QuestAir Technologies Inc.

First Quarter Report
Fiscal 2009

Additional information relating to the Company can be found on SEDAR at www.sedar.com.

The following management discussion and analysis ("MD&A"), dated February 9, 2009, relates to our interim financial statements for the first quarter of fiscal 2009, being the three month period ended December 31, 2008. The MD&A should be read in conjunction with the Company's unaudited financial statements and related notes therein that are prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). All financial information is stated in Canadian dollars, unless otherwise indicated. Additional information regarding QuestAir Technologies Inc. ("QuestAir" or "the Company"), including our Annual Information Form ("AIF") and MD&A for the financial year ended September 30, 2008 ("fiscal 2008"), can be found on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

Forward Looking Statements

This MD&A contains forward-looking statements, including statements regarding the future success of our business, technology, and market opportunities. Forward-looking statements typically contain words such as "believes", "expects", "anticipates", "continue", "could", "indicates", "plans", "will", "intends", "may", "projects", "schedule", "would" or similar expressions suggesting future outcomes or events, although not all forward-looking statements contain these identifying words. Examples of such statements include, but are not limited to, statements concerning: (i) expectations regarding the Company's future success in the biogas and other markets; (ii) the key market drivers and other factors that are expected to impact the Company's performance; (iii) future financial results; (iv) the expected actions of the third parties described herein; and (v) the business and financial outlook of the Company for fiscal 2009. In addition, this MD&A contains financial outlook information that is intended to provide general guidance for readers based on management's current estimates, but which is based on numerous assumptions and may prove to be incorrect and therefore such financial outlook information should not be relied upon by readers. These statements are neither promises nor guarantees, but involve known and unknown risks and uncertainties that may cause our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed in or implied by these statements. These risks include, but are not limited to, risks related to revenue growth, operating results, industry and products, technology, competition, foreign exchange rates, general economic conditions and those factors described in detail herein under the heading 'Risks & Uncertainties'.

The forward-looking statements contained herein are also based on assumptions that management believes are current and reasonable, including but not limited to, assumptions regarding: (i) trends in certain market segments and the economic climate generally; (ii) the financial strength of our customers; (iii) the value of the Canadian dollar; and (iv) the expected expenses of the Company going forward. The Company cannot assure readers that actual results will be consistent with the statements contained in this MD&A. The forward-looking statements and financial outlook information contained herein are made as of the date of this MD&A and are expressly qualified in their entirety by this cautionary statement. Except to the extent required by law, the Company undertakes no obligation to publicly update or revise any such statements to reflect any change in our expectations or in events, conditions, or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those described herein.

Significant Developments

QuestAir made the following progress in our commercial activities during the first quarter of fiscal 2009:

- In October, we received an order valued at approximately $700,000 from Venoco Inc., one of the largest independent oil and natural gas companies in California, to provide an M-3100 pressure swing adsorption ("PSA") system for use on an off-shore platform.

QuestAir's PSA will be used to remove carbon dioxide from sub-quality "associated gas", in order to meet the strict quality specifications for natural gas sold in California. This is our second sale of an M-3100 into this market, and the first sale of a system for use on an off-shore platform, where QuestAir's compact, skid-mounted gas purification systems offer significant benefits.

- In December, we announced the sale of two M-3200 PSA systems that will be used to create renewable compressed natural gas ("CNG") from biogas. The two projects, one in Korea and the other in Austria, build on the success QuestAir has enjoyed with biogas-to-CNG projects in California and Europe. Creating renewable vehicle fuel to replace gasoline and diesel is the highest value-added use of biogas, and a promising market for QuestAir's products.
- Also in December, we announced that we would delist from the AIM Market in the United Kingdom, in order to reduce administrative costs. The delisting became effective in January 2009. The Company's shares continue to be listed on the Toronto Stock Exchange under the symbol "QAR".

Financial Overview

The first quarter of fiscal 2009 was the strongest quarter in our history. Select financial highlights are noted below, and discussed in more detail further in this MD&A:

- This quarter was the first profitable quarter in the Company's history. Net income was $692,951 ($0.06 per share) for the quarter, compared to a loss of $2,390,476 ($0.45 per share) in the same period in fiscal 2008. Higher revenue and margins, lower operating costs and foreign exchange gains all contributed to this significant improvement in earnings.
- Revenue was $3,511,719 for the quarter, an increase of $1,943,794, or 124%, compared to the same period in fiscal 2008. Revenues from both gas purification systems and engineering service contracts increased substantially compared to the same period in fiscal 2008.
- Sales order backlog at December 31, 2008 was $10,044,448, a decrease of $823,440, or 8%, from September 30, 2008.
- Cash used by operations and capital requirements was $153,062 for the quarter, a decrease of $2,673,790, or 95%, compared to the same period in fiscal 2008. Management's efforts to reduce cash usage since March 2008 continue to deliver strong results.

Results of Operations

Revenues

The following table provides a breakdown of our revenues from the sale of gas purification systems and engineering service contracts for the reported periods:

(Unaudited)	Three months ended December 31,	
	2008	2007
Gas purification systems	2,045,168	1,362,811
Engineering service contracts	1,466,551	205,114
Total revenue	$3,511,719	$1,567,925

Revenue from gas purification systems increased 50% compared to the same period in fiscal 2008, as revenue from a large capacity H-3200 hydrogen purifier, for use in a new hydrogen plant at an oil refinery in Montana, was recognized during the first quarter of fiscal 2009. Also included in revenue are a number of biogas purification systems, including an M-3200 PSA system for the 'Biomethane for Vehicle Fuel' project located at the Hilarides Dairy in Lindsay, California and two M-3200 PSA systems sold to Acrona Systems Ltd. (formerly Verdesis Suisse) to purify methane generated from anaerobic digestion of organic waste in Switzerland.

The increase in revenue from engineering service contracts reflects the higher value of these contracts in backlog compared to the prior periods. This trend is expected to continue for several quarters as a result of the US$6.35 million engineering service contract that we signed with ExxonMobil Research and Engineering ("EMRE") in March 2008. This contract will elevate the revenue recognized from engineering service contracts until it is completed in December 2009.

Fluctuations in recognized revenue and the receipt of new sales orders are expected in the markets that we serve. In addition, the timing of receipt of new engineering service contracts can vary from year to year. We believe that both recognized revenue and changes in our sales order backlog should be monitored together to determine the strength of our commercial operations.

Our sales order backlog is defined as future revenue from signed contracts that have not yet been recognized as revenue. The following table provides an analysis of the changes in our sales order backlog for the quarter ended December 31, 2008.

(Unaudited)	For the quarter ended December 31, 2008		
	Gas Purification Systems	Engineering Service Contracts	Total
Opening Balance	5,502,442	5,365,446	10,867,888
Bookings	1,226,020	287,775	1,513,795
Revenue	(2,045,168)	(1,466,551)	(3,511,719)
Adjustments[1]	308,129	866,355	1,174,484
Ending Balance	4,991,423	5,053,025	10,044,448

The total sales order backlog decreased by $823,440, or 8%, during the first quarter of fiscal 2009. Favourable foreign exchange adjustments increased the value of our sales order backlog during the quarter, partially offsetting the fact that new orders received were less than the value of revenue recognized during the quarter. Without foreign exchange gains, total sales order backlog would have been less than $9 million at December 31, 2008. As is discussed further in the 'Outlook' section of this MD&A, the current economic environment has impacted our ability to secure new orders for gas purification equipment.

Gross Profit

The following table provides a calculation of our gross profit for the reported periods:

(Unaudited)	Three months ended December 31, 2008	2007
Revenue	3,511,719	1,567,925
Cost of goods sold	1,704,689	1,319,736
Gross Profit	1,807,030	248,189
Gross Margin (%)	51.5%	15.8%

Gross profit increased in the first quarter of fiscal 2009 compared to the same period last year due in part to an increase in the amount of revenue recognized on engineering service contracts, which tend to generate higher gross margins than equipment sales. In addition, a warranty

[1] Includes adjustments for fluctuations in foreign currency exchange rates.

obligation expired during the first quarter of fiscal 2009, resulting in a $367,626 reduction of cost of goods sold, contributing to the increased gross margin compared to the same period in fiscal 2008. Margins are expected to fluctuate from quarter to quarter depending on the mix of revenues recognized from engineering service contracts and gas purification systems.

Research and Development
Research and development ("R&D") expenses were $417,983 for the first quarter of fiscal 2009, a decrease of 56% compared to $955,864 for the same period in fiscal 2008. In the second quarter of fiscal 2008, management decided to limit the amount of self-funded R&D activities in order to reduce the Company's operational cash usage. As a result, R&D expenses have decreased significantly compared to the prior period.

General and Administrative
General and administrative ("G&A") expenses were $680,270 for the first quarter of fiscal 2009, a decrease of 23% compared to $885,568 for the same period in fiscal 2008. The decrease is primarily related to a decrease in overall facilities costs, including rent and associated utilities expenses, as we reduced the size of our leased facilities at the end of fiscal 2008 to better match our current requirements. In addition, stock based compensation expenses were much lower in the current quarter compared to the first quarter of fiscal 2008.

Operations
Operations expenses were $276,010 for the first quarter of fiscal 2009, a decrease of 37% compared to $437,618 for the same period in fiscal 2008. This decrease is due to a decrease in salary costs and related overheads, as staffing levels have declined in the department compared to the same period in fiscal 2008.

Sales and Marketing
Sales and marketing expenses were $295,598 for the first quarter of fiscal 2009, a decrease of 26% compared to $401,576 for the same period in fiscal 2008. The reduction in sales and marketing expenses for the quarter reflects a decrease in salary costs and related overheads compared to the prior period.

Other Income and Expense
Other income was $711,314 for the first quarter of fiscal 2009 as a result of substantial foreign exchange gains compared the same period in fiscal 2008.

Net Income (Loss)
The first quarter of fiscal 2009 was our first profitable quarter since inception. Net income was $692,951 compared to a loss of $2,390,476 for the first quarter of fiscal 2008. Timing of revenue recognition, increased gross profit and favorable foreign exchange gains have contributed to the positive results in the current quarter. In spite of the net income in the quarter, a net loss is projected for the full fiscal year.

Capital Expenditures
Capital expenditures net of proceeds on sale ("Net CAPEX") for the first quarter of fiscal 2009 were $37,557 compared to $153,793 for the same prior in fiscal 2008. It is expected that capital expenditures will fluctuate from year to year depending on the requirements of specific product development programs and administrative needs.

Summary of Quarterly Results

(Unaudited, $ '000 except income/loss per share data)	2008				2007			
	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Total Revenues	3,512	4,864	2,702	2,298	1,568	880	3,616	873
Gas Purification Systems	2,045	3,747	1,300	1,348	1,363	709	3,333	858
Eng. Service Contracts	1,467	1,117	1,402	950	205	171	283	15
% Gross Margin	51%	21%	40%	45%	16%	(15%)	34%	(157%)
R&D	418	704	411	934	956	1,025	1,424	1,348
General & Administrative	680	1,138	769	1,190	886	772	1,233	903
Net Income (Loss)	693	(1,613)	(1,582)	(2,057)	(2,390)	(2,989)	(2,559)	(4,644)
Net Income (Loss) per share	0.06	(0.14)	(0.25)	(0.39)	(0.45)	(0.57)	(0.49)	(0.89)
Net CAPEX	38	57	45	87	154	15	37	99
Cash used in operations & capital requirements	153	1,582	512	2,166	2,827	2,947	2,264	1,210
Backlog	10,044	10,868	14,502	16,022	10,141	11,054	7,136	7,513
Gas Purification Systems	4,991	5,502	8,328	8,390	8,144	8,955	6,660	7,078
Eng. Service Contracts	5,053	5,366	6,174	7,632	1,997	2,099	476	435

Our operating results have fluctuated from quarter to quarter and this trend is expected to continue for the foreseeable future.

Revenues and gross margins fluctuate quarter to quarter based on the mix of recognized revenue from gas purification equipment and engineering service contracts, which in turn is impacted by the length of the sales cycle required to close a customer order, and by contractual terms related to the timing of delivery and acceptance of products and services by customers. In the quarters ended March 31, 2007 and September 30, 2007 we recognized losses on certain sales orders, contributing to the quarterly fluctuation in percentage gross margins.

R&D expenses have trended lower in the past year, as we have increased our focus on customer-funded development programs and reduced our self-funded development activities. This lower level of R&D expenses is expected to continue over the balance of the fiscal year. G&A expenses have varied quarter by quarter, largely as a result of quarterly variations in legal, regulatory and investor relations costs, and specific to the quarters ended June 30, 2007; March 31, 2008; and September 30, 2008 severance and termination benefits associated with the restructuring of our operations and termination of employees.

Cash usage has declined in recent quarters, as a result of the restructuring that took place in March 2008 as well as the increased emphasis on customer-funded development programs noted above. Cash used in operations and capital requirements totaled $4.4 million over the trailing 12 month period, down from $9.2 million in the prior 12 month period.

Cash Flows, Liquidity and Capital Resources

Cash Flows

Cash and cash equivalents totaled $9,032,063 at December 31, 2008, a decrease of $233,186 from $9,265,249 at September 30, 2008. This decrease in cash and cash equivalents during the quarter was driven by cash outflows from operating and financing activities, which were only partially offset by cash inflows from investing activities.

Cash used by operations for the first quarter of fiscal 2009 decreased 96% to $115,505 compared to $2,673,059 for the same period in fiscal 2008. Cash inflows related to the net income in the quarter were offset by cash outflows related to changes in working capital accounts, primarily due to increased cash outflows from accounts payable and accrued liabilities compared to the same period in fiscal 2008.

Cash provided by investing activities declined to $24,491 in the first quarter of fiscal 2009, compared to $2,928,691 for the same period in fiscal 2008. Fewer short-term investments matured and no restricted cash was released during the quarter compared to the same period in fiscal 2008.

Cash used by financing activities was $142,172 in the first quarter of fiscal 2009, relatively unchanged from the same period in fiscal 2008 and includes repayments of bank debt.

Cash used by operations and capital requirements decreased 95% in the first quarter of fiscal 2009 to $153,062, compared to $2,826,852 for the same period in fiscal 2008. The decrease in cash usage reflects reduced cash used in operations discussed above as well as fewer capital expenditures during the quarter compared to the same period in fiscal 2008.

The calculation of this measure of cash usage and a reconciliation of this financial measure to the statement of cash flows is as follows:

(Unaudited)	For the three months ended December 31, 2008	2007
Cash used in operating activities	(115,505)	(2,673,059)
Add: purchase of property, plant and equipment ("PP&E")	(37,557)	(153,793)
Cash used in operations and capital requirements	(153,062)	(2,826,852)
Reconciliation to GAAP statements of cash flow:		
Add: short term investments	62,048	2,998,398
Add: restricted cash	-	84,085
Less: cash used in financing activities	(142,172)	(134,408)
Increase (decrease) in cash and cash equivalents	(233,186)	121,223

Liquidity and Capital Resources

Since incorporation, we have financed our operations through cash generated from revenue, the issuance of equity and funding received from government and strategic partners. At December 31, 2008 cash and short-term investments were $9,032,063, compared to $9,327,297 at September 30, 2008. Not included in cash and short term investments at December 31, 2008 and September 30, 2008 was $281,005 of restricted cash to secure letters of credit with customers. At our forecasted cash burn rate, we have sufficient financial resources to fund our operations for more than 24 months.

Our cash resources will be used to promote sales and fulfill orders for our products and meet our working capital requirements. Our working capital requirements are met through our current cash reserves, current accounts receivable and future progress payments not yet invoiced related to orders in backlog. Our standard contract terms for equipment sales require customers to pay progress payments for eighty percent of the total value of the order prior to shipment of the goods; this serves to fund our working capital for inventory purchases, and also reduces our credit risk.

Historically, our accounts receivable collection has been very strong, however, the recent liquidity crisis and economic downturn has created financial difficulties for a small number of our customers in the past several months. As a result, in the fourth quarter of fiscal 2008, we recorded a provision for doubtful accounts for the first time in more than five years which remains unchanged during the first quarter of fiscal 2009. Importantly, the majority of our receivables are with creditworthy, high-quality customers, which mitigates our credit risk. Nevertheless, we will continue to monitor the Company's credit risk closely.

Credit Facilities

During fiscal 2005, we signed a credit facilities agreement with Comerica Bank. This agreement is amended and restated each year as part of the annual renewal of these facilities, most recently in June 2008. The amended credit facilities include a US$1 million accounts receivable line of credit and a US$1 million term loan, in addition to amounts outstanding under the prior term loan agreements. Both facilities are secured by the assets of the Company with certain exceptions. As at December 31, 2008, we had drawn $529,425 against the term loans net of repayments, including $190,924 drawn under the amended term loan. We expect to use the equipment line to fund capital expenditures, and we may use the accounts receivable line to fund working capital requirements from time to time. At December 31, 2008 we were in compliance with all of our bank covenants.

Contractual Obligations

The following table lists our contractual obligations at December 31, 2008. We expect to fund these expenditures out of our cash reserves, current accounts receivables and future progress payments not yet invoiced related to orders in backlog:

(Unaudited)

	Total	In the next year	2-3 years	After 4 years
Bank debt	529,425	356,319	173,106	-
Capital leases	120,722	120,722	-	-
Operating leases	943,420	353,400	590,020	-
Purchase obligations[2]	1,069,943	1,069,943	-	-
Total contractual obligations	2,663,510	1,900,384	763,126	-

If our debt facilities with Comerica Bank were terminated or not renewed, amounts currently classified as long-term would become due and payable within the current year. Termination of our debt facilities without replacing them with a new facility would also result in reduced cash on hand, reduced interest expenses, and decreased borrowing capacity. Termination of our debt facilities is not anticipated.

Termination of our leases may require us to continue to pay the full amounts shown in the above table, unless, in the case of operating leases, we are able to sublet the premises under lease.

Our purchase obligations relate primarily to work in progress, therefore, termination of these obligations may impact our ability to fill customer orders in backlog. In many cases, termination of our purchase obligations would not result in reduced financial obligations, although in certain circumstances reduced payments may be possible.

<u>Contingent Off-Balance Sheet Financing Arrangements</u>

We have received funding contributions from various programs of the Canadian Government to support the development and commercialization of our gas purification technology. A summary of these funding arrangements is provided in our MD&A for fiscal 2008. We did not enter into any new contingent off-balance sheet financing arrangements during the quarter ended December 31, 2008.

[2] Purchase obligation is defined as an agreement to purchase goods or services that is enforceable or legally binding on the Company that specifies all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction.

Outstanding Share Data

Common Shares Outstanding

Our authorized share capital consists of an unlimited number of common shares, of which 11,269,318 common shares were issued and outstanding as of January 31, 2009. We also have an unlimited number of preferred shares authorized, none of which are issued.

On May 13, 2008, we completed an offering of subscription receipts, which were automatically converted into common shares and share purchase warrants following receipt of shareholder approval of the offering on June 16, 2008. On June 27, 2008, we completed a common share consolidation on a 10 for 1 basis, reducing the number of common shares outstanding from 112,683,647 to 11,268,318. All share data in this MD&A and in the associated financial statements for the period ended December 31, 2008 are reported on a consolidated basis and the basic and diluted earnings per share data have been adjusted retroactively for all periods presented to reflect the common share consolidation.

The following table provides the weighted average number of common shares outstanding for the relevant periods:

(Unaudited)	For the three months ended December 31, 2008	2007
Weighted average common shares outstanding	11,268,807	5,256,213

The average number of common shares outstanding increased for the quarter ended December 31, 2008 compared to the prior period from the issuance of 6,000,000 new common shares as a result of the equity offering completed during fiscal 2008.

Stock Options and Warrants Outstanding

As at January 31, 2009 there were 231,804 stock options outstanding with an average exercise price of $5.52, of which 126,962 were exercisable. As at January 31, 2009 there were 6,180,000 warrants outstanding, unchanged from September 30, 2008. The outstanding warrants expire on May 13, 2010. Of the warrants issued and outstanding, 6,000,000 have an exercise price of $2.15 and 180,000 have an exercise price of $1.50.

Related Party Transactions

There were no related party transactions during the quarter ended December 31, 2008.

Outlook

The strong financial results in the first quarter of fiscal 2009 will positively impact our financial results for the full fiscal year.

In December 2008, we forecast that our revenues in fiscal 2009 would be in the range of $10 million to $12 million, and that our cash used in operations and capital expenditures would be in the range of $4 million to $5 million. Assuming that exchange rates remain at current levels for the remainder of fiscal 2009, we expect that our revenue for fiscal 2009 will be at the high end of the $10 million to $12 million range. Similarly, our cash usage was much lower than expected in the first quarter of the fiscal year due to cost containment and strong foreign exchange gains. If current exchange rates continue for the balance of fiscal 2009, we expect that cash used in operations and capital requirements will be in the range of $3 million to $4 million for the full fiscal year.

In spite of the strong financial results for the quarter ended December 31, 2008, as a supplier of capital equipment we are facing a challenging economic environment for our products. The credit crisis has limited access to project financing for prospective customers and caused the delay or cancelation of certain biogas projects. In addition, declining natural gas prices are expected to affect smaller farm-scale biogas projects where the economies of scale are not as strong.

In addition, demand for hydrogen has declined in recent months, as the spreading global recession has impacted hydrogen-consuming industries such as oil refining, glass manufacturing and the steel industry. A number of potential hydrogen generation and hydrogen recovery projects have been delayed or cancelled, particularly in Asia. This has reduced our pipeline of prospective new hydrogen PSA orders over the balance of this fiscal year.

We remain optimistic that government initiatives to increase available credit and to promote investments in renewable energy projects will help increase demand for gas purification equipment. At this time, however, it is difficult to determine how long the current economic conditions will impact our ability to secure new orders in the biogas and industrial hydrogen markets.

Despite current economic conditions, management is confident that QuestAir is well positioned going forward from a cash, product and strategy standpoint. The restructuring of QuestAir's operations that took effect in the second quarter of fiscal 2008, together with the increased emphasis on customer-funded development programs, have significantly lowered our operating expenses. QuestAir's strong cash balance and improved operational results will help us weather the current recession.

In addition, our strategic focus on the biogas market has positioned QuestAir to benefit from significant macro-economic drivers, including increased demand for domestic renewable energy and cleaner transportation fuels. We are expanding our reach into the biogas market by offering integrated biogas upgrading plants, which provide project developers with a turn-key solution to upgrade raw biogas to pipeline or vehicle fuel-grade product. This will also allow us to expand service offerings to include operating and maintenance contracts for such plants.

Critical Accounting Policies and Estimates

The significant accounting policies that we believe to be most critical in fully understanding and evaluating our financial results are revenue recognition, stock-based compensation, inventory valuation and warranty provisions. These accounting principles require us to make certain estimates and assumptions. We believe that the estimates and assumptions upon which we rely are reasonable based upon information available at the time that these estimates and assumptions are made. Actual results may differ from our estimates. Our critical accounting estimates affect our net income or loss calculation and the balance sheet value of our assets and liabilities. Our accounting policies are described in note 2 to the audited financial statements for the financial year ended September 30, 2008 and any new accounting policies adopted during the first quarter of fiscal 2009 are described in note 3 to the unaudited financial statements for the three months ended December 31, 2008.

Revenue Recognition

We earn revenues from the sale of commercial gas purification systems, long-term production type contracts, and from engineering service contracts. Revenue recognized from long-term production type contracts and engineering service contracts are determined under the percentage-of-completion method, whereby revenues are recognized on a pro rata basis in relation to contact costs incurred. There is a risk that estimated costs to complete a contract might change, which may result in an adjustment to revenues previously recorded.

During the quarters ended December 31, 2008 and 2007 there were no material adjustments to long-term production-type contract and engineering service contract revenue relating to revenue recognized in a prior period.

Stock-based compensation
We account for stock options using the fair value method calculated using the Black-Scholes option pricing model. This requires that certain inputs into the model, including the expected life of the options and expected volatility of the stock, be estimated at the time the options are awarded. We amortize the fair value over the vesting period of the options, generally a period of four years. Should these estimates prove to be incorrect, the actual fair value of the options may differ from the estimated fair value of the options, resulting in a different stock compensation expense calculation.

Inventory
In establishing whether or not a provision is required for inventory obsolescence, we estimate the likelihood that inventory carrying values will be affected by changes in market demand for our products and by changes in technology, which could make inventory on hand obsolete. We perform regular reviews to assess the impact of changes in technology, sales trends and other changes on the carrying value of inventory. Where we determine that such changes have occurred and that they will have a negative impact on the carrying value of inventory on hand, adequate provisions are made.

The majority of our inventory is purchased directly to work in process when a customer order is received, and only a small portion is held in raw materials. This reduces the exposure to provisions for obsolescence. For the quarter ended December 31, 2008, raw materials on hand of $878,607 includes $47,980 of spare parts inventory available for sale to customers for use on commercial units in the field.

Warranty Provision
A provision for warranty costs is recorded on gas purification systems at the time of commissioning and customer acceptance. In estimating the accrued warranty liability, past and projected experience and the nature of the contracts are considered. Should these estimates prove to be incorrect, we may incur costs different from those provided for in our warranty provision. In each of the quarters ended December 31, 2008 and 2007, actual warranty costs incurred were less than the provision recorded.

Changes in Accounting Policies Including Initial Adoption

Inventories
The CICA issued Section 3031, Inventories, which supersedes the previously issued standard on inventory and introduces significant changes to the measurement and disclosure of inventory. The measurement changes include: the elimination of LIFO and the reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories. Disclosures of inventories have also been enhanced. Inventory policies, carrying amounts, amounts recognized as an expense, write-downs and the reversals of write-downs are required to be disclosed. This new standard came into effect for fiscal years beginning on or after January 1, 2008; accordingly we adopted this new standard on October 1, 2008, which did not materially affect our financial statements.

Goodwill & Intangible Assets
The CICA has issued new accounting recommendations for goodwill and intangible assets which establish standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets (including internally developed intangible assets). We adopted this new standard on October 1, 2008, which did not materially affect our financial statements.

Financial Statement Preparation
The CICA has revised section 1400, *General Standards of Financial Statement Presentation,* which requires management to make an assessment of, and disclose material uncertainties related to, the ability of an entity to continue as a going concern. This new standard came into effect for fiscal years beginning on or after January 1, 2008; accordingly we adopted this new standard on October 1, 2008, which did not materially affect our financial statements

International Financial Reporting Standards
On February 13, 2008, the Canadian Accounting Standards Board confirmed that International Financial Reporting Standards will replace Canada's current generally accepted accounting principles for publicly accountable profit-oriented enterprises for interim and annual financial statements effective January 1, 2011. The Company is presently considering the effect these standards will have on its financial statements.

Business Combinations
The CICA recently introduced Section 1582, *Business Combinations* to replace CICA Section 1581. The new standard will become effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. The Company is presently considering the effect this new standard will have on its financial statements.

Consolidated Financial Statements and Non-controlling Interests
The CICA recently introduced sections 1601 and 1602, which will replace CICA Section 1600, *Consolidated Financial Statements* and establish a new section for accounting for a non-controlling interest in a subsidiary. These new sections apply to interim and annual consolidated financial statements for years beginning on or after January 1, 2011. The Company is presently considering the effect these new standards will have on its financial statements.

Disclosure Controls and Procedures

The Company maintains a set of disclosure controls and procedures designed to ensure that material information relating to the Company is made known to the Chief Executive Officer and Chief Financial Officer, particularly during the period in which the interim filings are being prepared and that information required to be disclosed is recorded, processed, summarized and reported within the time periods specified under Canadian securities legislation. The Company evaluated its disclosure controls and procedures as defined under National Instrument 52-109 as at the end of the interim period covered by the interim filings. This evaluation was performed by the Chief Executive Officer and the Chief Financial Officer with the assistance of other Company employees to the extent necessary and appropriate. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

Internal Controls and Procedures

The Company maintains a set of internal controls over financial reporting which have been designed using the COCO Framework, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP. The Company evaluated the design of its internal controls and procedures as defined under National Instrument 52-109 as at the end of the interim period covered by the interim filings. This evaluation was performed by the Chief Executive Officer and the Chief Financial Officer with the assistance of other Company employees to the extent necessary and appropriate. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design of these internal controls and procedures was effective. No material weaknesses related to design existed at the end of the interim period, and no limitations on the scope of the design were relied upon.

There were no changes in the Company's internal control over financial reporting that occurred during the period beginning on October 1, 2008 and ended on December 31, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Risks

The Company's ability to generate revenue and profit from operations is subject to a number of risks. The risks and uncertainties described below are not the only ones QuestAir faces. Additional risks and uncertainties, including those that the Company is not aware of now or that management may believe are currently not material, may also adversely affect the ability to generate a viable business. The risk factors presented below are divided into categories of risks impacting QuestAir's internal and external environment. Specific risks within each category are listed in approximate order of seriousness, from most to least serious.

Risk factors related to QuestAir's business

The Company has a limited operating history and it may be difficult to assess its business and future prospects.

The Company commenced operations in 1997 and since that time, the Company has been engaged in the development, manufacture and supply of PSA systems. The Company has made limited sales of PSA systems to date and has incurred substantial losses since its founding. These losses are expected to continue for the foreseeable future. For the year ended September 30, 2008, the Company's sales totalled $11.4 million and its accumulated deficit totalled $115.1 million. The Company's historical operating data may be of limited value in evaluating QuestAir's future prospects. The Company cannot predict when it will operate profitably, if ever.

Potential fluctuations in financial results make financial forecasting difficult.

The Company expects its revenues, expenses, cash flows and other operating results to vary significantly from quarter to quarter. Sales and margins may be lower than anticipated due to general economic conditions and market-related factors, product quality, performance and safety issues and competitive factors. Expenditures and cash receipts may also vary from quarter to quarter due to the timing of such expenditures and cash collections from customers, government entities and other entities providing funding to the Company. As a result, quarter-to-quarter comparisons of revenues, expenses, cash flows and other operating results may not be meaningful. In addition, due to the Company's early stage of development, the Company cannot accurately predict its future revenues, cash flows or results of operations. It is likely that in one or more future quarters, financial results will fall below the expectations of securities analysts and investors. If this occurs, the trading price of the Company's shares may be materially and adversely affected.

The Company depends upon a limited number of customers for potential revenue due to the nature of its markets.

To date, a small number of customers have accounted for a majority of the Company's revenues and the Company expects that they will continue to do so for the foreseeable future. For the year ended September 30, 2008, sales to 2 customers accounted for 63% of the Company's total revenue. For the year ended September 30, 2007, sales to 2 customers accounted for 70% of the Company's total revenue.

The Company sells its products to a limited number of customers, some of which may experience financial difficulty, which may result in bad debts for the Company

The current financial crisis can be expected to affect the ability of some of the Company's customers to pay their invoices in a timely fashion. The Company sells to customers of varying financial strength and in various geographic locations and markets. Some of these customers, particularly smaller companies with limited financial resources, may be unable to pay their invoices when they become due. This risk is amplified by the current liquidity crisis and general decline in global economies, which is calling into question the sustainability of some of the Company's customers. The Company mitigates this risk through its standard contract terms for equipment sales, which require payment of the majority of the contract value prior to shipment. Nevertheless, it is possible that some of the Company's customers will default on certain amounts owing.

The Company's revenue and near term prospects depend to a great extent on its relationships with EMRE.

The Company's business and results of operations would be materially adversely affected if EMRE was to change or terminate its relationship with the Company. There is no guarantee that the interests of the Company will be aligned with the interests of EMRE or that the Company's relationship with EMRE will continue in its current form. Furthermore, any change in EMRE's strategy with respect to PSA technology, whether as a result of market, economic or competitive pressures, could also harm the Company's business. Such a change in strategy could include, for example, any decision by EMRE to:

- alter its commitment to PSA systems in favour of other competing technologies;
- delay its introduction of products incorporating PSA systems; or
- initiate the internal development of PSA systems or to purchase PSA systems from another supplier.

The Company may be unable to raise additional capital to pursue its long term development and commercialization plans and may be forced to discontinue product development, reduce its sales and marketing efforts or forego attractive business opportunities.

The Company does not have a history of profitable operations and has relied on non-operational sources of financing to fund its operations. The Company may need to raise additional funds in order to fund its operations. It may also require additional capital to acquire or invest in complementary businesses or products or obtain the right to use complementary technologies. The Company may be unable to raise additional capital or may not be able to do so on acceptable terms to pursue its long-term development and commercialization plans. Either of these outcomes could adversely affect the ability of the Company to respond to competitive pressures or prevent the Company from conducting all or a portion of its planned operations.

The development and commercialization of its products could be delayed or discontinued if the Company is unable to fund its research and product development activities or the development of its manufacturing capabilities. In addition, it may be forced to reduce its sales and marketing efforts or forego attractive business opportunities. If the Company issues additional equity securities in order to raise funds, the ownership percentage in the Company of each of its existing shareholders who do not participate in the financing will be reduced.

The Company's PSA systems may not meet performance expectations, which could negatively affect its customer relationships and the components of its PSA systems may contain defects or errors that could negatively affect its customer relationships and increase its manufacturing and warranty costs.

The performance of the Company's PSA system may encounter problems due to the failure of its technology, the failure of the technology of others, the failure to combine these technologies properly, operator error and the failure to maintain and service the systems properly. Many of these potential problems and delays are beyond the Company's control. In addition, poor performance may involve delays in product roll-out and modifications to product design, as well as third party involvement. Any problem or perceived problem with the Company's PSA systems, whether originating from its technology, design, or from third parties, could hurt its reputation and the reputation of its products and limit its sales. Such failures may negatively affect the Company's relationships with customers and may require the Company to extend development longer than anticipated before undertaking commercial sales. In addition, the Company may be required to offer customers services, products or compensation if the failure of a product to perform results in a claim under the warranties offered by the Company.

The Company's strategy for the sale of its products depends upon developing key relationships with a number of customers who will incorporate its products into theirs.

Other than with respect to a limited number of specific markets, the success of the Company's business depends on its ability to develop relationships with parties who will integrate the Company's products into their products. The ability of the Company to sell its products to its target markets depends to a significant extent upon its partners' worldwide sales and distribution network and service capabilities, and there can be no assurance that any future relationships that the Company enters into will not require the Company to share some of its intellectual property. The Company is mitigating this risk in part by developing its own integrated biogas upgrading plants, which will reduce its dependence upon other integrators and project developers.

The Company will need to recruit, train and retain key management and other qualified personnel to successfully expand its business.

The Company's future success will depend in large part upon its ability to recruit and retain experienced research and development, engineering, manufacturing, operating, sales and marketing, customer service and management personnel. If the Company does not attract and retain such personnel, the Company may not be able to expand its business. Competition for qualified personnel in its industry is intense. Even if the Company invests significant resources to recruit, train and retain qualified personnel, the Company may not be successful in its efforts. The Company's success also depends upon the continuing contribution of its key management, research, product development, engineering, marketing and manufacturing personnel, many of whom would be difficult to replace.

The Company currently faces and will continue to face significant competition from other developers and manufacturers of PSA systems and face competition for its PSA systems from developers and manufacturers of other gas purification systems.

The Company competes with a number of companies that manufacture conventional gas purification equipment and other competing technologies, such as membrane systems. In addition, new developments in technology may adversely affect the development or sale of some or all of the Company's products or make its products uncompetitive or obsolete. Other companies, many of which have substantially greater resources than the Company does, are currently engaged in the development of products and technologies that are similar to, and competitive with, many of its products and technologies. The Company's competition includes numerous companies located throughout the world, some of which may have advantages over the Company in terms of government incentives, labour, component costs and technology. Each of these competitors has the potential to capture market share in the Company's target markets, which would harm its position in the industry. New competitors may also emerge and entire product lines may be threatened by new technologies or market trends which reduce the commercial viability of the Company's product lines. In addition, the Company's customers could potentially become its competitors if they decide to develop and manufacture their own PSA systems.

As the markets for gas purification systems develop, other large industrial companies may enter these fields and compete with the Company. These large industrial companies may have research and development, manufacturing, marketing and sales resources necessary to deliver PSA systems more quickly and effectively than the Company does. In addition, the Company believes that price will become a more important competitive factor as competition increases. The Company may not be able to compete effectively with all of these competitors, which would adversely affect its business, financial condition and results of operations.

Rapid technological advances could impair the Company's ability to deliver its products in a timely manner, and as a result, its revenues would suffer.
The Company's success depends in large part on its ability to keep its products current and compatible with evolving technologies and codes and standards. Unexpected changes in technology could disrupt the development of its products and prevent the Company from meeting deadlines for the delivery of products. If it is unable to keep pace with technological advancements and adapt its products in a timely manner, its products may become uncompetitive or obsolete and its revenues would be adversely affected.

The Company is in the development stage of its second generation PSA systems.
The Company is in the development stage of its second generation PSA systems and is subject to all the risks and uncertainties inherent in such development. These risks include the successful execution of the Company's product development and commercialization plan, the ability to successfully integrate the modules and components of these systems, and the ability to meet the cost, reliability and performance standards of a viable commercial product.

The Company depends on its intellectual property and failure to protect that intellectual property could adversely affect the future growth and success of the Company.
Failure to protect its existing intellectual property rights may reduce the Company's ability to prevent others from using its technology. The Company relies on a combination of patent, trade secret, trademark and copyright laws to protect its intellectual property. Some of its intellectual property is currently not covered by any patent or patent application. The Company does not have, and is unlikely to obtain, complete patent protection for its primary products. The Company's patent protection is subject to complex factual and legal issues that may give rise to uncertainty as to the validity, scope and enforceability of a particular patent. Accordingly, the Company cannot be assured that:

- any of the U.S., Canadian or other patents owned by the Company will not be invalidated, circumvented, challenged, rendered unenforceable, or licensed to others; or
- any of its pending or future patent applications will be issued with the breadth of protection sought by the Company, if issued at all.

In addition, effective patent, trademark, copyright and trade secret protection may be unavailable, limited, not applied for or unenforceable in foreign countries. Litigation may be necessary to enforce its patents and other intellectual property rights. Any such litigation may result in substantial costs and diversion of resources with no assurance of success. Furthermore, although the Company typically retains sole ownership of the intellectual property that the Company develops, its relationships with EMRE and others provide for shared intellectual property rights in certain situations.

The Company also seeks to protect its proprietary intellectual property through contracts, including, when possible, confidentiality agreements and inventors' rights agreements with its customers and employees. The Company cannot be assured that the parties that enter into such agreements with the Company will not breach them, that the Company will have adequate remedies for any breach or that such persons or institutions will not assert rights to intellectual property arising out of these relationships. If necessary, the Company may seek licenses under the patents or other intellectual property rights of others. However, the Company can give no assurances that the Company will obtain such licenses or that the terms of any offered licenses will be acceptable to it. The failure to obtain a license from a third party for intellectual property that the Company uses in the future could cause it to: incur substantial liabilities; suspend the development, manufacturing and the shipment of products; or suspend its use of processes which exploit such intellectual property.

The Company may become subject to lawsuits in which it is alleged that the Company has infringed the intellectual property rights of others or commence lawsuits against others who the Company believes are infringing upon its rights. Its involvement in intellectual property litigation could result in significant expense to the Company, adversely affecting the development of sales of the challenged product or intellectual property and diverting the efforts of its technical and management personnel, whether or not such litigation is resolved in its favor. In the event of an adverse outcome as a defendant in any such litigation, the Company may, among other things, be required to:

- pay substantial damages;
- cease the development, manufacture, use, sale or importation of products that infringe upon other patented intellectual property;
- expend significant resources to develop or acquire non-infringing technology; or
- obtain licenses to the infringing intellectual property.

The complexity of the technology involved and the uncertainty of intellectual property litigation increase these risks. The Company may not be able to develop non-infringing technology or obtain royalty or license agreements on terms acceptable to the Company, or at all. The Company may also be subject to significant damages or injunctions against development and sale of certain of its products.

The Company has foreign currency risk.
The majority of the Company's revenues are in US dollars and Euros while most of the operating expenses are in Canadian dollars. Foreign exchange gains and losses are included in results from operations. A large decline in the US dollar or the Euro relative to the Canadian dollar could impair revenues, margins and other financial results. The Company has not entered into foreign exchange contracts to hedge against gains and losses from foreign currency fluctuations.

The Company is dependent upon third party suppliers for materials and components for its products.
The Company relies upon third party suppliers to provide materials and components for its products. A supplier's failure to provide materials or components in a timely manner, or to provide materials and components that meet the Company's quality, quantity or cost requirements, or its inability to obtain substitute materials and components in a timely manner or on terms acceptable to the Company, may harm the Company's ability to manufacture its products. To the extent that the Company is unable to develop and patent its own technology and manufacturing processes, and to the extent that the processes, which its suppliers use to manufacture materials and components, are proprietary, the Company may be unable to obtain comparable materials or components from alternative suppliers, and that could adversely affect its ability to produce commercially viable products.

The Company anticipates undergoing a period of continuing growth in its business, the scope of its operations and the number of its employees and its failure to manage this growth could cause its results to fluctuate and harm its business.
The Company anticipates undergoing a period of growth in the scope of its operations and in the number of its employees. The Company may be unable to manage its growth effectively, and its failure to do so could have a material adverse effect on its operating results and cause its results

to fluctuate. As part of its growth strategy the Company intends to introduce new products, increase its outsourcing capacity and develop additional customer and distributor relationships. Its expense levels are based, in part, on expected future revenues and the Company is limited in its ability to reduce expenses quickly if for any reason its purchase orders do not meet its expectations in a particular quarter or period. Furthermore, expansion will likely place a strain on its senior management team, key and technical personnel, its business operations and other resources. The Company's ability to manage growth will depend in part on its ability to continue to enhance its manufacturing and management information systems. It may be difficult to increase manufacturing or outsourcing capacity in a timely fashion if customer demands increase in ways that the Company did not anticipate. Any inability to manage growth could result in shipment delays and cancellation of customer orders.

Risk factors related to the Company's target markets

The Company's markets are exposed to recessionary risk

The current financial crisis and global recession may result in lost or delayed sales orders, as many of the Company's existing and targeted customers may cut back their proposed capital spending in the face of economic uncertainty and limited access to project financing. This would impact the ability of the Company to grow its business, and as a result sales orders may be lower than expected. Any decrease in sales would negatively impact the Company's cash burn and other financial results. Different gas purification markets and different geographies may be impacted to different extents, making it difficult to forecast the likely impact.

Volatility of Oil and Natural Gas Prices

The Company's PSA systems represent a significant potential capital cost to the Company's existing and target customers and their ability to purchase the Company's products is dependent upon factors which affect energy industries

The Company's existing and target customers' results of operations and financial condition are dependent on the prices they receive for oil, natural gas and renewable natural gas. Oil and natural gas prices have fluctuated widely during recent years and are determined by local and worldwide supply and demand factors, including actions by the Organization of Petroleum Exporting Countries, weather conditions, the U.S. dollar exchange rate, transportation, competition, and general economic conditions as well as conditions in other oil producing regions, which are beyond the Company's control. Any material decline in oil or natural gas prices could have a material adverse effect on the Company's existing and target customers' operations, financial condition, and the amount they spend on new capital equipment and the development of new technology, which could have a material adverse effect on the Company's existing and target customers' ability to purchase the Company's products. If the shift to heavier crude oils were reversed due to the uneconomic nature of their extraction, such as oil sands extraction, the target markets for the Company's PSA systems could be adversely affected.

In addition, the Company's prospects would be adversely affected should the price of natural gas fall to levels where production of renewable natural gas from raw biogas becomes uneconomic.

Changes in government policies and regulations could hurt the market for the Company's products.

The biogas upgrading industry is subject to different government incentives and regulations in various jurisdictions around the world. Any significant change in these incentives or regulations, including a decision to reverse subsidy programs for renewable natural gas production or a decision to subsidize electricity generation rather than renewable natural gas, would adversely impact the Company's ability to sell its PSAs and integrated biogas upgrading plants in those jurisdictions. Furthermore, the inability of its potential customers to obtain a permit, or the inconvenience often associated with the permit process, could harm demand for biogas upgrading plants and, therefore, harm the Company's business.

The expected demand for biogas upgrading plants is driven in part by local pollution regulations and regulatory pressures to reduce greenhouse gas emissions. The Company's business may suffer if these environmental policies and regulations change and no longer encourage the development and growth of clean power technologies. There can be no guarantee that these laws and regulations will not change. Changes in these laws and regulations could result in reduced demand for biogas upgrading systems. In addition, if current laws and regulations are not kept in force or if further environmental laws and regulations are not adopted in certain jurisdictions, demand for biogas upgrading equipment may be limited.

The demand for QuestAir's refinery related products is driven in part by regulations mandating the reduction of sulphur levels in transportation fuels such as gasoline and diesel. The Company's business may suffer if these environmental policies and regulations change and no longer encourage the production of 'clean' transportation fuels. There can be no guarantee that these laws and regulations will not change.

The Company's products use flammable fuels that are inherently dangerous substances and could subject the Company to product liabilities.

The Company's results of operations could be materially harmed by accidents involving either its products or those of other manufacturers, either because the Company faces claims for damages or because demand for its products could suffer and its sales could decline. The Company's products purify hydrogen and methane containing gases. While its PSA systems do not use these fuels in a combustion process, natural gas used to generate hydrogen, biogas and biomethane are flammable fuels that could leak and then combust if ignited by another source. In addition, certain of the Company's customers may experience significant product liability claims. As a supplier of products and systems, the Company faces an inherent business risk of exposure to product liability claims in the event that its products, or the equipment into which its products are incorporated, malfunction and result in personal injury, death or property damage. The Company may be named in product liability claims even if there is no evidence that its systems or components caused the accidents. Product liability claims could result in significant losses as a result of expenses incurred in defending claims or the award of damages. Since the Company's products have not yet gained widespread market acceptance, any accidents involving its systems, or those used to produce purified biomethane or hydrogen could materially impede acceptance of its products.

Environmental Risks

All phases of the oil and natural gas business, and of the processing of organic wastes, are subject to environmental regulation pursuant to a variety of Canadian federal, provincial, state and municipal laws and regulations, as well as international conventions (collectively, "Environmental Legislation").

Environmental Legislation imposes, among other things, restrictions, liabilities and obligations in connection with the generation, handling, storage, transportation, treatment and disposal of hazardous substances and waste and in connection with spills, releases and emissions of various substances to the environment. Environmental Legislation also requires that wells, facility sites and other properties associated with oil and natural gas operations be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. In addition, certain types of operations, including exploration and development projects and significant changes to certain existing projects, may require the submission and approval of environmental impact assessments. Compliance with Environmental Legislation can require significant expenditures and failure to comply with Environmental Legislation may result in the imposition of fines, penalties and liability for clean up costs and damages. Changes in Environmental

Legislation may require, among other things, reductions in emissions to the air from the Company's existing and target customers' operations and result in increased capital expenditures. Future changes in Environmental Legislation could occur and result in stricter standards and enforcement, larger fines and liability, and increased capital expenditures and operating costs, which could have a material adverse effect on the Company's existing and target customers' ability to purchase the Company's products.

(expressed in Canadian dollars)

Balance Sheets	As at December 31 2008 $	As at September 30 2008 $
Assets		
Current assets		
Cash and cash equivalents	9,032,063	9,265,249
Restricted cash (note 4)	281,005	281,005
Short-term investments	-	62,048
Accounts receivable- net of allowance for doubtful accounts of $92,689 (2008 - $92,689)	989,212	974,404
Inventories (note 5)	3,755,510	5,214,342
Prepaid expenses	309,480	199,269
	14,367,270	15,996,317
Long-term assets		
Property, plant and equipment	1,212,010	1,329,986
Other long-term assets	178,930	178,930
	15,758,210	17,505,233
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	2,040,252	2,896,719
Deferred revenue	3,249,034	4,735,258
Current portion of bank debt (note 7)	356,319	443,345
Obligation under capital lease	120,722	105,479
	5,766,327	8,180,801
Long -term liabilities		
Bank debt (note 7)	173,106	228,262
	5,939,433	8,409,063
Shareholders' Equity		
Share capital (note 8)		
Authorized		
Unlimited common shares, voting, no par value		
Unlimited preferred shares, issuable in series, no par value		
Common shares	115,373,625	115,363,615
Contributed surplus (note 8)	8,882,871	8,863,225
Deficit	(114,437,719)	(115,130,670)
	9,818,777	9,096,170
	15,758,210	17,505,233

(expressed in Canadian dollars)

Statement of Operations, Comprehensive Income (Loss) and Deficit

	For the three months ended December 31 2008 $	2007 $
Revenues	3,511,719	1,567,925
Cost of goods sold	1,704,689	1,319,736
Gross profit	1,807,030	248,189
Operating expenses		
Research and development	417,983	955,864
General and administration	680,270	885,568
Operations	276,010	437,618
Sales and marketing	295,598	401,576
Amortization	155,532	174,021
	1,825,393	2,854,647
Loss before undernoted	(18,363)	(2,606,458)
Other income (expense)		
Foreign exchange gain	708,657	111,979
Interest income	36,533	69,290
Other income (expense)	(33,876)	34,713
	711,314	215,982
Income (loss) and comprehensive income (loss) for the period	692,951	(2,390,476)
Deficit – Beginning of period	(115,130,670)	(107,487,737)
Deficit – End of period	(114,437,719)	(109,878,213)
Basic and diluted earnings (loss) per share (note 11)	0.06	(0.45)
Weighted average number of common shares outstanding	11,268,807	5,256,213

(expressed in Canadian dollars)

Statements of Cash Flows

	For the three months ended December 31 2008 $	2007 $
Cash flows from operating activities		
Income (loss) for the period	692,951	(2,390,476)
Items not involving cash		
Amortization	155,532	174,021
Unrealized foreign exchange gain on derivatives	(384)	(73,941)
Non-cash compensation expense	29,646	104,947
Foreign currency loss (gain)	15,244	(689)
	892,989	(2,186,138)
Changes in non-cash operating working capital		
Accounts, grants and funding receivables	(14,808)	(1,446,495)
Inventories	1,458,832	(1,268,105)
Prepaid expenses	(110,211)	151,809
Accounts payable and accrued liabilities	(856,083)	420,838
Deferred revenue	(1,486,224)	1,655,032
	(1,008,494)	(486,921)
	(115,505)	(2,673,059)
Cash flows from investing activities		
Decrease in short-term investments	62,048	3,060,447
Increase in short-term investments	-	(62,048)
Purchase of property, plant and equipment	(37,557)	(153,793)
Decrease in restricted cash	-	84,085
	24,491	2,928,691
Cash flows from financing activities		
Issuance of common shares on exercise of stock options	10	143
Term loan advance	-	7,250
Repayment of bank debt	(142,182)	(141,802)
	(142,172)	(134,409)
(Decrease) Increase in cash and cash equivalents	(233,186)	121,223
Cash and cash equivalents – Beginning of period	9,265,249	5,726,245
Cash and cash equivalents – End of period	9,032,063	5,847,468

Supplemental cash flow information (note 12)

1 Description of business

QuestAir Technologies Inc. (the "Company"), a federally incorporated Canadian company, is an emerging developer, manufacturer and supplier of advanced pressure swing adsorption ("PSA") gas purification systems. PSA systems are used extensively in the production of purified gases for a wide variety of industries. The Company's products, which incorporate patented, proprietary technology, primarily target methane and hydrogen purification in a range of existing energy and industrial markets, including biogas and oil refinery processing applications. The Company's ultimate success and the recoverability of long-lived assets will depend on its ability to successfully execute its business plan.

2 Unaudited interim financial statements

The unaudited balance sheet as at December 31, 2008 and the unaudited interim statements of operations, comprehensive income (loss) and deficit and cash flows for the three months ended December 31, 2008 and 2007, have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"), on the same basis as the audited financial statements of the Company for the year ended September 30, 2008 except as described in note 3. These interim financial statements include all adjustments, which, in the opinion of management, are necessary for the fair presentation of the results of operations for the interim periods presented. Results for the three months ended December 31, 2008 are not necessarily indicative of the results to be expected for the full year. These unaudited interim financial statements do not include all the disclosures required for annual financial statements, and should be read in conjunction with the Company's annual audited financial statements for the year ended September 30, 2008, and the summary of significant accounting policies included therein.

3 Significant accounting policies

These unaudited interim financial statements follow the same accounting policies and methods of their application as the Company's annual audited financial statements for the year ended September 30, 2008 with the exception of Inventories, Goodwill and Intangible Assets, and General Standards of Financial Statement Presentation.

The CICA issued Section 3031, Inventories, which supersedes the previously issued standard on inventory and introduces significant changes to the measurement and disclosure of inventory. The measurement changes include: the elimination of LIFO, and the reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories. Disclosures of inventories have also been enhanced. Inventory policies, carrying amounts, amounts recognized as an expense, write-downs and the reversals of write-downs are required to be disclosed. This new standard came into effect for fiscal years beginning on or after January 1, 2008; accordingly the Company adopted this new standard in fiscal 2009 which has not materially affected the Company's financial statements.

Inventories are stated at the lower of cost and net realizable value. Costs of raw material are determined on an average cost basis. The cost of finished goods and work in progress comprise design costs, raw material, direct labour, other direct costs and related production overheads. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Inventories are recorded net of any obsolescence provision. Further disclosures required under this section are included in note 5.

(expressed in Canadian dollars)

The CICA issued Section 3064, Goodwill and Intangible Assets, which establish standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets (including internally developed intangible assets). These recommendations are effective for the Company beginning October 1, 2008; accordingly the Company adopted this new standard in fiscal 2009. As the Company has no goodwill or intangible assets, adoption of this standard has not materially affected the Company's financial statements.

The CICA revised section 1400, General Standards of Financial Statement Presentation, which requires management to make an assessment of, and disclose material uncertainties related to, the ability of an entity to continue as a going concern. This new standard came into effect for fiscal years beginning on or after January 1, 2008; accordingly QuestAir adopted this new standard in fiscal 2009 which has not materially affected the Company's financial statements.

4 Restricted cash

During 2008, the Company was required to deposit cash with Comerica Bank as collateral in order to secure its obligations under irrevocable standby and documentary letters of credit. Restricted cash is released as the letters of credit are drawn upon or expire. Expiry dates of the letters of credit vary and extend to July 20, 2009. Restricted cash at December 31, 2008 was $281,005 (September 30, 2008 - $281,005).

5 Inventories

	December 31 2008 $	September 30 2008 $
Raw materials and supplies	878,607	823,006
Work-in-progress	457,868	1,577,912
Finished goods	2,419,035	2,813,424
	3,755,510	5,214,342

(expressed in Canadian dollars)

The cost of inventories recognized as expense and included in “cost of goods sold” for the three months ended December 31, 2008 amounted to $2,077,888 (December 31, 2007 - $1,305,038). Non-inventory items recorded in cost of goods sold include items such as warranty expense or recovery and losses recorded on contracts. During the three months ended December 31, 2008 total cost of goods sold was less than expensed inventory due to the expiration of a warranty obligation and corresponding reduction of the warranty provision.

6 Derivatives

Included in income for the three months ended December 31, 2008 is an unrealized foreign exchange gain on embedded derivatives of $384 (December 31, 2007- $73,941). This gain was determined based on future billing under sales contracts, exchange rates prevailing at the time such contracts were entered into, and exchange rates prevailing at December 31, 2008.

7 Bank debt

In April 2005, the Company signed a credit facilities agreement with Comerica Bank. This agreement was amended and restated in June 2008 as part of the annual renewal of these facilities (Tranche 4). The amended credit facilities include a US$1 million accounts receivable line of credit and a US$1 million term loan to finance equipment purchases, in addition to amounts outstanding under prior term loan agreements. Both facilities are secured by the assets of the Company, with certain exceptions. Under the terms of the agreement, the Company must comply with financial covenants and certain other business terms.

The variable interest rate of the Tranche 4 term loan is 1.75% above the Prime Rate compared to 0.75% above the Prime Rate on the prior term loans. As at December 31, 2008, the Company had drawn $529,425 (September 30, 2008 - $671,607) on the term loans net of repayments.

	December 31 2008 $	September 30 2008 $
Current portion of bank debt	356,319	443,345
Long-term portion of bank debt	173,106	228,262
	529,425	671,607

Accrued interest payable as at December 31, 2008 was $1,392 (September 30, 2008 - $1,939) and is included in accounts payable and accrued liabilities. Total interest expense was $7,684 (December 31, 2007 - $22,248) for the three months ended December 31, 2008. Draws can be made against the Tranche 4 term loan, to a maximum of US$1 million, prior to June 19, 2009. As at December 31, 2008, $190,924 had been drawn against the Tranche 4 term loan.

(expressed in Canadian dollars)

8 Shareholders' equity

Changes to shareholders' equity for the three months ended December 31, 2008 and 2007 are presented below:

	Common shares $	Contributed surplus $	Accumulated other comprehensive income(loss) $	Deficit $	Total shareholders' equity $
Balance at September 30, 2008	115,363,615	8,863,225	-	(115,130,670)	9,096,170
Income and comprehensive income	-	-	-	692,951	692,951
Exercise of share options	10	-	-	-	10
Stock-based compensation allocated to common shares on exercise of share options	10,000	(10,000)	-	-	-
Stock-based compensation on fair value share options	-	29,646	-	-	29,646
Balance at December 31, 2008	115,373,625	8,882,871	-	(114,437,719)	9,818,777

	Common shares $	Contributed surplus $	Accumulated other comprehensive income(loss) $	Deficit $	Total shareholders' equity $
Balance at September 30, 2007	109,383,859	6,626,825	-	(107,487,737)	8,522,947
Income and comprehensive income	-	-	-	(2,390,476)	(2,390,476)
Exercise of share options	143	-	-	-	143
Stock-based compensation allocated to common shares on exercise of share options	318,556	(318,556)	-	-	-
Stock-based compensation on fair value share options	-	104,947	-	-	104,947
Balance at December 31, 2007	109,702,558	6,413,216	-	(109,878,213)	6,237,561

a) Common shares – issued and outstanding

Authorized share capital consists of an unlimited number of common shares, of which 11,269,318 (September 30, 2008 – 11,268,318) common shares were issued and outstanding as of December 31, 2008. During the three months ended December 31, 2008 1,000 (December 31, 2007 - 14,316) common shares were issued on exercise of share options. An unlimited number of preferred shares are authorized, none of which are issued.

b) Share purchase warrants - issued and outstanding

6,180,000 warrants issued in the prior fiscal year remain outstanding at December 31, 2008. 6,000,000 were issued on exchange of subscription receipts, with each warrant entitling the holder to acquire one additional common share at a price of $2.15 per share until May 13, 2010. The remaining 180,000 warrants were issued to Underwriters and entitle the holder to acquire one common share at a price of $1.50 per share until May 13, 2010.

c) Contributed surplus

During the three months ended December 31, 2008 $29,646 (December 31, 2007 - $104,947) stock-based compensation on share options issued to employees under the fair value method was recorded in contributed surplus and $10,000 (December 31, 2007 - $318,556) was allocated from contributed surplus to common shares on exercise of share options.

d) Comprehensive income (loss)

Comprehensive income (loss) is the increase or decrease in equity from sources other than owners and is comprised of net income (loss) and other revenues, expenses, gains, and losses that, pursuant to Canadian GAAP, are excluded from net income or loss. The Company had no other comprehensive gains or losses during the three months ended December 31, 2008, therefore the comprehensive income equals net income of $692,951 (December 31, 2007 - $2,390,476 loss) .

9 Share Options

The Company has issued stock options under two different stock-based incentive plans. The 2004 Stock Option Plan (“2004 Plan”) only allowed for the issuance of stock options. On February 6, 2007, Shareholders approved the adoption of the 2006 Omnibus Plan (“2006 Plan”), which allows for the issuance of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards and other stock-based awards. Under the 2006 Plan, common shares approved for issuance under all stock-based compensation arrangements are limited to the greater of 591,560 and 10% of the common shares issued and outstanding. At December 31, 2008, the maximum number of common shares available for issuance under all stock-based compensation arrangements is 1,126,931.

(expressed in Canadian dollars)

Under the terms of the 2006 Plan, stock options are granted with an exercise price not less than the volume weighted average trading price of the common shares for the five trading days prior to the date of grant. Stock options generally vest quarterly over four years and are exercisable for seven years from the date of grant. No form of stock-based awards were issued under the 2006 Plan during the three months ended December 31, 2008 (December 31, 2007 – 12,500).

Share option activity for the three months ended December 31, 2008 and 2007 is presented below:

Three months ended December 31, 2008	Number of Options	Weighted average exercise price	Expiry Dates
Outstanding – September 30, 2008 (222,531 share options exercisable)	360,934	$8.13	
Granted	-	-	
Exercised	(1,000)	0.01	
Expired	(124,349)	13.05	
Outstanding – December 31, 2008 (130,743 share options exercisable)	235,585	$5.56	Jan. 3, 2009, to Sep. 26, 2016

Three months ended December 31, 2007	Number of Options	Weighted average exercise price	Expiry Dates
Outstanding – September 30, 2007 (381,584 share options exercisable)	476,792	$13.21	
Granted	1,250	4.60	
Exercised	(14,316)	0.01	
Expired	(191,962)	13.58	
Outstanding – December 31, 2007 (191,570 share options exercisable)	271,764	$13.60	Feb. 28, 2008 to Sep. 26, 2016

10 Segmented information

During the three months ended December 31, 2008, the Company changed the composition of its reporting segments from one segment to three: gas purification, engineering and corporate. The gas purification segment produces gas purification equipment for sale to a range of existing energy and industrial markets, including biogas and oil refinery processing applications. The engineering segment produces engineering services for external customers and includes internal product development and intellectual property expenses for the Company. The corporate segment includes all corporate growth activities and administrative, financial and other support to all business units. Corporate profit (loss) includes general and administrative costs, amortization and other income.

(expressed in Canadian dollars)

The Company's reportable segments are strategic business units that offer different products and services. The operating results and achievement of internal segment milestones are regularly reviewed by senior management to assess performance of each business unit.

The accounting policies of the segment are the same as those described in the summary of significant accounting policies in note 3.

The operating results for each reportable segment and reconciliation to the Company's totals are as follows:

	Three months ended December 31, 2008			
	Gas Purification $	**Engineering $**	**Corporate $**	**Company Total $**
Revenues from external customers	2,045,168	1,466,551	-	3,511,719
Interest income	-	-	36,533	36,533
Amortization	-	-	155,532	155,532
Segment profit (loss)	255,258	562,181	(124,488)	692,951

	Three months ended December 31, 2007			
	Gas Purification $	**Engineering $**	**Corporate $**	**Company Total $**
Revenues from external customers	1,362,811	205,114	-	1,567,925
Interest income	-	-	69,290	69,290
Amortization	-	-	174,021	174,021
Segment profit (loss)	(675,167)	(871,702)	(843,607)	(2,390,476)

All property, plant and equipment is recorded in the corporate segment.

Summarized product sales and service revenue by geographic area, as determined by the location of the customer, is as follows:

	Three months ended	
	December 31 2008 $	**December 31 2007 $**
Revenue		
United States	2,716,868	445,821
Europe	596,780	454,563
South America	-	610,941
Asia	198,071	56,600
	3,511,719	1,567,925

All of the Company's property, plant and equipment are located in Canada.

(expressed in Canadian dollars)

Major customers, representing 10% or more of total sales, include:

	Three months ended	
	December 31 2008 $	**December 31 2007 $**
Customer A	1,466,551	444,430
Customer B	1,049,355	-
Customer C	387,318	160,027
Customer D	-	610,941
Customer E	-	199,461

11 Earnings (Loss) per share

Basic and diluted earnings (Loss) per share is calculated using the weighted average number of common shares outstanding for the three months ended December 31, 2008 of 11,268,807 (December 31, 2007 – 5,256,213). Outstanding share options and warrants to purchase common shares were not included in the computation of diluted earnings per share as the average market price of the common shares during the three months ended December 31, 2008 did not exceed the exercise price of the outstanding share options or warrants. Outstanding share options and warrants to purchase common shares were not included in the computation of diluted loss per share in the comparative three months ended December 31, 2007 as their impact are anti-dilutive.

12 Supplemental cash flow information

	Three months ended	
	December 31 2008 $	**December 31 2007 $**
Supplemental cash flow information		
Cash paid for interest	8,908	25,494
Cash received for interest	46,560	101,083
Non-cash operating, investing and financing activities		
Issuance of common shares on exercise of stock options	10,000	318,556