QUESTAR CORP
Form 10-K
March 02, 2006

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

# FORM 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Year Ended December 31, 2005**

**Commission File Number 1-8796**

**QUESTAR CORPORATION**

| | | |
|---|---|---|
| STATE OF UTAH | 1-8796 | 87-0407509 |
| (State of other jurisdiction of incorporation or organization) | (Commission File No.) | (I.R.S. Employer Identification No.) |

**Phone: (801) 324-5000**

Securities registered pursuant to Section 12(b) of the Act:

Common stock, without par value,

with attached common stock purchase rights

The above Securities are listed on the New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:  None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  [X]     No  [ ]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  [ ]     No  [X]

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  [X]     No  [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.   [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.  See definition of  accelerated filer and large accelerated filer  in Rule 12b-2 of the Exchange Act.  (Check one):

Large accelerated filer [X]     Accelerated filer [ ]     Non-accelerated filer [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ]     No [X]

Aggregate market value of the voting common equity held by non-affiliates of the registrant as of the last business day of the registrant s most recently completed second quarter (June 30, 2005):  $5,572,015,000 *

On February 28, 2006, 85,488,814 shares of the registrant s common stock, without par value, were outstanding.

Documents Incorporated by Reference. Portions of the registrant s definitive Proxy Statement for the 2006 Annual Meeting of Stockholders to be held on May 16, 2006, which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2005, are incorporated by reference into Part III. The sections of the Proxy Statement labeled Committee Report on Executive Compensation and Cumulative Total Shareholder Returns are expressly not incorporated into this document.

*Calculated by excluding all shares held by directors and executive officers of registrant and three nonprofit foundations established by registrant without conceding that all such persons are affiliates for purposes of federal securities laws.

TABLE OF CONTENTS

Gas Management

Energy Trading

Questar Pipeline

Questar Gas

Corporate and Other Operations

Environmental Matters

Employees

Executive Officers

Item 1A.

RISK FACTORS

Item 1B.

UNRESOLVED STAFF COMMENTS

Item 2.

PROPERTIES

Questar E&P

Wexpro

Gas Management

Energy Trading

Questar Pipeline

Questar Gas

Corporate and Other Operations

Item 3.

LEGAL PROCEEDINGS

Item 4.

SUBMISSION OF MATTERS TO A VOTE OF

SECURITY HOLDERS

PART II

Item 5.

MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED

STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY

SECURITIES

Item 6.

SELECTED FINANCIAL DATA

Item 7.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL

CONDITION AND RESULTS OF OPERATION

Item 7A.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT

MARKET RISK

Item 8.

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Item 9.

CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS

ON ACCOUNTING AND FINANCIAL DISCLOSURE

Item 9A.

CONTROLS AND PROCEDURES

Item 9B.

OTHER INFORMATION

PART III

Item 10.

DIRECTORS AND EXECUTIVE OFFICERS OF THE

REGISTRANT

Item 11.

EXECUTIVE COMPENSATION

Item 12.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Item 13.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Item 14.

PRINCIPAL ACCOUNTING FEES AND SERVICES

PART IV

Item 15.

EXHIBITS, FINANCIAL STATEMENT SCHEDULES

SIGNATURES

## Where You Can Find More Information

Questar Corporation (Questar) and its principal subsidiaries, Questar Market Resources, Inc., Questar Pipeline Company and Questar Gas Company, each file annual, quarterly, and current reports with the Securities and Exchange Commission (SEC). Questar also regularly files proxy statements and other documents with the SEC. The public may read and copy these reports and any other materials filed with the SEC at its Public Reference Room at 450 Fifth

Street, N.W., Washington, D.C. 20549-0213. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. The SEC also maintains a website that contains information filed electronically that can be accessed over the Internet at www.sec.gov.

Investors can also access financial and other information via Questar s website at www.questar.com. Questar and each of its reporting subsidiaries make available, free of charge, through the website copies of Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to such reports and all reports filed by executive officers and directors under Section 16 of the Exchange Act reporting transactions in Questar securities. Access to these reports is provided as soon as reasonably practical after such reports are electronically filed with the SEC. Questar s website also contains Statements of Responsibility for Board Committees, Corporate Governance Guidelines and its Business Ethics and Compliance Policy.

Finally, you may request a copy of filings, other than an exhibit to a filing unless that exhibit is specifically incorporated by reference into that filing, at no cost by writing or calling Questar, 180 East 100 South Street, P.O. Box 45433, Salt Lake City, Utah 84145-0433 (telephone number (801) 324-5000).

**Forward-Looking Statements**

This Annual Report may contain or incorporate by reference information that includes or is based upon forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements give expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. They use words such as anticipate, estimate, expect, project, intend, plan, believe, and other words a similar meaning in connection with a discussion of future operating or financial performance. In particular, these include statements relating to future actions, prospective services or products, future performance or results of current and anticipated services or products, exploration efforts, expenses, the outcome of contingencies such as legal proceedings, trends in operations and financial results.

Any or all forward-looking statements may turn out to be wrong. They can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Many such factors will be important in determining actual future results. These statements are based on current expectations and the current economic environment. They involve a number of risks and uncertainties that are difficult to predict. These statements are not guarantees of future performance. Actual results could differ materially from those expressed or implied in the forward-looking statements. Among factors that could cause actual results to differ materially are:

•

the risk factors discussed in Part I, Item 1A. of this Annual Report;

- general economic conditions, including the performance of financial markets and interest rates;
- changes in industry trends;
- changes in laws or regulations; and
- other factors, most of which are beyond control.

Questar undertakes no obligation to publicly correct or update the forward-looking statements in this Annual Report, in other documents, or on the website to reflect future events or circumstances. All such statements are expressly qualified by this cautionary statement.

## Glossary of Commonly Used Terms

**B**

Billion

**bbl**

Barrel, which is equal to 42 U.S. gallons and is a common measure of volume of crude oil and other liquid hydrocarbons.

**basis**

The difference between a reference or benchmark commodity price and the corresponding sales price at various regional sales points.

**Btu**

One British thermal unit a measure of the amount of energy required to raise the temperature of a one-pound mass of water one degree Fahrenheit at sea level.

**cash-flow hedge**

A derivative instrument that complies with Statement of Financial Accounting Standards (SFAS) 133, as amended, and is used to reduce the exposure to variability in cash flows from the forecasted physical sale of gas and oil production whereby the gains (losses) on the derivative transaction are anticipated to offset the losses (gains) on the forecasted physical sale.

**cf**

Cubic foot is a common unit of gas measurement. One standard cubic foot equals the volume of gas in one cubic foot measured at standard conditions a temperature of 60 degrees Fahrenheit and a pressure of 30 inches of mercury (approximately 14.7 pounds per square inch).

**cfe**

Cubic feet of natural gas equivalents

**development well**

A well drilled into a known producing formation in a previously discovered field.

**dewpoint**

A specific temperature and pressure at which hydrocarbons condense to form a liquid.

**dry hole**

A well drilled and found to be incapable of producing hydrocarbons in sufficient quantities such that proceeds from the sale of production exceed expenses and taxes.

**dth**

Decatherms or ten therms. One dth equals one million Btu or approximately one Mcf.

**dthe**

Decatherms of natural gas equivalents

**equity production**

Production at the wellhead attributed to Questar ownership.

**exploratory well**

A well drilled into a previously untested geologic prospect to determine the presence of gas or oil.

**finding costs**

Finding costs are the sum of costs incurred for gas and oil exploration and development activities; including purchases of reserves in place, leasehold acquisitions, seismic, geological and geophysical, development and exploration drilling and asset retirement obligations for a given period, divided by the total amount of estimated net proved reserves added through discoveries, positive and negative revisions and purchases in place for the same period. The Company expresses finding costs in dollars per Mcfe averaged over a five-year period.

**frac spread**

The difference between the market price for NGLs extracted from the gas stream and the market value of the Btu-equivalent volume of natural gas required to replace the extracted liquids.

**futures contract**

An exchange-traded contract to buy or sell a standard quantity and quality of a commodity at a specified future date and price.

**gal**

U.S. gallon.

**gas**

All references to gas in this report refer to natural gas.

**gross**

Gross natural gas and oil wells or gross acres equal the total number of wells or acres in which the Company has a working interest.

**heating degree days**

A measure of the number of degrees the average daily outside temperature is below 65 degrees Fahrenheit.

**hedging**

The use of derivative-commodity and interest-rate instruments to reduce financial exposure to commodity price and interest-rate volatility.

**infill development drilling**

Drilling wells between established producing wells; a drilling program to reduce the spacing between wells in order to increase production and/or recovery of in-place hydrocarbons.

**lease operating expenses**

The expenses, usually recurring, which are incurred to operate the wells and equipment on a producing lease.

**M**

Thousand.

**MM**

Million.

**natural gas equivalents**

Oil and NGL volumes are converted to natural gas equivalents using the ratio of one barrel of crude oil, condensate or NGL to 6,000 cubic feet of natural gas.

**natural gas liquids (NGL)**

Liquid hydrocarbons that are extracted and separated from the natural gas stream. NGL products include ethane, propane, butane, natural gasoline and heavier hydrocarbons.

**net**

Net gas and oil wells or net acres are determined by the sum of the fractional ownership working interest the Company has in those gross wells or acres.

**net revenue interest**

A share of production after all burdens, such as royalties and overriding royalties, have been deducted from the working interest. It is the percentage of production that each owner actually receives.

**production replacement ratio**

The production replacement ratio is calculated by dividing the net proved reserves added through discoveries, positive and negative revisions and purchases and sales in-place for a given period by the production for the same period, expressed as a percentage. The production replacement ratio is typically reported on an annual basis.

**proved reserves**

Those quantities of natural gas, crude oil, condensate and NGL on a net revenue interest basis, which geological and engineering data demonstrate with reasonable certainty to be recoverable under existing economic and operating conditions. See 17 C.F.R. Section 4-10(a)(2) for a complete definition.

**proved developed reserves**

Reserves that include proved developed producing reserves and proved developed nonproducing reserves. See 17 C.F.R. Section 4-10(a)(3).

**proved developed producing reserves**

Reserves expected to be recovered from existing completion intervals in existing wells.

**proved undeveloped reserves**

Reserves expected to be recovered from new wells on proved undrilled acreage or from existing wells where a relatively major expenditure is required for recompletion. See 17 C.F.R. Section 4-10(a)(4).

**reservoir**

A porous and permeable underground formation containing a natural accumulation of producible natural gas and/or oil that is confined by impermeable rock or water barriers and is individual and separate from other reservoirs.

**royalty**

An interest in an oil and gas lease that gives the owner the right to receive a portion of the production from the leased acreage (or of the proceeds of the sale thereof), but generally does not require the owner to pay any portion of the costs of drilling or operating the wells on the leased acreage. Royalties may be either landowner s royalties, which are reserved by the owner of the leased acreage at the time the lease is granted, or overriding royalties, which are usually reserved by an owner of the leasehold in connection with a transfer to a subsequent owner.

**seismic**

An exploration method of sending energy waves or sound waves into the earth and recording the wave reflections to indicate the type, size, shape and depth of a subsurface rock formation. (2-D seismic provides two-dimensional information and 3-D seismic provides three-dimensional views.)

**wet gas**

Unprocessed natural gas that contains a mixture of heavier hydrocarbons including ethane, propane, butane and natural gasoline.

**working interest**

An interest in an oil and gas lease that gives the owner the right to drill, produce and conduct operating activities on the leased acreage and receive a share of any production.

**workover**

Operations on a producing well to restore or increase production.

FORM 10-K

ANNUAL REPORT, 2005

PART I

ITEM 1. BUSINESS.

Nature of Business

Questar Corporation (Questar or the Company) is a natural gas-focused energy company with four major lines of business gas and oil exploration and production, midstream field services, interstate gas transportation, and retail gas distribution which are conducted through its three principal subsidiaries. Questar Market Resources, Inc. (Market Resources) engages in gas and oil exploration, development and production and midstream field services-gas gathering and processing, as well as wholesale gas and oil marketing and gas storage. Questar Pipeline Company (Questar Pipeline) provides interstate natural gas transportation and storage services. Questar Gas Company (Questar Gas) provides retail natural gas distribution. See Note 15 to the consolidated financial statements included in Item 8 of Part II of this Annual Report for financial information concerning Questar's lines of business that contribute 10% or more of consolidated revenues.

Questar is a holding company, as that term is defined in the Public Utility Holding Company Act of 2005 (PUHCA 2005), because its subsidiary Questar Gas is a gas utility company. Questar, however, qualifies for and will file for an exemption and waiver from provisions of the Act applicable to holding companies. PUHCA 2005 supersedes the Public Utility Holding Company Act of 1935 under which Questar qualified for an exemption. Questar conducts most of its operations through subsidiaries. The parent-holding company performs certain management, legal, tax, administrative and other services for its subsidiaries

Questar operates in the Rocky Mountain and Midcontinent regions of the United States of America and is headquartered in Salt Lake City, Utah. Shares of Questar common stock trade on the New York Stock Exchange under the symbol STR.

The corporate-organization structure and major subsidiaries are summarized below:

Market Resources

Market Resources is a natural gas-focused energy company, a wholly owned subsidiary of Questar and Questar s primary growth driver. Market Resources is a sub-holding company with four principal subsidiaries: Questar Exploration and Production Company (Questar E&P) acquires, explores for, develops and produces natural gas, oil, and NGL; Wexpro Company (Wexpro) manages, develops and produces cost-of-service reserves for affiliated company, Questar Gas; Questar Gas Management Company (Gas Management) provides midstream field services including natural gas-gathering and processing services for affiliates and third parties; and Questar Energy Trading Company (Energy Trading) markets equity and third-party gas and oil, provides risk-management services, and through its wholly owned limited liability company, Clear Creek Storage Company, LLC, owns and operates an underground natural gas-storage reservoir.

Questar E&P

Questar E&P operates in two core areas the Rocky Mountain region of Wyoming, Utah and Colorado and the Midcontinent region of Oklahoma, Texas and Louisiana. Questar E&P has a large inventory of identified development drilling locations, primarily on the Pinedale Anticline in western Wyoming and in the Uinta Basin of Utah. Questar E&P continues to conduct exploratory drilling to determine commerciality of its inventory of undeveloped leaseholds located primarily in the Rocky Mountain region, including the assessment of deeper reservoirs under approximately 143,000 net leasehold acres in the Vermillion Basin of southwest Wyoming and northwestern Colorado. In the Midcontinent, Questar E&P has several active development projects, including an ongoing coalbed methane project in the Arkoma Basin of eastern Oklahoma and an infill development drilling project in the Elm Grove area in northwestern Louisiana. Questar E&P seeks to maintain geographical and geological diversity with its two core areas. Questar E&P has in the past and may in the future pursue acquisition of producing properties through the purchase of assets or corporate entities to expand its presence in its core areas or create a new core area.

Questar E&P reported 1,480 Bcfe of estimated proved reserves as of December 31, 2005. Approximately 80% of Questar E&P s proved reserves, or 1,179 Bcfe, were located in the Rocky Mountain region of the United States, while the remaining 20%, or 301 Bcfe, were located in the Midcontinent region. Approximately 920 Bcfe of the proved reserves reported by Questar E&P at year-end 2005 were developed, while 560 Bcfe were proved undeveloped. The majority of the proved undeveloped reserves were associated with the Company s Pinedale Anticline leasehold. Questar E&P s primary focus is natural gas. Natural gas comprised about 90% of Questar E&P s total proved reserves at year-end 2005. See Item 2 in Part I and Note 17 to the consolidated financial statements included in Item 8 of Part II of this Annual Report for more information on Questar E&P s proved reserves.

Questar E&P Competition and Customers

Questar E&P faces competition in every part of its business, including the acquisition of reserves and leases. Its longer-term growth strategy depends, in part, on its ability to purchase reasonably priced reserves and develop them in a low-cost and efficient manner. Competition is particularly intense when prices are high, as has been the case in recent years.

Questar E&P, through Energy Trading, sells natural gas production to a variety of customers, including pipelines, gas-marketing firms, industrial users and local-distribution companies. It regularly evaluates counterparty credit and may require financial guarantees from parties that fail to meet its credit criteria. Energy Trading sells equity crude-oil production to refiners, remarketers and other companies, including some with pipeline facilities near company producing properties. In the event pipeline facilities are not available, Energy Trading transports crude oil by truck to storage, refining or pipeline facilities.

Questar E&P Regulation

Questar E&P's operations are subject to various government controls and regulation at the federal, state and local levels. Questar E&P must obtain permits to drill and produce; maintain bonding requirements to drill and operate wells; submit and implement spill-prevention plans; and file notices relating to the presence, use, and release of specified contaminants incidental to gas and oil production. Questar E&P is also subject to various conservation matters, including the regulation of the size of drilling and spacing units, the number of wells that may be drilled in a unit and the unitization or pooling of gas and oil properties.

Most Questar E&P leases in the Rocky Mountain area are granted by the federal government and administered by federal agencies. Development of Pinedale leasehold acreage is subject to the terms of certain winter-drilling restrictions. During the last two years, Market Resources has been working with federal and state officials in Wyoming to obtain authorization for limited winter-drilling activities and has developed innovative measures, such as drilling multiple wells from a single location, to minimize the impact of its activities on wildlife and wildlife habitat. The presence of wildlife and potential endangered species could limit access to public lands. Various wildlife species inhabit Market Resources leaseholds at Pinedale and in other areas. Current federal regulations restrict activities during certain times of the year on portions of Market Resources leaseholds due to wildlife activity and/or habitat. Some species that are known to be present may be listed under federal law as endangered or threatened. Such listing could have a material impact on access to Market Resources leaseholds in certain areas or during periods when the particular species is present.

Wexpro

Wexpro develops and produces gas and oil on certain properties owned by affiliate Questar Gas under the terms of a comprehensive agreement, the Wexpro Agreement. Pursuant to the Wexpro Agreement, Wexpro recovers its costs and receives an unlevered after-tax return of approximately 19% on its investment in commercial wells and related facilities adjusted for working capital and reduced for deferred income taxes and depreciation its investment base. The term of the Wexpro Agreement coincides with the productive life of the gas and oil properties covered therein. Wexpro s investment base totaled $206.3 million at December 31, 2005.

Wexpro delivers natural gas production to Questar Gas at a price equal to Wexpro s cost-of-service. Wexpro cost-of-service gas satisfied 41% of Questar Gas system requirements during 2005 at cost of service pricing that is significantly lower than Questar Gas cost for purchased gas.

Wexpro gas and oil-development and production activities are subject to the same type of regulation as Questar E&P. In addition, the Utah Division of Public Utilities has oversight responsibility and retains an outside reservoir-engineering consultant and a financial auditor to assess the prudence of Wexpro s activities.

Wexpro owns oil-producing properties. Under terms of the Wexpro Agreement, revenues from crude-oil sales offset operating expenses and provide Wexpro with a return on its investment. Any remaining revenues, after recovery of expenses and Wexpro's return on investment, are divided between Wexpro (46%) and Questar Gas (54%).

Wexpro operations are contractually limited to a finite set of properties set forth in the Wexpro Agreement. Advances in technology (pad drilling and multi-stage hydraulic fracture stimulation) have unlocked significant unexploited potential on many of the subject properties. Wexpro has identified $600 to $750 million of additional drilling opportunities that could support high single-digit to low double-digit growth in revenues and net income over the next five to ten years while delivering cost-of-service natural gas supplies to Questar Gas at prices competitive with alternative sources.

See Note 14 to the consolidated financial statements included in Item 8 of Part II of this Annual Report for more information on the Wexpro Agreement.

Gas Management

Gas Management provides natural gas-gathering and processing services to affiliates and third-party producers in the Rocky Mountain region. Gas Management also owns 50% of Rendezvous Gas Services, LLC, (Rendezvous), a joint venture that operates gas-gathering facilities in western Wyoming. Rendezvous gathers natural gas for Pinedale Anticline and Jonah field producers for delivery to various interstate pipelines. Under a contract with Questar Gas, Gas Management also gathers cost-of-service volumes produced from properties operated by Wexpro.

Approximately 56% of Gas Management's revenues are derived from fee-based gathering and processing agreements. The remaining revenues are derived from natural gas processing margins that are in part exposed to the frac spread. To reduce processing margin risk, Gas Management has restructured many of its processing agreements with producers from keep-whole contracts to fee-based contracts. A keep-whole contract insulates producers from frac spread risk while a fee-based contract eliminates commodity price risk for the processing plant owner. To further reduce processing margin volatility associated with keep-whole contracts, Gas Management may also attempt to reduce processing margin risk with forward-sales contracts for NGL or hedge NGL prices and equivalent gas volumes with the intent to lock in a processing margin.

Energy Trading

Energy Trading markets natural gas, oil and NGL. It combines gas volumes purchased from third parties and equity production to build a flexible and reliable portfolio. As a wholesale marketing entity, Energy Trading concentrates on markets in the Rocky Mountains, Pacific Northwest and Midcontinent that are close to reserves owned by affiliates or accessible by major pipelines. It contracts for firm-transportation capacity on pipelines and firm-storage capacity at Clay Basin, a large baseload-storage facility owned by affiliate Questar Pipeline. Energy Trading, through its Clear Creek Storage Company, LLC, operates an underground gas-storage reservoir in southwestern Wyoming. It uses owned and leased-storage capacity together with firm-transportation capacity to take advantage of price differentials and arbitrage opportunities.

Energy Trading uses derivatives to manage commodity price risk. Energy Trading primarily uses fixed-price swaps to secure a known price for a specific volume of company production. Energy Trading does not engage in speculative hedging transactions. See Notes 1 and 10 to the consolidated financial statements included in Item 8 and Quantitative and Qualitative Disclosures About Market Risk in Item 7A in Part II of this Annual Report for additional information relating to hedging activities.

Questar Pipeline

Questar Pipeline is an interstate pipeline company that provides natural gas-transportation and underground storage services in Utah, Wyoming and Colorado. As a natural gas company under the Natural Gas Act of 1938, Questar Pipeline and certain subsidiary pipeline companies are regulated by the Federal Energy Regulatory Commission (FERC) as to rates and charges for storage and transportation of natural gas in interstate commerce, construction of new facilities, and extensions or abandonments of service and facilities, accounting and other activities.

Questar Pipeline and its subsidiaries own 2,499 miles of interstate pipeline with total daily capacity of 3,399 Mdth. Questar Pipeline's core-transmission system is strategically located in the Rocky Mountain area near large reserves of natural gas in six major Rocky Mountain producing areas. Questar Pipeline transports natural gas from these producing areas to other major pipeline systems and to the Questar Gas distribution system. In addition to this core system, Questar Pipeline, through a subsidiary, owns and operates the Southern Trails Pipeline, a 488-mile line that extends from the Blanco hub in the San Juan Basin to just inside the California state line.

Questar Pipeline owns and operates the Clay Basin storage facility, the largest underground- storage reservoir in the Rocky Mountain region. Through a subsidiary, Questar Pipeline also owns gathering lines and a processing plant near Price, Utah, which provides heat-content-management services for Questar Gas and carbon-dioxide extraction for third parties.

Questar Pipeline   Customers, Growth and Competition

Questar Pipeline faces risk of recontracting firm capacity as contract terms expire. Questar Pipeline  s transportation system is nearly fully subscribed, and firm contracts had a weighted-average remaining life of 10.9 years as of December 31, 2005. All of Questar Pipeline storage capacity is fully contracted with a weighted-average remaining life of 8.0 years as of December 31, 2005.

Questar Gas remains Questar Pipeline's largest transportation customer. During 2005, Questar Pipeline transported 116.3 MMdth for Questar Gas compared to 116.5 MMdth in 2004. Questar Gas has reserved firm-transportation capacity of 951 Mdth per day under long-term contracts, or about 50% of Questar Pipeline's reserved capacity, during the three coldest months of the year. Questar Pipeline's primary transportation agreement with Questar Gas will expire on June 30, 2017.

Questar Pipeline also transported 259.3 MMdth for nonaffiliated customers to pipelines owned by Kern River Pipeline, Northwest Pipeline, Colorado Interstate Gas, TransColorado, Wyoming Interstate Company and other systems. Questar Pipeline may be adversely affected by proposals before the FERC to establish natural gas-quality standards, specifically for hydrocarbon dewpoint. Questar Pipeline's tariff allows a higher hydrocarbon dewpoint specification than most other systems, which requires less processing by producers before natural gas volumes are delivered into Questar Pipeline's system. As a consequence, Questar Pipeline must incur higher costs to blend lower dewpoint-processed gas with wet gas and in some instances isolate processed gas for delivery to other pipelines. In effect, Questar Pipeline currently provides a bundled gas-transportation and dewpoint-management service for shippers at certain delivery points. Questar Pipeline may need to restructure its tariff to unbundle these services.

During 2005, Questar Pipeline expanded its southern system in central Utah. This expansion was completed and placed into service in the fourth quarter of the year and added 102 Mdth of daily capacity under long-term contracts.

Questar Pipeline received FERC approval for the expansion in January 2005. Also, Questar Pipeline began service to a new power plant near Mona, Utah in the second quarter of 2005. These projects will contribute about $3 million in net income per year.

Rocky Mountain producers, marketers and end-users seek capacity on interstate pipelines that move gas to California (Kern River), the Pacific Northwest (Northwest Pipeline) or Midwestern markets (Wyoming Interstate Company and Colorado Interstate Gas). Questar Pipeline provides access for many producers to these third-party pipelines. Some parties, including Gas Management, an affiliate of Questar Pipeline, are building gathering lines that allow producers to make direct connections to competing pipeline systems.

Questar Pipeline seeks to extend and expand its core pipeline and storage business. Questar Pipeline has proposed to further expand its southern system in central Utah. In addition, Questar Pipeline and other pipelines have proposed projects to connect northwestern Colorado and southwestern Wyoming gas supplies with pipelines moving gas east out of Wyoming. Following successful open seasons in 2005, Questar Pipeline is finalizing contracts with customers to support these new projects. Questar Pipeline is also assessing the feasibility of a gas-storage project in western Wyoming.

***Southern Trails Pipeline.*** In mid-2002, Questar Southern Trails Pipeline, a Questar Pipeline subsidiary, placed the eastern segment of the Southern Trails pipeline into service. The eastern segment extends from the San Juan Basin to inside the California border. Capacity on this segment is fully committed under contracts that expire in mid-2008 and mid-2015.

The California segment of the Southern Trails Pipeline, which extends from near the California-Arizona border to Long Beach, California, is currently not in service. Questar Pipeline is pursuing several options to sell or place this line in service.

See Note 4 to the consolidated financial statements included in Item 8 of Part II of this Annual Report for discussion of an impairment of the California segment of Southern Trails.

Questar Pipeline    Regulation

FERC Order No. 2004 requires employees engaged in transportation system operations to function independently from employees of marketing and energy affiliates. In addition a transportation provider must treat all transportation customers on a non-discriminatory basis and must not operate its transportation system to preferentially benefit its marketing or energy affiliates. Questar Pipeline has determined that all Market Resources subsidiaries except Gas Management are marketing or energy affiliates. Questar Gas is not an energy or marketing affiliate.

Questar Pipeline is required to comply with the Pipeline Safety Improvement Act of 2002. This Act and the rules issued by the DOT require interstate pipelines and local distribution companies to implement a 10-year program of risk analysis, pipeline assessment and remedial repair for transportation pipelines located in high-consequence areas such as densely populated locations. Questar Pipeline s annual cost to comply with the Act is approximately $1 million, not including costs of pipeline replacement, if necessary.

***Clay Basin Storage Gas.*** See Results of Operation included in Item 7 of Part II of this Annual Report for discussion of Clay Basin storage gas loss.

Questar Gas

Questar Gas distributes natural gas as a public utility in Utah, southwestern Wyoming and a small portion of southeastern Idaho. As of December 31, 2005, Questar Gas was serving 824,447 sales and transportation customers. Questar Gas is the only non-municipal gas-distribution utility in Utah, where over 96% of its customers are located. The Public Service Commission of Utah (PSCU), the Public Service Commission of Wyoming (PSCW) and the Public Utility Commission of Idaho have granted Questar Gas the necessary regulatory approvals to serve these areas. Questar Gas also has long-term franchises granted by communities and counties within its service area.

Questar Gas growth is tied to the economic growth of Utah and southwestern Wyoming. It has over 90% of the load for residential space heating and water heating in its service territory. During 2005, Questar Gas added a record 30,330 customers, a 3.8% increase.

Questar Gas faces the same risks as other local-distribution companies. These risks include revenue variations based on seasonal changes in demand, sufficient gas supplies, declining residential usage per customer, adequate distribution facilities and adverse regulatory decisions. Questar Gas's sales to residential and commercial customers are seasonal, with a substantial portion of such sales made during the heating season. The typical residential customer in Utah (defined as a customer using 115 dth per year) consumes over 77% of total gas requirements in the coldest six months of the year. Questar Gas, however, has a weather-normalization mechanism for its general-service customers. This mechanism adjusts the non-gas portion of a customer's monthly bill as the actual heating-degree days in the billing cycle are warmer or colder than normal. This mechanism reduces dramatic fluctuations in any given customer's monthly bill from year to year and reduces fluctuations in Questar Gas gross margin.

Questar Gas minimizes gas supply risks by owning natural gas reserves. During 2005, Questar Gas satisfied 41% of its system requirements with the cost-of-service gas and associated royalty-interest volumes. Wexpro produces the gas from these properties, which is then gathered by Gas Management and transported by Questar Pipeline. Questar Gas had estimated proved cost-of-service natural gas reserves of 497.3 Bcf as of year-end 2005 compared to 531.1 Bcf a year earlier. Questar Gas also has a balanced and diversified portfolio of gas-supply contracts for volumes produced in

Wyoming, Colorado, and Utah. Questar Gas has regulatory approval to include costs associated with hedging activities in its balancing account for pass-through treatment.

Questar Gas has designed its distribution system and annual gas-supply plan to handle design-day demand requirements. It periodically updates its design-day demand, the volume of gas that firm customers could use during extremely cold weather. For the 2005-06 heating season, Questar Gas used a design-day demand of 1,106 Mdth for firm customers.

Questar Gas has long-term contracts with Questar Pipeline for transportation and storage capacity at Clay Basin and three peak-day storage facilities. Questar Gas also has contracts to take deliveries at several locations on the Kern River Pipeline.

Questar Gas Regulation

As a public utility, Questar Gas is subject to the jurisdiction of the PSCU and PSCW. Natural gas sales and transportation services are made under rate schedules approved by the two regulatory commissions. Questar Gas is authorized to earn a return on equity of 11.2% in Utah and 11.83% in Wyoming. Both the PSCU and PSCW permit Questar Gas to recover gas costs through a balancing-account procedure and to reflect natural gas-price changes on a periodic, generally semi-annual basis. Questar Gas has also received permission from the PSCU and PCSW to reflect in its gas costs specified costs associated with hedging contracts.

See Note 2 of the consolidated financial statements included in Item 8 of Part II in this Annual Report for a discussion of gas-processing cost coverage.

Questar Gas has significant relationships with affiliates that have allowed it to lower its costs and improve efficiency. These affiliate relationships, however, are subject to oversight by regulatory commissions for evidence of subsidization and above-market payments.

Questar Gas is subject to the requirements of the Pipeline Safety Improvement Act. Questar Gas estimates that it will cost $4.0 to $5.0 million per year to comply with the Act, not including costs of pipeline replacement if necessary. The PSCU has allowed Questar Gas to record a regulatory asset for these incremental operating costs incurred to comply with this Act until the next rate case or 2007, whichever is sooner.

Questar Gas Competition

Questar Gas is a public utility and currently has no direct competition from other distributors of natural gas for residential and commercial customers. It has historically enjoyed a favorable price comparison with other energy sources used by residential and commercial customers except coal and occasionally fuel oil. It provides transportation service to industrial customers that can buy volumes of gas directly from others. Questar Gas earns lower margins on this transportation service than firm-sales service and could lose customers to Kern River.

Corporate and Other Operations

Historically, Questar's Other Operations included information-technology and communication services; web-hosting and data centers (Consonus); commercial real-estate management; and wellhead gas analysis and automation, field compression and engine maintenance (Energy Services). Questar reorganized these activities in 2004 and 2005 to refocus attention on its primary business activities and reduce costs. Questar has no plans to enlarge the scope of these activities. The majority of information-technology employees and assets were transferred to the separate business segments, and the assets of Consonus were sold. The scope of commercial real estate activities was significantly reduced. Energy Services focuses on wellhead automation and gas analysis.

Environmental Matters

A discussion of Questar s environmental matters is included in Item 3. Legal Proceedings of Part I in this Annual Report.

Employees

At January 1, 2006, the Company had 2,105 employees, including 601 in Market Resources, 178 in Questar Pipeline, 1,170 in Questar Gas, and 156 in Corporate and Other Operations.

Executive Officers

The following individuals are serving as executive officers of the Company:

Primary Positions Held with the Company

and Affiliates, Other Business Experience

Name

Keith O. Rattie

52

Chairman (2003); President (2001); Chief Executive Officer (2002); Director (2001); Chief Operating Officer (2001 to 2002); Director, Questar affiliates (2001). Prior to coming to Questar, Mr. Rattie served successively as Vice President and Senior Vice President of the Coastal Corporation (1996 to 2001).

Charles B. Stanley

47

Executive Vice President, Director Questar (2002); President, Chief Executive Officer and Director, Market Resources and Market Resources subsidiaries (2002); Senior Vice President, Questar (2002 to 2002); Executive Vice President and Chief Operating Officer, Market Resources and Market Resources subsidiaries (2002 to 2002). Prior to joining Questar, Mr. Stanley was President, Chief Executive Officer and Director, Coastal Gas International Co. (1995 to 2000); President and Chief Executive Officer, El Paso Oil and Gas Canada, Inc. (2000 to January 2002).

Alan K. Allred

55

Executive Vice President, Questar (2003); President and Chief Executive Officer and Director, Questar Regulated Services and Questar Gas (2003); Chief Executive Officer and Director, Questar Pipeline (2003 to 2006); President, Questar Pipeline (2003 to 2005); Executive Vice President and Chief Operating Officer, Questar Regulated Services, Questar Gas and Questar Pipeline (2002 to 2003); Senior Vice President, Questar Regulated Services, Questar Gas and Questar Pipeline (2002 to 2002); Vice President, Business Development, Questar Regulated Services, Questar Gas and Questar Pipeline (2000 to 2002); Manager, Regulatory Affairs, Questar Gas and Questar Pipeline (1997 to 2000).

R. Allan Bradley

54

Senior Vice President, Questar (2005); Chief Executive Officer, Questar Pipeline (2006); President, Chief Operating Officer and Director, Questar Pipeline (2005); Prior to joining Questar, Mr. Bradley was Managing Director and founding member, Ventura Energy LLC (2002 to 2004) and Senior Vice President, Coastal Corporation and El Paso Corporation affiliates (1990-2002).

Stephen E. Parks

54

Senior Vice President and Chief Financial Officer (2001); Chief Financial Officer (1996); Treasurer (1984 to 2004); Vice President (1990 to 2001); Vice President, Treasurer and Chief Financial Officer of all affiliates (at various dates beginning 1984); and Director Market Resources subsidiaries (at various dates beginning in 1996).

Thomas C. Jepperson

51

Vice President and General Counsel, Questar (2005); Division Counsel (2000 to 2004); Managing Attorney (1990 to 1999) and Senior Attorney (1988 to 1989) for Market Resources; prior to joining Questar, Mr. Jepperson was a partner of the law firm Nielsen and Senior (Salt Lake City).

Brent L. Adamson

54

Vice President Ethics, Compliance and Audit (2002); Director, Audit (1982 to 2002); Compliance Officer (1995 to 2002).

There is no family relationship between any of the listed officers or between any of them and the Company's directors. The executive officers serve at the pleasure of the Board of Directors. There is no arrangement or understanding under which the officers were selected.

## ITEM 1A. RISK FACTORS.

**Investors should read carefully the following factors as well as the cautionary statements referred to in Forward-Looking Statements herein. If any of the risks and uncertainties described below or elsewhere in this Annual Report actually occur, the Company s business, financial condition or results of operations could be materially adversely affected.**

***The future price of natural gas, oil and NGL is unpredictable.*** Historically the price of natural gas, oil and NGL has been volatile and is likely to continue to be volatile in the future. Any significant or extended decline in commodity prices would impact the Company s future financial condition, revenues, results of operations, cash flows and rate of growth. Because approximately 90% of Questar s proved reserves at December 31, 2005, was natural gas, the Company is substantially more sensitive to changes in natural gas prices than to changes in oil prices.

Questar cannot predict the future price of natural gas, oil and NGL because of factors beyond its control, including but not limited to:

*

changes in domestic and foreign supply of natural gas, oil and NGL;

*

changes in local, regional, national and global demand for natural gas, oil, and NGL;

*

regional price differences resulting from available pipeline transportation capacity or local demand;

*

the level of imports of, and the price of, foreign natural gas, oil and NGL;

*

domestic and global economic conditions;

*

domestic political developments;

*

weather conditions;

*

domestic and foreign government regulations and taxes;

*

political instability or armed conflict in oil and natural gas producing regions;

*

the price, availability and acceptance of alternative fuels;

*

U.S. storage levels of natural gas, oil, and NGL.

***Questar uses derivative instruments to manage exposure to uncertain prices***. Questar uses financial contracts to hedge exposure to volatile natural gas, oil, and NGL prices and to protect cash flow, returns on capital, net income and credit ratings from downward commodity price movements. To the extent the Company hedges commodity price exposure, it forgoes the benefits otherwise experienced if commodity prices increase. Questar believes its regulated businesses interstate natural gas transportation and retail gas distribution and its Wexpro subsidiary generate revenues that are not significantly sensitive to short-term fluctuations in commodity prices.

Questar enters into commodity price hedging arrangements with creditworthy counterparties (banks and industry participants) with a variety of credit requirements. Some contracts do not require the Company to post cash collateral, while others allow some amount of credit before requiring deposits of collateral for out-of-the-money hedges. The amount of credit available may vary depending on the credit rating assigned to the Company s debt securities. A substantial increase in the price of natural gas, oil and/or NGL could result in the requirement to deposit large amounts of collateral with counterparties that could seriously impact the Company s cash liquidity. Additionally a downgrade in the Company s credit ratings to sub-investment grade could result in the acceleration of obligations to hedge counterparties.

***The Company may not be able to economically find and develop new reserves***. The Company s profitability depends not only on prevailing prices for natural gas, oil and NGL, but also its ability to find, develop and acquire gas and oil reserves that are economically recoverable. Substantial capital expenditures are required to find, develop and acquire gas and oil reserves to replace those depleted by production.

***Gas and oil reserve estimates are imprecise and subject to revision***. Questar E&P s proved natural gas and oil reserve estimates are prepared annually by independent reservoir-engineering consultants. Gas and oil reserve estimates are subject to numerous uncertainties inherent in estimating quantities of proved reserves, projecting future rates of production and timing of development expenditures. The accuracy of these estimates depends on the quality of available data and on engineering and geological interpretation and judgment. Reserve estimates are imprecise and will change as additional information becomes available. Estimates of economically recoverable reserves and future net cash flows prepared by different engineers, or by the same engineers at different times may vary significantly. Results of subsequent drilling, testing and production may cause either upward or downward revisions of previous estimates. In addition the estimation process also involves economic assumptions relating to commodity prices, production costs, severance and other taxes, capital expenditures and remedial costs. Actual results most likely will vary from the estimates. Any significant variance could reduce the estimated future net revenues from proved reserves and the present value of those reserves.

Investors should not assume that the standardized measure of discounted future net cash flows from Questar E&P s proved reserves referred to in this Annual Report is the current market value of the estimated natural gas and oil reserves. In accordance with SEC requirements, the estimated discounted future net cash flows from Questar E&P s proved reserves is based on prices and costs in effect on the date of the estimate, holding the prices constant throughout the life of the properties. Actual future prices and costs may differ materially from those used in the current estimate, and future determinations of the standardized measure of discounted future net cash flows using then current prices and costs may be significantly less than the current estimate.

***Questar faces many operating risks to develop and produce its reserves***. Drilling is a high-risk activity. Operating risks include: fire, explosions and blow-outs; unexpected drilling conditions such as abnormally pressured formations; abandonment costs; pipe, cement or casing failures; environmental accidents such as oil spills, natural gas leaks, ruptures or discharges of toxic gases, brine or well fluids (including groundwater contamination). The Company could incur substantial losses as a result of injury or loss of life; pollution or other environmental damage; damage to or destruction of property and equipment; regulatory investigation; fines or curtailment of operations; or attorney s fees and other expenses incurred in the prosecution or defense of litigation.

As is customary in the oil and gas industry, the Company maintains insurance against some, but not all, of these potential risks and losses. Questar can not assure that insurance will be adequate to cover these losses or liabilities. Losses and liabilities arising from uninsured or underinsured events could have an adverse effect on the Company s financial condition and operations.

***Shortages of oilfield equipment, services and qualified personnel could impact results of operations.*** The demand for qualified and experienced field personnel to drill wells and conduct field operations, geologists, geophysicists, engineers and other professionals in the oil and gas industry can fluctuate significantly, often in correlation with oil and natural gas prices, causing periodic shortages. There have also been shortages of drilling rigs and other equipment, as demand for rigs and equipment has increased along with the number of wells being drilled. These factors also cause significant increases in costs for equipment, services and personnel. Higher oil and natural gas prices generally stimulate increased demand and result in increased costs for drilling rigs, crews and associated supplies, equipment and services. These shortages or cost increases could impact profit margin, cash flow and operating results or restrict the ability to drill wells and conduct operations.

***A significant portion of Market Resources production, revenue and cash flow are derived from assets that are concentrated in a geographical area.*** While geographic concentration of assets provides scope and scale that can reduce operating costs and provide other operating synergies, asset concentration does increase exposure to certain risks. Market Resources has extensive operations on the Pinedale Anticline and in the Greater Green River Basin of southwestern Wyoming. Any circumstance or event that negatively impacts the operations of Questar E&P, Wexpro or Gas Management in that area could materially reduce earnings and cash flow.

***Questar is subject to complex regulations on many levels***. The Company is subject to federal, state and local environmental, health and safety laws and regulations. Environmental laws and regulations are complex, change frequently and tend to become more onerous over time. In addition to the costs of compliance, substantial costs may be incurred to take corrective actions at both owned and previously owned facilities. Accidental spills and leaks requiring cleanup may occur in the ordinary course of business. As standards change, the Company may incur significant costs in cases where past operations followed practices that were considered acceptable at the time but that now require remedial work to meet current standards. Failure to comply with these laws and regulations may result in fines, significant costs for remedial activities, or injunctions.

Questar must comply with numerous and complex regulations governing activities on federal and state lands in the Rocky Mountain region, notably the National Environmental Policy Act, the Endangered Species Act, and the National Historic Preservation Act. Federal and state agencies frequently impose conditions on the Company s activities. These restrictions tend to become more stringent over time and can limit or prevent exploring for, finding and producing natural gas and oil on the Company s Rockies leasehold. Certain environmental groups oppose drilling on some of Market Resources federal and state leases.

Various federal agencies within the U.S. Department of the Interior, particularly the Minerals Management Service and the Bureau of Indian Affairs, along with each Native American tribe, promulgate and enforce regulations pertaining to gas and oil operations on Native American tribal lands. These regulations include such matters as lease provisions, drilling and production requirements, environmental standards and royalty considerations. In addition each Native American tribe is a sovereign nation having the right to enforce laws and regulations independent from federal, state and local statutes and regulations. These tribal laws and regulations include various taxes, fees, requirements to employ Native American tribal members and other conditions that apply to lessees, operators and contractors conducting operations on Native American tribal lands. Finally, lessees and operators conducting operations on tribal lands are generally subject to the Native American tribal court system. One or more of these factors may increase the Company s costs of doing business on Native American tribal lands and have an impact on the viability of its gas, oil and transportation operations on such lands.

Both Questar Pipeline and Questar Gas incur significant costs to comply with federal pipeline-safety regulations. Questar may also be affected by possible future regulations requiring the tracking, reporting and reduction of greenhouse-gas emissions.

***FERC regulates interstate transportation of natural gas.*** Questar Pipeline s natural gas transportation and storage operations are regulated by the FERC under the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978. The FERC has authority to: set rates for natural gas transportation, storage and related services; set rules governing business relationships between the pipeline subsidiary and its affiliates; approve new pipeline and storage-facility construction; and establish policies and procedures for accounting, purchase, sale, abandonment and other activities. FERC policies may adversely affect Questar Pipeline profitability. The FERC also has various affiliate rules that may cause the Company to incur additional costs of compliance.

***State agencies regulate the distribution of natural gas.*** Questar Gas natural gas-distribution business is regulated by the PSCU and the PSCW. These commissions set rates for distribution services and establish policies and procedures for services, accounting, purchase, sale and other activities. PSCU and PSCW policies may adversely affect Questar Gas profitability.

***Questar is dependent on bank credit facilities and continued access to capital markets to successfully execute its operating strategies***. The Company relies on bank borrowing and access to public capital markets to finance a material portion of its operating strategies. Also, Questar relies on access to short-term commercial paper markets. The Company is dependent on these capital sources to provide capital to acquire and develop properties. The availability and cost of these credit sources is cyclical, and these capital sources may not remain available or the Company may not be able to obtain money at a reasonable cost in the future. All Questar s bank loans are floating-rate debt. From time to time the Company may use interest rate derivatives to fix the rate on a portion of its variable rate debt. The interest rates on bank loans are tied to debt credit ratings of Questar and its subsidiaries published by Standard & Poor's and Moody's. A downgrade of credit ratings could increase the interest cost of debt and decrease future availability of money from banks and other sources. Management believes it is important to maintain investment grade credit ratings to conduct the Company s businesses, but may not be able to keep investment grade ratings.

***General economic and other conditions impact Questar s results***. Questar s results may also be negatively affected by: changes in general economic conditions; changes in regulation; availability and economic viability of gas and oil properties for sale or exploration; creditworthiness of counterparties; rate of inflation and interest rates; assumptions used in business combinations; weather and natural disasters; changes in customers' credit ratings; competition from other forms of energy, other pipelines and storage facilities; effects of accounting policies issued periodically by accounting standard-setting bodies; terrorist attacks or acts of war; changes in business or financial condition; changes in credit ratings; and availability of financing for Questar.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

Questar E&P and Wexpro

***Reserves*** ***Questar E&P***. The following table sets forth Questar E&P's estimated proved reserves, the estimated future net revenues from the reserves and the standardized measure of discounted net cash flows as of December 31, 2005. The estimates were collectively prepared by Ryder Scott Company, Netherland, Sewell & Associates, Inc. and H. J. Gruy and Associates, Inc., independent reservoir-engineering consultants. Questar E&P does not have any long-term supply contracts with foreign governments or reserves of equity investees or of subsidiaries with a significant minority interest. All reported reserves are located in the United States.

| | |
|---|---|
| Estimated proved reserves | |
| Natural gas (Bcf) | 1,324.8 |
| Oil and NGL (MMbbl) | 25.9 |
| Total proved reserves (Bcfe) | 1,480.4 |
| Proved developed reserves (Bcfe) | 920.5 |
| Estimated future net revenues before future income taxes (in thousands) (1) | $8,599,579 |
| Standardized measure of discounted net cash flows (in thousands) (2) | $2,707,072 |

(1)

Estimated future net revenue represents estimated future gross revenue to be generated from the production of proved reserves, using average year-end 2005 prices of $7.80 per Mcf for natural gas and $56.47 per bbl for oil and NGL combined, net of estimated production and development costs (but excluding the effects of general and administrative expenses; debt service; depreciation, depletion and amortization; and income tax expense).

(2)

The standardized measure of discounted future net cash flows prepared by the Company represents the present value of estimated future net revenues after income taxes, discounted at 10%.

Estimates of proved reserves and future net revenues are made at year-end, using sales prices estimated to be in effect as of the date of such reserve estimates and are held constant throughout the remaining life of the properties (except to the extent a contract specifically provides for escalation). Year-end prices do not include the effect of hedging. Estimated quantities of proved reserves and future net revenues are affected by natural gas and oil prices, which have fluctuated widely in recent years. There are numerous uncertainties inherent in estimating natural gas and oil reserves and their estimated values, including many factors beyond the control of the Company.

Questar E&P s reserve statistics for the years ended December 31, 2003 through 2005, are summarized below:

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. A significant estimate in 2012 and 2011 included a 100% valuation allowance for deferred tax assets arising from net operating losses incurred since inception.

Making estimates requires management to exercise significant judgment. It is at least reasonably possible that the estimate of the effect of a condition, situation or set of circumstances that existed at the date of the financial statements, which management considered in formulating its estimate could change in the near term due to one or more future confirming events. Accordingly, the actual results could differ materially from estimates.

**Cash and Cash Equivalents**

The Company considers all highly liquid instruments purchased with a maturity of six months or less to be cash equivalents. At April 30, 2013 and July 31, 2012, respectively, the Company had no cash equivalents.

The Company minimizes its credit risk associated with cash by periodically evaluating the credit quality of its primary financial institution. The balance at times may exceed federally insured limits. At April 30, 2013 and July 31, 2012, respectively, there were no balances that exceeded the federally insured limit.

**Earnings per Share**

The Company reports earnings (loss) per share in accordance with ASC Topic 260-10, "Earnings per Share." Basic earnings (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted average number of common shares available. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Diluted earnings (loss) per share has not been presented since the effect of the assumed conversion of warrants and debt to purchase common shares would have an anti-dilutive effect. Potential common shares as of April 30, 2013 that have been excluded from the computation of diluted net loss per share amounted to 1,531,959,556 shares which include $521,076 of debt and accrued interest convertible into shares of the Company’s common stock.

**Alternative Energy Partners, Inc.**

**(A Development Stage Company)**

**Notes to Condensed Consolidated Financial Statements**

**April 30, 2013**

(Unaudited)

**Note 2 Nature of Operations and Summary of Significant Accounting Policies (continued)**

**Share Based Payments**

The Company accounts for stock-based payments to employees in accordance with ASC 718, "Stock Compensation" ("ASC 718"). Stock-based payments to employees include grants of stock, grants of stock options and issuance of warrants that are recognized in the consolidated statement of operations based on their fair values at the date of grant.

The Company accounts for stock-based payments to non-employees in accordance with Topic 505-50, "Equity-Based Payments to Non-Employees." Stock-based payments to non-employees include grants of stock, grants of stock options and issuances of warrants that are recognized in the consolidated statement of operations based on the value of the vested portion of the award over the requisite service period as measured at its then-current fair value as of each financial reporting date.

The Company calculates the fair value of option grants and warrant issuances utilizing the Black-Scholes pricing model. The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. ASC 718 requires forfeitures to be estimated at the time stock options are granted and warrants are issued to employees and non-employees, and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term "forfeitures" is distinct from "cancellations" or "expirations" and represents only the unvested portion of the surrendered stock option or warrant. The Company estimates forfeiture rates for all unvested awards when calculating the expense for the period. In estimating the forfeiture rate, the Company monitors both stock option and warrant exercises as well as employee termination patterns.

These standards define a fair-value-based method of accounting for stock-based compensation. In accordance with ASC 718 and 505, the cost of stock-based compensation is measured at the grant date based on the value of the award and is recognized over the vesting period. The value of the stock-based award is determined using the Binomial or Black-Scholes option-pricing models, whereby compensation cost is the excess of the fair value of the award as determined by the pricing model at the grant date or other measurement date over the amount that must be paid to acquire the stock. The resulting amount is charged to expense on the straight-line basis over the period in which the

Company expects to receive the benefit, which is generally the vesting period.

The resulting stock-based compensation expense for both employee and non-employee awards is generally recognized on a straight-line basis over the requisite service period of the award.

**Long-Lived Assets**

The Company accounts for its long-lived assets in accordance with Accounting Standards Codification ("ASC") Topic 360-10-05, "Accounting for the Impairment or Disposal of Long-Lived Assets." ASC Topic 360-10-05 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the historical cost carrying value of an asset may no longer be appropriate. The Company assesses recoverability of the carrying value of an asset by estimating the future net cash flows expected to result from the asset, including eventual disposition. If the future net cash flows are less than the carrying value of the asset, an impairment loss is recorded equal to the difference between the asset's carrying value and fair value or disposable value. As of April 30, 2012, the Company determined that the carry amount of its goodwill exceeded it future value and recorded impairment in the amount of $304,129.

**Alternative Energy Partners, Inc.**

**(A Development Stage Company)**

**Notes to Condensed Consolidated Financial Statements**

**April 30, 2013**

(Unaudited)

**Note 2 Nature of Operations and Summary of Significant Accounting Policies (continued)**

**Fair Value of Financial Instruments**

All financial instruments, including derivatives, are to be recognized on the balance sheet initially at fair value. Subsequent measurement of all financial assets and liabilities except those held-for-trading and available for sale are measured at amortized cost determined using the effective interest rate method. Held-for-trading financial assets are measured at fair value with changes in fair value recognized in earnings. Available-for-sale financial assets are measured at fair value with changes in fair value recognized in comprehensive income and reclassified to earnings when derecognized or impaired.

The carrying amounts of the Company's other short-term financial instruments, including accounts payable and accrued liabilities, approximate fair value due to the relatively short period to maturity for these instruments. The Company does not utilize financial derivatives or other contracts to manage commodity price risks. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price).

The fair value of the Company's financial assets and liabilities reflects the Company's estimate of amounts that it would have received in connection with the sale of the assets or paid in connection with the transfer of the liabilities in an orderly transaction between market participants at the measurement date. In connection with measuring the fair value of its assets and liabilities, the Company seeks to maximize the use of observable inputs (market data obtained from sources independent from the Company) and to minimize the use of unobservable inputs (the Company's

assumptions about how market participants would price assets and liabilities). The following fair value hierarchy is used to classify assets and liabilities based on the observable inputs and unobservable inputs used in order to value the assets and liabilities:

.

Level 1 - Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

.

Level 2 - Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reported date and includes those financial instruments that are valued using models or other valuation methodologies.

.

Level 3 - Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

**Derivatives**

The Company evaluates embedded conversion features within convertible debt under ASC 815 "*Derivatives and Hedging*" to determine whether the embedded conversion feature should be bifurcated from the host instrument and accounted for as a derivative at fair value with changes in fair value recorded in earnings. The Company uses a binomial pricing model to estimate the fair value of convertible debt conversion features at the end of each applicable reporting period. Changes in the fair value of these derivatives during each reporting period are included in the consolidated statement of operation. Inputs into the Binomial pricing model require estimates, including such items as estimated volatility of the Company's stock, risk-free interest rate and the estimated life of the financial instruments being fair valued. If the conversion feature does not require derivative treatment under ASC 815, the instrument is evaluated under ASC 470-20 "*Debt with Conversion and Other Options*" for consideration of any beneficial conversion feature.

**Alternative Energy Partners, Inc.**

**(A Development Stage Company)**

**Notes to Condensed Consolidated Financial Statements**

**April 30, 2013**

(Unaudited)

**Note 2 Nature of Operations and Summary of Significant Accounting Policies (continued)**

**Convertible Debentures**

If the conversion features of conventional convertible debt provides for a rate of conversion that is below market value at issuance, this feature is characterized as a beneficial conversion feature (“BCF”). A BCF is recorded by the Company as a debt discount pursuant to ASC Topic 470-20 “Debt with Conversion and Other Options.” In those circumstances, the convertible debt is recorded net of the discount related to the BCF, and the Company amortizes the discount to interest expense or equity (if the debt is due to a related party), over the life of the debt using the effective interest method.

**Recent Accounting Pronouncements**

In August 2012, the FASB issued ASU 2012-03, "Technical Amendments and Corrections to SEC Sections" ("ASU 2012-03"), which provides amendments to certain paragraphs pursuant to SEC Staff Accounting Bulletin No. 114, technical amendments to SEC Release No. 33-9250 and corrections related to FASB ASU 2010-22. ASU 2012-03 is effective for the Company for annual and interim periods ending October 31, 2012.

In January 2013, the FASB issued ASU 2013-01, " Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities" ("ASU 2013-01"), the amendments clarify that the scope of Update 2011-11 applies to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The Company has adopted the amendments for its fiscal year beginning after January 1, 2013, and interim periods within those annual periods. The Company does not believe the adoption of ASU 2013-01 will have a material impact on its consolidated financial statements.

The Company continually assesses any new accounting pronouncements to determine their applicability to the Company. Where it is determined that a new accounting pronouncement affects the Company's financial reporting, the Company undertakes a study to determine the consequence of the change to its financial statements and assures that there are proper controls in place to ascertain that the Company's financials properly reflect the change.

**Note 3 Going Concern**

As reflected in the accompanying financial statements, the Company has a net loss of $664,016 for the nine months ended April 30, 2013; and an accumulated deficit during the development stage of $7,789,334 at April 30, 2013.

These factors, among others, raise doubt about the Company's ability to continue as a going concern. The accompanying financial statements do not include any adjustments related to recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

In response to these problems, management has taken the following actions:

- The Company is seeking third party debt and/or equity financing;
- The Company is cutting operating costs, and
- As described in Note 6, the Company has been involved in numerous acquisitions with the intent of achieving a level of profitability

**Alternative Energy Partners, Inc.**

**(A Development Stage Company)**

**Notes to Condensed Consolidated Financial Statements**

**April 30, 2013**

(Unaudited)

## Note 4 Related Party Transactions

Financing transactions:

During fiscal year ended July 31, 2010, the Company issued two promissory notes to a related party, McDowell, LLC, managed by a former officer and director of the Company, totaling $12,500. Each note bears interest at a rate of 8% per annum and due on demand. On December 3, 2010, the Company received written demand for payment of the notes and upon failure to fulfill the demand, subsequently filed suit for collection of all amounts owed resulting in a judgment being entered in favor of the holder. As of April 30, 2013 and July 31, 2012, the principal balance together with accrued interest totaled $15,675 and $14,661, respectively.

On December 31, 2012, the Company issued a convertible promissory note representing accrued liabilities in the amount of $164,547 to a former consultant to the Company for services rendered. The Company's former controlling shareholder, Novation Holdings, Inc. ("Novation") subsequently acquired the note as part of an unrelated transaction. The convertible note bears interest at a rate of 5% per annum, matures on December 31, 2014 and is convertible at a rate of $0.0005 per share. Subsequent to April 30, 2013, Novation transferred the note to an unrelated third party. As of April 30, 2013 and July 31, 2012, the principal balance together with accrued interest totaled $166,978 and $0, respectively.

Consulting agreements:

In August, 2010, the Company entered into a consulting agreement with CFOs to Go, Inc., an unrelated party, for financial, accounting, compliance and other support services at a monthly fee of $10,000. Additionally, pursuant to the terms of the agreement, the Company was afforded use of office equipment, software, servers, and office personnel of the consultant, as well as use of the consultant's offices as its mailing address. That agreement was terminated by the parties effective December 31, 2012. On January 1, 2013, the Company entered into a Consulting Agreement with Novation Services, Inc., for financial, accounting, compliance and other support services. Additionally, pursuant to the terms of the agreement, the Company was afforded use of office equipment, software, servers, and office personnel of the consultant, as well as use of the consultant's offices as its mailing address. Novation Services, Inc. is a wholly-owned subsidiary of Novation, the Company's former majority shareholder through May 5, 2013, when Novation sold its voting interest to iEquity Corp. and the Company relocated its principal offices to Boca Raton, Florida. The Company recorded consulting expenses totaling $10,000 per month, or a total of $90,000 in each of the nine month periods ended April 30, 2013 and 2012, respectively, in connection with these two consulting agreements.

**Note 5 Notes Payable**

Notes payable and convertible notes payable consisted of the following as of:

| | | April 30, 2013 | July 31, 2012 |
|---|---|---|---|
| Asher Enterprises, Inc. [1] | | | |
| | Convertible promissory note dated February 7, 2012, bearing interest at a rate of 8% per annum, maturing May 9, 2013, convertible at a 55% discount to the average of the three lowest ten-day trading prices at date of conversion. | $ 16,800 | $ 32,500 |
| | Convertible promissory note dated March 8, 2012, bearing interest at a rate of 8% per annum, maturing September 12, 2013 convertible at a 55% discount to the average of the three lowest ten-day trading prices at date of conversion. | 48,750 | 32,500 |
| | Convertible promissory note dated April 26, 2012, bearing interest at a rate of 8% per annum, maturing October 26, 2013 convertible at a 55% discount to the average of the three lowest ten-day trading prices at date of conversion. | 48,750 | 32,500 |
| | Convertible promissory note dated November 14, 2012, bearing interest at a rate of 8% per annum, maturing August 14, 2013 convertible at a 55% discount to the average of the three lowest ten-day trading prices at date of conversion. | 27,375 | - |
| **Principal balance due Asher Enterprises, Inc.** | | **141,675** | **97,500** |



**Alternative Energy Partners, Inc.**

**(A Development Stage Company)**

**Notes to Condensed Consolidated Financial Statements**

**April 30, 2013**

(Unaudited)

**Note 5 Notes Payable (continued)**

| | April 30, 2013 | July 31, 2012 |
|---|---|---|
| Less: Discount related to beneficial conversion features | (35,194) | - |
| **Total balance due net of discounts** | **$ 106,480** | **$ 97,500** |
| **Notes payable and other liabilities, related and other parties:**[2] | | |
| Indian River Financial Services, LLC[3] | | |
| Convertible promissory note dated January 22, 2013, bearing interest at a rate of 8% per annum, maturing January 31, 2014 and convertible at a rate of $0.0005 per share. | $ 161,250 | $ - |
| CF Consulting, LLC | | |
| Convertible promissory note dated December 10, 2012, bearing interest at a rate of 8% per annum, maturing December 31, 2013 and convertible at a rate of $0.0005 per share. | 32,363 | - |
| Novation Holdings, Inc. – related party[4] | | |
| Convertible promissory note dated December 31, 2012, bearing interest at a rate of 5% per annum, maturing December 31, 2014 and convertible at a rate of $0.0005 per share. | 164,547 | - |
| McDowell, LLC – former related party | | |
| Judgment payable dated July 2010, bearing interest at a rate of 8% per annum and currently in default | 12,500 | 12,500 |
| **Principal balance due to related and other parties:** | **370,660** | **12,500** |
| Less: Discount related to beneficial conversion features | (166,216) | - |
| **Total balance due net of discounts** | **$ 204,444** | **$ 12,500** |
| Other notes payable | - | 113,500 |
| Lin-Han Century Corp. | | |
| Note payable bearing interest at a rate of 5% per annum and maturing December 31, 2014 | 11,754 | 30,000 |
| **Principal balance due on notes payable** | **-** | **143,500** |
| Less: Discount related to beneficial conversion features | - | 34,161 |
| **Total balance due net of discounts** | **$ 11,754** | **$ 109,339** |
| **Total balance due net of discounts on convertible debt** | **322,679** | **219,339** |

| | | | | |
|---|---|---|---|---|
| Less long term debt | | (35,918) | | - |
| **Total short term debt** | **$** | **286,761** | **$** | **219,339** |

(1)

During the nine months ended April 30, 2013, Asher Enterprises Inc. converted a total of $21,400 of principal into 81,871,980 shares of common stock. Although the first Asher Enterprises note matured May 9, 2013 and is now in default, Asher continues to convert the principal and accrued interest

(2)

During the nine months ended April 30, 2013, related and other parties converted a total of $13,167 of principal into 26,333,333 shares of common stock.

(3)

In May 2013, the note was sold to an unrelated party

(4)

In May 2013, Novation sold its controlling interest in the Company and is no longer an affiliate or related party. Novation also transferred the note to an unrelated party as consideration for an acquisition, and no longer has any interest in the note.

11

**Alternative Energy Partners, Inc.**

**(A Development Stage Company)**

**Notes to Condensed Consolidated Financial Statements**

**April 30, 2013**

(Unaudited)

**Note 6 Derivative Liabilities**

The Company has various convertible instruments outstanding more fully described in Note 8. Because the number of shares to be issued upon settlement cannot be determined under these instruments, the Company cannot determine whether it will have sufficient authorized shares at a given date to settle any other of its share-settleable instruments. As a result, under ASC 815-15 "*Derivatives and Hedging*", all other share-settleable instruments must be classified as liabilities.

**Embedded Derivative Liabilities in Convertible Notes**

During the quarter ended April 30, 2013, the Company recognized new derivative liabilities of $90,143 as a result of convertible debt instruments having embedded conversion options.

As a result of conversion of notes payable described in Note 8, the Company recognized a loss of $18,800 on the settlement of derivatives liabilities and a gain on the change in fair value of $79,818.

As of April 30, 2013 and July 31, 2012, the fair value of the Company's derivative liabilities totaled $94,717 and $0.

**Note 7 Acquisitions**

On October 22, 2012, the Company entered into an Acquisition Agreement with its former majority shareholder, to acquire Safford Acquisition I, Corp., an Arizona corporation ("SAC"), in exchange for 100,000,000 shares of post-reverse split common stock. Although the transaction nominally closed in December 2012 and was announced at that time, the Company subsequently learned that Safford Acquisition 1 Corp. was not successfully formed, and in any event the share consideration for the acquisition has not yet been issued, pending the completion of the reverse split and the increase in the number of authorized common shares. The Board of Directors and majority shareholder approved a 1:100 reverse split of the common stock of the Company and an amendment to its Articles of Incorporation to increase the number of authorized shares of common stock to 600 million.

Due to confusion over the status of the transaction, the recently discovered fact that Safford Acquisition 1 Corp. had not been correctly formed, and the fact that the acquisition shares have not yet been issued, and the reverse split of the common stock has been delayed indefinitely by the Financial Industry Regulatory Association (FINRA) until a chill on the electronic trading of the shares imposed by the Depository Trust Company (DTC) has been lifted, the Board of Directors has concluded that the acquisition should not be completed.

The Company also entered into an agreement to acquire ownership of the operating assets of StarPoint USA, Inc. ("StarPoint"), a U.S. based vehicle distribution company that has a proven track record and that is not exclusive to any specific vehicle brand, which allows it to distribute a number of different automobile and truck brands and models in the U.S. market. That acquisition did not close and, due to the change in the business model and direction of the

Company announced in May, 2013, the Board determined not to pursue the acquisition.

**Note 8 Stockholders' Equity (Deficit)**

During the three months ended April 30, 2013, the Company converted $34,567 in notes into 108,205,313 shares of common stock.

In April 2013, Élan Energy and Water retired 40,000,000 common shares and will be reissued these shares when the next amendment is completed.

**Alternative Energy Partners, Inc.**

**(A Development Stage Company)**

**Notes to Condensed Consolidated Financial Statements**

**April 30, 2013**

(Unaudited)

**Note 9 Subsequent Events**

In May, 2013, the Company agreed to acquire the PharmaJanes™ marketing operation from iEquity Corp. and will be changing its business model to focus purely in the medical marijuana marketing space.  AEGY will be changing its name to PharmaJanes, Inc and will no longer move forward with the previously announced 1:100 reverse split.

PharmaJanes™ is currently developing a web and phone application that allows individuals to place orders for medical marijuana through a website and smart phone application anywhere such a transaction is legal in the United States.  The purpose of PharmaJanes™ is to give patients a simple ordering platform, while allowing local collectives to service the orders in compliance with state and local laws and ordinances.  PharmaJanes™ will act solely as an expediter and processor of the orders, and the fulfillment function will be done entirely within the particular state of residence of the purchaser, by licensed collectives or other licensed medical marijuana providers in that state

PharmaJanes™ currently has over $5M in annual marketing contracts in place for this service and will be the exclusive point-of sale for the collectives under contract.  The Company also has signed an agreement with SK3 Group, Inc.  to become the exclusive on-line and smart phone ordering platform for Collectives managed through the SK3 Group system.  Members of the Collectives managed by SK3 Group will soon be able to order their medical cannabis needs through PharmaJanes™.

The Company has signed a definitive agreement in May 2013 to acquire the Simple Prepay™ merchant payment solution from iEquity Corp.  The Simple Prepay™ system was developed to offer dispensaries, collectives, and delivery services of medical cannabis a convenient payment solution. Medical marijuana patients will be able to upload funds onto their Simple Prepay™ account via a smart phone application or via a website, allowing them to purchase their medical cannabis needs with privacy and simplicity.

Combined with the PharmaJanes™ on-line and smart phone ordering platform, medical marijuana patients will be able to order, process and pay for their authorized needs, in a simple, safe and secure ordering and payment interface. Local licensed collectives or other licensed medical marijuana providers in the home state of the end user, will then fulfill the orders provided through this new system, in full compliance with state and local laws and ordinances.  The Company itself will act solely as a background ordering and payment service, and will not be cultivating, shipping, delivering, or otherwise handling the medical mariju8ana, all of which will be handled directly by collectives or other providers licensed and authorized in the state in which the delivery is both authorized and completed

PharmaJanes™ will act solely as an expediter and processor of the authorized orders, and Simple Prepay™ will provide the secure payment platform, while the actual fulfillment function will be done entirely within the particular state of residence of the purchaser, by a locally licensed and regulated independent medical marijuana provider.

In accordance with ASC 855, management evaluated all activity of the Company through the date of filing, (the issue date of the financial statements) and concluded that no other subsequent events have occurred that would require recognition or disclosure in the financial statements.

Subsequent to the quarter ending April 30, 2013, the Company converted notes payable principal of $72,285 into 278,179,702 common shares. As of June 14, 2013, there were 523,137,304 shares of our common stock outstanding.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation**

The following discussion includes certain forward-looking statements within the meaning of the safe harbor protections of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Statements that include words such as "believe," "expect," "should," "intend," "may," "anticipate," "l "contingent," "could," "may," or other future-oriented statements, are forward-looking statements. Such forward-looking statements include, but are not limited to, statements regarding our business plans, strategies and objectives, and, in particular, statements referring to our expectations regarding our ability to continue as a going concern, generate increased market awareness of, and demand for, our current products, realize profitability and positive cash flow, and timely obtain required financing. These forward-looking statements involve risks and uncertainties that could cause actual results to differ from anticipated results. The forward-looking statements are based on our current expectations and what we believe are reasonable assumptions given our knowledge of the markets; however, our actual performance, results and achievements could differ materially from those expressed in, or implied by, these forward-looking statements. Factors within and beyond our control that could cause or contribute to such differences include, among others, our critical capital raising efforts in an uncertain and volatile economical environment, our ability to maintain relationship with strategic companies, our cash preservation and cost containment efforts, our ability to retain key management personnel, our relative inexperience with advertising, our competition and the potential impact of technological advancements thereon, the impact of changing economic, political, and geo-political environments on our business, as well as those factors discussed elsewhere in this Form 10-Q and in "Item 1 - Our Business," "Item 7 - Management's Discussion and Analysis," and elsewhere in our most recent Form 10-K, filed with the United States Securities and Exchange Commission.

Readers are urged to carefully review and consider the various disclosures made by us in this report and those detailed from time to time in our reports and filings with the United States Securities and Exchange Commission that attempt to advise interested parties of the risks and factors that are likely to affect our business.

**Our Business**

Alternative Energy Partners, Inc. (the "Company" or "AEGY") was organized under the laws of the State of Florida on April 28, 2008. We formed our company for the purpose of establishing renewable fuel sources initially within the State of Florida. Ethanol was our initial intended product and we intend to establish other alternative energy products and services including, but not limited to, solar-thermal energy production, energy management controls, and more. Our intended original products, while not technically difficult to produce, must meet all regulatory requirements prior to being marketed. Moreover, there are a multitude of competitive products already in the market place. Due to the competitive nature of the market and our continuing capital requirements, we expanded our initial plan to include solar and thermal projects, with the acquisition of Sunarias Corporation on May 18, 2010 and Shovon, LLC on July 9, 2010. During the year ended July 31, 2012 and to date, we continued our business development activities with the acquisition of Clarrix Energy, LLC. Due to limited working capital, we have been unable to implement the planned activities or Shovon and Sunarias, and have decided to close those operations in order to concentrate our efforts and limited funds on Clarrix and the new acquisitions we have planned.

**Current Business of the Company**

We are a holding company engaged through our subsidiary, Clarrix Energy, LLC, in the business of energy production and management. Our business model of vertical integration recognizes that customers have unique energy needs, and by offering an array of energy services we believe we can best provide customized, efficient energy solutions that will appeal to our markets. We believe our intended products and services could represent an important alternative for customers looking to lower their overhead costs or improve public image through efficient energy usage.

In May, 2013, the Company agreed to acquire the PharmaJanes™ marketing operation from iEquity Corp. and will be changing its business model to focus purely in the medical marijuana marketing space. AEGY will be changing its name to PharmaJanes, Inc and will no longer move forward with the previously announced 1:100 reverse split.

PharmaJanes™ is currently developing a web and phone application that allows individuals to place orders for medical marijuana through a website and smart phone application anywhere such a transaction is legal in the United

States. The purpose of PharmaJanes™ is to give patients a simple ordering platform, while allowing local collectives to service the orders in compliance with state and local laws and ordinances. PharmaJanes™ will act solely as an expediter and processor of the orders, and the fulfillment function will be done entirely within the particular state of residence of the purchaser, by licensed collectives or other licensed medical marijuana providers in that state

PharmaJanes™ currently has over $5M in annual marketing contracts in place for this service and will be the exclusive point-of sale for the collectives under contract. The Company also has signed an agreement with SK3 Group, Inc. to become the exclusive on-line and smart phone ordering platform for Collectives managed through the SK3 Group system. Members of the Collectives managed by SK3 Group will soon be able to order their medical cannabis needs through PharmaJanes™.

The Company has signed a definitive agreement in May 2013 to acquire the Simple Prepay™ merchant payment solution from iEquity Corp. The Simple Prepay™ system was developed to offer dispensaries, collectives, and delivery services of medical cannabis a convenient payment solution. Medical marijuana patients will be able to upload funds onto their Simple Prepay™ account via a smart phone application or via a website, allowing them to purchase their medical cannabis needs with privacy and simplicity.

Combined with the PharmaJanes™ on-line and smart phone ordering platform, medical marijuana patients will be able to order, process and pay for their authorized needs, in a simple, safe and secure ordering and payment interface. Local licensed collectives or other licensed medical marijuana providers in the home state of the end user, will then fulfill the orders provided through this new system, in full compliance with state and local laws and ordinances. The Company itself will act solely as a background ordering and payment service, and will not be cultivating, shipping, delivering, or otherwise handling the medical mariju8ana, all of which will be handled directly by collectives or other providers licensed and authorized in the state in which the delivery is both authorized and completed

PharmaJanes™ will act solely as an expediter and processor of the authorized orders, and Simple Prepay™ will provide the secure payment platform, while the actual fulfillment function will be done entirely within the particular

**CLARRIX ENERGY, LLC**

The company focuses on a creative online strategy to attract and manage clients. Management is developing a sales force in all areas their supply agreements allow. Management plans to technology and state-of-the-art web and social networking strategies to maximize lead generation and minimize advertising costs. The Company acquired Clarrix Energy, LLC from its sole member, Élan Energy & Water, Inc., for a total of forty million (40,000,000) common shares and 5,000,000 Series A Convertible Preferred Shares of the Company. The acquisition closed on May 30, 2012. The Series A Convertible Preferred Stock is a voting stock which votes on a par with the common shares except that the Series A Preferred always has a vote equal to 51 percent of the total votes eligible to vote on any matter, and is convertible at the election of the holder into 51% of the resulting common shares outstanding at the time of the election to convert. Élan Energy subsequently conveyed the preferred stock to its shareholders and liquidated.

Clarrix Energy, LLC provides consultative and brokerage services to business of all sizes. The objective of these services is to decrease utility costs in as many ways as possible for every client. The company currently has agreements with energy suppliers in several states, and is in pursuit of additional supply partners. Clarrix Energy was founded in 2011 by a management team composed of a diverse group of highly skilled executives with broad base of skills medicine, finance, web development, and retail. The company's initial source of revenue is from commissions generated by saving businesses from 1 to 25% on their utility bills. Management will be diligently searching for products and services for clients, including solar, surge protection, lighting and more.

The deregulation of energy by the federal government has created multiple opportunities in the energy sector. Multiple states allow businesses and consumers to select the supplier of their commodity (gas or electricity). This, of course, is intended to give business the opportunity to save on their utility costs.

**Employees**

Mario Barrera currently is our Chairman, President and CEO and sole officer. He is not an employee of the company and is not paid as an employee. Our former sole officer and director, Michael Gelmon, resigned in May, 2013 when Novation Holdings, Inc. conveyed its control position to unrelated third parties. He was also not an employee of the Company and was not paid as an employee. Currently, we have no paid employees, full or part-time, and rely on paid consultants to provide necessary services.

**Acquisitions**

During the quarter ended January 31, 2013, the Company announced the acquisition of Safford Acquisition 1 Corp. , which was to be formed solely for the purpose of acquiring certain mineral rights to 160 acres of land in Safford, Arizona under an acquisition agreement dated October 22, 2012 with Élan Energy & Water, Inc., a former control shareholder of the Company. Under the terms of the acquisition agreement, Élan Energy was to form Safford Acquisition, acquire the mineral rights in question in Safford Acquisition 1, and then transfer the ownership of Safford Acquisition 1 to the Company, in exchange for shares of common stock of the Company, to be issued following a reverse split of the common stock and an amendment to the articles of incorporation to increase the number of authorized shares of common stock.

On March 7, 2013, the Board of Directors of the Company and its control shareholder approved the 1:100 reverse split of the common stock and the amendment to increase the shares authorized to 500 million shares. That action was expected to become effective 20 days after the mailing of an Information Statement to all shareholders of record

on March 7, 2013, which mailing was anticipated to occur on or about March 19, 2013. Due to confusion over the status of the transaction, the recently discovered fact that Safford Acquisition 1 Corp. had not been correctly formed, and the fact that the acquisition shares have not yet been issued, the Company and the reverse split of the common stock has been delayed indefinitely by the Financial Industry Regulatory Association (FINRA) until a chill on the electronic trading of the shares imposed by the Depository Trust Company (DTC) has been lifted, the Board of Directors has concluded that the acquisition should not be completed.

The Company also entered into an agreement to acquire ownership of the operating assets of StarPoint USA, Inc. (“StarPoint”), a U.S. based vehicle distribution company that has a proven track record and that is not exclusive to any specific vehicle brand, which allows it to distribute a number of different automobile and truck brands and models in the U.S. market. That acquisition did not close and, due to the change in the business model and direction of the Company announced in May, 2013, the Board determined not to pursue the acquisition. Note 10

As noted above, we are changing our business plan and will be acting as a service provider for authorized users of medical marijuana products.

**Results of Operations for the Three Months Ended April 30, 2013 and 2012.**

For the three months ended April 30, 2013 and 2012, the Company had revenues of $1,112 and $0 respectfully. Since inception, the Company has earned $5,604 in revenues and has incurred cumulative net losses of $7,789,334. For the three months ended April 30, 2013 and 2012, we incurred operating expenses of $56,694 and $52,938, respectively, and we had net losses of $50,705 and $84,343, respectively. Our activities have been attributed primarily to start up and business development.

**Results of Operations for the Nine Months Ended April 30, 2013 and 2012.**

For the nine months ended April 30, 2013 and 2012, the Company had revenues of $3,380 and $0 respectfully. Since inception, the Company has earned $5,604 in revenues and has incurred cumulative net losses of $7,789,334. For the nine months ended April 30, 2013 and 2012, the Company had net losses of $664,016 and $386,034, respectively. Our activities have been attributed primarily to start up and business development.

16

For the nine months ended April 30, 2013 and 2012, we incurred operating expenses of $531,337 and $206,787, respectively. The increases relate primarily to consulting fees and an impairment loss due to the write-off of goodwill.

**Liquidity and Capital Resources**

As shown in the accompanying financial statements, for the nine months ended April 30, 2013 and 2012 and since April 28, 2008 (date of inception) through April 30, 2013, the Company has had net losses of $664,016, $386,034 and $7,789,334, respectively. As of April 30, 2013, the Company had not emerged from the development stage. In

view of these matters, the Company's ability to continue as a going concern is dependent upon the Company's ability to begin operations and to achieve a level of profitability. Since inception, the Company has financed its activities principally from the sale of public equity securities. The Company intends on financing its future development activities and its working capital needs largely from the sale of public equity securities with some additional funding from other traditional financing sources.

We have incurred significant net losses and negative cash flows from operations since our inception. As of April 30, 2013, we had an accumulated deficit of $7,789,334 and a working capital deficit of $629,940.

We anticipate that cash used in product development and operations, especially in the marketing, production and sale of our products, will increase significantly in the future.

If we are unable to secure additional financing to cover our operating losses until breakeven operations can be achieved, there is no assurance that we will be able to continue as a going concern.

**Off-Balance Sheet Arrangements**

We currently do not have any off-balance sheet arrangements.

**Critical Accounting Policies**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. We believe that the following critical policies affect our more significant judgments and estimates used in preparation of our financial statements.

The Company has incurred deferred offering costs in connection with raising additional capital through the sale of its common stock. These costs are capitalized and charged against additional paid-in capital when common stock is issued. If there is no issuance of common stock, the costs incurred are charged to operations.

Research and development costs are charged to operations when incurred and are included in operating expenses.

**Contractual Obligations**

The Company has had consulting agreements with companies for various advisement services. Crystal Falls Investments, LLC provided acquisition and related services under an agreement calling for payment of $10,000 per month for a 24 month period ended September 30, 2012. Prior to December 10, 2012, the Company had issued a total of six convertible promissory notes totaling $206,780 in principal amount, to Crystal Falls Investments, LLC, in return for conversion of accounts payable for services rendered by Crystal Falls under the consulting agreement, and for cash investments in the Company. By an Assignment and Modification Agreement dated December 10, 2012, Crystal Falls assigned all of the remaining notes to CF Consulting, LLC, an unrelated party, in the amount of $39,030 in principal, and to Indian River Financial Services, LLC, also an unrelated party, in the principal amount of $167,750, in payment of unrelated debts owed to them by Crystal Falls. As part of the assignment, the parties agreed to modify the conversion terms to a fixed conversion rate of $0.005 per share, the market price at the time of the re-statement of the notes. Accordingly, no debt discount has been calculated for these notes. In addition, the maturity date was extended to December 31, 2013.

The Company entered into a consulting agreement with Lin-Han Equity Corp. to provide services and assistance in locating, identifying and assisting with due diligence in strategic acquisitions, as well as for the introduction of potential investor sources. The consulting agreement was executed on May 1, 2011 and called for a fixed monthly fee of $15,000 commencing May 1, 2011 for a period of one year. A total of $45,000 was charged as expenses related to this agreement for the six months ended October 31, 2011, and a total of $45,000 in fees owed was included in accounts payable. Lin-Han Equity Corp. is not a shareholder or affiliate of the Company. On December 1, 2011, a total of $30,000 in accrued payable amounts under this agreement was converted into a convertible promissory note due in two years. The consulting agreement was terminated by mutual agreement in December 2011. On November 1, 2012, the Company consolidated the existing $30,000 promissory note payable to Lin-Han Century Corp. with several other obligations, and reissued a new note for $11,754 including interest accrued on the old note of $1,381, with no beneficial conversion features. The new note is due December 31, 2014.

We also entered into a consulting agreement effective August 1, 2010 with CFOs to Go, Inc., a financial and legal consulting firm, to provide financial, accounting, legal, and administrative, HR, supply chain management, corporate governance, SEC compliance and similar services to the Company for a monthly fee of $10,000. CFOs to Go also provided contract principal accounting officer and corporate counsel services to the Company under its agreement and also provided telephone, office address, access to software and servers owned by CFOs to Go, and related office support. We maintained our corporate offices at the Florida offices of CFOs to Go under this arrangement. As of December 10, 2012, a total of $164,547 had accrued as consulting fees under this agreement. By agreement dated December 31, 2012, Novation Holdings, Inc., the former controlling parent of the Company, acquired a portion of the administration, financial and legal consulting business formerly operated by CFOs to Go, Inc., so that Novation could thereafter manage and control its own administrative, financial and legal consulting business, and provide similar services to other companies. As part of that agreement, to which the Company was not a party, Novation acquired certain outstanding receivables of CFOs owed by certain of its clients, including the Company, which owed CFOs to Go a total of $164,547. The payable amount was then converted to a promissory note in the same principal amount dated December 31, 2012, payable at 5 percent interest at maturity on December 31, 2104 and convertible at $0.0005 per share, the market price at the time. The previous consulting agreement with CFOs to Go, Inc. also was cancelled effective December 31, 2012 and replaced by a consulting agreement with Novation Services, Inc., which remains in effect.

In May 2013, Novation Holdings, Inc. sold its controlling interest in the Company to iEquity Corp., an unrelated party, and we re-located out offices to Boca Raton, Florida. The consulting agreement with Novation Services, Inc. remains in effect.

**Recent Accounting Pronouncements**

In August 2012, the FASB issued ASU 2012-03, "Technical Amendments and Corrections to SEC Sections" ("ASU 2012-03"), which provides amendments to certain paragraphs pursuant to SEC Staff Accounting Bulletin No. 114, technical amendments to SEC Release No. 33-9250 and corrections related to FASB ASU 2010-22. ASU 2012-03 is effective for the Company for annual and interim periods ending October 31, 2012.

In January 2013, the FASB issued ASU 2013-01, " Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities" ("ASU 2013-01"), the amendments clarify that the scope of Update 2011-11 applies to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The Company has adopted the amendments for its fiscal year beginning after January 1, 2013, and interim periods within those annual periods. The Company does not believe the adoption of ASU 2013-01 will have a material impact on its consolidated financial statements.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and are not required to provide the information required under this item.

**Item 4. Controls and Procedures**

Disclosure controls and procedures are designed with an objective of ensuring that information required to be disclosed in our periodic reports filed with the Securities and Exchange Commission, such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. Disclosure controls also are designed with an objective of ensuring that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, in order to allow timely consideration regarding required disclosures.

The evaluation of our disclosure controls by our chief executive officer, who is also our acting chief financial officer, included a review of the controls' objectives and design, the operation of the controls, and the effect of the controls on the information presented in this Quarterly Report. Our management, including our chief executive officer, does not expect that disclosure controls can or will prevent or detect all errors and all fraud, if any. A control

system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Also, projections of any evaluation of the disclosure controls and procedures to future periods are subject to the risk that the disclosure controls and procedures may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on his review and evaluation as of the end of the period covered by this Form 10-Q, and subject to the inherent limitations all as described above, our chief executive officer, who is also our acting chief financial officer, has concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) contain material weaknesses and are not effective.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

The material weaknesses we have identified are the direct result of a lack of adequate staffing in our accounting department. Currently, our chief executive officer and an outsourced controller have sole responsibility for receipts and disbursements. We do not employ any other parties to prepare the periodic financial statements and public filings. Reliance on these limited resources impairs our ability to provide for a proper segregation of duties and the ability to ensure consistently complete and accurate financial reporting, as well as disclosure controls and procedures. As we grow, and as resources permit, we project that we will hire such additional competent financial personnel to assist in the segregation of duties with respect to financial reporting, and Sarbanes-Oxley Section 404 compliance.

Changes in Internal Control Over Financial Reporting

The Company has not made any changes in its internal control over financial reporting during the quarter ended April 30, 2013.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

Neither the Company nor any of our officers or directors are involved in any other litigation either as plaintiffs or defendants and we have no knowledge of any other threatened or pending litigation against us or any of our officers or directors.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the three months ended April 30, 2013, we issued 108,205,313 common shares resulting from conversions of outstanding notes resulting in total shares outstanding at April 30, 2013 of 244,957,602 shares.

**Item 3. Defaults Upon Senior Securities**

There were no defaults on any debt or senior securities outstanding.

**Item 4. Submission of Matters to a Vote of Security Holders**

There were no matters submitted to a vote of our shareholders during the quarter ended April 30, 2013.

**Item 5. Other Information.**

**Item 6. Exhibits**

| Exhibit No. | Description of Exhibit |
|---|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act |
| 31.2 | Certification of principal accounting officer pursuant to Section 302 of the Sarbanes-Oxley Act |
| 32.1 | Certification of Chief Executive Officer pursuant to Section 906 |
| 32.2 | Certification of principal accounting officer pursuant to Section 906 |

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the Company caused this report to be signed on its behalf by the undersigned, hereunto duly authorized.

**Alternative Energy Partners, Inc.**

Date: June 13, 2013

*/s/ Mario Barrera*

Mario Barrera

President

20