MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") was prepared at, and is dated, March 28, 2007. This MD&A is provided by management of Questerre Energy Corporation ("Questerre" or the "Company") to review 2006 activities and results as compared to the previous year and should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2006 and 2005. Additional information relating to Questerre, including Questerre's Annual Information Form is available on SEDAR at www.sedar.com.

Questerre is involved in the exploration and development of scalable large natural gas projects. The Company has two main projects — the Beaver River Field in British Columbia (the "Field") and the St. Lawrence Lowlands in Quebec. To mitigate the risks associated with these projects, the Company has secured partners to assist in their development. To further diversify risk, the Company is also developing a portfolio of conventional exploration and production assets in Central and Southern Alberta.

The Company's Common Shares are listed on the Toronto Stock Exchange and Oslo Stock Exchange under the symbol QEC.

This MD&A contains forward-looking statements. Management's assessment of future plans and operations, production estimates, drilling inventory and wells to be drilled, timing of drilling and tie in of wells, productive capacity of new wells, capital expenditures and the timing thereof, may constitute forward-looking statements under applicable securities laws and necessarily involve risks including, without limitation, risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services, the timing and length of plant turnarounds and the impact of such turnarounds and the timing thereof, delays resulting from or inability to obtain required regulatory approvals and ability to access sufficient capital from internal and external sources. As a consequence, the Company's actual results could differ materially from those expressed in, or implied by, the forward-looking statements. Readers are cautioned that the foregoing list of factors is not exhaustive. The forward-looking statements contained in this MD&A are made as at the date of this MD&A and the Company does not undertake any obligation to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.

This document contains the terms "funds generated from operations" and "netbacks" which are non-GAAP terms. The Company uses these measures to help evaluate its performance. The Company considers netbacks a key measure as it demonstrates its profitability relative to current commodity prices. The Company considers funds generated from operations a key measure as it demonstrates the Company's ability to generate funds necessary to repay debt and to fund future growth through capital investment. Funds generated from operations should not be considered as an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with Canadian GAAP as an indicator of Questerre's performance. Questerre's determination of funds generated from operations may not be comparable to that reported by other companies. The reconciliation between net income and funds generated from operations can be found in the consolidated statements of cash flows in the consolidated financial statements.

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 of oil and is based on an energy equivalent conversion method application at the burner tip and does not necessarily represent an economic value equivalency at the wellhead.

SELECT ANNUAL INFORMATION

Item	December 31, 2006	December 31, 2005
Financial ($)		
For the year ended		
Petroleum and natural gas revenue	**12,030,736**	2,097,422
Funds generated from operations	**5,076,419**	4,230
Per share – basic	**0.04**	0.00
Per share – fully diluted	**0.04**	0.00
Net loss	**(876,835)**	(3,005,562)
Per share – basic	**(0.01)**	(0.03)
Per share – fully diluted	**(0.01)**	(0.03)
Capital expenditures (including acquisitions)	**29,790,006**	10,307,805
At year end		
Working capital	**22,696,421**	9,802,130
Total assets	**71,039,440**	26,192,763
Shareholders' equity	**59,163,470**	22,169,887
Common shares outstanding		
Basic	**155,171,750**	113,014,594
Fully diluted	**168,041,336**	122,219,594
Operations (units as noted)		
Average production		
Crude oil and natural gas liquids (bbls/d)	**113**	5
Natural gas (mcf/d)	**3,984**	629
Total (boe/d)	**778**	110
Average sales price		
Crude oil and natural gas liquids (C$/bbl)	**63.08**	84.36
Natural gas (C$/mcf)	**6.46**	8.43
Total ($/boe)	**42.29**	52.20
Netback ($/boe)		
Total revenue	**42.29**	52.20
Royalties	**9.93**	9.03
Percent	**23.42%**	17.29%
Transportation and processing	**3.06**	2.09
Field operating expense	**6.79**	15.70
Operating netback	**22.51**	25.38
Net cash G&A	**5.64**	25.75
Cash netback	**16.87**	(0.36)
Wells drilled		
Gross	**20**	17
Net	**10.21**	5.93

QUARTERLY FINANCIAL INFORMATION

Period ended December 31, 2006	Q1	Q2	Q3	Q4	Total
Production revenue, net of royalties	$ 754,204	$ 1,737,888	$ 2,780,169	$ 3,941,222	$ 9,213,483
Net loss	$ (599,982)	$ 2,842,247	$ (1,954,289)	$ (1,164,811)	$ (876,835)
Per share – basic	(0.01)	0.02	(0.01)	(0.01)	(0.01)
Per share – diluted	(0.01)	0.02	(0.01)	(0.01)	(0.01)

Period ended December 31, 2005	Q1	Q2	Q3	Q4	Total
Production revenue, net of royalties	$ 461,249	$ 520,965	$ 282,696	$ 469,567	$ 1,734,477
Net income (loss)	$ (1,159,310)	$ (410,079)	$ (548,764)	$ (887,409)	$ (3,005,562)
Per share – basic	(0.02)	(0.01)	(0.01)	(0.01)	(0.03)
Per share – diluted	(0.02)	(0.01)	(0.01)	(0.01)	(0.03)

HIGHLIGHTS

- Talisman drilled discovery well in the St. Lawrence Lowlands, Quebec
- Appraisal drilling commenced for the Mattson/Besa River horizon at the Beaver River Field
- Completed development drilling of gas pool in Vulcan
- Established Westlock as a new core area
- Exited 2006 with production over 1,600 boe/d and cash flow of $5.08 million for the year
- Increased proved and probable reserves to 2.25 mmboe from 0.9 mmboe in 2005

2006 ACTIVITIES

St. Lawrence Lowlands, Quebec

Questerre holds over 715,000 acres under its farm-out agreement with Talisman Energy Inc. ("Talisman"). Pursuant to this agreement, Talisman has the right to drill up to four wells to earn an interest on all of Questerre's acreage. Questerre and its minority partners may participate for up to a 15% working interest, while retaining a 10% carried interest and a 5% royalty on all production.

Talisman successfully acquired a 2-D seismic survey over two of Questerre's prospects in the St. Lawrence Lowlands in early 2006.

Following the processing and interpretation of this seismic data, Talisman committed to drill Gentilly #1, its first well on this acreage. The well was designed to test multiple horizons including the Trenton Black-River, Utica shales and two deeper formations. Questerre elected to participate in this well and paid 10.5% of the well costs to retain a net 17.5% interest in addition to an overriding royalty from Talisman on production from the well.

The well was spud in late October 2006 and drilled to a vertical depth of 2529m. A testing program commenced in early 2007 for the Trenton Black River and the fractured shales. On initial cleanup, the well flowed sweet natural gas from the Trenton Black-River at rates of up to 4.5 mmcf/d. Additional testing is underway to determine commerciality and results are expected in the second quarter of 2007.

Questerre plans to participate in additional exploration activities in the St. Lawrence Lowlands that could include additional wells and a further seismic acquisition program.

The Company also holds a 50% working interest in an additional 300,000 acres in the St. Lawrence Lowlands with Gastem Inc. The acreage is divided into two blocks – the Yamaska block adjacent to Questerre's acreage with Talisman and the St. Jean block close to the US border. During the first quarter of 2007, Questerre secured additional acreage of approximately 53,000 acres adjacent to the St. Jean block.

A geological and geophysical work program commenced on these two blocks in 2006. Questerre believes that its preliminary work has confirmed that the blocks are prospective for natural gas in multiple horizons, with the target horizons identified at much shallower depths on the St. Jean block. This work program has since been expanded in 2007 to include a high-resolution aeromagnetic survey in advance of a possible well in 2008.

In early 2007, Questerre and Gastem entered into a letter of intent for the Yamaska acreage. Pursuant to the letter of intent, Gastem will commit to spend a minimum of $3 million and a maximum of $13 million on the Yamaska permits. Gastem will earn the 50% working interest currently held by Questerre in these permits subject to a 7.5% convertible gross overriding royalty ("GORR") payable to Questerre. The GORR is convertible into a 20% working interest. Gastem may work with additional partners to fulfill its spending commitments under the letter of intent. Under the minimum work program, Gastem estimates that it will drill at least two wells to test the Utica shales on the Yamaska permits. Gastem expects to spud the first well in the spring of 2007.

Beaver River Field, British Columbia

The winter work program completed at the Field during the first quarter of 2006 yielded the A-2 well as a natural gas producer from the lower interval of the relatively shallow Mattson/Besa River horizon.

Initially testing at 1.64 mmcf/d, the A-2 well was placed on production at 2 mmcf/d at the end of the first quarter. Production from the well continued to improve throughout the year and the well is currently producing approximately 4 mmcf/d. It is estimated the well has an AOF of between 5 and 6 mmcf/d. The Company's independent reservoir engineers have assigned gross proved plus probable reserves of 4.16 Bcf to the A-2 well as of December 31, 2006. Questerre has a 50% interest in this well.

Based on the results from A-2 well and additional technical work completed by its partner, Transeuro Energy Corp. ("Transeuro"), Questerre and Transeuro commenced a drilling program to evaluate the Mattson/Besa River as a potential resource play.

The first well in the program, the A-7 well, spud in September 2006. The well was drilled at the crest of the Mattson/Besa River structure, approximately 1.3 kilometres away from the A-2 well to a depth of 1930m. Five prospective intervals in the Mattson/Besa River were identified and two were fracture stimulated during the first quarter of 2007. One of these intervals flowed sweet natural gas on initial cleanup at rates of up to 1.9 mmcf/d. Operations are underway to put both stimulated intervals on test concurrently and determine the combined flow rate for this well. Transeuro funded 100% of the A-7 well costs to earn a 50% interest in the well.

The second well in this program, the B-3 well, was spud in January 2007 and will assist in delineating the Mattson/Besa River horizon in the southern part of the Field. The well reached total depth of 2115m in March 2007. Questerre funded 50% of the B-3 well and hold a 50% working interest in the well.

In early 2007, the partners agreed to amend their existing farmin and operating agreement (the "Agreement") as follows:

- Transeuro will be recognized as the participating party and Ampac Petroleum Inc. was released from its obligations under the Agreement;
- The requirement for a fourth re-entry to further evaluate the Mattson was dropped from the earning requirements;
- Transeuro will no longer be committed to drilling a Nahanni well at its sole cost and risk. Instead, Transeuro will earn a 50% interest in the entire Field and all infrastructure upon payment of $10 million to Questerre by April 2007; and
- The partners have committed to spud a joint Nahanni well by summer 2007. The Nahanni well will be managed by the same joint venture operating committee management structure that drilled the B-3 well.

Questerre participated in a private placement of Transeuro in March 2007. The Company subscribed for three million units at $0.61 per unit for gross subscription proceeds of $1.83 million. Each unit consists of one common share of Transeruo and one common share purchase warrant entitling the holder to acquire one Transeuro share at $0.61 until December 31, 2007.

Questerre doubled its land holdings in the Beaver River area during the first quarter of 2007 to over 23,000 acres including the exploration rights to all horizons in acreage surrounding the Field. It also acquired the rights to additional horizons at the Field. Questerre expects to validate these additional lands with its work program in 2007 and 2008.

Vulcan, Southern Alberta

During 2006, Questerre's principal focus in Vulcan was the development of its new Mannville pool discovery. Questerre has a 50% interest in this pool.

Three (1.28 net) wells were drilled to delineate this pool in the first nine months of 2006. The wells all tested natural gas with associated liquids and were placed on production by year-end. Additionally, four (2.0 net) wells were drilled to determine the extent of the adjacent oil pool. Two (1.0 net) wells are currently producing oil from the primary formation, one (0.5 net) well is suspended and one (0.5 net) well is producing oil from a shallower horizon.

An analysis of pressure data from these wells indicated that the oil and gas are in two separate pools, allowing development to proceed independently. Full field production from the gas pool commenced early in 2007 when Questerre and its partner received approval for its "Good Production Practice" ("GPP") plan from the Alberta Energy & Utilities Board ("AEUB"). Subject to development of a secondary recovery scheme to maximize recovery from the oil pool, Questerre anticipates development drilling for the oil pool will begin in late 2007.

Questerre and its partner continued to evaluate secondary targets on its acreage in Vulcan including the Horseshoe Canyon coal bed methane ("CBM") horizon. Three (1.5 net) wells were drilled in 2006 for this horizon with additional locations identified for 2007.

A further two (0.8 net) wells were drilled in Vulcan for separate Mannville pools. Both of these tested natural gas from the primary horizon. One (0.5 net) well was on production at year-end and the other (0.3 net) will be completed and tied-in during the first half of 2007.

To alleviate pipeline constraints in Vulcan, Questerre and its partner installed a central oil battery and gas compression facility in 2006. The facility was tied in to two recently constructed pipelines connected to third party processing plants. The gas compression facility provides flexibility to deliver gas to a second gas plant in the area. It also provides flexibility to develop shallow gas zones, including the CBM and conserve solution gas from the adjacent oil pool. The licensed capacity of the oil battery is 1,000 bbls per day and the licensed capacity of the gas compression facility is 15 mmcf/d.

The Company acquired 640 net acres of land in Vulcan during 2006 and expects to participate in additional exploration in the Vulcan area during 2007.

Westlock, Central Alberta

The Company established a new core area in the Westlock area of Central Alberta through the acquisition of Stride Energy Ltd. ("Stride") a private exploration and production company in April 2006 (see "Acquisition of Stride").

This land position was expanded through a farm-in agreement with Apache Canada Ltd. ("Apache") covering 33 sections of land in the area. Pursuant to the agreement, Questerre will fund an initial five-well program to earn a majority working interest in ten sections of Apache's land. Questerre will have the option to drill additional wells to earn on additional land on the same terms.

During the year, Questerre participated in the drilling of seven (4.13 net) wells, resulting in two (1.4 net) gas wells, 1 (0.5) dry well and four (2.23) suspended wells.

December 2006, Questerre acquired a 3-D seismic survey over three sections of land in advance of a drilling program during the first half of 2007. Questerre completed a four well program in the area during the first quarter of 2007. The program resulted in one dry and abandoned well and three suspended gas wells. Questerre is currently reviewing this area in advance of its proposed summer drilling program.

DRILLING ACTIVITIES

In 2006, Questerre participated in the drilling of 20 gross wells (10.21 net wells) resulting in 8 (4.18 net) gas wells, 6 (2.8 net) oil wells, 1 (0.5 net) dry hole and 5 (2.73 net) suspended wells for a 70% success rate.

CORPORATE

Equity Offerings

In 2006, the Company completed three equity issuances on a private placement basis through the issuance of 34,709,000 common shares for gross proceeds of $35.91 million as follows:

- In February 2006, 11,000,000 common shares were issued at $0.65 per common share for gross proceeds of $7.15 million;
- In June 2006, 9,709,000 common shares were issued on a flow-through basis at $1.03 per common share for gross proceeds of $10 million;
- In December 2006, 14,000,000 common shares were issued at $1.34 per common share for gross proceeds of $18.7 million.

Acquisition of Stride Energy Ltd.

In April 2006, Questerre acquired Stride Energy Ltd., a private exploration and production company with land and production focused in the Westlock area of Central Alberta. Stride held 26 (13 net) sections and production of approximately 227 boe/d. Total consideration for this acquisition was $6.28 million in cash and 7,262,742 common shares.

Acquisition of Interest in Gastem Inc.

In January 2006, Questerre acquired an interest in Gastem Inc., a public Montreal-based junior exploration and production company through a private placement. The placement consisted of the issuance of 1.46 million units of Gastem at $0.10 per unit to Questerre. Each unit consisted of one common share of Gastem and one purchase warrant entitling Questerre to acquire an additional common share of Gastem at $0.10 per share until January 2008.

PRODUCTION

Questerre experienced an exponential increase in production during 2006 - average daily production grew from 250 boe in January to over 1,400 boe in December with an exit rate of approximately 1,600 boe. Over the year, production averaged 778 boe per day as compared to 110 boe per day in 2005.

The Company maintained its focus on natural gas with gas representing 85% of production in 2006 down 10% from 95% in 2005. Questerre's oil production is mainly light oil and natural gas liquids from the Vulcan pool.

Increased activity in Alberta accounted for the majority of production growth. The development of the gas pool in Vulcan and the acquisition of Stride saw the Company grow its average production in Alberta from 72 boe per day in 2005 to 592 boe per day in 2006. Production during the year was primarily from its core assets in Vulcan and Westlock. For the prior year, production in Alberta was natural gas from Questerre's minority interests in various non-operated properties.

The Field also contributed to growth with production averaging 186 boe per day in 2006 and accounting for 24% of the Company's total production. Daily gross production from A-2, the only producing well at the Field in 2006, increased from 2 mmcf per day (332 boe) in early April to over 4 mmcf per day (667 boe) at year-end. In the prior year, average Field production of 39 boe per day was entirely attributable to the A-5 well and accounted for 35% of the Company's average production. The A-5 well was shut-in early in the third quarter of 2005 due to a down-hole obstruction.

With the receipt of AEUB approval of the GPP plan for the gas pool and the commencement of full field production in Vulcan, Questerre anticipates its daily production will average approximately 1,600 boe per day during the first quarter of 2007.

The Company plans to grow its conventional asset base in Alberta and the Field through an active drilling program. Based on current plans, the company expects its exit production rate for 2007 to be approximately 2,200 boe per day.

2006 FINANCIAL RESULTS

REVENUE

Questerre reported petroleum and natural gas revenues of $12.03 million in 2006 (2005 - $2.10 million). 2006 revenues include $2.46 million (2005: $0.57 million) in natural gas sales from the Field and $9.57 million (2005: $1.53 million) from producing properties in Central and Southern Alberta.

With all production sold on the spot market and lower average natural gas prices in 2006, Questerre experienced a 23% decrease in realized natural gas prices to $6.46 per mcf from $8.43 per mcf in 2005. Although 78% of revenue was from natural gas, the lower realized prices were substantially offset by the significant increase in average daily production. Strong oil and NGL prices coupled with better production resulted in oil and NGL revenue representing approximately 22% of gross revenue with an average selling price of $63.08 per barrel in 2006.

ROYALTIES

Questerre recorded royalty expense of $2.82 million for the year ended December 31, 2006 (2005: $0.36 million). This represents an effective royalty rate of 23.42% (2005:17.29%) with Crown royalties accounting for 18.23% (2005: 9.48%) and freehold and overriding royalties 5.17% (2005: 7.83%) of revenue.

Royalties as a percentage of revenue in Alberta decreased from 32.25% in 2005 to 25.84% in 2006. During the year, the new production and associated royalties from Vulcan were offset by a lower rate on production from other assets in Alberta. Questerre anticipates its royalty rate in Alberta to increase in 2007 as Vulcan grows to represent a larger portion of the Company's production base.

Royalties on production from the Beaver River Field averaged 14.00% (2005: N/A) for the year ended December 31, 2006. Questerre benefited from a summer drilling royalty credit of $0.10 million from the Crown in 2006. For the prior year, the Company recorded a recovery of $0.14 million on 2004 production and recorded no Crown royalties on 2005 production. This reflected a $0.75 million drilling royalty credit for the A-5 well.

OPERATING COSTS

Total operating expenses for the year ended December 31, 2006 increased approximately three times to $2.80 million from $0.71 million in 2005. Of this amount, processing and gathering charges comprised $0.87 million in 2006.

Operating expenses for Questerre's production in Alberta totaled $1.81 million in 2006 (2005: $0.22 million) or $8.39 on a boe basis, unchanged from the prior year. Beaver River Field operating expenses of $0.99 million in 2006 (2005: $0.5 million) relate to the increased activity and processing charges associated with the higher production volumes.

The Company recorded minimal operating expenses for the Beaver River Field during the second half of 2005. With the A-5 well shut-in in July, operations at the Field were directed towards the reconstruction of the operators' quarters and workshop after the fire in June 2005. The Company was reimbursed for these specific expenses under its insurance policy during the fourth quarter of 2006.

GENERAL & ADMINISTRATIVE EXPENSES

General and administrative expenses for 2006, net of capitalized overhead, were $1.60 million (2005: 1.03 million). The active development of the Company's entire portfolio of assets was responsible for the increased costs in 2006 that translated to $5.64 on a boe basis (2005: $25.75 per boe). During the year, the Company continued to capitalize overhead expenses equal to 5% of its capital expenditures for the year up to a maximum of 50% of gross general and administrative expenses.

Questerre expects these expenses to decrease on a boe basis through 2007 with the increased production levels forecasted.

($ thousands)	**2006**	2005
General & administrative expenses	**2,719**	1,450
Capitalized overhead	**(1,117)**	(416)
General & administrative expenses, net	**1,602**	1,034

STOCK-BASED COMPENSATION

Stock-based compensation expense for the year ended December 31, 2006 totaled $1.35 million (2005: $0.70 million) During the year the Company issued 3.92 million options at an average exercise price of $0.93 per common share. The weighted average fair value of these options using the Black Scholes option pricing model is $0.45 per option. By comparison, the Company issued a total of 6.02 million options in 2005 at a weighted average price of $0.59 per common share. The weighted average fair value of these options issued in 2005 was $0.26 per option.

OTHER INCOME AND EXPENSES

Lower interest expense of $0.02 million in 2006 (2005: $0.07 million) reflected the lower debt held by the Company. In 2005, interest was paid on the bank loan and a $0.6 million promissory note. The note was subsequently converted into common shares during the fourth quarter of 2005.

The higher cash balances held by the Company in 2006 contributed to the interest income of $0.36 million (2005: $0.04 million). As at December 31, 2006, the Company held cash and equivalents of $26.7 million.

The Company realized a loss of $0.02 million in 2006 (2005: nil) on the disposition of a portion of its marketable securities portfolio. The securities represented an investment in a public junior exploration and production company. As at year-end, the Company held marketable securities with a market value of $0.51 million and a cost of $0.15 million.

DEPLETION, DEPRECIATION AND SITE RESTORATION

Questerre recognized $7.76 million in depletion and depreciation in 2006 (2005: $2.07 million). This equates to $27.33 on a per boe basis.

The Company did not incur a writedown of its assets in 2006. Included in 2005 depletion is a $1.31 million writedown incurred in early 2005 when the Company had a significantly smaller depletable base. The amount reflects the costs of an unsuccessful well drilled in the Simonette area of Alberta during the first quarter of 2005.

Questerre does not include costs of $9.46 million (2005: $6.1 million) relating to unproved properties in the calculation of depletion or in costs subject to the ceiling test calculation. During the year, the Company incurred expenditures of $4.73 million on drilling, land acquisition and seismic relating to unproved properties. In 2006, $1.37 million in costs relating to unproved properties were added to the depletion base.

The Company's estimated undiscounted asset retirement cost for 2006 is $3.99 million. (2005: 2.38 million). During the year, the Company increased its asset retirement obligations through the acquisition of Stride and the participation in the drilling of 20 gross wells.

INCOME TAXES

Questerre had sufficient tax pools and deductions to offset taxable income in 2006. The Company's tax pools allowed it to record a $3.22 million future tax recovery to offset the future tax liability associated with the flow-through share issuance completed in June. The current taxes of $0.08 million relate to the Stride assets prior to the acquisition by Questerre.

The Company's tax assets continue to significantly exceed tax liabilities. No tax asset is recognized at December 31, 2006, as it is not more likely than not that the Company will be able to realize the value of the tax assets in the future.

NET INCOME AND CASH FLOW

Questerre recorded a net loss of $0.88 million in 2006 compared to net loss of $3.01 million in 2005. The net loss is due to the higher depletion and depreciation expense partially offset by the future tax recovery.

Funds generated from operations for the twelve months ended December 31, 2006 were $5.08 million, a significant increase from $0.004 million for the same period in 2005. Higher production was principally responsible for this increase in cash flow from operations.

LIQUIDITY AND CAPITAL RESOURCES

CAPITAL EXPENDITURES

Questerre incurred capital expenditures of $29.79 million in 2006 compared to $10.31 million in 2005.

The vast majority of these expenditures relate to the development of the portfolio of assets in Central and Southern Alberta:

- $12.79 million was incurred in Vulcan, including $7.85 million on drilling and completions, $4.22 million on tie-ins and facilities, $0.57 million on undeveloped land and $0.15 million on seismic;
- $5.79 million was incurred in Westlock, including $2.58 million on drilling and completions, $0.71 million on tie-ins and facilities, $1.20 million on undeveloped land and $1.30 million on seismic;
- $6.74 million was incurred on the acquisition of petroleum and natural gas assets of Stride; and
- $1.15 million was incurred at the Field and the St. Lawrence Lowlands.

($ thousands)	**2006**	2005
Capital expenditures		
Alberta Properties	**28,645**	10,060
Beaver River Field, British Columbia	**588**	227
St. Lawrence Lowlands, Quebec	**557**	21
Total	**29,790**	10,308

WORKING CAPITAL POSITION

Questerre reported a working capital surplus of $22.70 million at December 31, 2006 compared to a working capital surplus of $9.80 million as of December 31, 2005. The improved working capital position reflects the equity placements completed by the Company in 2006.

The Company's current assets at December 31, 2006 consisted of cash of $26.7 million, accounts receivable of $3.59 million and Field inventory of $0.32 million. The current assets include marketable securities with a book value of $0.15 million.

Questerre's current liabilities consist of trade payables of $8.34 million, $0.08 million in current taxes, and $0.07 million representing the term bank loan. This loan was paid out at the beginning of 2007.

The Company's working capital and cash flow will finance its projected capital expenditures of approximately $30 million for 2007. Approximately $14 million has been allocated to drilling activities in Southern and Central Alberta, $15 million to drilling at the Beaver River Field and $1 million to exploration activities in the St. Lawrence Lowlands. Questerre believes that future capital expenditures will continue to be financed by existing working capital, cash flow and equity placements.

SHARE CAPITAL

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

In 2006, the Company completed three equity issuances, all on a private placement basis, through the issuance of 34,709,000 common shares for gross proceeds of $35.91 million.

A total of 185,414 common shares were issued on the exercise of stock options. At December 31, 2006, there were no Class B common voting shares or preferred shares outstanding, a total of 155,171,750 common shares outstanding, 12,869,586 stock options outstanding and 291,270 warrants outstanding. As at March 26, 2007, there were no Class B shares outstanding, 155,191,750 common shares outstanding, 12,984,585 stock options outstanding and 291,270 warrants outstanding.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

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 annual commitment under this agreement is $126,000 for 2007.

In June 2006, the Company completed a private placement of 9,709,000 common shares issued on a flow-through basis at $1.03 per share for gross proceeds of $10 million. The flow-through shares require the Company to incur qualifying Canadian Exploration Expenses ("CEE") by December 31, 2007. As at December 31, 2006, the Company had spent approximately $2.95 million on CEE and had a remaining commitment of $7.05 million. The Company anticipates it will incur expenditures in 2007 to satisfy these obligations.

In June 2006, the Company entered into a farm-in agreement with a major independent oil and gas company (the "Farmor") in Central Alberta. The Company has an obligation to drill five wells and will pay the Farmor $0.1 million for each well it does not drill. As of December 31, 2006 the Company drilled one well under this agreement and, during the first quarter of 2007, the Company drilled three additional wells under the agreement.

OFF-BALANCE SHEET ARRANGEMENTS

Questerre has no off-balance sheet arrangements.

RELATED PARTY TRANSACTIONS

Questerre incurred fees of $126,000, described above, for the years ended December 31, 2006 and 2005 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.

FINANCIAL INSTRUMENTS

The Company's financial instruments included in the balance sheet are comprised of accounts receivable, accounts payable, accrued liabilities, marketable securities and the bank loan. The fair value of financial instruments classified as current assets and current liabilities approximate their carrying amounts due to the short-term maturity of these instruments. The fair value of the bank loan approximates its carrying amount as the interest rate approximates market.

The Company's accounts receivable are for revenue due on production from the Company's interest in operated and non-operated properties in Alberta and British Columbia and amounts due under operating agreements. The Company is exposed to credit risks normal for the oil and gas industry.

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. The following discussion outlines the accounting estimates that are critical to determining Questerre's financial results.

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 and 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 reservoir engineering firm. 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 petroleum and natural gas properties 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.

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. The Company has recorded a $1.78 million obligation on the Field and $2.21 million on its assets in Southern and Central Alberta.

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.

RISK MANAGEMENT

Companies engaged in the petroleum and natural gas industry face a variety of risks. For Questerre, these include risks associated with exploration and development drilling as well as production operations, commodity prices, exchange rate and interest rate fluctuations. Unforeseen significant changes in such areas as markets, prices, royalties, interest rates and government regulations could have an impact on the Company's future operating results and/or financial condition. While management realizes that all the risks may not be controllable, they can be monitored and managed.

A significant risk for Questerre as a junior exploration company is access to capital. The Company attempts to secure both equity and debt financing on terms it believes are attractive in current markets. Management also endeavors to seek farm-in participants to participate in the development of its projects on favorable terms. However, there can be no assurance that the Company will be able to secure sufficient capital if required or that such capital will be available on terms satisfactory to the Company.

The Company has issued and will continue to issue flow through shares to investors. The Company uses its best efforts to ensure that qualifying expenditures of CEE are incurred in order to meet its flow through obligations. However, in the event that the Company incurs qualifying expenditures of CDE or has CEE expenditures reclassified under audit by the Canada Revenue Agency, the Corporation may be required to liquidate certain of its assets in order to meet the indemnity obligations under the flow through share subscription agreements.

Exploration and development drilling risks are managed through the use of geological and geophysical interpretation technology, employing technical professionals and working in areas where those individuals have experience. For its non-operated properties, the Company strives to develop a good working relationship with the operator and monitors the operational activity on the property. The Company also carries appropriate insurance coverage for risks associated with its operations.

Although Questerre has no formal hedging policy, the Company may use financial instruments to reduce corporate risk in certain situations. Questerre currently has no hedges or other financial instruments in place.

Interest rates on long-term debt float with the Bank of Canada rate. The Company does not have any US$ denominated debt. If strong indications arise that interest rates would be increasing significantly, steps would be taken where possible to fix the interest rate for a period of time.

Potential risks to the environment are inherent in some of the business activities of the Company. Questerre endeavors to conduct its operations in a manner consistent with environmental regulations as stipulated in provincial and federal legislation. Facilities are modern and are well maintained complying with environmental and safety regulations. The Company also mitigates the potential financial exposure of environmental risks by maintaining adequate insurance.

NEW FINANCIAL INSTRUMENT PRONOUNCEMENTS

The CICA issued new accounting standards, CICA Accounting Standard Handbook section 3855, "Financial Instruments Recognition and Measurement", section 3865 "Hedges" and section 1530 "Comprehensive Income". These standards prescribe how and at what amount financial assets, financial liabilities and non-financial derivatives are to be recognized on the balance sheet. The standards prescribe fair value in some cases while cost-based measures are prescribed in other cases. It also specifies how financial instrument gains and losses are to be presented. The new standards are effective for fiscal years beginning on or after October 1, 2006. The Company is currently assessing the impact of these standards on its financial statements.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures as of the end of such period are effective to provide reasonable assurance that material information related to the Company is made known. It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated can provide only reasonable, not absolute, assurance that objectives of the control system are met.

INTERNAL CONTROL OVER FINANCIAL REPORTING

The Chief Executive Officer and Chief Financial Officer of the Company are able to certify the design of the Company's internal controls over financial reporting, but have identified the following weaknesses in the design of these internal controls.

As a small company, there is a potential for a lack of segregation of duties that may lead to inaccuracies in financial reporting. The Company has engaged knowledgeable and competent accounting staff to ensure quality financial reporting.

The Company endeavors to have written contracts in place with all its major vendors. Due to the nature of the oil and gas industry it may not be possible to do so in most cases. This increases the potential for a misunderstanding between the Company and these vendors with regards to their respective responsibilities, the goods and services to be provided, and the terms and conditions of the agreement. As a result, the cost estimates and accruals may potentially be misstated.

The Company is in the process of documenting its business processes and procedures. In 2007, Questerre expects to begin implementing policies and procedures that Management believes will provide additional comfort regarding the reliability of the Company's financial reporting for both internal and external purposes. Notwithstanding these weaknesses, based on the Company's mitigating procedures, the Chief Executive Officer and Chief Financial Officer have satisfied themselves that these weaknesses have not resulted in material errors on the financial statements.