

Management's Discussion and Analysis

The following discussion and analysis was prepared by management at May 7, 2004 and offers Management's assessment of Questerre's historical financial and operating results. This interim discussion and analysis should be read in conjunction with the unaudited interim consolidated financial statements of the Company for the three months ended March 31, 2004, and the MD&A and audited financial statements for the year ended December 31, 2003 together with the notes related thereto. The reader should be aware that historical results are not necessarily indicative of future performance. This discussion may contain forward-looking statements that involve risks and uncertainties. Such information, though considered reasonable by Questerre at the time of preparation, may prove to be incorrect and actual results may differ materially from those anticipated in the statements made and the variances may be significant. When calculating unit costs, natural gas is converted to a barrel of oil equivalent using a conversion ratio of six thousand cubic feet equal to one barrel (6:1 ratio).

BEAVER RIVER FIELD DRILLING OPERATION

In the first quarter of 2004 Questerre finalized the drilling, completion and tie-in of the new A-5 well at the Beaver River field. The operation commenced in August 2003 and encountered significant operational delays and cost overruns. Well results fell substantially short of expectations with significantly less production and the presence of formation water. The well was tied-in to existing production facilities in March 2004 and brought on-stream for an extended production test in April 2004.

CREDITOR PROTECTION – QUESTERRE BEAVER RIVER INC.

The substantial cost overruns encountered on the A-5 drilling operations led to serious financial difficulties for Questerre's wholly owned subsidiary, Questerre Beaver River Inc. ("QBR"). On April 1, 2004, QBR applied for and was granted an Initial Order by the Court of Queen's Bench of Alberta providing for creditor protection under the Companies' Creditors Arrangement Act ("CCAA"). The filing under CCAA is intended to allow QBR to restructure its affairs while continuing operations on a normalized basis. The Court Order prohibits creditors from taking action against QBR and prevents QBR from paying most claims which arose before April 1, 2004. QBR is working to put together a plan of arrangement between QBR and its creditors and other stakeholders. If the restructuring cannot be completed, QBR may not be able to realize its assets and discharge its liabilities in the normal course of business. The Company's future outlook and plans of operation for QBR and the Beaver River project will be determined by the outcome of the restructuring of QBR under CCAA.

FIRST QUARTER 2004 FINANCIAL RESULTS

PRODUCTION

The Company had no production from the Beaver River field for the first quarter of 2004 as the two producing wells were shut-in in 2003 due to water disposal constraints and to facilitate the drilling of the new A-5 well. In the first quarter of 2003, the Company recorded production from the field of 606 mcf/day. Consistent with first quarter 2003, the Company's production from minor Alberta properties in the first quarter of 2004 was approximately 25 boe/day in natural gas and associated natural gas liquids.

REVENUE

Questerre reported petroleum and natural gas revenue of \$87,000 from January to March 2004, all of which was attributable to non-operated minority interests in Alberta properties. Comparatively, first quarter 2003 revenues included \$498,000 in natural gas sales and priority right to cash flow from the Beaver River field and \$115,000 from Alberta properties.

ROYALTIES

Questerre's royalty expense decreased from \$121,000 in the first quarter of 2003 to \$22,800 for the first quarter of 2004 as a result of reduced revenues. The royalty rate on minor Alberta properties was consistent at 26% for the first quarter of 2003 and 2004. In 2003 the Company also recorded royalties associated with the Beaver River field at a rate of 24%.

Crown royalties for the Beaver River property are governed by a royalty agreement which provides for the deferral of all royalties until the earlier of June 30, 2004 and cumulative production of 13 Bcf from the project. Repayment of deferred royalties is contingent on both the success of the experimental project for which the deferral was granted and on monthly production exceeding volumes established by the Crown. In December 2003, Questerre reported a royalty recovery which included the reversal of 2003 and prior years' royalty expense recognized under the royalty agreement. Based on the limited production and disappointing results to date, the Company adjusted the liability for crown royalties to Nil at December 31, 2003 on the basis that the conditions for repayment no longer exist.

OPERATING COSTS

The shut-in production at the Beaver River field in 2004 resulted in a decrease in total operating expenses from \$362,000 in the first quarter of 2003 to \$167,000 in 2004. Although the Beaver River property was not producing, due to the remote location, there continued to be fixed costs associated with maintaining field operations.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses of \$419,000 for the first quarter of 2004 included \$150,000 of bad debt expense recorded against amounts receivable from partners on the Beaver River project. Excluding bad debt expense, net general and administrative expenses decreased compared to 2003 primarily as a result of increased overhead recoveries associated with an increased capital expenditure program in the first quarter of 2004.

| (\$ thousands) | Three Months Ended March 31, | |
|--|------------------------------|--------|
| | 2004 | 2003 |
| General & administrative expenses | \$ 269 | \$ 191 |
| Bad debt expense | 150 | - |
| Overhead recoveries | (299) | (4) |
| General & administrative expenses, net | \$ 120 | \$ 187 |

STOCK BASED COMPENSATION

Effective January 1, 2004 the Company adopted the new accounting standard for stock based compensation resulting in stock based compensation expense of \$47,200 in the first quarter of 2004. The new accounting standard was applied retroactively without restatement of prior periods, therefore no corresponding expense was recorded in the first quarter of 2003.

INTEREST ON LONG-TERM DEBT

Interest on bank debt totaled \$7,800 for the first quarter of 2004 compared to \$17,612 for the first quarter of 2003. Interest expense for the first quarter of 2003 included a \$10,000 financing fee related to the Company's bank loan.

DEPLETION, DEPRECIATION AND ACCRETION

Questerre recognized \$5.2 million in depletion and depreciation in the first quarter of 2004 compared to \$0.2 million in 2003. Included in 2004 is a \$5.18 million "ceiling test" write-down recorded by the Company on its Beaver River petroleum and natural gas 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 new A-5 well. The write-down amount was calculated in accordance with the new accounting guideline utilizing an internal estimate of reserves and cash flows. Management's internal estimates were based on the results from the production test of the new A-5 well during the month of April 2004.

Questerre does not include costs associated with its St. Lawrence Lowlands acreage in Quebec in the calculation of depletion or in costs subject to the ceiling test calculation. The Quebec assets remains undeveloped at March 31, 2004.

The Company estimates the total future liability for asset retirement obligations to be \$907,500 at March 31, 2004. Based on the current financial position of QBR, the full estimated asset retirement obligation related to the Beaver River project has been estimated as a current year liability. Accretion of asset retirement obligations for the first quarter of 2004 was \$14,800 compared to \$13,900 for the same period in 2003. Questerre did not acquire any new properties in 2003 or 2004 which would result in additional asset retirement obligations.

TAXES

Consistent with the prior year, Questerre had sufficient tax pool deductions to offset taxable income in the first quarter of 2004 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, 2004, 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 \$5.5 million (\$0.13/share) in the first quarter of 2004 compared to \$0.3 million (\$0.01/share) in the first quarter of 2003. The first quarter 2004 net loss included a \$5.18 million ceiling test write-down on the Beaver River property. 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 new A-5 well.

LIQUIDITY AND CAPITAL RESOURCES

CAPITAL EXPENDITURES

Questerre incurred capital expenditures of \$5.7 million in the first quarter of 2004 compared to \$0.16 million in 2003. Substantially all of the first quarter 2004 capital spending related to drilling, completion and tie-in costs of the A-5 well, an operation that commenced in August 2003.

| | Three Months Ended March 31, | |
|-------------------------------|------------------------------|------------|
| (\$ thousands) | 2004 | 2003 |
| Beaver River Project, BC | 5,664 | 109 |
| St. Lawrence Lowlands, Quebec | 14 | 49 |
| Minor Alberta Properties | 1 | - |
| Total | 5,679 | 158 |

WORKING CAPITAL DEFICIENCY

Questerre reported a working capital deficiency of \$7.5 million at March 31, 2004, which includes outstanding bank debt of \$294,800. The Company is not in compliance with the financial covenants and, therefore, the bank loan has been classified as a current liability.

Questerre's current assets at March 31, 2004 include accounts receivable of \$0.2 million compared to \$0.6 million at December 31, 2003. GST refunds received in the first quarter of 2004 accounted for the decrease in accounts receivable. Inventory decreased from \$0.7 million at December 31, 2003 to \$0.3 million at March 31, 2004. The December 31, 2003 balance included \$0.5 million in drilling mud, all of which was utilized or returned for credit in the first quarter of 2004.

Questerre's trade payables of \$9.4 million primarily relate to capital expenditures and significant cost overruns associated with the Beaver River A-5 well to March 31, 2004, with \$5.7 million incurred in the first quarter of 2004 for additional drilling, completion and tie-in costs. A portion of the 2004 costs were financed by a flow-through share offering which raised gross proceeds of \$2.4 million; however the remainder of the costs increased the working capital deficiency. These conditions ultimately led to QBR's declaration of insolvency and application for court protection on April 1, 2004.

Statements of claim have been filed by various parties against the Company and its subsidiary, QBR. All of the claims relate to the provision of services and materials for the drilling of the Beaver River well. The amounts claimed have been fully provided for as part of accounts payable at March 31, 2004. The outcome of the lawsuits is dependent, in part, on the CCAA process and is unknown at this time.

SHARE CAPITAL

The Company is authorized to issue an unlimited number of Class A common voting 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.

On February 13, 2004, the Company completed a private placement for 642,860 common shares and 1,878,791 flow-through common shares for gross proceeds of \$3.16 million. Proceeds from the flow-through offering were primarily used to finance the completion and tie-in of the A-5 well at the Beaver River field.

At March 31, 2004, there were no Class B common voting shares or preferred shares outstanding and there were a total of 44,665,892 common shares outstanding and 8,200,261 common share purchase warrants outstanding.

CONTRACTUAL OBLIGATIONS

The following table summarizes the Company's contractual obligations, which require payments to be made over the next four years.

| | Payments due by period | | | | |
|-------------------------|------------------------|-----------|-----------|-----------|------------|
| | Remainder of 2004 | 2005 | 2006 | 2007 | Total |
| Bank debt | \$ 60,300 | \$ 80,400 | \$ 80,400 | \$ 73,700 | \$ 294,800 |
| Office rental agreement | \$ 94,500 | - | - | - | - |

Questerre is party to an Office Rental Agreement with a related party for the provision of offices, office equipment and support personnel. The agreement may be terminated by either party with six month's written notice.

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, 2003 and the notes to the unaudited interim financial statements at March 31, 2004. 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 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 would 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.

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.

CHANGES IN ACCOUNTING POLICIES

The following new and amended standards were implemented by the Company in 2004 with the following impact on the 2003 financial statements where retroactive restatement was required.

STOCK BASED COMPENSATION

In January 2004, the Company adopted the amended CICA Handbook Section 3870 "Stock-based Compensation and Other Stock-based Payments". This change in accounting policy has been applied retroactively without restatement of prior periods presented.

Under this amended standard, the Company must account for compensation expense based on the fair value of rights granted under its stock-based compensation plan. 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. Upon exercise of the stock options, consideration paid by the unit holder together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

As a result of adopting this change in accounting policy, the consolidated financial statements at January 1, 2004 were changed as follows: contributed surplus increased by \$117,726 and the opening deficit was increased by \$70,527.

ASSET RETIREMENT OBLIGATIONS

In January 2004, the Company adopted CICA Handbook Section 3110 "Asset Retirement Obligations". This change in accounting policy has been applied retroactively with restatement of prior periods presented.

Utilizing the new accounting policy, 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 as accretion expense is recorded. 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 would 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.

As a result of adopting this change in accounting policy, the previously reported amounts for 2003 have been restated due to the retroactive application of this new standard. Net loss for the three months ended March 31, 2003 decreased by \$8,474. The asset retirement obligation at December 31, 2003 decreased by \$30,699 to \$848,134, property, plant and equipment increased by \$20,599, net of accumulated depletion. Opening 2003 accumulated deficit increased by \$408,202 to reflect the cumulative impact of accretion and depletion expense, less the previously recorded cumulative site restoration provision. There was no impact on the Company's cash flow as a result of adopting this new policy.

FULL COST ACCOUNTING GUIDELINE

In January 2004, the Company prospectively adopted the new Accounting Guideline 16 "Oil and Gas Accounting – Full Cost" issued by the Canadian Institute of Chartered Accountants ("CICA").

Consistent with the former guideline, the net carrying cost of the Company's petroleum and natural gas properties is limited to an estimated net recoverable amount ("ceiling test"). Under the new guideline, the ceiling test calculation is a two step process. First, the Company determines whether a write-down is required by comparing the carrying value of the properties to the undiscounted cash flow of its proved reserves (based on management's best estimate of future prices) plus the lower of cost and market value for unproved properties. If there is an impairment calculated under the first step, the carrying value of properties is written down to the discounted value of the proved plus probable reserves (based on management's best estimate of future prices) plus the lower of cost and market of unproved properties.

The Company recorded a \$5.2 million ceiling test write-down for the three months ended March 31, 2004 related to the Beaver River Project. This amount was calculated in accordance with the new accounting guideline utilizing an internal estimate of reserves and cash flows. The write-down is included in the depletion, depreciation and amortization provision on the income statement for the three months ended March 31, 2004.

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 quarter ended March 31, 2004 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



Jackie Cugnet, CA
Chief Financial Officer