

**QUEST OIL CORPORATION**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**For the quarter ended September 30, 2010**

**1. ORGANIZATION AND DESCRIPTION OF THE BUSINESS**

The accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of only normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ended March 31, 2011. For further information, refer to the Company's financial statements and footnotes thereto included in the Company's annual report for the year ended March 31, 2010.

The information furnished herein was taken from the books and records of the Company without audit. However, such information reflects all adjustments which are, in the opinion of management, necessary to properly reflect the results of the period presented. The reader is advised that due to our extremely weak cash positions, among other considerations, the Company has not engaged a mainstream industry standard of valuation on all its oil and gas properties and reserves in some time. As a result, management has tried to take a conservative approach when valuing these properties and have used its best judgment when valuing its properties for impairment, depletion and estimated proved reserves.

**Any reader of these financials and footnotes is well advised to thoroughly review filings previously made by the Company with the SEC and Pinksheets.**

**2. GOING CONCERN**

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. Because of the recurring operating losses, little revenues and the excess of current liabilities over current assets, there is substantial doubt about the Company's ability to continue as a going concern. The Company is also in default of several Notes in excess of \$4,800,000.

**Given the definition of "insolvent" found in the Merriam-Webster dictionary, as "having liabilities in excess of reasonable market value of assets held" and "having insufficient resources to pay all bills and debts as they become due" – Quest Oil Corporation is insolvent.**

These consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classification of liabilities that might be necessary in the event Quest Oil cannot continue in existence.

**3. NOTES PAYABLE**

Through its recently acquired subsidiary, B&B Oil, Inc. (see Note 7.), the Company entered into a debt agreement, whereas a secured lender ("Holder" or "Lender"), would loan up to the principal sum of two million dollars (\$2,000,000.00), as may be amended and updated from time to time as additional funds are loaned, if any (each, a "Loan Advance"), with interest on the outstanding principal balance as set forth herein. Interest accrues at six percent (6%) per annum on each Loan Advance from the date of disbursement of such Loan Advance. Interest only shall be due and payable quarterly (every three (3) months) commencing on September 30, 2010 and every three (3) months thereafter until the Maturity Date at which time all unpaid principal and all accrued but unpaid Interest shall be due and payable. At September 30, 2010, the Company has been advanced \$50,000 under this agreement.

Senior Secured Notes Payable that are currently in default consist of the following:

	At September 30, 2010
Gross proceeds from notes	\$ 6,000,000
Less: discount on notes	(6,000,000)

Less: principal payments	(1,352,524)
Add: Amortization of discounts	6,240,000
Carrying Value of notes	\$ 4,887,476

These notes are currently in default. Such default may provide the basis for the note holders to force further liquidation of our assets.

#### **4. PREFERRED SHARES**

Quest Oil is authorized to issue up to 2,000,000 preferred shares with a par value of \$0.001 per share. The Company currently has (2) series of preferred stock authorized for issuance, Series B and Series C. At September 30, 2010 there were 413,497 preferred shares issued and outstanding.

#### **5. COMMON SHARES**

Quest Oil is authorized to issue up to 14,998,000,000 common shares with a par value of \$0.001 per share, at September 30, 2010 there were 8,522,051,219 shares issued and outstanding.

On July 27, 2010 the Company retired 170,454 shares as part of a settlement agreement.

On August 8, 2010, the Company entered into and completed an acquisition following a Share Exchange Agreement pursuant to which Quest Oil Corporation acquired 100% ownership of B&B Oil, Inc. in exchange for the issuance of 100,000,000 shares of common stock of Quest Oil Corporation. Further disclosure regarding the transaction can be found within Note 7.

On August 17, 2010 the Company issued 10,000,000 shares valued at \$97,000 to Frank Grabbs for consulting work including “pumping” work on the Company’s oil and gas leases.

On August 17, 2010 the Company issued 10,000,000 shares valued a \$97,000 to JR McAlister in exchange for the acquisition of oil and gas properties.

#### **6. INCOME TAXES**

Income tax expense is provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes. Deferred taxes are recognized for differences between the basis of assets and liabilities for financial statement and income tax purposes. The differences relate primarily to the effects of net operating loss carry forwards and differing basis, depreciation methods, and lives of depreciable assets. The deferred tax assets represent the future tax return consequences of those differences, which will be deductible when the assets are recovered.

No income tax benefit (expense) was recognized for the three months ended September 30, 2010 as a result of tax losses in this period and because deferred tax benefits, derived from the Company’s prior net operating losses, were previously fully reserved and the Company has cumulative net operating losses for tax purposes in excess of \$35 million.

The Company currently has not filed tax returns and these periods remain open beginning with December 31, 2003 through December 31, 2009.

#### **7. ACQUISITION – SHARE EXCHANGE WITH B&B OIL, INC.**

On August 8, 2010, following a share exchange agreement the Company acquired 100% ownership of B&B Oil, Inc. (“B&B”) in exchange for the issuance of 100,000,000 shares of Quest common stock, which is approximately 1% of the voting equity interest of the Company. The shares were issued to B&B’s sole shareholder, Joe Wallen. The primary reason for the acquisition was to obtain certain assets and rights to oil and gas leases B&B controls. B&B’s lenders maintain senior security interests on B&B assets, as well as 100% of Quest’s interest in B&B’s stock.

B&B was incorporated in the State of Texas in June 2004, B&B Oil Inc. is primarily focused on the exploration and development of proven oil and gas properties. From 2007 to the present, B&B Oil acquired oil and gas leases that consist of approximately 560 acres in Hawkeye Field and approximately 398 acres in the Midkiff Field in Eastland County, Texas. These properties include wells that are currently productive, and numerous prospects that

management believes warrant further development. Productive wells on the leases will require relatively modest capital expenditures to generate cash flow from production. Looking forward, Quest Oil plans to implement a development strategy that will combine proven producing wells, new developmental wells, and highly predictable reworks, thereby diversifying exploration and development expenditures with the intent to maximize returns and minimize risk.

This transaction was accounted for as a using the purchase method of accounting. As a result, all financial information prior to August, 8 2010 does not include any activity of B&B Oil, Inc. The assets acquired and liabilities assumed were recorded at their fair market value. The value of the stock issued in the transaction was deemed nominal based upon the estimated fair market value of the underlying assets and liabilities. The following represents the unaudited condensed balance sheets of B&B Oil, Inc. at the date of the acquisition

**B&B OIL, INC.  
BALANCE SHEET AT**

	<b>August 8, 2010</b>
	<b>(Unaudited)</b>
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<b>ASSETS</b>	
Current Assets	\$ 72,051
Equipment, net	241,848
Oil and Gas Properties, net	2,133,512
Total Assets	<u>\$ 2,447,410</u>
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<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>	
Current Liabilities	\$ 28,776
Long term liabilities	69,692
Total Liabilities	98,468
Total Stockholders' Equity	2,348,942
Total Liabilities and Stockholders' Equity	<u>\$ 2,447,410</u>

The following is an unaudited income statement representing the approximate pro-forma effect assuming the acquisition of B&B had occurred on April 1, 2010 (the beginning of our current fiscal year):

**QUEST OIL CORPORATION  
PROFORMA INCOME STATEMENT**

	<b>For the six months ended</b>
	<b>September 30, 2010</b>
	<b>(unaudited)</b>
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Revenues	\$ 87,313
Operating Expenses	
Cost of Sales	58,050
Depreciation	534,429
Other operating expenses	130,255
Change in fair value of derivatives	5,754,997
Total operating expenses	6,477,730
Interest (expense)	(381,766)
Net Loss from Operations	<u>\$ (6,772,183)</u>
Net (loss) per common share - basic and diluted	<u>\$ (0.00)</u>

**8. DERIVATIVE INSTRUMENTS**

Effective for financial statements issued for fiscal periods beginning after December 15, 2008, or interim periods therein, FASB ASC 815 (formerly, EITF 07-05) requires that warrants and convertible instruments with certain conversion or exercise price protection features be recorded as derivative liabilities on the balance sheet based on the fair value of the instruments. In determining fair value, the Company uses various valuation approaches within the ASC 820-10 fair value measurement framework. Fair value measurements are determined based on the assumptions that market participants would use in pricing an asset or liability. ASC 820-10 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. FASB ASC 820 establishes a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following three levels:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and must be used to measure fair value whenever available.
- Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability. For example, level 3 inputs would relate to forecasts of future earnings and cash flows used in a discounted future cash flows method.

ASC 820-10 requires the use of observable market data if such data is available without undue cost and effort.

The following table reflects the fair value as defined by the authoritative guidance of the Company's embedded derivative liabilities at September 30, 2010:

	Balance at September 30, 2010	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Embedded derivative liability	\$ 5,754,997	\$ -	\$ 5,754,997	\$ -

The Company recorded a charge of \$5,754,997 for the period ended September 30, 2010 in the statement of operations associated with the fair value of the embedded derivative liabilities. A binomial model was used to value the liabilities. The primary determinants of the economic value of the derivative under the model are (1) the price of Quest's stock, and (2) the volatility of Quest's common stock price. These estimates directly affect the reported amounts of the derivative instrument liabilities. At September 30, 2010, Quest estimated the fair value of the derivative liability at \$5,754,997 and recorded a loss of \$5,754,997.