



## LETTER TO SHAREHOLDERS

We are pleased to inform our shareholders that the Castor Underground Gas Storage development has successfully reached another major milestone essentially on time and on budget, a no-mean achievement for a construction and drilling project of the size of Castor, comprising offshore and onshore facilities and pipelines. The €1.6 billion project is now continuing on its path to become a key component of Spain's natural gas system with commercial storage operations expected to commence in early 2013.

Castor has now completed the hook-up stage, including tying the 14 wells into the wellhead platform, making key connections between pipelines and facilities, and pre-commissioning of equipment to satisfy functional tests without gas. With the introduction of gas on April 12, 2012, all systems are being commissioned with gas.

The first phase of the commissioning process will be completed with issuance of the provisional start-up certificate, allowing the operating company, Escal UGS S.L. (Escal), to commence the injection of approximately 600 million cubic meters of cushion gas, currently targeted for mid June 2012 and expected to be completed in September 2012. This will be followed by the issuance of the definitive start-up certificate upon the successful completion of certain performance tests required by regulations.

Castor's smooth progression depended on it being well-financed. A €1.3 billion bank financing was completed in 2010, during a period of financial and economic uncertainty, reflecting the project's strategic importance and fundamentally low risks owing in part to the regulated remuneration regime.

The European Investment Bank supported the project by making funds available to the members of the lending syndicate.

Recently the Government of Spain, faced with increasing economic difficulties, implemented certain austerity measures impacting most sectors of the economy, including the energy sector in general. After a number of years of high growth, gas demand has flattened due to the weak economy. However, natural gas plays a key role in providing primary energy, ensuring system reliability and fuelling standby electricity generation, and will continue to do so being much more cost effective than expensive alternative energy sources, where subsidies place undue pressure on consumers in a weak economy. For an economy that imports virtually all of its natural gas, a gas storage facility, strategically placed, with high deliverability, will always be essential to the balancing of supply and demand in the gas system. Castor UGS is such a facility, and of long-term strategic value to Spain.

On March 30, 2012, the Spanish government issued a royal decree, changing the terms of the provisional remuneration available prior to final commissioning certification for gas storage projects, such as Castor. 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 income receivable on gas storage investment remains unchanged at 10 year Spanish bond rate plus 350 basis points. 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.

### **Ontario Producing Assets**

Dundee Energy produces net 10.5 mmcf per day of natural gas and approximately 718 bbls of oil and liquids per day. No oil is produced on Lake Erie.

In 2011 Dundee Energy's capital program of \$11.1 million included workovers and new well drilling, plus the acquisition of a 3-dimensional survey over onshore oil producing lands. This activity added production of approximately 60 bbls per day and 450 mcf per day.

Natural gas prices have plummeted over the past year to near-uneconomic levels due to two factors: the surplus of shale gas now on the market, and the warm winter weather in North America. In response, Dundee Energy will focus its 2012 capital program on oil-related projects, including six workovers, six new drills, and seismic acquisition.

Due to the relatively small size of the Ontario petroleum industry, it lacks a robust service infrastructure to serve oil and gas operations, resulting in equipment shortages and delays, hence affecting profitability. The Company addressed this situation by acquiring an onshore drilling rig that will be delivered in time for the Q4 drilling program.

Dundee Energy's drilling and optimization activity has lowered the natural gas production decline trend experienced over the past decade, with the gross gas rate stabilized at approximately 16 mmcf per day exiting 2011. On the oil side, the combination of drilling, workovers and the Torque acquisition reversed the decline in crude oil production. Oil volumes have risen from their 2011 average of 692 bbls per day to nearly 800 bbls per day by January 2012. Proved plus probable reserves increased by 10 percent year-over-year, net of 2011 production, to 16.1 million boe at December 31, 2011.

These are positive developments, though we remain at an early stage of optimizing the large base of producing wells and evaluating the reservoirs for potential new drilling opportunities. Financially, the Ontario assets also performed well, as strong crude oil prices increased our 2011 average realized price by 17 percent year-over-year, generating an average netback of \$58.47 per bbl. Despite the downward trend in gas prices, our realized gas price in Ontario continued to be at a premium to benchmarks, providing us with a netback of \$2.22 per mcf.

Ontario assets generated revenues of \$42.2 million and cash flow from operating activities of \$15.1 million. Year-end debt stood at \$59.5 million. The Company hedged approximately 70 percent of its 2012 oil and natural gas production through year-end to backstop its capital program and debt repayment. Additional details in respect of the operations of the Company may be found on the Company website at [www.dundee-energy.com](http://www.dundee-energy.com).

Given Castor's independent financing, and cash flow from the Ontario assets, the Company is in a solid financial position and able to fund its continuing development of its oil and gas assets.

We look forward to further demonstrating the potential of the Ontario assets in 2012, and to the Castor project taking its final commissioning steps and moving towards commencement of commercial gas storage operations. We would like to thank Dundee Energy's shareholders and Board of Directors for their support, and our dedicated field operations staff in Ontario for another year of safe, efficient and profitable operations.

On behalf of the Board of Directors,



**Ned Goodman**

Chairman of the Board



**M. Jaffar Khan**

President and Chief Executive Officer

April 16, 2012