



Q2

*Questerre  
energy*

*...realizing  
our potential*

2007 INTERIM REPORT



**Questerre Energy Corporation is a Calgary-based petroleum and natural gas exploration and production company. The Company aims to create shareholder value through the development of scalable, high-impact projects.**

**Questerre's common shares are listed on the Toronto Stock Exchange and Oslo Stock Exchange under the symbol QEC.**

## PRESIDENT'S MESSAGE

In the second quarter of 2007 we achieved our best financial results to date. We attained both quarter over quarter and year over year growth in cash flow from operations. These operating results coupled with our strong balance sheet well position Questerre to capitalize on any opportunities that may arise.

Due to the wet weather and unusually long spring breakup, the second quarter was quiet operationally. Our primary focus was the planning for the A-8 Nahanni well. This well will be the biggest operation in our Company's history.

### *Highlights*

- Quarterly cash flow from operations increased to \$3.18 million from \$1.08 million in 2006
- Daily production for the quarter increased 127% to 1,443 boe/d from 635 boe/d in 2006
- \$10 million received from Transeuro to complete earn-in obligations at the Beaver River Field
- Talisman commits to follow-on exploration in the St. Lawrence Lowlands
- Two wells drilled to test shale gas play on the Yamaska permits in the Lowlands

### *Beaver River Field*

Cognizant of the challenges associated with operating in frontier areas and the scale of the work program, we diligently planned the logistics and well operations for this summer.

Our philosophy is that minimizing the day rate helps mitigate the financial risks associated with operational challenges. In keeping with this low-cost approach that was successful with the B-3 well, we continued to purchase additional equipment that will payout over this season. Furthermore, we took advantage of current market conditions to secure longer-term contracts at preferential rates while minimizing or eliminating standby charges.

Equipment mobilization commenced in July and initial operations are underway with the completion and testing of the B-3 and A-7 wells for possible production from the Mattson. The Mattson is an 800 – 1,000 m thick section of interbedded shales, siltstone and sandstone that, based on our analysis, has the potential to host significant gas in place. The key to unlocking this potential will be to identify the prospective intervals in this horizon and develop the optimal completion and stimulation techniques to sustain commercial flow rates.

With our partner, Transeuro, we have initially planned two different completion techniques : a nitrogen-energized gelled water and an emulsified CO<sub>2</sub> to assess their effectiveness in this horizon. We also engaged Netherland Sewell & Associates (“NSA”), a Houston-based engineering firm to prepare an independent report on the Mattson resource potential. NSA has extensive experience evaluating unconventional reservoirs and we expect their input will be invaluable.

While developing the appropriate stimulation techniques is key to the Mattson, the challenge with the deeper Nahanni is proving the existence of undrilled compartments and unswept areas of this horizon.

Following the results from the A-5 well in 2004, we have reprocessed and reinterpreted our 3-D survey over the Field. This has included a pre-stack depth migration of the data set completed late last year. Independently, Transeuro processed and interpreted the survey. Both interpretations have identified a structurally high, undrilled fault compartment. This compartment will be the primary target for the new A-8 well. This well will also test several uphole prospects including the A-2 interval in the Mattson sands, the Mississippian carbonates and the Devonian shales.

Notwithstanding the potential of these unevaluated horizons, we continue to believe a successful Nahanni well could have a major impact on Questerre. The Nahanni is a highly productive formation in the Beaver River Field and in the surrounding area, including Pointed Mountain, Kotaneelee and Chevron Liard. Nahanni wells at Beaver River have produced at rates between 12 mmcf/d (2,000 boe/d) to over 50 mmcf/d (8,300 boe/d) and recovered, on average, approximately 30 Bcf per well. Success of the new well will support up to 10 additional locations we have identified to recover an estimated 120 Bcf in gross possible reserves with a remaining resource potential of 540 Bcf.

### *St. Lawrence Lowlands*

The preliminary test results from the Gentilly #1 discovery well validated our exploration concepts in the Lowlands and provided the impetus for future exploration work.

During the quarter, our partner, Talisman, elected to proceed with an additional seismic acquisition program to further evaluate our acreage. We have been working with them to reprocess existing seismic data over two prospective areas to firm up the extent of the seismic program. We understand that permitting for this program started this month with field work to commence later this fall. Subject to the results from the seismic program and Talisman's election, we will participate with them in drilling additional wells in early 2008.

Contiguous to our acreage with Talisman, Gastem spud two back-to-back wells on the Yamaska permits. In early 2007, we exchanged a 50% working interest in these permits for a 7.5% gross overriding royalty convertible into a 20% working interest. This allowed a major US independent, Forest Oil Corporation, to earn an option to evaluate these wells and spend up to \$10 million to earn a 60% interest in the permits.

The St. Francois du Lac #1 and St. Louis de Richelieu wells were drilled by Gastem to evaluate primarily the fractured Utica shale as a possible resource play in the Lowlands. The Utica appears to be an analog to the producing Ohio shales in the Appalachian Basin to the south. Both wells were completed on budget and on schedule. Based on our discussions with Gastem, we were pleased to learn that, in conjunction with their partner, they are planning to complete and stimulate both wells, including a possible horizontal leg into these shales.

### *Southern and Central Alberta*

We participated in the drilling of two (0.98 net) wells in Alberta during the second quarter. The first (0.33 net) well was drilled in Vulcan with our joint partners as a follow up to the discovery well drilled late in the first quarter of this year. The second (0.65 net) well was drilled in Westlock to test an oil target. The wells in Vulcan will be tied in this year and we expect to test the Westlock well in the third quarter.

### *Corporate*

Early in the third quarter, we entered into an agreement with a Canadian bank for a \$7.5 million credit facility. However, we expect that our capital budget for the remainder of 2007 will be funded from our existing working capital and cash flow.

### *Outlook*

We are looking forward to the spud of the A-8 Nahanni well in the third quarter. This project is second only to Quebec in upside potential to Questerre. Our positive financial results, strong balance sheet and experience in Northern Canada well position us to be successful in the A-8 operation.



*Michael Binnion  
President and Chief Executive Officer*

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") was prepared at, and is dated, August 8, 2007. This MD&A is provided by Management of Questerre Energy Corporation ("Questerre" or the "Company") to review second quarter 2007 activities and results as compared to the same period in the prior year. This MD&A should be read in conjunction with the unaudited interim consolidated financial statements for the six months ended June 30, 2007 and the audited consolidated financial statements for the year ended December 31, 2006.

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.

Item	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
<b>Financial (\$)</b>				
Petroleum and natural gas sales	<b>6,555,860</b>	2,158,396	<b>14,058,296</b>	3,318,993
Funds generated from operations	<b>3,183,088</b>	1,083,075	<b>6,229,817</b>	1,330,063
Per Share – Basic	<b>0.021</b>	0.008	<b>0.040</b>	0.011
Per Share – Diluted	<b>0.020</b>	0.008	<b>0.038</b>	0.010
Net Earnings (loss)	<b>980,543</b>	2,842,727	<b>1,774,445</b>	2,242,745
Per Share – Basic	<b>0.006</b>	0.022	<b>0.011</b>	0.018
Per Share – Diluted	<b>0.006</b>	0.021	<b>0.011</b>	0.018
Capital Expenditures (including acquisitions)	<b>3,297,067</b>	10,345,506	<b>10,460,246</b>	16,896,564
Working Capital	<b>29,911,344</b>	13,092,540	<b>29,911,344</b>	13,092,540
Total Assets	<b>80,758,475</b>	52,606,238	<b>80,758,475</b>	52,606,238
Shareholders' Equity	<b>62,412,993</b>	44,077,413	<b>62,412,993</b>	44,077,413
Weighted Average Common Shares Outstanding				
Basic	<b>155,198,536</b>	129,681,964	<b>155,194,720</b>	123,642,940
Diluted	<b>161,897,966</b>	133,483,848	<b>162,174,451</b>	127,691,278

### Operations (units as noted)

Average Production				
Crude Oil and Natural Gas Liquids (bbls/d)	<b>168</b>	87	<b>189</b>	58
Natural Gas (mcf/d)	<b>7,650</b>	3,286	<b>8,297</b>	2,443
Total (boe/d)	<b>1,443</b>	635	<b>1,572</b>	464
Average Sales Price				
Crude Oil and Natural Gas Liquids (C\$/bbl)	<b>65.69</b>	67.08	<b>64.99</b>	67.08
Natural Gas (C\$/mcf)	<b>7.96</b>	5.35	<b>7.86</b>	5.90
Total (\$/boe)	<b>49.83</b>	36.86	<b>49.30</b>	39.25
Netback (\$/boe)				
Total Revenue	<b>49.91</b>	37.39	<b>49.41</b>	39.45
Royalties	<b>10.61</b>	7.29	<b>12.11</b>	9.83
Percent	<b>21.26</b>	19.50	<b>24.51</b>	24.92
Field Operating Expense	<b>11.19</b>	9.06	<b>11.09</b>	11.71
Operating Netback	<b>28.11</b>	21.04	<b>26.21</b>	17.91
Net Cash G&A	<b>4.52</b>	4.27	<b>4.97</b>	5.46
Cash Netback	<b>23.59</b>	16.77	<b>21.24</b>	12.45
Wells Drilled				
Gross	<b>2.0</b>	6.0	<b>10.0</b>	13.0
Net	<b>0.98</b>	3.21	<b>6.49</b>	6.71

## HIGHLIGHTS

- Quarterly cash flow from operations increased to \$3.18 million from \$1.08 million in 2006
- Average daily production for the quarter increased 127% to 1,443 boe/d from 635 boe/d in 2006
- \$10 million received from Transeuro to complete earn-in obligations at the Beaver River Field
- Talisman commits to follow-on exploration in the St. Lawrence Lowlands
- Two wells drilled to test shale gas play on the Yamaska permits in the Lowlands

## SECOND QUARTER 2007 ACTIVITIES

### *Beaver River Field, British Columbia*

During spring breakup, Questerre focused on the planning for the upcoming summer work program at the Beaver River Field (the “Field”).

The work program will involve evaluation of the shallow Mattson horizon with the completion and testing of the A-7 and B-3 wells and the spud of a new well, A-8, to test multiple horizons, particularly the deep Nahanni horizon.

The A-7 and B-3 wells were drilled in late 2006 and early 2007 respectively to appraise and delineate the A-2 discovery well. Production from the Mattson for the A-2 well averaged approximately 3.2 mmcf/d (533 boe/d) for the quarter. While neither well has access to the producing Mattson interval in the A-2 well, analysis of the drilling logs identified other prospective intervals in both wells.

In conjunction with its partner, Transeuro Energy Corp. (“Transeuro”), Questerre proposes to utilize two different stimulation techniques — a nitrogen-energized gelled water and an emulsified CO<sub>2</sub> — to determine which is more effective for this horizon. To assist in the evaluation of the Mattson, the partners have engaged Netherland Sewell & Associates Inc. (“Netherland Sewell”) to prepare an independent report on the Mattson resource potential at the Field. Netherland Sewell is a Houston-based reservoir-engineering firm with extensive experience evaluating shale gas and other unconventional reservoirs.

The A-8 well will target a structurally high undrilled Nahanni fault block identified on the reprocessed 3-D seismic survey. In addition to the primary Nahanni target, the well has been designed to test three additional zones of interest including the Mattson, Mississippian fractured carbonate and the Devonian shale. Lease construction commenced early in the middle of the third quarter and the well is scheduled to spud this August.

In April 2007, Questerre received a cash payment of \$10 million from Transeuro to complete its earn-in obligations at the Field. In consideration of this payment, Transeuro was released from its obligations to drill additional wells at its sole cost. Upon receipt of this payment, Questerre and Transeuro each hold a 50% interest in all producing and prospective horizons in the Field and the associated infrastructure.

### *St. Lawrence Lowlands, Quebec*

In June 2007, Talisman Energy Inc. (“Talisman”) elected to exercise its option to conduct additional exploration work on Questerre’s acreage in the St. Lawrence Lowlands. Subject to Talisman completing its earning on the remaining acreage, Questerre will hold a net 21.25% working interest in addition to a gross overriding royalty (“GORR”) on any production from Talisman.

Talisman has committed to acquiring an additional 2-D seismic survey. The seismic program will assist in evaluating and determining future exploration drilling locations on the remaining unearned land. The seismic acquisition program is scheduled to begin in the fall, subject to surface access, regulatory approval and equipment availability.

Talisman’s election follows the further testing of the discovery well, Gentilly #1, in the second quarter. The well is now shut-in after the testing of several intervals within the Trenton Black-River formation. During the primary three-day clean-up period, the well initially flowed at rates between 4.5 mmcf/d and 9.5 mmcf/d. However, during additional testing, the final gas flow rates declined into the range of 340 mcf/d to 630 mcf/d with associated water inflows ranging from 5 bbls/d to 344 bbls/d. Lower rates of water production were noted in the uppermost tested interval.

Given the test results to date and the high costs associated with the long tie-in to the existing pipeline and distribution system, the Gentilly #1 well will be suspended, contingent on future area appraisal and development. The commerciality of the Gentilly area will require additional successful wells to warrant the necessary capital investment in equipment and infrastructure.

Towards the end of the quarter, Questerre's partner, Gastem Inc. ("Gastem"), spud two wells on the jointly held Yamaska licenses in the Lowlands. These licenses cover over 100,000 acres and lie adjacent to Questerre's farmout lands with Talisman. Questerre holds a 7.5% GORR convertible into a 20% working interest in these licenses.

The St. Francois du Lac No. 1 and St. Louis de Richelieu wells were drilled to evaluate the fractured Utica shale sequence. Both wells were completed on schedule and budget to a target depth of approximately 1700m. Gastem is presently evaluating the data gathered from these wells and plans to complete and test them later this year.

Gastem has entered into a farm-in agreement with a major US independent for these licenses. The agreement allows its partner to evaluate these wells, including testing and fracture stimulation of the Utica shales. The partner may commit to further exploration work of up to \$10 million to earn a 60% working interest in these permits.

### *Southern and Central Alberta*

In its core area of Vulcan, Southern Alberta, Questerre participated in the drilling of one (0.33 net) well in May 2007. The well is the second drilled under a recent participation and farm-in agreement with two industry partners. The partners elected to drill a third well in the third quarter and have an option to drill one additional well.

The first two wells were drilled for new Mannville exploration targets adjacent to Questerre's existing Mannville G Pool and tested early in the third quarter. One well flowed at 340 boe/d on an 18/64" choke during the last 24 hours of a three-day flow test. The second well flowed at 80 boe/d on a 24/64" choke during the last 24 hours of a three-day flow test. Questerre and its partners are evaluating tie-in options to the local gathering system for these wells.

The Company drilled one (0.65 net) well in the Westlock area targeting a new Mannville exploration play. As of the date of this report, testing of this well is underway.

## **DRILLING ACTIVITIES**

For the second quarter of 2007, the Company participated in the drilling and testing of two (0.98 net) wells resulting in one (0.33 net) gas well and one (0.65 net) unevaluated well for a 50% success rate.

## **PRODUCTION**

Questerre's daily production averaged 1,443 boe/d during the second quarter of 2007 and 1,572 boe/d for the first six months of the year. This represents a 127% increase over production of 635 boe/d for the three months ended June 30, 2006 and 238% increase over production of 464 boe/d for the six months ended June 30, 2006. In comparison to average daily production of 1,702 boe/d in the first quarter of 2007, production in the second quarter decreased 15%.

The decrease in production over the preceding quarter is due to natural declines as well as power outages and capacity constraints. In Vulcan, approximately 20 boe/d of oil production over the quarter was shut in due to a power outage and pressure survey of the oil pool. At the Field, higher than expected line pressure in the Spectra Energy pipeline and the absence of boost compression has resulted in lower production than expected from the A-2 well.

The Company's assets in Vulcan represent the majority of Questerre's production in 2007. During the second quarter of 2007, Vulcan accounted for 917 boe/d or approximately 64% of the average daily production. By comparison in 2006, Vulcan contributed 211 boe/d or 33% of the Company's average daily production. Vulcan production increased dramatically in 2007 when the Company received approval from the Alberta Energy and Utilities Board for its Good Production Practice ("GPP") plan for the Mannville G Pool. Production from the Company's other assets in Alberta, grew to 259 boe/d in the second quarter of 2007 from 196 boe/d for the same period in 2006. Due to the higher production from Vulcan, this production only contributes 18% of total volumes in 2007 as compared to 31% in 2006.

Production from the Beaver River Field is attributable in its entirety to the A-2 well. The A-2 well was an Amoco well that was recompleted by Transeuro in 2005 and placed on production at the end of the first quarter of 2006. Cumulative production from the A-2 well from the Mattson is approximately 1.5 Bcf. During the second quarter of 2007, production from the Field averaged 267 boe/d or just under 20% of daily production. For the same period in 2006, production from this well averaged 185 boe/d or 29% of daily production.

The Company's gas weighting remained at 88% for the first half of 2007 and increased slightly from 86% during the first half of 2006. Excluding 48 boe/d of 25° API oil production from the Grand Forks area, Questerre's oil production is light oil and associated natural gas liquids from the Vulcan area.

Questerre anticipates the successful wells in Vulcan will be tied-in and placed on production early in the fourth quarter. Subject to the test results from the A-7 and B-3 wells at the Field, Questerre expects these will be tied-in to the local gathering system later this year.

## **SECOND QUARTER 2007 FINANCIAL RESULTS**

### *Revenue*

For the three months ended June 30, 2007, Questerre reported petroleum and natural gas revenue of \$6.55 million. This compares to petroleum and natural gas revenue of \$2.16 million for the same period in 2006 and \$7.5 million for the preceding period in 2007.

Increased natural gas production during the second quarter of 2007 benefited from higher prices than prices during the same period in 2006. By comparison to the prior period in 2007, decreased gas production in the second quarter was, by and large, offset by marginally higher realized prices.

Index natural gas prices over the second quarter of 2007 averaged \$7.02/mcf and declined approximately 14% during the quarter. The decline reflects the record storage levels and the increased US gas production that appears to have compensated for any declines in Canadian gas production. Questerre realized natural gas prices of \$7.96/mcf during the quarter (2006: \$5.35/mcf), primarily reflecting the higher heat content of its gas production from Vulcan.

Conversely, oil prices remained relatively buoyant during the quarter and the Edmonton Light reference price averaged \$71.87/barrel and increased by 3%. The pricing reflects perceived threats to international supply and the limited excess supply capacity. On average, Questerre realized prices of \$65.69/barrel during the quarter (2006: \$67.08). The realized pricing mainly reflects the premium for its Vulcan oil production offset by the discount for the Company's heavier oil production from the Grand Forks area.

Questerre does not utilize any hedging or fixed price contracts on its production.

### *Royalties*

Questerre recorded royalty expense of \$1.39 million for the second quarter (2006: 0.42 million) and \$3.45 million for the six months ended June 30, 2007 (2006: \$0.83 million).

This resulted in an effective royalty rate as a percentage of revenue of 21.26% (2006: 19.50%) and 24.51% for the year to date (2006: 24.92%). This rate is lower than the 27.36% realized in the first quarter of 2007 mainly due to a one-time adjustment for crown royalty credits for 2006 operating costs in Alberta recorded in the second quarter of 2007.

In the second quarter of 2007, royalties on Field production increased marginally to 18.5% from 17.66% in the first quarter. For the second quarter of 2006, the Company qualified for a \$0.1 million summer drilling royalty credit, resulting in minimal royalties payable. Questerre expects its royalty rate on Field production to increase in 2008 as new wells will attract a higher base rate.

### *Operating Costs*

For the quarter ended June 30, 2007 operating expenses increased to \$1.47 million from \$0.52 million for the same period in 2006. By comparison, operating expenses for the quarter ended March 31, 2007 were \$1.69 million.

Operating expenses for the Company's Alberta production totaled \$1.03 million in the second quarter of 2007 (2006: \$0.35 million). On a boe basis, this equates to \$9.61 or a decrease of 12% from \$10.94 in 2006 and on par with \$9.88 per boe in the first three months of 2007.

Consistent with the increased volumes and activity at the Field, operating expenses for the second quarter of 2007 were \$0.44 million, unchanged from \$0.45 million in the first quarter. By comparison, the lower production volumes and operations during the second quarter of 2006 resulted in lower operating costs of \$0.17 million. Excluding transportation and processing charges of approximately \$6.30/boe, Questerre expects net fixed Field operating expenses to average \$0.1 million per month for the remainder of the year.

### *General & Administrative Expenses*

In 2007, Questerre recorded general and administrative expenses (“G&A”) of \$0.59 million, net of capitalized overhead and bad debt expense for the quarter (2006: \$0.25 million) and \$1.42 million for the year to date (2006: \$0.46 million). Despite the higher production volumes, the higher gross expenses due to increased staffing in 2007 saw G&A expenses per boe for the second quarter increase to \$4.52 from \$4.27 in 2006, but decrease on a quarter over quarter basis from \$5.36 in the first quarter of 2007.

For the six months ended June 30, 2007, Questerre 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.

(\$ thousands)	2007	2006
General & administrative expenses	1,702	996
Bad debt expense	200	–
Overhead capitalization	(487)	(537)
General & administrative expenses, net	1,415	459

### *Stock Based Compensation*

Questerre recorded stock based compensation expense of \$0.36 million for the quarter ended June 30, 2007 (2006: \$0.30 million), an increase of 10% from the prior quarter of \$0.33 million. The expense relates to the options granted in prior years and during the quarter. As at June 30, 2007, Questerre had 12.95 million options outstanding at a weighted average exercise price of \$0.60 per option.

### *Other Income and Expenses*

Questerre realized a gain on the disposition of marketable securities of \$0.21 million during the quarter (2006: (\$0.01 million)) and \$0.55 million for the first half of 2007 (2006: (\$0.02 million)). The Company’s marketable securities portfolio represents investments in junior exploration and production companies.

In accordance with the new accounting guidelines, the Company has classified these securities as held for trading and marks these securities to market value every quarter. This ‘mark to market’ adjustment is recorded as an unrealized gain or loss on the income statement. At June 30, 2007, the Company held marketable securities with a market value of \$2.79 million (2006: \$0.34 million).

The results for the six months include an adjustment to the valuation of share purchase warrants included in the marketable securities portfolio that relates to the opening transition reflecting new accounting policies adopted in 2007 (See Note 2 to Financial Statements) and the results of the first quarter of 2007. Based on the difference between a Black-Scholes pricing model now being used and a valuation used by the Company in the first quarter, the Company increased its unrealized gains on marketable securities for the three months ended March 31, 2007 by \$313,936 and the opening deficit for the change in accounting policies by \$75,961.

The payment of \$10 million received from Transeuro to complete its earn-in obligations was classified as proceeds on the sale of a portion of the Company’s interest in the Field. Utilizing a cost base of \$8.50 million, Questerre realized a gain of \$1.50 million in the second quarter of 2007 for this transaction.

### *Depletion, Depreciation and Accretion*

Questerre recognized \$2.53 million in depletion and depreciation for the three months ended June 30, 2007 (2006: \$0.82 million) and \$5.87 million for the first six months of 2007 (2006: \$1.40 million). On a boe basis, year to date depletion increased by 24% to \$20.61 from \$16.60 in 2006. The increase reflects the higher depletable base of the Company due to the capital spending over the last eighteen months, offset by the credit for the cost of the Beaver River assets sold to Transeuro. Quarter over quarter, the depletion rate in the second quarter of 2007 of \$19.23/boe was approximately 12% lower than the rate in the first quarter of \$21.80/boe.

Questerre does not include costs of \$12.68 million (2006: 4.78 million) relating to unproved properties in the calculation of depletion or in costs subject to the ceiling test calculation. During the quarter, the Company incurred expenditures of \$2.99 million on drilling, land acquisition and seismic relating to unproved properties.

The Company estimates its total undiscounted future liability for asset retirement obligations to be approximately \$4.49 million, with a present value of \$3.80 million at June 30, 2007. Accretion of asset retirement obligations in the second quarter was unchanged from the first at \$0.03 million.

### *Taxes*

Consistent with the prior year, Questerre had sufficient tax pool deductions to offset taxable income in the second quarter of 2007 resulting in no current income taxes payable for the quarter. In addition, the Company's tax assets exceed tax liabilities. No tax asset is recognized at June 30, 2007 as there is a very low probability that the Company will be able to realize the value of the tax assets in the future.

### *Net Earnings and Cash Flow*

Questerre recorded net earnings of \$1.77 million (\$0.01/share) for the first half of 2007 compared to \$2.24 million (\$0.02/share) in 2006. The net gain in 2007 represents the gain on the sale of a portion of its working interest in the Field to Transeuro. In 2006, the earnings represents a future tax recovery to offset the deferred tax liability associated with a flow-through share issuance renounced that year.

Excluding these non recurring amounts, Questerre had earnings of \$0.27 million for the six months ended June 30, 2007 and a loss of \$0.66 million for the same period in 2006.

Funds generated from operations for the three months ended June 30, 2007 were \$3.18 million, a minor improvement over the preceding quarter of \$3.05 million and a significant improvement over \$1.08 million for the second quarter of 2006. The improved cash flow can be attributed to higher daily production volumes and improved natural gas prices.

## **CAPITAL EXPENDITURES**

Questerre incurred capital expenditures of \$10.46 million in the first half of 2007 compared to \$16.90 million in 2006. Approximately \$5.11 million was incurred in British Columbia for the drilling of the B-3 well with \$4.68 million incurred in Central and Southern Alberta and the balance in Quebec.

(\$ thousands)	2007	2006
Capital Expenditures		
Central and Southern Alberta	4,675	16,705
Beaver River Field, British Columbia	5,113	149
St. Lawrence Lowlands, Quebec	672	42
Total	10,460	16,896

Capital expenditures of \$16.90 million in 2006 related mainly to the active drilling programs in Vulcan and Westlock and the acquisition of Stride.

## **CAPITALIZATION AND FINANCIAL RESOURCES**

Questerre reported a working capital surplus of \$29.91 million at June 30, 2007 as compared to \$22.70 million at December 31, 2006. Current assets at June 30, 2007 consisted primarily of \$35.54 million in cash and \$5.39 million in receivables. Questerre's current liabilities consisted mainly of trade payables and cash calls payable of \$14.45 million. The cash and equivalents at the end of the quarter includes the \$10 million payment by Transeuro and an additional \$7.7 million cash call from Transeuro for the Nahanni well.

Questerre believes that its capital expenditure program for the remainder of this year of approximately \$24 million will continue to be financed by existing working capital and cash flow.

In August 2007, the Company entered into an agreement with a Canadian chartered bank for a \$7.50 million credit facility. The credit facility bears interest at the bank's prime rate plus 0.50% and is payable on demand. The assets of the Company are pledged as security for the facility under a general security agreement.

## 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 June 30, 2007 and August 9, 2007, there were no Class B common voting shares or preferred shares outstanding and there were a total of 155,207,583 Common Shares outstanding and 12,946,253 stock options outstanding.

The Company issued 15,833 Common Shares during the quarter on the exercise of stock options by a former employee at an average exercise price of \$0.25 per share.

## CONTRACTUAL OBLIGATIONS

Questerre is party to an Office Rental Agreement with a related party for the provision of offices, office equipment and support personnel. Either party may terminate the agreement with six months written notice. Questerre's commitment under this agreement for the remainder of 2007 is \$63,000. A total of \$63,000 was paid in 2007 and 2006 under this agreement.

The Company is obligated to make total payments under another operating lease of \$57,906 for the remainder of 2007 and \$115,812 in each of the following years: 2008, 2009 and 2010.

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 June 30, 2007, the Company had spent approximately \$9.82 million on CEE and had a remaining commitment of \$0.18 million.

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 at June 30, 2007, the Company drilled four wells under the agreement and paid the Farmor \$0.1 million for the last well. The Company has no further financial obligations under this agreement.

## OFF-BALANCE SHEET ARRANGEMENTS

Questerre has no off-balance sheet arrangements.

## BUSINESS ENVIRONMENT AND RISK

The business risks Questerre is exposed to are those inherent in the oil and gas industry as well as those governed by the individual nature of Questerre's operations. Geological and engineering risks, the uncertainty of discovering commercial quantities of reserves, commodity prices, access to capital, availability of equipment and personnel, competition and government regulations – all of these govern the business and influence the controls and management of the Company. These risks are managed by:

- Securing farm-in partners to mitigate the risks associated with developing its key properties;
- Attracting and retaining a team of highly qualified and motivated professionals who have a vested interest in the success of the Company;
- Operating properties in order to identify and capitalize on opportunities;
- Maintaining a strong financial position; and
- Maintaining strict environmental, safety and health practices.

## **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, 2006.

## **CHANGES IN ACCOUNTING POLICIES**

Effective January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") section 3855, "Financial Instruments – Recognition and Measurement," section 3865, "Hedges," section 1530, "Comprehensive Income" and section 3861, "Financial Instruments – Disclosure and Presentation." These standards have been adopted retroactively without restatement. For a discussion of the change in accounting policies, refer to Note 2 to the Consolidated 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 at June 30, 2007 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 Corporation'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.

## **ADDITIONAL INFORMATION**

Additional information relating to Questerre, including the Company's Annual Information Form can be obtained on SEDAR at [www.sedar.com](http://www.sedar.com) or on the Company's website at [www.questerre.com](http://www.questerre.com).

## NOTICE TO READER

The accompanying unaudited interim consolidated financial statements of Questerre Energy Corporation for the six months ended June 30, 2007 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



Jason D'Silva  
Chief Financial Officer

Calgary, Alberta, Canada  
August 8, 2007

# CONSOLIDATED BALANCE SHEETS

(unaudited)

	June 30, 2007	December 31, 2006
<b>Assets</b>		
Current assets		
Cash	\$ 35,541,768	\$ 26,616,233
Marketable securities (note 6)	2,786,603	146,250
Accounts receivable	5,392,627	3,589,316
Inventory	307,928	321,437
Deposits and prepaid expenses	417,520	421,308
	<b>44,446,446</b>	31,094,544
Restricted cash (note 7)	—	100,000
	<b>44,446,446</b>	31,194,544
Goodwill (note 4)	2,467,816	2,467,816
Petroleum and natural gas properties – net of accumulated depletion and depreciation (note 3)	33,844,213	37,377,080
	<b>\$ 80,758,475</b>	<b>\$ 71,039,440</b>
<b>Liabilities</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 14,452,647	\$ 8,341,968
Bank loan (note 7)	—	73,700
Current income taxes	82,455	82,455
	<b>14,535,102</b>	8,498,123
Asset retirement obligation (note 5)	3,810,440	3,377,847
	<b>18,345,542</b>	11,875,970
<b>Shareholders' Equity</b>		
Common shares (note 8)	85,821,861	85,809,663
Contributed surplus (note 8 (f))	2,753,761	2,068,902
Deficit	(26,162,689)	(28,715,095)
	<b>62,412,933</b>	59,163,470
	<b>\$ 80,758,475</b>	<b>\$ 71,039,440</b>

See accompanying notes to consolidated financial statements.

Approved by the Board of Directors



Director



Director

# CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE INCOME AND DEFICIT

(unaudited)

	For the Three Months Ended June 30		For the Six Months Ended June 30	
	2007	2006	2007	2006
<b>Revenue</b>				
Petroleum and natural gas revenue	\$ 6,555,860	\$ 2,158,396	\$ 14,058,296	\$ 3,318,993
Royalties	(1,393,998)	(420,508)	(3,445,914)	(826,901)
	\$ 5,161,862	\$ 1,737,888	\$ 10,612,382	\$ 2,492,092
<b>Expenses</b>				
Operating	\$ 1,469,527	\$ 523,004	\$ 3,156,590	\$ 985,448
General and administrative	593,961	246,288	1,415,173	458,996
Stock-based compensation (note 8)	359,775	297,285	689,825	594,571
Interest expense	1,661	3,325	5,250	7,034
Interest income	(86,375)	(62,731)	(194,448)	(239,341)
(Gain) loss on sale of marketable securities	(214,788)	14,445	(553,497)	24,926
Unrealized (gain) loss on marketable securities	1,001,044	—	(106,662)	—
Foreign exchange gain	—	(55,073)	—	(100,968)
Depletion and depreciation	2,525,949	815,797	5,865,129	1,397,055
Accretion on asset retirement obligation (note 5)	31,609	18,951	61,621	27,756
	\$ 5,682,363	\$ 1,801,291	\$ 10,338,981	\$ 3,155,477
<b>Net earnings (loss) before the following</b>	<b>(520,501)</b>	<b>(63,403)</b>	<b>273,401</b>	<b>(663,385)</b>
Gain on sale of petroleum and natural gas properties (note 3)	\$ 1,501,044	\$ —	\$ 1,501,044	\$ —
<b>Net earnings (loss) before income taxes</b>	<b>\$ 980,543</b>	<b>\$ (63,403)</b>	<b>\$ 1,774,445</b>	<b>\$ (663,385)</b>
<b>Income Taxes</b>				
Future Tax Recovery	—	(2,906,130)	—	(2,906,130)
	\$ —	\$ (2,906,130)	\$ —	\$ (2,906,130)
<b>Net earnings and comprehensive income</b>	<b>\$ 980,543</b>	<b>\$ 2,842,727</b>	<b>\$ 1,774,445</b>	<b>\$ 2,242,745</b>
Deficit, beginning of period	\$ (27,143,232)	\$ (28,438,242)	\$ (28,715,095)	\$ (27,838,260)
Opening deficit adjustment for changes in accounting policies	—	—	777,961	—
Financial Instruments (note 2)				
<b>Deficit, end of period</b>	<b>\$ (26,162,689)</b>	<b>\$ (25,595,515)</b>	<b>\$ (26,162,689)</b>	<b>\$ (25,595,515)</b>
<b>Net earnings per share</b>				
Basic	\$ 0.006	\$ 0.022	\$ 0.011	\$ 0.018
Diluted	\$ 0.006	\$ 0.021	\$ 0.011	\$ 0.018

See accompanying notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	For the Three Months Ended June 30		For the Six Months Ended June 30	
	2007	2006	2007	2006
<b>Cash provided by (used in):</b>				
<b>Operating Activities</b>				
Net earnings	\$ 980,543	\$ 2,842,727	\$ 1,774,445	\$ 2,242,745
Items not affecting cash				
Depletion and depreciation	2,525,949	815,797	5,865,129	1,397,055
Stock-based compensation expense	359,775	297,285	689,825	594,571
Accretion on asset retirement obligation	31,609	18,951	61,621	27,756
(Gain) loss on marketable securities	(214,788)	14,445	(553,497)	24,926
Unrealized (gain) loss on marketable securities	1,001,044	—	(106,662)	—
Gain on sale of petroleum and natural gas properties	(1,501,044)	—	(1,501,044)	—
Future tax expense (recovery)	—	(2,906,130)	—	(2,906,130)
Abandonment expenditures	—	—	—	(50,860)
	<b>3,183,088</b>	<b>1,083,075</b>	<b>6,229,817</b>	<b>1,330,063</b>
Net change in non-cash working capital	<b>(3,387,390)</b>	<b>(863,967)</b>	<b>(2,885,673)</b>	<b>277,773</b>
	\$ <b>(204,302)</b>	\$ 219,108	\$ <b>3,344,144</b>	\$ 1,607,836
<b>Financing Activities</b>				
Issue of common shares	\$ 3,917	\$ 3,016,810	\$ 15,317	\$ 10,166,810
Issue of flow-through shares	—	10,000,270	—	10,000,270
Share issue costs	(9,081)	(772,558)	(8,085)	(1,108,054)
Repayment of bank loan	—	(20,100)	(73,700)	(40,200)
	\$ <b>(5,164)</b>	\$ 12,224,422	\$ <b>(66,468)</b>	\$ 19,018,826
<b>Investing Activities</b>				
Expenditures on petroleum and natural gas properties	\$ (3,297,067)	\$ (7,776,047)	\$ (10,460,246)	\$ (14,327,105)
Acquisition of Stride (note 4)	—	(6,282,000)	—	(6,282,000)
Cash acquired on acquisition of Stride (note 4)	—	3,712,541	—	3,712,541
Sale of petroleum and natural gas properties (note 3)	10,000,000	—	10,000,000	—
Sale of marketable securities	252,388	123,522	637,997	247,142
Purchase of marketable securities	—	—	(1,840,230)	—
Release of restricted cash	—	—	100,000	—
Net change in non-cash working capital	<b>5,612,459</b>	<b>9,230</b>	<b>7,210,338</b>	<b>280,038</b>
	\$ <b>12,567,780</b>	\$ (10,212,754)	\$ <b>5,647,859</b>	\$ (16,369,384)
Increase in cash	\$ 12,358,314	\$ 2,230,776	\$ 8,925,535	\$ 4,257,278
Cash, beginning of period	23,183,454	11,322,662	26,616,233	9,296,160
<b>Cash, end of period</b>	\$ <b>35,541,768</b>	\$ 13,553,438	\$ <b>35,541,768</b>	\$ 13,553,438

See accompanying notes to consolidated financial statements.

# SELECTED NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

*For the six months ended June 30, 2007 (unaudited)*

The interim consolidated financial statements include the accounts of Questerre Energy Corporation and its subsidiaries (“Questerre” or the “Company”) and have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles. The interim consolidated financial statements are unaudited and have not been subject to review by the Company’s external auditors. The interim financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended December 31, 2006 except for changes in accounting policies described in Note 2. Certain comparative figures have been reclassified to conform with the presentation adopted in the current year. The disclosure which follows is incremental to the disclosure included with the annual consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Company’s annual report for the year ended December 31, 2006.

## 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Questerre Energy Corporation (“Questerre” or the “Company”) is involved in the exploration and development of high-impact scalable 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 farm-in partners to assist in the development of these projects.

The Company has also developed a portfolio of conventional exploration and production assets primarily in Central and Southern Alberta.

## 2. CHANGES IN ACCOUNTING POLICIES

### *a) Financial Instruments*

Effective January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants (“CICA”) section 3855, “Financial Instruments – Recognition and Measurement,” section 3865, “Hedges,” section 1530, “Comprehensive Income”. These standards have been adopted retroactively without restatement.

#### i) Financial Instruments

Section 3855 establishes a framework for classifying and measuring financial instruments. Under this section all financial instruments must be initially recognized at their fair value on the balance sheet. In accordance with section 3855, the Company has classified each financial instrument into the five categories set out in the standard: Financial assets and liabilities held for trading, financial assets held to maturity, loans and receivables, financial assets available for sale and other liabilities. Measurement of each of these items is contingent upon initial classification. Unrealized gains and losses on financial instruments classified as held for trading are recognized in earnings in the period incurred. Gains and losses on assets available for sale are recognized in other comprehensive income, and are charged to earnings when the asset is derecognized or impaired. The effective interest rate method using amortized cost is applied to the remaining categories of financial instruments.

As a result of adopting this change in accounting policy, the consolidated financial statements at January 1, 2007 were changed as follows: Marketable securities increased by \$777,961, and the deficit decreased by the same amount. The Company’s marketable securities are classified as held for trading. Any changes in the fair value of the marketable securities at the end of the fiscal period are classified as unrealized gains or losses on the income statement.

The classification of financial instruments occurred upon adoption of the standard, and is irrevocable.

ii) Derivative Instruments and Hedging

The Company currently does not use derivative instruments to manage its exposure to the volatility in commodity prices

iii) Embedded Derivatives

An embedded derivative is a component of a financial instrument or other contract that has a feature similar to a derivative. New accounting section 3855 requires certain embedded derivatives be identified and recorded separately from the host contract if the economic characteristics and risks of the embedded derivative are not closely related to that of the host contract. The terms of the embedded derivatives are the same as the terms of a freestanding derivative, and the hybrid instrument is not re-measured at fair value.

iv) Comprehensive Income

Comprehensive income is the change in equity of the Company from net earnings and other comprehensive income (“OCI”). OCI consists of the change in the fair value of any financial instruments classified as available for sale. Amounts recognized in OCI must eventually be reclassified to income when the related gains or losses are realized.

*b) Accounting Changes*

Effective January 1, 2007, the Company adopted the revised CICA section 1506, “Accounting Changes.” Under the revised section, voluntary changes in accounting policy are permitted only if they result in financial statements that provide more reliable and relevant information to the reader. Changes in accounting policy must be applied retroactively, while changes in accounting estimates are to be applied prospectively. The revised section also outlines additional disclosure required when accounting changes are applied, including the justification for the change, a complete description of the policy, the primary source of GAAP and the detailed effect on financial statement line items.

### 3. PETROLEUM AND NATURAL GAS PROPERTIES

	June 30, 2007	December 31, 2006
Petroleum and natural gas properties	\$ 83,214,761	\$ 80,882,499
Accumulated depletion and depreciation	(49,370,548)	(43,505,419)
	\$ 33,844,213	\$ 37,377,080

During the six months ended June 30, 2007, the Company capitalized administrative overhead charges of \$487,701 (December 31, 2006 : \$1,117,037) relating to exploration and development activities.

During the six months ended June 30, 2007, petroleum and natural gas properties included \$12,682,919 (December 31, 2006: \$9,457,946), net of any dispositions, relating to seismic expenditures and unproved properties which have been excluded from the depletion calculation.

Pursuant to an amendment to its farm-in and operating agreement for the Field with its partner, the partner will no longer be obligated to drill additional wells at its sole cost to complete its earning obligations. In consideration of a payment of \$10 million to Questerre, the partner is deemed to have earned a 50% interest in the remainder of the Field.

The Company received this payment during the second quarter of 2007. The amount has been treated as a disposal of a portion of its interest in petroleum and natural gas properties at the Field. Based on a cost of \$8,498,955, Questerre realized a gain of \$1,501,045 on this disposition.

#### 4. ACQUISITION OF STRIDE ENERGY LTD.

Effective April 24, 2006, Questerre acquired all of the outstanding common shares of Stride Energy Ltd. (“Stride”), a private exploration and development company. Total consideration of \$12,310,076 was paid through the issuance of 7,262,742 Common Shares and a cash payment of \$6,282,000.

The purchase price was allocated based on the fair value of the assets and liabilities as follows:

<b>Consideration Paid:</b>	
Cash	\$ 6,282,000
Common Shares	6,028,076
	<b>12,310,076</b>
<b>Allocation of Purchase Price:</b>	
Current assets	4,837,086
Current liabilities	(1,378,564)
	<b>3,458,522</b>
Petroleum and natural gas properties	6,743,152
Goodwill	2,467,816
Asset retirement obligations	(359,414)
	<b>\$ 12,310,076</b>

#### 5. ASSET RETIREMENT OBLIGATION

The total future asset retirement obligation was estimated by management based on Questerre’s net ownership interest in all wells and facilities, estimated costs to reclaim and abandon wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company estimates its total undiscounted asset retirement obligations to be \$4,490,974 at June 30, 2007. Questerre uses a credit adjusted risk free rate of seven percent and an inflation rate of three percent over the varying lives of the assets to calculate the present value of the asset retirement obligation.

The following table provides a reconciliation of the Company’s total asset retirement obligation:

	<b>June 30, 2007</b>	December 31, 2006
Balance, beginning of period	<b>\$ 3,377,847</b>	\$ 2,271,192
Liabilities assumed on corporate acquisition	–	359,414
Increase due to drilling activity	<b>370,972</b>	709,172
Accretion expense	<b>61,621</b>	88,929
Liabilities settled during the period	–	(50,860)
<b>Balance, end of period</b>	<b>\$ 3,810,440</b>	\$ 3,377,847

## 6. MARKETABLE SECURITIES

As at June 30, 2007, the Company held marketable securities with a market value of \$2,786,603 (December 31, 2006: \$511,875).

The Company realized a gain of \$553,497 on the disposition of a portion of the marketable securities and recorded an unrealized gain of \$106,662 during the six months ended June 30, 2007.

The six month results include an adjustment to the valuation of share purchase warrants that relates to the opening transition reflecting new accounting policies adopted in 2007 (See Note 2) and the results of the first quarter of 2007. Based on the difference between a Black-Scholes pricing model now being used and a valuation used by the Company in the first quarter, the Company increased its unrealized gains on marketable securities for the three months ended March 31, 2007 by \$313,936 and the opening deficit for the change in accounting policies by \$75,961.

## 7. BANK INDEBTEDNESS

In July 2002, the Company obtained a five-year, \$400,000 term loan with a Canadian bank. Under the terms of the loan, the Company was required to make monthly payments of \$6,700 principal plus interest until the loan was paid out. The interest rate under the loan was the bank's floating base rate plus 2.0% and the Company had the right to lock in the rate at any time. The loan was secured by the first assignment to the bank of a \$100,000 Guaranteed Investment Certificate and by a General Security Agreement over the assets of the Company and its wholly owned subsidiary, Questerre Beaver River Inc. Financial covenants include maintaining a minimum long-term debt to tangible equity ratio of 0.8 to 1.0 and maintaining a working capital ratio of at least 1.0 to 1.0.

In January 2007, the term loan was paid out.

## 8. SHARE CAPITAL

### a) Authorized

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 June 30, 2007, there were no Class B common voting shares or preferred shares outstanding.

### b) Issued and Outstanding – Class A common shares and common share warrants

	Number		Amount
Common Shares			
Balance, December 31, 2006	155,171,750	\$	85,809,663
Issued for cash on exercise of options	35,833		15,317
Transfer from contributed surplus	–		4,966
Share issue costs	–		(8,085)
<b>Balance, June 30, 2007</b>	<b>155,207,583</b>	<b>\$</b>	<b>85,821,861</b>

### c) Per Share Amounts

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

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Basic	<b>155,198,536</b>	129,681,964	<b>155,194,720</b>	123,642,940
Diluted	<b>161,897,966</b>	133,483,848	<b>162,174,451</b>	127,691,278

The reconciling items between the basic and diluted average common shares are stock options and warrants.

#### d) Stock Options

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

The following table sets forth a reconciliation of the stock option plan activity for the six months ended June 30, 2007:

	Number of Options	Weighted Average Exercise Price
Outstanding, December 31, 2006	12,869,586	\$0.59
Granted	185,000	\$1.26
Forfeited	(72,500)	\$0.58
Exercised	(35,833)	\$0.43
Outstanding, June 30, 2007	12,946,253	\$0.60
Exercisable, June 30, 2007	7,355,870	\$0.46

The outstanding options have a range of exercise prices from \$0.10 to \$1.35, and a weighted average number of years to expiry of 3.2 years (2006 – 3.9 years). The exercisable options have a range of exercise prices from \$0.10 to \$1.34 and 2.9 years to expiry (2006 – 3.7 years). For options with an exercise price ranging between \$0.10 to \$0.65, there are 7,661,253 options outstanding, 5,448,787 options exercisable, a weighted average exercise price of \$0.35 and a weighted average contractual life of 2.8 years. For options with an exercise price ranging between \$0.72 and \$1.35, there are 5,285,000 options outstanding, 1,907,083 options exercisable, a weighted average exercise price of \$0.96 and a weighted average contractual life of 3.8 years.

#### e) Stock-based Compensation Costs

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

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

For the six months ended June 30,	2007	2006
Weighted average fair value per option	0.63	0.31
Risk free interest rate (%)	4%	4%
Expected life (years)	3.0	3.0
Expected volatility (%)	65%	80%

#### f) Contributed Surplus

The following table sets forth a reconciliation of contributed surplus:

	June 30, 2007	December 31, 2006
Balance, beginning of period	\$ 2,068,902	\$ 739,640
Stock-based compensation expense	689,825	1,349,989
Option Exercise	(4,966)	(20,727)
<b>Balance, end of period</b>	<b>\$ 2,753,761</b>	<b>\$ 2,068,902</b>

## **9. CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

Questerre is party to an Office Rental Agreement (the “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 the Agreement is \$126,000 for 2007. The Company is obligated to make total payments under another operating lease of \$57,906 for the remainder of 2007 and \$115,812 in each of the following years: 2008, 2009 and 2010.

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 June 30, 2007, the Company had spent approximately \$9.82 million on CEE and had a remaining commitment of \$0.18 million.

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 at June 30, 2007, the Company drilled four wells under the agreement and paid the Farmor \$0.1 million for the last well. The Company has no further financial obligations under this agreement.

## **10. RELATED PARTY TRANSACTIONS**

At June 30, 2007, Questerre had no amounts owing to Terrenex Acquisition Corporation (“Terrenex”) (2006: \$766). All of the Directors of Terrenex serve as directors or officers of Questerre.

Questerre incurred fees of \$63,000 for the six months ended June 30, 2007 (2006 – \$63,000) to a company with common directors and officers. The transactions were in the normal course of business paid pursuant to the Agreement.

## **11. SUBSEQUENT EVENTS**

In August 2007, the Company entered into an agreement with a Canadian chartered bank for a \$7.50 million credit facility. The credit facility bears interest at the bank’s prime rate plus 0.50% and is payable on demand. The assets of the Company are pledged as security for the facility under a general security agreement.

## CORPORATE INFORMATION

### *Directors*

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

### *Officers*

Michael Binnion  
*President and Chief  
Executive Officer*

John Brodylo  
*VP Exploration*

Peter Coldham  
*VP Engineering  
and Operations*

Jason D'Silva  
*Chief Financial Officer*

Maria Rees  
*Corporate Secretary*

Rick Tityk  
*VP Land*

### *Bankers*

Royal Bank of Canada  
335 Eighth Avenue SW  
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T2P 1C9

### *Legal Counsel*

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T2P 4H2

### *Transfer Agent*

Computershare Trust  
Company of Canada  
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### *Auditors*

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3100, 111 Fifth Avenue SW  
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T2P 5L3

### *Independent Reservoir Engineers*

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Consultants Ltd.  
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T2P 3G6

### *Head Office*

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Email: [info@questerre.com](mailto:info@questerre.com)

### *Stock Information*

Toronto Stock Exchange  
Oslo Stock Exchange  
Symbol: QEC

