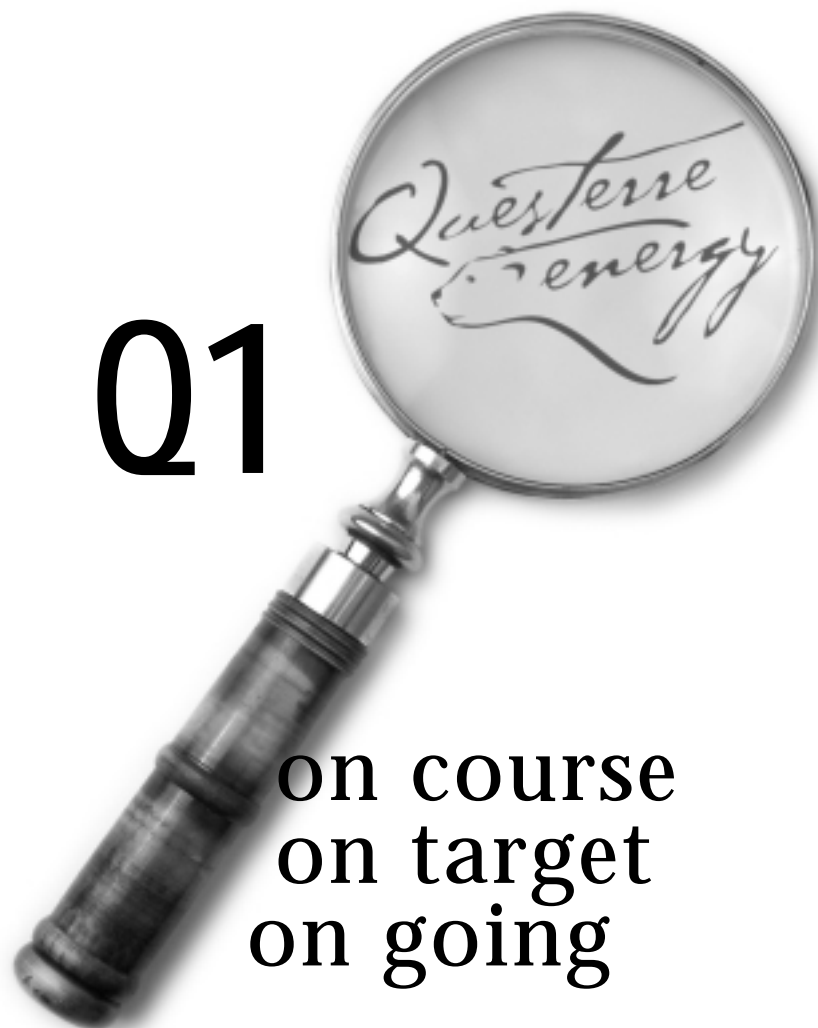


QUESTERRE ENERGY CORPORATION

Q1



**on course
on target
on going**

2005 QUARTERLY REPORT

CORPORATE PROFILE

Questerre Energy Corporation is a Calgary-based petroleum and natural gas exploration and production company. The Company aims to create shareholder value through the development of scalable, high-impact projects. Questerre's common shares are listed on the Toronto Stock Exchange under the symbol QEC.



PRESIDENT'S MESSAGE

We made substantial progress on our business plan in the first quarter of 2005 – a successful drilling program was completed and we significantly increased our land position in Alberta.

In early 2005 we participated in the drilling and completion of five wells in the Simonette, Westlock, Vulcan, and Parkland areas of Alberta. Four were cased as oil and gas wells and one was dry and abandoned representing an 80% success rate. Three of the wells were completed and tested towards the end of the quarter with the fourth well awaiting completion and testing following spring breakup. On an aggregate basis, the three completed wells flowed at a stable rate of 400 boe per day on test, with an estimated 170 boe per day net to Questerre's interest.

Participation in the wells earned Questerre a total of 9 gross sections (3.8 net). Based on the success of our winter drilling program we are currently evaluating the acquisition of additional acreage for further drilling this summer. We also acquired two sections in Westlock prospective for shallow natural gas. We anticipate drilling will commence on these lands in the second quarter.

To further expand our portfolio of conventional oil and gas assets in Alberta, we entered into an agreement to acquire producing assets in the Westlock area for \$2 million. The assets include an interest in five producing wells and 13 gross sections (3.8 net). Production net to Questerre is expected to be 75 boe per day. Concurrent with the development of this portfolio, we have been progressing our high impact projects. While our conventional assets will provide a base value for our company, we believe our high impact projects could deliver exponential returns to our shareholders.

Some progress was made on further development of the Beaver River Field. We commenced discussions with a private company regarding a farm-in opportunity at the Field. We subsequently executed a non-binding letter of intent and are currently negotiating detailed agreements. It is expected the initial phase of this farm-in will focus on the shallow Mattson sands with the second phase targeting the deeper Nahanni horizon.

Our first well in the St. Lawrence Lowlands did not spud during the quarter. We have granted the operator a further extension until July 2005 to complete their equity financing and spud the well. In the interim, we have commenced discussions with other parties regarding further exploration work in the Lowlands, including the acquisition of 3-D seismic data.

To fund our capital requirements for the remainder of this year, we executed a mandate agreement with DnB NOR Bank ASA, one of the largest banks in Scandinavia to complete a C\$5-C\$10 million public offering in Norway. In conjunction with this offering, DnB has also been appointed as our advisor in connection with our proposed listing on the Oslo Stock Exchange. We are pleased to report that Pareto Securities ASA, a leading brokerage firm in Norway, recently agreed to join DnB NOR as co-lead on this offering. We are scheduled to complete this transaction by mid-June. Revenue for the first quarter was \$461,000, a significant increase over revenue of \$65,000 for the same period last year. Cash flow from operations for the quarter increased from a loss of \$226,000 in 2004 to a loss of \$10,000 in 2005. With the proposed acquisition of producing assets in Westlock area, we expect to be positive cash flow from operations by the second quarter of this year.

Based on our successful winter drilling program, we are maintaining our target exit production of 500 boe per day for 2005. Subject to the execution of the farm-in agreement, we hope that drilling operations at the Beaver River Field this summer will help us exceed this production target.



Michael Binnion
President and Chief Executive Officer

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") was prepared at, and is dated, May 5, 2005. This MD&A is provided by Management of Questerre Energy Corporation ("Questerre" or the "Company") to review first quarter 2005 activities and results as compared to the previous period. This MD&A should be read in conjunction with the unaudited interim consolidated financial statements for the three months ended March 31, 2005 and the audited consolidated financial statements for the year ended December 31, 2004.

This MD&A contains forward-looking statements. Forward-looking statements are based on current expectations that involve a number of risks and uncertainties which could cause events or results to differ materially from those reflected in the MD&A. Forward-looking statements are based on the estimates and opinions of Questerre's management at the time the statements were made. Questerre assumes no obligation to update forward-looking statements should circumstances or management's estimates change.

Barrel of oil equivalent ("boe") amounts may be misleading, particularly if used in isolation. A boe conversion ratio has been calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel and is based on an energy equivalent conversion method application at the burner tip and does not necessarily represent an economic value equivalent at the wellhead.

Drilling Activities

The Company participated in the drilling and completion of five wells in Alberta during the first quarter of 2005. Four wells (1.8 net) were cased as oil and gas producers and one well (0.3 net) was dry and abandoned. Three of the four wells were completed and tested for stable initial flow rates towards the end of the quarter. The remaining well will be completed and tested after break-up.

In aggregate, the three tested wells flowed over 400 boe per day with an estimated 170 boe per day net to Questerre's interest. The Company anticipates that production from one of these wells could be improved and it will be re-stimulated and re-tested during the second quarter. In conjunction with the operator, the Company is developing plans for facilities and pipeline tie-ins for these wells. Questerre is currently evaluating follow-on locations and expects to participate in additional wells during the remainder of the year.

2004 FINANCIAL RESULTS

Production

The Company's existing production is primarily natural gas from the Beaver River Field (the "Field") and its minority interests in non-operated properties in Alberta.

The Company reported raw natural gas production of approximately 83 boepd from the Field for the first quarter of 2005. This production is attributable to the A-5 re-entry, completed during the first quarter of 2004. There was no production from the Field during the first quarter of 2004 as the A-5 re-entry operation was still underway and the other producing well, B-2, was shut-in in 2003 due to water disposal constraints.

Production from the Company's non-operated properties in Alberta during the quarter decreased marginally to 24 boepd from 25 boepd during the same period in 2004.

Revenue

For the three months ended March 31, 2005, Questerre reported petroleum and natural gas revenue of \$0.36 million. This compares to petroleum and natural gas revenue of \$0.08 million for the same period in 2004. Revenue in 2005 is ascribed to production from the Field and the non-operated properties in Alberta. By comparison, revenue in 2004 is ascribed only to production from the non-operated properties in Alberta.

Royalties

The Company recorded a recovery of Crown royalties of \$0.14 million accrued on Field production in 2004. The recovery reflected the Company's qualification during the quarter for a royalty credit in the amount of \$0.75 million for the A-5 re-entry.

Crown and gross overriding royalties on production from the Company's minor properties in Alberta remained unchanged at \$0.02 million or 26% of gross revenue attributable to these properties.

Operating Costs

For the first quarter of 2005, operating expenses increased 22% to \$0.2 million in 2005 from \$0.17 million in 2004. The majority of the increase can be attributed to the gas processing and transmission fees for Field production in 2005 of \$0.05 million. Excluding this amount, operating costs remained relatively constant over the two periods due to the fixed nature of operating costs at the Field.

General and Administrative Expenses

In 2005, general and administrative expenses of \$0.25 million for the first quarter did not include bad debt expense or overhead recoveries associated with capital expenditures incurred. Exclusive of overhead recoveries and bad debt expense, general and administrative expenses decreased marginally to \$0.25 million in 2005 from \$0.27 million in 2004.

<i>(\$ thousands)</i>	2005	2004
General & administrative expenses	254	\$ 269
Bad debt expense	-	150
Overhead recoveries	-	(299)
General & administrative expenses, net	254	\$ 120

Stock Based Compensation

Effective January 1, 2004 the Company adopted a new accounting standard for stock based compensation. This resulted in stock based compensation expense of \$0.08 million in 2005 (2004: \$0.05 million).

Interest Expense

Interest expense on the Company's promissory note and bank debt totaled \$0.02 million for the first quarter of 2005 (2004:\$0.01 million). The increase is attributable primarily to the issuance of the promissory note in 2004 that bears interest at 8% per annum.

Depletion and Depreciation

Questerre recognized \$1.07 million in depletion and depreciation in the first quarter of 2005 compared to \$5.24 million in 2004. Included in 2005 depletion is \$1.00 million, representing the Company's share of drilling costs of an unsuccessful well in the Simonette area of Alberta. 2004 depletion includes a \$5.18 million ceiling test write-down recorded by the Company on its Field assets. The write-down reflected the majority of costs incurred during the first quarter of 2004 to finish the drilling, completion and tie-in of the A-5 re-entry.

Questerre does not include costs associated with its assets in the St. Lawrence Lowlands of Quebec nor the costs associated with its exploration projects in the Parkland, Vulcan and Westlock areas of Alberta in the calculation of depletion or in costs subject to the ceiling test calculation. These properties remained unproved at March 31, 2005.

Taxes

Consistent with the prior year, Questerre had sufficient tax pool deductions to offset taxable income in the first quarter of 2005 resulting in no current income taxes payable for the quarter. In addition, the Company's tax assets significantly exceed tax liabilities. No tax asset is recognized at March 31, 2005, as there is no certainty that the Company will be able to realize the value of the tax assets in the future.

Net Loss and Cash Flow

Questerre recorded a net loss of \$1.16 million (\$0.02/share) in the first quarter of 2005 compared to \$5.52 million (\$0.13/share) in the first quarter of 2004. The loss in the first quarter reflected the writedown of costs of \$1.00 million associated with the unsuccessful well at Simonette, Alberta.

Cash flow from operations for the quarter decreased from a loss of \$0.23 million in 2004 to a loss of \$0.01 million in 2005. The improvement can be attributed to the net revenue from Field production in 2005.

LIQUIDITY AND CAPITAL RESOURCES

Capital Expenditures

Questerre incurred capital expenditures of \$2.46 million in the first quarter of 2005 compared to \$5.68 million in 2004. The expenditures in 2005 related to the costs of drilling and completion of wells in the Parkland, Vulcan and Simonette areas of Alberta. It also includes land acquisition costs of \$0.27 million in the Westlock area of Alberta. Substantially all of the first quarter 2004 capital spending related to drilling, completion and tie-in of the A-5 re-entry at the Field.

(\$thousands)	Three Months Ended March 31,	
	2005	2004
Capital Expenditures		
Beaver River Project, BC	10	5,664
St. Lawrence Lowlands, Quebec	–	14
Alberta Properties	2,453	1
Total	2,463	5,679

Working Capital

Questerre reported a working capital surplus of \$0.37 million at March 31, 2005. Current assets at March 31, 2005 consisted primarily of \$0.43 million in cash and deposits and \$0.15 million in receivables. The receivables primarily represent natural gas revenue from the Field and the Company's non-operated Alberta properties.

Questerre's current liabilities consisted of trade payables of \$0.30 million and \$0.21 million representing the term bank loan that has been classified as a current liability.

The Company anticipates it will need to raise additional equity capital to fund further drilling, completion, and tie-in costs at its projects in the Parkland, Vulcan and Westlock areas of Alberta. To this end, the Company has completed a \$1.0 million private placement in the second quarter of 2005. It has also entered into a mandate agreement with a major Norwegian financial institution to complete a \$5-\$10 million equity offering through an initial public offering in Norway concurrent with the listing of the Company's shares on the Oslo Stock Exchange.

Share Capital

The Company is authorized to issue an unlimited number of Class A common voting shares ("Common Shares"). The Company is also authorized to issue an unlimited number of Class B common voting shares and an unlimited number of preferred shares, issuable in one or more series.

At March 31, 2004, there were no Class B common voting shares or preferred shares outstanding and there were a total of 66,751,904 Common Shares outstanding and 3,445,000 stock options outstanding. An additional 2,000,000 Common Shares have been reserved for the conversion of the \$0.6 million promissory note. The Company did not complete any equity placements during the first quarter of 2005. In April 2005, the Company completed a private placement of 3.13 million shares for gross proceeds of \$1.0 million.

Contractual Obligations

Questerre is party to an Office Rental Agreement with a related party for the provision of offices, office equipment and support personnel. Either party may terminate the agreement with six months written notice. Questerre's commitment under this agreement for the remainder of 2005 is \$94,500.

The Company is responsible for principal payments on its bank loan in the amount of \$60,300 for the remainder of 2005, \$80,400 in 2006 and \$73,700 in 2007. The Company has a \$100,000 restricted cash deposit against these obligations.

Off-Balance Sheet Arrangements

Questerre has no off-balance sheet arrangements.

Related Party Transactions

The Company has entered into a purchase and sale agreement with Rupert's Crossing, an Investment Corporation ("Rupert's") to acquire its interest in five producing oil and gas wells in addition to 8,320 acres gross (2,432 acres net) of undeveloped land in Central Alberta. Rupert's is private investment holding company controlled by the President and Chief Executive Officer of Questerre.

Current production from these wells, net to Rupert's, is approximately 75 boe per day.

The purchase price for these assets is \$2.0 million and is based on an evaluation of these assets prepared by an independent reservoir engineering firm. The transaction was approved by an independent committee of the Board established for the purposes of evaluating this acquisition. The closing of this transaction is conditional upon to the successful completion of an equity placement by the Company in June 2005.

CRITICAL ACCOUNTING ESTIMATES

Management is required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company. A comprehensive discussion of the Company's significant accounting policies is contained in the notes to the audited consolidated financial statements at December 31, 2004. The following discussion outlines the accounting estimates that are critical to determining Questerre's financial results.

Management is required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company. The following discussion outlines the accounting estimates that are critical to determining Questerre's financial results.

Going Concern

Questerre's financial statements have been prepared using Canadian generally accepted accounting principles ("GAAP") and, accordingly, have been prepared using the same principles as those for a going concern.

Full Cost Accounting

Questerre follows the Canadian Institute of Chartered Accountants' ("CICA") guideline on full cost accounting to account for its oil and natural gas properties. Under this method, all costs associated with the acquisition of, exploration for and development of natural gas and crude oil reserves are capitalized and costs associated with production are expensed. The capitalized costs are depreciated, depleted and amortized using the unit-of-production method based on estimated proved reserves. Reserve estimates can have a significant impact on earnings, as they are a key component in the calculation of depreciation, depletion and amortization ("DD&A"). A downward revision in a reserve estimate could result in a higher DD&A charge to earnings. In addition, if net capitalized costs are determined to be in excess of the calculated ceiling, which is based largely on reserve estimates, the excess must be written off as an expense charged against earnings.

Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly to determine if proved reserves should be assigned or if impairment has occurred. If reserves can be assigned, the cost of the properties would be included in the depletion calculation. If impairment has occurred, any write-down would be included in depletion and depreciation expense for the period.

Oil and Gas Reserves

Questerre's proved oil and gas reserves are evaluated and reported on by an independent petroleum engineering consultant. The estimation of reserves is a subjective process. Forecasts are based on engineering data, projected future rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to a number of uncertainties and various interpretations. These estimates are the basis for the determination of the fair market value and the estimated net revenue stream of these reserves. The

Company expects that its estimate of reserves will change to reflect updated information. Reserve estimates can be revised upward or downward based on the results of future drilling, testing, production levels and economics of recovery based on cash flow forecasts. Reserve estimates can have a significant impact on net earnings, as they are a key component in the calculation of depletion and depreciation. A revision to the reserve estimate could result in a higher or lower DD&A charge to net earnings. Downward revisions to reserve estimates could also result in a write-down of oil and natural gas property, plant and equipment under the ceiling test.

Asset Retirement Obligation

The Company recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be determined. The liability is recorded at fair value and is adjusted to its present value in subsequent periods and the amount of the accretion is charged to earnings in the period. The associated asset retirement costs are capitalized as part of the carrying amount of the related asset. The capitalized amount is depleted on a unit of production basis in accordance with the Company's depletion policies.

Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost also result in an increase or decrease to the asset retirement obligation. The Company's estimated undiscounted asset retirement cost for the Field is \$1.8 million.

Actual costs incurred upon settlement of the obligation are charged against the liability to the extent the liability is recorded. Any difference between actual costs incurred upon settlement of the asset retirement obligation and the recorded liability is recognized as a gain or loss in the Company's earnings in the period in which settlement occurs.

Determination of the original undiscounted retirement obligations and timing of these obligations are based on internal estimates using current costs and technology in accordance with existing legislation and industry practice. These estimates are subject to change over time and, as such, may impact the charge against income for asset retirement obligations.

Additional Information

Additional information relating to Questerre, including the Company's Annual Information Form can be obtained on SEDAR at www.sedar.com or on the Company's website at www.questerre.com.

Notice to Reader

The accompanying unaudited interim consolidated financial statements of Questerre Energy Corporation for the three months ended March 31, 2005 have been prepared by management and approved by the Audit Committee and the Board of Directors of the Corporation. These statements have not been reviewed by the Corporation's external auditors.



Michael Binnion
President and Chief Executive Officer



David Mallory
Interim Chief Financial Officer

CONSOLIDATED BALANCE SHEETS

	March 31 2005	December 31 2004
	(unaudited)	
Assets		
Current assets		
Cash	402,213	2,701,477
Accounts receivable	152,610	218,249
Inventory	198,027	141,373
Deposits and cash calls paid	31,606	502,522
	784,456	3,563,621
Restricted cash (note 4)	100,000	100,000
Petroleum and natural gas properties – net of accumulated depletion and depreciation (note 3)	7,529,049	6,140,058
	8,413,505	9,803,679
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	297,402	572,033
Bank loan (note 4)	214,400	234,500
	511,802	806,533
Promissory note payable (note 5)	600,000	600,000
Asset retirement obligation	1,848,503	1,848,503
	2,960,305	3,255,036
Shareholders' Equity		
Common shares (note 7)	31,327,921	31,339,389
Contributed surplus (note 7)	117,287	41,952
Deficit	(25,992,008)	(24,832,698)
	5,453,200	6,548,643
Going Concern Matters (note 1)		
	8,413,505	9,803,679

See accompanying notes to consolidated financial statements.

Approved by the Board of Directors



Director



Director

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

(unaudited)

	For the three months ended March 31	
	2005	2004
Revenue		
Petroleum and natural gas, net of royalties	\$ 318,399	\$ 64,555
Recovery of accrued Crown royalties	142,850	–
	461,249	64,555
Expenses		
Operating	204,700	166,630
General and administrative	253,591	119,582
Stock-based compensation	75,335	47,199
Interest expense	17,516	7,785
Interest income	(4,631)	(3,504)
Depletion and depreciation	1,074,048	5,235,314
Accretion on asset retirement obligation	–	14,842
	1,620,559	5,587,848
Net loss	(1,159,310)	(5,523,293)
Deficit, beginning of period	(24,832,698)	(25,455,674)
Restatement for changes in accounting policies		
Stock-based compensation	–	(70,527)
Deficit, end of period	(25,992,008)	\$ (31,049,494)
Net loss per share		
Basic and diluted	\$ (0.02)	\$ (0.13)

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	For the three months ended March 31	
	2005	2004
Cash provided by (used in):		
Operating Activities		
Net loss	\$ (1,159,310)	\$ (5,523,293)
Items not affecting cash		
Depletion and depreciation	1,074,048	5,235,314
Accretion on asset retirement obligation	–	14,842
Stock-based compensation expense	75,335	47,199
	(9,927)	(225,938)
Recovery of Crown royalties	(142,850)	–
Net change in non-cash working capital	(110,554)	91,086
	(263,331)	(134,852)
Financing Activities		
Issue of common shares	–	745,570
Issue of flow-through shares	–	2,442,428
Share issue costs	(11,468)	(214,839)
Repayment of bank loan	(20,100)	(20,100)
	(31,568)	2,953,059
Investing Activities		
Expenditures on petroleum and natural gas properties	(2,463,039)	(5,679,275)
Net change in non-cash working capital	458,674	2,891,670
	(2,004,365)	(2,787,605)
Increase (decrease) in cash	(2,299,264)	30,602
Cash, beginning of period	2,701,477	1,678,611
Cash, end of period	\$ 402,213	\$ 1,709,213

See accompanying notes to consolidated financial statements.

During the three months ended March 31, 2005, the Company paid \$17,516 (2004 – \$7,785) of interest on bank indebtedness and \$Nil in cash taxes (2004 – \$Nil).

SELECTED NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months ended March 31, 2005 (unaudited)

The interim consolidated financial statements include the accounts of Questerre Energy Corporation and its subsidiaries (“Questerre” or the “Company”) and have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles. The interim consolidated financial statements are unaudited and have not been subject to review by the Company’s external auditors. The interim financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended December 31, 2004. Certain comparative figures have been reclassified to conform with the presentation adopted in the current year. The disclosure which follows is incremental to the disclosure included with the annual consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Company’s annual report for the year ended December 31, 2004.

1 Nature of Operations and Basis of Presentation

Questerre is primarily involved in the exploration and development of naturally fractured and hydrothermally dolomitized reservoirs.

As at March 31, 2005, the Company has four primary projects – the Beaver River Field in British Columbia, the St. Lawrence Lowlands in Quebec, and the Parkland and Vulcan areas in Southern Alberta. Questerre also holds minority interests in producing, non-operated properties in Alberta.

The St. Lawrence Lowlands and Southern Alberta projects remained unproved at March 31, 2005.

The Company’s efforts and resources are directed at developing a portfolio of projects and ultimately realizing the value of these projects. Due to the numerous risks inherent in these projects, there can be no assurance the Company will be successful. While the Company seeks to mitigate risks by securing joint venture partners and developing a stable production base, the Company’s success will, to a large extent, depend on its continued ability to finance the development of existing projects and the acquisition and development of new projects.

These financial statements have been prepared using Canadian generally accepted accounting principles (“GAAP”) and, accordingly, have been prepared using the same principles as those for a going concern. Should the Company be unsuccessful in realizing the value of its current and future projects, it may not be able to realize its assets and discharge its liabilities in the normal course of business.

2 Corporate Restructuring

On April 1, 2004, Questerre Beaver River Inc. (“QBR”), a wholly owned subsidiary of Questerre was granted an Order by the Court of Queen’s Bench of Alberta providing for creditor protection under the Companies’ Creditors Arrangement Act (“CCAA”). On June 22, 2004, Questerre also applied for and was granted an Order by the Court of Queen’s Bench of Alberta providing for creditor protection under CCAA.

QBR’s financial difficulty was the result of significant problems and cost overruns associated with a re-entry operation undertaken at the Beaver River natural gas field (the “Beaver River Field” or the “Field”) that is located approximately 100 miles northwest of Fort Nelson, British Columbia. QBR holds a 60% working interest and a 100% priority right to cash flow (subject to payouts) in the Field. QBR held a 100% working interest in the operation as a result of joint venture partners choosing to forego participation under penalty. The CCAA filing by Questerre was necessary due to claims advanced or threatened by

certain parties that provided goods and services in connection with the re-entry operation and was intended to allow the Company to restructure its affairs while continuing operations on a normalized basis.

On August 9, 2004, the Company filed Plans of Compromise or Arrangement (the "Plans") under the CCAA for the settlement of all outstanding claims. The Plans were approved by the requisite majority of unsecured creditors at meetings of creditors held on August 31, 2004 and sanctioned by the Court of Queen's Bench of Alberta on September 9, 2004. Questerre and QBR subsequently emerged from Court protection under the CCAA on October 8, 2004.

Pursuant to the Plans proposed by Questerre and QBR, unsecured creditors received either the lesser of the amount of their claim or \$2,000. Alternatively, unsecured creditors elected to receive a cash dividend of \$0.05 plus one Common Share of Questerre for each dollar of their claims. The Common Shares of Questerre issued under the Plans are subject to a contractual escrow and released in two equal instalments on the fourth and eighth month anniversary of the date the Plans received final Court approval.

In addition to the proposed settlement, Questerre arranged for a liquidity option. Under this liquidity option, unsecured creditors received \$0.05 for each dollar of their claims, and also received an additional \$0.07 for each dollar of their claim in exchange for foregoing each Common Share they would have otherwise received. This resulted in a cash settlement of \$0.12 per dollar of claim outstanding.

The Common Shares that would otherwise have been issued to these unsecured creditors were issued to Terrenex Acquisition Corporation ("Terrenex"), a related party, pursuant to the terms of the Liquidity Option Agreement. In consideration, Terrenex established a fund to finance the liquidity option up to a maximum of \$668,500.

A total of \$0.56 million in cash and 9,623,012 Common Shares were issued on the implementation of these Plans. 6,756,102 Common Shares were issued to Terrenex pursuant to the Liquidity Option Agreement.

3 Capital Assets

	March 31 2005	December 31 2004
Petroleum and natural gas properties	42,861,596	40,075,517
Less: Accumulated depletion and depreciation	(35,332,547)	(33,935,459)
	7,529,049	6,140,058

The Company incurred a ceiling test writedown of \$1.1 million for the three months ended March 31, 2005 (December 31, 2004 – \$6.4 million). This related to the Company's share of drilling costs of an unsuccessful well in the Simonette area of Alberta. This amount is included in the depletion, depreciation and amortization provision on the income statement.

As at March 31, 2005, petroleum and natural gas properties included \$7.0 million (December 31, 2004 – \$5.7 million) relating to unproved properties that have been excluded from the depletion and depreciation calculation. All costs associated with the Beaver River Field, net of estimated salvage values, have been written down and included in depletion expense except \$2.9 million of geological and geophysical costs. These costs primarily relate to the 3-D seismic survey acquired over the Field in 2002. Management does not believe these assets are impaired as the data is a key component of the Company's plan for future development of the Field.

Questerre also does not include costs of \$1.9 million associated with its St. Lawrence Lowlands acreage in Quebec in the calculation of depletion or in costs subject to the ceiling test calculation. The Company also does not include costs of \$1.8 million related to its exploration projects in the Parkland and Vulcan areas in Southern Alberta and \$0.3 million relating to land acquired in the Westlock area of Alberta in its calculation of depletion or in costs subject to the ceiling test calculation. The projects in Alberta and in Quebec remain unproved at March 31, 2005.

4 Bank Indebtedness

In July 2002, the Company obtained a five-year, \$400,000 term loan with a Canadian bank. Under the terms of the loan, the Company must make monthly payments of \$6,700 principal plus interest until the loan is paid out. The interest rate under the loan is the bank's floating base rate plus 2.0% and the Company may lock in the rate at any time. The loan is secured by the first assignment to the bank of a \$100,000 Guaranteed Investment Certificate and by a General Security Agreement over the assets of the Company and QBR. Financial covenants include maintaining a minimum long term debt to tangible equity ratio of 0.8 to 1.0 and maintaining a working capital ratio of at least 1.0 to 1.0. The Company was not in compliance with this covenant in the past and, therefore, the bank loan has been classified as a current liability.

5 Promissory Note

As at March 31, 2005, the Company has issued a promissory note for \$0.6 million to Rupert's Crossing, an Investment Corporation ("Rupert's"). Rupert's is a private investment holding company controlled by the President and Chief Executive Officer of Questerre. The promissory note was issued in 2004 on the receipt of \$0.6 million in cash from Rupert's.

The promissory note is due November 14, 2006 and bears interest at 8% per annum, payable monthly. It is secured by a General Security Agreement over the assets of the Company and the hypothecation of the Company's exploration licenses in the St. Lawrence Lowlands in Quebec.

Pursuant to the terms of the note, the Company has the right to prepay the entire amount or any portion thereof with 30 days' notice in writing to Rupert's. Rupert's has been granted an option, subject to regulatory approval, to convert the entire amount into Common Shares of the Company at a conversion rate of \$0.30 per Common Share.

6 Crown Royalties

The Company accrued Crown royalties of \$0.14 million for the year ended December 31, 2004 on production from the Beaver River Field during the second half of 2004. Payment of this royalty was contingent on the Company reaching an agreement with the Ministry of Energy and Mines in British Columbia regarding its qualification for a deep royalty credit in the amount of \$2.2 million.

In March 2005, the Company received confirmation from the Ministry of Energy and Mines in British Columbia that it qualified for a re-entry royalty credit in the amount of \$0.75 million. The Company has since recorded a recovery of the accrued Crown royalties of \$0.14 million.

7 Share Capital

a) Authorized

The Company is authorized to issue an unlimited number of Class A common voting shares (“Common Shares”). The Company is also authorized to issue an unlimited number of Class B common voting shares and an unlimited number of preferred shares, issuable in one or more series. At March 31, 2005, there were no Class B common voting shares or preferred shares outstanding.

b) Issued and outstanding – Class A common shares

	Number	Amount
Common Shares		
Balance, December 31, 2004	66,751,904	\$ 31,339,389
Share issue costs related to December 2004 financing		(11,468)
Balance, March 31, 2005	66,751,904	31,327,921

c) Per Share Amounts

The following table summarizes the weighted average Common Shares used in calculating net loss per common share:

	For the three months ended March 31	
	2005	2004
Basic	66,751,904	43,433,975
Diluted	68,520,083	43,436,987

The reconciling item between the basic and diluted average common shares is stock options.

d) Stock Options

The Company has a stock option plan that provides for the issuance of options to its directors, officers and employees at or above market prices. The stock options granted under the plan vest evenly over a three year period and expire five years from the date of grant.

The following table sets forth a reconciliation of the stock option plan activity for the three months ended March 31, 2005:

	Number of Options	Weighted Avg. Exercise Price
Outstanding, December 31, 2004	3,365,000	\$ 0.16
Cancelled	(170,000)	\$ 0.10
Granted	250,000	\$ 0.72
Outstanding, March 31, 2005	3,445,000	\$ 0.21
Exercisable, March 31, 2005	445,000	\$ 0.14

The outstanding options have a range of exercise prices between \$0.10 per share and \$1.00 per share, and a weighted average number of years to expiry of 4.5. The exercisable options have a range of exercise prices between \$0.10 and \$0.30 per share and have a weighted average number of years to expiry of 4.5.

e) Stock-based Compensation Costs

The Company accounts for its stock based compensation plan using the fair value method. Under this method, compensation cost attributable to share options granted to employees or directors is measured at fair value at the grant date and expensed over the expected exercise time frame with a corresponding increase to contributed surplus.

The fair value of each option granted is estimated in the date of grant using the Black-Scholes option pricing model with weighted average assumptions for grants as follows:

Risk free interest rate (%)	3.0
Expected life (years)	3.0
Expected volatility (%)	77.0

f) Contributed Surplus

The following table sets forth a reconciliation of contributed surplus for the three months ended March 31, 2005:

Balance, December 31, 2004	\$	41,952
Stock based compensation expense		75,335
Balance, March 31, 2005	\$	117,287

8 Related Party Transactions

At March 31, 2005, Questerre had amounts owing to Terrenex totalling \$89,812 (2004 – \$1,836). All of the directors of Terrenex serve as directors or officers of Questerre.

Questerre incurred fees of \$31,500 for the three months ended March 31, 2005 (2004 – \$31,500) to a company with common directors and officers. The transactions were in the normal course of business paid pursuant to an Office Rental Agreement for the provision of office space, office equipment and support personnel. The agreement may be terminated by either party with six months written notice.

The Company has entered into a purchase and sale agreement with Rupert's to acquire its interest in five producing oil and gas wells in addition to 8,320 acres gross (2,432 acres net) of undeveloped land in Central Alberta. Current production from these wells, net to Rupert's, is approximately 75 boe per day.

The purchase price for these assets is \$2 million and is based on an evaluation of these assets prepared by an independent reservoir engineering firm. The transaction was approved by an independent committee of the Board established for the purposes of evaluating this acquisition. The closing of this transaction is subject to the successful completion of an equity placement by the Company (Note 9).

9 Subsequent Events

In April 2005, the Company submitted an application for a secondary listing of its Common Shares on the Oslo Stock Exchange in Norway. In conjunction with this listing, the Company has entered into a mandate agreement with a major Norwegian financial institution to complete an equity placement for gross proceeds between \$5 – \$10 million.

In April 2005, the Company completed a private placement of 3,125,000 Common Shares for gross proceeds of \$1 million. A cash commission of \$0.06 million was paid on the closing of the private placement. Terrenex subscribed for 2,812,500 common shares and Rupert's subscribed for 312,500 Common Shares.

In May 2005, the Company received a statement of defence and counterclaim filed by a seismic processing company in connection with the processing of the seismic survey over the Beaver River Field. At the present time, the Company is unable to ascertain the impact of this legal action on its financial position.

Directors

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Michael Binnion
Russ Hammond
Tom Landry, Jr.
David Mallory
Peder Paus
Jed Wood

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John Brodylo
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