2020 ANNUAL REPORT

QUESTERRE ENERGY CORPORATION

QUESTERRE

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QUESTERRE

QUESTERRE ENERGY CORPORATION is an energy technology and innovation company. It is leveraging its expertise gained through early exposure to low permeability reservoirs to acquire significant high-quality resources. We believe we can successfully transition our energy portfolio. With new clean technologies and innovation to responsibly produce and use energy, we can sustain both human progress and our natural environment.

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 are traded on the Toronto Stock Exchange and Oslo Stock Exchange under the symbol QEC.

President’s Message

We emerged from an incredibly challenging year with our assets and liquidity intact.

Early in the year, we decisively cut all non-essential capital and reduced overheads and operating costs where possible. By prioritizing financial liquidity, we weathered the collapse in prices. While spot prices have improved materially in the first quarter of this year, we are closely watching the longer-term prices before committing to new capital spending.

Going forward, what has becoming equally if not more important than commodity prices for our business is the ESG movement.

The growing importance of these standards has led many energy companies to commit to net-zero emissions targets within the next two decades. Governments are making similar pledges including Canada which has committed to legislate the goal of net-zero by 2050. One approach to achieve this goal is the introduction of the Clean Fuel Standard by the Federal Government in 2020 which seeks to reduce emissions intensity through aggressive targets.

We are confident that we have the right approach to deal with this new reality, notwithstanding how long it is taking. As Quebec was at the forefront of this movement, over the last four years we made a significant investment in engineering a zero-emissions solution for our discovery and building social acceptability. We recently published a report that confirms our Clean Gas would produce 75% less emissions than any other major supply of gas to Quebec. It’s important to note that our Clean Tech Energy project reduces 16 different environmental impacts, not just emissions, by approximately three quarters.

Near the end of the year, we began looking at reducing emissions from the consumption of our product. One promising approach using proven technology is producing hydrogen from Clean Gas. There is an emerging approach to a circular economy where carbon dioxide emissions are reduced, recycled, or stored. We believe our project is leading edge and can demonstrate the circular economy. It would also establish natural gas as a sustainable energy option.

Our recent contract with CIRAIG will study how hydrogen from Clean Gas combined with carbon capture and storage, or blue hydrogen, can provide the economic advantages of grey hydrogen (hydrogen produced from natural gas) with the environmental benefits of green hydrogen (hydrogen produced from water). We were pleased to learn that the Government of Canada and leading-edge companies like Equinor see blue hydrogen as essential to reducing emissions. We are also evaluating novel technologies including those using catalysts and pyrolysis that have the potential to be even better.

We see the main benefits of blue hydrogen are to turn abundant fossil fuels into zero emissions hydrogen and be a potential mass market emissions solution. In contrast, green hydrogen turns green electricity into less green energy due to inefficiencies in the electrolysis process. Though there are clearly opportunities for both green and blue hydrogen to improve environmental impacts depending on the local market conditions.

We believe the social benefits of our project are just as significant as the environmental benefits. However, conveying these benefits to key stakeholders to garner their support in our discussions with the Government has been our biggest challenge.

The pandemic underscored the value of these benefits, including a secure local, stable, and low-cost supply of natural gas.

The disruption of supply chains led to rationing of propane in Quebec, threatening farmers using it for heating and crop drying, hospitals and care facilities using it as backup heat and others. The collapse in industrial demand has led large consumers to seek local alternatives to mitigate the import costs as well as peak winter pricing. As a side note, this is becoming a growing risk across the continent with the Governor of Texas threatening to suspend natural gas supplies to Mexico (which imports more than 60% of its natural gas from Texas) during the recent polar vortex which crippled local production for power generation.

Farmers and industrial gas users are now interested in our Clean Gas as a more reliable and cost-effective solution. We hope they will soon join a growing list of other stakeholders including local municipalities and First Nations that will benefit from our profit-sharing initiatives and local economic activity. Building this coalition of broad and vocal supporters remains our top priority.

Achieving this critical mass of support is taking much longer than we hoped. Since this is a prerequisite for government approvals, we do not have a firm start date for our pilot. We acknowledge the frustration of many of our shareholders regarding these delays and lack of milestones. However, our current work to reduce emissions from consumption plus recent emphasis from the Federal Government of Canada should improve our prospects.

We have respected the provincial Government's wishes and maintained a low profile during this time. On balance, we are optimistic they will approve our project once we can demonstrate social acceptability. This optimism is based on their keen interest in projects to restart the economy and their awareness that few, if any other projects, have the potential to create significant jobs and economic activity, with demonstrated economics.

We are also optimistic that strengthening oil prices reflect the improving fundamentals of recovering demand and limited supply growth. But we are mindful that prices are often volatile (falling to below zero last spring and rising to over US$60/bbl this winter) and can stay depressed for extended periods as they did last year. This had a knock-on effect in the market with several financial restructurings and M&A transactions including one with the largest Montney operator at Kakwa earlier this year.

We were able to adjust quickly to this pricing environment and both joint ventures suspended any discretionary drilling last year. The impact of this deferral on our reserve report was minimal with our volumes decreasing marginally by 5%, consistent with the results of other operators in the area.

As we ramp up our efforts in Quebec, we are looking at strategic alternatives, in particular, for our Kakwa working interests.

The drop in prices and the rising ESG movement also provided an opportunity to re-evaluate our oil shale investments including our project in Jordan and equity interest in Red Leaf, which remains a core investment for us.

As a significant shareholder, we supported Red Leaf's corporate restructuring efforts to right-size the company and preserve cash. They reduced overheads and completed an issuer bid in the year, reducing their share capital by 14%. We now own 38% of a company that has over US$20 million in unrestricted cash and a promising technology.

The main goal at Red Leaf is to reduce up-front capital and lower break-even prices below US$60/bbl while lowering their emissions footprint. The early progress is very encouraging and this could make a material difference for our resource in Jordan. The next steps for us are to finalize the terms of our concession agreement with the Jordanian Government and seek partners for a small-scale commercial demonstration project.

Another goal for Red Leaf is to look at new market opportunities for their technology both in and out of the oil shale space. We are most excited about the application of their technology for the new and growing biofuels and biogas markets as well as the potential for hydrogen production.

Operating and Financial

With capital spending largely deferred in 2020, corporate production averaged just under 2,000 boe/d, marginally lower than last year. Until we resume drilling at Kakwa, we expect this will decline naturally in 2021.

Our adjusted funds flow from operations was directly impacted by the dramatic drop in oil prices, particularly in the second quarter when they fell 60% from the prior year. Partly offsetting this drop were cost cutting measures and efficiencies. For the year, we reported funds from operations of $6.1 million compared to $14.4 million last year. These funds essentially financed our capital spending of $5.9 million for the year, which consisted of one (0.25 net) well at Kakwa and capitalized overhead in Quebec and Jordan.

As a result, we ended the year with a slight improvement in our net working capital and our credit facility maintained at $20 million.

Outlook

With lockdowns still in effect and concerns about a third wave of the pandemic, we are cautious about the near-term movement in oil prices and the headlines of a new super cycle in commodities. We remain focused on preserving financial liquidity over growing our production.

We were encouraged by the resurgence of interest in natural gas as a clean and reliable power source during the polar vortex. Both within North America and internationally, spot prices for natural gas and LNG rose to record highs as renewable power sources were unable to meet demand. This demonstrates the important role natural gas can play in energy transition.

The market has made it clear that energy development today needs to be sustainable, both from an economic and an ESG perspective. With our head start in Quebec, we are well positioned to benefit from these new market dynamics.

Michael Binnion
President and Chief Executive Officer

Environmental, Social and Governance

Questerre believes the oil and gas industry can go from laggards to leaders on the global environment.

From today to 2050, the world's population is estimated to grow from 7.5 billion to almost 9.5 billion people who will expect a better standard of living. We believe providing the increased energy needed tomorrow, with lower environmental impacts than today, is the challenge of our times. We refer to this as the '7 to 9 challenge.' Transitioning our energy diet to lower emissions is essential to meet this challenge and we believe the oil and gas industry has the biggest improvements to make.

Our Clean Tech Energy project to deliver the world's first zero emissions natural gas production is an example of meeting this challenge. It will have a dramatic impact on the emissions from production in addition to other environmental criteria. It will also contribute to reducing the emissions from consumption by providing a cleaner burning alternative domestically and internationally through LNG exports. We are also looking at hydrogen production combined with carbon capture to further reduce the emissions from consumption.

It requires a new way of thinking to become leaders on environmental issues. Our industry runs most of today's energy systems. We have the experience, expertise, capital and technology to meet the world's energy and environmental challenges. Delivering on projects like our zero emissions natural gas project is just one example of how our industry can be leaders on transitioning our global energy systems.

Questerre has also taken leadership in working with communities for local benefits. We have committed to share 3% of our profits with communities. We have also engaged with local First Nations in Quebec to include them in our contracting and benefits program.

We unilaterally made the decision not to work in communities where the plurality of the community does not want development. Our approach of consulting first and applying for permits second is consistent with this approach.

People know they need energy to maintain progress for their families and communities. They want to know the providers of that energy are being responsible and sustainable in the way it is produced. Questerre is an entrepreneurial leader in making the seemingly impossible task of producing more with less impact, possible. Our zero emissions Clean Tech Energy project is our contribution to meeting this '7 to 9 challenge.'

Management's Discussion and Analysis

This Management's Discussion and Analysis ("MD&A") was prepared as of March 24, 2021 and should be read in conjunction with the audited consolidated financial statements of Questerre Energy Corporation ("Questerre" or the "Company") as at and for the years ended December 31, 2020 and 2019. Additional information relating to Questerre, including Questerre's Annual Information Form for the year ended December 31, 2020 dated March 24, 2021 ("AIF"), is available on SEDAR under Questerre's profile at www.sedar.com.

Questerre is a energy technology and innovative company actively involved in the acquisition, exploration and development of oil and gas projects, and, in specific, non-conventional projects such as tight oil, oil shale, shale oil and shale gas. Questerre is committed to the economic development of its resources in an environmentally conscious and socially responsible manner. The Company's Class "A" Common voting shares ("Common Shares") are listed on the Toronto Stock Exchange and the Oslo Stock Exchange under the symbol "QEC".

Basis of Presentation

Questerre presents figures in the MD&A using accounting policies within the framework of International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board, representing generally accepted accounting principles ("GAAP"). All financial information is reported in Canadian dollars, unless otherwise noted.

Forward-Looking Statements

Certain statements contained within this MD&A 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 using the use of words such as "anticipate", "assume", "believe", "budget", "can", "commitment", "continue", "could", "estimate", "expect", "forecast", "foreseeable", "future", "intend", "may", "might", "plan", "potential", "project", "will" 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. Management believes 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 this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A.

Management has not adjusted or revised any forward-looking statements in this MD&A to account for the potential disruption to the Company's business from the coronavirus ("COVID-19") pandemic, the impact of which is not immediately known or quantifiable.

This MD&A contains forward-looking statements including, but not limited to, those pertaining to the following:

- The elimination of non-essential capital spending;

- drilling plans and the development and optimization of producing assets;
- future production of oil, natural gas and natural gas liquids and the weighting thereof;
- future commodity prices in light of decisions by OPEC and non-OPEC member countries, including Saudi Arabia and Russia on production levels as well as the impacts of COVID-19;
- legislative and regulatory developments in the Province of Quebec;
- requirement of significant additional capital to develop the Company's Quebec assets;
- the timing of the development of the Company's resources in Quebec;
- the Company's focus on securing social acceptability in Quebec;
- liquidity and capital resources;
- the Company's negotiations for a concession agreement in Jordan;
- the Company's compliance with the terms of its credit facility;
- timing of the next review of the Company's credit facility by its lender;
- ability of the Company to meet its foreseeable obligations;
- expectations regarding the Company's liquidity increasing over time;
- capital expenditures and the funding thereof;
- Questerre's reserves and resources;
- impacts of capital expenditures on the Company's reserves and resources;
- average royalty rates;
- commitments and Questerre's participation in future capital programs;
- risks and risk management;
- potential for equity and debt issuances and farm-out arrangements;
- counterparty creditworthiness;
- joint venture partner willingness to participate in capital programs;
- flow-through shares and use of proceeds and renunciation and indemnity obligations associated therewith;
- insurance;
- use of financial instruments; and
- critical accounting estimates.

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, the AIF, and the documents incorporated by reference into this document:

- volatility in market prices for oil, natural gas liquids and natural gas due to, among other things, the production agreements between OPEC and non-OPEC member countries, including Saudi Arabia and Russia, on production levels as well as the impact of COVID-19;
- access to capital;
- the terms and availability of credit facilities;
- counterparty credit risk;
- changes or fluctuations in oil, natural gas liquids and natural gas production levels;
- liabilities inherent in oil and natural gas operations;
- adverse judicial rulings, regulatory rulings, orders and decisions;
- attracting, retaining and motivating skilled personnel;

- uncertainties associated with estimating oil and natural gas reserves and resources;
- competition for, cost and availability of, among other things, capital, acquisitions of reserves, undeveloped lands, equipment, skilled personnel 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;
- the passage of applicable hydrocarbon and environmental legislation and regulations and local acceptability;
- 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, tax, or other legislation applicable to the Company's operations, and its 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.

The discounted and undiscounted net present values of future net revenue attributable to reserves and resources do not represent the fair market value thereof.

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. Certain information set out herein with respect to forecasted results is "financial outlook" within the meaning of applicable securities laws. The purpose of this financial outlook is to provide readers with disclosure regarding the Company's reasonable expectations as to the anticipated results of its proposed business activities. Readers are cautioned that this financial outlook may not be appropriate for other purposes.

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. Given that the value ratio based on the current price of crude oil as compared to natural gas is significantly different from the energy equivalent of 6:1, utilizing a conversion on a 6:1 basis may be misleading as an indication of value.

Non-GAAP Measures

This document contains certain financial measures, as described below, which do not have standardized meanings prescribed under GAAP. As these measures are commonly used in the oil and gas industry, the Company believes that their inclusion is useful to investors. The reader is cautioned that these amounts may not be directly comparable to measures for other companies where similar terminology is used.

This document contains the term "adjusted funds flow from operations", which is an additional non-GAAP measure. The Company uses this measure to help evaluate its performance.

As an indicator of the Company's performance, adjusted funds flow from operations should not be considered as an alternative to, or more meaningful than, net cash from operating activities as determined in accordance with GAAP. The Company's determination of adjusted funds flow from operations may not be comparable to that reported by other companies. Questerre considers adjusted funds 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.

Adjusted Funds Flow from Operations Reconciliation

($ thousands)	2020	2019
Net cash from operating activities	$ 6,408	$ 11,337
Interest received	(321)	(388)
Interest paid	619	748
Change in non-cash working capital	(560)	2,658
Adjusted funds flow from operations	$ 6,146	$ 14,355

This document also contains the terms "operating netbacks", "cash netbacks" and "working capital surplus (deficit)", which are non-GAAP measures.

The Company considers netbacks a key measure as it demonstrates its profitability relative to current commodity prices. Operating and cash netbacks, as presented, do not have any standardized meaning prescribed by GAAP and may not be comparable with the calculation of similar measures for other entities. Operating netbacks have been defined as revenue less royalties, transportation and operating costs. Cash netbacks have been defined as operating netbacks less general and administrative costs. Netbacks are generally discussed and presented on a per boe basis.

The Company also uses the term "working capital surplus (deficit)". Working capital surplus (deficit), as presented, does not have any standardized meaning prescribed by GAAP, and may not be comparable with the calculation of similar measures for other entities. Working capital surplus (deficit), as used by the Company, is calculated as current assets less current liabilities excluding the risk management contracts.

Select Annual Information

As at/for the years ended December 31,	2020	2019	2018
Financial ($ thousands, except as noted)			
Petroleum and Natural Gas Revenue	21,924	32,847	32,969
Adjusted Funds Flow from Operations	6,146	14,355	15,213
Basic and Diluted ($/share)	0.01	0.03	0.04
Net Income (Loss)	(117,623)	65,704	13,466
Basic and Diluted ($/share)	(0.28)	0.16	0.03
Capital Expenditures	5,622	85,429	31,102
Working Capital Deficit	(7,707)	(8,110)	(9,078)
Total Non-Current Financial Liabilities	2,025	1,838	–
Total Assets	196,177	318,062	233,372
Shareholders' Equity	152,120	268,656	187,291
Common Shares Outstanding (thousands)	427,516	427,907	389,007
Weighted average - basic (thousands)	427,613	415,651	388,712
Weighted average - diluted (thousands)	427,613	417,041	395,715
Operations (units as noted)			
Average Production			
Crude Oil and Natural Gas Liquids (bbls/d)	1,278	1,357	1,263
Natural Gas (Mcf/d)	4,126	4,586	3,635
Total (boe/d)	1,966	2,121	1,869
Average Sales Price			
Crude Oil and Natural Gas Liquids ($/bbl)	41.80	64.12	66.27
Natural Gas ($/Mcf)	2.51	1.92	1.82
Total ($/boe)	30.47	42.43	48.33
Netback ($/boe)			
Petroleum and Natural Gas Revenue	30.47	42.43	48.33
Royalties Expense	(1.83)	(2.09)	(2.76)
Percentage	6%	5%	6%
Operating Expense	(16.60)	(16.86)	(17.09)
Operating Netback	12.04	23.49	28.48
General and Administrative Expense	(3.52)	(4.93)	(6.50)
Cash Netback	8.52	18.56	21.99
Wells Drilled			
Gross	1.00	5.00	3.00
Net	0.25	1.02	0.71

Highlights

- Preserved financial liquidity by eliminating non-essential capital and cutting overhead in response to collapse in oil prices and COVID-19
- Re-engaged with stakeholders to build social acceptability for Clean Tech Energy in Quebec
- Evaluating hydrogen production from Clean Gas in Quebec
- Total proved and probable reserves declined by 5% to 33 MMBoe with a before income tax NPV-10% of $154.4 million
- Average daily production of 1,966 boe/d with adjusted funds flow from operations of $6.2 million

2020 Activities

Western Canada

Kakwa, Alberta

With the collapse in oil prices and the uncertainty surrounding the impacts of the COVID-19 pandemic, the operators curtailed development at both Kakwa joint ventures during the year.

Capital investment in Kakwa totalled $3.9 million for the year (2019: $19.8 million) with daily production averaging 1,609 boe/d (2019: 1,707 boe/d) comprised approximately 4.1 MMcf/d of gas (2019: 4.6 MMcf/d) and 925 bbl/d (2019: 946 bbl/d) of condensate and natural gas liquids. Total proved and probable reserves as of December 31, 2020 were estimated at 31.5 MMBoe (2019: 33.4 MMBoe) with a before income tax NPV-10% of $134.5 million (2019: $199.5 million). The Company currently holds 40,800 (17,880 net) acres in the Kakwa area.

At Kakwa Central, the operator drilled two wells early in the year compared to five (1.02 net) last year. Of the two wells, the Company elected to go penalty in the Lower Montney well due to the limited well results from this interval and participated in the Upper Montney well. The well was completed and tied-in the fourth quarter. Other field work included optimizing existing production and expansion of the gas-lift infrastructure.

At Kakwa North, the operator completed the tie-in of the fourth and final well under its farm-in commitment. Upon completion of its earning obligations the operator and the Company each hold a 50% working interest at Kakwa North. The Company holds a royalty interest in the four farm-in wells convertible into a 50% working interest after payout.

The Company is in discussion with the operators regarding their prospective drilling plans for the next 12-18 months. Questerre's participation in any future wells on either joint venture will depend on, among other things, an improvement in the long-term commodity prices. Should the Company participate it will require additional financial liquidity through potential asset dispositions, equity or debt issuances. There can be no guarantee that such liquidity will be available when required on terms acceptable to Questerre.

Antler, Saskatchewan

Consistent with prior years, activities at Antler focused on optimizing existing production and expanding the pilot secondary recovery scheme to increase recovery of the oil in place.

The Company invested $0.3 million (2019: $0.4 million) at Antler with daily production averaging 319 bbl/d (2019: 356 boe/d). Total proved and probable reserves as at December 31, 2020 were estimated at 1.4 MMBbls (2019: 1.8 MMBbls) with a before income tax NPV-10% of $22.3 million (2019: $38.3 million). The Company currently holds 11,952 net acres in the area.

In 2021, the Company expects to continue its work to enhance existing production through workovers and monitoring of the pilot secondary recovery scheme.

St. Lawrence Lowlands, Quebec

Recognizing the growing importance of social acceptability for energy projects, the Company is prioritizing consultation ahead of permitting and regulatory approvals for its Clean Tech Energy Project in Quebec.

In 2020, these efforts included engagement with farmers and First Nations. The discussions focused on the importance of local supplies of natural gas and local projects that can contribute to economic development. Commercial gas users were another stakeholder group that expressed interest in local gas supplies with zero emissions that offer lower supply costs, security of supply and reduced dependence on imports. The Company also met with municipal officials on the benefits of its profit-sharing arrangements. Questerre is optimistic about partnering with these groups to gain their support.

Based on its productive discussions with the Government of Quebec, including their approval of the recent acquisition, the Company granted a further deferral of the judicial review related to the new oil and gas regulations introduced in June 2018. These regulations include a selective prohibition on hydraulic fracturing and increases in the setbacks for oil and gas activity. In 2021, the Company requested a new hearing date for this judicial review following the resumption of activity by the Quebec Superior Court.

In 2021, the Company announced it had commissioned a report by the International Reference Centre for Life Cycle Products, Services and Systems ("CIRAIG") on producing hydrogen, including blue hydrogen, using its zero-emissions natural gas in Quebec.

The Company updated its resource assessment for its acreage in Quebec (the "Quebec Resource Assessment"). The Quebec Resource Assessment was prepared by GLJ Ltd. effective December 31, 2020. The Quebec Resource Assessment was prepared in accordance with *National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities ("NI 51-101")* and the standards contained in the Canadian Oil & Gas Evaluation ("COGE") Handbook.

The best estimate by the Company's independent reserve engineers of risked Contingent Resources in the development on hold sub-category, net to Questerre, is 1.3 Tcf (213.9 million barrels of oil equivalent ("MMboe")) with a risked net present value, discounted at 10% of $0.8 billion. The best estimate of risked Contingent Resources in the development unclarified category, net to Questerre, is 0.4 Tcf (59.1 MMboe) with a risked net present value, discounted at 10% of $0.2 billion. The best estimate of risked Prospective Resources net to Questerre is 5.4 Tcf (894.6 MMboe).

An estimate of risked net present value of future net revenue of contingent resources is preliminary in nature and is provided to assist the reader in reaching an opinion on the merit and likelihood of the Company proceeding with the required investment. It includes contingent resources that are considered too uncertain with respect to the chance of development to be classified as reserves. There is uncertainty that the risked net present value of future net revenue will be realized.

The Quebec Resource Assessment assigned Economic Contingent Resources for approximately 20% of Questerre's acreage based on the results from several pilot vertical and horizontal wells on Questerre's acreage that have all encountered pay in the Utica. Furthermore, available test data from these wells in conjunction with offset development and analogy examination of the Utica development in the United States provides sufficient evidence that the evaluated resource is capable of commercial production.

The Company's Contingent Resources require additional data gathering, the preparation of firm development plans, and regulatory application and approval for development. Therefore, the Contingent Resources have been sub-classified as development on hold and development unclarified. Those areas classified as development on hold are primarily contingent on government and public approval for development. Remaining areas classified as development unclarified have additional contingency or risk associated with public approval of respective county populations, thereby lowering priority for development by the Company. Additional contingencies include firm development plans, detailed cost estimates and corporate approvals and sanctioning. There is no certainty that any portion of the Contingent Resources will be economic to develop. Though pilot horizontal development plans have been proposed, the project evaluation scenario for the Contingent Resources is not sufficiently defined by the Company to make an investment decision to proceed to development.

Contingent Resources are evaluated based on the same fiscal conditions used in the assessment of reserves, and as such, are forecasted to be economic. Contingent Resource values are estimated based on established technology, namely modern completion technologies that are widely used in the development of the Utica formation in Ohio and in similar plays such as the Marcellus and Western Canadian shale gas plays.

The Contingent Resources have been risked for the chance of commerciality, or commercial development, defined as the product of the chance of discovery and the chance of development. For Contingent Resources, the chance of discovery is equal to one. The chance of development is the estimated probability that once discovered, a known accumulation will be commercially developed. Prospective Resources were also risked for chance of discovery. There is no certainty that any portion of Prospective Resources will be discovered. If discovered there is no certainty that it will be economically viable to produce any portion of the Prospective Resource.

Significant positive factors relevant to the estimate of Questerre's resources include the importation of all natural gas consumed in Quebec creating demand for local production, premium realized pricing due to the transportation costs associated with importing natural gas for consumption, production test data from Questerre's existing wells and the development of the analogous Utica natural gas field in the United States. Significant negative factors include the limited number of wells on Questerre's acreage, lack of a developed service sector providing uncertainty regarding estimates of capital and operating costs, hydrocarbon regulations and environmental legislation and the requirement to obtain social acceptability for oil and gas operations.

While Questerre believes it will be able to access sufficient financial capability to fund its share of the costs associated with the development program in the Quebec Resource Assessment, it may not have access to the necessary capital when required.

For more information, please refer to the AIF available on the Company's website at www.questerre.com and on SEDAR at www.sedar.com.

Oil Shale Mining

To preserve capital during the year, Questerre suspended all third-party engineering for its oil shale project in the Kingdom of Jordan. In the interim, the Company continued to internally assess the project design, targeting a reduction in upfront capital to improve break-even pricing. The Company is also evaluating a small-scale commercial project and a more modular design to further improve economics.

Negotiations with the Government of Jordan for the fiscal and other terms of the concession agreement for the project are ongoing. Questerre continues to hold the exclusive exploration rights to the project during the term of these negotiations.

The Company increased its equity investment in Red Leaf Resources Inc. ("Red Leaf"), following a corporate restructuring completed during the year.

Red Leaf is a private Utah based company whose principal assets include its proprietary Eco-Shale technology to produce oil from shale, oil shale leases in the state of Utah and approximately US$23 million in unrestricted cash as of December 31, 2020.

Following the change in market conditions, Red Leaf materially reduced overheads to preserve cash and the value of its other assets while it evaluates strategic alternatives. It subsequently completed an issuer bid, reducing the outstanding equity capital of the company by 14%. As at December 31, 2020, Questerre owns approximately 38% of the equity capital of Red Leaf. As part of the restructuring, Questerre, along with a significant long-term shareholder of Red Leaf, also increased their representation on the company's board.

Corporate

Following a review conducted in the second quarter, the Company's facilities with a Canadian chartered bank were renewed at $20 million. The renewed facilities will consist of a revolving operating demand loan of $17 million and an uncommitted demand non-conforming revolving facility for $3 million. Any borrowing under the facilities, except letters of credit, are subject to the Bank's prime rate and applicable basis point margin. The effective interest rate on the facilities for the year was 3.45% (2019: 4.45%). As at December 31, 2020, $15.4 million (2019: $16.4 million) was drawn on the facilities and the Company held unrestricted cash and term deposits of $10.4 million (2019: $15.0 million).

Drilling Activities

One (0.25 net) well was spud at Kakwa Central during the year.

Production

	2020			2019		
	Oil and Liquids (bbls/d)	Natural Gas (Mcf/d)	Total (boe/d)	Oil and Liquids (bbls/d)	Natural Gas (Mcf/d)	Total (boe/d)
Alberta	926	4,126	1,614	950	4,586	1,714
Saskatchewan	319	–	319	356	–	356
Manitoba	33	–	33	51	–	51
	1,278	4,126	1,966	1,357	4,586	2,121

Note: Oil and liquids includes light & medium crude oil and natural gas liquids. Natural gas includes conventional and shale gas.

Production decreased nominally over the prior year reflecting natural declines and the restricted capital spending at Kakwa.

Accounting for over 80% of corporate volumes, Kakwa production declined with only one (0.25 net) well tied-in in 2020 compared to six (1.23 net) wells in 2019. The declines were mitigated by field work to optimize volumes from existing wells. Royalty volumes from Kakwa North represented 201 boe/d (2019: 189 boe/d) or 12% (2019: 11%) of total area volumes.

Oil and liquids production is comprised primarily of light crude oil and condensate as well as small volumes of other natural gas liquids. Natural gas production is shale gas from Kakwa. The liquids weighting remained relatively stable at approximately two thirds in the last two years. Combined production from Saskatchewan and Manitoba declined over the prior year in part due to the postponement of workovers in a low-price environment. The Company anticipates its liquids weighting to average approximately 60% reflecting the relative weighting of natural gas liquids to natural gas at Kakwa.

With no additional wells planned for the first half of this year, the Company anticipates its production will decline. The Company is assessing its participation in future drilling at Kakwa based on among other factors, commodity prices and its focus on preserving financial liquidity.

2020 Financial Results

Petroleum and Natural Gas Revenue

	2020			2019		
($ thousands)	Oil and Liquids	Natural Gas	Total	Oil and Liquids	Natural Gas	Total
Alberta	$ 12,299	$ 3,681	$ 15,980	$ 19,363	$ 3,119	$ 22,482
Saskatchewan	5,426	–	5,426	9,133	–	9,133
Manitoba	518	–	518	1,232	–	1,232
	$ 18,243	$ 3,681	$ 21,924	$ 29,728	$ 3,119	$ 32,847

Note: Oil and liquids includes light & medium crude oil and natural gas liquids. Natural gas includes conventional and shale gas.

The collapse in crude oil prices was largely responsible for the material decline in revenue in the year with the decline in production volumes accounting for under 10% of the change. Although natural gas prices improved, this was more than offset by lower production volumes.

Pricing

	2020	2019
Benchmark prices:		
Natural Gas - AECO, daily spot ($/Mcf)	2.11	1.68
Crude Oil - Canadian Light Sweet Blend ($/bbl)	46.60	69.25
Realized prices:		
Natural Gas ($/Mcf)	2.51	1.92
Crude Oil and Natural Gas Liquids ($/bbl)	41.80	64.12

Note: Oil and liquids includes light & medium crude oil and natural gas liquids. Natural gas includes conventional and shale gas.

Crude oil prices declined over the prior year and the benchmark West Texas Intermediate ("WTI") averaged US$39/bbl in 2020 compared to US$57/bbl in the prior year.

The increased supply from the OPEC+ disagreement on production cuts and the demand destruction from the impact of the COVID-19 pandemic brought crude oil prices to their lowest levels in decades. Spot prices briefly turning negative in the second quarter on concerns there would be insufficient physical storage. They gradually recovered over the remainder of the year with a tightening of the supply demand balance. Production cuts re-instituted by OPEC+, voluntary production shut-ins and reduced capital spending on tight oil in the United States coupled with increased demand from Asia restored some confidence in the market, although there are lingering concerns about the strength and timing of the demand recovery.

In Canada, the price volatility was matched by the volatility in differentials. In the month of May, the differential exceeded more than half the price of WTI. These later normalized with the differential between WTI and condensate prices averaging US$2.24/bbl (2019: US$4.20/bbl) for the year.

Realized prices for Questerre's light oil and natural gas liquids track the Canadian light oil MSW benchmark. Condensate often receives a premium to this price and other natural gas liquids receive a discount.

Mild winter weather and the collapse in demand due to COVID-19 saw prices decline over the prior year. The benchmark Henry Hub averaged US$2.06/MMBtu in 2020 down from US$2.60/MMBtu in 2019.

The decline in demand included lower LNG exports from the United States which peaked at over 8 Bcf/d in the first quarter, or approximately 9% of US dry gas production. Prices improved in the last quarter of the year on optimism about demand recovery from the loosening of lockdowns and the increase in demand for power generation with the retirement of coal-fired plants. In Canada, the differential and local prices improved over the prior year due to the changes made to the regional system in late 2019 granting all shippers access to storage.

The higher heat content natural gas from Kakwa resulted in realized natural gas prices of $2.51/Mcf (2019: $1.92/Mcf) compared to the AECO benchmark price of $2.11/Mcf (2019: $1.68/Mcf).

Royalties

($ thousands)	**2020**	2019
Alberta	**$ 850**	$ 780
Saskatchewan	**348**	599
Manitoba	**117**	236
	$ **1,315**	$ 1,615
% of Revenue:		
Alberta	**5%**	3%
Saskatchewan	**6%**	7%
Manitoba	**23%**	19%
Total Company	**6%**	5%

Consistent with the decline in petroleum and natural gas sales, royalties declined by 20% to $1.3 million from $1.6 million last year. As a percentage of revenue this increased from 5% to 6%.

Both on a gross and percentage of revenue basis, Crown royalties at Kakwa increased over the prior year with new production from older wells that no longer benefit from incentive programs. This resulted in Crown royalties of 40% on condensate production. By comparison newer wells that benefit from current incentive programs record royalty rates of 5% on condensate. The Company anticipates its royalty rate on production from Kakwa will average approximately 10% reflecting the forecast rate on production from this area.

Operating Costs

($ thousands)	2020	2019
Alberta	$ 8,687	$ 8,708
Saskatchewan	2,507	3,930
Manitoba	163	277
Quebec	588	132
	$ 11,945	$ 13,047
$/boe:		
Alberta	14.71	14.13
Saskatchewan	21.44	30.25
Manitoba	13.38	15.02
Total Company	$ 16.60	$ 16.86

Operating costs decreased over the prior year by just under 10% to $11.9 million from $13.0 million in the prior year.

With approximately 75% of operating costs at Kakwa, including firm transportation and processing commitments considered as fixed costs, the decline in production volumes had a negligible impact on operating costs on a unit of production basis. Excluding the effect of royalty production, operating costs on a boe basis also remained unchanged. At Antler, a deferral of workovers for the first nine months of the year and other cost-cutting measures contributed to a material reduction in costs on a gross and boe basis. The closing of the acquisition and assumption of operatorship of its assets in Quebec early in the first quarter accounted for the increase in operating costs in this province.

General and Administrative Expenses

($ thousands)	2020	2019
General and administrative expenses, gross	$ 3,542	$ 5,132
Capitalized expenses and overhead recoveries	(1,008)	(1,316)
General and administrative expenses, net	$ 2,534	$ 3,816

Gross and net general and administrative expenses ("G&A") decreased by approximately one third over the prior year.

This reflects the cost-cutting measures implemented in the first quarter in response to the COVID-19 pandemic. These included implementing a four-day work week, a 20% to 50% reduction in salaries and a 20% reduction in directors' fees. G&A expenses are recorded net of $0.3 million (2019: nil) in qualifying credits under the Canada Emergency Wage Subsidy, representing part of the Federal Government's pandemic assistance program. Capitalized expenses are overhead costs associated with the Company's projects in Quebec and Jordan which declined commensurately with the decline in salaries.

Depletion, Depreciation, Impairment, Accretion and Lease Expiries

For the year ended December 31, 2020, Questerre recorded depletion, depreciation and accretion expense of $9.4 million (2019: $13.1 million) with depletion accounting for over 90% of this amount. The lower amount represents the reduction in book value over the prior year as a result of the impairment expense incurred in the first quarter. This combined with a reduction in future development costs also accounts for the reduction in expense on a unit of production basis to $12.83/boe from $16.88/boe last year.

The Company recorded an impairment expense of $113 million in the first quarter of the year as a result of lower future commodity prices. The variance between the carrying value of its plant, property and equipment assets ("PP&E") and the fair value less costs of disposal ("FVLCD") using a discounted cash flow model resulted in an impairment of a $96.3 million. The Company also incurred an impairment of $14.4 million related to the carrying value of its exploration and evaluation ("E&E") assets in the Kakwa area where the Company has no plans for operated development. Impairment expense also includes $2.3 million relating to goodwill on the basis that the FVLCD of its PP&E assets was below carrying value at March 31, 2020.

Share Based Compensation

Pursuant to the Company's share option plan, an optionee may request that the Company purchase all or any part of the then vested options of the optionee, for an amount equal to the market price of the Common Shares less the exercise price of the option shares. Notwithstanding the foregoing, the Company may, at its sole discretion, decline to accept and, accordingly, has no obligations with respect to the exercise of this put right at any time. Once the options are cash settled, the options are cancelled.

The Company recorded share-based compensation expense of $0.5 million (2019: $1.0 million) net of $0.9 million (2019: $0.7 million) in expense that was capitalized during the year.

Other Income and Expenses

The Company incurred interest expense of $0.6 million (2019: $0.7 million) related to its credit facilities with a Canadian chartered bank. The amount drawn on the facilities at year-end was $15.4 million (2019: $16.4 million) and the effective interest rate was 3.45% (2019: 4.45%). The Company also earned interest income of $0.3 million on its cash and term deposits (2019: $0.4 million).

Other Comprehensive Loss

In 2020, the Company recorded other comprehensive loss of $0.3 million (2019: $0.2 million) related to the change in foreign exchange rates.

A loss of $0.2 million in the current year (2019: $0.01 million) was attributable to the change in the US dollar denominated investment in Red Leaf. The Company also incurred a nominal loss of $0.02 million (2019: $0.2 million) due to the depreciation in the Jordanian dinar impacting its dinar-denominated assets in Jordan.

Total Comprehensive Income

For the year ended December 31, 2020, the Company recorded a total comprehensive loss of $117.9 million compared to income of $65.5 million in the prior year.

The loss in the current year is attributable largely to the impairment expense of $113 million along with lower petroleum and natural gas revenue partly offset by the lower expenses in all other categories. By comparison, the income in 2019 reflects several one-time non-cash items related to the acquisition of assets in Quebec (the "Quebec Acquisition") and reversal of previously incurred impairment on its investment in Red Leaf. For more information, please see MD&A for the fiscal year ended 2019.

Net Income Per Share

Questerre's basic net loss was $0.28 per share compared to income of $0.16 per share in 2019. With no change in outstanding shares and nominal OCI, the change in net income (loss) per share mirrors the change in net income described above.

Cash Flow from Operating Activities

The Company recorded cash flow from operating activities of $6.4 million (2019: $11.3 million). The variance over last year is attributable to lower adjusted funds flow from operations due to the materially lower petroleum and natural gas revenue. This was offset partly by the increase in non-cash working capital compared to a decrease in non-cash working capital in the prior year.

Cash Flow used in Investing Activities

The materially lower capital investment in 2020 contributed to the lower cash used in investing activities. This was partly offset by the reduction in non-cash working capital in the current year compared to an increase last year.

Cash Flow provided by Financing Activities

In 2020, the Company reported net cash used in financing activities of $1.0 million, representing a net reduction in borrowing under its credit facility. In the prior year, the company increased its net borrowing under its credit facilities by $2.5 million and completed an equity placement for net proceeds of $14 million.

Capital Expenditures

($ thousands)	2020	2019
Alberta	$ 3,935	$ 19,810
Saskatchewan & Manitoba	340	509
Jordan & Other	304	211
Quebec	780	1,531
	5,359	22,061
Quebec Acquisition	263	63,368
Total	$ 5,622	$ 85,429

Notes:
1. Capital expenditures exclude certain non-cash items such as, stock based compensation and asset retirement obligations.
2. See note 9 to the Financial Statements for additional information on the Quebec Acquisition completed in 2019.

For the year ended December 31, 2020, the Company incurred capital expenditures of $5.6 million as follows:

- In Alberta, $3.9 million for drilling, completing and equipping one (0.25 net) well on the Kakwa Central joint venture and expanding field infrastructure;
- In Quebec, $1.1 million for well monitoring and capitalized overhead related to advancing social acceptability and engineering for its Clean Tech Energy project, including closing adjustments relating to the Quebec Acquisition;
- In Saskatchewan, $0.3 million for infrastructure related to its secondary recovery scheme; and
- In Jordan, $0.3 million was spent on advancing the engineering for its oil shale project.

For the year ended December 31, 2019, the Company incurred capital expenditures of $85.4 million as follows:

- In Alberta, $19.8 million was invested in wells and infrastructure on the Kakwa Central joint venture acreage;
- In Quebec, the Company invested a total of $64.9 million including $63.4 million for the Quebec Acquisition and the remainder for well maintenance operations and work to secure social acceptability for its Clean Tech Energy project;
- In Saskatchewan, $0.5 million to maintain and upgrade production facilities; and
- In Jordan, $0.2 million its oil shale project.

Liquidity and Capital Resources

The Company's objectives when managing its capital are firstly to maintain financial liquidity, and secondly to optimize the cost of capital at an acceptable risk to sustain the future development of the business.

Although crude oil prices have partially recovered, the volatility arising from the actions of OPEC+ and the fallout from COVID-19 will have a material impact on the Company's liquidity in 2021. To manage its liquidity, the Company eliminated all non-essential capital spending and instituted a 20% reduction in salaries and directors' fees in 2020. These remain in effect, pending improving commodity prices.

The Company also plans to partially or completely shut-in production when realized prices fall materially below break-even prices.

At December 31, 2020, $15.4 million (December 31, 2019: $16.4 million) was drawn on the credit facilities and the Company is compliant with all its covenants under the credit facilities. As a consequence of the foregoing, Management does not believe there is a reasonably foreseeable risk of non-compliance with the covenants for its credit facilities. Under the terms of the credit facilities, 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, 2020 was 2.95 and the covenant was met. See Note 13 of the Financial Statements.

While the credit facilities were renewed during the year at $20 million, the uncertainty in the outlook for commodity prices could result in the facilities being reduced at their next review scheduled during the second quarter of 2021. The credit facilities are a demand facility and can be reduced, amended or eliminated by the lender for reasons beyond the Company's control. Should the credit facilities be reduced or eliminated, the Company would need to seek alternative credit facilities or consider the issuance of equity to enhance its liquidity. In the current market the Company may be unable to secure additional financing on acceptable terms, if at all.

On the assumption that commodity prices stabilize and improve over the next 12 to 18 months, the Company believes that it should have access to sufficient financial liquidity to meet its foreseeable obligations in the normal course of operations.

Considering current market conditions, the Company is assessing its investment in the 2021 future development costs associated with proved reserves in its independent reserves assessment as of December 31, 2020. It anticipates that, as a result, reserves associated with wells not drilled in 2021 will remain in the proved undeveloped category.

For a detailed discussion of the risks and uncertainties associated with the Company's business and operations, see the Risk Management section of the MD&A and the AIF.

Share Capital

The Company is authorized to issue an unlimited number of 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, 2020, there were no Class "B" common voting shares or preferred shares outstanding.

The following table provides a summary of the outstanding Common Shares and options as at the date of the MD&A and the current and preceding fiscal year end.

(thousands)	March 24, 2021	December 31, 2020	December 31, 2019
Common Shares	427,516	427,516	427,907
Stock Options	33,701	25,351	27,087
Weighted average Common Shares			
Basic		427,613	415,651
Diluted		427,613	417,041

A summary of the Company's stock option activity during the years ended December 31, 2020 and 2019 follows:

	December 31, 2020		December 31, 2019	
	Number of Options *(thousands)*	Weighted Average Exercise Price	Number of Options *(thousands)*	Weighted Average Exercise Price
Outstanding, beginning of period	27,087	$ 0.40	21,412	$ 0.44
Granted	6,475	0.20	6,100	0.29
Forfeited	(846)	0.43	(50)	0.29
Expired	(7,365)	0.29	(375)	1.07
Outstanding, end of period	25,351	$ 0.38	27,087	$ 0.40
Exercisable, end of period	16,191	$ 0.42	16,632	$ 0.37

Commitments

A summary of the Company's net commitments at December 31, 2020 follows:

($ thousands)	2021	2022	2023	2024	Thereafter	Total
Transportation and Processing	$ 2,988	$ 2,791	$ 2,791	$ 2,791	$ 3,255	$ 14,616

To maintain its capacity to execute its business strategy, the Company expects that it will need to continue the development of its producing assets. There will also be expenditures in relation to G&A and other operational expenses. These expenditures are not yet commitments, but Questerre expects to fund such amounts primarily out of adjusted funds flow from operations and its existing credit facilities.

Risk Management

Companies engaged in the petroleum and natural gas industry face a variety of risks. For Questerre, these include risks associated with commodity prices, exploration and development drilling as well as production operations, foreign exchange and interest rate fluctuations. Unforeseen significant changes in such areas as markets, prices, royalties, interest rates and government regulations could have an impact on the Company's future operating results and/or financial condition. While Management realizes that all the risks may not be controllable, Questerre believes that they can be monitored and managed. For more information, please refer to the "Risk Factors" and "Industry Conditions" sections of the AIF and Note 6 to the audited consolidated financial statements for the year ended December 31, 2020.

Volatility in the oil and gas industry is a major risk facing the Company. Market events and conditions, including global oil and natural gas supply and demand, actions taken by OPEC and non-OPEC member countries' decisions, including recent decisions by Saudi Arabia and Russia, on production growth and spare capacity, market volatility and disruptions, weakening global relationships, conflict between the U.S. and Iran, isolationist and punitive trade policies, U.S. shale production, sovereign debt levels and political upheavals in various countries including growing anti-fossil fuel sentiment, have caused significant volatility in commodity prices. These events and conditions have been a factor in the decrease in the valuation of oil and gas companies and a decrease in confidence in the oil and gas industry. These difficulties have been exacerbated in Canada by political and other actions resulting in uncertainty surrounding regulatory, tax and royalty changes and other environmental regulations.

In addition, the difficulties in obtaining the necessary approvals to build pipelines and other facilities to provide better access to markets for the oil and gas industry in Western Canada has led to additional uncertainty and reduced confidence in the oil and gas industry in Western Canada. Lower commodity prices may also affect the volume and value of the Company's reserves especially as certain reserves become uneconomic. In addition, lower commodity prices have reduced the Company's cash flow leading to a reduction in funds available for capital expenditures. As a result, the Company may not be able to replace its production with additional reserves and both the Company's production and reserves could be reduced on a year over year basis. Any decrease in value of the Company's reserves may reduce the borrowing base under its credit facilities, which, depending on the level of the Company's indebtedness, could result in the Company having to repay all or a portion of its indebtedness. Given the current market conditions and the lack of confidence in the Canadian oil and natural gas industry, the Company may have difficulty raising additional funds in the future to raise funds on unfavourable and highly dilutive terms.

The global market is also currently volatile due to the uncertainty around how severely the COVID-19 will affect global energy consumption. The global economy is reliant on the manufacturing and trade of products and the movement of people, and any slowdown in this process has a chain reaction that impacts energy consumption by both manufacturers and consumers. As a result of the pandemic's impact on the global economy, there may be a further weakening in prices as the effects move through the demand and supply chains. Travel restrictions announced by various countries as a measure to reduce the spread of COVID-19 may also impact global energy consumption. Potential delays in global vaccination programs may impact the length of the pandemic, global economic recovery and commodity prices.

With respect to its Quebec assets the Company faces the risk it does not receive Government approvals for its Clean Tech Energy project and the existing regulations are not amended nor set aside to permit development. Should this risk materialize, the carrying value of its exploration and evaluation assets in Quebec of $102 million as of December 31, 2020, could be materially impaired.

Another significant risk for Questerre as a junior exploration company is access to capital. The Company attempts to secure both equity and debt financing on terms it believes are attractive in current markets. Management also endeavors to seek participants to farm-in on the development of its projects on favorable terms. However, there can be no assurance that the Company will be able to secure sufficient capital if required or that such capital will be available on terms satisfactory to the Company.

As future capital expenditures will be financed out of adjusted funds flow from operations, borrowings and possible future equity sales, the Company's ability to do so is dependent on, among other factors, the overall state of capital markets and investor appetite for investments in the energy industry, and the Company's securities. To the extent that external sources of capital become limited or unavailable, or available but on onerous terms, the Company's ability to make capital investments and maintain existing assets may be impaired, and its assets, liabilities, business, financial condition and results of operations may be materially and adversely affected. Based on current funds available and expected adjusted funds flow from operations, the Company believes it has sufficient funds available to fund its projected capital expenditures. However, if adjusted funds flow from operations is lower than expected, or capital costs for these projects exceed current estimates, or if the Company incurs major unanticipated expense related to development or maintenance of its existing properties, it may be required to seek additional capital to maintain its capital expenditures at planned levels. Failure to obtain any financing necessary for the Company's capital expenditure plans may result in a delay in development or production on the Company's properties. The Company anticipates that future development of its Quebec assets will require significant additional capital to be financed by potential future equity issuances, asset dispositions or other means.

Questerre faces several financial risks over which it has no control, such as commodity prices, exchange rates, interest rates, access to credit and capital markets, as well as changes to government regulations and tax and royalty policies.

The Company uses the following guidelines to address financial exposure:

- Internally generated cash flow provides the initial source of funding on which the Company's annual capital expenditure program is based.
- Equity, including flow-through shares, if available on acceptable terms, may be raised to fund acquisitions and capital expenditures.
- Debt may be utilized to expand capital programs, including acquisitions, when it is deemed appropriate and where debt retirement can be controlled.
- Farm-outs of projects may be arranged if management considers that a project requires too much capital or where the project affects the Company's risk profile.

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. In the past, the Company manages credit risk exposure by investing 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 if possible.

Substantially all of the accounts receivable are with oil and natural gas marketers and joint venture partners in the oil and natural 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 and infrastructure companies and the Company has not experienced any credit loss relating to these sales to date. Pursuant to IFRS 9, the Company made a provision of $0.02 million at December 31, 2020 for its expected credit losses related to its accounts receivable.

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.

The Company has issued and may continue in the future to issue flow-through shares to investors. The Company has historically used its best efforts to ensure that qualifying expenditures of Canadian Exploration Expense ("CEE") are incurred in order to meet its flow-through obligations. In 2017, the Federal Government amended the law regarding what expenses constitute CEE. Generally, oil and gas drilling expenses are now Canadian Development Expense rather than CEE. In the event that the Company has CEE expenditures reclassified under audit by the Canada Revenue Agency or fails to incur expenditures required under a flow-through share agreement, the Company may be required to liquidate certain of its assets in order to meet the indemnity obligations under flow-through share subscription agreements.

Exploration and development drilling risks are managed through the use of geological and geophysical interpretation technology, employing technical professionals and working in areas where those individuals have experience. For its non-operated properties, the Company strives to develop a good working relationship with the operator and monitors the operational activity on the property. The Company also carries appropriate insurance coverage for risks associated with its operations.

The Company may use financial instruments to reduce corporate risk in certain situations. Questerre's hedging policy is up to a maximum of 40% of total production at management's discretion.

As at December 31, 2020, the Company had no outstanding commodity risk management contract in place.

Environmental Regulation and Risk

The oil and natural gas industry is currently subject to environmental regulations pursuant to provincial and federal legislation. Environmental legislation provides for restrictions and prohibitions on releases of emissions and regulation on the storage and transportation of various substances produced or utilized in association with certain oil and natural gas industry operations, which can affect the location and operation of wells and facilities, and the extent to which exploration and development is permitted. In addition, legislation requires that well and facility sites are abandoned and reclaimed to the satisfaction of provincial authorities. As well, applicable environmental laws may impose remediation obligations with respect to property designated as a contaminated site upon certain responsible persons, which include persons responsible for the substance causing the contamination, persons who caused the release of the substance and any past or present owner, tenant or other person in possession of the site. Compliance with such legislation can require significant expenditures, and a breach of such legislation may result in the suspension or revocation of necessary licenses and authorizations, civil liability for pollution damage, the imposition of fines and penalties or the issuance of clean-up orders. The Company mitigates the potential financial exposure of environmental risks by complying with the existing regulations and maintaining adequate insurance. For more information, please refer to the “Risk Factors” and “Industry Conditions” sections of the AIF.

Climate change policy is evolving at regional, national and international levels, and political and economic events may significantly affect the scope and timing of climate change measures that are ultimately put in place. The federal and certain provincial governments have implemented legislation aimed at incentivizing the use of alternatives fuels and in turn reducing carbon emissions. The taxes placed on carbon emissions may have the effect of decreasing the demand for oil and natural gas products and at the same time, increasing the Company’s operating expenses, each of which may have a material adverse effect on the Company’s profitability and financial condition. Further, the imposition of carbon taxes puts the Company at a disadvantage with the Company’s counterparts who operate in jurisdictions where there are less costly carbon regulations.

Interest Rate Risk

Interest rate risk is the risk that changes in the applicable interest rates for its credit facilities will impact the Company’s interest expense. At December 31, 2020, the Company had credit facilities outstanding of $15.4 million (December 31, 2019: $16.4 million) with an effective rate of 3.45% (2019: 4.45%).

Critical Accounting Estimates

The preparation of the consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

These estimates and judgments have risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Petroleum and Natural Gas Reserves and Resources

All of Questerre's petroleum and natural gas reserves and resources are evaluated and reported on by independent petroleum engineering consultants in accordance with NI 51-101 and the COGE Handbook. For further information, please refer to "Statement of Reserves Data and Other Oil and Gas Information" in the AIF.

The estimation of reserves and resources is a subjective process. Forecasts are based on engineering data, projected future rates of production, commodity prices and the timing of future expenditures, all of which are subject to numerous uncertainties and various interpretations. The Company expects that its estimates of reserves and resources will change to reflect updated information. Reserve and resource estimates can be revised upward or downward based on the results of future drilling, testing, production levels and changes in costs and commodity prices. These estimates are evaluated by independent reserve engineers at least annually.

Proved and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. If probabilistic methods are used, there should be at least a 50 percent probability that the quantities actually recovered will equal or exceed the estimated proved plus probable reserves and there should be at least a 90 percent probability that the quantities actually recovered will equal or exceed the estimated proved reserves.

Reserve and resource estimates impact a number of the areas, in particular, the valuation of property, plant and equipment, exploration and evaluation assets and the calculation of depletion.

Cash Generating Units

A CGU is defined as the lowest grouping of assets that generate identifiable cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The allocation of assets into CGUs requires significant judgment and interpretations. Factors considered in the classification include geography and the way management monitors and makes decisions about its operations.

Impairment of Property, Plant and Equipment, Exploration and Evaluation and Goodwill

The Company assesses its oil and natural gas properties, including exploration and evaluation assets, for possible impairment or reversal of previously recognized impairments if there are events or changes in circumstances that indicate that carrying values of the assets may not be recoverable or indications that previously recognized losses should be reversed. Determining if there are facts and circumstances present that indicate that carrying values of the assets may not be recoverable requires management's judgment and analysis of the facts and circumstances.

The recoverable amounts of CGUs have been determined based on the higher of value in use ("VIU") and the FVLCD. The key assumptions the Company uses in estimating future cash flows for recoverable amounts are anticipated future commodity prices, expected production volumes, the discount rate, future operating and development costs and recent land transactions. Changes to these assumptions will affect the recoverable amounts of the CGUs and may require a material adjustment to their related carrying value.

Goodwill is the excess of the purchase price paid over the fair value of the net assets acquired. Since goodwill results from purchase accounting, it is imprecise and requires judgment in the determination of the fair value of assets and liabilities. Goodwill is assessed for impairment on an operating segment level based on the recoverable amount for each CGU of the Company. Therefore, impairment of goodwill uses the same key judgments and assumptions noted above for impairment of assets.

Asset Retirement Obligation

Determination of the Company's asset retirement obligation is based on internal estimates using current costs and technology in accordance with existing legislation and industry practice and must also estimate timing, a risk-free rate and inflation rate in the calculation. These estimates are subject to change over time and, as such, may impact the charge against profit or loss. The amount recognized is the present value of estimated future expenditures required to settle the obligation using a risk-free rate. The associated abandonment and 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 policy. Changes to assumptions related to future expected costs, risk-free rates and timing may have a material impact on the amounts presented.

Share Based Compensation

The Company has a stock option plan enabling employees, officers and directors to receive Common Shares or cash at exercise prices equal to the market price or above on the date the option is granted. Under the equity settled method, compensation costs attributable to stock options granted to employees, officers or directors are measured at fair value using the Black-Scholes option pricing model. The assumptions used in the calculation are: the volatility of the stock price, risk-free rates of return and the expected lives of the options. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. Changes to assumptions may have a material impact on the amounts presented.

Income Tax Accounting

Deferred tax assets are recognized when it is considered probable that deductible temporary differences will be recovered in the foreseeable future. To the extent that future taxable income and the application of existing tax laws in each jurisdiction differ significantly from the Company's estimate, the ability of the Company to realize the deferred tax assets could be impacted.

The Company has revised its estimate related to deferred tax assets in the year. Since December 31, 2016, the recoverability of deferred tax assets is assessed using proved reserves including an estimate of G&A associated with the assets.

The determination of the Company's income and other tax assets or liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax asset or liability may differ significantly from that estimated and recorded by management.

Investment in Red Leaf

Questerre has investments in certain private companies, including Red Leaf, which it classifies as an equity investment and assesses for indicators of impairment at each period end. For the purposes of impairment testing, the Company measures the fair value of Red Leaf by valuation techniques such as the net asset value approach. The net asset value is based on the net current assets of Red Leaf less the face value and accrued dividends for its preferred shares. The primary risk related to the investment in Red Leaf is the decline in the net current assets of the company without a sufficient advancement in the engineering for the EcoShale process.

Accounting Standards Changes

Changes in Accounting Policies for 2020

IFRS 3 Business Combinations, has been amended to revise the definition of a business to include an input and a substantive process that together significantly contribute to the ability to create outputs. Effective for the years beginning January 1, 2020 the Company has adopted this combination.

Design and Evaluation of Internal Controls over Financial Reporting and Disclosure Controls and Procedures

Questerre is required to comply with National Instrument 52-109 "*Certification of Disclosure in Issuers' Annual and Interim Filings*" ("NI 52-109") and is required to make specific disclosures with respect to NI 52-109 as follows:

- The Company has designed and evaluated the effectiveness of Disclosure Controls and Procedures ("DC&P"). The President and Chief Executive Officer and the Chief Financial Officer have concluded that DC&P are designed appropriately and are operating effectively as at December 31, 2020.
- The Chief Executive Officer and the Chief Financial Officer have designed, or caused to be designed under their supervision, internal controls over financial reporting ("ICFR"), in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. The Chief Executive Officer and the Chief Financial Officer have evaluated the effectiveness of the Company's ICFR as at December 31, 2020 and have concluded that such ICFR have been designed appropriately and are operating effectively.

- The Company reports that no changes were made to ICFR during the quarter ended December 31, 2020 that have materially affected or are reasonably likely to materially affect the Company's ICFR.

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.

Fourth Quarter 2020 Results

In the last quarter of 2020, petroleum and natural gas revenue declined by approximately one third to $6.1 million from $9 million in the same period last year. Just over half the variance is due to the lower oil and liquids prices with the remainder attributable to the lower production volumes.

Limited drilling activity in the year and natural declines were responsible for daily production in the fourth quarter averaging 1,851 boe/d compared to 2,160 boe/d in the prior year. Though benchmark prices improved over the preceding quarters in 2020, they decreased over the same period last year. This decline was partly mitigated by a smaller differential between WTI and Canadian condensate prices.

Operating costs for the quarter remained largely flat at $3.2 million. As fixed costs represent the majority of costs at both Kakwa and Antler, the lower production volumes resulted in higher costs on a boe basis for the current quarter at $18.67/boe compared to $16.75/boe last year.

The Company reported a total comprehensive loss of $0.6 million for the quarter. By comparison in 2019, the Company recorded total comprehensive income of $67.2 million largely due to the one-time items related to the Quebec Acquisition and the reversal of previous impairment related to its investment in Red Leaf.

In the fourth quarter, net cash from operating activities decreased to $1.9 million from $4.1 million last year. This reflects the materially lower adjusted funds flow from operations over the prior year. Net cash used in investing activities also decreased over the prior year with the reduced capital expenditures and increase in non-cash working capital.

Quarterly Financial Information

($ thousands, except as noted)	**December 31, 2020**	September 30, 2020	June 30, 2020	March 31, 2020
Production (boe/d)	**1,851**	1,875	2,058	2,078
Average Realized Price ($/boe)	**35.85**	31.26	18.20	37.12
Petroleum and Natural Gas Revenue	**6,105**	5,391	3,410	7,018
Adjusted Funds Flow from Operations	**1,857**	1,623	206	2,460
Net Profit (Loss)	**(75)**	(970)	(2,702)	(113,876)
Basic and Diluted ($/share)	**–**	–	(0.01)	(0.27)
Capital Expenditures, net of acquisitions and dispositions	**1,621**	348	515	2,875
Working Capital Surplus (Deficit)	**(7,705)**	(8,095)	(9,272)	(8,603)
Total Assets	**196,177**	195,925	201,255	204,782
Shareholders' Equity	**152,120**	152,508	153,509	156,263
Weighted Average Common Shares Outstanding				
Basic (thousands)	**427,516**	427,516	427,516	427,907
Diluted (thousands)	**427,516**	427,516	427,516	427,907

($ thousands, except as noted)	December 31, 2019	September 30, 2019	June 30, 2019	March 31, 2019
Production (boe/d)	2,160	2,343	2,035	1,944
Average Realized Price ($/boe)	45.52	40.33	43.30	40.61
Petroleum and Natural Gas Revenue	9,033	8,690	8,019	7,105
Adjusted Funds Flow from Operations	4,108	5,038	2,662	2,547
Net Profit (Loss)	67,414	1,331	(2,099)	(934)
Basic and Diluted ($/share)	0.14	–	(0.01)	–
Capital Expenditures, net of acquisitions and dispositions	4,868	6,756	7,496	2,941
Working Capital Surplus (Deficit)	(8,111)	(2,573)	(776)	(9,543)
Total Assets	318,062	251,454	248,070	231,975
Shareholders' Equity	268,656	200,966	199,108	186,812
Weighted Average Common Shares Outstanding				
Basic (thousands)	427,907	427,907	417,220	389,007
Diluted (thousands)	428,022	428,591	417,220	389,007

The general trends over the last eight quarters are as follows:

- Petroleum and natural gas revenues and adjusted funds flow from operations have fluctuated with production volumes and realized commodity prices. Revenue declined materially in the last year due to the collapse in prices.
- Production volumes reflect the capital investment in drilling and completing wells at Kakwa in preceding quarters. In 2020, with non-essential capital investments suspended, production volumes declined in the last two quarters.

- The level of capital expenditures over the quarters has varied largely due to the timing and number of wells drilled and completed for the Kakwa asset as well as the timing of the infrastructure investment.
- The working capital deficit has generally increased when capital expenditures and other investments have been higher than adjusted funds flow from operations and cash from financing activities.
- Shareholders' equity decreased significantly in the first quarter of 2020 with materially lower commodity prices resulting in an impairment expense of $113 million. In the preceding quarter, shareholder's equity increased due to the $58.5 million gain realized by the Company on the release of litigation related to the Quebec Acquisition. For the quarter ended June 30, 2019, shareholder equity increased as a result of a private placement completed during the period. In previous quarters, shareholder equity has generally fluctuated with the changes in net income (loss).

Off-Balance Sheet Transactions

The Company did not engage in any off-balance sheet transactions during the year ended December 31, 2020.

Related Party Transactions

The Company paid fees of $0.1 million (2019: nil) to a law firm where a Director of the Company is currently a partner.

Management's Report

The consolidated financial statements of Questerre Energy Corporation were prepared by management in accordance with International Financial Reporting Standards. The financial and operating information presented in this annual report is consistent with that shown in the consolidated financial statements.

Management has designed and maintains a system of internal accounting controls that provide reasonable assurance that all transactions are accurately recorded, that the financial statements reliably report the Company's operations and that the Company's assets are safeguarded. Timely release of financial information sometimes necessitates the use of estimates when transactions affecting the current accounting period cannot be finalized until future periods. Such estimates are based on careful judgments made by management.

PricewaterhouseCoopers LLP, an independent firm of Chartered Professional Accountants, was appointed by a resolution of the shareholders to audit the consolidated financial statements of the Company and provide an independent opinion. They have conducted an independent examination of the Company's accounting records in order to express their opinion on the consolidated financial statements.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board of Directors exercises this responsibility through its Audit Committee. The Audit Committee, which consists of non-management directors, has met with PricewaterhouseCoopers LLP and management in order to determine that management has fulfilled its responsibilities in the preparation of the consolidated financial statements. The Audit Committee has reported its findings to the Board of Directors, who have approved the consolidated financial statements.

Michael Binnion
President and Chief Executive Officer

Jason D'Silva
Chief Financial Officer

Calgary, Alberta, Canada
March 24, 2021

Independent Auditor’s Report

To the Shareholders of Questerre Energy Corporation

Our Opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Questerre Energy Corporation and its subsidiaries (together, the Company) as at December 31, 2020 and 2019, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

What we have audited

The Company's consolidated financial statements comprise:

- the consolidated balance sheets as at December 31, 2020 and 2019;
- the consolidated statements of net income (loss) and comprehensive income (loss) for the years then ended;
- the consolidated statements of changes in equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor’s responsibilities for the audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Key Audit Matters

Key audit matters ("KAM") are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the year ended December 31, 2020. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matters	How our audit addressed the key audit matters

The impact of petroleum and natural gas reserves on net property, plant and equipment (PP&E) for the Company's Western Canada operating segment
 	
Refer to note 1a – Segmented disclosure, note 2 – Basis of preparation, note 3 –Significant accounting policies and note 8 – Property, plant and equipment to the consolidated financial statements.
 	
The Company has $52.5 million of net PP&E within their Western Canada operating segment as at December 31, 2020. Depletion, depreciation and accretion (DD&A) expense for these properties was $9.2 million for the year then ended. The net carrying value of development and production assets are depleted using the unit of production method based on estimated proved and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production.
 	
For the purposes of impairment testing, development and production assets are grouped together into cash generating units (CGUs). The carrying amounts of the Company's non-financial assets, including oil and gas properties, are reviewed at each reporting period to determine if there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated and compared to the carrying amount. The recoverable amount of the CGUs within the Western Canada segment was estimated based on the fair value less cost of disposal (FVLCD) using a discounted cash flow model determined using discounted future cash
	Our approach to addressing the matter included the following procedures, among others:
	
	• The work of management's expert was used in performing the procedures to evaluate the reasonableness of the proved and probable reserves used to determine DD&A expense and the recoverable amount of PP&E for the CGUs within the Western Canada operating segment. As a basis for using this work, management's expert's competence, capability and objectivity were evaluated, their work performed was understood and the appropriateness of their work as audit evidence was evaluated by considering the relevance and reasonableness of the assumptions, methods and findings.
	
	• Tested how management determined the recoverable amount of the CGUs within the Western Canada operating segment and the DD&A expenses, which included the following:
	
	  • Evaluated the appropriateness of the methods used by management in making these estimates.
	
	  • Tested the data used in determining these estimates.
	
	  • Evaluated the reasonableness of significant assumptions used in developing the underlying estimates:
	
	    o Expected production volumes and future operating and development costs by considering the past performance of the CGUs and whether these assumptions were

flows of proved and probable reserves. The proved and probable reserves are estimated by the Company's independent reserve engineers (management's experts). During the year ended December 31, 2020, $96.3 million was recorded as impairment expense on the Western Canada PP&E assets.

Significant assumptions the Company uses in estimating the recoverable amount of the CGUs within the Western Canada operating segment include the anticipated future commodity prices, quantities of reserves, expected production volumes, the discount rate and future operating and development costs.

We determined that this is a key audit matter due to (i) the significant judgment made by management, including the use of management's experts, when developing the discounted future cash flows to determine the recoverable amount and the proved and probable petroleum and natural gas reserves; (ii) a high degree of auditor judgment, subjectivity and effort in performing procedures relating to the significant assumptions; and (iii) the audit effort that involved the use of professionals with specialized skill and knowledge in the field of valuation.

consistent with evidence obtained in other areas of the audit.

  - Forecasts of future commodity prices by comparing those forecasts with other reputable third party industry forecasts.
  - The discount rate, through the assistance of professionals with specialized skill and knowledge in the field of valuation.

- Recalculated the unit of production rates used to calculate DD&A expense for the CGUs within Western Canada operating segment.

Assessment of impairment indicators for the Quebec segment exploration and evaluation (E&E) assets

Refer to note 1a – Segmented disclosure, note 2 – Basis of preparation, note 3 – Significant accounting policies and note 9 – Exploration and evaluation assets to the consolidated financial statements.

The Company has $101.9 million of exploration and evaluation assets within the Quebec segment as at December 31, 2020. E&E assets are subject to ongoing management review to confirm the continued intent to establish the technical feasibility and commercial viability of the assets, including judgement over the amount of economically recoverable resources, and whether

Our approach to addressing the matter included the following procedures, among others:

Assessed the judgment made by management in determining the impairment indicators which included the following:

- Read the Board of Directors' minutes and obtained budget approvals to evidence continued and planned exploration expenditure, which included evaluating the Company's objectives of securing social acceptability and regulatory approvals for the clean technology energy project.
- Assessed whether the amount economically recoverable resources will not be technically feasible or commercially viable, or if other facts and circumstances suggest that the carrying

the appropriate government, regulatory, or internal approvals are likely to be received. At each reporting period E&E assets are assessed for impairment, to determine if (i) sufficient data exists to determine technical feasibility and commercial viability, or (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. The Company determined no impairment indicators for its E&E assets within the Quebec segment as at December 31, 2020.

We considered this a key audit matter due to the significance of the E&E assets within the Quebec segment and the judgments made by management in its assessment of indicators of impairment related to the E&E assets, and these have resulted in a high degree of subjectivity in performing audit procedures related to these judgments applied by management.

amount of the assets may exceed the recoverable amount, based on evidence obtained in other areas of the audit.

Other Information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis and the information, other than the consolidated financial statements and our auditor’s report thereon, included in the annual report.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Alisa Sorochan.

/s/ PricewaterhouseCoopers LLP

Chartered Professional Accountants

Calgary, Alberta

March 24, 2021

Consolidated Balance Sheets

($ thousands)	Note	December 31, 2020	December 31, 2019
Assets			
Current Assets			
Cash and cash equivalents	5	$ 10,404	$ 15,037
Accounts receivable	6	2,683	3,868
Deposits and prepaid expenses		819	881
		13,906	19,786
Right-of-use assets	19	249	116
Investments	7	7,979	8,439
Property, plant and equipment	8	52,484	152,794
Exploration and evaluation assets	9	114,203	127,081
Restricted cash	13	7,356	7,500
Goodwill		–	2,346
		$ 196,177	$ 318,062
Liabilities			
Current Liabilities			
Lease liabilities	19	$ 50	$ 101
Accounts payable and accrued liabilities		6,186	11,519
Credit Facilities	13	15,427	16,377
		21,663	27,997
Lease liabilities	19	205	18
Contingent liabilities		1,820	1,820
Asset retirement obligation	12	20,369	19,571
		44,057	49,406
Shareholders' Equity			
Share capital	14	429,703	429,703
Contributed surplus		23,047	21,700
Accumulated other comprehensive loss		(473)	(213)
Deficit		(300,157)	(182,534)
		152,120	268,656
		$ 196,177	$ 318,062

Commitments (note 20)

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

Signed on behalf of the Board of Directors

Bjorn Inge Tonnessen, Director

Dennis Sykora, Director

Consolidated Statements of Net Income (Loss) and Comprehensive Income (Loss)

		For the year ended December 31,	
($ thousands, except per share amounts)	Note	2020	2019
Revenue			
Petroleum and natural gas revenues	15	$ 21,924	$ 32,847
Royalties		(1,315)	(1,615)
Petroleum and natural gas revenue, net of royalties		20,609	31,232
Expenses			
Direct operating		11,945	13,047
General and administrative		2,534	3,816
Depletion, depreciation and accretion	8,12	9,422	13,093
Gain on mutual release of litigation	9	–	(58,503)
Settlement of lawsuit	9	–	(5,970)
Gain on equity investment	7	–	(8,162)
Impairment	8,9	113,019	–
Lease expiries	9	717	–
Share based compensation	11	489	1,029
Interest expense		619	748
Interest and other income		(503)	(575)
Income (loss) before taxes		(117,633)	72,709
Deferred tax expense (recovery)	10	(10)	7,005
Net income (loss)		(117,623)	65,704
Other Comprehensive Loss, Net of Tax			
Items that may be reclassified subsequently to profit or loss:			
Foreign currency translation adjustment		(20)	(210)
Loss on foreign exchange on investments	7	(240)	(13)
		(260)	(223)
Total Comprehensive Income (Loss)		$ (117,883)	$ 65,481
Net income (loss) per Share			
Basic and diluted	14	$ (0.28)	$ 0.16

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

Consolidated Statements of Changes in Equity

($ thousands)	For the year ended December 31, 2020	2019
Share Capital		
Balance, beginning of year	$ 429,703	$ 415,747
Private Placements	-	14,474
Share issue costs (net of tax)	-	(518)
Balance, end of year	429,703	429,703
Contributed Surplus		
Balance, beginning of year	21,700	19,772
Share based compensation	1,347	1,928
Balance, end of year	23,047	21,700
Accumulated Other Comprehensive Loss		
Balance, beginning of year	(213)	10
Other comprehensive loss	(260)	(223)
Balance, end of year	(473)	(213)
Deficit		
Balance, beginning of year	(182,534)	(248,238)
Net income (loss)	(117,623)	65,704
Balance, end of year	(300,157)	(182,534)
Total Shareholders' Equity	$ 152,120	$ 268,656

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

Consolidated Statements of Cash Flows

($ thousands)	Note	For the years ended December 31, 2020	2019
Operating Activities			
Net income (loss)		$ (117,623)	$ 65,704
Adjustments for:			
Depletion, depreciation and accretion	8,12	9,422	13,093
Impairment	8,9	113,019	–
Gain on settlement of lawsuit	9	–	(5,970)
Lease expiries	9	717	–
Gain on mutual release of litigation	9	–	(58,503)
Gain on equity investment	7	–	(8,162)
Share based compensation	11	489	1,029
Deferred tax expense (recovery)	10	(10)	7,005
Interest expense		619	748
Interest and other income		(428)	(453)
Abandonment expenditures	12	(59)	(136)
Adjusted funds flow from operations		6,146	14,355
Interest expense		(619)	(748)
Interest income		321	388
Change in non-cash working capital	18	560	(2,658)
Net cash from operating activities		6,408	11,337
Investing Activities			
Property, plant and equipment expenditures	8	(1,691)	(7,816)
Exploration and evaluation expenditures	9	(3,668)	(14,245)
Acquisition of exploration assets	9	(263)	(3,044)
Change in non-cash working capital	18	(4,528)	714
Net cash used in investing activities		(10,150)	(24,391)
Financing Activities			
Proceeds from issue of share capital		–	14,474
Share issue costs		–	(518)
Principal portion of lease payments		(85)	(108)
Increase in credit facilities		24,550	40,035
Repayment of credit facilities		(25,500)	(37,500)
Net cash from (used in) financing activities		(1,035)	16,383
Change in cash, cash equivalents and restricted cash		(4,777)	3,329
Cash, cash equivalents and restricted cash, beginning of year		22,537	19,208
Cash, cash equivalents and restricted cash, end of year		$ 17,760	$ 22,537

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

1. Reporting Entity

Questerre Energy Corporation ("Questerre" or the "Company") is a energy technology and innovation company actively engaged in the acquisition, exploration and development of oil and gas projects, specifically, non-conventional projects such as tight oil, oil shale, shale oil and shale gas. The consolidated financial statements of the Company as at and for the years ended December 31, 2020 and 2019 comprise the Company and its wholly-owned subsidiaries in those periods owned. The Company wholly owns Questerre Energy Corporation/Jordan, which holds interests in the oil shale assets in Jordan.

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 Sixth Avenue SW, Calgary, Alberta.

a) Segmented Disclosure

Management has determined the operating segments based on information regularly reviewed for the purposes of decision making, allocating resources, and assessing operational performance by Questerre's chief operating decision makers comprising of the Chief Executive Officer and other members of executive management. The operating segments have been aggregated based on several factors including geographic location and stage of development as well as the assignment of reserves and resources.

The accounting policies applied by the segments are the same as those applied by the Company.

The Company's operating segments at year end are as follows:

- Western Canada – Exploration and development activities in Western Canada including Alberta, Saskatchewan and Manitoba with existing production of natural gas, crude oil and natural gas liquids.
- Quebec – Development of a significant natural gas discovery in the province with a focus on securing social acceptability and regulatory approvals for a clean technology energy project.
- Corporate & other – General and administrative resources to manage the respective operating segments. Includes exploration activities in the Kingdom of Jordan and an investment in Red Leaf Resources Inc. ("Red Leaf").

Segmented assets are those assets associated with each operating segment as recorded on the consolidated balance sheets.

The table below details the breakdown of assets by operating segment to the consolidated balance sheets and the reconciliation of income by operating segment to the consolidated statements of net income and comprehensive income.

($ thousands)	Western Canada	Quebec	Corporate & other	Consolidated
Assets by operating segment				
Exploration and Evaluation	$ 6,381	$ 101,946	$ 5,876	$ 114,203
Property, Plant & Equipment	52,484	–	–	52,484
Other	3,502	7,356	18,632	29,490
Total Assets, December 31, 2020	**$ 62,367**	**$ 109,302**	**$ 24,508**	**$ 196,177**
Exploration and Evaluation	$ 20,820	$ 100,989	$ 5,272	$ 127,081
Property, Plant & Equipment	152,794	–	–	152,794
Other	7,095	7,500	23,592	38,187
Total Assets, December 31, 2019	$ 180,709	$ 108,489	$ 28,864	$ 318,062

Results by operating segment				
Revenues	$ 20,609	$ –	$ –	$ 20,609
Expenses	(134,116)	(987)	(3,139)	(138,242)
Segmented Income, December 31, 2020	$ (113,507)	$ (987)	$ (3,139)	**$ (117,633)**
Deferred tax recovery				10
Total Loss, December 31, 2020				**$ (117,623)**
Revenues	$ 31,232	$ –	$ –	$ 31,232
Expenses	(17,846)	(132)	(5,018)	(22,996)
Segmented Income, December 31, 2019	**$ 13,386**	**$ 64,341**	**$ (5,018)**	**$ 72,709**
Deferred tax expense				(7,005)
Total Income, December 31, 2019				**$ 65,704**

2. Basis of Preparation

a) Statement of compliance

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Boards ("IASB"). The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as at March 24, 2021, the date the Board of Directors approved the statements.

b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for financial assets classified as fair value through profit and loss which are measured at fair value with changes in fair value recorded in profit or loss and changes due to foreign exchange recorded through other comprehensive income or loss as disclosed in Note 3.

c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency. The Company has a wholly-owned subsidiary with a functional currency of the Jordanian Dinar.

d) Jointly controlled assets

The Company conducts many of its oil and gas production activities through jointly controlled operations. Interests in joint arrangements are classified as either joint operations or joint ventures, depending on the rights and obligations of the parties to the arrangement. Joint operations arise when the Company has rights to the assets and obligations for the liabilities of the arrangement. The Company recognizes its share of assets, liabilities, revenues and expenses of a joint operation. Joint ventures arise when the Company has rights to the net assets of the arrangement. Joint ventures are accounted for under the equity method.

e) Use of estimates and judgments

The preparation of consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. These estimates and judgments have risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Petroleum and natural gas reserves

All of Questerre's petroleum and natural gas reserves are evaluated and reported on by independent reserve engineers in accordance with the COGE Handbook and Canadian Securities Administrators' *National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities* ("NI 51-101"). The estimation of reserves and resources is a subjective process. Forecasts are based on engineering data, anticipated future commodity prices, expected production volumes, future operating and development costs, all of which are subject to numerous uncertainties and various interpretations. The Company expects that its estimates 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 changes in costs and commodity prices. These estimates are evaluated by independent reserve engineers at least annually.

Proved and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. If probabilistic methods are used, there should be at least a 50 percent probability that the quantities actually recovered will equal or exceed the estimated proved plus probable reserves and there should be at least a 90 percent probability that the quantities actually recovered will equal or exceed the estimated proved reserves.

Reserve estimates impact a number of areas, in particular, the valuation of property, plant and equipment, exploration and evaluation assets and the calculation of depletion.

Refer to Note 8 & 9 for carrying amounts of property, plant and equipment, exploration and evaluation assets.

Exploration and evaluation assets

The application of the Company's accounting policy for exploration and evaluation assets requires judgement in determining whether it is likely that future economic benefit exists when activities have not reached a stage where technical feasibility and commercial viability can be reasonably determined. In addition, Management uses judgement to determine when exploration and evaluation ("E&E") assets are reclassified to property, plant and equipment ("PP&E") assets.

Exploration and evaluation assets are subject to ongoing management review to confirm the continued intent to establish the technical feasibility and commercial viability of the assets. In making this determination, various factors are considered such as drilling results, future capital and operating expenditures, including judgement over the amount of economically recoverable resources, and whether the appropriate government, regulatory, or internal approvals are likely to be received.

Cash generating units ("CGU")

A CGU is defined as the lowest grouping of assets that generate identifiable cash inflows that are largely independent of the cash inflows of other assets or groups of assets. The allocation of assets into CGUs requires significant judgment and interpretations. Factors considered in the classification include geography and the way management monitors and makes decisions about its operations.

Refer to Note 8 for carrying amounts of property, plant and equipment.

Impairment of property, plant and equipment, exploration and evaluation and goodwill

The Company assesses its oil and gas properties, including exploration and evaluation assets, for possible impairment or reversal of previously recognized impairments if there are events or changes in circumstances that indicate that carrying values of the assets may not be recoverable or indications that previously recognized losses should be reversed. Determining if there are facts and circumstances present that indicate that carrying values of the assets may not be recoverable requires management's judgment and analysis of the facts and circumstances.

The recoverable amounts of CGUs have been determined based on the higher of value in use ("VIU") and the fair value less costs of disposal ("FVLCD"). Significant assumptions the Company uses in estimating future cash flows for recoverable amounts are anticipated future commodity prices, quantities of reserves, expected production volumes, the discount rate, future operating and development costs and recent land transactions. Changes to these assumptions will affect the recoverable amounts of CGUs and may require a material adjustment to their related carrying value.

Goodwill is the excess of the purchase price paid over the fair value of the net assets acquired. Since goodwill results from purchase accounting, it is imprecise and requires judgment in the determination of the fair value of assets and liabilities. Goodwill is assessed for impairment at an operating segment level based on the recoverable amount for each CGU of the Company. Therefore, impairment of goodwill uses the same significant assumptions noted above for impairment of assets.

Asset retirement obligation

Determination of the Company's asset retirement obligation is based on internal estimates using current costs and technology in accordance with existing legislation and industry practice and must also estimate timing, a risk-free rate and inflation rate in the calculation. These estimates are subject to change over time and, as such, may impact the charge against profit or loss. The amount recognized is the present value of estimated future expenditures required to settle the obligation using a risk-free rate. The associated abandonment and 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 policy. Changes to assumptions related to future expected costs, risk-free rates and timing may have a material impact on the amounts presented.

Refer to Note 12 for the carrying amounts related to the asset retirement obligation.

Share based compensation

The Company has a stock option plan enabling employees, officers and directors to receive Class "A" Common voting shares ("Common Shares") or cash at exercise prices equal to the market price or above on the date the option is granted. Notwithstanding, the Company has the right to only equity settle options. While the Company has equity settled options for the past nine years, it may change this in the future at its discretion. Under the equity settled method, compensation costs attributable to stock options granted to employees, officers or directors are measured at fair value using the Black-Scholes option pricing model. The assumptions used in the calculation are: the volatility of the stock price, risk-free rates of return and the expected lives of the options. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. Changes to assumptions may have a material impact on the amounts presented.

For further detail refer to Note 11.

Income tax accounting

Deferred tax assets are recognized when it is considered probable that deductible temporary differences will be recovered in the foreseeable future. To the extent that future taxable income and the application of existing tax laws in each jurisdiction differ significantly from the Company's estimate, the ability of the Company to realize the deferred tax assets could be impacted.

The determination of the Company's income and other tax assets or liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax asset or liability may differ significantly from that estimated and recorded by management.

Refer to Note 10 for the carrying amounts related to deferred taxes.

Investment in Red Leaf

Questerre holds investments in certain private companies including its investment in Red Leaf. For the purposes of testing for impairment, the Company measures the fair market value of Red Leaf by valuation techniques such as net asset value analysis. Considerable judgment is required in measuring the fair value of the Company's investment in Red Leaf, which may result in material adjustments to its related carrying value.

The Company uses the equity method of accounting to reflect its ownership in Red Leaf. Under the equity method, the Company's initial and subsequent investments are recognized at cost and subsequently adjusted for the Company's share of Red Leaf's income or loss, less distributions received. The Company is deemed to have significant influence in Red Leaf on the basis that it holds more than 20% of the voting power and the ability to participate in the decision making process of Red Leaf through its current Board representation.

Refer to Note 7 for the carrying amounts related to the Company's investment in Red Leaf.

3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

a) Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are considered.

The acquisition method of accounting is used to account for business combinations that meet the definition of a business under IFRS. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. Contingent consideration is included in the cost of acquisitions at fair value. Directly attributable transaction costs are expensed in the current period and reported within general and administrative expenses. The excess of the cost of acquisition over the fair value of the identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of the acquisition is less than the fair value of the net assets acquired, the difference is recognized immediately in profit or loss.

Transactions eliminated on consolidation

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

b) Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires.

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

The Company classifies its financial instruments in the following categories, at initial recognition, depending on the purpose for which the instruments were acquired.

Financial assets and liabilities at fair value through profit or loss

A financial asset or liability is classified in this category if it is held for trading. Derivatives are also included in this category unless they are designated as hedges. The Company has designated its risk management contracts in this category.

Financial assets at amortized cost

Financial assets at amortized cost are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They include accounts receivable and deposits. These assets are included in current assets due to their short-term nature. They are recognized initially at the amount expected to be received, less, when material, a discount to reduce to fair value. Subsequently, they are measured at amortized cost using the effective interest method less a provision for impairment.

Cash and cash equivalents include deposits held with banks, less outstanding cheques, and short-term deposits with original maturities of one year or less.

Financial liabilities at amortized cost

Financial liabilities at amortized cost comprise credit facilities and accounts payable and accrued liabilities. Financial liabilities are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, financial liabilities are measured at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within twelve months.

c) Share capital

Common Shares are classified as equity. Incremental costs directly attributable to the issue of Common Shares are recognized as a deduction from equity, net of any tax effects.

d) Property, plant and equipment and exploration and evaluation assets

Recognition and measurement

Exploration and evaluation expenditures

Costs incurred prior to acquiring the legal rights to explore an area are recognized as exploration and evaluation expense in profit or loss.

Exploration and evaluation costs, including the costs of acquiring licenses, exploratory well expenditures, costs to evaluate the commercial potential of underlying resources and directly attributable general and administrative costs, are capitalized as exploration and evaluation assets. The costs are accumulated in cost centres by exploration area pending determination of technical feasibility and commercial viability. Gains and losses on exploration and evaluation assets are recognized on disposal through the income statement.

At each reporting period, exploration and evaluation assets are assessed for impairment to determine if (i) sufficient data exists to determine technical feasibility and commercial viability, or (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable based on several factors including the assignment of reserves. A review of each exploration license or field is carried out, at each reporting date, to ascertain whether technical feasibility and commercial viability has been achieved. Upon determination of technical feasibility and commercial viability, intangible exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to property, plant and equipment.

Every reporting period, the Company evaluates individually significant exploration and evaluation wells for impairment, if there are specific impairment indicators evident at the well level. If technical feasibility and commercial viability of the well is not established, the well costs are written off. For insignificant wells, overall exploration and evaluation well indicators are evaluated. If there are indicators of impairment, the wells are tested for impairment at the CGU level.

Development and production costs

Items of property, plant and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Cost includes all costs required to acquire developed or producing oil and gas properties and to develop oil and gas properties. Development and production assets are grouped into CGUs for impairment testing.

Gains and losses on disposal of an item of property, plant and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of the property, plant and equipment and are recognized net within gain (loss) on divestures in profit or loss.

Exchanges of properties are measured at fair value, unless the transaction lacks commercial substance or fair value cannot be reliably measured. When the exchange is at fair value, a gain or loss is recognized in profit or loss.

Business Combinations

Business combinations are accounted for using the acquisition method of accounting. The determination of fair value often requires management to make assumptions and estimates about future events. The assumptions and estimates with respect to determining the fair value of exploration and evaluation assets and property, plant and equipment acquired generally require the most judgment and include estimates of reserves acquired, forecast benchmark commodity prices and discount rates. Assumptions are also required to determine the fair value of decommissioning obligations associated with the properties. Changes in any of these assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to assets, liabilities and goodwill (or gain from a bargain purchase) in the acquisition equation. Future profit (loss) can be affected as a result of changes in future depletion and depreciation or impairment.

<u>Other property, plant and equipment</u>

Expenditures related to workovers or betterments that improve the productive capacity or extend the life of an asset are capitalized. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.

<u>Depletion and depreciation</u>

The net carrying value of development and production assets is depleted using the unit of production method based on estimated proved and probable reserves, considering estimated future development costs necessary to bring those reserves into production. These estimates are evaluated by independent reserve engineers at least annually.

For other assets, depreciation is recognized in profit or loss on a straight-line basis over the respective useful lives.

Depreciation methods and useful lives are reviewed at each reporting date.

e) Goodwill

Goodwill arises on the acquisition of businesses, subsidiaries, associates and joint ventures. Goodwill is measured at cost less accumulated impairment losses. Goodwill is not amortized.

f) Impairment

<u>Non-financial assets</u>

The carrying amounts of the Company's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated and compared to the carrying amount. For goodwill an impairment test is completed each year, or when any indication of impairment exists.

For the purpose of impairment testing, assets are grouped together into CGUs. Goodwill, for the purpose of impairment testing, is assessed for impairment on an operating segment basis. The Company has three operating segments. Exploration and evaluation assets are allocated to related CGUs when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their reclassification to producing assets.

The recoverable amount of an asset or a CGU is the greater of its VIU and FVLCD. FVLCD is determined using discounted future cash flows of proved and probable reserves using an after tax discount rate for FVLCD. In determining FVLCD, recent market transactions are considered, if available. In the absence of such transactions, the discounted cash flow model is used. In assessing VIU, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized. Impairment reversals are recognized in profit or loss.

<u>Impairment of financial assets</u>

Questerre applies the simplified approach to providing for expected credit losses prescribed by IFRS 9 *Financial Instruments* ("IFRS 9") which permits the use of the lifetime expected loss provision for all trade receivables carried at amortized costs.

At each reporting date, the Company measures the lifetime expected loss provision taking into consideration Questerre's historical credit loss experience as well as forward-looking information in order to establish loss rates. The impairment loss (or reversal) is the amount of expected credit losses that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognized. Also refer to Note 6.

<u>Share based compensation</u>

The Company has issued options to directors, officers and employees.

The Company accounts for its stock-based compensation awards on the basis that they will be equity settled. Under the equity settled method, compensation costs attributable to stock options granted to employees, officers or directors are 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. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

g) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Asset retirement obligation

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. Provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Asset retirement obligations are measured at the present value of management's best estimate of expenditure required to settle the present obligation at the balance sheet date. The best estimate of the provision is recorded on a discounted basis using a risk-free interest rate. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as accretion of the asset retirement obligation whereas increases or decreases due to changes in the estimated future cash flows and risk-free rates are adjusted through property, plant and equipment or exploration and evaluation assets. Actual costs incurred upon settlement of the asset retirement obligations are charged against the provision.

h) Revenue from commodity sales and royalties

Questerre principally generates revenue from the sale of commodities, which include crude oil, natural gas, condensate and natural gas liquids ("NGLs"). Questerre also generates revenue from royalties on production from leases where it owns a working interest. Revenue associated with the sale of commodities is recognized when control is transferred from Questerre to its customers. Questerre's commodity sale contracts represent a series of distinct transactions. Questerre considers its performance obligations to be satisfied and control to be transferred when all of the following conditions are satisfied:

- Questerre has transferred title and physical possession of the commodity to the buyer;
- Questerre has transferred the significant risks and rewards of ownership of the commodity to the buyer; and
- Questerre has the present right to payment.

Revenue represents the Company's share of commodity sales net of royalty obligations to governments and other mineral interest owners. Questerre sells its production pursuant to variable priced contracts. The transaction price for variable priced contracts is based on the commodity price, adjusted for quality, location or other factors, whereby each component of the pricing formula can be either fixed or variable, depending on the contract terms. Under these contracts, the Company is required to deliver a variable volume of crude oil, natural gas, condensate or NGLs to the contract counterparty.

Revenue is recognized when a unit of production is delivered to the contract counterparty. The amount of revenue recognized is based on the agreed upon transaction price, whereby any variability in revenue is related specifically to the Company's efforts to deliver production. Therefore, the resulting revenue is allocated to the production delivered in the period during which the variability occurs. Payment terms for Questerre's commodity sales contracts are on the 25th of the month following delivery. Questerre does not have any contracts where the period between the transfer of the promised goods or services to the customer and payment by the customer exceeds one year and therefore Questerre does not adjust its revenue transactions for the time value of money. The Company enters into contracts with customers that can have performance obligations that are unsatisfied, or partially unsatisfied, at the reporting date.

Royalty revenue is recognized as it accrues in accordance with the terms of the governing agreement, which is generally in the month when the product is produced with production volumes primarily marketed with the payor's production. Royalty revenue is measured at fair value of the consideration received when Management can reliably estimate the amount pursuant to the terms of the royalty agreement. An accrual is included in revenue and accounts receivable for amounts not received at the reporting date based on historical trends, new wells on stream and current market prices. Differences between the estimates and actual amounts received are adjusted and recorded in the period when the actual amounts are received.

i) Income tax

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax asset will be realized.

The effect of a change in enacted or substantively enacted income tax rates on future income tax assets and liabilities is recognized in profit or loss in the period that the change occurs unless the original entry was recorded to equity.

j) Net profit or loss per share

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year. Diluted per share amounts are calculated using the weighted average number of shares outstanding, adjusted for the potential number of shares which may have a dilutive impact on net profit. Potentially dilutive shares include stock options. The weighted average number of diluted shares is calculated in accordance with the treasury stock method. The treasury stock method assumes that the proceeds received from the exercise of all potentially dilutive instruments are used to repurchase Common Shares at the average market price.

Since the options may be settled in cash or shares at the Company’s discretion and therefore there is no obligation to settle in cash, the share units are accounted for as equity-settled share based payment transactions and included in diluted profit per share if the effect is dilutive.

k) Leases

Under IFRS 16, the Company recognizes right-of-use assets and lease liabilities for most leases. Certain short-term leases (less than 12 months) and leases of low-value assets are exempt from the requirements and may continue to be treated as operating leases. The right-of-use assets recognized are subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful life of the right-of-use assets or the end of the lease term. The estimated useful lives of right-of-use assets are determined on the same basis as those of property and equipment. In addition, the right-of-use assets are periodically reduced by impairment losses, if any, and adjusted for certain re-measurements of the lease liabilities.

The lease liabilities are initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate. The Company uses its incremental borrowing rate as the discount rate.

The lease liabilities are subsequently measured at amortized cost using the effective interest method. It is re-measured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Company's estimate of the amount expected to be payable under a residual value guarantee, or if the Company changes its assessment of whether it will exercise a purchase, extension or termination option.

When the lease liabilities are re-measured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use assets or is recorded in profit or loss if the carrying amount of the right-of-use assets has been reduced to $0. The Company presents right-of-use assets and lease liabilities separately in the balance sheet.

The application of IFRS 16 requires significant judgments and estimations to be made. Areas that require judgment include identifying whether a contract (or part of a contract) includes a lease, determining whether it is reasonably certain that an extension or termination option will be exercised, determining whether variable payments are in substance fixed, establishing whether there are multiple leases in an arrangement and determining the stand-alone amounts for lease and non-lease components. Other sources of estimation uncertainty in the application of IFRS 16 include estimating the lease term, determining the appropriate discount rate to apply to lease payments and assessing whether a right-of-use assets are impaired.

4. Changes in Accounting Policies and Disclosures

a) Future Accounting Pronouncements

IFRS 3 Business Combinations

Business Combinations ("IFRS 3") has been amended to revise the definition of a business to include an input and a substantive process that together significantly contribute to the ability to create outputs. The amendment to IFRS 3 is effective for the years beginning on or after January 1, 2020. The Company has determined that the amendments to IFRS 3 will have no impact on the financial statements.

5. Cash and Cash Equivalents

($ thousands)		December 31, 2020		December 31, 2019
Bank balances	$	177	$	30
Short-term bank deposits		10,227		15,007
	$	10,404	$	15,037

6. 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, 2020 included cash and cash equivalents, accounts receivable, deposits, investments, credit facilities and accounts payable and accrued liabilities. As at December 31, 2020, the fair values of the Company's financial assets and liabilities equaled their carrying values due to the short-term maturity.

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.

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.

Level 3 Fair Value Measurements

The fair value of PP&E recognized is based on market values. The market value of PP&E is the estimated amount for which PP&E could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests (included in PP&E) are generally estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on internally and externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions. The market value of E&E assets is estimated with reference to the market values of current arm's length transactions in comparable locations. Refer to Notes 8 and 9.

c) 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 principally from the Company's receivables from joint venture partners and oil and gas marketers. The carrying amounts of accounts receivable and cash and cash equivalents represent the maximum credit exposure.

Substantially all of the accounts receivable are with oil and natural gas marketers and joint venture partners in the oil and natural 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.

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

The Company's accounts receivables are aged as follows:

($ thousands)		December 31, 2020		December 31, 2019
Current	$	2,759	$	3,835
31 - 60 days		31		2
61 - 90 days		4		2
>90 days		177		181
Expected credit loss provision		(288)		(152)
	$	2,683	$	3,868

The Company does not anticipate any material default as it transacts with creditworthy customers and management does not expect any losses from non-performance by these customers. There are no material financial assets that the Company considers past due that are considered impaired.

Cash and cash equivalents include cash bank balances and short-term deposits. The Company manages the credit risk exposure by investing in Canadian banks and credit unions. Management does not expect any counterparty to fail to meet its obligations.

d) Liquidity risk

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

Since the Company operates in the upstream oil and natural gas industry, it requires sufficient cash to fund capital programs necessary to maintain or increase production, develop reserves and to potentially acquire strategic assets. The Company's capital programs are funded principally by cash obtained through its credit facilities, equity issuances and from operating activities. During times of low oil and natural gas prices or when cash resources may be limited, a portion of capital programs can generally be deferred, however, due to the long cycle times and the importance to future cash flow in maintaining the Company's production, it may be necessary to utilize alternative sources of capital to continue the Company's strategic investment plan during periods of low commodity prices. As a result, the Company frequently evaluates the options available with respect to sources of long and short-term capital resources. Occasionally, to the extent possible, the Company will use derivative instruments to manage cash flow in the event of commodity price declines.

The Company's financial obligations relates to amounts due under the credit facilities, including trade and other payables, which consist of invoices payable to trade suppliers relating to the office and field operating activities and its capital spending program. The Company processes invoices within a normal payment period and all amounts are due within the next 12 months.

The timing of cash outflows relating to financial liabilities as at December 31, 2020 and 2019 are as follows:

($ thousands)	Less than one year	One to three years	Subsequent years	Total
Credit Facilities	$ 15,427	$ –	$ –	$ 15,427
Trade and other liabilities	6,186	–	–	6,186
Lease Liabilities	57	166	47	270
Contingent Liabilities	–	2,100	–	2,100
December 31, 2020	$ 21,670	$ 2,266	$ 47	$ 23,983

($ thousands)	Less than one year	One to Three Years	Subsequent years	Total
Credit Facilities	$ 16,377	$ –	$ –	$ 16,377
Trade and other liabilities	11,519	–	–	11,519
Lease Liabilities	105	18	–	123
Contingent Liabilities	–	2,100	–	2,100
December 31, 2019	$ 28,001	$ 2,118	$ –	$ 30,119

e) 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 the 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 not only by the relationship between the Canadian and United States dollar, but 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 cash flow on future sales. The contracts reduce the volatility in sales revenue by locking in prices with respect to future deliveries of oil and natural gas.

As at December 31, 2020, the Company had no outstanding commodity risk management contracts.

Currency risk

All of Questerre's petroleum and natural gas sales are denominated in Canadian dollars; however, the underlying market prices for these commodities are impacted by the exchange rate between Canada and the United States. The Company also incurs expenditures in its Jordanian subsidiary that are denominated in Jordanian Dinar and United States dollars. As at December 31, 2020, the Company had no forward foreign exchange contracts in place.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. At December 31, 2020, the Company had credit facilities outstanding of $15.4 million (December 31, 2019: $16.4 million).

f) Capital management

The Company believes with its expected positive adjusted funds flow from operations and existing credit facilities in the near future it will be able to meet its foreseeable obligations in the normal course of operations. On an ongoing basis, the Company reviews its capital expenditures to ensure that funds flow from operations or access to credit facilities are available to fund these capital expenditures. To execute its current business plan including incurring capital expenditures related to the full participation in the current and future drilling programs it anticipates it will be require access to additional financial liquidity.

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 the current and projected funds flow from operations.

($ thousands)	December 31, 2020	December 31, 2019
Credit facilities	$ 15,427	$ 16,377
Shareholders' equity	152,120	268,656

7. Investment in Red Leaf

Red Leaf is a private Utah based oil shale and technology company whose principal assets are its proprietary EcoShale technology to recover oil from shale and its oil shale leases in the state of Utah.

As at December 31, 2020, Questerre holds 132,293 common shares, representing approximately 38% of the common share capital of Red Leaf and 288 Series A Preferred Shares of Red Leaf representing less than 16% of the issued and outstanding preferred shares capital of Red Leaf.

Questerre has determined its investment in Red Leaf will be accounted for using the equity method. This is based on several criteria including its current equity interest in Red Leaf and ability to participate in the decision making process of Red Leaf through its current Board representation. The Company measures the fair market value of its investment using a net asset value approach. The net asset value is calculated as the current assets of Red Leaf less the accrued and unpaid dividends associated with the preferred shares.

($ thousands)		December 31, 2020		December 31, 2019
Balance, beginning of year	$	8,439	$	287
Reversal of impairment		–		8,162
Dividends received on preferred shares		(228)		–
Loss on foreign exchange		(232)		(10)
Balance, end of the year	$	7,979	$	8,439

The assets, liabilities and net loss of Red Leaf as of December 31, 2020 were comprised as follows:

($ thousands)		2020		2019
Cash and Cash Equivalents	$	24,756	$	47,564
Other Current Assets		222		532
Current Liabilities		507		3,344
Non-current liabilities		1,221		1,867
Net Loss[2]	$	(9,605)	$	(37,492)

[1] Converted at an exchange rate of US$1=C$1.2732
[2] Converted at an average exchange rate of US$1=C$1.3415

The issued and outstanding share capital of Red Leaf as of December 31, 2020 is comprised of the following:

	Issued and Outstanding	Questerre Ownership
Common Shares	343,937	132,293
Preferred Shares	1,795	288

The Series A Preferred Shares carry voting rights and dividends accrue on a cumulative basis, whether or not declared, at a rate of 8% per annum compounding annually. On the occurrence of a defined liquidation event, including certain reorganizations, takeovers, the sale of all or substantially all the assets of the company, and shareholder distributions, the Series A Preferred shareholders are entitled to an amount representing the original issue price plus any accrued dividends. As of December 31, 2020, this priority amount is approximately US$1.2 million.

8. Property, Plant and Equipment

A reconciliation of the property, plant and equipment assets is detailed below.

($ thousands)		Total
Cost or deemed cost:		
Balance, December 31, 2018	$	275,548
Additions		8,041
Disposition of assets		(8,082)
Derecognition of fully depreciated assets		(4,721)
Transfer from exploration and evaluation assets		14,954
Balance, December 31, 2019		285,740
Additions		2,496
Transfer from exploration and evaluation assets		2,687
Balance, December 31, 2020	**$**	**290,923**
Accumulated depletion, depreciation and impairment losses:		
Balance, December 31, 2018	$	132,984
Depletion and depreciation		13,077
Disposition of assets		(8,082)
Derecognition of fully depreciated assets		(4,721)
Impairment		(312)
Balance, December 31, 2019		132,946
Depletion and depreciation		9,236
Impairment		96,257
Balance, December 31, 2020	**$**	**238,439**

($ thousands)		Total
Net book value:		
At December 31, 2019	$	152,794
At December 31, 2020	**$**	**52,484**

During the years ended December 31, 2020 and 2019, the Company did not capitalize any administrative overhead or share based compensation expense directly related to development activities. Included in the December 31, 2020 depletion calculation are future development costs of $267.8 million (December 31, 2019: $341.5 million).

Effective March 31, 2020, the Company reviewed the carrying amounts of its oil and natural gas assets based on the material decline in commodity prices and the resulting decrease in forward benchmark commodity prices as of March 31, 2020 compared to December 31, 2019. Based on this review, the Company tested its CGUs for impairment in accordance with its accounting policy. The recoverable amount of the CGUs was estimated based on the FVLCD using a discounted cash flow model. The impairment testing concluded that the carrying amounts of Montney, Antler and Other Alberta CGUs exceeded their FVLCD. As a result, the Company recorded an impairment expense of

$96.3 million in aggregate. The amount attributable to the Montney, Antler and Other Alberta CGUs is respectively $78.2 million, $17.9 million and $0.2 million.

The estimates of FVLCD were determined using discount rates ranging from 11% to 13% (2019: 10% to 12%) and forecasted after tax cash flows based on proved plus probable reserves, with escalating prices and future development costs. The future prices used to determine cash flows from crude oil and natural gas reserves are as follows as at March 31, 2020:

	2021	2022	2023	2024	2025	Average Annual % Change Thereafter
WTI (US$/barrel)	40.45	49.17	53.28	55.66	56.87	2.00
AECO ($/MMbtu)	2.20	2.38	2.45	2.53	2.60	2.00

Impairment losses can be reversed in future periods if the estimated recoverable amount of the CGU exceeds its carrying value. The impairment recovery is limited to a maximum of the estimated depleted historical cost if the impairment had not been recognized.

($ thousands)	One Percent Increase in the Discount Rate	Five Percent Decrease in the Forward Price Estimates
Impairment charge (recovery) of property, plant and equipment	$ 7,058	$ 19,142

Effective December 31, 2020, no indicators of impairment nor indicators to reverse previously incurred impairment were noted.

9. Exploration and Evaluation Assets

Exploration and evaluation assets consist of the Company's exploration projects which are pending the determination of technical feasibility and commercial viability. Additions represent the Company's share of costs incurred on exploration and evaluation assets during the period.

A reconciliation of the movements in exploration and evaluation assets is detailed below.

($ thousands)	December 31, 2020	December 31, 2019
Balance, beginning of year	$ 127,081	$ 58,092
Acquisition	263	67,278
Additions	4,811	16,880
Transfers to property, plant and equipment	(2,687)	(14,954)
Undeveloped lease impairments	(14,416)	–
Undeveloped lease expiries and farmouts	(717)	–
Foreign currency translation adjustment - Jordan	(132)	(215)
Balance, end of period	$ 114,203	$ 127,081

During the year ended December 31, 2020, the Company capitalized administrative overhead charges of $1.9 million (2019: $1.8 million) including $0.9 million (2019: $0.7 million) for capitalized share based compensation expense directly related to exploration and evaluation activities.

Effective March 31, 2020, as a result of the decline in commodity prices and no future plans to pursue development of its wholly-owned and operated exploration and evaluation assets in Kakwa, the Company impaired exploration and evaluation assets in Kakwa totaling $14.4 million. Additionally there were no impairment indicators noted for its assets in Quebec and Jordan.

The Company determined that there were no impairment indicators for its exploration and evaluation assets as of December 31, 2020.

In 2019, Questerre acquired the exploration rights to 753,000 net acres in Quebec, associated wells and equipment, geological and geophysical data and other miscellaneous assets (the "Quebec Acquisition"). Consideration included a mutual release from all outstanding litigation, cash and contingent payments and the security required for the assumption of abandonment and reclamation liabilities ("A&R Liabilities"). Total consideration was $67.3 million as detailed below.

The Company assessed if the transaction qualified as a business combination as defined in IFRS 3, *Business Combinations*. Based on the assets acquired and the current stage of development for the acreage, the Company determined that the acquisition should be accounted for as an asset acquisition. Exploration and evaluation assets have been recorded at the value of the consideration given as part of the transaction, consistent with IFRS 6, *Exploration for and evaluation of mineral resources*.

The following provides a summary of the consideration paid for the Quebec Acquisition:

($ thousands)		
Cash payment	$	1,400
Contingent payment		1,820
Acquisition of A&R liabilities		5,555
Mutual release of litigation		58,503
Total consideration	$	67,278

The consideration relating to the mutual release was based on an independent assessment of the Company's damages related to its outstanding litigation with the vendor as determined by a third party valuation firm.

In September 2018, the Ministry of Energy and Natural Resources in Quebec (the "Ministry") introduced regulations effectively prohibiting any exploitation of natural gas in the province including the banning of hydraulic fracturing of shale. The Company filed a legal motion requesting a temporary stay and judicial review to have the specific regulations relating to the ban on hydraulic fracturing to be set aside. The Company has since granted deferrals for the hearing date to allow the parties to resolve the issues raised in its legal motion in a constructive manner. Should the Company be unsuccessful in resolving the situation to its satisfaction and the Company's legal motion subsequently denied, the carrying value of its exploration and evaluation assets in Quebec of $102 million as of December 31, 2020, could be materially impaired.

10. Deferred Income Taxes

The tax on the Company's net loss before taxes differs from the amount that would arise using the weighted average tax rate applicable to profits or losses of the consolidated entities as follows:

($ thousands)	December 31, 2020	December 31, 2019
Net income (loss) before taxes	$ (117,633)	$ 72,709
Combined federal and provincial tax rate	24.47%	26.58%
Computed "expected" deferred tax expense (recovery)	(28,785)	19,326
Increase (decrease) in deferred taxes resulting from:		
Non-deductible differences and permanent items	831	645
Non-taxable portion of capital items	54	(1,210)
Change in deferred tax asset not recognized	26,077	(15,020)
Rate adjustments and other	1,823	3,264
Deferred tax expense	$ –	$ 7,005

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 and a deduction for estimated general and administrative costs associated with these proved reserves. The combined statutory tax rate was 24.47% in 2020 and 26.58% in 2019.

The movement in deferred tax assets and liabilities during the year, without taking into consideration the valuation allowances, are as follows:

($ thousands)	Petroleum and natural gas properties	Investments	Asset retirement obligation	Share issue costs	Non-capital losses	Capital losses
December 31, 2019	(14,393)	3,637	4,604	506	23,575	4,292
Change	35,971	13	191	(232)	(8,483)	3
December 31, 2020	$ 21,578	$ 3,650	$ 4,795	$ 274	$ 15,092	$ 4,295

The amount and timing of reversals of temporary differences will be dependent upon, among other things, the Company's future operating results, and acquisitions and dispositions of assets and liabilities.

Deferred income tax assets are recognized for tax loss carry-forwards to the extent that the realization of the related tax benefit through future taxable profits is probable. It is expected that future cash flows, generated from its existing proved reserves, will be sufficient to provide future taxable profits to utilize the deferred tax assets.

Non-capital loss carry-forwards at December 31, 2020 expire from 2036 to 2039.

The following temporary differences have not been recognized:

($ thousands)	December 31, 2020	December 31, 2019
Petroleum and natural gas properties	$ 91,655	$ (61,175)
Investments	31,006	30,915
Asset retirement obligation	20,368	19,571
Share issue costs	1,016	1,875
Non-capital losses	64,107	100,203
Capital losses	36,488	36,488
Total	$ 244,640	$ 127,877

11. Share Based Compensation

The Company has a stock option program that provides for the issuance of options to purchase Common Shares 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.

Under the Company's option plan, a put right is included that allows the optionee to settle options with cash or equity. Under the put right, the optionee will receive the net cash proceeds that is the excess of the closing price of the Common Shares at the day of the put notice over the exercise price of the option. The Company has the option to decline a put right exercise at any time. The Company does not intend to cash settle options in future periods.

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

	Options Outstanding			Options Exercisable		
	Number of Options *(thousands)*	Weighted Average Years to Expiry	Weighted Average Exercise Price	Number of Options *(thousands)*	Weighted Average Years to Expiry	Weighted Average Exercise Price
$0.15 - $0.25	9,793	2.84	$ 0.19	4,973	1.61	$ 0.02
$0.26 - $0.50	9,058	2.91	0.36	5,810	2.88	0.37
$0.51 - $0.75	6,500	1.30	0.69	5,408	1.30	0.69
	25,351	2.47	$ 0.38	16,191	1.96	$ 0.42

The following table summarizes information about stock options outstanding and exercisable at December 31, 2020:

	December 31, 2020			December 31, 2019		
	Number of Options *(thousands)*		Weighted Average Exercise Price	Number of Options *(thousands)*		Weighted Average Exercise Price
Outstanding, beginning of period	27,087	$	0.40	21,412	$	0.44
Granted	6,475		0.20	6,100		0.29
Forfeited	(846)		0.43	(50)		0.29
Expired	(7,365)		0.29	(375)		1.07
Outstanding, end of period	25,351	$	0.38	27,087	$	0.40
Exercisable, end of period	16,191	$	0.42	16,632	$	0.37

The fair value of the liability was calculated using the Black-Scholes valuation model. The following weighted average assumptions were used in the model for options granted in 2020 and 2019:

	December 31, 2020	December 31, 2019
Weighted average fair value per award ($)	0.14	0.20
Volatility (%)	90.43	85.98
Forfeiture rate (%)	11.57	12.60
Expected life (years)	5.00	5.00
Risk free interest rate (%)	1.31	1.85

This forfeiture rate estimate is adjusted to the actual forfeiture rate. Expected volatility and expected life is based on historical information.

12. 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 $20.4 million as at December 31, 2020 (December 31, 2019: $19.6 million) based on an undiscounted total future liability of $22.1 million (December 31, 2019: $23.2 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 0.65% (December 31, 2019: 1.74%). An inflation rate of 2% (December 31, 2019: 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, 2020		December 31, 2019
Balance, beginning of year	$	19,571	$	13,736
Liabilities settled		(59)		(136)
Revisions due to change in discount rates & estimates		756		179
Liabilities acquired		–		5,555
Accretion		101		237
Balance, end of year	$	20,369	$	19,571

13. Credit Facility

Following a review conducted in the second quarter, the Company's facilities with a Canadian chartered bank were renewed at $20 million. The credit facilities include a revolving operating demand facility of $17 million and a uncommitted demand non-conforming revolving facility of $3 million. The revolving facility can be used for general corporate purposes, ongoing operations, and capital expenditures within Canada. Any borrowing under the credit facilities, 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 facilities are 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, 2020 was 2.95 (2019: 2.02) and the covenant was met. At December 31, 2020, $15.4 million (December 31, 2019: $16.4 million) was drawn on Credit Facility A with an effective average interest rate of 3.45% for 2020 (2019: 4.45%). As at December 31, 2020, the Company has outstanding letters of credit for $7.3 million with the Quebec Government for abandonment costs. The letters of credit are secured by term deposits.

The following table reconciles the movement in the credit facilities during the year.

($ thousands)		December 31, 2020		December 31, 2019
Credit Facilities beginning of year	$	16,377	$	13,842
Drawdown from Credit Facilities		24,550		40,035
Repayment of Credit Facilities		(25,500)		(37,500)
Credit Facilities end of year	$	15,427	$	16,377

The credit facilities are a demand facility and can be reduced, amended or eliminated by the lender for reasons beyond the Company's control. Should the credit facilities, 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. The next scheduled review will be in the second quarter of 2021.

14. Share Capital

The Company is authorized to issue an unlimited number of 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, 2020, 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, 2018	389,007	$ 415,747
Private placement	38,900	14,474
Share issue costs (net of tax effect)	–	(518)
Balance, December 31, 2019	427,907	429,703
Shares returned to treasury	(391)	–
Balance, December 31, 2020	**427,516**	**$ 429,703**

In the first quarter of 2020, the Company returned 0.4 million unclaimed Common Shares, related to prior corporate acquisitions, to treasury for no associated monetary consideration.

b) Per share amounts

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

(thousands, except as noted)	December 31, 2020	December 31, 2019
Net income (loss)	$ (117,623)	$ 65,704
Issued Common Shares at beginning of year	427,907	389,007
Private Placements	–	26,644
Shares returned to Treasury	(294)	–
Weighted average number of Common Shares outstanding (basic)	427,613	415,651
Basic net income (loss) per share	$ (0.28)	$ 0.16

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

(thousands, except as noted)	December 31, 2020	December 31, 2019
Net income (loss)	$ (117,623)	$ 65,704
Weighted average number of Common Shares outstanding (basic)	427,613	415,651
Effect of outstanding options	–	1,390
Weighted average number of Common Shares outstanding (diluted)	427,613	417,041
Diluted net income (loss) per share	$ (0.28)	$ 0.16

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 Common 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, 2020, 25.4 million options (December 31, 2019: 21.7 million) were excluded from the diluted weighted average number of Common Shares outstanding calculation as their effect would have been anti-dilutive.

15. Petroleum and Natural Gas Revenue

($ thousands)	December 31, 2020	December 31, 2019
Oil and liquids	$ 17,164	$ 28,259
Natural gas	3,131	2,748
Royalty revenue	1,629	1,840
	$ 21,924	$ 32,847

16. Employee Salaries and Benefits

($ thousands)	December 31, 2020	December 31, 2019
Salaries, bonuses and other short-term benefits	$ 1,381	$ 2,160
Share based compensation	1,234	1,928
	$ 2,615	$ 4,088

Note: Salaries are net of Canada Emergency Wage Subsidy Federal Government assistance program.

17. Key Management Compensation

Key management includes directors and officers. The compensation paid or payable to key management is as follows:

($ thousands)	December 31, 2020	December 31, 2019
Salaries, bonuses, director fees and other short-term benefits	$ 1,397	$ 1,639
Share based compensation	1,276	1,687
	$ 2,673	$ 3,326

The Company has entered into written executive employment agreements with each of the officers of the Company. Each of these written agreements provides that in the event of a change of control of the Company, each of the officers is entitled to: (i) 18 months of then applicable base salary with 24 months for the CEO; and (ii) the vesting of all options to purchase Common Shares. In the event of a change in control, all options will vest and the severance payable to key management would have been $2.1 million at December 31, 2020. This amount does not include accelerated share based compensation expense.

18. Supplemental Cash Flow Information

Changes in non-cash working capital are detailed below:

($ thousands)	December 31, 2020	December 31, 2019
Accounts receivable	$ 1,185	$ (1,949)
Deposits and prepaid expenses	62	1,258
Accounts payable and accrued liabilities	(5,215)	(1,253)
Change in non-cash working capital	$ (3,968)	$ (1,944)
Related to:		
Operating activities	$ 560	$ (2,658)
Investing activities	(4,528)	714
	$ (3,968)	$ (1,944)

Note: Change in accounts payable and accrued liabilities excludes forgiveness of debt related to Quebec Acquisition

19. Right-of-use Assets and Lease Liabilities

a) *Right-of-use assets*

($ thousands)	Real Estate	Other	Total
Cost			
Balance, January 1, 2019	$ 198	$ –	$ 198
Additions	–	25	25
Balance, December 31, 2019	$ 198	$ 25	$ 223
Additions (net of prior lease termination)	218	0	218
Balance, December 31, 2020	$ 416	$ 25	$ 441
Accumulated Depreciation			
Balance, January 1, 2019	$ –	$ –	$ –
Depreciation	104	4	108
Balance, December 31, 2019	$ 104	$ 4	$ 108
Depreciation	80	5	85
Balance, December 31, 2020	$ 184	$ 9	$ 193
Carrying value			
Balance, January 1, 2019	$ 198	$ –	$ 198
Additions, net of depreciation	(104)	21	(82)
Balance, December 31, 2019	$ 94	$ 21	$ 116
Additions, net of depreciation	138	(5)	133
Balance, December 31, 2020	$ 232	$ 16	$ 249

b) *Lease liabilities*

($ thousands)		
Balance, January 1, 2019	$	198
Additional leases acquired during period		25
Interest expense		9
Lease payments		(84)
Balance, December 31, 2019	$	**148**
Additional leases acquired during period		218
Interest expense		7
Lease payments		(118)
Balance, December 31, 2020	$	**255**
Current portion		50
Long term portion		205
Balance, December 31, 2020	$	**255**

Amounts related to lease liabilities recognized in profit or loss are as follows:		
Interest expense on lease liabilities	$	7

20. Commitments

A summary of the Company's net commitments at December 31, 2020 follows:

($ thousands)	2021	2022	2023	2024	Thereafter	Total
Transportation and Processing	$ 2,988	$ 2,791	$ 2,791	$ 2,791	$ 3,255	$ 14,616

21.Related Party Transactions

The Company paid fees of $0.1 million (2019: nil) to a law firm where a Director of the Company is currently a partner.

CORPORATE INFORMATION

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