

Management's Discussion and Analysis

The following discussion and analysis was prepared by management at November 11, 2004 and offers management's assessment of Questerre's historical financial and operating results. This interim discussion and analysis should be read in conjunction with the unaudited interim consolidated financial statements of the Company for the nine months ended September 30, 2004, and the MD&A and audited financial statements for the year ended December 31, 2003 together with the notes related thereto. The reader should be aware that historical results are not necessarily indicative of future performance. This discussion may contain forward-looking statements that involve risks and uncertainties. Such information, though considered reasonable by Questerre at the time of preparation, may prove to be incorrect and actual results may differ materially from those anticipated in the statements made and the variances may be significant.

When calculating unit costs, natural gas is converted to a barrel of oil equivalent using a conversion ratio of six thousand cubic feet equal to one barrel (6:1 ratio).

CORPORATE RESTRUCTURING

Questerre Beaver River Inc. ("QBR"), a wholly owned subsidiary of Questerre Energy Corporation ("QEC") encountered a financial crisis in April 2004 as a result of significant problems associated with the drilling of a re-entry well (the "A-5 well") at the Beaver River Field in British Columbia (the "Field"). The drilling operation commenced in August 2003 and was completed in March 2004 with the tie-in of the well. The objective of the re-entry was to access "attic gas" which, based upon extensive seismic work, QBR believed to exist above the highest producing well in the Field. The A-5 re-entry well did not encounter any attic gas and is currently producing from a previously drained section of an existing compartment at 700 mcf/day of raw gas with 700 cubic metres per day of formation water.

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

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

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

On August 9, 2004, the Company filed Plans of Compromise or Arrangement for QEC and QBR (the "Plans" or "Plans of Arrangement") under the CCAA for the settlement of all outstanding claims. Pursuant to the Plans proposed by QEC and QBR, unsecured creditors would receive either the lesser of the amount of their claim or \$2,000. Alternatively, unsecured creditors could elect instead to receive a cash dividend of \$0.05 plus one Common Share of QEC for each dollar of their claim. The Common Shares of QEC would be subject to a contractual escrow and released in two equal installments on the four and eight month anniversary of the date the Plans received final Court approval.

In addition to the proposed settlement, QEC arranged for a liquidity option for interested creditors. Under this liquidity option, unsecured creditors would still receive \$0.05 for each dollar of their claim, and would also receive an additional \$0.07 for each dollar of their claim in exchange for foregoing each Common Share of QEC they would have otherwise received. This would result in a cash settlement of \$0.12 per dollar of claim outstanding.

The Common Shares that would otherwise have been issued to these unsecured creditors would be issued to Terrenex Acquisition Corporation ("Terrenex") pursuant to the terms of a Liquidity Option Agreement. Under the Liquidity Option Agreement, Terrenex would establish a fund to finance the liquidity option up to a maximum of \$668,500, representing the maximum number of Common Shares of QEC to be issued under the Plans of Arrangement multiplied by \$0.07. In consideration for providing this liquidity option, Terrenex would receive 300,000 Common Shares of QEC. It will also be issued Common Shares of QEC that, but for the election of the unsecured creditors to participate in the liquidity option, would have been issued to the creditors of QBR and QEC. These Common Shares that would be issued to Terrenex, are subject to the same hold obligations were they issued to the creditors of QBR and QEC.

The Plans were approved by the requisite majority of unsecured creditors at meetings of creditors of QBR and QEC held on August 31, 2004. The Plans were subsequently sanctioned by the Court of Queen's Bench of Alberta on September 9, 2004. A total of \$0.56 million in cash and 9,623,012 Common Shares of QEC were issued on the implementation of these Plans. QEC and QBR subsequently emerged from Court protection on October 8, 2004.

THIRD QUARTER 2004 FINANCIAL RESULTS

PRODUCTION

Production from the Company's Beaver River Field averaged 546 mcf/day for the three months ended September 30, 2004 (2003 – 392 mcf/day) and 685 mcf/day for the first nine months of 2004 (2003 – 807 mcf/day). Production from the Field during 2004 can be attributed solely to the new A-5 well brought on production at the beginning of the second quarter. Field production in the first half of 2003 included two producing wells, both of which were shut-in during the third quarter of 2003 due to water disposal constraints and to facilitate drilling the new A-5 well. Consistent with the first nine months of 2003, the Company's production from minor Alberta properties in the nine and three months ended September 30, 2004 was approximately 25 BOE/day in natural gas and associated natural gas liquids.

REVENUE

Due to higher production during the quarter, Questerre reported petroleum and natural gas revenue of \$0.29 million in the third quarter of 2004 compared to \$0.12 million for the same period in 2003. This accounted for year-to-date revenues in 2004 increasing to \$1.3 million from \$1.1 million in 2003.

ROYALTIES

Royalty expense decreased to \$0.18 million for the nine months ending September 30, 2004 compared to \$0.27 million for the same period in 2003 as no Crown royalties were recorded for production from the Beaver River Field for the six months ended June 30, 2004. The royalty rate on production from the Company's minor Alberta properties remained at 22% for this period in 2004 and 2003.

Crown royalties for the Field are governed by a royalty agreement which provides for the deferral of all royalties until the earlier of June 30, 2004 and cumulative production of 13 bcf from the project. Repayment of deferred royalties was contingent on both the success of the experimental project for which the deferral was granted and on monthly production exceeding volumes established by the Crown. In December 2003, Questerre reported a royalty recovery which included the reversal of 2003 and prior years' royalty expense recognized under the royalty agreement. Based on the limited production and disappointing results to date, the Company adjusted the liability for Crown royalties to Nil at December 31, 2003 on the basis that the conditions for repayment no longer existed. On the same basis, the Company did not accrue Crown royalties on its Beaver River production in the first and second quarters of 2004.

The Company has accrued Crown royalties of \$0.07 million for the three months ended September 30, 2004 on production from the Beaver River Field. Payment of this royalty is contingent on the Company reaching an agreement with the Ministry of Energy and Mines in British Columbia regarding its qualification for a deep royalty credit of \$2.2 million. The Company continues to have ongoing discussions with the Ministry regarding its qualification for this credit.

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OPERATING COSTS

Total operating expenses increased to \$0.35 million for the third quarter of the year (2003 – \$0.24 million) and \$1.3 million for the nine months ended September 30, 2004 (2003 – \$0.98 million). A portion of the increase is attributed to higher equipment and facility maintenance costs. The remainder is attributed to the Company bearing responsibility for 100% of the operating costs associated with the Field, as compared to 60% for the same period in 2003.

GENERAL AND ADMINISTRATIVE EXPENSES

Questerre reported general and administrative ("G&A") expenses of \$0.19 million in the third quarter of 2004 compared to \$0.24 million for the third quarter of 2003. G&A expenses of \$0.4 million for the first nine months of 2004 (2003 – \$0.58 million) included \$150,000 of bad debt expense recorded against amounts receivable from partners on the Beaver River Field. Overhead recoveries of \$0.54 million associated with the increased capital expenditure program in the first six months of 2004 offset a substantial portion of 2004 G&A expenses.

	Nine Months Ended September 30	
(\$ thousands)	2004	2003
General & administrative expenses	\$ 804	\$ 760
Bad debt expense	150	–
Overhead recoveries	(542)	(182)
General & administrative expenses, net	\$ 412	\$ 578

OTHER INCOME AND EXPENSES

During the third quarter of 2004, Questerre recorded restructuring costs of \$0.29 million representing professional services associated with the Company's filings and restructuring under the CCAA.

Questerre recorded a gain of \$7.36 million in the third quarter of 2004 representing the net forgiveness of outstanding amounts owing by the Company to its unsecured trade creditors settled under the Plans of Arrangement.

STOCK BASED COMPENSATION

Effective January 1, 2004 the Company adopted the new accounting standard for stock based compensation resulting in stock based compensation expense of \$0.02 million in the third quarter of 2004 and \$0.11 for the nine months ending September 30, 2004. The new accounting standard was applied retroactively without restatement of prior periods, therefore no corresponding expense was recorded in 2003.

INTEREST EXPENSE

In June 2004, Questerre borrowed \$0.5 million from Rupert's Crossing, an investment corporation ("Rupert's"), a private investment holding company controlled by the Company's President. In August 2004, Questerre borrowed an additional \$0.1 million from Rupert's. Interest expense of \$0.02 million for the third quarter of 2004 (2003 – \$0.01 million) reflects interest on this new borrowing as well as interest on the term bank loan. On a year to date basis, interest expense also increased from \$0.04 million for the first nine months of 2003 to \$0.05 million for the first nine months of 2004.

DEPLETION, DEPRECIATION AND ACCRETION

Questerre recognized \$0.06 million in depletion and depreciation for the third quarter of 2004 (2003 – \$0.18 million) and \$6.2 million in depletion and depreciation for the first nine months of 2004 (2003 – \$0.53 million). Included in 2004 depletion is a \$5.18 million "ceiling test" write-down recorded by the Company on its Beaver River Field petroleum and natural gas assets. The write-down reflected the majority of costs incurred during the first and second quarter of 2004 to finish the drilling, completion and tie-in of the new A-5 well. The write-down amount was calculated in accordance with the new accounting guideline utilizing an internal estimate of reserves and cash flows. Management's reserve estimates were based on the results from the production test of the new A-5 well. As of September 30, 2004, all costs associated with the Beaver River Field, net of estimated salvage values, have been written down and included in depletion except \$2.8 million of geological and geophysical costs.

Questerre excludes \$1.8 million of costs associated with its St. Lawrence Lowlands, Quebec prospect in the calculation of depletion or in costs subject to the ceiling test calculation. The Quebec property remains undeveloped at September 30, 2004.

In the second quarter of 2004, the Company increased its estimated undiscounted asset retirement cost for its Beaver River field from \$0.9 million to \$1.8 million. The \$0.9 million increase in estimate was added to the asset retirement obligation and also capitalized as part of the carrying amount of the related asset. The full estimated asset retirement obligation related to the Beaver River Field has been estimated as a current year liability. Accretion of asset retirement obligations for the first nine months of 2004 was \$0.06 million compared to \$0.04 million for the same period in 2003. Questerre did not acquire any new properties in 2003 or 2004 which would result in additional asset retirement obligations.

TAXES

Consistent with the prior year, Questerre had sufficient tax pool deductions to offset taxable income in the first nine months of 2004 resulting in no current income taxes payable for the previous quarters. In addition, the Company's tax assets significantly exceed tax liabilities. No tax asset is recognized at September 30, 2004, as there is no certainty that the Company will be able to realize the value of the tax assets in the future.

NET INCOME

Questerre recorded net income of \$0.27 million (\$0.03 /share) for the nine months ended September 30, 2004 compared to a net loss of \$1.1 million (\$0.04/share) for the first nine months of 2003. The net income for the first nine months of 2004 was due to the gain on the settlement of all outstanding obligations under the Plans, offset by higher depletion including a \$5.18 million ceiling test write-down on the Beaver River Field. The write-down reflected the majority of costs incurred during the first quarter of 2004 to finish the drilling, completion and tie-in of the new A-5 well.

LIQUIDITY AND CAPITAL RESOURCES

CAPITAL EXPENDITURES

Questerre incurred capital expenditures of \$6.3 million in the first nine months of 2004 compared to \$4.3 million in 2003. Substantially all of the 2004 capital spending related to drilling, completion and tie-in of the Beaver River A-5 well, an operation that commenced in August 2003.

	Nine Months Ended September 30	
(\$ thousands)	2004	2003
Capital Expenditures		
Beaver River Project, BC	6,257	3,459
St. Lawrence Lowlands, Quebec	64	815
Minor Alberta Properties	1	68
Total	6,322	4,342

WORKING CAPITAL

Questerre reported a working capital surplus of \$0.23 million at September 30, 2004, which includes outstanding bank debt of \$0.25 million and a \$0.6 million promissory note payable on November 14, 2004. The Company is not in compliance with the bank's financial covenants and, therefore, the bank loan has been classified as a current liability. The Company has extended the terms of the promissory note to November 14, 2006.

Questerre's current assets at September 30, 2004 include accounts receivable of \$0.1 million compared to \$0.6 million at December 31, 2003. GST refunds received in the first quarter of 2004 accounted for the decrease in accounts receivable. Inventory decreased from \$0.68 million at December 31, 2003 to \$0.19 million at September 30, 2004. The December 31, 2003 balance included \$0.5 million in drilling mud, all of which was utilized or returned for credit in the first half of 2004. Deposits and cash calls of \$0.89 million at September 30, 2004 includes \$0.68 million paid in trust to the operator for the drilling of the first well on the Company's Quebec property. In addition, \$0.1 million is recorded as deposits for retainers paid to counsel and the court monitor for services required in the Company's CCAA proceedings.

Current liabilities as at September 30, 2004 of \$1.4 million include \$0.57 million in accrued and contingent payables, a promissory note of \$0.6 million and \$0.25 million of bank debt. Questerre's trade payables and contingent liabilities of \$0.57 million primarily relate to professional fees incurred in connection with the Company's CCAA proceedings. The current liabilities as at December 31, 2003 of \$7.5 million primarily reflect the expenditures incurred in connection with the A-5 re-entry.

SHARE CAPITAL

The Company is authorized to issue an unlimited number of Class A common voting shares. The Company is also authorized to issue an unlimited number of Class B common voting shares and an unlimited number of preferred shares, issuable in one or more series.

On February 13, 2004, the Company completed a private placement for 642,860 common shares and 1,878,791 flow-through common shares for gross proceeds of \$3.16 million. Proceeds from the flow-through offering were primarily used to finance the completion and tie-in of the A-5 well at the Beaver River Field.

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

At September 30, 2004, there were no Class B common voting shares or preferred shares outstanding, a total of 54,288,904 common shares outstanding, 5,338,330 common share purchase warrants outstanding and 2,315,000 stock options outstanding.

CONTRACTUAL OBLIGATIONS

The following table summarizes the Company's contractual obligations, which require payments to be made over the next four years.

	Payments due by period				
	Remainder of 2004	2005	2006	2007	Total
Bank debt	\$ 20,100	\$ 80,400	\$ 80,400	\$ 73,700	\$ 254,600
Office rental agreement	\$ 31,500	-	-	-	

Questerre is party to an Office Rental Agreement with a related party for the provision of offices, office equipment and support personnel. The agreement may be terminated by either party with six months written notice.

CRITICAL ACCOUNTING ESTIMATES

Management is required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company. A comprehensive discussion of the Company's significant accounting policies is contained in the notes to the audited consolidated financial statements at December 31, 2003 and the notes to the unaudited interim financial statements at September 30, 2004. The following discussion outlines the accounting estimates that are critical to determining Questerre's financial results.

GOING CONCERN

Questerre's financial statements have been prepared using Canadian generally accepted accounting principles ("GAAP") and, accordingly, have been prepared using the same principles as those for a going concern.

FULL COST ACCOUNTING

Questerre follows the Canadian Institute of Chartered Accountants' ("CICA") guideline on full cost accounting to account for its oil and natural gas properties. Under this method, all costs associated with the acquisition of, exploration for and development of natural gas and crude oil reserves are capitalized and costs associated with production are expensed. The capitalized costs are depreciated, depleted and amortized using the unit-of-production method based on estimated proved reserves. Reserve estimates can have a significant impact on earnings, as they are a key component in the calculation of depreciation, depletion and amortization ("DD&A"). A downward revision in a reserve estimate could result in a higher DD&A charge to earnings. In addition, if net capitalized costs are determined to be in excess of the calculated ceiling, which is based largely on reserve estimates, the excess must be written off as an expense charged against earnings.

Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly to determine if proved reserves should be assigned or if impairment has occurred. If reserves can be assigned, the cost of the properties would be included in the depletion calculation. If impairment has occurred, any write-down would be included in depletion and depreciation expense for the period.

OIL AND GAS RESERVES

Questerre's proved oil and gas reserves are evaluated and reported on by an independent petroleum engineering consultant. The estimation of reserves is a subjective process. Forecasts are based on engineering data, projected future rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to a number of uncertainties and various interpretations. These estimates are the basis for the determination of the fair market value and the estimated net revenue stream of these reserves. The Company expects that its estimate of reserves will change to reflect updated information. Reserve estimates can be revised upward or downward based on the results of future drilling, testing, production levels and economics of recovery based on cash flow forecasts. Reserve estimates can have a significant impact on net earnings, as they are a key component in the calculation of depletion and depreciation. A revision to the reserve estimate could result in a higher or lower DD&A charge to net earnings. Downward revisions to reserve estimates could also result in a write-down of oil and natural gas property, plant and equipment under the ceiling test.

ASSET RETIREMENT OBLIGATION

The Company recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be determined. The liability is recorded at fair value and is adjusted to its present value in subsequent periods and the amount of the accretion is charged to earnings in the period. The associated asset retirement costs are capitalized as part of the carrying amount of the related asset. The capitalized amount is depleted on a unit of production basis in accordance with the Company's depletion policies.

Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost also result in an increase or decrease to the asset retirement obligation. In the second quarter of 2004, the Company increased its estimated undiscounted asset retirement cost for its Beaver River field from \$0.9 million to \$1.8 million. The \$0.9 million increase was added to the asset retirement obligation and also capitalized as part of the carrying amount of the related asset.

Actual costs incurred upon settlement of the obligation are charged against the liability to the extent the liability is recorded. Any difference between actual costs incurred upon settlement of the asset retirement obligation and the recorded liability is recognized as a gain or loss in the Company's earnings in the period in which settlement occurs.

Determination of the original undiscounted retirement obligations and timing of these obligations are based on internal estimates using current costs and technology in accordance with existing legislation and industry practice. These estimates are subject to change over time and, as such, may impact the charge against income for asset retirement obligations.

CHANGES IN ACCOUNTING POLICIES

The following new and amended standards were implemented by the Company in 2004 with the following impact on the 2003 financial statements where retroactive restatement was required.

STOCK BASED COMPENSATION

In January 2004, the Company adopted the amended CICA Handbook Section 3870 "Stock-based Compensation and Other Stock-based Payments". This change in accounting policy has been applied retroactively without restatement of prior periods presented.

Under this amended standard, the Company must account for compensation expense based on the fair value of rights granted under its stock-based compensation plan. Compensation cost attributable to share options granted to employees or directors is measured at fair value at the grant date and expensed over the expected exercise time frame with a corresponding increase to contributed surplus. Upon exercise of the stock options, consideration paid by the unit holder together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

As a result of adopting this change in accounting policy, the consolidated financial statements at January 1, 2004 were changed as follows: contributed surplus increased by \$70,527 and the opening deficit was increased by \$70,527.

ASSET RETIREMENT OBLIGATIONS

In January 2004, the Company adopted CICA Handbook Section 3110 "Asset Retirement Obligations". This change in accounting policy has been applied retroactively with restatement of prior periods presented.

Utilizing the new accounting policy, the Company recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be determined. The liability is recorded at fair value and is adjusted to its present value in subsequent periods as accretion expense is recorded. The associated asset retirement costs are capitalized as part of the carrying amount of the related asset. The capitalized amount is depleted on a unit of production basis in accordance with the Company's depletion policies. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost would also result in an increase or decrease to the asset retirement obligation. Actual costs incurred upon settlement of the obligation are charged against the liability to the extent the liability is recorded. Any difference between actual costs incurred upon settlement of the asset retirement obligation and the recorded liability is recognized as a gain or loss in the Company's earnings in the period in which settlement occurs.

As a result of adopting this change in accounting policy, the previously reported amounts for 2003 have been restated due to the retroactive application of this new standard. Net loss for the nine months ended September 30, 2003 decreased by \$11,931. The asset retirement obligation at December 31, 2003 decreased by \$30,699 to \$848,134, property, plant and equipment increased by \$20,599, net of accumulated depletion. Opening 2003 accumulated deficit increased by \$408,202 to reflect the cumulative impact of accretion and depletion expense, less the previously recorded cumulative site restoration provision. There was no impact on the Company's cash flow as a result of adopting this new policy.

FULL COST ACCOUNTING GUIDELINE

In January 2004, the Company prospectively adopted the new Accounting Guideline 16 "Oil and Gas Accounting – Full Cost" issued by the Canadian Institute of Chartered Accountants ("CICA").

Consistent with the former guideline, the net carrying cost of the Company's petroleum and natural gas properties is limited to an estimated net recoverable amount ("ceiling test"). Under the new guideline, the ceiling test calculation is a two step process. First, the Company determines whether a write-down is required by comparing the carrying value of the properties to the undiscounted cash flow of its proved reserves (based on management's best estimate of future prices) plus the lower of cost and market value for unproved properties. If there is an impairment calculated under the first step, the carrying value of properties is written down to the discounted value of the proved plus probable reserves (based on management's best estimate of future prices) plus the lower of cost and market of unproved properties.

The Company recorded a \$5.2 million ceiling test write-down for the nine months ended September 30, 2004 related to the Beaver River Field. This amount was calculated in accordance with the new accounting guideline utilizing an internal estimate of reserves and cash flows. The write-down is included in the depletion and depreciation provision on the income statement for the nine months ended September 30, 2004.

ADDITIONAL INFORMATION

Additional information relating to Questerre, including the Company's Annual Information Form can be obtained on SEDAR at www.sedar.com or on the Company's website at www.questerre.com.

NOTICE TO READER

The accompanying unaudited interim consolidated financial statements of Questerre Energy Corporation for the nine months ended September 30, 2004 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



David Mallory, CA
Interim Chief Financial Officer

Calgary, Alberta
November 11, 2004