any additional revenue from its oil and gas properties until a deposit is posted with the ERCB and its wells can be brought back on-line.

17. The ERCB evaluates LMRs on the first Saturday of each month. The ERCB has advised Cougar Oil and Gas that the LMR Security Deposit required to bring its oil and gas wells back on-line for February is approximately $700,000

18. Cougar Oil and Gas has estimated that the ERCB will require an additional LMR Security Deposit of $590,000 between March 1, 2012 and June 30, 2012 bringing the total estimated LMR Security Deposit in June 2012 to $1.29 million as identified in the Revised Cash Flow Projection attached hereto as Appendix B.

DEBTOR IN POSSESSION ("DIP") FINANCING

19. Cougar Oil and Gas has arranged with Zentrum Energie Trust AG ("Zentrum"), the third secured creditor of Cougar Oil and Gas and a shareholder in Cougar Oil and Gas, to provide Cougar Oil and Gas with a debtor-in-possession credit facility (the "DIP Facility") of $1.7 million. The DIP Facility would be used to post the estimated $1.29 million LMR Security Deposit with the ERCB to get Cougar Oil and Gas's wells back on production to generate revenue and to fund capital expenditures to increase production and prevent an increase to the LMR Security Deposit above the maximum estimated LMR Security Deposit of $1.29 million which Cougar Oil and Gas Inc. estimates will be owing in June 2012.

20. Zentrum is proposing to advance (the "DIP Advances") the DIP Facility on the following dates:

Date of Advance	**Amount of Advance**
Within one business day of receiving court approval of the DIP Financing ("Initial Advance")	Cdn. $750,000
March 15, 2012	Cdn. $285,000
April 16, 2012	Cdn. $215,000
April 30, 2012	Cdn. $350,000
May 31, 2012	Cdn. $100,000

21. The significant terms of the DIP Facility are as follows:

a) the DIP Facility shall have a first ranking charge, subject to the Administration Charge and the Directors' Charge, against the LMR Security Deposit to the extent that the DIP Advances fund the LMR Security Deposit and the remaining DIP Facility shall have a security ranking behind only the Administration Charge, the Directors' Charge and the Canadian Western Bank's ("CWB") security;

b) Cougar Oil and Gas is required to repay the entire principle amount outstanding under the DIP Facility on the earlier of the date which is twelve months from the date of the Initial Advance and the date on which the CCAA proceedings are terminated;

c) Cougar Oil and Gas is required to pay to Zentrum, within three days of receipt, any funds returned from the ERCB as a result of a reduction in the LMR Security Deposit;

d) Cougar Oil and Gas is required to make interest payments to Zentrum on a monthly basis based upon the principle outstanding on the DIP Facility and a rate of 16% per annum;

e) Cougar Oil and Gas is required to pay a fee of 2% on each of the DIP Advances; and

f) Cougar is responsible to pay all of Zentrum's out-of-pocket expenses associated with the DIP Facility up to an amount of $40,000.

22. The Monitor understands that Cougar Oil and Gas has the following secured creditors:

a) Canadian Western Bank is owed approximately $2.4 million under an operating loan which is secured by a floating first charge on all of Cougar Oil and Gas's assets (the "CWB Loan");

b) Sword Energy Inc. ("Sword") is owed approximately $2.81 million relalting to a vendor take back mortgage (the "Sword Loan") and Sword Loan is secured by a charge, subordinated to CWB, on the Trout Property and other assets of Cougar Oil and Gas; and

c) Zentrum is owed approximately $2.75 million under several convertible debentures (the "Zentrum Debentures") secured by a third ranking fixed and floating mortgage over all of Cougar Oil and Gas Inc.'s assets.

23. The DIP Facility will prime both the CWB Loan and Sword Loan for the portion of the DIP Advances that will be posted with the ERB for the LMR Security Deposit. The Monitor understands that without posting the LMR Security Deposit, Cougar Oil and Gas would be unable to resume production or sell any of its oil and gas properties as the ERCB would prohibit the transfer of well licenses to a purchaser until the potential abandonment liability was rectified. As a result, CWB and Sword are unable to realize upon their security position until the LMR

Security Deposit has been posted and therefore their security is not reduced by Zentrum having a first charge over the LMR Security Deposit funded by the DIP Advances.

24. The security for the remaining DIP Facility which Cougar Oil and Gas will use to fund capital expenditures and operations will rank behind the Administration Charge, the Directors' Charge and the charge over Cougar Oil and Gas's assets as security for the CWB Loan, however, will prime the charge that Sword has on the Trout Property and other assets of Cougar Oil and Gas to secure the Sword Loan.

25. In the absence of DIP Facility, Cougar Oil and Gas would likely be placed into liquidation with their oil and gas assets being subject to an expedited sale process which, in the Monitor's view, could possibly compromise Sword's recovery under their security and result in no recovery to Zentrum and the unsecured creditors of Cougar Oil and Gas.

26. Management believes that obtaining the DIP Facility and getting Cougar Oil and Gas's wells back on-line and generating revenue will significantly increase the value of the Property and increase the recovery to all of the stakeholders.

27. The Monitor further understands that all of Cougar Oil and Gas's secured creditors have been provided sufficient notice of the application for court approval of the DIP Facility.

28. The Monitor supports Cougar Oil and Gas's application for the DIP Facility as it allows a period of time for the Company to consider its strategic restructuring alternatives which the Monitor believes will provide a more certain outcome and potentially greater recovery than in liquidation.

29. Accordingly, the Monitor considers the DIP financing to be reasonable and necessary in order to maintain and preserve business operations, and to provide additional time to restructure which preserves value for all stakeholders.

BUDGET TO ACTUAL RESULTS

30. Attached as Appendix A to this First Report is a summary of Cougar Oil and Gas's actual receipts and disbursements for the Reporting Period combined with an analysis of variances from the cash flow forecast (the "Initial Forecast") as previously provided to this Honourable Court in the affidavit of William S. Tighe dated February 3, 2012. A summary budget to actual analysis is provided in the table below:

Cougar Oil and Gas - Budget to Actual	Actual Feb. 3/12 to Feb. 16/12	Forecast Feb. 3/12 to Mar. 2/12	Difference
Receipts	5,570	176,519	(170,949)
Disbursements	19,993	373,965	(353,972)
Net change in cash	(14,423)	(197,446)	183,023
Opening cash	200,000	200,000	-
Ending cash	185,577	2,554	183,023

31. The cash flow budget to actual contains the actual cash receipts and disbursements for the period of February 3, 2012 to February 16, 2012 as compared to the cash flow forecast for the period of February 3, 2012 to March 2, 2012 previously provided to this Court in the affidavit of William S. Tighe dated February 3, 2012.

32. As set out in the table above, Cougar Oil and Gas's total receipts for the Reporting Period approximated $5,570, approximately $170,000 less than the total receipts projected in the Initial Forecast. The reduced receipts was a result of the cash flow forecast estimating that January 2012 revenue would be collected on February 25, 2012 however the actual receipts and disbursements being reported above are only for the period up to February 16, 2012 and therefore Cougar Oil and Gas has not yet received their January revenue.

33. Cougar Oil and Gas's disbursements for the Reporting Period totalled approximately $20,000, which was approximately $350,000 less than the total disbursements projected in the Initial Forecast. The variance primarily related to

the actual results only covering the period of February 3, 2012 to February 16, 2012 while the forecast was for the period of February 3, 2012 to March 2, 2012 and the majority of the expenses were forecast to occur subsequent to February 16, 2012

34. The ending cash balance as at February 16, 2012 was approximately $185,000.

REVISED CASH FLOW FORECAST THROUGH JULY 31, 2012

35. The Company, with the assistance of the Monitor, has prepared a forecast for the period February 17, 2012 to July 31, 2012 (the "Forecast Period") which are attached as Appendix B to this report (the "Forecast"). Management has prepared the Forecast based on the most current information available. The table below summarizes cash flow for the Forecast Period:

Cash flow Forecast
February 17, 2012 - July 31, 2012

RECEIPTS	
Petroleum and natural gas revenue	1,434,152
Debtor-in-possession financing	1,700,000
Non-operated joint venture revenue	31,982
GST Received	71,708
Overhead recovery	25,170
Joint Venture Receipts	141,035
Total receipts	**3,404,047**
DISBURSEMENTS	
Operating expenses	678,000
General & administrative expenses	663,030
Capital expenditures	185,000
ERCB LLR deposit	1,199,000
Mineral and Surface lease rentals & acquisitions	34,118
Joint Venture payments	220,584
GST Paid	75,602
Contingency	61,700
DIP Financing Fees and Interest Payments	107,155
CCAA professional fees	280,000
Total disbursements	**3,504,189**
NET CASH FLOWS	(100,142)
OPENING CASH	185,577
NET CHANGE IN CASH FLOWS	(100,142)
ENDING CASH	**85,435**

36. As summarized above, Cougar Oil and Gas is projecting total cash receipts of approximately \$3.4 million against cash disbursements of approximately \$3.5 million, resulting in a net decrease in cash of approximately \$120,000 during the Forecast Period.

37. The Monitor has reviewed the assumptions supporting the Forecast and believes the assumptions to be reasonable.

38. Significant assumptions made by Cougar Oil and Gas's management with respect to the Forecast are:

a) Revenue collected from oil and gas properties of approximately \$1.6 million;

b) DIP Facility of \$1.7 million will be provided by Zentrum;

c) Operating expenses and general and administrative expenses are based on historical results;

d) Minimal capital expenditures to bring wells back on-line after posting the LRM Security Deposit and increase production where cost effective;

e) Posting of approximately \$1.2 million LRM Security Deposit with the ERCB, assuming an approximately \$90,000 return of LRM Security Deposit in July 2012; and

f) Professional fees relate to the costs of the Monitor and legal counsel.

39. Based on the above assumptions, the Forecast indicates that Cougar Oil and Gas will have sufficient cash throughout the Forecast Period.

THE COMPANY'S REQUEST FOR AN EXTENSION OF THE STAY PERIOD

40. Pursuant to the Initial Order, as amended, the Stay Period expires on March 2, 2012. Cougar Oil and Gas is seeking an extension of the Stay Period to and including May 23, 2012 (the "Stay Extension").

41. The Stay Extension is necessary to allow Cougar Oil and Gas to fully explore the possible restructuring alternatives, improve their financial position by bring wells back on-line that have been shut-in as a result of the Closure Orders and develop a restructuring plan to present to their creditors.

42. In the Monitor's view, Cougar Oil and Gas is acting in good faith and with due diligence.

RECOMMENDATIONS

43. The Monitor recommends that this Honourable Court approve:

   a) the DIP Facility; and

   b) the Stay Extension.

Dated at Calgary, this 17 day of February, 2012.

ERNST & YOUNG INC.
in its capacity as the Monitor
of Cougar Oil and Gas

Neil Narfason, CA•CIRP, CBV
Senior Vice-President

Peter Chisholm, CA
Manager

APPENDIX A

Budget to Actual

Cougar Oil and Gas Canada Inc.
Comparison of actual to projected cash flow for the period of February 3, 2012 to February 16, 2012

Appendix A

	Actual	Forecast	Variance
	Feb-3 to Feb-16	Feb-3 to Mar-2	Positive (Negative)
	a	b	a-b
Receipts			
Petroleum and natural gas revenue	987	125,709	(124,722)
Non-operated joint venture revenue	4,582	5,330	(748)
GST received		6,285	(6,285)
Overhead recovery		4,195	(4,195)
Joint venture receipts		35,000	(35,000)
Total Receipts	**5,570**	**176,519**	**(170,950)**
Disbursements			
Operating expenses		74,500	74,500
General & administrative expenses		109,100	109,100
Capital expenditures		20,000	20,000
Mineral and surface lease rentals & acquisitions	19,993	23,243	3,251
Joint venture payments		74,392	74,392
GST paid		12,730	12,730
CCAA professional fees		60,000	60,000
Total Operating Disbursements	**19,993**	**373,965**	**353,973**
Net change in cash	**(14,423)**	**(197,446)**	**183,023**
Opening cash	200,000	200,000	
Ending Cash	185,577	2,554	

Notes to variances:

1. Petroluem and natural gas revenue and joint venture receipts are collected on the 25th of the month for oil and gas production the previous month. The negative variance is a result of the cash flow forecast estimating that January revenue would be collected on February 25, 2012 however the actual results being reported above are only for the period up to February 16, 2012 and therefore Cougar Oil and Gas has not yet received their January revenue.

2. Expenditures are less than forecast as the actual results only cover the period of February 3, 2012 to February 16, 2012 while the forecast was for the period of February 3, 2012 to March 2, 2012 and the majority of the expenses were forecast to occur subsequent to February 16, 2012.

3. CCAA professionals have been accuring however will likely not be paid by Cougar Oil and Gas until April 2012, professionals will rely on the administrative charge per the Initial CCAA Order as security for their costs.

APPENDIX B

Cash Flow Forecast

Appendix B

Cougar Oil and Gas Canada, Inc.

Cash Flow Forecast for the period of February 17, 2012 to July 31, 2012
CDN $

Month Ending	Notes	Feb. 17/12 to Feb. 29/12	Mar. 1/12 to Mar. 31/12	Apr. 1/12 to Apr.	May 1/12 to May 31/12	Jun. 1/12 to Jun.	Jul. 1/12 to Jul. 31/12
Receipts							
Petroleum and natural gas revenue	2	125,709	-	266,032	308,401	361,025	372,985
Debtor-in-possession financing	3	750,000	285,000	565,000	100,000		-
Non-operated joint venture revenue		5,330	5,330	5,330	5,330	5,330	5,330
GST Received		6,285	-	13,302	15,420	18,051	18,649
Overhead recovery		4,195	4,195	4,195	4,195	4,195	4,195
Joint Venture Receipts		3,000	1,926	5,239	67,845	31,713	31,312
Total Receipts		894,519	296,451	859,099	501,192	420,314	432,472
Disbursements							
Operating expenses		50,500	125,500	125,500	125,500	125,500	125,500
General & administrative expenses		105,505	105,505	135,505	105,505	105,505	105,505
Capital expenditures	4	20,000	50,000	115,000	-	-	-
ERCB LLR deposit	5	700,000	165,000	303,000	109,000	13,000	(91,000)
Mineral and Surface lease rentals & Acquis		3,251	3,413	3,900	8,064	1,044	14,447
Joint Venture payments	6	-	-	-	65,651	72,368	82,566
GST Paid		6,350	11,600	19,850	12,600	12,600	12,600
Contingency		-	-	24,050	12,550	12,550	12,550
DIP Financing Fees		15,000	5,700	11,300	2,000	-	-
DIP Interest Payments		-	1,644	12,191	15,178	21,786	22,356
CCAA professional fees		-	-	70,000	70,000	70,000	70,000
Total Disbursements		900,606	468,362	820,296	526,048	434,353	354,525
Net Cash Flow		(6,087)	(171,911)	38,803	(24,856)	(14,039)	77,947
Opening Cash		185,577	179,490	7,579	46,382	21,526	7,487
Ending Cash		179,490	7,579	46,382	21,526	7,487	85,434

Notes:

Management of Cougar Oil and Gas Canada, Inc. have prepared this Projected Cash Flow Statement based on the probable and hypothetical assumptions detailed in Notes 1 - 6. Consequently, actual results will likely vary from performance projected and such variations may be material.

1. Receipts and disbursements are based upon historical results and forecasted production levels.

2. Petroleum and Natural Gas Revenues are received on the 25th of the month following production.

3. DIP Facility from Zentrum of $1.7 million.

4. Estimated Capital Expenditures are considered necessary for the general preservation, maintenance and upgrade of the capital assets.

5. Estimated ERCB deposit required based on 12 month rolling production and capital expenditures to add additional future production.

6. Pre-CCAA joint venture amounts not paid until status determined in claims process.