



Q2

QUARTERLY REPORT
QUESTERRE ENERGY
CORPORATION

2010

*Questerre
energy*

Questerre Energy Corporation is an independent energy company focused on shale gas in North America. The company is concentrated on establishing commerciality of its Utica shale gas discovery in the St. Lawrence Lowlands, Québec. Questerre is committed to the economic development of its resources in an environmentally conscious and socially responsible manner.

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

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PRESIDENT'S MESSAGE

The excellent results from St. Edouard No. 1A provided the impetus for Questerre to begin planning work on the next phase of early commercialization.

The pilot horizontal well program has three more wells to test. Gentilly No. 2 is currently testing two intervals concurrently – the middle Utica and a new interval, the lower Utica. Fortierville No. 1 and St. Gertrude No. 1 have both been drilled and will test the middle Utica later this year once frac equipment is available. There will also be at least three wells by other operators that will contribute to our understanding of the Utica shale.

We anticipate the next phase will be a demonstration project for the Utica shale also referred to as a pilot project by some operators. Our goal for this project is to have a pad development producing and selling natural gas in Québec. We are currently in negotiations with our partners including GazMetro, the pipeline distribution company, for this project. Some engineering and permitting work has already been started. Subject to the final results from the pilot horizontal well program and the ongoing negotiations, the current time line could see gas on production as early as mid 2011.

This demonstration project will be a major milestone. Producing the gas consumed in Québec locally will be a positive endorsement for the project. Establishing that gas wells can be drilled, completed and put on production safely and without environmental problems will increase confidence of local stakeholders. It will also be another important step on the learning curve with respect to recovery rates and capital costs.

During the quarter we also received some market recognition of the progress we have already made on our business plan. In June, the strong liquidity and turnover of our shares saw Questerre added to the main OBX Index in Norway and the S&P TSX 500 in Canada.

Highlights

- Two Utica shale horizontal wells spud in St. Lawrence Lowlands, Québec
- Completed long term testing of St. Edouard No. 1A exceeded expectations
- Commenced negotiations and planning work on Utica shale commercial demonstration project in the Lowlands
- Included in the Oslo Bors main OBX and TSX S&P 500 indices
- Positive cash flow from operations of \$0.19 million and production of 620 boe/d with minimal spending on developed assets
- Maintained balance sheet strength with over \$160 million in positive working capital and no debt

St. Lawrence Lowlands, Québec

The results from the ongoing pilot horizontal well program will be a step up the Utica shale learning curve.

Following the successful vertical well program that validated the rock properties over our acreage, this program will help us develop gas production type curves for both the structured and unstructured areas of the deep Utica fairway. These will be more meaningful to assess recovery factors as an alternative to analogs from other shale plays.

The 5.7 MMcf/d average flow rate over the first thirty days and 1.4 MMcf/d flow rate at the end of a long term production test from the first well, St. Edouard No. 1A, exceeded our expectations. Our interpretation of the production and pressure data indicates a type curve that closely matches that of the prolific Haynesville shale in Louisiana and Texas. The extensive over pressuring and fracturing may contribute to higher initial rates and a more pronounced initial decline when compared to wells drilled in the unstructured part of the fairway.

Correlating this production data with the microseismic data gathered during the completion suggests approximately 40% of the fracs were successful. Our interpretation is only 300m-400m of the 1,000m horizontal section is currently contributing to production. With increased frac effectiveness and longer horizontals in this structured area, we could see recoverable reserves and initial rates improve significantly.

We are currently testing Gentilly No. 2 to evaluate both the middle and lower Utica intervals with a total of five frac stages. This well will be our first test of the lower Utica interval and it will also be a partial evaluation of the middle Utica, results are expected in the third quarter.

We plan to complete and test the next two wells, Fortierville No. 1 and St. Gertrude No. 1, with eight stage fracs in the middle Utica. Subject to frac equipment returning this fall, results should be available from these two wells by year-end.

There is significant variability between well results in every other shale gas play, including the more established ones. Given this statistical nature of shale plays, we continue to target an average initial 30-day flow rate from this pilot horizontal program of approximately 2 MMcf/d.

After the completion of the pilot horizontal wells, we believe the next step change on the learning curve will come from our planned commercial demonstration project.

The location of the demonstration project will ultimately be based on the final results from the pilot horizontal well program. Initially, we are targeting the St. Edouard area. We started planning for a 3-D seismic survey this coming winter to identify potential pad locations. We also plan to drill multiple wells off a single pad location and tie-in these wells to the local distribution system. The timing of this project will be contingent upon, among other things, the ongoing negotiations with our partners.

We are hopeful that the new Québec hydrocarbon legislation, promised by the Minister of Natural Resources this fall, will facilitate increased activity with a streamlined application process and a stable fiscal regime. We see this as a prerequisite to the significant capital investment needed to commercialize this play.

Questerre has made a commitment to transparency and responsible development of our shale gas resources. As part of our enhanced communications initiative with local stakeholders, we launched a bilingual video on shale gas development in the Lowlands which can be found on our website at www.questerre.com/fr/shale-gas-background-french/. We see a growing demand for facts on shale gas development, particularly with respect to the environmental impacts. To this end we are taking a more active role in the media to communicate these facts and educate the public.

Operational & Financial

Our pilot program at Antler, Saskatchewan this winter led to two additional horizontal wells in the quarter. We plan to complete these wells during the third quarter and drill up to eight more wells over the remainder of this year.

Our financial results reflect the limited investment in development drilling over the last year and a half.

Production for the quarter averaged 620 boe/d with operating cash flow of \$0.19 million. For the first half of the year, production averaged 610 boe/d with cash flow of \$0.71 million. Crude oil and liquids continue to account for approximately one half of our production volumes, mitigating the impact of lower natural gas prices.

We invested just under \$4 million in our assets during the quarter. Subject to the timing of further activity in Antler and Québec, we estimate our year-end working capital position to be approximately \$150 million.

Outlook

The results from the ongoing pilot horizontal well program will add valuable data points to the learning curve.

With drilling operations on St. Gertrude No. 1 now finalized, both St. Gertrude No. 1 and Fortierville No. 1 will be completed and tested by year-end, subject to frac equipment availability this fall.

We are well capitalized to finance this pilot program, our plans for 2011 and well into 2012. This will include the proposed commercial demonstration project that is scheduled to start early in 2011. We are confident that this will create the next step up the learning curve and, with success, lead to full commercial development of the Utica.



Michael Binnion
President and Chief Executive Officer

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") was prepared as of August 11, 2010. This MD&A is provided by the Management of Questerre Energy Corporation ("Questerre" or the "Company") to review 2010 activities and results as compared to the previous corresponding periods. This MD&A should be read in conjunction with the unaudited interim consolidated financial statements for the three and six months ended June 30, 2010 and the audited consolidated financial statements for the year ended December 31, 2009. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts are in Canadian dollars unless otherwise noted. Additional information relating to Questerre, including Questerre's Annual Information Form for December 31, 2009 is available on SEDAR at www.sedar.com.

Questerre is an independent energy company focused on shale gas in North America. The Company is concentrated on establishing commerciality of its Utica shale gas discovery in the St. Lawrence Lowlands, Québec. The Company also continues to develop a portfolio of conventional assets in Western Canada. Questerre is committed to the economic development of its resources in an environmentally conscious and socially responsible manner.

The Company's common shares are listed on the Toronto Stock Exchange and Oslo Stock Exchange under the symbol "QEC".

Forward Looking Statements

Certain statements contained within this MD&A, and in certain documents incorporated by reference into this document, constitute forward-looking statements. These statements relate to future events or our future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. We believe the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in, or incorporated by reference into, this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A or as of the date specified in the documents incorporated by reference into this MD&A, as the case may be.

This MD&A, and the documents incorporated by reference, contain forward-looking statements pertaining to the following:

- the performance of our oil and natural gas properties;
- the size of our oil, natural gas liquids and natural gas reserves and production levels;
- estimates of future cash flow;
- projections of prices and costs;
- drilling plans and timing of drilling, recompletion and tie-in of wells by the Company and its partners;
- weighting of production between different commodities;
- commodity prices, exchange rates and interest rates;
- expected levels of royalty rates, operating costs, general and administrative costs, costs of services and other costs and expenses;
- capital expenditure programs and other expenditures and the timing and method of financing thereof;
- supply of and demand for oil, natural gas liquids and natural gas;
- expectations regarding our ability to raise capital and to continually add to reserves through acquisitions and development;
- our ability to grow or sustain production and reserves through prudent management;
- the emergence of accretive growth opportunities and continued access to capital markets;
- our future operating and financial results;
- schedules and timing of certain projects and our strategy for future growth; and
- treatment under governmental and other regulatory regimes and tax, environmental and other laws.

In particular, this MD&A contains the following forward-looking statements pertaining to the following:

- production volumes;
- timing of drilling programs and resulting cash flows;
- future oil and gas prices;
- operating costs;
- royalty rates;
- future development, exploration and acquisition activities and related expenditures;
- the amount of future asset retirement obligations; and
- future liquidity and future financial capacity.

With respect to forward-looking statements contained in this MD&A and the documents incorporated by reference herein, we have made assumptions regarding, among other things:

- future oil and natural gas prices;
- the continued availability of capital, undeveloped lands and skilled personnel;
- the costs of expanding our property holdings;
- the ability to obtain equipment in a timely manner to carry out exploration, development and exploitation activities;
- the ability to obtain financing on acceptable terms;
- the ability to add production and reserves through exploration, development and exploitation activities; and
- the continuation of the current tax and regulatory regime and other assumptions contained in this MD&A and the documents incorporated by reference herein.

The actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth below and elsewhere in this MD&A and the documents incorporated by reference into this document:

- volatility in market prices for oil, natural gas liquids and natural gas;
- counterparty credit risk;
- access to capital;
- changes or fluctuations in oil, natural gas liquids and natural gas production levels;
- liabilities inherent in oil and natural gas operations;
- adverse regulatory rulings, orders and decisions;
- attracting, retaining and motivating skilled personnel;
- uncertainties associated with estimating oil and natural gas reserves;
- competition for, among other things, capital, acquisitions of reserves, undeveloped lands, and services;
- incorrect assessments of the value of acquisitions and targeted exploration and development assets;
- fluctuations in foreign exchange or interest rates;
- stock market volatility, market valuations and the market value of the securities of Questerre;
- failure to realize the anticipated benefits of acquisitions;
- actions by governmental or regulatory authorities including changes in royalty structures and programs and income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry;
- limitations on insurance;
- changes in environmental or other legislation applicable to our operations, and our ability to comply with current and future environmental and other laws; and
- geological, technical, drilling and processing problems and other difficulties in producing oil, natural gas liquids and natural gas reserves.

Statements relating to "reserves" or "resources" are by their nature deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future.

Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward-looking statements contained in this MD&A and the documents incorporated by reference herein are expressly qualified by this cautionary statement. We do not undertake any obligation to publicly update or revise any forward-looking statements except as required by applicable securities law.

BOE Conversions

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.

Non-GAAP Terms

This document contains the terms "cash flow from operations" and "netbacks" which are non-GAAP terms. The Company uses these measures to help evaluate its performance.

As an indicator of Questerre's performance, cash flow from operations should not be considered as an alternative to, or more meaningful than, cash flows from operating activities as determined in accordance with Canadian GAAP. Questerre's determination of cash flow from operations may not be comparable to that reported by other companies. Questerre considers cash flow from operations to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund operations and support activities related to its major assets.

Cash Flow from Operations Reconciliation

	<i>Three months ended June 30</i>		<i>Six months ended June 30</i>	
	2010	2009	2010	2009
Cash flows from operating activities	\$ (484,182)	\$ 461,941	\$ 2,179,972	\$ (1,553,863)
Net change in non-cash working capital	674,199	255,210	(1,473,564)	3,334,365
Cash flow from operations	\$ 190,017	\$ 717,151	\$ 706,408	\$ 1,780,502

The Company considers netbacks a key measure as it demonstrates its profitability relative to current commodity prices. Operating netbacks per boe equal total petroleum and natural gas revenue per boe adjusted for royalties per boe and operating expenses per boe.

Select Information

<i>As at/for the period ended June 30,</i>	<i>Three months ended</i>		<i>Six months ended</i>	
	2010	2009	2010	2009
Financial (\$, except common shares outstanding)				
Petroleum and Natural Gas Revenue	2,813,743	2,974,761	5,789,096	6,699,760
Cash Flow from Operations	190,017	717,151	706,408	1,780,502
Per share – Basic	–	–	–	0.01
Per share – Diluted	–	–	–	0.01
Net Loss	(5,939,261)	(3,835,057)	(9,292,396)	(8,243,082)
Per share – Basic	(0.03)	(0.02)	(0.04)	(0.04)
Per share – Diluted	(0.03)	(0.02)	(0.04)	(0.04)
Capital Expenditures, net of acquisitions and dispositions	3,806,236	1,732,487	8,883,276	5,291,398
Working Capital Surplus	160,932,087	50,953,325	160,932,087	50,953,325
Total Assets	268,125,765	149,650,802	268,125,765	149,650,802
Shareholders' Equity	249,894,514	131,820,858	249,894,514	131,820,858
Common Shares Outstanding	233,835,478	197,618,809	233,835,478	197,618,809
Weighted average – basic	233,809,187	197,370,978	220,174,636	197,335,508
Weighted average – diluted	240,694,908	205,065,933	228,789,956	205,059,942
Operations (units as noted)				
Average Production				
Crude Oil and Natural Gas Liquids (bbl/d)	303	357	299	410
Natural Gas (Mcf/d)	1,904	2,694	1,866	3,102
Total (boe/d)	620	806	610	927
Average Sales Price				
Crude Oil and Natural Gas Liquids (\$/bbl)	75.25	63.98	77.32	55.62
Natural Gas (\$/Mcf)	4.25	3.64	4.75	4.58
Total (\$/boe)	49.87	40.56	52.43	39.93
Netback (\$/boe)				
Petroleum and Natural Gas Revenue	49.87	40.56	52.43	39.93
Royalties Expense	(12.87)	(1.40)	(10.21)	(3.41)
Percentage	26%	3%	19%	9%
Operating Expense	(15.53)	(12.19)	(16.55)	(12.67)
Operating Netback	21.47	26.97	25.67	23.85
Wells Drilled				
Gross	4.00	–	7.00	1.00
Net	1.46	–	2.96	0.25

Highlights

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- Completed long term testing of St. Edouard No. 1A exceeded expectations
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Second Quarter 2010 Activities

St. Lawrence Lowlands, Québec

Following an early spring break, the pilot program to assess commerciality of the Utica shale in the Lowlands resumed during the quarter.

The third horizontal well in the program, Fortierville No. 1, was successfully drilled and cased to a measured depth of 3390m including an approximate 1000m horizontal leg. Drilling also commenced on the fourth well, St. Gertrude No. 1, at the end of June and was completed in early August. This well is programmed at 3300m with a 1000m horizontal leg into the target middle Utica interval.

Completion operations for the Fortierville No. 1 and St. Gertrude No. 1 wells, are expected to include 8-stage fracture stimulations. Contingent on equipment availability in the Lowlands, Questerre anticipates these wells will be completed and tested by year-end. The Company is targeting initial 30-day average flow rates of approximately 2 MMcf/d from these wells drilled in the unstructured area of the Utica fairway.

Completion operations on the Gentilly No. 2 well began at the end of the second quarter. The completion program includes five fracs targeting the middle and lower Utica intervals. Subject to final testing, results are expected in the third quarter.

Questerre and the operator also finalized long term testing on the first well in the program, St. Edouard No. 1A. Drilling in the structured area of the play fairway, initial flow rates from the middle Utica following an 8-stage frac were over 12 MMcf/d with a 30 day average flow rate of approximately 5.7 MMcf/d. After 134 days of testing, the well was producing at a rate of approximately 1.4 MMcf/d. These initial and stabilized flow rates have exceeded Management's expectations for this well.

A preliminary analysis of the pressure and production data by Questerre confirms the production curve is most analogous to the Haynesville shale in Louisiana and Texas. The results are consistent with the extensive overpressure and natural fracturing encountered in the well which, in the Company's opinion, contribute to higher initial flow rates with subsequent production at lower stabilized rates. Based on an early interpretation of the microseismic gathered during the completion, the Company believes that flow rates and ultimate recovery could be improved significantly with optimization of frac performance coupled with longer horizontal sections and more fracs.

Questerre also commenced negotiations and planning work on a commercial demonstration project as an extension to the pilot horizontal well program. This will include the drilling and completion of multiple horizontal wells from a single pad and a pipeline tie-in to the main distribution system. Initially targeting the St. Edouard area, plans are being developed for a winter 2011 3-D seismic survey to identify prospective pad locations. The Company is currently negotiating with its partners including GazMetro, the pipeline distribution company, on the demonstration project. The final project timeline and location will be dependent upon, among other factors, the results from the pilot horizontal well program and the negotiations.

During the quarter, Questerre confirmed its participation in a 2-D seismic program operated by Forest Oil on the joint Yamaska acreage. Acquisition of approximately 90 km of data began early in the third quarter. The survey will identify potential drilling locations to evaluate the structured area of this acreage next year.

Northeast British Columbia

Forecasted natural gas prices and significant third party transportation and processing charges resulted in limited investment in the Company's assets in northeast British Columbia ("BC") over the last year.

At the Beaver River Field, Questerre continued to assess cost-effective options and joint venture opportunities to further evaluate the potential of the Liard shale. Production from the shale was limited to two wells, A-2 and A-7, as the A-5 well remained shut-in due to facility constraints. In the interim, field operations during the quarter focused on implementation of a phyto-remediation program for lease clean-up and rehabilitation.

Antler, Saskatchewan

Initial results from the pilot program conducted this winter led to further drilling during the spring. Questerre spud two horizontal wells and completed two earlier wells in the second quarter. Subject to equipment availability, Questerre plans to complete the remaining wells and drill and complete up to eight additional wells.

The drilling and completion programs utilized on these new wells continue to show promise. Well completions utilizing a larger number of smaller fracture stimulations have been successful at confining the frac in the target Torquay/Bakken formation while minimizing water production from adjacent intervals. Cemented liners allow for more effective well workovers and cleanouts as required to extend the productive life of the wells.

Drilling Activities

During the second quarter of 2010, Questerre participated in the drilling of two (0.46 net) natural gas wells in Québec and two (1.00 net) oil wells in Saskatchewan. For the same period in 2009, a focus on capital preservation resulted in no wells drilled.

Production

With minimal development drilling over the last 18 months, production declined over the prior year. A marginal increase from the first quarter volumes of 600 boe/d, production in the second quarter averaged 620 boe/d as compared to 806 boe/d for the same period in 2009. For the first half of the year production was 610 boe/d in 2010 and 927 boe/d in 2009.

Consistent with the prior quarter, Questerre's product mix remained stable with oil and natural gas liquids accounting for 49% of production (2009: 44%). Light oil from Antler accounted for just over three quarters of the Company's oil volumes. The remaining oil and liquids are largely from its Mannville pools in Vulcan, Southern Alberta.

Alberta production declined marginally to 280 boe/d in the second quarter of this year from 285 boe/d in the first quarter. Vulcan remained the largest component of this production, contributing 78% or 219 boe/d in the quarter (2009: 86% and 327 boe/d). The decline in production over the prior year reflects the natural production profile of the assets in Vulcan. Volumes from the company's ancillary assets grew to 61 boe/d in the second quarter from 48 boe/d in the first quarter due to a gross overriding royalty interest in a new gas well in north central Alberta. Subject to regulatory approval of a proposed infill location in Vulcan, Questerre has no plans for further drilling in Alberta.

Of the Company's volumes in the quarter 108 boe/d (2009: 190 boe/d) or 17% are attributable to its assets in British Columbia. Beaver River continues to represent the majority of BC production with 79 boe/d (2009: 152 boe/d) or 73% (2009: 80%) of the volumes. In 2010, the A-2 and A-7 wells accounted for the production while the A-5 well was shut in due to facility constraints. By comparison in 2009, production was entirely attributable to the A-5 well. The remaining production from BC of 29 boe/d during the quarter (2009: 38 boe/d) is allocated to its interest in two gas wells in the Greater Sierra region of the province.

The Antler assets in southeast Saskatchewan accounted for the residual quarterly volumes of 232 boe/d mainly unchanged from 235 boe/d for the same period in 2009. Increased production from three wells drilled and completed over the last year offset declines in existing production. With continued success, Questerre expects to drill and complete several additional wells during this year.

Second Quarter 2010 Financial Results

Revenue

Lower commodity prices in the second quarter offset the increased production over the prior quarter. Petroleum and natural gas revenue for the quarter ended June 30, 2010 was \$2.81 million as compared to \$2.98 million in the first quarter of 2010. In comparison to the same quarter last year, Questerre reported revenue of \$2.97 million based on higher production volumes and lower realized prices.

Year to date, Questerre reported gross revenue of \$5.79 million for 2010 and \$6.70 million for 2009.

Crude oil prices declined during the quarter largely due to the European sovereign debt crisis and the potential impacts on European and global oil consumption. Prices were further affected by concerns of a double dip recession in the United States based on weak economic data, slow growth worldwide and growing inventory levels.

High inventory levels negatively impacted Canadian crude oil prices with the differential between the Canadian Par price and the West Texas price averaging \$7/bbl in the second half of the quarter with a high of almost \$14/bbl.

The reference Edmonton Light price declined to \$75.18/bbl from \$80.07/bbl in the first quarter. Questerre's realized prices mirrored this change with an average selling price of \$75.25/bbl in the second quarter down from \$79.47/bbl in the first quarter.

Rig counts, demand and storage levels continued to affect natural gas prices in the second quarter of the year. Despite higher cooling degree days over last year, storage injections and inventory levels remain consistent with the record levels reached in 2009. Significant increases in the horizontal rig count over the prior year also contributed to a bearish sentiment for natural gas prices.

In the second quarter, lower US prices and the increasing differential between the US and Canadian prices saw the benchmark AECO price average \$3.89/Mcf down from \$4.97/Mcf in the first quarter. This translated into a realized price of \$4.25/Mcf in the second quarter as compared to \$5.27/Mcf in the first quarter.

All oil and gas production is sold on the spot market and Questerre does not hold any hedges, financial or physical as at June 30, 2010.

Royalties

Royalty expense for the second quarter totaled \$0.73 million (2009: \$0.10 million) and \$1.13 million for the first half of 2010 (2009: \$0.57 million). This represented a gross royalty rate of 26% for the quarter and 19% for the year to date.

Second quarter royalties include a \$0.33 million adjustment primarily for gross overriding royalties in Vulcan, Southern Alberta. The royalty adjustment arose from an internal audit conducted by the royalty holder and relates to production from Vulcan for 2008 to date. A prior period adjustment of \$0.09 million was also recorded in the quarter based on a revised gas cost allowance assessment conducted by the Alberta government for 2009.

Excluding the adjustments, royalties incurred on production in Alberta remained relatively stable at 23% in the second quarter as compared to 25% for the prior quarter and 21% for the same period in 2009.

In British Columbia, royalties for the quarter were a credit of \$0.01 million (2009: \$0.18 million). This reflects one time credit adjustments for prior periods issued by the BC government and recorded in the quarter. Excluding the credits, the Company's royalty rate at the Beaver River Field is approximately 13% for production from the A-2 and A-7 wells. At Greater Sierra, the rate is approximately 1% as the Company's wells in this area qualify for the Crown's ultra marginal gas well royalty program.

The royalty rate in the second quarter of 2010 on Saskatchewan production, including all Crown, freehold and overriding royalties, was 5% (2009: 2%). The lower rate in 2009 reflects a credit amendment received for Crown royalties relating to earlier periods based on an assessment received by the provincial government. Questerre expects this rate to increase later this year as additional wells are drilled on freehold land that attract an average royalty rate of 17% as compared to an effective Crown royalty rate of 2.5%. On a year to date basis the royalties were relatively consistent with 2010 and 2009 rates of 6% and 5%, respectively.

Operating Costs

Total operating expenses including gathering and processing charges, for the second quarter were \$0.88 million (2009: 0.89 million) and \$1.83 million (2009: \$2.13 million) for the first half of this year. In the previous quarter, operating costs totaled \$0.95 million.

Field operating expenses in Alberta averaged \$13.07/boe for the quarter, slightly lower than \$13.41/boe in the first quarter of 2010 and materially higher than \$9.26/boe for the second quarter of 2009. The variance from the prior year principally relates to the declining production and higher proportion of fixed costs at Vulcan.

Operating costs at Beaver River totaled \$0.23 million for the second quarter of this year as compared to \$0.32 million for the second quarter of 2009 and \$0.25 million in the previous quarter. Costs at Beaver River are primarily fixed in nature and lower costs reflect the lower production volumes over the prior year and the associated gathering and processing charges. At Greater Sierra, operating costs of \$0.05 million were relatively unchanged from \$0.06 million in the previous quarter.

Operating costs in Antler in the second quarter of 2010 improved to \$12.06/bbl from \$15.13/bbl in the previous quarter as a result of increased operating efficiencies. The costs in the second quarter increased in comparison to the prior year costs of \$9.91/bbl as additional wells were brought on in the second half of 2009 that were not pipeline connected to the central battery.

General and Administrative Expenses

	<i>Three months ended June 30</i>		<i>Six months ended June 30</i>	
	2010	2009	2010	2009
General and administrative expenses, gross	\$ 1,615,504	\$ 1,410,632	\$ 3,125,690	\$ 2,750,906
Capitalized expenses and overhead recoveries	(164,910)	(90,168)	(465,265)	(303,524)
General and administrative expenses, net	\$ 1,450,594	\$ 1,320,464	\$ 2,660,425	\$ 2,447,382

Gross general and administrative expenses (“G&A”) saw an increase in the second quarter of 2010 to \$1.62 million (2009: \$1.41 million) from \$1.51 million in the prior quarter. For the first six months of 2010 the gross expense was \$3.13 million (2009: \$2.75 million). Increases in stock exchange and transfer agent fees coupled with higher staffing costs account for the higher expenses in 2010.

With capital expenditures 68% higher in the first half of 2010 compared to last year, capitalized expenses and overhead recoveries for the period saw a similar increase and totaled \$0.47 million (2009: \$0.30 million). With the increase in the gross expense partially offset by the increase in the capitalized expenses and overhead recoveries, the net G&A increased by a smaller amount to \$2.66 million this year from \$2.45 million in 2009.

Other Income and Expenses

Questerre reported interest income of \$0.54 million for the first six months of the year (2009: \$0.29 million) and \$0.43 million for the three months ended June 30, 2010 (2009: \$0.09 million). The interest was earned on the net proceeds of the equity issues completed by Questerre in the second quarter of 2008 and the issues completed in March 2010. The increased interest income in 2010 is due to the higher cash balances held by the Company and higher interest rates. The cash is invested in Guaranteed Investment Certificates issued in Canadian chartered banks and credit unions.

All of the remaining marketable securities held by Questerre were sold in the second quarter of 2010 which resulted in a year to date realized gain of \$0.24 million. The marketable securities held by the Company represented investments in junior exploration and production companies. In accordance with the financial instruments accounting guidelines, the Company had classified these

securities as held for trading and marked these securities to market value at the end of each fiscal period. This 'mark to market' adjustment is recorded as an unrealized gain or loss on the statements of operations. In the first six months of 2010, the Company recorded an unrealized gain of \$0.08 million compared to a \$0.03 million unrealized loss in the prior year.

In the second quarter of 2010, Questerre recorded an allowance for doubtful accounts of \$0.99 million for amounts due from a joint venture partner. The Company is the operator of the joint property and amounts due to Questerre are secured by a first charge operators' lien on the property which allows Questerre the right to sell its partners production to offset any amounts due.

Stock-based Compensation

Stock-based compensation expense for the second quarter of 2010 totaled \$2.86 million (2009: \$1.28 million) as compared to \$1.39 million in the prior quarter. For the first half of 2010 the stock-based compensation expense was \$4.25 million (2009: \$2.69 million). As mandated by existing accounting standards, this represents the estimated fair value of stock options granted using the Black Scholes pricing model amortized over the vesting period.

The Black Scholes model calculates a theoretical value of the options based on the price of the Company's shares, its volatility, risk free rate and expected life. The increased expense in the second quarter of 2010 and the first half of 2010 is due to increased volatility in Questerre's share price, higher exercise prices and the number of options granted at the end of March 2010. The expense is a non-cash item, and, upon exercise of options in fact results in increased cash.

The weighted average fair value of the options granted in the first half of 2010 using the Black Scholes pricing model was \$2.66 (2009: \$1.21) and the weighted average exercise price was \$4.03 (2009: \$1.80).

Depletion, Depreciation and Accretion

Depletion and depreciation expense for the second quarter of 2010 increased 2% to \$3.30 million from \$3.22 million in the prior quarter. With minimal additions to the depletable base in the second quarter, the increase in the gross expense is due to the 3% increase in production volumes. On a boe basis, this remained relatively stable at rates of \$58.45 and \$59.72 for the second and first quarters of 2010 respectively.

The higher depletable base in the current year explains the 12% increase, on a unit of production basis, from \$52.20/boe in the prior year second quarter. The 23% decrease in production volumes offset this increase and resulted in a decrease in gross depletion and depreciation expense from \$3.83 million in the second quarter of 2009 to \$3.30 million in the second quarter of 2010.

At June 30, 2010, property, plant and equipment included \$28.21 million (December 31, 2009: \$23.62 million) relating to 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 \$5.30 million (December 31, 2009: \$6.15 million).

Questerre recognized \$0.09 million in accretion expense for the second quarter of 2010 (2009: \$0.11 million) and \$0.12 million in the prior quarter. Year to date the accretion expense is \$0.22 million (2009: \$0.21 million). With only a few wells being drilled in 2010 the year over year increase in the accretion expense is, as expected, minimal. The estimated net present value of the total asset retirement obligation is \$5.31 million as at June 30, 2010 based on a total future undiscounted liability of \$9.86 million.

Income Taxes

The recovery of future taxes for the second quarter of 2010 was \$1.13 million compared to a recovery of \$0.64 million in the second quarter of 2009 and a \$0.52 million recovery in the prior quarter. The higher future tax recovery when compared to the second quarter of 2009 and the prior quarter is due to a \$2.63 million and \$3.20 million increase in the net loss before income taxes for the respective periods.

Net Loss

Questerre recorded a net loss of \$5.94 million for the three months ended June 30, 2010 (2009: \$3.84 million) and a net loss of \$9.29 million for the six months ended June 30, 2010 (2009: \$8.24 million). The loss in the current year was attributable to reduced production volumes coupled with higher expenses offset partially by the increased interest income and realized pricing. In the prior year, higher revenue and comparatively lower expenses resulted in a smaller loss.

Capital Expenditures

	<i>Three months ended June 30</i>		<i>Six months ended June 30</i>	
	2010	2009	2010	2009
Expenditures on Property, Plant and Equipment				
Alberta	(173,407)	59,204	(51,159)	115,965
British Columbia	23,790	679,612	34,812	774,939
Saskatchewan	2,005,268	446,069	4,291,238	1,667,669
Québec	1,937,259	547,602	4,595,059	2,732,825
Corporate	13,326	–	13,326	–
	3,806,236	1,732,487	8,883,276	5,291,398

Questerre incurred capital expenditures of \$3.81 million in the second quarter of 2010 (2009: \$1.73 million) and \$8.88 million for the first half of the year (2009: \$5.29 million).

The Company's significant capital expenditures for the first half of 2010 consisted of the following:

- \$4.60 million was invested in the St. Lawrence Lowlands, Québec where the Company finished the drilling of Gentilly No. 2 spud in the fourth quarter of 2009, spud two wells Fortierville No. 1 and St. Gertrude No. 1 and continued the completion and testing of St. Edouard No. 1A to assess the Utica shale.
- In Saskatchewan \$4.29 million was incurred in Antler primarily to drill, complete and tie-in several wells. In the first half of 2010, the Company spud five (2.50 net) wells.
- In Alberta the resolution of a joint venture audit in the second quarter of 2010 resulted in the credit balance for the quarter and year to date.

In 2009, significantly lower commodity prices led Questerre to suspend a planned capital program for its conventional assets in Antler and Greater Sierra. The Company's significant capital expenditures in the first half of 2009 consisted of the following:

- \$2.73 million was invested in Québec focused on the shale gas appraisal program, participating in the drilling and completion of several shale gas wells.
- \$1.67 million was incurred in Antler to tie-in existing wells to the central battery, expand water disposal facilities and finalize the drilling and completion of wells spud in the fourth quarter of 2008.
- \$0.77 million was invested to acquire additional exploration acreage in the Greater Sierra region of British Columbia.

Liquidity and Capital Resources

Questerre reported a working capital surplus of \$160.93 million at June 30, 2010 as compared to a surplus of \$46.50 million at December 31, 2009.

The Company's current assets consist of cash and cash equivalents of \$166.32 million, \$6.28 million of accounts receivable, \$0.15 million of inventory and \$1.10 million in prepaids and deposits. Current liabilities of \$12.92 million represent accounts payable and accrued liabilities.

In March 2010, Questerre closed an equity issuance of 30,000,000 Common Shares for gross proceeds of \$127.91 million. This was comprised of 19,972,000 Common Shares on a private placement basis in Norway at 24.50 NOK per share and 10,028,000 Common Shares by way of a short-form prospectus offering in Canada at C\$4.30 per share.

The Company believes it is sufficiently capitalized with a working capital surplus of \$160.93 million at June 30, 2010 that includes the proceeds from the financing, positive cash flow from operations and no debt. The majority of future planned capital spending will be incurred in Québec and is in part contingent upon the results of the pilot program conducted by Questerre's partners. The Company does not anticipate utilizing its existing credit facility in the foreseeable future. The credit facility is believed to provide adequate contingency for unanticipated changes in capital spending or market conditions.

Cash Flow from Operations and Cash Flows from Operating Activities

Cash flow from operations in the current quarter of \$0.19 million was \$0.33 million, or 63% lower than the preceding quarter and \$0.53 million or 74% lower than the prior year second quarter. Year to date the cash flow from operations was \$0.71 million compared to \$1.78 million in the first six months of 2009. The lower cash flow from operations in the current quarter and year to date when compared to the prior periods is primarily due to lower production volumes and increased royalty expenses offset by higher realized prices and interest income.

Cash flows from operating activities for the first six months of 2010 was \$2.18 million compared to a negative \$1.55 million in the same period in 2009. The increased cash flows from operating activities of \$3.73 million is due to the positive change in the non-cash working capital of \$4.80 million offset by the decrease in the cash flow from operations of \$1.07 million as discussed above.

Share Capital

The following table provides a summary of the outstanding common shares and options as at the date of the MD&A, the current quarter end and the preceding year-end.

	August 11 2010	June 30 2010	December 31 2009
Common shares	234,060,478	233,835,478	199,722,143
Stock options	20,143,753	20,368,753	18,618,753
Weighted average common shares			
Basic		220,174,636	197,940,390
Diluted		228,789,956	206,729,689

In March 2010, Questerre closed an equity issuance of 30,000,000 Common Shares for gross proceeds of \$127.91 million. This was comprised of 19,972,000 Common Shares on a private placement basis in Norway at 24.50 NOK per share and 10,028,000 Common Shares by way of a short-form prospectus offering in Canada at C\$4.30 per share.

A total of 4,113,335 common shares were issued pursuant to the exercise of stock options by directors, officers and employees during the first six months of 2010.

Contractual Obligations and Commitments

Questerre has certain contractual obligations relating to the lease of office space and equipment rentals as set out in the table below:

	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Equipment rentals	\$67,556	\$67,556	–	–	–
Office lease	151,473	151,473	–	–	–
	\$219,029	\$219,029	–	–	–

Risk Management

Except as detailed below, there were no changes to Questerre's risk management policies during the period from those detailed in the MD&A for the year ended December 31, 2009.

Alberta Royalty and Tax Regime

On March 11, 2010, the government of Alberta announced that the following will become permanent features of the royalty structure, effective with the January 2011 production month:

Permanent 5% front-end royalty

- The current incentive program rate of 5% on new natural gas and conventional oil wells will become a permanent feature of the royalty system, with the current time and volume limits.

Lower Maximum Rates

- The maximum royalty rate for conventional oil will be reduced at higher price levels from 50% to 40% to provide better risk-reward balance to investors.
- Recognizing the fundamental changes to the North American supply/demand balance and increased competition from other jurisdictions, the maximum royalty rate for conventional and unconventional natural gas will be reduced at higher price levels from 50% to 36%.

Implementation/Transition

- The transitional royalty framework for oil and natural gas introduced in November 2008 will continue until its original announced expiration on December 31, 2013. Effective January 1, 2011, no new wells will be allowed to select the transitional royalty rates. Wells that have already selected the transitional royalty rates will have the option to stay with those rates or switch to the new rates effective January 1, 2011.
- The drilling royalty credit will continue until expiry on March 31, 2011 and all other programs will continue as designed.

As part of the recognition of the significant changes in the North American natural gas market, the government will continue to analyze various components of natural gas royalties. It is envisaged that with the current production profiles of the existing wells and limited future capital plans for Alberta these changes will have a negligible impact on Questerre's Crown royalty rates.

Accounting Standards Changes

Future Accounting Pronouncements

International Financial Reporting Standards (“IFRS”)

Questerre’s IFRS Changeover Plan

In February 2008, the CICA’s Accounting Standards Board confirmed that IFRS will replace Canadian GAAP 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 2010 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 stakeholders.

As of June 30, 2010, Questerre has made significant progress on its changeover plan. The Company has analyzed accounting policy alternatives and preliminarily drafted its IFRS accounting policies. Process and system changes have been implemented in 2010 to ensure IFRS comparative data is captured, while adhering to existing internal control requirements. IFRS education and training sessions have been held with internal stakeholders and these sessions will continue throughout 2010.

Questerre plans to complete its preliminary January 1, 2010 IFRS opening balance sheet and the necessary 2010 quarterly adjustments based on its draft accounting policies by year end. The preliminary plan is for Questerre’s external auditors to review the Company’s draft IFRS accounting policies, IFRS opening balance sheet impacts and 2010 quarterly adjustments in the fourth quarter of 2010.

Questerre will continue to update its IFRS changeover plan to reflect new and amended accounting standards issued by the International Accounting Standards Board.

Expected Accounting Policy Impacts

Questerre’s significant areas of impact continue to include property, plant and equipment (“PP&E”), asset retirement obligations (“ARO”), impairment testing and income taxes. These areas of impact have the greatest potential impact to the Company’s financial statements. The following discussion provides an overview of these areas, as well as the exemptions available under IFRS 1, First-time Adoption of International Financial Reporting Standards. In general, IFRS 1 requires first time adopters to retrospectively apply IFRS, although it does provide optional and mandatory exemptions to these requirements.

Property, Plant and Equipment

Under Canadian GAAP, Questerre follows the CICA’s guideline on full cost accounting in which all costs directly associated with the acquisition of, the exploration for, and the development of natural gas and crude oil reserves are capitalized on a country-by-country cost centre basis. Costs accumulated within each country cost centre are depleted using the unit-of-production method based on proved reserves determined using estimated future prices and costs. Upon transition to IFRS, Questerre will be required to adopt new accounting policies for upstream activities, including pre-exploration costs, exploration and evaluation costs and development costs.

Pre-exploration costs are those expenditures incurred prior to obtaining the legal right to explore and must be expensed under IFRS. In recent years, pre-exploration costs have not been material to Questerre.

Exploration and evaluation costs are those expenditures for an area or project for which technical feasibility and commercial viability have not yet been determined. Under IFRS, Questerre will initially capitalize these costs as Exploration and Evaluation assets on the balance sheet. When the area or project is determined to be technically feasible and commercially viable, the costs will be transferred to PP&E. Unrecoverable exploration and evaluation costs associated with an area or project will be expensed.

Development costs include those expenditures for areas or projects where technical feasibility and commercial viability have been determined. Under IFRS, Questerre will continue to capitalize these costs within PP&E on the balance sheet. However, the costs will be depleted on a unit-of-production basis over a component level (unit of account) instead of the country cost centre level currently utilized under Canadian GAAP. Questerre has not finalized the components or the inputs to be utilized in the unit-of-production depletion calculation.

Under IFRS, upstream divestitures will generally result in a gain or loss recognized in net earnings. Under Canadian GAAP, proceeds of divestitures are normally deducted from the full cost pool without recognition of a gain or loss unless the deduction would result in a change to the depletion rate of 20% or greater, in which case a gain or loss is recorded.

Questerre expects to adopt the IFRS 1 exemption, which allows the Company to deem its January 1, 2010 IFRS upstream asset costs to be equal to its Canadian GAAP historical upstream net book value. On January 1, 2010, the IFRS exploration and evaluation costs will be equal to the Canadian GAAP unproved properties balance and the IFRS development costs will be equal to the full cost pool balance. Questerre will allocate this upstream full cost pool over reserves to establish the area level depletion units.

Asset Retirement Obligation

Under Canadian GAAP, ARO is measured as the estimated fair value of the retirement and decommissioning expenditures expected to be incurred. Existing liabilities are not re-measured using current discount rates. Under IFRS, ARO is measured as the best estimate of the expenditure to be incurred and requires the use of risk free discount rates at each remeasurement date. Generally, the change in discount rates results in a balance being added to or deducted from PP&E.

The Company is required to revalue its January 1, 2010 ARO balance and recognize the adjustment in retained earnings.

Impairment

Under Canadian GAAP, Questerre is required to recognize an upstream impairment loss if the carrying amount exceeds the undiscounted cash flows from proved reserves for the country cost centre. If an impairment loss is to be recognized, it is then measured at the amount the carrying value exceeds the sum of the fair value of the proved and probable reserves and the costs of unproved properties. Impairments recognized under Canadian GAAP are not reversed.

Under IFRS, Questerre is required to recognize and measure an upstream impairment loss if the carrying value exceeds the recoverable amount for a cash-generating unit. Under IFRS, the recoverable amount is the higher of fair value less cost to sell and value in use. Impairment losses, other than goodwill, are reversed under IFRS when there is an increase in the recoverable amount. Questerre will group its upstream assets into cash-generating units based on the independence of cash inflows from other assets or other groups of assets.

Income Taxes

In transitioning to IFRS, the Company's future tax liability will be impacted by the tax effects resulting from the IFRS changes discussed above. Questerre continues to assess the impact that the IFRS income tax principles may have on the Company.

Other IFRS 1 Considerations

Business combinations and joint ventures entered into prior to January 1, 2010 will not be retrospectively restated using IFRS principles.

Internal Control Over Financial Reporting

Questerre is required to comply with National Instrument 52-109 "Certification of Disclosure in Issuers' Annual and Interim Filings", otherwise referred to as Canadian SOX ("C-Sox"). The 2010 certificate requires that the Company disclose in the interim MD&A any changes in the Company's internal controls over financial reporting that occurred during the period that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

There have been no significant changes in Questerre's internal control over financial reporting during the quarter ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

It should be noted that a control system, including the Company's disclosure and internal controls and procedures, no matter how well conceived can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

Quarterly Financial Information

	June 30 2010	March 31 2010
Production (boe/d)	620	600
Average Realized Price (\$/boe)	49.87	55.10
Petroleum and Natural Gas Revenue	2,813,743	2,975,353
Cash Flow from Operations	190,017	516,391
Per share – Basic	–	–
Per share – Diluted	–	–
Net Loss	(5,939,261)	(3,353,135)
Per share – Basic	(0.03)	(0.02)
Per share – Diluted	(0.03)	(0.02)
Capital Expenditures, net of acquisitions and dispositions	3,806,236	5,077,040
Working Capital Surplus	160,932,087	165,597,791
Total Assets	268,125,765	273,631,441
Shareholders' Equity	249,894,514	252,991,983
Weighted Average Common Shares Outstanding		
Basic	233,809,187	206,388,591
Diluted	240,694,908	216,789,825

	December 31 2009	September 30 2009	June 30 2009	March 31 2009
Production (boe/d)	759	632	806	1,049
Average Realized Price (\$/boe)	49.37	47.92	40.56	39.46
Petroleum and Natural Gas Revenue	3,447,123	2,786,384	2,974,761	3,724,999
Cash Flow from Operations	595,717	502,357	717,151	1,063,351
Per share – Basic	–	–	–	0.01
Per share – Diluted	–	–	–	0.01
Net Loss	(3,898,088)	(1,581,718)	(3,835,057)	(4,408,025)
Per share – Basic	(0.02)	(0.01)	(0.02)	(0.02)
Per share – Diluted	(0.02)	(0.01)	(0.02)	(0.02)
Capital Expenditures, net of acquisitions and dispositions	3,438,205	3,259,938	1,732,487	3,558,911
Working Capital Surplus	46,500,671	49,016,405	50,953,325	51,756,719
Total Assets	145,272,364	149,304,238	149,650,802	154,599,633
Shareholders' Equity	129,977,202	132,216,221	131,820,858	134,190,125
Weighted Average Common Shares Outstanding				
Basic	199,243,068	197,827,758	197,370,978	197,299,642
Diluted	208,653,009	206,723,239	205,065,933	205,069,693

	December 31 2008	September 30 2008	June 30 2008	March 31 2008
Production (boe/d)	907	1,292	1,241	1,274
Average Realized Price (\$/boe)	55.65	74.81	80.03	62.38
Petroleum and Natural Gas Revenue	4,644,224	8,892,160	9,037,355	7,231,829
Cash Flow from Operations	2,799,792	5,411,554	5,138,828	3,939,125
Per share – Basic	0.01	0.03	0.03	0.02
Per share – Diluted	0.01	0.03	0.03	0.02
Net Earnings (Loss)	(7,487,376)	292,647	(2,670,086)	652,201
Per share – Basic	(0.04)	–	(0.01)	–
Per share – Diluted	(0.04)	–	(0.01)	–
Capital Expenditures, net of acquisitions and dispositions	14,377,062	7,352,744	3,066,281	17,694,854
Working Capital Surplus (Deficiency)	54,307,989	67,826,776	68,450,058	(4,506,141)
Total Assets	165,531,133	162,756,977	160,395,379	102,606,756
Shareholders' Equity	137,189,444	145,328,700	143,603,481	72,783,296
Weighted Average Common Shares Outstanding				
Basic	197,293,327	197,250,522	181,275,421	169,733,932
Diluted	206,230,961	208,686,342	194,380,878	172,902,492

INTERIM CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	June 30 2010	December 31 2009
Assets		
Current assets		
Cash and cash equivalents	\$ 166,322,202	\$ 51,396,052
Marketable securities (note 3)	–	204,336
Accounts receivable (note 7 (a))	6,283,949	4,509,203
Inventory (note 9)	147,303	301,599
Prepays and deposits	1,100,985	619,990
	173,854,439	57,031,180
Future income taxes	4,825,224	1,486,533
Goodwill	2,467,816	2,467,816
Property, plant and equipment, net (note 2)	86,978,286	84,286,835
	\$ 268,125,765	\$ 145,272,364
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 12,922,352	\$ 10,530,509
Asset retirement obligations (note 5)	5,308,899	4,764,653
	18,231,251	15,295,162
Shareholders' Equity		
Common shares (note 6 (b))	310,073,315	183,706,643
Contributed surplus (note 6 (f))	14,061,634	11,218,598
Deficit	(74,240,435)	(64,948,039)
	249,894,514	129,977,202
	\$ 268,125,765	\$ 145,272,364

Contractual obligations and commitments (note 11).

See accompanying notes to the consolidated financial statements.

INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT (UNAUDITED)

	<i>Three months ended June 30</i>		<i>Six months ended June 30</i>	
	2010	2009	2010	2009
Revenue				
Petroleum and natural gas revenue	\$ 2,813,743	\$ 2,974,761	\$ 5,789,096	\$ 6,699,760
Royalties	(726,043)	(103,003)	(1,127,268)	(572,000)
	2,087,700	2,871,758	4,661,828	6,127,760
Expenses				
Operating	876,530	893,649	1,827,162	2,126,073
General and administrative	1,450,594	1,320,464	2,660,425	2,447,382
Interest income	(430,053)	(89,293)	(537,391)	(291,349)
Realized gain on sale of marketable securities (note 3)	(156,680)	(106)	(241,870)	(106)
Unrealized (gain) loss on marketable securities (note 3)	178,555	(25,210)	(79,654)	30,500
Allowance for doubtful accounts (note 7 (a))	985,939	-	985,939	-
Stock-based compensation (note 6 (e))	2,862,960	1,279,164	4,254,389	2,687,870
Depletion and depreciation	3,297,822	3,829,013	6,522,551	8,658,919
Accretion of asset retirement obligations (note 5)	93,888	106,214	218,744	210,126
	9,159,555	7,313,895	15,610,295	15,869,415
Net loss before income taxes	(7,071,855)	(4,442,137)	(10,948,467)	(9,741,655)
Income Taxes				
Current	-	29,787	-	32,652
Future (recovery)	(1,132,594)	(636,867)	(1,656,071)	(1,531,225)
	(1,132,594)	(607,080)	(1,656,071)	(1,498,573)
Net loss and comprehensive loss	(5,939,261)	(3,835,057)	(9,292,396)	(8,243,082)
Deficit, beginning of period	(68,301,174)	(42,839,447)	(64,948,039)	(38,431,422)
Deficit, end of period	\$ (74,240,435)	\$ (46,674,504)	\$ (74,240,435)	\$ (46,674,504)
Net loss per share (note 6 (c))				
Basic and diluted	\$ (0.025)	\$ (0.019)	\$ (0.042)	\$ (0.042)

See accompanying notes to the consolidated financial statements.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Operating Activities				
Net loss	\$ (5,939,261)	\$ (3,835,057)	\$ (9,292,396)	\$ (8,243,082)
Items not affecting cash and cash equivalents:				
Depletion and depreciation	3,297,822	3,829,013	6,522,551	8,658,919
Stock-based compensation (note 6 (e))	2,862,960	1,279,164	4,254,389	2,687,870
Accretion of asset retirement obligations (note 5)	93,888	106,214	218,744	210,126
Realized gain on sale of marketable securities (note 3)	(156,680)	(106)	(241,870)	(106)
Unrealized (gain) loss on marketable securities (note 3)	178,555	(25,210)	(79,654)	30,500
Allowance for doubtful accounts (note 7 (a))	985,939		985,939	
Future income tax recovery	(1,132,594)	(636,867)	(1,656,071)	(1,531,225)
Abandonment expenditures (note 5)	(612)	–	(5,224)	(32,500)
	190,017	717,151	706,408	1,780,502
Net change in non-cash working capital	(674,199)	(255,210)	1,473,564	(3,334,365)
	(484,182)	461,941	2,179,972	(1,553,863)
Financing Activities				
Issue of common shares	35,825	186,626	130,273,375	186,626
Share issue costs	(77,496)	–	(7,000,676)	–
	(41,671)	186,626	123,272,699	186,626
Investing Activities				
Expenditures on property, plant and equipment	(3,806,236)	(1,732,487)	(8,883,276)	(5,291,398)
Sale of marketable securities (note 3)	346,425	12,058	525,860	12,058
	(3,459,811)	(1,720,429)	(8,357,416)	(5,279,340)
Net change in non-cash working capital	(3,806,469)	(516,635)	(2,169,105)	(2,145,943)
	(7,266,280)	(2,237,064)	(10,526,521)	(7,425,283)
Increase (decrease) in cash and cash equivalents	(7,792,133)	(1,588,497)	114,926,150	(8,792,520)
Cash and cash equivalents, beginning of period	174,114,335	58,175,317	51,396,052	65,379,340
Cash and cash equivalents, end of period	\$166,322,202	\$ 56,586,820	\$166,322,202	\$ 56,586,820

See supplemental cash flow information contained in note 10.

See accompanying notes to the consolidated financial statements.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended June 30, 2010 and 2009 (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, 2009. These interim consolidated financial statements do not include all disclosures required in the annual consolidated financial statements and 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, 2009. 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 consolidated 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 and has developed a portfolio of 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 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. Court approval of this proposal was obtained on April 2, 2009. Questerre has lost control of Magnus due to the bankruptcy and appointment of a trustee, however, because of uncertainty over responsibility for the liabilities recorded in Magnus relating to the investment in the subsidiary, the investment has been recorded as a liability equal to the amount of the book value of Magnus’s liabilities at the time of bankruptcy protection. No adjustments have been made to the carrying values of these liabilities pending confirmation of the settlement amounts. This is expected to be completed during 2010.

2. Property, Plant and Equipment

	June 30 2010	December 31 2009
Property, plant and equipment	\$ 183,660,658	\$ 174,446,656
Accumulated depletion and depreciation	(96,682,372)	(90,159,821)
	\$ 86,978,286	\$ 84,286,835

During the six months ended June 30, 2010, the Company capitalized administrative overhead charges of \$438,127 (December 31, 2009: \$571,651) directly relating to exploration and development activities.

At June 30, 2010, property, plant and equipment included \$28,207,216 (December 31, 2009: \$23,621,537) relating to 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 \$5,297,214 (December 31, 2009: \$6,154,700).

3. 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 the statements of operations for the period in which they arise.

The following table sets out the changes in marketable securities:

	June 30 2010	December 31 2009
Balance, beginning of period	\$ 204,336	\$ 198,080
Sale of marketable securities	(525,860)	(12,058)
Realized gain on sale of marketable securities	241,870	106
Unrealized gain on marketable securities	79,654	18,208
Balance, end of period	\$ -	\$ 204,336

4. Bank Indebtedness

The Company has a \$5 million revolving credit facility with a Canadian chartered bank. The advances bear interest at the bank prime rate plus 1.5%. The authorized limit is currently under review and the Company is evaluating its requirements for this facility in light of its cash position and planned capital programs in 2010. The facility is collateralized with a \$20 million fixed and floating charge debenture over the assets of the Company. As at June 30, 2010, there were no amounts outstanding under this facility.

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. At June 30, 2010, the Company estimates its total undiscounted asset retirement obligation to be \$9,860,234 (December 31, 2009: \$9,578,736).

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

	June 30 2010	December 31 2009
Balance, beginning of period	\$ 4,764,653	\$ 4,994,862
Revision in estimates	260,203	-
Liabilities incurred	70,523	56,103
Accretion expense	218,744	424,335
Liabilities settled	(5,224)	(710,647)
Balance, end of period	\$ 5,308,899	\$ 4,764,653

6. 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, 2010, there were no Class B common voting shares or preferred shares outstanding.

b) Issued and Outstanding – Class A Common Shares

	Number	Amount
Balance, December 31, 2009	199,722,143	\$ 183,706,643
Issued for cash on exercise of options	4,113,335	2,365,961
Issued on private placement	19,972,000	84,787,014
Issued on prospectus offering	10,028,000	43,120,400
Reclassification to share capital on exercise of stock options		1,411,353
Share issue costs, net of tax		(5,318,056)
Balance, June 30, 2010	233,835,478	\$ 310,073,315

In March 2010, Questerre closed an equity issuance of 30,000,000 Common Shares for gross proceeds of \$127.91 million. This was comprised of 19,972,000 Common Shares on a private placement basis in Norway and 10,028,000 Common Shares by way of a short-form prospectus offering in Canada.

c) Per share amounts

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

	<i>Three months ended June 30</i>		<i>Six months ended June 30</i>	
	2010	2009	2010	2009
Basic	233,809,187	197,370,978	220,174,636	197,335,508
Diluted	240,694,908	205,065,933	228,789,956	205,059,942

For the purpose of calculating the diluted net loss per share for the three and six months ended June 30, 2010 and 2009, incremental shares from assumed exercise of stock options are not included due to their 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 or five years from the commencement of the vesting.

The following table sets forth a reconciliation of the stock option plan activity:

	Number of Options	Weighted Average Exercise Price
Outstanding, December 31, 2009	18,618,753	\$1.53
Granted	5,963,335	4.03
Forfeited	(100,000)	2.64
Exercised	(4,113,335)	0.58
Outstanding, June 30, 2010	20,368,753	\$2.45
Exercisable, June 30, 2010	7,908,732	\$1.20

The following table summarizes information about stock options outstanding and exercisable at June 30, 2010:

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	
\$0.40 - \$0.45	4,763,334	2.65	\$0.45	3,555,832	\$0.45	
\$0.65 - \$0.82	2,030,834	0.96	0.73	1,989,167	0.73	
\$1.28 - \$1.80	2,361,250	2.98	1.54	1,256,866	1.38	
\$2.37 - \$2.78	2,745,000	5.25	2.49	271,874	2.74	
\$4.00 - \$4.70	8,468,335	4.21	4.23	834,993	4.70	
	20,368,753	3.52	\$2.45	7,908,732	\$1.20	

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, officers 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 incurred and any unvested stock based compensation expense is recorded as a reduction in the expense.

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:

	<i>Three months ended June 30</i>		<i>Six months ended June 30</i>	
	2010	2009	2010	2009
Weighted average fair value per option (\$)	2.97	—	2.66	1.21
Risk free interest rate (%)	2.59	—	1.20	1.61
Expected life (years)	4.8	—	3.0	3.6
Expected volatility (%)	95	—	108	101

f) Contributed surplus

The following table provides a reconciliation of the Company's contributed surplus:

	June 30 2010	December 31 2009
Balance, beginning of period	\$ 11,218,598	\$ 6,739,230
Stock-based compensation expense	4,254,389	5,225,313
Reclassification to share capital on exercise of stock options	(1,411,353)	(745,945)
Balance, end of period	\$ 14,061,634	\$ 11,218,598

7. Financial Instruments*a) Credit risk*

The Company's accounts receivable are aged as follows:

Aging	
Current	\$ 3,923,244
31 – 60 days	1,349,572
61 – 90 days	657,493
> 90 days	4,755,119
Allowance for doubtful accounts	(4,401,479)
Balance, June 30, 2010	\$ 6,283,949

In the second quarter of 2010, Qwesterre recorded an allowance for doubtful accounts of \$0.99 million for amounts due from a joint venture partner. The Company is the operator of the joint property and amounts due to Qwesterre are secured by a first charge operators' lien on the property.

b) Fair values of financial instruments

The carrying and fair values of the Company's financial instruments as at June 30, 2010 are as follows:

	Carrying Value	Fair Value
Financial Assets		
Held-for-trading:		
Cash and cash equivalents	\$ 166,322,202	\$ 166,322,202
Deposits	917,256	917,256
Loans and receivables:		
Accounts receivable	6,283,949	6,283,949
Financial Liabilities		
Accounts payable and accrued liabilities ¹	\$ 12,922,352	\$ 11,098,994

(1) The fair value of the Magnus payables of \$1,823,358 cannot be estimated as the final settlement amounts are unknown and this has been deducted above to arrive at fair value (See Note 1). Additional liabilities continue to be incurred by Magnus, however Qwesterre Energy Corporation will not be liable for these costs and therefore are not included in the consolidated balance sheet. These liabilities currently amount to \$344,065.

8. Capital Disclosures

The Company considers its capital structure to include shareholders' equity, 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, securing additional credit facilities and/or adjusting its capital spending. Questerre monitors its capital structure based on the current and projected cash flow from operations.

	June 30 2010	December 31 2009
Shareholders' equity	\$ 249,894,514	\$ 129,977,202
Debt	–	–
Working Capital	160,932,087	46,500,671
	\$ 410,826,601	\$ 176,477,873

9. Inventory

Inventory is carried at the lower of weighted average cost or net realizable value. For the six months ended June 30, 2010, there were no write downs or reversals of previously written down amounts. During the six month period, \$nil fuel inventory was purchased (2009: \$nil) and \$154,296 (2009: \$166,011) was recognized as an expense.

10. Supplemental Cash Flow Information

	<i>Three months ended June 30</i>		<i>Six months ended June 30</i>	
	2010	2009	2010	2009
Cash taxes (refunded) paid	\$ –	\$(9,070)	\$ –	\$12,002

11. Contractual Obligations and Commitments

The Company is obligated to make total payments under an operating lease of \$57,905 in 2010 and \$9,651 in 2011. Questerre has commitments under a lease for office space of \$151,473 in 2010.

12. Comparative Figures

Certain comparative figures have been reclassified to conform with the current year's financial statement presentation.

CORPORATE INFORMATION

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Patrick Quinlan
Bjorn Inge Tonnessen

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VP Exploration
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