

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

The following Management Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") was prepared at, and is dated, March 28, 2005. This MD&A is provided by Management of Questerre Energy Corporation ("Questerre" or the "Company") to review 2004 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, 2004 and 2003. Additional information relating to Questerre, including Questerre's Annual Information Form is available on SEDAR at www.sedar.com.

Questerre was incorporated as a private company in October 1971. The Company initially operated as an oil and gas exploration and production company with minority interests in several producing properties in Western Canada. In November 2000, a new management team was assembled and the Company changed its focus to pursuing what Management believes will be large-scale exploration and development projects. Management intends to leverage its specialized knowledge of naturally fractured and hydrothermally dolomitized reservoirs to develop these projects.

To mitigate the financial and operational risks, the Company will seek industry partners to participate in the development of these projects. The Company plans to further temper risk through the acquisition and development of a portfolio of lower risk projects. It is expected these lower risk projects will provide near-term cash flow and growth.

In July 2003, the Company completed an initial public offering and listed its Common Shares on the Toronto Stock Exchange.

As at March 28, 2005, the Company has two projects it believes hold the potential to create significant shareholder value – the Beaver River Field in British Columbia and the St. Lawrence Lowlands in Quebec. The Company is also developing its portfolio of lower risk exploration projects that include recently acquired assets in the Parkland and Vulcan areas of Alberta. In addition, Questerre also holds minority interests in producing non-operated properties in Alberta.

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.

Select Annual Information

Item	For Year Ended		
	December 31 2004	December 31 2003	December 31 2002
Total Revenues	1,636,096	2,788,701	1,821,252
Expenses	2,768,162	19,513,827	8,128,217
Net Income (Loss) before discontinued operations and extraordinary items			
– Total	693,503	(16,725,126)	(6,318,364)
– Per Share	0.02	(0.54)	(0.24)
– Per Share (Diluted)	0.02	(0.54)	(0.24)
Total Assets	9,803,679	8,240,837	9,966,445
Working Capital (Deficiency)	2,824,588	(4,557,846)	235,850
Total Long Term Debt	600,000	–	–
Total Liabilities	3,255,036	8,388,171	3,438,965
Shareholders' Equity	6,548,643	(147,334)	6,527,480
Cash Dividend per Share	0.00	0.00	0.00

Quarterly Financial Information

Period ended December 31, 2004

	Q1	Q2	Q3	Q4	Total
Production revenue, net of royalties	64,555	903,601	286,365	381,575	1,636,096
Net income (loss)	(5,523,293)	(909,815)	6,698,361	428,250	693,503
Per share – basic	(0.13)	(0.02)	0.15	0.01	0.02
Per share – diluted	(0.13)	(0.02)	0.15	0.01	0.02

Period ended December 31, 2003

	Q1	Q2	Q3	Q4	Total
Production revenue, net of royalties	491,366	490,265	124,850	242,811	1,349,292
Net loss	(254,512)	(239,813)	(532,340)	(15,698,461)	(16,725,126)
Per share – basic	(0.01)	(0.01)	(0.02)	(0.50)	(0.54)
Per share – diluted	(0.01)	(0.01)	(0.02)	(0.50)	(0.54)

2004 ACTIVITIES

A-5 Re-Entry

The Company's primary focus in early 2004 was the completion of the A-5 re-entry operation at the Beaver River Field (the "Field") in British Columbia.

The objective of this re-entry was to generate sufficient cash flow to spud a new compartment well at the Field. The target, clearly defined on a 3-D seismic survey, was 130m of relatively low risk reservoir structure up-dip from the highest producing well in the Field.

Operations commenced in August 2003 and were completed in March 2004 with the tie-in of the well. The A-5 re-entry did not encounter any up-dip structure and intersected the reservoir at the same subsea level as the old well. It is currently producing from a previously drained section of an existing compartment at rates of approximately 600 mcf of raw gas and 700 cubic meters of formation water per day, substantially below Management's expectations. This is presently the only producing well at the Field.

Corporate Restructuring

The unsuccessful results of the A-5 re-entry were compounded by significant operational delays and cost overruns. Questerre engaged a reputable drilling consultant to plan and manage the drilling of this re-entry. The cost estimate prepared by this consultant was \$5.3 million based on a multi-well program and \$6.5 million based on a single well program. The total project costs, including completion, testing and tie-in, were over \$19 million, or almost three times the original cost estimate. Despite raising a total of \$11.5 million in cash net of financing and administrative costs, over \$9 million remained unpaid to unsecured trade creditors. Accordingly, on April 1, 2004, Questerre Beaver River Inc. ("QBR"), a wholly owned subsidiary of the Company, applied for and was granted an order by the Court of Queen's Bench of Alberta providing for creditor protection under the Companies' Creditors Arrangement Act ("CCAA").

Subsequent to QBR filing for protection under CCAA, several parties who provided goods and services in respect of the A-5 re-entry filed statements of claim against the Company with respect to those services. Several other parties indicated that they intended to advance similar claims, either jointly against the Company or, as an alternative to settlement from QBR. Although Questerre disputed liability for most of the claims advanced by parties who worked on the A-5 re-entry, and in some cases both Questerre and QBR disputed the amounts claimed, the Company believed that the cost of defending the actions could exceed its available cash resources. As well, the existence of claims and the possibility of further potential claims against the Company seriously restricted its ability to raise capital in the public markets.

On June 22, 2004, the Company sought and was granted protection under the CCAA and was added as a petitioner in QBR's CCAA proceedings.

On August 9, 2004, Plans of Compromise or Arrangement for the Company and QBR (the "Plans" or "Plans of Arrangement") were filed 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 of QBR and the Company held on August 31, 2004. The Plans were subsequently sanctioned by the Court of Queen's Bench of Alberta on September 9, 2004. Questerre and QBR subsequently emerged from Court protection 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 a Liquidity Option Agreement. See “Related Party Transactions.” Under the Liquidity Option Agreement, 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 of Questerre were issued on the implementation of these Plans. 6,756,102 Common Shares were issued to Terrenex pursuant to the Liquidity Option Agreement.

Seismic Reprocessing

The results of the A-5 re-entry necessitated a reassessment of the seismic data over the Field. The review confirmed that the false imaging of the up-dip structure was due to improper processing of the seismic data, not the interpretation.

A new processing company and geophysicist were engaged to re-process the seismic survey during the year. This reprocessing was required to correct velocity anomalies responsible for the false imaging and more accurately image the Nahanni reservoir. Two key stages of the reprocessing were completed during the year. The reprocessing has dramatically reduced the noise associated with the data and resulted in more clearly defined imaging of the Nahanni reservoir.

Based on the new interpretation, it appears the Nahanni has more potentially undrilled compartments than originally expected. Management believes this could translate into a higher recovery factor for the Field. The reprocessing has also identified a new compartment that appears to contain up-dip structure less than 500 meters away from the existing A-5 well. A new well into this compartment could test both the new compartment and up-dip hypothesis.

The reprocessing has also resulted in better imaging of the horizons above the Nahanni at a depth of 1600m – 2800 m TVD. An analysis of these horizons has indicated these could be tight gas zones, or non-conventional reservoir, where proper completion techniques play an important role in achieving commercial production. The Company continues to evaluate these new targets.

Based on these results and further interpretation of the seismic data, Questerre is currently evaluating locations to test both the shallow potential and the new compartment potential of the Field.

In early 2005, Questerre filed a statement of claim in the Court of Queen’s Bench of Alberta against the company that processed the 3-D seismic survey over the Field. The statement of claim can be viewed on the Company’s web site. Questerre anticipates the seismic processing company will file its statement of defense during the second quarter of 2005.

St. Lawrence Lowlands

The Company successfully concluded a farm-in and participation agreement covering its exploration acreage in the St. Lawrence Lowlands during the year. The farm-in partners, including a director of the Company (See “Related Party Transactions”), will collectively earn a 60% interest in the Sainte Sophie #1 well and 2,000 surrounding hectares by funding 90% of the costs. These partners will have the option of drilling additional wells on the same terms for six months from the completion of the initial well. Questerre will be responsible for funding 6 1/4% of the costs to earn a 32 1/2% interest in the well.

The Sainte Sophie #1 well was scheduled to spud by July 31, 2004. Due primarily to financing and rig availability, the operator has been unable to spud the well in 2004. To this end, Questerre has granted the operator an extension until July 1, 2005 to spud. In the interim, the Company has commenced discussions with other parties regarding additional exploration activities on its acreage.

New Projects

During the fourth quarter of 2004, the Company began evaluating and acquiring additional projects to diversify its existing portfolio.

Questerre acquired a 50% interest in 10 sections of land in west central Alberta prospective for a Swan Hills reef play. The acreage is adjacent to two discovered fields that have produced in excess of 15 million barrels each from the Swan Hills formation. During the first quarter of 2005, Questerre successfully farmed out a 26.667% interest in this well to a major independent exploration and production company. The well spud in early February and was completed by late March ahead of schedule and under budget at a cost of approximately \$3.7 million. The well did not encounter reservoir in the Swan Hills formation and was subsequently abandoned. Questerre does not have any additional financial commitments with regard to this project.

The Company also concluded a farm-in and participation agreement in the Parkland and Vulcan areas of Alberta in the fourth quarter. Prospective for natural gas in multiple horizons, Questerre participated in the drilling of two wells in late 2004 and early 2005 to earn a 50% interest in 5 sections of land. Questerre has also acquired a 50% interest in two additional sections in these areas.

In early 2005, the Company participated in the drilling of an additional well in the Vulcan area to earn a 50% interest in an additional 2 sections of land. All three wells are currently being completed and tested. Subject to successful production testing, the wells will be tied in and placed on production during the second quarter of 2005. Questerre anticipates drilling additional wells in these areas in 2005.

In conjunction with its farm-in partners in the St. Lawrence Lowlands, Questerre participated in the drilling of an exploration well in the Gaspé Peninsula of Quebec in November 2004. The well was targeting three oil and/or gas targets, characterized by seismic anomalies and structural/stratigraphic traps. Total well costs are estimated at \$1.6 million, with the Company share estimated at \$0.2 million. The well did not encounter commercial hydrocarbons and was subsequently abandoned.

To finance the drilling of wells in Alberta, the Company completed a \$3.6 million financing in the fourth quarter of 2004. The financing consisted of the issuance of a total of 12.4 million common shares on a private placement basis.

Production

The Company's production is primarily natural gas from the Field and its minority interests in non-operated producing properties in Alberta.

Production from the Field in 2004 is solely attributable to the A-5 re-entry that was placed on production in April 2004. In 2003, production from the Field is attributable to two wells – B-2 and A-5. Both these wells were shut in by year-end 2003 – the A-5 well was shut in July to drill the A-5 re-entry and the B-2 well was shut in October due to pipeline pressures and water disposal constraints.

For the year ended December 31, 2004, the Field averaged 758 mcf/d of raw gas (126 boe/d). Production peaked at 3870 mcf/d (645 boe/d) in April and gradually declined to 575 mcf/d (96 boe/d) year-end. By comparison, gross production from the Field for 2003 averaged 704 mcf/d of raw gas (117boe/d). Questerre conducted the A-5 re-entry operation on a sole risk basis; as such 100% of the production from the Field in 2004 is attributable to Questerre. In 2003, Questerre was attributed 60% of gross production from the Field.

Production from the Company's interest in non-operated producing properties in Alberta for 2004 remained unchanged from the previous year at 25 boe/d of natural gas and associated natural gas liquids.

The Company plans to grow its production base in 2005 through further exploration and development drilling in Parkland and Vulcan and the acquisition of additional lower-risk projects. Questerre expects that further drilling at the Field will commence once the Company secures a joint venture partner and sufficient financing.

2004 FINANCIAL RESULTS

Revenue

Questerre reported petroleum and natural gas revenues of \$1.94 million in 2004 (2003 – \$1.5 million). 2004 revenues included \$1.53 million (2003 – \$1.11 million) in natural gas sales from the Field and \$0.40 million (2003 – \$0.39 million) from its interest in non-operated Alberta properties. Questerre's realized natural gas prices decreased by 8% to \$6.25/mcf in 2004 from \$6.79/mcf in 2003. Decreased pricing in 2004 marginally offset increases in revenue associated with increased production.

Royalties

Crown royalties for the Field are governed by a royalty agreement with the Crown that provides for the deferral of all royalties until the earlier of June 30, 2004 and cumulative production of 13 bcf from the Field. Repayment of deferred royalties was contingent on both the commercial 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 existed. On the same basis, the Company did not accrue Crown royalties on its Field production in the first and second quarters of 2004.

The Company has accrued Crown royalties of \$0.14 million for the second half of 2004 on production from the Field. Payment of this royalty is 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 of \$2.2 million for the A-5 re-entry. Discussions are ongoing with the Ministry regarding the Company's qualification for this credit.

Due to increased natural gas revenue from the Field in 2004, overriding royalties on production in 2004 increased 50% to \$0.06 million from \$0.03 million in 2003.

Crown and gross overriding royalties on production from the Company's minor properties in Alberta in 2004 remained unchanged at \$0.1 million or 28% of gross resource revenue attributable to these properties.

Operating Costs

Total operating expenses increased 50% from \$1.1 million in 2003 to \$1.7 million in 2004. Gas processing and transportation fees, which account for 17% of operating expenses in 2004, are directly proportionate to production from the Field. These fees are based on interruptible service rates at the Duke Fort Nelson plant.

Due to the fixed nature of operating costs at the Beaver River Field, the remainder of the increase in 2004 is attributed to the Company bearing responsibility for 100% of operating costs associated with the Field, as compared to 60% in 2003.

Marketing fees in 2003 were charged at 5% of gross revenue pursuant to an existing marketing contract. This contract was terminated in 2003 and a daily spot price contract was negotiated for 2004 with substantially reduced marketing fees.

General & Administrative Expenses

General and administrative expenses of \$0.74 million in 2004 included \$0.14 million of bad debt expense recorded against amounts receivable from partners on the Beaver River Field. Overhead capitalization of \$0.4 million associated with the increased capital expenditures in the first six months of 2004 offset a significant portion of 2004 expenses.

<i>(\$ thousands)</i>	2004	2003
General & administrative expenses	\$ 1,010	\$ 1,023
Bad debt expense	139	650
Overhead recoveries	(411)	(671)
General & administrative expenses, net	\$ 738	\$ 1,002

Other Income and Expenses

During the year ended December 31, 2004, Questerre recorded restructuring expenses of \$0.43 million representing professional services associated with the Company's filings under the CCAA.

Questerre recorded a gain of \$7.63 million during the year representing the net forgiveness of outstanding amounts owing by the Company to its unsecured trade creditors. \$7.3 million of this amount related to amounts settled under the Plans.

Stock Based Compensation

Effective January 1, 2004, the Company adopted the new accounting standard for stock based compensation. See "Changes in Accounting Policies – Stock Based Compensation." This resulted in stock based compensation expense of (\$0.03) million for the year ended December 31, 2004. This was due to a recovery realized on the cancellation of share options previously expensed during the year, partially offset by the expense for share options subsequently issued.

The new accounting standard was applied retroactively without restatement of prior periods, therefore no corresponding expense was recorded in 2003.

Interest Expense

Interest expense of \$0.07 million in 2004 was relatively unchanged from 2003. In 2004, this comprised primarily of \$0.02 million in interest payable on the term bank loan and \$0.04 million in interest payable on the promissory note to Rupert's Crossing, an Investment Corporation ("Rupert's"). Rupert's is a private investment holding company controlled by Michael Binnion, the Company's President. See "Related Party Transactions". The interest expense in 2003 relates solely to the interest payable on the term bank loan.

Depletion, Depreciation and Site Restoration

Questerre recognized \$7.4 million in depletion and depreciation in 2004 compared to \$17.3 million in 2003. Included in 2004 depletion is a \$7.0 million "ceiling test" write-down and depletion charge recorded by the Company on its Field petroleum and natural gas assets. The write-down reflects the majority of the costs incurred to finish the drilling, completion and tie-in of the A-5 re-entry in 2004. Depletion for 2004 also includes \$0.2 million relating to the Company's costs of an unsuccessful well in the Gaspé Peninsula, Quebec. As of December 31, 2004, all costs associated with the Beaver River Field, net of salvage values, have been written down and included in depletion, except \$2.9 million of geological and geophysical costs.

Included in 2003 depletion is a \$16.7 million "ceiling test" write-down recorded by the Company on its Field petroleum and natural gas assets. Based on the reserve evaluation, the Company had no proved or probable reserves associated with the Field at December 31, 2003.

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. This asset remains unproved at December 31, 2004.

The Company's estimated undiscounted asset retirement cost for the Beaver River Field at December 31, 2004 was \$1.8 million (2003 – \$0.89 million). The increase of \$0.9 million during the year was based on Management's revised assessment of asset retirement costs associated with the Field. Accretion of asset retirement obligations for the year ended December 31, 2004 was \$0.09 million (2003 - 0.06 million). Questerre did not acquire any new properties in 2003 or 2004 that would result in additional asset retirement obligations.

Taxes

Consistent with prior years, Questerre had sufficient tax pool deductions to offset taxable income in 2004 resulting in no income taxes payable for the current year. In addition, the Company's tax assets continue to significantly exceed tax liabilities. No tax asset is recognized at December 31, 2004 as there is no certainty that the Company will be able to realize the value of the tax assets in the future.

The Company recorded a \$1.8 million recovery in recognition of the tax benefit of flow-through shares issued in 2004.

The Company has non-capital loss carryforwards at December 31, 2004 of \$0.71 million. This represents non-capital losses created in 2004 and, therefore, expire in 2011. The non-capital losses accumulated to December 31, 2003 were used to offset the taxable income related to the gain on settlement of obligations.

Net Loss and Cash Flow

Questerre recorded net income of \$0.07 million (\$0.02 per share) in 2004 compared to a net loss of \$16.7 million (\$0.54 per share) in 2003. The net income for the year is primarily due to the gain on settlement of all outstanding obligations under the Plans and the recovery due to future tax on flow-through shares offset by higher depletion including a \$6.2 million ceiling test write-down.

LIQUIDITY AND CAPITAL RESOURCES

Capital Expenditures

Questerre incurred capital expenditures of \$7.48 million in 2004 compared to \$14 million in 2003.

The majority of capital spending in 2004 at the Field related to the drilling, completion and tie-in of the A-5 re-entry. In Quebec, approximately \$0.2 million was spent on the drilling of the Miguasha #1 well with the remainder incurred in the St. Lawrence Lowlands. In Alberta, Questerre incurred approximately \$0.8 million in drilling costs in the Parkland area with the remainder spent on land acquisition in the Vulcan and Simonette areas.

The majority of 2003 capital spending related to the Field – primarily the drilling of the A-5 re-entry. Capital expenditures on the Company's Lowlands acreage were largely directed to the acquisition of exploration licenses. In May 2003, the Company issued 750,000 common shares at a deemed price of \$1.00 per share, to Terrenex on the termination of a farmout agreement covering the St. Lawrence Lowlands licenses. Subsequent to terminating the agreement, Questerre successfully obtained the exploration licenses previously covered by this agreement.

<i>(\$ thousands)</i>	2004	2003
Capital Expenditures		
Beaver River Field, British Columbia	\$ 6,271	13,090
St. Lawrence Lowlands & Gaspé, Quebec	287	876
Alberta Properties	917	72
Total	\$ 7,475	14,038

Working Capital Position

Questerre reported a working capital surplus of \$2.76 million at December 31, 2004 as compared to a working capital deficiency of \$4.56 million as of December 31, 2003.

Questerre's current assets at December 31, 2004 primarily consist of cash of \$2.7 million, accounts receivable of \$0.22 million and field inventory of \$0.14 million. It also includes \$0.4 million placed in trust with the operator for the drilling of the Sainte Sophie #1 well on the Company's acreage in the St. Lawrence Lowlands in Quebec. Due to delays in spudding this well, this amount was refunded to the Company during the first quarter of 2005. In addition \$0.12 million is held as a deposit with the Crown in British Columbia as deposits for reclamation and abandonment costs at the Beaver River Field.

Questerre's current liabilities consist of trade payables of \$0.57 million and \$0.23 million representing the term bank loan that has been classified as a current liability.

The majority of the Company's cash holdings were used to finance drilling and completion activities in Alberta during the first quarter of 2005. The Company incurred expenditures of approximately \$2.4 million to finance the drilling and completion of wells in the Parkland, Vulcan and Simonette areas of Alberta. The Company anticipates it will need to raise additional capital to finance further exploration and development work in the Parkland and Vulcan areas and new project acquisition in 2005.

Revenue from the Field and its non-operated properties in Alberta does not generate sufficient cash to maintain the Company's current level of expenditures. The Company expects that, based on successful testing, its recently drilled wells in Parkland and Vulcan will significantly improve near-term cash flow. The Company plans to further enhance cash flow through additional drilling in these areas in conjunction with the acquisition of lower-risk exploration and development projects.

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. At December 31, 2004, there were no Class B common voting shares or preferred shares outstanding.

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 this offering were primarily used to finance the drilling and completion of the A-5 re-entry at the Field.

On September 21, 2004, the Company issued a total of 9,623,012 common shares on the implementation of the Plans of Arrangement under the CCAA.

On December 22, 2004 the Company completed a private placement for 2,638,000 common shares and 9,825,000 flow-through common shares for gross proceeds of \$3.61 million. Proceeds from this placement were primarily used to finance acquisition and drilling of new projects in Alberta.

At December 31, 2004, there were no Class B common voting shares or preferred shares outstanding, a total of 66,751,904 common shares outstanding and 3,365,000 stock options outstanding. An additional 2,000,000 common shares have been reserved for the conversion of the \$0.6 million promissory note.

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 annual commitment under this agreement is \$126,000 for 2005.

The Company is responsible for principal payments on its bank loan in the amount of \$80,400 annually in 2005 and 2006 and \$73,700 in 2007.

Off-Balance Sheet Arrangements

Questerre has no off-balance sheet arrangements.

Related Party Transactions

In August 2004, the Company entered into a Liquidity Option Agreement with Terrenex to facilitate acceptance of the Plans by the unsecured creditors of Questerre and QBR. Pursuant to the Liquidity Option Agreement, Terrenex funded a payment of \$0.07 per Common Share to those unsecured creditors that did not wish to hold the Common Shares received under the Plans (the "Liquidity Option"). In consideration for this payment, Terrenex was issued that number of Common Shares that, but for their election to participate in the Liquidity Option, would have been issued to the unsecured creditors. The Common Shares issued to Terrenex are subject to the same contractual hold period were they issued to these unsecured creditors. For fulfilling its obligations under the Liquidity Option Agreement, Terrenex was issued 300,000 Common Shares of the Company.

On the approval of the Plans on August 31, 2004, unsecured creditors of Questerre and QBR with claims totalling \$6.7 million elected to participate in the Liquidity Option. Terrenex funded a payment of \$0.47 million to these unsecured creditors and was issued 6,756,102 Common Shares.

Questerre incurred fees of \$126,000 for the years ended December 31, 2004 and 2003 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.

In June 2004, Questerre entered into a farmout agreement with a director of the Company. The farmout agreement covers the Company's exploration acreage in the St. Lawrence Lowlands, Quebec utilizing the same terms and conditions of a farmout agreement with independent arms-length parties.

In June 2004, the Company obtained \$0.5 million on the issue of a \$0.5 million promissory note to Rupert's. Rupert's is a private investment holding company controlled by the President and Chief Executive Officer of Questerre. The promissory note was originally due on November 14, 2004 with interest calculated at 12% per annum, payable monthly. The promissory note is secured by a General Security Agreement over the assets of the Company and the hypothecation of the Company's exploration licenses in Quebec.

In August 2004, the Company amended its \$0.5 million financing agreement with Rupert's when Rupert's advanced an additional \$0.1 million which was placed in trust with the Company's legal counsel. Upon the approval of the Plans, these funds were advanced to the Company on the same terms as the original \$0.5 million. The funds were used to finance a portion of the cash component of the Plans.

In October 2004, the Company further amended the terms of the \$0.5 million financing agreement with Rupert's when Rupert's advanced an additional \$0.08 million to the Company for general working capital. The advance was made on the same terms as the original advance of \$0.5 million. The \$0.08 million was repaid in December 2004.

In November 2004, the Company and Rupert's amended the terms of the financing agreement extending the due date of the promissory note from November 14, 2004 to November 14, 2006 and reducing the interest rate from 12% per annum to 8% per annum. The Company has been granted 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. As at December 31, 2004, a total of \$0.6 million is due to Rupert's under this financing agreement.

Financial Instruments

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

Virtually all of the Company's accounts receivable are for revenue due on production from the Field and the Company's minority interest in non-operated properties in Alberta. The Company is not exposed to significant credit risks.

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.

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. In the second quarter of 2004, the Company increased its estimated undiscounted asset retirement cost for the Field from 0.9 million to \$1.8 million. The \$0.9 million increase was added to the asset retirement obligation and also capitalized as part of the carrying amount of the related asset.

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.

CHANGE IN ACCOUNTING POLICIES

The following new and amended standards were implemented by the Company in 2004 with the following impact on the 2004 financial statements.

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 \$70,527 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.

The previously reported amounts for 2003 have been restated due to the retroactive application of this new standard. Adoption of this standard had the following effects on the Company’s consolidated balance sheet and statement of income and deficit for the year ended December 31, 2003:

Increase in petroleum and natural gas properties:	\$ 20,600
Decrease in future site restoration and abandonment liability:	878,833
Increase in asset retirement obligation	(848,134)
Increase in opening deficit	408,201
Decrease in site restoration expense	(525,285)
Increase in depletion and depreciation expense	10,300
Increase in asset retirement obligation accretion expense	55,485

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 \$6.2 million ceiling test write-down for the year ended December 31, 2004 related to the Field and a \$0.2 million write-down relating to the Company’s share of an unsuccessful well drilled in Quebec. The write-downs are included in the depletion and depreciation provision on the income statement.

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. Being the operator and maintaining a high working interest in its properties allows the Company to best manage operational risk by giving the Company control over costs and timing of expenditures, and the method and sales of production. Where the Company is not the operator of a property, it strives to develop a good working relationship with the operator and the other partners in the property 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 rate for a period of time.

Potential risks to the environment are inherent in some of the business activities of the Company. Questerre intends 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.