

notice to reader

The accompanying unaudited interim consolidated financial statements of Questerre Energy Corporation for the six months ended June 30, 2006 have been prepared by management and approved by the Audit Committee and the Board of Directors of the Corporation. These statements have not been reviewed by the Corporation's external auditors.



Michael Binnion
President and Chief Executive Officer



Jason D'Silva
Vice President, Finance

Calgary, Alberta, Canada
August 10, 2006

consolidated balance sheets

	June 30 2006 <i>(unaudited)</i>	December 31 2005
Assets		
Current assets		
Cash	\$ 13,553,438	\$ 9,296,160
Marketable securities	299,590	499,311
Accounts receivable	4,213,790	1,533,354
Inventory	216,074	92,925
Deposits and cash calls paid	182,341	32,064
	18,465,233	11,453,814
Restricted cash (note 6)	100,000	100,000
	18,565,233	11,553,814
Goodwill (note 2)	2,467,816	-
Petroleum and natural gas properties – net of accumulated depletion and depreciation (note 3)	31,573,189	14,638,949
	\$ 52,606,238	\$ 26,192,763
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 5,170,419	\$ 1,597,584
Bank loan (note 6)	113,900	154,100
Current income taxes	188,374	-
	5,472,693	1,751,684
Asset retirement obligation (note 4)	3,056,132	2,271,192
	8,528,825	4,022,876
Shareholders' Equity		
Common shares (note 7)	68,338,718	49,268,507
Contributed surplus (note 7)	1,334,210	739,640
Deficit	(25,595,515)	(27,838,260)
	44,077,413	22,169,887
	\$ 52,606,238	\$ 26,192,763

See accompanying notes to consolidated financial statements.

Approved by the Board of Directors



Director



Director

consolidated statements of income (loss) and deficit

(unaudited)

	For the Three Months Ended June 30		For the Six Months Ended June 30	
	2006	2005	2006	2005
Revenue				
Petroleum and natural gas revenue	2,158,396	630,260	3,318,993	967,260
Royalties	(420,508)	(109,295)	(826,901)	(2,999)
	1,737,888	520,965	2,492,092	964,261
Expenses				
Operating	523,004	329,747	985,448	534,305
General and administrative	246,288	74,239	458,996	311,766
Stock-based compensation (note 7)	297,285	115,610	594,571	190,945
Interest expense	3,325	28,171	7,034	45,687
Interest income	(62,731)	(2,751)	(239,341)	(9,128)
Loss on sale of marketable securities	14,445	-	24,926	-
Foreign exchange gain	(55,073)	-	(100,968)	-
Depletion and depreciation	815,797	344,510	1,397,055	1,418,557
Accretion on asset retirement obligation (note 4)	18,951	41,518	27,756	41,518
	1,801,291	931,044	3,155,477	2,533,650
Income (Loss) before income taxes	(63,403)	(410,079)	(663,385)	(1,569,389)
Income Taxes				
Current taxes	-	-	-	-
Future Tax Recovery	(2,906,130)	-	(2,906,130)	-
	(2,906,130)	-	(2,906,130)	-
Net Income (Loss)	2,842,247	(410,079)	2,242,745	(1,569,389)
Retained Earnings (Deficit), beginning of period	(28,437,762)	(25,992,008)	(27,838,260)	(24,832,698)
Retained Earnings (Deficit), end of period	(25,595,515)	(26,402,087)	(25,595,515)	(26,402,087)
Net income (loss) per share				
Basic and diluted	0.02	(0.01)	0.02	(0.02)

See accompanying notes to consolidated financial statements.

consolidated statements of cash flows

(unaudited)

	For the Three Months Ended June 30		For the Six Months Ended June 30	
	2006	2005	2006	2005
Cash provided by (used in):				
Operating Activities				
Net gain (loss)	2,842,727	(410,079)	2,242,745	(1,569,389)
Items not affecting cash				
Depletion and depreciation	815,797	344,510	1,397,055	1,418,557
Stock-based compensation expense	297,285	115,610	594,571	190,945
Accretion on asset retirement obligation	18,951	41,518	27,756	41,518
Loss on marketable securities	14,445	–	24,926	–
Future tax expense (recovery)	(2,906,130)	–	(2,906,130)	–
	1,083,075	91,559	1,380,923	81,631
Net change in non-cash working capital	(863,967)	662,879	277,773	397,233
	219,108	754,438	1,658,696	478,864
Financing Activities				
Issue of common shares	3,016,810	10,985,567	10,166,810	10,985,567
Issue of flow-through shares	10,000,270	–	10,000,270	–
Share issue costs	(772,558)	(1,292,795)	(1,108,054)	(1,304,263)
Repayment of bank loan	(20,100)	(20,100)	(40,200)	(40,200)
	12,224,422	9,672,672	19,018,826	9,641,104
Investing Activities				
Expenditures on petroleum and natural gas properties	(7,345,506)	(3,654,055)	(13,947,424)	(6,117,093)
Acquisition of Stride (note 2)	(3,000,000)	–	(3,000,000)	–
Net change in non-cash working capital	9,230	218,346	280,038	689,262
Sale of marketable securities	123,522	–	247,142	–
	(10,212,754)	(3,435,709)	(16,420,244)	(5,427,831)
Increase (decrease) in cash	2,230,776	6,991,401	4,257,278	4,692,137
Cash, beginning of period	11,322,662	402,213	9,296,160	2,701,477
Cash, end of period	13,553,438	7,393,614	13,553,438	7,393,614

See accompanying notes to consolidated financial statements.

notes to the consolidated financial statements

For the six months ended June 30, 2006 (unaudited)

These interim consolidated financial statements include the accounts of Questerre Energy Corporation and its subsidiaries ("Questerre" or the "Company") and have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles. The interim consolidated financial statements are unaudited and have not been subject to review by the Company's external auditors. The interim financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the fiscal year ended December 31, 2005. Certain comparative figures have been reclassified to conform with the presentation adopted in the current year. The disclosure that follows is incremental to the disclosure included with the annual consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Company's annual report for the year ended December 31, 2005.

Goodwill is the excess purchase price over the fair value of identifiable assets and liabilities acquired. Goodwill is not amortized. However, goodwill impairment will be assessed annually, or as economic events dictate, by comparing the fair value of the net assets to its carrying value, including goodwill. If the fair value of the net assets is less than its carrying value, the fair value of the goodwill is compared with its carrying value to measure the amount of goodwill impairment loss.

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Questerre is primarily involved in the exploration and development of naturally fractured and hydrothermally dolomitized reservoirs. The Company has two primary projects – the Beaver River Field in British Columbia and the St. Lawrence Lowlands in Quebec. To mitigate the risks associated with these primary projects, the Company has secured partners to assist in their development. The Company has also developed a portfolio of conventional exploration and production assets in Central and Southern Alberta.

2. ACQUISITION OF STRIDE ENERGY LTD.

Effective April 24, 2006, Questerre acquired all of the outstanding common shares of Stride Energy Ltd. ("Stride"). Stride shareholders elected to receive either \$2.4092 in cash or 2.834 Common Shares of Questerre ("Questerre Shares"), or a combination thereof, for each Stride common share subject to a maximum of \$6,282,000 and a maximum of 7,262,856 Questerre Shares. Total consideration of \$12,310,076 was paid through the issuance of 7,262,742 Questerre Shares (at a deemed price of \$0.83 per Questerre Share) and a cash payment of \$6,282,000.

The Questerre Shares issued to Stride shareholders were valued at \$0.83. This value was based on the weighted average trading price of Questerre Shares on the TSX for the five days prior to the execution of the letter of intent and five days after the execution of the pre-acquisition agreement. The acquisition may be subject to adjustments if additional information related to Stride during the pre-acquisition period becomes known. The acquisition was accounted for using the purchase method of accounting as follows:

Consideration Paid	
Cash	\$ 6,282,000
Common Shares	6,028,076
	<hr/>
	12,310,076
<hr/>	
Allocation of Purchase Price	
Current assets	4,837,086
Current liabilities	(1,378,564)
	<hr/>
	3,458,522
Property, plant and equipment	6,743,152
Goodwill	2,467,816
Asset retirement obligations	(359,414)
	<hr/>
	\$ 12,310,076
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3. CAPITAL ASSETS

	June 30 2006	December 31 2005
Petroleum and natural gas properties (net of accumulated depletion and depreciation)		
Alberta	\$ 26,145,912	\$ 9,402,290
British Columbia	3,579,148	3,430,376
Quebec	1,848,129	1,806,283
	\$ 31,573,189	\$ 14,638,949

During the six months ended June 30, 2006, the Company capitalized administrative overhead charges of \$536,789 (December 31, 2005 – \$415,957) relating to exploration and development activities.

The Company did not incur a ceiling test writedown for the six months ended June 30, 2006 (December 31, 2005 – \$1.31 million).

As at June 30, 2006, petroleum and natural gas properties included \$4.78 million (December 31, 2005 – \$6.13 million) relating to unproved properties that have been excluded from the depletion and depreciation calculation. All costs associated with the Beaver River Field, net of estimated salvage values, have been written down in previous years and included in depletion expense except \$2.93 million of seismic costs. These costs primarily relate to the 3-D seismic survey acquired over the Field in 2002 and have continuing value to the Company.

Questerre also does not include costs of \$1.85 million associated with its St. Lawrence Lowlands acreage in Quebec in the calculation of depletion or in costs subject to the ceiling test calculation. The Company's assets in Quebec remain unproved at June 30, 2006.

4. ASSET RETIREMENT OBLIGATION

The total future asset retirement obligation was estimated by management based on Questerre's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon the wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company estimates its total undiscounted asset retirement obligations to be \$3,618,202 at June 30, 2006. Questerre used a credit adjusted risk free rate of seven percent and an inflation rate of three percent to calculate the present value of the asset retirement obligation. Settlement of the obligations will be funded from general corporate funds at the time of retirement or removal. As at June 30, 2006, no funds have been set aside to settle these obligations.

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

	June 30 2006	December 31 2005
Balance, beginning of period	\$ 2,271,192	\$ 1,848,503
Liabilities assumed on corporate acquisition	359,414	-
Increase due to drilling activity	448,630	265,629
Accretion expense	27,756	157,060
Liabilities settled during period	(50,860)	-
Balance, end of period	\$ 3,056,132	\$ 2,271,192

5. MARKETABLE SECURITIES

As at June 30, 2006, the Company holds marketable securities with a market value of \$434,630. (December 31, 2005: \$546,120). The Company realized a loss of \$24,926 on the disposition of a portion of these securities during the first half of 2006.

6. BANK INDEBTEDNESS

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

While Questerre currently meets this financial covenant, the Company has not been in compliance with this covenant in the past, and, therefore, the bank loan has been classified as a current liability.

7. 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, 2006, 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, 2005	113,014,594	\$ 49,268,507
Issued for cash	20,709,000	17,150,270
Issued on acquisition of Stride Energy Ltd.	7,262,742	6,028,076
Tax effect of flow-through share issuance	–	(3,000,081)
Share issue costs	–	(1,108,054)
Balance, June 30, 2006	140,986,336	\$ 68,338,718

In June 2006, the Company completed a private placement for gross proceeds of \$10 million. The placement consisted of the issuance of 9,709,000 Common Shares, on a flow-through basis, at \$1.03 per Common Share.

c) Per share amounts

The following table summarizes the weighted average Common Shares used in calculating net income (loss) per Common Share:

	2006	Three months Ended June 30 2005	2006	Six Months Ended June 30 2005
Basic	129,681,964	74,399,871	123,642,940	70,597,014
Diluted	133,483,848	76,190,872	127,691,278	72,484,868

The reconciling item between the basic and diluted average common shares is stock options.

d) Stock options

The Company has a stock option plan that provides for the issuance of options to its directors, officers and employees at or above market prices. The stock options granted under the plan vest quarterly over a three-year period and expire five years from the date of grant. The following table sets forth a reconciliation of the stock option plan activity for the six months ended June 30, 2006:

	Number of Options	Weighted Avg Exercise Price
Outstanding, December 31, 2005	9,205,000	\$ 0.44
Granted	1,080,000	0.65
Forfeited	(70,000)	0.82
Outstanding, June 30, 2006	10,215,000	0.46
Exercisable, June 30, 2006	3,592,083	\$ 0.36

The outstanding options have a range of exercise prices between \$0.10 per share and \$1.00 per share, and a weighted average number of years to expiry of 4.0. The exercisable options have a range of exercise prices between \$0.10 and \$1.00 per share and have a weighted average number of years to expiry of 3.7.

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 expected exercise time frame with a corresponding increase to contributed surplus. The fair value of each option granted is estimated in the date of grant using the Black-Scholes option pricing model with weighted average assumptions for grants as follows:

	For the six months ended June 30	
	2006	2005
Weighted average fair value per option	\$ 0.26	\$ 0.18
Risk free interest rate (%)	3.0	3.0
Expected life (years)	3.0	3.0
Expected volatility (%)	113.0	131.0

f) Contributed surplus

The following table sets forth a reconciliation of contributed surplus for the six months ended June 30, 2006:

Balance, December 31, 2005	\$ 739,640
Stock-based compensation expense	594,571
Balance, June 30, 2006	\$ 1,334,211

8. RELATED PARTY TRANSACTIONS

At June 30, 2006, Questerre had amounts owing to Terrenex Acquisition Corporation ("Terrenex") totaling \$766 (2005 - \$804). All of the directors of Terrenex serve as directors or officers of Questerre.

Questerre incurred fees of \$63,000 for the six months ended June 30, 2006 (2005 - \$63,000) to a company with common directors and officers. The transactions were in the normal course of business paid pursuant to an Office Rental Agreement for the provision of office space, office equipment and support personnel. The agreement may be terminated by either party with six months' written notice.

Questerre incurred fees of \$9,900 for the six months ended June 30, 2006 (2005 - \$3,750) to a director for the provision of an office in Oslo, Norway.