

2008 QUARTERLY REPORT
QUESTERRE ENERGY CORPORATION


BUILDING our PORTFOLIO



*Questerre
Energy*

Q4

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.



*Questerre
Energy*

SELECT INFORMATION

| As at/for the period ended December 31 | Three Months Ended | | Twelve Months Ended | |
|---|--------------------|-------------|---------------------|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Financial (\$) | | | | |
| Petroleum and Natural Gas Sales | 4,644,224 | 5,387,928 | 29,805,568 | 23,785,489 |
| Cash Flow from Operations | 2,799,792 | 1,584,590 | 17,289,298 | 10,229,020 |
| Per share - Basic | 0.01 | 0.01 | 0.09 | 0.07 |
| Per share - Diluted | 0.01 | 0.01 | 0.09 | 0.06 |
| Net Earnings (Loss) | (7,487,376) | (2,379,620) | (9,212,614) | (1,281,674) |
| Per share - Basic | (0.04) | (0.01) | (0.05) | (0.01) |
| Per share - Diluted | (0.04) | (0.01) | (0.05) | (0.01) |
| Capital Expenditures, net of acquisitions and dispositions | 14,377,062 | 9,355,590 | 42,490,941 | 15,462,461 |
| Working Capital Surplus | 54,307,989 | 10,007,846 | 54,307,989 | 10,007,846 |
| Total Assets | 165,531,133 | 93,074,767 | 165,531,133 | 93,074,767 |
| Shareholders' Equity | 137,189,444 | 71,627,841 | 137,189,444 | 71,627,841 |
| Common Shares Outstanding | 197,299,642 | 168,930,470 | 197,299,642 | 168,930,470 |
| Weighted average - basic | 197,293,327 | 162,650,245 | 186,447,776 | 157,078,211 |
| Weighted average - diluted | 206,230,961 | 166,729,098 | 196,593,333 | 163,260,612 |
| Operations (units as noted) | | | | |
| Average Production | | | | |
| Crude Oil and Natural Gas Liquids (bbls/d) | 421 | 182 | 385 | 176 |
| Natural Gas (mcf/d) | 2,911 | 6,200 | 4,761 | 7,282 |
| Total (boe/d) | 907 | 1,216 | 1,178 | 1,390 |
| Average Sales Price | | | | |
| Crude Oil and Natural Gas Liquids (\$/bbl) | 64.87 | 84.16 | 99.42 | 71.42 |
| Natural Gas (\$/mcf) | 7.35 | 6.88 | 8.99 | 7.17 |
| Total (\$/boe) | 55.65 | 48.16 | 69.13 | 46.88 |
| Netback (\$/boe) | | | | |
| Total Revenue | 55.65 | 48.16 | 69.13 | 46.88 |
| Royalties | 8.38 | 9.91 | 11.55 | 11.06 |
| Percentage | 15 | 21 | 17 | 24 |
| Field Operating Expense | 14.83 | 14.44 | 14.05 | 12.07 |
| Operating Netback | 32.44 | 23.81 | 43.53 | 23.75 |
| Net Cash G&A | 7.74 | 9.56 | 6.66 | 5.44 |
| Cash Netback | 24.70 | 14.25 | 36.87 | 18.31 |
| Wells Drilled | | | | |
| Gross | 8.0 | 6.0 | 19.0 | 17.0 |
| Net | 5.3 | 3.5 | 12.1 | 10.3 |

NOTICE TO READER

The accompanying unaudited interim consolidated financial statements of Questerre Energy Corporation for the twelve months ended December 31, 2008 have been prepared by management and approved by the Audit Committee and the Board of Directors of the Corporation.



Michael Binnion
President and Chief Executive Officer



Jason D'Silva
Chief Financial Officer

Calgary, Alberta, Canada
February 26, 2009

INTERIM CONSOLIDATED BALANCE SHEETS

(unaudited)

| | December 31 2008 | December 31 2007 |
|--|-----------------------|---------------------|
| Assets | | |
| Current assets | | |
| Cash | \$ 65,328,078 | \$ 13,091,476 |
| Short term investments | 51,262 | 807,800 |
| Marketable securities (note 6) | 198,080 | 1,979,250 |
| Accounts receivable (note 11) | 8,049,421 | 8,028,997 |
| Inventory (note 13) | 352,127 | 204,462 |
| Prepays and deposits | 970,003 | 2,764,647 |
| | 74,948,971 | 26,876,632 |
| Goodwill | 2,467,816 | 2,467,816 |
| Future income tax | – | 1,124,731 |
| Property, plant and equipment, net (note 3) | 88,114,346 | 62,605,588 |
| | \$ 165,531,133 | \$ 93,074,767 |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | \$ 20,640,982 | \$ 16,868,786 |
| Future income tax | 2,705,845 | – |
| Asset retirement obligations (note 5) | 4,994,862 | 4,578,140 |
| | 28,341,689 | 21,446,926 |
| Shareholders' Equity | | |
| Common shares (note 8) | 191,991,012 | 97,341,561 |
| Questerre shares held by subsidiary (note 4) | (23,109,376) | – |
| Contributed surplus (note 8 (f)) | 6,739,230 | 3,505,088 |
| Deficit | (38,431,422) | (29,218,808) |
| | 137,189,444 | 71,627,841 |
| | \$ 165,531,133 | \$ 93,074,767 |

Contractual Obligations and Commitments (note 9)

See accompanying notes to consolidated financial statements.

INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

(unaudited)

| | For the Three Months Ended December 31 | | For the Twelve Months Ended December 31 | |
|---|---|------------------------|--|------------------------|
| | 2008 | 2007 | 2008 | 2007 |
| Revenue | | | | |
| Petroleum and natural gas revenue | \$ 4,644,224 | \$ 5,387,928 | \$ 29,805,568 | \$ 23,785,489 |
| Royalties | (699,453) | (1,108,582) | (4,979,101) | (5,609,308) |
| | 3,944,771 | 4,279,346 | 24,826,467 | 18,176,181 |
| Expenses | | | | |
| Operating | 1,237,619 | 1,615,877 | 6,057,492 | 6,126,998 |
| General and administrative | 646,175 | 1,069,450 | 2,871,308 | 2,757,220 |
| Realized gain on risk management activities | (128,898) | – | (109,749) | – |
| Interest expense | 26,239 | 47,177 | 151,781 | 67,641 |
| Interest income | (598,069) | (171,351) | (1,501,223) | (1,063,886) |
| Realized (gain) loss on sale of marketable securities | – | (179,078) | 704,699 | (903,721) |
| Allowance for doubtful accounts | 1,730,462 | – | 1,730,462 | – |
| Unrealized loss on marketable securities | 97,862 | 513,203 | 97,862 | 785,441 |
| Unrealized loss on risk management activities | 151,013 | – | – | – |
| Stock-based compensation (note 8 (e)) | 2,222,311 | 415,898 | 4,076,503 | 1,465,498 |
| Depletion and depreciation | 4,125,480 | 5,189,592 | 17,234,553 | 13,546,694 |
| Accretion of asset retirement obligations (note 5) | 101,175 | 49,326 | 248,481 | 142,557 |
| | 9,611,369 | 8,550,094 | 31,562,169 | 22,924,442 |
| Net loss before the following | (5,666,598) | (4,270,748) | (6,735,702) | (4,748,261) |
| Gain on sale of property, plant and equipment | – | – | – | 1,501,044 |
| Net loss before income taxes | (5,666,598) | (4,270,748) | (6,735,702) | (3,247,217) |
| Income Taxes | | | | |
| Current taxes | 54,223 | 133,603 | 67,560 | 59,188 |
| Future tax (recovery) | 1,766,555 | (2,024,731) | 2,409,352 | (2,024,731) |
| | 1,820,778 | (1,891,128) | 2,476,912 | (1,965,543) |
| Net loss and comprehensive loss | (7,487,376) | (2,379,620) | (9,212,614) | (1,281,674) |
| Deficit, beginning of period | (30,944,046) | (26,839,188) | (29,218,808) | (28,715,095) |
| Opening deficit adjustment for changes in accounting policies | | | | |
| Financial instruments | – | – | – | 777,961 |
| Deficit, end of period | \$ (38,431,422) | \$ (29,218,808) | \$ (38,431,422) | \$ (29,218,808) |
| Net loss per share (note 8 (c)) | | | | |
| Basic and diluted | \$ (0.038) | \$ (0.015) | \$ (0.049) | \$ (0.008) |

See accompanying notes to consolidated financial statements.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

| | For the Three Months Ended December 31 | | For the Twelve Months Ended December 31 | |
|--|---|----------------|--|----------------|
| | 2008 | 2007 | 2008 | 2007 |
| Operating Activities | | | | |
| Net loss | \$ (7,487,376) | \$ (2,379,620) | \$ (9,212,614) | \$ (1,281,674) |
| Items not affecting cash: | | | | |
| Unrealized loss on risk management activities | 151,013 | – | – | – |
| Depletion and depreciation | 4,125,480 | 5,189,592 | 17,234,553 | 13,546,694 |
| Stock-based compensation | 2,222,311 | 415,898 | 4,076,503 | 1,465,498 |
| Accretion of asset retirement obligations | 101,175 | 49,326 | 248,481 | 142,557 |
| Realized (gain) loss on sale of marketable securities | – | (179,078) | 704,699 | (903,721) |
| Unrealized loss on marketable securities | 97,862 | 513,203 | 97,862 | 785,441 |
| Allowance for doubtful accounts | 1,730,462 | – | 1,730,462 | – |
| Gain on sale of property, plant and equipment | – | – | – | (1,501,044) |
| Future tax expense (recovery) | 1,766,555 | (2,024,731) | 2,409,352 | (2,024,731) |
| Abandonment expenditures | 92,310 | – | – | – |
| | 2,799,792 | 1,584,590 | 17,289,298 | 10,229,020 |
| Net change in non-cash working capital | 4,806,890 | (4,894,964) | 6,176,758 | (7,953,721) |
| | 7,606,682 | (3,310,374) | 23,466,056 | 2,275,299 |
| Financing Activities | | | | |
| Issue of common shares | 7,754 | 3,017,291 | 77,301,878 | 3,040,858 |
| Share issue costs | (41,243) | (89,598) | (5,267,071) | (101,308) |
| Repayment of bank loan | – | – | – | (73,700) |
| | (33,489) | 2,927,693 | 72,034,807 | 2,865,850 |
| Investing Activities | | | | |
| Expenditures on property, plant and equipment | (15,561,132) | (9,054,653) | (43,956,604) | (25,161,524) |
| Acquisition of Magnus Energy Inc. | – | (300,937) | – | (300,937) |
| Acquisition of Terrenex Ltd. (note 4) | (71,308) | – | (680,161) | – |
| Sale of property, plant and equipment | 1,255,378 | – | 2,145,824 | 10,000,000 |
| Cash acquired on the acquisition of Magnus Energy Inc. | – | 551,294 | – | 551,294 |
| Sale of short term investments | – | – | 807,800 | – |
| Purchase of short term investments | (51,262) | (807,800) | (51,262) | (807,800) |
| Sale of marketable securities | – | 212,078 | 1,274,551 | 1,049,971 |
| Purchase of marketable securities | (295,942) | (146,500) | (295,942) | (1,986,730) |
| Release of restricted cash | – | – | – | 100,000 |
| | (14,724,266) | (9,546,518) | (40,755,794) | (16,555,726) |
| Net change in non-cash working capital | 3,202,350 | 1,153,898 | (2,508,467) | (2,110,180) |
| | (11,521,916) | (8,392,620) | (43,264,261) | (18,665,906) |
| Increase (decrease) in cash | (3,948,723) | (8,775,301) | 52,236,602 | (13,524,757) |
| Cash, beginning of period | 69,276,801 | 21,866,777 | 13,091,476 | 26,616,233 |
| Cash, end of period | \$ 65,328,078 | \$ 13,091,476 | \$ 65,328,078 | \$ 13,091,476 |

See supplemental cash flow information contained in note 10.

See accompanying notes to consolidated financial statements.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the twelve months ended December 31, 2008 (unaudited)

1. Basis of Presentation and Nature of Operations

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. The interim consolidated 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, 2007, except as disclosed in Note 2. 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, 2007. Preparation of the interim consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results may differ from these estimates.

Questerre is a full cycle exploration and production company. The Company targets scalable high-impact projects. The Company is also developing a portfolio of conventional exploration and production assets.

On June 18, 2008, Magnus Energy Inc. ("Magnus") and its wholly owned subsidiary Magnus One Energy Corp. (collectively the "Magnus Entities") applied for protection under the Bankruptcy and Insolvency Act. Magnus Energy is a wholly owned subsidiary of Questerre. At meetings of the creditors of the Magnus Entities held on September 30, 2008, the creditors approved a proposal to settle amounts outstanding. Final regulatory approval for this proposal is expected prior to the end of the first quarter of 2009. No adjustments have been made to the carrying values of the liabilities pending receipt of this regulatory approval.

2. Changes in Accounting Policies

On January 1, 2008, the Company adopted the following Canadian Institute of Chartered Accountants ("CICA") Handbook Sections:

Section 1535, "Capital Disclosures". This section establishes standards for disclosing information about an entity's objectives, policies and processes for how it manages its capital. A company must also disclose qualitative data about what the entity regards as capital; and whether the company has complied with any capital requirements and if not, the consequences of such non-compliance. The Company adopted this standard effective January 1, 2008 (see Note 12).

Section 3862, "Financial Instruments – Disclosures". This section describes the required disclosures to evaluate the significance of financial instruments for the entity's financial position and performance as well as the nature and extent of risks arising from both recognized and unrecognized financial instruments to which the entity is exposed and how the entity manages those risks. The Company adopted this standard effective January 1, 2008 (see Note 11).

Section 3863, "Financial Instruments – Presentation". This section establishes standards for presentation of financial instruments and non-financial derivatives. It details the presentation of the standards described in Section 3861, "Financial Instruments – Disclosure and Presentation". The Company adopted this standard effective January 1, 2008 (see Note 11).

Section 3031, "Inventories". This section establishes standards for presentation of inventories. The new standard replaces the previous inventories standard and requires inventory to be valued on a first-in, first-out or weighted average basis, which is consistent with Questerre's former accounting policy. The new standard allows the reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories. The adoption of this standard has had no material impact on the Company's financial statements (see Note 13).

Future Accounting Pronouncements

In February 2008, the CICA's Accounting Standards Board confirmed that International Financial Reporting Standards ("IFRS") will replace Canadian generally accepted accounting principles in 2011 for profit-oriented Canadian publicly accountable enterprises. Questerre will be required to report its results in accordance with IFRS beginning in 2011. The Company has developed a changeover plan to complete the transition to IFRS by January 1, 2011, including the preparation of required comparative information.

The key elements of Questerre's changeover plan include:

- determine appropriate changes to accounting policies and required amendments to financial disclosures;
- identify and implement changes in associated processes and information systems;
- comply with internal control requirements;
- communicate collateral impacts to internal business groups; and
- educate and train internal and external stakeholders.

The Company is currently analyzing accounting policy alternatives and identifying implementation options for the corresponding process changes. Questerre will update its IFRS changeover plan to reflect new and amended accounting standards issued by the International Accounting Standards Board. As IFRS is expected to change prior to 2011, the impact of IFRS on the Company's consolidated financial statements is not reasonably determinable at this time.

In February 2008, the AcSB issued Handbook Section 3064, "Goodwill and Intangible Assets" and amended Section 1000, "Financial Statement Concepts" clarifying the criteria for the recognition of assets, intangible assets and internally developed intangible assets. Items that no longer meet the definition of an asset are no longer recognized with assets. The standard is effective for fiscal years beginning on or after October 1, 2008 and early adoption is permitted. The adoption of this standard should not have a material impact on Questerre's consolidated financial statements.

3. Property, Plant and Equipment

| | December 31 2008 | December 31 2007 |
|--|-----------------------------|---------------------|
| Property, plant and equipment | \$ 162,401,012 | \$ 119,657,700 |
| Accumulated depletion and depreciation | (74,286,666) | (57,052,112) |
| | \$ 88,114,346 | \$ 62,605,588 |

During the twelve months ended December 31, 2008, the Company capitalized administrative overhead charges of \$2,090,419 (December 31, 2007: \$1,474,269) relating to exploration and development activities.

At December 31, 2008, property, plant and equipment included \$19,889,320 (December 31, 2007: \$11,895,668) relating to seismic expenditures and unproved properties which have been excluded from the depletion calculation. Amounts are carried at the lower of cost or fair value. Included in the depletion calculation are future development costs of \$5,355,000 (December 31, 2007: \$2,699,600).

Questerre applies a two-stage ceiling test to determine if the value of its petroleum and natural gas properties is impaired. The carrying value of the Company's petroleum and natural gas properties at December 31, 2008 was determined to be in excess of the undiscounted net cash flow from the proved reserves by \$10.87 million. However, since the carrying value of these properties is less than the net cash flow from the proved and probable reserves using a risk free discount rate, no impairment loss is recognized. The Company did not incur a writedown of its assets in 2007.

4. Acquisition of Terrenex Ltd.

Effective April 30, 2008, Questerre acquired all the outstanding common shares and preferred shares of Terrenex Ltd. ("Terrenex"), a public investment company.

Terrenex was a related party with common directors and officers. Terrenex's principal assets were a working interest in sixteen exploration licenses and a seismic database in the Quebec St. Lawrence Lowlands and 10,698,785 Questerre common shares. On February 22, 2008, the Company entered into an agreement to acquire Terrenex for consideration of 15,892,785 common shares and \$0.50 million in cash. On April 27, 2008, the agreement was amended and the share consideration increased to 18,910,403 common shares. On April 28, 2008, the transaction received the requisite Terrenex shareholder and regulatory approval. Net of the 10,698,785 common shares held by Terrenex at the time of acquisition, a total of 8,211,618 common shares were issued for the acquisition.

This related party transaction has been measured at the carrying amount of the items exchanged. Accordingly, the property, plant and equipment were recorded at a book value of \$764,291. The Questerre common shares, held by Terrenex, were recorded at \$23,109,376, the carrying value of the Questerre common shares at the date of acquisition. Cash and transaction costs were \$680,161. In addition, a future income tax liability of \$2,884,415 was recognized on acquisition. Based on the carrying amount of the assets acquired, the common shares issued as part of this transaction have been assigned a value of \$20,309,091.

5. Asset Retirement Obligations

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 obligation to be \$9,840,101 at December 31, 2008. Commencing October 1, 2008, incremental asset retirement obligations are calculated using a revised credit adjusted risk-free rate of 12 percent. Asset retirement obligations prior to this period were calculated using a credit adjusted risk-free rate of 7 percent. An inflation rate of three percent over the varying lives of the assets remains unchanged to calculate the present value of the asset retirement obligations.

The following table provides a reconciliation of the Company's total asset retirement obligations:

| | December 31 2008 | December 31 2007 |
|--|-----------------------------|---------------------|
| Balance, beginning of period | \$ 4,578,140 | \$ 3,377,847 |
| Revision in estimates | 829,910 | - |
| Liabilities assumed on corporate acquisition | - | 512,078 |
| Liabilities incurred | 423,934 | 545,658 |
| Accretion expense | 248,481 | 142,557 |
| Property dispositions | (1,085,603) | - |
| Balance, end of period | \$ 4,994,862 | \$ 4,578,140 |

6. Marketable Securities

Marketable securities represent investments in shares of public companies which are designated as held for trading and are stated at fair value. Any unrealized gains or losses are recognized in net earnings/(loss) for the period in which they arise.

The following table sets out the changes in marketable securities:

| | December 31 2008 | December 31 2007 |
|---|-----------------------------|---------------------|
| Balance, beginning of period | \$ 1,979,250 | \$ 146,250 |
| Change in accounting policy | – | 777,961 |
| Purchase of marketable securities | 295,942 | 1,986,730 |
| Sale of marketable securities | (1,274,551) | (1,049,971) |
| Realized gain (loss) on sale of marketable securities | (704,699) | 903,721 |
| Unrealized loss on marketable securities | (97,862) | (785,441) |
| Balance, end of period | \$ 198,080 | \$ 1,979,250 |

7. Bank Indebtedness

In July 2002, the Company obtained a five-year, \$400,000 term loan with a Canadian chartered 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 collateralized 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. In January 2007, the term loan was paid out.

The Company has a revolving credit facility with a Canadian chartered bank. The amount of the facility was reassessed at \$5 million during the fourth quarter of 2008 pending a review of the borrowing base in early 2009. The advances bear interest at bank prime rate plus 1.5%. The authorized limit is subject to a periodic review and potential revision of the borrowing base by the bank. The most recent borrowing base review was completed in December 2008. The facility is collateralized with a \$20 million fixed and floating charge debenture over the assets of the Company. As at December 31, 2008, there were no amounts outstanding under this facility.

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 December 31, 2008, there were no Class B common voting shares or preferred shares outstanding.

b) Issued and outstanding – Class A common shares

| | Number | Amount |
|--|--------------------|-----------------------|
| Common Shares | | |
| Balance, December 31, 2007 | 168,930,470 | \$ 97,341,561 |
| Issued for cash on exercise of options | 4,032,554 | 1,514,378 |
| Issued on acquisition of Terrenex Ltd. ⁽¹⁾ | 8,211,618 | 20,309,091 |
| Issued on private placement | 7,500,000 | 35,250,000 |
| Issued on prospectus offering | 8,625,000 | 40,537,500 |
| Stock based compensation recognized on exercise of stock options | | 842,361 |
| Share issue costs | | (3,803,879) |
| Balance, December 31, 2008 | 197,299,642 | \$ 191,991,012 |

(1) Net of the pending cancellation of 10,698,785 Questerre common shares held by Terrenex, a total of 8,211,618 common shares were issued for the acquisition (See Note 4).

c) Per share amounts

The following table summarizes the weighted average common shares used in calculating net earnings (loss) per common share:

| | Three Months Ended December 31 | | Twelve Months Ended December 31 | |
|---------|--------------------------------|-------------|---------------------------------|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Basic | 197,293,327 | 162,650,245 | 186,447,776 | 157,078,211 |
| Diluted | 206,230,961 | 166,729,098 | 196,593,333 | 163,260,612 |

For the purpose of calculating the diluted net loss per share for the three and twelve months ended December 31, 2008 and 2007, incremental shares from assumed exercise of stock options are not included due to the anti-dilutive effect.

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 generally vest evenly over a three-year period or vest evenly over a three-year period starting one year from the grant date. The grants generally expire five years from the date of grant.

The following table sets forth a reconciliation of the stock option plan activity for the twelve months ended December 31, 2008:

| | Number of Options | Weighted Average Exercise Price |
|---------------------------------------|-------------------|---------------------------------|
| Outstanding, December 31, 2007 | 13,064,170 | \$0.59 |
| Granted | 9,045,000 | 1.80 |
| Forfeited | (421,195) | 1.02 |
| Exercised | (4,032,554) | 0.38 |
| Outstanding, December 31, 2008 | 17,655,421 | \$1.26 |
| Exercisable, December 31, 2008 | 9,467,078 | \$0.65 |

| Range of exercise price | Options Outstanding | | | Options Exercisable | | |
|-------------------------|------------------------|----------------------------------|---------------------------------|------------------------|---------------------------------|--|
| | Common shares issuable | Weighted average years to expiry | Weighted average exercise price | Common shares issuable | Weighted average exercise price | |
| \$0.10 - \$0.30 | 827,501 | 0.97 | \$0.30 | 827,501 | \$0.30 | |
| \$0.39 - \$0.65 | 9,075,835 | 3.09 | 0.46 | 5,026,667 | 0.46 | |
| \$0.72 - \$1.00 | 3,280,835 | 2.24 | 0.80 | 2,676,043 | 0.81 | |
| \$1.23 - \$1.60 | 1,571,250 | 3.36 | 1.36 | 796,242 | 1.34 | |
| \$2.38 - \$4.70 | 2,900,000 | 4.49 | 4.48 | 140,625 | 2.78 | |
| | 17,655,421 | 3.09 | \$1.26 | 9,467,078 | \$0.65 | |

e) Stock-based compensation costs

The Company accounts for its stock based compensation plan using the fair value method. Under this method, compensation cost attributable to share options granted to employees or directors is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. The exercise of stock options is recorded as an increase in common shares with a corresponding reduction in contributed surplus. Forfeiture of options are recorded as a reduction in expense in the period in which they occur.

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

| | Three Months Ended December 31 | | Twelve Months Ended December 31 | |
|---|-----------------------------------|------|------------------------------------|------|
| | 2008 | 2007 | 2008 | 2007 |
| Weighted average fair value per option (\$) | 0.98 | 0.33 | 1.27 | 0.45 |
| Risk free interest rate (%) | 2.65 | 4.00 | 3.01 | 4.00 |
| Expected life (years) | 3.0 | 3.0 | 3.0 | 3.0 |
| Expected volatility (%) | 102 | 61 | 97 | 63 |

f) Contributed surplus

The following table sets forth a reconciliation of contributed surplus for the twelve months ended December 31, 2008:

| | | |
|--|-----------|------------------|
| Balance, December 31, 2007 | \$ | 3,505,088 |
| Stock-based compensation expense | | 4,076,503 |
| Stock based compensation recognized on exercise of stock options | | (842,361) |
| Balance, December 31, 2008 | \$ | 6,739,230 |

9. Contractual Commitments and Obligations

The Company is obligated to make total payments under an operating lease of \$115,811 in each of 2009 and 2010 and \$9,651 in 2011. Questerre has commitments under a lease for office space of \$339,708 in 2009 and \$311,399 in 2010.

10. Supplemental Cash Flow Information

| | Three Months Ended December 31 | | Twelve Months Ended December 31 | |
|--------------------|-----------------------------------|--------|------------------------------------|--------|
| | 2008 | 2007 | 2008 | 2007 |
| Cash interest paid | 26,239 | 47,177 | 151,781 | 67,641 |
| Cash taxes paid | 9,006 | – | 155,946 | 28,334 |

11. Financial Instruments

A) Risks associated with financial assets and liabilities

The Company holds various forms of financial instruments. The nature of these instruments and its operations expose the Company to market risk (commodity prices, foreign exchange rates and interest rates), credit risk and liquidity risk. The Company manages its exposure to these risks by operating in a manner that minimizes this exposure.

Market risk

Market risks are generally those risks that are outside of the control of the Company. These are: commodity prices, foreign exchange rates and interest rates. The objective of the Company is to mitigate exposure to these risks while maximizing returns to the Company.

- Commodity price risk

Due to the volatility of commodity prices the Company is potentially exposed to adverse consequences in the event of declining prices. The Company may enter into oil and natural gas contracts to protect its cash flow on future sales. The contracts reduce the volatility in sales revenue by locking in prices with respect to future deliveries of oil and natural gas. As at December 31, 2008 the Company had no oil and natural gas risk management contracts in place. The Company has estimated the impact of changing commodity prices on its net earnings/(loss) as follows: A \$10 change in realized oil prices would result in a \$1.18 million change in net earnings/(loss). A \$1.00 change in realized natural gas prices would result in a \$1.46 million change in net earnings/(loss).

- Foreign currency exchange risk

Even though all of Questerre's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market prices for these commodities are impacted by the exchange rate between Canada and the United States. As at December 31, 2008 the Company had no forward foreign exchange contracts in place.

- Interest rate risk

The Company's revolving demand loan facility is subject to floating rates and is therefore exposed to fluctuations in the market rate of interest. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates. The Company had no interest rate swaps or financial contracts in place at or during the twelve months ended December 31, 2008.

Credit risk

Substantially all of the accounts receivable are with customers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. The Company generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by entering into transactions with long-standing, reputable, counterparties and partners. Wherever possible, the Company requires cash calls from its partners on capital projects before they commence. Accounts receivable related to the sale of the Company's petroleum and natural gas production are from major marketing companies who have excellent credit ratings. These revenues are normally collected on the 25th day of the month following delivery. The Company has not experienced any credit loss in the collection of its accounts receivable relating to the sale of petroleum and natural gas production.

The Company's accounts receivable excluding doubtful accounts was aged as follows:

| Aging | |
|-----------------------------------|----------------------|
| Current | \$ 5,943,064 |
| 31 - 60 days | 635,241 |
| 61 - 90 days | 594,825 |
| > 90 days | 3,253,781 |
| Balance, December 31, 2008 | \$ 10,426,911 |

The Company's allowance for doubtful accounts at December 31, 2008 was \$2,377,490.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's processes for managing liquidity risk include ensuring, to the extent possible, that it will have sufficient liquidity to meet its liabilities when they become due. The Company prepares annual capital expenditure budgets which are monitored and are updated as required. In addition, the Company requires authorizations for expenditures on projects to assist with the management of capital.

Since the Company operates in the upstream oil and gas industry, it requires sufficient cash to fund capital programs necessary to maintain or increase production and develop reserves and to potentially acquire strategic assets. The Company's capital programs are funded principally by cash obtained through equity issuances and from operating activities. During times of low oil and gas prices, a portion of capital programs can generally be deferred, however, due to the long cycle times and the importance to future cash flow in maintaining the Company's production, it may be necessary to utilize alternative sources of capital to continue the Company's strategic investment plan during periods of low commodity prices. As a result, the Company frequently evaluates the options available with respect to sources of long and short-term capital resources. Occasionally, the Company will hedge a portion of its production to protect cash flow in the event of commodity price declines. In addition, the Company has access to a revolving credit facility which allows the Company to borrow money if required.

One of the Company's subsidiaries, Magnus recently sought protection under the Bankruptcy and Insolvency Act (See Note 1). See Note 12 for disclosure related to the management of the Company's capital program. The Company's goal is to prudently spend its capital while maintaining its credit reputation amongst its suppliers.

B) Fair values of financial instruments

Questerre's financial assets and liabilities are comprised of cash, short term investments, marketable securities, accounts receivable, deposits, accounts payable and accrued liabilities. The carrying and fair values of the Company's financial instruments as at December 31, 2008 are as follows:

| | Carrying Value | Fair Value |
|---|----------------|---------------|
| Financial Assets | | |
| Held-for-trading: | | |
| Cash | \$ 65,328,078 | \$ 65,328,078 |
| Short term investments | 51,262 | 51,262 |
| Deposits | 743,673 | 743,673 |
| Marketable securities | 198,080 | 198,080 |
| Loans and receivables: | | |
| Accounts receivable | 8,049,421 | 8,049,421 |
| Financial Liabilities | | |
| Accounts payable and accrued liabilities ⁽¹⁾ | \$ 20,640,982 | \$ 19,070,850 |

(1) The fair value of the Magnus payables has not been estimated as it is subject to receipt of final regulatory approval for its proposed settlement with its creditors (See Note 1).

The fair value of marketable securities is determined by the closing trading price per share as at the balance sheet date multiplied by the number of shares. Questerre's line of credit bears interest at a floating market rate. As at December 31, 2008 the company has no amounts outstanding. As at each reporting period, the Company will assess whether a financial asset, other than those classified as held-for-trading is impaired. Any impairment loss will be included in the earnings for the period.

12. Capital Disclosures

The Company believes it is well capitalized to weather the current volatility in financial markets with positive cash flow from operations, no debt and a working capital surplus of over \$50 million consisting mainly of cash.

The majority of planned capital spending in 2009 will be incurred in Quebec and is in part contingent upon the results of the pilot programs conducted by Questerre's partners. The Company does not currently anticipate using its line of credit to fund capital expenditures in 2009. The line of credit is believed to provide adequate contingency for unanticipated changes in capital spending or market conditions.

The recent change in commodity prices will have a material impact on Questerre's cash flow from operations. Questerre attempts to mitigate the effect of lower prices by shutting in production in unusually low pricing environments and reallocating capital to more profitable areas or reducing capital spending based on results and other market considerations.

The Company considers its capital structure to include shareholders' equity, bank debt and working capital. The Company will adjust its capital structure to minimize its cost of capital through the issuance of shares, increasing its bank line of credit and/or adjusting its capital spending. Questerre monitors its capital based on the current and projected cash flow from operations.

| | December 31 2008 | December 31 2007 |
|----------------------|-----------------------------|---------------------|
| Shareholders' equity | \$ 137,189,444 | \$ 71,627,841 |
| Bank debt | - | - |
| Working capital | 54,307,989 | 10,007,846 |
| | \$ 191,497,433 | \$ 81,635,687 |

Questerre's objectives in managing its capital structure are to:

1. Create and maintain flexibility so that Questerre can continue to meet its financial obligations; and
2. Finance its growth either through internally generated cash flows, joint venture relationships or asset/corporate acquisitions which are financed primarily through share issuances.

The Company's capital is not subject to any external restrictions as to how capital is deployed nor does it have any financial covenants in respect of its bank credit facility.

13. Inventory

Inventory is carried at the lower of weighted average cost or net realizable value. For the twelve months ended December 31, 2008, there were no write downs or reversals of previously written down amounts. During the year, \$676,724 in fuel inventory was purchased (2007: \$388,564) and \$529,059 (2007: \$294,201) recognized as an expense.

14. Related Party Transactions

At December 31, 2008, amounts due from Rupert's Crossing Ltd. ("Rupert's"), a related party with common directors and officers, were \$623 (2007: \$155,469).

Questerre incurred fees of \$63,000 for the year ended December 31, 2008 (2007: \$122,430) to Rupert's. The payment was made pursuant to the termination of an Office Rental Agreement for the provision of office space, office equipment and support personnel in December 2007. Related to this, Rupert's also sold office furniture and equipment to Questerre in 2008 for \$39,595. These payments were in the normal course of operations, made on commercial terms and therefore recorded at their exchange amounts.

See Note 4 "Acquisition of Terrenex Ltd."

CORPORATE INFORMATION

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Les Beddoes, Jr.
Michael Binnion
Pierre Boivin
Russ Hammond
David Mallory
Peder Paus
Bjorn Inge Tonnessen

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Michael Binnion
President and Chief
Executive Officer

John Brodylo
VP Exploration

Peter Coldham
VP Engineering
and Operations

Paul Harrington
VP Finance

Jason D'Silva
Chief Financial Officer

Maria Rees
Corporate Secretary

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Stock Information

Toronto Stock Exchange
Oslo Stock Exchange
Symbol: QEC

