Q4

2016 QUARTERLY REPORT

QUESTERRE ENERGY CORPORATION

2016

QUESTERRE ENERGY CORPORATION IS LEVERAGING ITS EXPERTISE GAINED THROUGH EARLY EXPOSURE TO SHALE AND OTHER NON-CONVENTIONAL RESERVOIRS.

THE COMPANY HAS BASE PRODUCTION AND RESERVES IN THE TIGHT OIL BAKKEN/TORQUAY OF SOUTHEAST SASKATCHEWAN.

IT IS BRINGING ON PRODUCTION FROM ITS LANDS IN THE HEART OF THE HIGH-LIQUIDS MONTNEY SHALE FAIRWAY.

IT IS A LEADER ON SOCIAL LICENSE TO OPERATE ISSUES FOR ITS GIANT UTICA SHALE GAS DISCOVERY IN QUEBEC.

IT IS PURSUING OIL SHALE PROJECTS WITH THE AIM OF COMMERCIALLY DEVELOPING THESE SIGNIFICANT RESOURCES.

QUESTERRE IS A BELIEVER THAT THE FUTURE SUCCESS OF THE OIL AND GAS INDUSTRY DEPENDS ON A BALANCE OF ECONOMICS, ENVIRONMENT AND SOCIETY. WE ARE COMMITTED TO BEING TRANSPARENT AND ARE RESPECTFUL THAT THE PUBLIC MUST BE PART OF MAKING THE IMPORTANT CHOICES FOR OUR ENERGY FUTURE.

QUESTERRE'S COMMON SHARES TRADE ON THE TORONTO STOCK EXCHANGE AND OSLO STOCK EXCHANGE UNDER THE SYMBOL QEC.

As at/for the period ended December 31,	Three months ended 2016	2015	Twelve months ended 2016	2015
Financial ($ thousands, except as noted)				
Petroleum and Natural Gas Sales	**4,574**	5,311	**17,120**	22,015
Adjusted Funds Flow from Operations	**1,943**	2,269	**7,045**	9,778
Basic and diluted ($/share)	**0.01**	0.01	**0.03**	0.04
Net Income (Loss)	**3,674**	(56,044)	**169**	(73,534)
Basic and diluted ($/share)	**0.01**	(0.21)	**-**	(0.28)
Capital Expenditures, net of acquisitions and dispositions	**5,260**	1,014	**14,218**	20,524
Working Capital Deficit	**(17,019)**	(21,478)	**(17,019)**	(21,478)
Total Assets	**177,761**	161,894	**177,761**	161,894
Shareholders' Equity	**139,660**	127,453	**139,660**	127,453
Common Shares Outstanding (thousands)	**308,274**	264,932	**308,274**	264,932
Weighted average - basic (thousands)	**293,470**	264,932	**278,662**	264,932
Weighted average - diluted (thousands)	**308,017**	264,932	**280,410**	264,932
Operations (units as noted)				
Average Production				
Crude Oil and Natural Gas Liquids (bbls/d)	**755**	939	**801**	913
Natural Gas (Mcf/d)	**3,034**	4,255	**3,436**	4,012
Total (boe/d)	**1,261**	1,648	**1,373**	1,582
Average Sales Price				
Crude Oil and Natural Gas Liquids ($/bbl)	**50.15**	48.08	**46.38**	51.75
Natural Gas ($/Mcf)	**2.67**	2.96	**2.22**	3.26
Total ($/boe)	**39.43**	35.03	**34.06**	38.13
Netback ($/boe)				
Petroleum and Natural Gas Sales	**39.43**	35.03	**34.06**	38.13
Royalties Expense	**(1.66)**	(1.84)	**(1.86)**	(2.16)
Percentage	**4%**	5%	**5%**	6%
Direct Operating Expense	**(14.38)**	(14.69)	**(15.23)**	(13.97)
Operating Netback	**23.38**	18.50	**16.98**	22.00
Wells Drilled				
Gross	**1.00**	-	**3.00**	1.00
Net	**0.25**	-	**0.75**	0.25

(1) Adjusted Funds Flow from Operations is a non-GAAP measure defined as cash flows from operating activities before changes in non-cash operating working capital and interest paid or received.

(2) Working capital deficit is a non-GAAP measure calculated as current assets less current liabilities excluding the current portion of the share based compensation liability and risk management contracts.

(3) 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.

Notice to Reader

The accompanying unaudited consolidated financial statements have been prepared by management and approved by the Audit Committee and the Board of Directors. In accordance with National Instrument 51-201 released by the Canadian Securities Administrators, Questerre Energy Corporation discloses that its auditors have not reviewed the unaudited consolidated interim financial statements for the period ended December 31, 2016.

Condensed Consolidated Interim Balance Sheets *(unaudited)*

($ thousands)	Note		December 31, 2016		December 31, 2015
Assets					
Current Assets					
Cash and cash equivalents		$	8,275	$	343
Accounts receivable			2,339		2,668
Current portion of risk management contracts	10		-		1,032
Deposits and prepaid expenses			626		582
			11,240		4,625
Investments	3		490		632
Property, plant and equipment	4		87,125		87,547
Exploration and evaluation assets	5		58,915		47,917
Goodwill			2,346		2,346
Deferred tax assets			17,645		18,827
		$	177,761	$	161,894
Liabilities					
Current Liabilities					
Accounts payable and accrued liabilities		$	5,370	$	10,529
Current portion of risk management contracts	10		1,117		-
Credit facilities	11		22,888		14,542
			29,375		25,071
Risk management contracts	10		-		618
Asset retirement obligation	6		8,726		8,752
			38,101		34,441
Shareholders' Equity					
Share capital	7		359,151		347,345
Contributed surplus			17,254		16,951
Accumulated other comprehensive income			138		209
Deficit			(236,883)		(237,052)
			139,660		127,453
		$	177,761	$	161,894

The notes are an integral part of these condensed consolidated interim financial statements.

Condensed Consolidated Interim Statements of Net Income (Loss) and Comprehensive Income (Loss) *(unaudited)*

($ thousands, except per share amounts)	Note	*Three months ended December 31,* 2016	2015	*Twelve months ended December 31,* 2016	2015
Revenue					
Petroleum and natural gas sales		$ 4,574	$ 5,311	$ 17,120	$ 22,015
Royalties		(193)	(279)	(936)	(1,246)
Petroleum and natural gas revenue, net of royalties		4,381	5,032	16,184	20,769
Expenses					
Direct operating		1,668	2,229	7,652	8,067
General and administrative		807	772	2,761	3,546
Depletion and depreciation	4	1,940	2,762	8,861	9,730
Impairment of assets	3,4,5	(22,925)	47,171	(22,925)	66,490
Lease Expiries	5	17,750	1,079	17,838	3,130
Loss (gain) on risk management contracts	10	597	(428)	195	(468)
Share based compensation (recovery)		25	(125)	122	(54)
Accretion of asset retirement obligation	6	67	21	142	115
Interest expense		330	1,400	912	1,487
Other (income) expense		26	(5)	12	139
Net Income (loss) before taxes		4,096	(49,844)	614	(71,413)
Deferred tax expense		422	6,200	445	2,121
Net Income (Loss)		3,674	(56,044)	169	(73,534)
Other comprehensive income (loss), net of tax					
Items that may be reclassified subsequently to net income (loss):					
Foreign currency translation adjustment		15	22	(30)	22
Gain (loss) on foreign exchange on investments	3	11	355	(13)	2,422
Reclass to net income (loss) on investment impairment		(28)	(296)	(28)	(2,363)
		(2)	81	(71)	81
Total comprehensive income (loss)		$ 3,672	$ (55,963)	$ 98	$ (73,453)
Net income (loss) per share					
Basic and diluted	7	$ 0.01	$ (0.21)	$ -	$ (0.28)

Condensed Consolidated Interim Statements of Changes in Equity *(unaudited)*

			Twelve months ended December 31,		
($ thousands)	Note		2016		2015
Share Capital					
Balance, beginning of period	7	$	347,345	$	347,345
Private Placements			11,279		-
Warrants exercised			1,006		-
Options exercised			15		-
Share issue costs (net of tax effect)			(494)		-
Balance, end of period			359,151		347,345
Contributed Surplus					
Balance, beginning of period			16,951		16,686
Share based compensation			303		265
Balance, end of period			17,254		16,951
Accumulated Other Comprehensive Income					
Balance, beginning of period			209		128
Other comprehensive (gain) loss			(71)		81
Balance, end of period			138		209
Deficit					
Balance, beginning of period			(237,052)		(163,518)
Net Income (loss)			169		(73,534)
Balance, end of period			(236,883)		(237,052)
Total Shareholders' Equity		$	139,660	$	127,453

The notes are an integral part of these condensed consolidated interim financial statements.

Condensed Consolidated Interim Statements of Cash Flows *(unaudited)*

($ thousands)	Note	*Three months ended December 31,* 2016	2015	*Twelve months ended December 31,* 2016	2015
Operating Activities					
Net income (loss)		$ 3,674	$ (56,044)	$ 169	$ (73,534)
Adjustments for:					
Depletion and depreciation	4	1,940	2,762	8,861	9,730
Impairment of assets & lease expiries	3,4,5	(5,175)	48,250	(5,087)	69,620
Unrealized (gain) loss on risk management contracts	10	651	(205)	1,531	334
Share based compensation (recovery)		25	(125)	122	(54)
Accretion of asset retirement obligation	6	67	21	142	115
Deferred tax expense		422	6,200	445	2,121
Interest expense		330	1,400	912	1,487
Other items not involving cash		15	21	(32)	19
Abandonment expenditures	6	(6)	(11)	(18)	(60)
Adjusted Funds Flow from Operations		1,943	2,269	7,045	9,778
Interest paid		(328)	(122)	(912)	(225)
Change in non-cash working capital		1,086	(364)	586	(596)
Net cash from operating activities		2,701	1,783	6,719	8,957
Investing Activities					
Property, plant and equipment expenditures	4	(1,782)	(107)	(3,301)	(2,241)
Exploration and evaluation expenditures	5	(3,478)	(907)	(10,917)	(18,283)
Change in non-cash working capital		(1,354)	(3,845)	(5,457)	(13,637)
Net cash used in investing activities		(6,614)	(4,859)	(19,675)	(34,161)
Financing Activities					
Proceeds from issue of share capital	7	8,467	-	13,218	-
Share issue costs	7	(591)	-	(676)	-
Increase in credit facilities		10,579	10,196	32,246	33,767
Repayment of credit facilities		(6,600)	(7,013)	(23,900)	(19,225)
Net cash from financing activities		11,855	3,183	20,888	14,542
Change in cash and cash equivalents		7,942	107	7,932	(10,662)
Cash and cash equivalents, beginning of period		333	236	343	11,005
Cash and cash equivalents, end of period		$ 8,275	$ 343	$ 8,275	$ 343

The notes are an integral part of these condensed consolidated interim financial statements.

1. Nature of Operations and Basis of Presentation

Questerre Energy Corporation ("Questerre" or the "Company") is actively engaged in the acquisition, exploration and development of oil and gas projects, in specific non-conventional projects such as tight oil, oil shale, shale oil and shale gas. These condensed consolidated interim financial statements of the Company as at and for the three and twelve months ended December 31, 2016 and 2015, comprise the Company and its wholly-owned subsidiary in those periods owned.

Questerre is incorporated under the laws of the Province of Alberta and is domiciled in Canada. The address of its registered office is 1650, 801 – 6 Avenue SW, Calgary, Alberta.

These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of interim financial statements, including International Accounting Standard 34 *Interim Financial Reporting* ("IAS 34"). These condensed consolidated interim financial statements have been prepared following the same accounting policies and method of computation as the annual consolidated financial statements for the year ended December 31, 2015, with the exception of deferred taxes. Taxes in the interim periods are accrued using the tax rate that would be applicable to expected total annual net income (loss). The disclosures provided below are incremental to those included with the annual consolidated financial statements. Certain information and disclosures normally included in the notes to the annual consolidated financial statements have been condensed or have been disclosed on an annual basis only. Accordingly, these condensed consolidated interim financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2015, which have been prepared in accordance with IFRS as issued by the IASB.

These condensed consolidated interim financial statements of Questerre were approved by the Board of Directors on February 23, 2017.

2. Accounting Policy Changes

Changes in Accounting Policies for 2016

There were no new or amended accounting standards or interpretations adopted during the year ended December 31, 2016.

Future Accounting Pronouncements

There were no new or amended accounting standards or interpretations issued during the three months ended December 31, 2016 that are applicable to the Company in future periods. A description of accounting standards and interpretations that will be adopted by the Company in future periods can be found in the notes to the annual consolidated financial statements for the year ended December 31, 2015.

3. Investments

The investments balance is comprised of the following investments:

($ thousands)		December 31, 2016		December 31, 2015
Red Leaf Resources Inc.	$	490	$	500
Private Company		-		132
	$	490	$	632

The following table sets out the changes in investments:

($ thousands)		December 31, 2016		December 31, 2015
Balance, beginning of year	$	632	$	16,541
Gain (Loss) on foreign exchange		(13)		2,790
Impairment		(129)		(18,699)
Balance, end of period	$	490	$	632

For the year ended December 31, 2016, the loss on foreign exchange relating to investments was $0.01 million (December 31, 2015: gain $2.79 million), which was recorded in other comprehensive income (loss) net of deferred tax of $0.002 million (December 31, 2015: $0.37 million).

At December 31, 2016, the Company recorded an impairment charge of $0.13 million relating to an investment in a private company of which $0.1 million was recorded in net loss and $0.03 million in other comprehensive income (loss). At December 31, 2015, the Company recorded an impairment charge of $18.18 million for Red Leaf, of which $15.51 million was recorded in net loss and $2.67 million in other comprehensive income (loss). The remaining impairment charge in 2015 related to its investment in a private company.

4. Property, Plant and Equipment

The following table provides a reconciliation of the Company's property, plant and equipment assets:

($ thousands)		Oil and Natural Gas Assets		Other Assets		Total
Cost or deemed cost:						
Balance, December 31, 2014	$	175,686	$	1,334	$	177,020
Additions		2,116		-		2,116
Transfer from exploration and evaluation assets		26,299		-		26,299
Balance, December 31, 2015		204,101		1,334		205,435
Additions		3,171		-		3,171
Transfer from exploration and evaluation assets		5,740		-		5,740
Balance, December 31, 2016	**$**	**213,012**	**$**	**1,334**	**$**	**214,346**
Accumulated depletion, depreciation and impairment losses:						
Balance, December 31, 2014	$	79,821	$	1,192	$	81,013
Depletion and depreciation		9,676		54		9,730
Impairment		27,145		-		27,145
Balance, December 31, 2015		116,642		1,246		117,888
Depletion and depreciation		8,823		38		8,861
Impairment		472		-		472
Balance, December 31, 2016	**$**	**125,937**	**$**	**1,284**	**$**	**127,221**

($ thousands)		Oil and Natural Gas Assets		Other Assets		Total
Net book value:						
At December 31, 2015	$	87,459	$	88	$	87,547
At December 31, 2016	**$**	**87,075**	**$**	**50**	**$**	**87,125**

During the year ended December 31, 2016, the Company capitalized administrative overhead charges directly related to development activities of $0.06 million. For the year ended December 31, 2015, the Company derecognized $0.03 million in capitalized stock based compensation expense directly related to these activities. Included in the December 31, 2016 depletion calculation are future development costs of $177.86 million (December 31, 2015: $134.74 million). As at December 31, 2016, $2.50 million of assets under construction were included within property, plant and equipment (December 31, 2015: Nil) and not subject to depletion and depreciation.

In 2016, the Company reviewed the carrying amounts of its oil and gas assets for indicators of impairment such as changes in future prices, future costs and reserves. Based on this review, the Company's cash generating units ("CGUs") of Other Alberta and Vulcan were tested for impairment in accordance with the Company's accounting policy. The recoverable amount of the CGUs was estimated based on the fair value less cost of disposal ("FVLCD") using a discounted cash flow model.

The estimates of FVLCD were determined using a discount rate of 10% and forecasted after-tax cash flows based on proved plus probable reserves, with escalating prices and future development costs obtained from an independent reserve evaluation report.

The future prices used to determine cash flows from crude oil and natural gas reserves are as follows:

	2017	2018	2019	2020	2021	Average Annual % Change Thereafter
WTI (US$/barrel)	55.00	58.70	62.40	69.00	75.80	0.02
AECO ($/MMbtu)	3.40	3.15	3.30	3.60	3.90	0.02

Based on its assessment, the Company recorded an impairment loss of $0.47 million relating to its Vulcan and Other Alberta CGUs. The factor that led to the impairment was a reduction in forecasted commodity prices. The recoverable amounts at December 31, 2016 for these CGUs are as follows:

($ thousands)		Vulcan		Other Alberta
Recoverable amounts	$	-	$	307

In 2015, the Company recorded an impairment loss of $27.15 million. The factors that led to the impairment in 2015 were reductions in forecasted commodity prices.

5. Exploration and Evaluation Assets

The following table provides a reconciliation of the Company's exploration and evaluation assets:

($ thousands)		**December 31, 2016**		December 31, 2015
Balance, beginning of year	**$**	**47,917**	$	81,900
Additions		**11,078**		18,943
Transfers to property, plant and equipment		**(5,740)**		(26,299)
Undeveloped lease expiries		**(17,838)**		(3,129)
Impairment		**23,498**		(23,498)
Balance, end of period	**$**	**58,915**	$	47,917

During the year ended December 31, 2016, the Company capitalized administrative overhead charges of $1.09 million including $0.18 million for capitalized stock based compensation expense directly related to exploration and evaluation activities. During the year ended December 31, 2015, the Company capitalized administrative overhead charges of $1.38 million and no amount was recognized for capitalized stock based compensation expense directly related to exploration and evaluation activities.

In 2016, the Company reviewed the carrying amount of its exploration and evaluation assets for indicators of impairment. The future recovery of the Quebec assets was assessed in light of the introduction of new hydrocarbon legislation in the province in 2016 and an independent assessment of its natural gas resources in Quebec as of December 31, 2016. As a result, the Company has recognized a reversal of the impairment loss of $23.50 million recorded in 2015 associated with these assets. In 2016, the Company incurred an expense of $17.84 million for undeveloped land expiries (2015: $3.13 million).

6. Asset Retirement Obligation

The Company's asset retirement and abandonment obligations result from its ownership interest in oil and natural gas assets. The total asset retirement obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company has estimated the net present value of the asset retirement obligation to be $8.73 million as at December 31, 2016 (December 31, 2015: $8.75 million) based on an undiscounted total future liability of $11.37 million (December 31, 2015: $11.31 million). These payments are expected to be made over the next 40 years. The average discount factor, being the risk-free rate related to the liabilities, is 1.56% (December 31, 2015: 1.35%). An inflation rate of 2.2% (December 31, 2015: 2.2%) over the varying lives of the assets is used to calculate the present value of the asset retirement obligation.

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

($ thousands)		**December 31, 2016**		December 31, 2015
Balance, beginning of year	**$**	**8,752**	$	8,133
Liabilities disposed		**-**		(68)
Liabilities incurred		**161**		296
Liabilities settled		**(18)**		(60)
Revisions due to change in discount rates		**(311)**		(379)
Revisions due to change in estimates		**-**		715
Accretion		**142**		115
Balance, end of period	**$**	**8,726**	$	8,752

7. Share Capital

The Company is authorized to issue an unlimited number of Class "A" common voting shares ("Common Shares"). The Company is also authorized to issue an unlimited number of Class "B" common voting shares and an unlimited number of preferred shares, issuable in one or more series. At December 31, 2016, there were no Class "B" common voting shares or preferred shares outstanding.

a) Issued and outstanding – Common Shares

	Number *(thousands)*		Amount *($ thousands)*
Balance, December 31, 2015	264,932		347,345
Private Placements	41,592		11,279
Options exercised	1,677		1,006
Warrants exercised	73		15
Share issue costs (net of tax effect)	-		(494)
Balance December 31, 2016	**308,274**	**$**	**359,151**

In July 2016, the Company completed a private placement of 26.39 million flow-through units for gross proceeds of approximately $4.75 million (the "Flow-Through Placement"). Each flow-through unit consists of one Common Share issued on a "flow-through" basis and one-half of one non flow-through share purchase warrant. Each whole warrant will entitle the holder to purchase one additional non-flow-through Common Share at a price of $0.20 for a period of 18 months from closing. The warrants were valued using a Black-Scholes pricing model.

The gross proceeds of the Flow-Through Placement were used by the Company, pursuant to the provisions of the Income Tax Act (Canada), to incur eligible Canadian development expenses ("Qualifying Expenditures") and prior to December 31, 2016 on Questerre's properties. The Company renounced the Qualifying Expenditures to subscribers of the Flow-Through Units for the fiscal year ended December 31, 2016.

In the fourth quarter, the Company completed a private placement of 15.2 million Common Shares at a price of $0.49 per Common Share for gross proceeds of approximately $7.4 million.

See Note 14 for Common Shares issued in the first quarter of 2017.

b) Per share amounts

Basic net loss per share is calculated as follows:

		Three months ended December 31,				*Twelve months ended December 31,*		
(thousands, except as noted)		**2016**		2015		**2016**		2015
Net income (loss) ($thousands)	**$**	**3,674**	$	(56,044)	**$**	**169**	$	(73,534)
Issued Common Shares at beginning of period		**291,324**		264,932		**264,932**		264,932
Weighted average number of Common Shares outstanding (basic)		**293,470**		264,932		**278,662**		264,932
Basic net income (loss) per share	**$**	**0.01**	$	(0.21)	**$**	**-**	$	(0.28)

Diluted net income (loss) per share is calculated as follows:

(thousands, except as noted)	Three months ended December 31, 2016	2015	Twelve months ended December 31, 2016	2015
Net income (loss) ($thousands)	$ 3,674	$ (56,044)	$ 169	$ (73,534)
Weighted average number of Common Shares outstanding (diluted)	308,017	264,932	280,410	264,932
Diluted net income (loss) per share	$ 0.01	$ (0.21)	$ -	$ (0.28)

Under the current stock option plan, options can be exchanged for Common Shares of the Company, or for cash at the Company's discretion. They are considered potentially dilutive and are included in the calculation of diluted net loss per share for the period. The average market value of the Company's shares for purposes of calculating the dilutive effect of options was based on quoted market prices for the period that the options were outstanding. At December 31, 2016, 17.17 million options (December 31, 2015: nil) were excluded from the diluted weighted average number of Common Shares outstanding calculation as their effect would have been anti-dilutive.

8. Share Based Compensation

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

The number and weighted average exercise prices of the stock options are as follows:

	December 31, 2016		December 31, 2015	
	Number of Options *(thousands)*	Weighted Average Exercise Price	Number of Options *(thousands)*	Weighted Average Exercise Price
Outstanding, beginning of period	19,982	$0.72	17,792	$1.96
Granted	4,100	0.18	10,532	0.29
Forfeited	(4,289)	0.47	(2,819)	1.10
Expired	(3,260)	1.85	(5,523)	3.68
Exercised	(1,677)	0.60	-	-
Outstanding, end of period	14,856	$0.41	19,982	$0.72
Exercisable, end of period	5,939	$0.55	6,808	$0.97

9. Capital Management

The Company believes that with its current credit facilities and positive expected funds flow from operations (a non-GAAP measure defined as net cash from operating activities before changes in non-cash working capital and before deduction of interest expense), it will be able to meet its foreseeable obligations in the normal course of operations. On an ongoing basis the Company reviews its commitment to incur capital expenditures to ensure that funds flow from operations or access to credit facilities are available to fund these capital expenditures. Refer to Note 11.

The volatility of commodity prices has a material impact on Questerre's adjusted funds flow from operations. Questerre attempts to mitigate the effect of lower prices by entering into risk management contracts, shutting in production in unusually low pricing environments, reallocating capital to more profitable areas and reducing capital spending based on results and other market considerations.

The Company considers its capital structure to include shareholders' equity and any outstanding amounts under its credit facilities. The Company will adjust its capital structure to minimize risk and its cost of capital through the issuance of shares, securing additional credit facilities and adjusting its capital spending as required. Questerre monitors its capital structure based on current and projected funds flow from operations.

($ thousands)		**December 31, 2016**		December 31, 2015
Credit facilities	**$**	**22,888**	$	14,542
Shareholders' equity		**139,660**		127,453
	$	**162,548**	$	141,995

10. Financial Risk Management and Determination of Fair Values

a) Overview

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production, and financing activities such as credit risk, liquidity risk and market risk. The Company manages its exposure to these risks by operating in a manner that minimizes this exposure.

b) Fair value of financial instruments

The Company's financial instruments as at December 31, 2016 included cash and cash equivalents, accounts receivable, risk management contracts, deposits, investments, credit facilities and accounts payable and accrued liabilities. As at December 31, 2016, the fair values of the Company's financial assets and liabilities approximate their carrying values due to the short-term maturity with the exception of the Company's investments and the risk management contracts, which are recorded at fair value.

Disclosures about the inputs to fair value measurements are required, including their classification within a hierarchy that prioritizes the inputs to fair value measurement.

Level 1 Fair Value Measurements

Level 1 fair value measurements are based on unadjusted quoted market prices.

The Company does not hold any Level 1 financial instruments.

Level 2 Fair Value Measurements

Level 2 fair value measurements are based on valuation models and techniques where the significant inputs are derived from quoted indices.

The Company's risk management contracts are considered a level 2 instrument. The Company's financial derivative instruments are carried at fair value as determined by reference to independent monthly forward settlement prices and currency rates.

Level 3 Fair Value Measurements

Level 3 fair value measurements are based on unobservable information.

The Company's investments are considered a Level 3 instrument. The fair values are determined using a net asset value approach. Refer to Note 3.

As at each reporting period, the Company will assess whether a financial asset is impaired, other than those classified as fair value through profit or loss. Any impairment loss will be included in net income (loss) for the period.

c) Market risk

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's profit or loss or the value of its financial instruments. The objective of the Company is to mitigate exposure to these risks while maximizing returns to the Company.

Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and United States dollar and also world economic events that dictate the levels of supply and demand. The Company may enter into oil and natural gas contracts to protect, to the extent possible, its funds flows from future sales. The contracts reduce the volatility in sales revenue by locking in prices with respect to future deliveries of oil and natural gas.

As at December 31, 2016, the Company had the following outstanding commodity risk management contracts:

Risk Management Contract	Volumes	Average Price	Term	Fair Value (Asset) Liability *($ thousands)*
AECO - call option sale	3,000 GJ/d	$2.70/GJ	Jan. 1, 2017 - Dec. 31, 2017	764
WTI NYMEX - call option sale	200 bbls/d	$80/bbl	Jan. 1, 2017 - Dec. 31, 2017	353

The Company's risk management position is as follows:

($ thousands)		**December 31, 2016**		December 31, 2015
Risk Management Assets				
Current portion	**$**	**-**	$	1,032
	$	**-**	$	1,032

($ thousands)		**December 31, 2016**		December 31, 2015
Risk Management Liabilities				
Current portion	**$**	**1,117**	$	-
Non-current portion		**-**		618
	$	**1,117**	$	618

The Company recorded an unrealized loss of $1.53 million for the year ended December 31, 2016 and an unrealized loss of $0.33 million for the same period in 2015. The Company also recorded a realized gain of $1.33 million for the year ended December 31, 2016 and a realized gain of $0.80 million for the same period in 2015.

The value of Questerre's commodity price risk management contracts fluctuate with changes in the underlying market price of the relevant commodity. A summary of the impact to net income (loss) as a result of changes to commodity prices follows:

Risk Management Contract	Sensitivity Range	Increase *($ thousands)*	Decrease
WTI NYMEX futures sale	$1/bbl increase or decrease to WTI price over $80/bbl	73,000	(73,000)
AECO futures sale	$0.50/GJ increase or decrease to AECO price over $2.7/GJ	547,500	(547,500)

d) Credit risk

Credit risk represents the potential financial loss to the Company if a customer or counterparty to a financial instrument fails to meet or discharge their obligation to the Company. Credit risk arises from the Company's receivables from joint venture partners and oil and gas marketers. In the event such entities fail to meet their contractual obligations to the Company, such failures may have a material adverse effect on the Company's business, financial condition, results of operations and prospects. Credit risk also arises from the Company's cash and cash equivalents. The Company manages credit risk exposure by investing its cash in Canadian banks and credit unions. Management does not expect any counterparty to fail to meet its obligations.

Poor credit conditions in the industry may impact a joint venture partner's willingness to participate in the Company's ongoing capital program, potentially delaying the program and the results of such program until the Company finds a suitable alternative partner.

Substantially all of the accounts receivable are with oil and natural gas marketers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. The Company generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by entering into transactions with long-standing, reputable counterparties and partners.

Accounts receivable related to the sale of the Company’s petroleum and natural gas production is paid in the following month from major oil and natural gas marketing companies and the Company has not experienced any credit loss relating to these sales to date.

Receivables from joint venture partners are typically collected within one to three months after the joint venture bill is issued. The Company mitigates this risk by obtaining pre-approval of significant capital expenditures.

At December 31, 2016, there was $0.36 million (2015: $0.33 million) of accounts receivable greater than 90 days. The Company has provided an allowance against its doubtful accounts of $0.15 million at December 31, 2016 (2015: $0.15 million).

11. Credit Facilities

As at December 31, 2016, the credit facility includes a revolving operating demand facility of $24.9 million (“Credit Facility A”), a non-revolving acquisition and development facility of $5.0 million (“Credit Facility B”) and a corporate credit card of $0.1 million (“Credit Facility C”). Credit Facility A can be used for general corporate purposes, ongoing operations, capital expenditures within Canada, and acquisition of petroleum and natural gas assets within Canada. Credit Facility B can only be used for the acquisitions of producing reserves and/or development of existing proved non-producing/undeveloped reserves.

Any borrowing under the facility, with the exception of letters of credit, bears interest at the bank’s prime interest rate and an applicable basis point margin based on the ratio of debt to cash flow measured quarterly. The bank’s prime rate currently is 2.70% per annum. The facility is secured by a debenture with a first floating charge over all assets of the Company and a general assignment of books debts. Under the terms of the credit facility, the Company has provided a covenant that it will maintain an Adjusted Working Capital Ratio greater than 1.0. The ratio is defined as current assets (excluding unrealized hedging gains and including undrawn Credit Facility A availability) to current liabilities (excluding bank debt outstanding and unrealized hedging losses). The Adjusted Working Capital Ratio at December 31, 2016 was 2.47 and the covenant was met. At December 31, $22.89 million (December 31, 2015: $18.91 million) was drawn on Credit Facility A.

The credit facility is a demand facility and can be reduced, amended or eliminated by the lender for reasons beyond the Company’s control. Should the credit facility, in fact, be reduced or eliminated, the Company would need to seek alternative credit facilities or consider the issuance of equity to enhance its liquidity.

In February 2017, Credit Facility A was renewed at $22.9 million, Credit Facility B was terminated and Credit Facility C remains at $0.1 million.

12. Related Party Transactions

Other than indicated below, the Company did not engage in any related party transactions during the quarter ended December 31, 2016.

Certain directors and officers of the Company participated in the Flow-Through Placement, which constituted a "related party transaction" within the meaning of Multilateral Instrument 61-101 – Protection of Minority Security Holders in Special Transactions ("MI 61-101"). Questerre relied upon exemptions from the formal valuation and minority approval requirements of MI 61-101 based on a determination that the fair market value of the placement, insofar as it involved related parties, did not exceed 25% of the market capitalization of the Company.

13. Deferred Tax Assets

In the fourth quarter of 2016, the Company evaluated the recoverability of its deferred tax assets using forecasted before-tax cash flows based on proved reserves, with escalating prices and future development costs obtained from an independent reserve evaluation report. Based on this evaluation, the Company derecognized $1.18 million of its December 31, 2016 deferred tax asset.

14. Subsequent Events

In February 2017, the Company concluded a private placement of 30.8 million Common Shares at a price of $0.79 per Common Share for gross proceeds of approximately $24 million.

In February 2017, Credit Facility A was renewed at $22.9 million, Credit Facility B was terminated and Credit Facility C remains at $0.1 million.

Corporate Information

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Dennis Sykora

Bjorn Inge Tonnessen

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