



# **DUNDEE ENERGY LIMITED**

**(formerly Eurogas Corporation)**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**AS AT AND FOR THE THREE MONTHS ENDED MARCH 31, 2012**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Dundee Energy Limited ("Dundee Energy" or the "Corporation") is a Canadian-based company focused on creating long-term value through the development and acquisition of high-impact energy projects. The Corporation holds interests, both directly and indirectly, in the largest accumulation of producing oil and natural gas assets in southern Ontario and in the development of an offshore underground natural gas storage facility in Spain. The Corporation also holds an investment in preferred shares of Eurogas International Inc. ("Eurogas International"), an oil and gas exploration company that holds a 45% participating interest in the one million acre Sfax permit located offshore Tunisia.

The Corporation's common shares currently trade on the Toronto Stock Exchange ("TSX") under the symbol "DEN". Pursuant to a special resolution passed by the shareholders of the Corporation at its annual and special meeting held on June 14, 2011, the Corporation changed its name from "Eurogas Corporation" to "Dundee Energy Limited" in order to more clearly reflect its business operations in the energy sector, both in Canada and in Europe. On June 22, 2011, the common shares of the Corporation commenced trading on the TSX under the new symbol "DEN" (formerly "EUG").

**This Management's Discussion and Analysis ("MD&A") has been prepared with an effective date of April 30, 2012 and provides an update on matters discussed in, and should be read in conjunction with the Corporation's audited consolidated financial statements as at and for the year ended December 31, 2011 (the "2011 Audited Consolidated Financial Statements") and the unaudited condensed interim consolidated financial statements as at and for the three months ended March 31, 2012 (the "March 2012 Interim Consolidated Financial Statements"), prepared using International Financial Reporting Standards ("IFRS"). All amounts are in Canadian dollars unless otherwise specified. Tabular dollar amounts, unless otherwise specified, are in thousands of dollars, except for per unit or per share amounts.**

### PERFORMANCE MEASURES AND BASIS OF PRESENTATION

The Corporation's March 2012 Interim Consolidated Financial Statements are prepared in accordance with IFRS, as applicable to condensed interim consolidated financial statements, and use the Canadian dollar as its presentation currency. However, the Corporation believes that important measures of its economic performance include certain measures that are not defined under IFRS and as such, may not be comparable to similar measures used by other companies. Throughout this MD&A, there will be references to the following performance measures which management believes are valuable in assessing the economic performance of the Corporation. While these measures are not defined by IFRS, they are common benchmarks in the oil and natural gas industry, and are used by the Corporation in assessing its operating results, including net earnings and cash flow.

- "Barrel of Oil Equivalent" or "boe" is calculated at a barrel of oil conversion ratio of six thousand cubic feet ("Mcf") of natural gas to one barrel ("bbl") of oil (6 Mcf to 1 bbl), based on an energy equivalency conversion method which is primarily applicable at the burner tip and does not always represent a value equivalency at the wellhead.
- "Field Level Cash Flows" is calculated as revenues from oil and natural gas sales, less royalties and production expenditures, adjusted for the effect of the Corporation's risk management contracts. Field level cash flows contribute to the funding of the Corporation's working capital, as well as to capital expenditure requirements for these activities. Field level cash flows also provide for repayment of amounts owing pursuant to the Corporation's credit facilities (see "*Liquidity and Capital Resources*").
- "Field Netbacks" refer to field level cash flows expressed on a measurement unit or barrel of oil equivalent basis.
- "Proved Reserves" are those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated proved reserves.
- "Probable Reserves" are those additional reserves that are less certain to be recovered than proved reserves. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves.
- "Reserve Life Index" is determined by dividing proved reserves by expected annual production. For greater certainty, the reserve life index includes only proved reserves and does not include probable or possible reserves.
- "Per Day Amount" or ("/d") is used throughout this MD&A to reflect production volumes on an average per day basis.

## **SIGNIFICANT PROJECTS**

### **The Southern Ontario Assets**

Dundee Energy Limited Partnership (“DELP”), a limited partnership that is wholly-owned by the Corporation, holds a 95% working interest in 84,000 acres of onshore oil properties and a 65% working interest in 988,000 acres of offshore gas properties located in and around Lake Erie in southern Ontario. In addition to the oil and gas rights associated with these properties, DELP owns six onshore oil facilities, and holds a 65% ownership interest in an offshore fleet of drilling and completion barges and six gas plants and compressor stations that process offshore dry gas at onshore locations.

On August 4, 2011, the Corporation expanded its operations in southern Ontario through the acquisition of 100% of the outstanding common shares of Torque Energy Inc. (“Torque”), a Canadian based oil and natural gas company that was engaged in the exploration, development and acquisition of oil and natural gas properties. Torque held working interests in 47 wells, including 43 wells in southern Ontario that are located in relative proximity to the Corporation’s oil and natural gas interests held through DELP. Torque also had interests in four wells located in Alberta.

In June 2010, Torque had entered into an agreement with Union Gas, which provides Union Gas with the right to develop new natural gas storage capacity in the Trenton Reservoir located within the Dover East field, where Torque held a 50% non-operating working interest. In exchange, Torque will receive cash payments that are tiered to the developmental work undertaken by Union Gas for natural gas storage. Notwithstanding the transaction with Union Gas, Torque retained the right to further explore, drill and produce petroleum substances from all new and certain existing wells within the Dover East field, subject to maintaining the integrity of the designated storage reservoir.

On December 1, 2011, the Corporation completed the integration of the assets and business processes acquired from Torque, including Torque’s interest in the Union Gas transaction, with its existing operations in southern Ontario, providing the Corporation with efficiencies of scale.

### **Castor UGS Limited Partnership and the Castor Project**

The Corporation is involved in the conversion of the abandoned Amposta oil field, located off the eastern Mediterranean coast of Spain, to a natural gas storage facility (the “Castor Project”). The Castor Project will utilize the abandoned Cretaceous aged carbonate Amposta reservoir for gas storage, with gas injection scheduled to begin in May 2012. The Castor Project will provide Spain with a dedicated source of easily deliverable natural gas and will help to moderate periods of seasonal and daily peak demand. It will also provide Spain with strategic gas storage, ensuring supply continuity in the event of disruption to its national gas system.

The Corporation’s Castor Project is managed by ACS Servicios Comunicaciones y Energia S.L. (“ACS”), the largest construction group in Spain and a 67% shareholder of Escal UGS S.L., the owner of the Castor Project. Castor UGS Limited Partnership (“CLP”), the Corporation’s 74% subsidiary, holds the remaining 33% interest in Escal, providing the Corporation with an effective 25% interest.

### **Series A Preference Share Investment in Eurogas International Inc.**

The Corporation holds a \$32,150,000 preferred share investment in Eurogas International, an independent oil and gas company engaged in the exploration and evaluation of its extensive landholdings offshore Tunisia, targeting large scale oil and gas reserves. Eurogas International holds a 45% participating interest, and is the non-operating partner in the Sfax offshore permit covering 908,425 acres located in the Gulf of Gabes, in the Mediterranean waters immediately offshore and southeast of the city of Sfax.

In 2011, Eurogas International declared a condition of Force Majeure with respect to the Sfax permit and the related Ras El Besh concession, as it believes that the political uncertainty and civil unrest in Tunisia adversely affects its ability to continue exploration and evaluation activities in that region. Eurogas International has indicated that it believes that the declaration of Force Majeure will allow Eurogas International and its partner to suspend their activities while the conditions resulting in the Force Majeure continue.

## CONSOLIDATED RESULTS OF OPERATIONS

### Three months ended March 31, 2012 compared with the three months ended March 31, 2011

#### Consolidated Net Loss

During the three months ended March 31, 2012, the Corporation incurred a net loss attributable to the owners of the parent of \$0.4 million. This compares with a net loss attributable to the owners of the parent of \$2.0 million incurred in the three months ended March 31, 2011. First quarter results in 2012 were impacted by a significant mark-to-market gain of \$1.3 million in respect of the Corporation's risk management contracts (see "*Risk Management Contracts – Price Risk Management*"). In the first quarter of the prior year, the Corporation incurred a loss from these risk management contracts of \$1.4 million. A summary of the Corporation's net loss from its various projects is summarized below:

For the three months ended March 31,	2012			2011		
	Net Earnings (Loss)	Attributable to Owners of the Parent	Non-Controlling Interest	Net Earnings (Loss)	Attributable to Owners of the Parent	Non-Controlling Interest
Southern Ontario Assets	\$ 62	\$ 62	\$ -	\$ (1,756)	\$ (1,756)	\$ -
Castor Project	(28)	(21)	(7)	(42)	(31)	(11)
Loss from investment in preferred shares of Eurogas International	(320)	(320)	-	(317)	(317)	-
Corporate activities	(141)	(141)	-	64	64	-
Net loss for the period	\$ (427)	\$ (420)	\$ (7)	\$ (2,051)	\$ (2,040)	\$ (11)

#### Southern Ontario Assets

In accordance with industry practice, production volumes, reserve volumes and oil and gas sales are reported on a working interest or "net" basis.

#### Operating Performance

The Corporation's operating performance is dependent on production volumes of oil, natural gas and natural gas liquids, and the prices received for these commodities. In the first quarter of 2012, sales of oil and gas, net of royalty interests, were \$8.1 million, consistent with \$8.1 million earned in the same period of the prior year. However, a substantial decrease in the price of natural gas significantly altered the components of the Corporation's sale of oil and gas. As illustrated in the table below, the benefit of increased production volumes and improved prices for oil were essentially offset by the effect of decreases in the price for natural gas.

	Natural Gas	Oil and Liquids	Total
Net Sales			
Three months ended March 31, 2012	\$ 2,442	\$ 5,632	\$ 8,074
Three months ended March 31, 2011	3,656	4,416	8,072
Net increase (decrease) in net sales	\$ (1,214)	\$ 1,216	\$ 2
Effect of changes in production volumes	\$ 26	\$ 817	\$ 843
Effect of changes in commodity prices	(1,240)	399	(841)
	\$ (1,214)	\$ 1,216	\$ 2

### Production Volumes

Natural gas sales currently represent 69% (three months ended March 31, 2011 – 72%) of the Corporation's overall production volume on a boe basis, with oil production representing the remaining 31% (three months ended March 31, 2011 – 28%).

Average daily volume during the three months ended March 31,	2012	2011
Natural gas (Mcf/d)	10,123	10,164
Oil (bbls/d)	733	635
Liquids (bbls/d)	30	16
Total (boe/d)	2,450	2,345

The historical decline rate of approximately 15% in the Corporation's oil reserves was offset by drilling and workover programs undertaken in the third and fourth quarters of 2011, including a new oil well drilled in December 2011 that came on production at 40 bbls/d. The Corporation also benefitted from the acquisition of Torque, which was completed in the third quarter of 2011, and which added approximately 85 bbls/d to oil production volumes.

Average daily production volumes for natural gas in the first quarter of 2012 were consistent with average daily natural gas production volumes in the same period of the previous year. The natural decline in gas reserves of 5% to 8% annually was partially offset by the drilling of two offshore wells in the fourth quarter of 2011 that, on a combined basis, contributed production volumes of approximately 450 Mcf/d. The acquisition of Torque added another 300 Mcf/d to gas production.

### Net Sales of Oil and Gas

For the three months ended March 31,	2012			2011		
	Sales	Realized		Sales	Realized	
		Prices (\$ / unit)			Prices (\$ / unit)	
Natural gas	\$ 2,875	3.12	\$ 4,290	4.69		
Oil	6,398	95.89	5,211	91.18		
Liquids	173	63.37	68	47.22		
	9,446		9,569			
Less: Royalties at 15% (2011 - 16%)	(1,372)		(1,497)			
Net sales	\$ 8,074		\$ 8,072			

The Corporation pays a royalty on gross sales of approximately 15% (three months ended March 31, 2011 – 16%) to provincial governments, freehold landowners and overriding royalty owners.

### Effect of Commodity Prices on Revenues from Oil and Gas Sales

Prices for oil and natural gas may vary significantly from quarter to quarter due to several factors including supply, demand, weather, general economic conditions and changes in foreign exchange rates. The table below illustrates several benchmark prices for these commodities, compared with the Corporation's realized prices.

For the three months ended March 31,	2012			2011		
	US\$	CAD\$	Realized	US\$	CAD\$	Realized
			Prices (\$)			Prices (\$)
<b>Natural Gas</b>						
Dawn Hub	2.88	2.89	3.12	4.61	4.57	4.69
Nymex Henry Hub	2.45	2.46		4.21	4.17	
<b>Oil</b>						
Edmonton Par	n/a	92.94	95.89	n/a	88.57	91.18
West Texas Intermediate	102.98	103.29		94.07	93.15	

### *Realized Price on Natural Gas*

During the three months ended March 31, 2012, the Corporation realized an average price of \$3.12/Mcf on its sales of natural gas before royalty interests, a decrease of over 33% from the average price of \$4.69/Mcf realized in the same period of the prior year. In March 2012, natural gas prices in Canada fell below US\$2.00/Mcf, as relatively warmer winter weather diminished demand, at the same time as new discoveries and technological changes resulted in a surplus of supply. However, due to the proximity of the Corporation's operations to the Dawn Hub, a leading provider of natural gas supply to the greater Toronto market area, the Corporation's realized price from sales of natural gas continues to include a positive basis differential from the average industry benchmarks.

### *Realized Price on Oil*

Global economic uncertainties continue to cause substantial volatility in the price of oil. Concerns that a recession is possible in the European Union and expectations for slower economic growth in emerging countries, contrast with concerns over possible supply disruptions from certain areas of the Middle East. These concerns are reflected in the substantial volatility of the West Texas Intermediate ("WTI") Crude Oil Price, which reached a high of US\$109.39/bbl and a low of US\$96.36/bbl in the first quarter of 2012, closing at US\$103.03/bbl on March 31, 2012.

While international benchmarks continued to climb in the first quarter of 2012, oil prices fell in western Canada. Given quality differentials, the Edmonton Par Oil Price ("Edmonton Par") normally trades at a price discount to the WTI oil price. However, the magnitude of the discount was unusually wide in the latter part of the first quarter, increasing to \$10.35/bbl compared with \$4.58/bbl in the same period of the prior year. With the advent of improved technology, compounded by the growth of oil shale plays, production of oil in western Canada has now exceeded its export pipeline capacity, exerting downward pressure on the Edmonton Par.

Changes in the Corporation's realized oil price per bbl is more closely correlated to the Edmonton Par, reflecting the markets in which the Corporation operates. As a result, the Corporation realized an average price of \$95.89/bbl from its sales of oil during the first quarter of 2012, a 5% increase over \$91.18/bbl realized in the same period of the prior year, but substantially below the WTI benchmark price.

### *Risk Management Contracts – Price Risk Management*

In order to mitigate its exposure to price volatility, the Corporation may, from time to time, enter into fixed price contracts. These price risk management strategies assist the Corporation in securing a stable amount of cash flow to protect a desired level of capital spending and for debt management. As well, the Corporation's revenues are primarily received in Canadian dollars, however, pricing for commodities, including oil and natural gas, are closely referenced to the US dollar. The Corporation partially mitigates its exposure to changes in commodity prices resulting from foreign exchange variability by entering into commodity risk management contracts on a Canadian dollar basis.

The following table summarizes the realized and unrealized gains or losses from the Corporation's risk management contracts during the three months ended March 31, 2012 and March 31, 2011. For accounting purposes, the Corporation has not designated its risk management contracts as hedges. Accordingly, the gains or losses from these contracts are not reflected in the Corporation's reported amounts of oil and natural gas sales.

For the three months ended March 31,	2012			2011		
	Realized (loss) gain	Unrealized (loss) gain	Total	Realized (loss) gain	Unrealized (loss) gain	Total
Oil swaps	\$ (137)	\$ (487)	\$ (624)	\$ (93)	\$ (1,360)	\$ (1,453)
Gas swap	979	905	1,884	-	62	62
	\$ 842	\$ 418	\$ 1,260	\$ (93)	\$ (1,298)	\$ (1,391)

The following is a summary of commodity contracts entered into by the Corporation as of March 31, 2012. The positive value of the Corporation's natural gas-based risk management contracts at March 31, 2012 resulted from forecasted decreases in underlying commodity prices during the periods covered, compared with the fixed price pursuant to the terms of the contract itself.

Contract	Volume	Pricing Point	Strike Price (Cdn\$/unit)	Remaining Term	Fair Value March 31, 2012
Fixed Price Swap					
Crude oil	500 bbl/d	NYMEX	\$101.20	Apr 01/12 to Dec 31/12	\$ (536)
Natural gas	7,000 mbtu/d	NYMEX	\$3.84	Apr 01/12 to Dec 31/12	2,570
					\$ 2,034

In accordance with IFRS, the Corporation is required to estimate the fair values of outstanding contracts at each reporting date and to include changes in the fair values as a component of the Corporation's net earnings. The fair values of risk management contracts outstanding at the end of a reporting period are determined using market conditions and forecasts prevailing as at the reporting date. Any changes in the fair values of risk management contracts from amounts determined at the end of the previous reporting period are recognized as an unrealized risk management gain or loss. An unrealized risk management gain or loss may or may not be realized in subsequent periods depending upon subsequent fluctuations in commodity prices or foreign exchange rates affecting the risk management contracts.

#### *Production Expenditures*

Production expenditures include costs associated with bringing oil and natural gas from the reservoir to the surface sales point, and include separating the oil and gas, treating the oil and gas to remove impurities and disposing of produced water. Included in production expenditures is an allocation of general and administrative costs, including labour, which is directly attributable to these activities. During the first quarter of 2012, the Corporation incurred production expenditures of \$3.0 million or \$13.65/boe. This compares to \$2.9 million or \$13.73/boe in the same period of the prior year.

For the three months ended March 31,	2012			2011		
	Natural Gas	Oil and Liquids	Total	Natural Gas	Oil and Liquids	Total
Production expenditures	\$ 1,444	\$ 1,601	\$ 3,045	\$ 1,770	\$ 1,128	\$ 2,898
Production expenditures per unit	(per Mcf) \$ 1.57	(per bbl) \$ 23.05	(per boe) \$ 13.65	(per Mcf) \$ 1.94	(per bbl) \$ 19.26	(per boe) \$ 13.73

With the decline in the price of natural gas, the Corporation has focused its resources on oil and liquids production. As a result, production expenditures associated with natural gas have decreased to \$1.57/Mcf compared with \$1.94/Mcf in the same period of the prior year, while oil-based production expenditures have increased correspondingly to \$23.05/bbl in the first quarter of 2012 compared with \$19.26/bbl in the same period of the prior year.

#### *Field Level Cash Flows and Field Netbacks*

For the three months ended March 31,	2012			2011		
	Natural Gas	Oil and Liquids	Total	Natural Gas	Oil and Liquids	Total
Total sales	\$ 2,875	\$ 6,571	\$ 9,446	\$ 4,290	\$ 5,279	\$ 9,569
Realized risk management gain (loss)	979	(137)	842	-	(93)	(93)
Royalties	(433)	(939)	(1,372)	(634)	(863)	(1,497)
Production expenditures	(1,444)	(1,601)	(3,045)	(1,770)	(1,128)	(2,898)
Field level cash flows	\$ 1,977	\$ 3,894	\$ 5,871	\$ 1,886	\$ 3,195	\$ 5,081

For the three months ended March 31,	2012			2011		
	Natural Gas	Oil and Liquids	Total	Natural Gas	Oil and Liquids	Total
	\$/Mcf	\$/bbl	\$/boe	\$/Mcf	\$/bbl	\$/boe
Total sales	\$ 3.12	\$ 94.61	\$ 42.36	\$ 4.69	\$ 90.10	\$ 45.34
Realized risk management gain (loss)	1.06	(1.97)	3.78	-	(1.59)	(0.44)
Royalties	(0.47)	(13.52)	(6.15)	(0.69)	(14.74)	(7.09)
Production expenditures	(1.57)	(23.05)	(13.65)	(1.94)	(19.26)	(13.73)
Field netbacks	\$ 2.14	\$ 56.07	\$ 26.34	\$ 2.06	\$ 54.51	\$ 24.08

During the three months ended March 31, 2012, the Corporation earned field level cash flows of \$5.9 million or \$26.34/boe compared with \$5.1 million or \$24.08/boe earned in the same period of the prior year.

Field netbacks from natural gas were \$2.0 million or \$2.14/Mcf in the three months ended March 31, 2012, an improvement of \$0.08/Mcf or 4% over the \$1.9 million or \$2.06/Mcf earned in the same period of 2011. Through its price risk management strategies, the Corporation increased its field netbacks from natural gas by \$1.06/Mcf, effectively realizing an average sales price of \$4.18/Mcf in the first quarter of 2012, although still below an average sales price of \$4.69/Mcf realized in the same period of the prior year. The decrease in the effective realized sales price is offset by reduced production expenditures, consistent with the Corporation's strategy to refocus its resources in response to declining natural gas prices as discussed above (see "Production Expenditures").

Field netbacks from oil and liquids were \$3.9 million or \$56.07/bbl in the three months ended March 31, 2012 compared with \$3.2 million or \$54.51/bbl in the three months ended March 31, 2011. Field netbacks have improved largely in response to increasing oil prices (see "Effect of Commodity Prices on Revenues from Oil and Gas Sales – Realized Price on Oil"). The Corporation's oil-based price risk management strategies during the first quarter of 2012 resulted in an unfavourable decline in field netbacks of \$1.97/bbl (three months ended March 31, 2011 – \$1.59/bbl).

Field level cash flows should not be considered more meaningful than, or an alternative to, net earnings or loss as determined in accordance with IFRS.

### Capital Expenditures

During the three months ended March 31, 2012, the Corporation incurred capital expenditures of \$1.4 million on its assets in southern Ontario, the majority of which were incurred onshore and in respect of the Corporation's oil production.

For the three months ended March 31,	2012	2011
<i>Offshore</i>		
Workovers	\$ 6	\$ 100
Offshore fleet	34	183
Total Offshore	40	413
<i>Onshore</i>		
Drilling and completion	303	-
Pipeline	135	-
Workovers	-	216
Facilities	22	-
Seismic	325	-
Other	-	30
Total Onshore	785	246
Undeveloped properties	531	165
Office equipment, computer hardware and software	11	96
	\$ 1,367	\$ 920

Beginning in the fourth quarter of 2011, the Corporation drilled three wells on its 100% working interest lands in the Rochester oil field. One well was completed in two zones that tested at 23 bbl/d and 40 bbl/d, respectively. Drilling on a third well was suspended at the intermediate casing point and a rig will be moved back onto the site in mid-2012 to complete the drilling. Drilling costs totalled \$3.6 million, of which approximately \$0.3 million was incurred in the first quarter of 2012. In addition, during the first quarter of this year, the Corporation expended \$0.3 million to acquire and process seismic data that will assist in the identification of drill candidates for 2012 and beyond.

### **2012 Work Program**

The Corporation's remaining 2012 work program is budgeted at \$10.6 million. During the remainder of the year, the Corporation's capital programs will continue to focus on its onshore oil projects and will include a number of workover initiatives to optimize oil and natural gas production from existing fields. Furthermore, the Corporation continues to assess potential drill opportunities in an ongoing effort to replenish reserves. To that end, included in the 2012 onshore program is the acquisition of new 3-D seismic over undrilled lands for \$1.8 million. The seismic will identify undrained portions of existing oil reservoirs into which new wells can be drilled to add reserves and production.

Due to current natural gas prices, the Corporation will limit its offshore program in 2012. The Corporation has implemented a program to replace aging pipelines. As well, the Corporation's 2012 natural gas work program includes a workover of a well drilled in the second half of 2011 that had essentially stopped producing due to sand plugging.

In addition to its planned capital work program, the Corporation has purchased an onshore drilling rig at a cost of approximately \$3.1 million. The rig will augment the offshore drilling and completion barge operation in Lake Erie as the equipment and personnel will be interchangeable. The acquisition will enhance drilling efficiencies significantly, and provide the Corporation with complete control over the timing and safety aspects of its operations. It will also provide the Corporation with a monetization opportunity, as the rig may be leased to third parties.

### **Decommissioning Liabilities**

The Corporation has recorded a decommissioning liability, representing its best estimate of the costs that it will incur to settle future site restoration, abandonment and reclamation obligations. At March 31, 2012, the Corporation's estimate of these future costs on an undiscounted basis is approximately \$83.7 million, and is forecasted to be incurred over a 49-year period. Although there were no reclamation activities undertaken in the first quarter of 2012, the Corporation anticipates that it will incur approximately \$2.2 million in reclamation costs over the next twelve months.

In accordance with accounting requirements, the estimated decommissioning liability is recorded in the Corporation's consolidated financial statements on a discounted basis using discount rates that are specific to the underlying obligations. At March 31, 2012, the discounted amount of the Corporation's decommissioning liabilities was \$43.2 million. The discount used in calculating the Corporation's decommissioning liabilities is accreted over time. During the three months ended March 31, 2012, the Corporation incurred accretion expense of \$0.2 million (three months ended March 31, 2011 – \$0.3 million). These amounts have been included in the Corporation's March 2012 Interim Consolidated Financial Statements as "*interest expense*".

### **Castor Underground Gas Storage Project**

The Castor Project continues to progress on schedule and substantially within the approved engineering, procurement and construction budget. The construction of the Castor Project is substantially complete, and is now subject to testing and subsequent commissioning into the Spanish gas system. The 13-well drilling program was completed, and all 14 wells have been tied in to the wellhead platform. The offshore processing platform, which was manufactured in the United States and then shipped and received at the project site in November 2011, was installed and connected to the offshore wellhead platform by way of an interconnecting bridge. The subsea pipeline, which connects the processing platform to the onshore pipeline, has been laid on the ocean floor and subsequently tested.

Construction of the onshore gas treatment plant is also substantially complete, with many of the operating systems already transferred to the operations and maintenance contractors. The pipeline connecting the Castor Project to the Spanish national high-pressure grid was completed by Enagas, S.A., (“Enagas”), Spain’s top natural gas transportation company, the technical manager of the Spanish gas system and common carrier for the gas network in Spain, as was the associated metering system, which was also built by Enagas.

In early April 2012, gas was introduced into the onshore system as the first stage in the commissioning of the Castor Project, a process that will be carried out systematically in order to satisfy the integrity and functionality of each onshore and offshore system. The first phase of the commissioning process will be completed with the granting of a provisional start-up certificate, which will allow Escal to commence the injection of cushion gas. Total gas to be injected for this purpose is approximately one million cubic meters. Escal has targeted the initiation of the injection of cushion gas for mid-June 2012, with completion expected in September. At that time, Escal will apply for a definitive start-up certificate. Once granted, the definitive start-up certificate will allow Escal to apply for inclusion of the Castor Project into the Spanish gas system. Actual inclusion of the Castor Project into the Spanish gas system is subject to an independent technical review and an audit of the total investment in the project, which will provide the definitive basis for remuneration.

CLP has entered into certain agreements with ACS and with Enagas. These agreements provide that within 15 days of the formal inclusion into the Spanish gas system of the Castor Project, ACS will sell and Enagas will buy 50% of ACS’ interest in Escal based on a pre-established pricing formula at which point CLP, ACS and Enagas will each own 33% of the equity of Escal. In addition, and for a period of 180 days after the formal inclusion into the Spanish gas system of the Castor Project, CLP may sell part or all of its shares in Escal to ACS and/or Enagas on essentially the same terms and conditions, including the pre-established pricing formula, as are offered to Enagas.

#### *Share of (Loss) Earnings from Equity Accounted Investment in Escal*

The Corporation accounts for its investment in Escal using the equity method. As the Corporation’s investment in Escal was nominal, the Corporation did not recognize any equity earnings in respect of its investment in Escal during the first quarter of 2012. In the first quarter of the prior year, the Corporation recognized a \$5,000 gain, representing its share of earnings generated by Escal.

Escal has established a hedging strategy to mitigate its exposure to interest rate risk associated with the project financing for the Castor Project. At March 31, 2012, the fair value of Escal’s obligations in respect of these hedging strategies was approximately €9.1 million (December 31, 2011 – €74.8 million). Recording its share of Escal’s obligations in respect of these hedging contracts would draw the Corporation’s investment in Escal to below zero. Accordingly, the Corporation has not recognized its share of \$21.9 million of these losses, as it does not have the legal or constructive obligation in respect thereof.

From 2010 to March of 2012, Escal issued shares from treasury with a par value of €13,000. In order to maintain its 33% interest, CLP subscribed for one third of the newly issued par value shares at an aggregate cost of \$6,000 (€4,400). During this time, and in order to meet the equity ratios as required by the project financing, ACS also contributed a share premium of €38.7 million and issued €2.0 million in subordinated loans. CLP has not recognized the benefit of its 33% interest in the share premium and in the subordinated loans as the realization and measurement is subject to a number of risks and uncertainties, including but not limited to, execution risk associated with the construction of the project, the availability and terms of future financing arrangements and the 50-year life span of the project.

### Investment in Series A Preference Shares of Eurogas International

The terms of the Corporation's investment in the Series A Preference Shares of Eurogas International are detailed in Note 7 to the 2011 Audited Consolidated Financial Statements.

Because of the Corporation's entitlement to demand redemption of the Series A Preference Shares at any time from Eurogas International, the Corporation has classified its investment in the Series A Preference Shares as a loan receivable and the associated dividends as interest income. The Corporation has completed an assessment of the fair value of the Series A Preference Shares. In its assessment, the Corporation considered factors such as the delinquency of dividend payments, the financial resources available to Eurogas International to meet current commitments and pursue growth opportunities, and the declaration of Force Majeure. The Corporation concluded that there was significant impairment in the par value of the Series A Preference Shares and the related accrued dividends thereon and accordingly, the Corporation has fully provided against the carrying value of these assets. During the three months ended March 31, 2012, the Corporation provided for an impairment loss relating to its investment in Eurogas International of \$0.3 million (three months ended March 31, 2011 – \$0.3 million). Notwithstanding the Corporation not receiving any dividends from its investment at March 31, 2012, the Corporation has not exercised its entitlement to elect a majority of the members of the Board of Directors of Eurogas International.

In June 2011, Eurogas International received approval from the Tunisian government for a one-year extension of the expiry date in respect of the Sfax permit to December 8, 2012. As a condition to the extension, Eurogas International and its joint venture partners are committed to drilling one exploration well prior to the maturity date, with depth to a specified geological zone. In the event such work commitment is not completed, a compensation payment of up to US\$12 million will be payable to the Tunisian government by the joint venture partners, less certain amounts previously incurred by the joint venture partners associated with such obligation.

### Other Items in Consolidated Net Earnings

#### *General and Administrative Expenses*

General and administrative expenses incurred during the three months ended March 31, 2012 were \$2.0 million, a 4% increase from general and administrative expenses of \$1.9 million incurred during the three months ended March 31, 2011. Increases in general and administrative expenses reflect increased overall business activities. There were no significant changes in the nature of general and administrative expenses incurred by the Corporation on a quarter-over-quarter basis.

#### *Interest Expense*

The Corporation incurred interest expense of \$1.1 million during the first quarter of 2012, compared with \$1.1 million incurred in the first quarter of 2011. Included in interest expense is \$0.2 million (three months ended March 31, 2011 – \$0.3 million) of accretion expense associated with the Corporation's decommissioning liability. Interest expense on the Corporation's bank loan was \$0.8 million in the three months ended March 31, 2012, virtually unchanged from interest costs of \$0.8 million incurred in the same period of the prior year.

### SELECTED QUARTERLY FINANCIAL INFORMATION

	Prepared in accordance with IFRS							
	2012		2011			2010		
	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun
Revenues	\$ 8,074	\$ 9,459	\$ 8,757	\$ 9,530	\$ 8,072	\$ 8,301	\$ 8,179	\$ -
<b>Net (loss) earnings attributable to owners of the parent</b>	<b>(420)</b>	<b>985</b>	<b>(1,128)</b>	<b>937</b>	<b>(2,040)</b>	<b>(7,729)</b>	<b>(91)</b>	<b>(3,363)</b>
Basic and fully diluted (loss) earnings per share	\$ -	\$ 0.01	\$ (0.01)	\$ 0.01	\$ (0.01)	\$ (0.05)	\$ -	\$ (0.02)
Capital expenditures	1,366	4,763	4,109	1,319	920	1,720	2,042	-

- The Corporation completed the acquisition of its operating assets in southern Ontario on June 29, 2010. There were no operating revenues prior to this acquisition.
- In the second quarter of 2010, the Corporation incurred \$2.8 million of transaction costs relating to the acquisition of assets in southern Ontario.
- In the fourth quarter of 2010, the Corporation provided \$6.3 million against the carrying value of its preferred share investment in Eurogas International and associated accrued dividends.
- In the third quarter of 2011, the Corporation completed the acquisition of Torque. Included in the third quarter of 2011 are \$0.4 million of associated transaction costs.
- Changes in the fair value of the Corporation's risk management contracts are included in the Corporation's net earnings. These fair value changes may cause significant volatility in the Corporation's earnings, some of which is beyond the control of the Corporation. The following table illustrates the impact of changes in the fair value of the Corporation's risk management contracts to its net earnings:

	2012	2011				2010		
	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun
Changes in the fair value of risk management contracts	\$ 1,260	\$ 1,038	\$ 1,486	\$ 1,939	\$ (1,391)	\$ (455)	\$ -	\$ -

## LIQUIDITY AND CAPITAL RESOURCES

### Cash Resources Availability

At March 31, 2012, the Corporation held cash of \$1.3 million on deposit with Canadian chartered banks. In addition, the Corporation had access to a further \$16.6 million pursuant to its \$80.0 million revolving demand credit facility.

### Southern Ontario Assets

The Corporation has established an \$80.0 million credit facility with a syndicate of Canadian chartered banks. The credit facility is a direct obligation of DELP and is structured as a revolving demand loan with a tiered interest rate structure that varies based on DELP's net debt to cash flow ratio, as defined in the credit facility. Based on DELP's current ratios, draws on the credit facility bear interest, at DELP's option, at either the bank's prime lending rate plus 3% or, at the bank's then prevailing bankers' acceptance rate plus 4%. At March 31, 2012, the Corporation had drawn \$63.4 million against the credit facility, including a letter of credit for \$3.3 million, issued in favour of the Ministry of Natural Resources in connection with future abandonment and site restoration obligations.

The Corporation has assigned a limited recourse guarantee of its units in DELP as security pursuant to the credit facility. The credit facility is subject to certain covenants, including maintenance of minimum levels of working capital. At March 31, 2012, the Corporation was in compliance with all such covenants.

The Corporation anticipates that cash flows generated from ongoing operating activities, as well as amounts available pursuant to its credit facility, will provide sufficient cash flow to support the ongoing working capital requirements related to its activities in southern Ontario into the foreseeable future.

### Spain

ACS is responsible for providing equity and project financing for the Castor Project, including providing all guarantees that may be required, from the day it became a majority shareholder in Escal, through development and construction and inclusion of the underground storage facility into the Spanish gas system. After the system is operational, the Corporation will be responsible for its proportionate share of any new capital investments, unless otherwise funded through working capital generated directly by Escal.

Project financing was completed in July 2010, providing Escal with a 10-year, €1.3 billion credit facility through a syndicate of 19 banks. To provide security for the financing, CLP and ACS have each pledged their respective shares in Escal to the banking syndicate. Other than the pledging of its shares, CLP will not be required to provide any additional equity or debt funds or provide any warranties required by the project finance lenders. Notwithstanding any form by which ACS has, or may in the future, fund Escal during the construction phase, CLP's interest in Escal will at all times remain at 33%, and CLP will retain the right to 33% of all distributable cash flows.

#### **Outstanding Share Data and Dilutive Securities**

At March 31, 2012, the Corporation had 164,651,647 common shares outstanding. During the first quarter of 2012, the Corporation purchased 23,500 common shares for cancellation pursuant to its normal course issuer bid at an average cost of \$0.61 per common share.

On March 30, 2012, the Corporation received regulatory approval to continue its normal course issuer bid from April 3, 2012 to April 2, 2013. Subject to certain conditions, the Corporation may purchase up to a maximum of 8,232,582 common shares pursuant to these arrangements, representing approximately 5% of its common shares outstanding prior to approval of the normal course issuer bid.

At March 31, 2012, the Corporation had granted 5,665,000 stock options to directors and key management at a weighted average exercise price of \$0.92 per share. In addition, it had awarded 661,949 deferred share units.

#### **OFF BALANCE SHEET ARRANGEMENTS, COMMITMENTS AND CONTINGENCIES**

Other than as may be disclosed elsewhere in this MD&A, there have been no significant changes in the nature of off balance sheet arrangements, commitments and contingencies from those described in Note 20 to the 2011 Audited Consolidated Financial Statements and under "*Off-Balance Sheet Arrangements*" and "*Commitments and Contingencies*" in the Corporation's MD&A as at and for the year ended December 31, 2011.

#### **RELATED PARTY TRANSACTIONS**

Other than as described in Note 17 to the March 2012 Interim Consolidated Financial Statements, there have been no significant changes in the nature and scope of related party transactions to those described in Note 19 to the 2011 Audited Consolidated Financial Statements and the accompanying MD&A.

#### **BUSINESS RISKS**

On March 30, 2012, the Spanish government issued a royal decree, changing the terms of provisional remuneration available prior to final commissioning certification for initiatives similar to the Castor Project. The royal decree also imposed additional commissioning requirements that need to be met prior to acceptance of an underground gas storage project into the Spanish gas system. In addition, on April 27, 2012, a Spanish ministerial order was issued, increasing the term of the remuneration period for invested cost related to underground gas storage from 10 years to 20 years. The fees payable for gas storage investment remain unchanged. This modification may have an effect on Escal's current project financing arrangements. The Corporation is actively working with Escal, and with the majority shareholder of Escal, to obtain further clarification of the potential impact of these changes to the Castor Project.

There are a number of other inherent risks associated with the Corporation's activities and with its current stage of exploration and development. The risks faced by the Corporation are described in the Company's 2011 Annual Information Form dated February 15, 2012, under "*Risk Factors*", which may be accessed through the System for Electronic Document Analysis and Retrieval ("SEDAR") website [www.sedar.com](http://www.sedar.com). The Corporation has not identified any material changes to the risk factors affecting its business and its approach to managing those risks from those discussed in the document referred to above.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of the Corporation's consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the related disclosure of contingent assets and liabilities. Critical accounting estimates represent estimates made by management that are, by their very nature, uncertain. The Corporation evaluates its estimates on an ongoing basis. Such estimates are based on historical experience and on various other assumptions that the Corporation believes are reasonable under the circumstances, and these estimates form the basis for making judgments about the carrying value of assets and liabilities and the reported amount of revenues and expenses that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

There have been no changes in the accounting policies applied in the preparation of the Corporation's March 2012 Interim Consolidated Financial Statements from those detailed in Note 3 to the Corporation's 2011 Audited Consolidated Financial Statements. A summary of the more significant judgments and estimates made by management in the preparation of its financial information is provided in Note 4 to the 2011 Audited Consolidated Financial Statements. There have been no significant changes in these judgments and estimates during the three months ended March 31, 2012.

## **CONTROLS AND PROCEDURES**

In accordance with the Canadian Securities Administrators' National Instrument 52-109, the Corporation has filed certificates signed by its Chief Executive Officer and the Chief Financial Officer certifying that, among other things, the design of disclosure controls and procedures and the design of internal control over financial reporting are adequate as at March 31, 2012.

Disclosure controls and procedures are designed to ensure that information required to be disclosed by the Corporation in the reports it files or submits under securities legislation is recorded, processed, summarized and reported on a timely basis and that such information is accumulated and reported to management, including the Corporation's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow required disclosures to be made in a timely fashion. Based on their evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of March 31, 2012, the Corporation's disclosure controls and procedures were effective.

The Chief Executive Officer and Chief Financial Officer of the Corporation have also evaluated whether there were changes to the Corporation's internal control over financial reporting during the three months ended March 31, 2012 that have materially affected, or are reasonably likely to materially affect the Corporation's internal control over financial reporting. There were no changes identified during their evaluation.

## **FORWARD-LOOKING STATEMENTS**

This MD&A contains forward-looking statements that reflect management's expectations regarding the Corporation's future growth, results of operations, performance, business prospects and opportunities. Forward-looking statements include future-oriented financial information, within the meaning of the "safe harbor" provisions of the *U.S. Private Securities Litigation Reform Act of 1995* and the securities legislation of certain of the provinces of Canada, including the *Securities Act* (Ontario).

Certain information set forth in this MD&A, including management's assessment of the Corporation's future plans and operations, contains forward-looking statements. Forward-looking statements are statements that are predictive in nature, depend upon or refer to future events or conditions and may include words such as "expects", "anticipates", "intends", "plans", "believes", "estimates" or similar expressions. In particular, forward-looking statements contained in this document include, but are not limited to, statements with respect to: financial and business prospects and financial outlook; performance characteristics of the Corporation's oil and natural gas properties; oil and natural gas production levels and reserve estimates; the quantity of oil and natural gas reserves and recovery rates; the Corporation's capital expenditure programs; supply and demand for oil and natural gas and commodity prices; drilling plans and strategy; availability of rigs, equipment and other goods and services; expectations regarding the Corporation's ability to raise capital and continually add to reserves through acquisitions, exploration and development; treatment under government regulatory regimes and tax laws; anticipated work programs and land tenure; the granting of formal permits, licences or authorities to prospect; the timing of acquisitions; and the realization of the anticipated benefits of the Corporation's acquisitions and dispositions. In addition, statements relating to "reserves" or "resources" are, by their nature, 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.

By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond the Corporation's control, including risks related to the exploration, development and production of oil and gas, uncertainty of reserve estimates, project development risks, reliance on operators, management and key personnel, the cyclical nature of the oil and gas business, dependence on a small number of customers, the need for additional funding to execute on further exploration and development work, the granting of operating permits and licenses, and other risk factors discussed or referred to in the section entitled "*Risk Factors*" in our Annual Information Form and other documents filed from time to time with the securities administrators, all of which may be accessed at [www.sedar.com](http://www.sedar.com). These statements are only predictions, not guarantees, and actual events or results may differ materially. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements.

Forward-looking statements and other information contained herein concerning the oil and gas industry and the Corporation's general expectations concerning this industry are based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which the Corporation believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market share and performance characteristics. While the Corporation is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors.

In addition, a number of assumptions were made by the Corporation in connection with certain forward-looking information and forward-looking statements for 2012 and beyond. These assumptions include: the impact of increasing competition; the general stability of the economic and political environment in which the Corporation operates; the timely receipt of any required regulatory approvals; the ability of the Corporation to obtain qualified staff, equipment and services in a timely and cost efficient manner; drilling results; the ability of the operator of the projects in which the Corporation has an interest to operate such projects in a safe, efficient and effective manner; the ability of the Corporation to obtain financing on acceptable terms; field production rates and decline rates; the ability to replace and expand oil and natural gas reserves through acquisition, development and/or exploration; the timing and costs of pipeline, storage and facility construction and expansion and the ability of the Corporation to secure adequate product transportation; future oil and natural gas prices; currency, exchange and interest rates; the regulatory framework regarding royalties, taxes and environmental matters in the jurisdictions in which the Corporation operates; the ability of the Corporation to successfully market its oil and natural gas products; estimates on global industrial production in key geographic markets; global oil and natural gas demand and supply; that the Corporation will not have any labour, equipment or other disruptions at any of its operations of any significance in 2012 other than any planned maintenance or similar shutdowns and that any third parties on which the Corporation is relying will not experience any unplanned disruptions; that the reports it relies on for certain of its estimates are accurate; and that the above mentioned risks and the risk factors described in the Corporation's Annual Information Form do not materialize.

The Corporation's actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements and accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what resulting benefits the Corporation will derive. The forward-looking statements, including future-oriented financial information, contained herein are presented solely for the purpose of conveying management's reasonable belief of the direction of the Corporation and may not be appropriate for other purposes. The Corporation disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

**INFORMATION CONCERNING DUNDEE ENERGY LIMITED**

Additional information relating to Dundee Energy Limited, including a copy of the Corporation's Annual Information Form, may be accessed through the SEDAR website at [www.sedar.com](http://www.sedar.com) and the Corporation's website at [www.dundee-energy.com](http://www.dundee-energy.com).

Toronto, Ontario  
April 30, 2012