QuestAir Technologies Inc.

First Quarter Report
Fiscal 2008

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 12, 2008, relates to our interim financial statements for the first quarter of fiscal 2008, being the three month period ended December 31, 2007. 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 ("GAAP"). All financial information is stated in Canadian dollars, unless otherwise stated. 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, 2007 ("fiscal 2007"), 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) the expected demonstration timeline for the prototype H-6200 hydrogen purifier; (ii) management's belief that data from the prototype test will enhance marketing efforts with respect to the H-6200; (iii) the expected timeline for receipt of the first commercial order of an H-6200; (iv) management's expectation that efforts to lower costs, including through the procurement of more US sourced components, will result in improved margins in the coming months; (v) the European biogas market, which has been identified as a significant potential growth market for the Company; (vi) management's belief that the M-3200s recently commissioned in Europe will provide valuable reference sites for prospective customers; (vii) the expected continued growth in the sale of QuestAir's gas purifiers in the industrial hydrogen and biogas markets; and (viii) QuestAir's intended efforts to mitigate the risk of reduction in demand for refined petroleum products. 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 forward-looking statements. These risks include risks related to revenue growth, operating results, industry and products, technology, competition and other factors described herein.

Although the forward-looking statements contained herein are based upon what management believes to be current and reasonable assumptions, the Company cannot assure readers that actual results will be consistent with these forward-looking statements. The forward-looking statements contained herein are made as of the date of this MD&A and are expressly qualified in their entirety by this cautionary statement. 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 set forth in the forward-looking statements.

Business Overview

A detailed overview of QuestAir's business, including a summary of our core business, vision and strategy; key market drivers; key performance indicators; and resources and capabilities, is provided in our MD&A and AIF for the financial year ended September 30, 2007.

QuestAir
Pure Innovations™

Significant Developments

QuestAir made the following progress in our commercial and development activities during the first quarter of fiscal 2008:

- The prototype H-6200 hydrogen purifier ("prototype plant") was successfully started up at the ExxonMobil refinery in France. Testing of the prototype plant has been proceeding well, and results to date have been consistent with expected performance.
- We received two new orders from Verdesis Suisse ("Verdesis") for methane purification systems to be installed in Europe. These are the third and fourth systems purchased by Verdesis in the past 12 months. Both systems will purify methane generated from anaerobic digestion of organic waste. One installation will be used by a consortium of Swiss farmers, while the other will be fed with waste from an industrial application. Verdesis will be providing turn-key plants to both customers, which incorporate QuestAir's M-3200 pressure swing adsorption ("PSA") units.
- In November 2007, we successfully commissioned two M-3200 PSAs that were purchased by Verdesis as part of a biomethane processing plant. The gas generated from this plant has met the specifications for injection into the local natural gas grid, which validates the ability of our PSAs to meet the needs of the European biogas market.
- Also during the quarter, we successfully commissioned an M-3200 PSA which is supplying compressed biomethane to the City of Salzburg bus fleet. Salzburg AG has committed to converting 10% of their bus fleet per year over to CNG powered engines.

Financial Overview

The financial highlights for the first quarter of fiscal 2008 are noted below:

- Revenue was $1,567,925 for the quarter, decreased by $75,551, or 5% compared to the same period in fiscal 2007.
- Sales order backlog at December 31, 2007 was $10,140,566, decreased by $913,199, or 8%, from September 30, 2007.
- Cash used by operations and capital requirements was $2,826,852 for the quarter, decreased by $1,277,701, or 31% compared to the same period in fiscal 2007.
- Net loss was $2,390,476 ($0.05 per share) for the quarter, increased by $165,811 or 7% compared to the same period in fiscal 2007.

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, 2007	2006
Gas purification systems	1,362,811	1,422,845
Engineering service contracts	205,114	220,631
Total revenue	1,567,925	1,643,476

Total recognized revenue for the first quarter of fiscal 2008 was $1,567,925 compared to $1,643,476 for the same period in fiscal 2007. Revenue from gas purification systems decreased 4% while revenue from engineering service contracts decreased 7% compared to the prior period.

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

QuestAir's 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, 2007.

(Unaudited)	For the quarter ended December 31, 2007		
	Gas Purification Systems	Engineering Service Contracts	Total
Opening Balance	8,954,635	2,099,130	11,053,765
Bookings	510,309	107,200	617,509
Revenue Recognized	(1,362,811)	(205,114)	(1,567,925)
Adjustments[1]	41,726	(4,509)	37,217
Ending Balance	8,143,859	1,996,707	10,140,566

The total sales order backlog decreased by $913,199, or 8%, during the first quarter of fiscal 2008, as the dollar value of revenue recognized in the quarter exceeded new bookings in the quarter. We expect that most of this sales order backlog as of December 31, 2007 will be recognized as revenue by December 31, 2008.

Gross Profit

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

(Unaudited)	Three months ended December 31,	
	2007	2006
Sales	1,567,925	1,643,476
Cost of goods sold	1,319,736	1,360,069
Gross Profit	248,189	283,407
Gross Margin (%)	15.8%	17.2%

The decrease in gross margin for the first quarter of fiscal 2008 compared to the same period in fiscal 2007 resulted from slightly lower margins being realized on commercial equipment sales. The Company has been experiencing some margin compression due to the appreciation of the Canadian dollar, which has lowered the value of recognized revenue on sales contracts denominated in US dollars and increased costs of Canadian sourced components. Management is actively seeking ways to lower costs by, among other things sourcing more materials from lower cost US based suppliers, which is expected to generate increased margins over the coming months.

Research and Development

The gross Research and Development ("R&D") expenditures, offsetting government funding and the resulting net R&D expenditures for the relevant periods, were as follows:

(Unaudited)	Three months ended December 31,	
	2007	2006
Gross R&D Expenditure	955,864	1,387,642
Less: Government & Partner Funding	-	(384,565)
Net R&D Expenditure	955,864	1,003,077

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

The 31% reduction in gross R&D expenditures for the first quarter of fiscal 2008 compared to the same period in fiscal 2007 was due to a reduction in the amount of R&D undertaken as a result of the corporate reorganization that took place in May 2007. Although no government funding was recorded in the first quarter of 2008, net R&D expenses fell 5% compared to the same period in fiscal 2007.

Operations

This is the first quarter that operations appears as a caption on our financial statements, and is the result of the restructuring undertaken in the prior fiscal year to increase resources on commercial activities, and reduce R&D expenditures. Consistent with our accounting policy, comparative amounts have been reclassified, where necessary to conform to the presentation adopted in the current fiscal year. Included in operations are expenses related to supply chain management, shipping and receiving, quality management and non-development related engineering activities. Operations expenses were $437,618 for the first quarter of fiscal 2008, an increase of 51% from $290,322 for the same period in fiscal 2007. This increase is primarily due to the addition of human resources to the department since the prior period.

Other Expenses

Sales and marketing expenses and amortization expenses decreased while general and administrative ("G&A") expenses increased compared to the first quarter of fiscal 2007. On balance, other expenses decreased $29,529 or 2% in the first quarter of fiscal 2008 compared to the same period in fiscal 2007.

Other Income

Other income was $215,982 for the first quarter of fiscal 2008 compared to $276,021 in the same period in fiscal 2007. Lower interest income and higher interest expense were partially offset by increased foreign exchange gains in the current quarter compared to the prior period.

Net Loss

Net loss for the quarter ended December 31, 2007 was $2,390,476 ($0.05 per share) compared to $2,224,665 ($0.04 per share) for the same period in fiscal 2007. The increase in the net loss for the quarter was a result of reduced gross profits and higher expenses compared to the prior period.

Loss per share is calculated based on the weighted average number of common shares outstanding through the quarter. The increase in the loss per share for the quarter ended December 31, 2007 was a result of an increase in the net loss.

Capital Expenditures

Capital expenditures net of government funding and proceeds on sale ("Net CAPEX"), for the first quarter of fiscal 2008 was $153,793 compared to $261,319 for the same period in fiscal 2007. It is expected that capital expenditures will fluctuate from quarter to quarter depending on the requirements of specific product development programs and administrative needs.

Summary of Quarterly Results

(Unaudited, $'000 except loss per share data)	2007				2006			
	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Total Revenues	1,568	880	3,616	873	1,643	2,697	1,193	2,796
Gas Purification Systems	1,363	709	3,333	858	1,423	2,530	574	2,483
Eng. Service Contracts	205	171	283	15	220	167	619	313
% Gross Margin	16%	(15%)	34%	(157%)	17%	3%	39%	(7%)
R&D (net)	956	1,025	1,424	1,348	1,003	1,158	1,075	1,074
General & Administrative	886	772	1,233	903	760	767	713	825

(Unaudited, $'000 except loss per share data)	2007				2006			
	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Net Loss	2,390	2,989	2,559	4,644	2,225	2,724	2,135	3,336
Net Loss per share	(0.05)	(0.06)	(0.05)	(0.09)	(0.04)	(0.05)	(0.05)	(0.09)
Net CAPEX	154	15	37	99	261	302	354	66
Cash used in Operations & Net CAPEX	2,827	2,947	2,264	1,210	4,105	3,508	1,876	1,724
Backlog	10,141	11,054	7,136	7,513	5,819	5,044	4,976	5,840
Gas Purification Systems	8,144	8,955	6,660	7,078	5,697	4,908	4,570	4,815
Eng. Service Contracts	1,997	2,099	476	435	122	136	406	1,025

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

Revenues are comprised of sales of gas purification systems and engineering services contracts. In general, gross margins on engineering service contracts are higher than those on gas purification systems, resulting in increased gross margins for quarters with a high proportion of recognized revenue from engineering service contracts. The mix of these revenues and amount of revenue has fluctuated quarter by quarter based on the length of the sales cycle required to close a customer order, and on contractual terms related to the timing of delivery and acceptance of products and services by customers. In addition, we have been recognizing revenue from the sale of the prototype plant over the last eight quarters. In the quarters ended March 31, 2006, March 31, 2007 and September 30, 2007, we recognized losses on the prototype plant, which has contributed to the quarterly fluctuation in percentage gross margins.

Net R&D expenses have been relatively constant over the past eight quarters, with the exception of the quarters ended March 31, 2007 and June 30, 2007 in which offsetting government funding was lower than prior periods. Government funding is recognized as a reduction in R&D expenses when collection is reasonably probable, and the overall level of funding fell in fiscal 2007 as the Technology Partnerships Canada ("TPC") contribution agreement neared completion.

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 quarter ended June 30, 2007, severance and termination benefits associated with the restructuring of our operations.

Cash Flows, Liquidity and Capital Resources

Cash Flows

Cash and cash equivalents were $5,847,468 at December 31, 2007, an increase of $121,223 from $5,726,245 at September 30, 2007.

Cash used by operations for the first quarter of fiscal 2008 was $2,673,059, compared to $3,843,234 for the same period in fiscal 2007. The reduction in cash used by operations for the quarter resulted from less significant changes in non-cash working capital than in the prior period. Accounts receivable increased in the quarter, reflecting progress payments invoiced to customers for orders in backlog. Inventory also increased in the quarter related to construction of equipment to fulfill customer orders in backlog. These increases in uses of cash during the quarter were partially offset by increases in deferred revenue and accounts payable and accrued liabilities.

Cash provided by investing activities for the quarter ended December 31, 2007 was $2,928,691, compared to $2,403,661 for the same period in fiscal 2007. The increase in cash inflows from investing activities for the quarter primarily related to an increased amount of short-term investments converted to cash and cash equivalents compared to the prior quarter.

Net cash used in financing activities was $134,409 for the first quarter of fiscal 2008 compared to cash provided by financing activities of $181,508 for the same period in fiscal 2007. The cash outflow in the quarter resulted from repayments related to amounts previously drawn on our equipment line with Comerica Bank (see 'Credit Facilities'). The cash inflow in the prior period included a draw of $248,505 on the equipment line.

We monitor cash used by operations and capital requirements as a measure of our operational cash burn. Cash used by operations and capital requirements for the first quarter of fiscal 2008 was $2,826,852, compared to $4,104,553 for the same period in fiscal 2007. It should be noted that this metric is a non-GAAP measure of operational cash burn. 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)	Three months ended December 31, 2007	2006
Cash used in Operating Activities	(2,673,059)	(3,843,234)
Add: purchase of property, plant and equipment ("PP&E")	(153,793)	(266,819)
Add: government grants and funding related to PP&E	-	5,435
Add: proceeds from sale of PP&E	-	65
Cash used in Operations and Capital Requirements	(2,826,852)	(4,104,553)
Reconciliation to GAAP Statements of Cash Flow:		
Add: short-term investment increases	3,060,447	2,400,000
Add: short-term investment decreases	(62,048)	-
Add: restricted cash	84,085	264,980
Add: Cash from Financing Activities	(134,409)	181,508
Increase in Cash and Cash Equivalents	121,223	(1,258,065)

The decrease in cash burn for the first quarter of fiscal 2008 compared to the same period in fiscal 2007 is primarily due to the reduction in cash used by operating activities discussed above as well as decreased net capital expenditures.

Liquidity and Capital Resources

Since incorporation, we have financed our operations through cash generated from commercial sales, the issuance of equity and funding received from government and strategic partners. At December 31, 2007 cash and short-term investments were $5,909,516, compared to $8,786,692 at September 30, 2007. Not included in cash and short term investments at December 31, 2007 was $256,717 of restricted cash to secure letters of credit with customers.

Our cash resources will be used to promote sales and fulfill orders for our current commercial products, as well as to advance the development and commercialization of products under development. Our capital requirements may vary depending on a number of factors, including contributions from the sale of our systems and engineering service contracts, the progress of our current development programs and any decisions to enter into additional programs or partnerships. In addition, we review investment and acquisition opportunities for technologies and products that would complement our business or assist us in our commercialization plans. An investment opportunity would increase our capital requirements. If current funding and cash generated from operations is insufficient to satisfy our operating requirements, we may seek to sell additional equity or to arrange debt or other financing.

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 2007. 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, 2007, we had drawn $785,784 against the term loans net of repayments, and no funds have been drawn under either of the amended credit facilities. 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. We are in compliance with all of our bank covenants.

Contractual Obligations

The following table lists our contractual obligations at December 31, 2007. 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)		Payments due by Period			
	Total	In the next year	2-3 years	4-5 years	After 5 years
Bank debt	785,784	499,266	286,518	-	-
Capital leases	194,956	97,478	97,478	-	-
Operating leases	620,996	407,831	163,665	49,500	-
Purchase obligations[2]	1,753,645	1,753,645	-	-	-
Total contractual obligations	3,355,381	2,758,220	547,661	49,500	-

Contingent Off-Balance Sheet Financing Arrangements

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 2007. We did not enter into any new contingent off-balance sheet financing arrangements during the quarter.

Outstanding Share Data

Common Shares Outstanding

Our authorized share capital consists of an unlimited number of common shares, of which 52,683,647 common shares were issued and outstanding as of January 31, 2008. We also have an unlimited number of preferred shares authorized, none of which are issued.

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

(Unaudited)	Three months ended December 31,	
	2007	2006
Weighted Average Common Shares Outstanding	52,562,133	52,393,065

The average number of common shares outstanding increased for the quarter ended December 31, 2007 compared to the same period in fiscal 2007 as a result of the issuance of 143,160 common shares on the exercise of stock options during the quarter.

Stock Options and Warrants Outstanding

As at January 31, 2008 there were 2,715,804 stock options outstanding with an average exercise price of $1.36, of which 1,915,703 were exercisable. As at January 31, 2008 there were 192,308 warrants outstanding, unchanged from the prior period. These warrants have an exercise price of $3.88 each and expire June 6, 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.

Outlook

Our priorities for the next few months include completing the test of the prototype plant, and building our commercial products business.

Field testing of the prototype plant is progressing according to plan. Following the successful start-up of the prototype plant, the unit has demonstrated its ability to recover hydrogen from plant gas streams and return purified hydrogen for plant applications. The robustness of the prototype plan under various conditions bodes well for future sales of this product in the refinery market. The testing of the prototype plant is expected to be completed by the end of March, 2008.

Marketing efforts with respect to the H-6200 are expected to be bolstered by the data from the prototype test, which in turn is expected to support our objective of securing the first commercial sale of an H-6200 hydrogen purifier during this fiscal year.

We are continuing our efforts to increase our market penetration in the biomethane market. The successful start up and commissioning of two European biogas plants will facilitate this. These installations demonstrate the ability of our PSAs to generate high quality biomethane for sale into the natural gas grid and for use as a transportation fuel. We expect that these early installations will serve as valuable reference sites for prospective customers in Europe.

Growing our industrial hydrogen business is another priority over the coming months. We expect that the expansion of product capacity that we undertook in fiscal 2007 will improve our competitive position in the medium capacity range of the market.

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 fom our estimates. Our critical accounting estimates affect our net 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, 2007.

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, 2007 and 2006 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, 2007, raw materials on hand of $1,544,135 includes $50,301 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 commercial 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, 2007 and 2006, actual warranty costs incurred were less than the provision recorded.

Changes in Accounting Policies Including Initial Adoption

Capital Disclosures

The CICA issued Handbook Section 1535, *Capital Disclosures,* which establishes standards for disclosing information about an entity's capital and how it is managed. These changes come into effect for fiscal years beginning on or after October 1, 2007; accordingly, QuestAir has adopted this new standard effective October 1, 2007. As this standard relates only to disclosure requirements, this section does not impact on our financial results.

Accounting Changes

The CICA has issued section 1506, *Accounting Changes,* which establishes criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and correction of errors. As a result, changes in accounting policies are only permitted when required by a primary source of GAAP or when the change will result in reliable and more relevant information. These changes come into effect for fiscal years beginning on or after January 1, 2007; accordingly, QuestAir has adopted this new standard in effective October 1, 2007. At this time, we are not aware of any pending accounting changes other than those mandated by the CICA, and as such we do not anticipate any material effects as a result of this change.

Internal Controls and Procedures

There were no changes in the Company's internal control over financial reporting that occurred during the first fiscal quarter that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

QuestAir
Pure Innovations™

Risks & Uncertainties

A detailed explanation of the risk factors which we face is provided in our Annual Information Form for the year ended September 30, 2007 at www.sedar.com. A number of the key risks, as well as the strategies that management employs to manage these risks, are discussed briefly below:

Technology and Competitive Risks

The H-6200 hydrogen purifier incorporating QuestAir's second generation PSA technology is being field tested at a refinery, which is expected to be completed within the first half of fiscal 2008. Technology risks and uncertainties remain until the test of the prototype plant has been completed. In addition, risks remain related to our ability to meet the required cost, reliability and performance standards of a viable commercial offering. We have undertaken a rigorous review of the key technical risk areas in collaboration with ExxonMobil in order to manage these risks. We continue to gather information related to market requirements for cost, reliability and performance standards, and are undertaking additional development work to, among other things, reduce product costs and shorten delivery lead-times.

We currently face, and will continue to face competition from suppliers of conventional PSA systems as well as alternate gas purification technologies. We will continue to invest in fundamental R&D to continually improve the performance and cost position of our products. In addition, we pursue an active patenting program to protect our proprietary technology and competitive position.

Market Risks

The market opportunity for our H-6200 hydrogen purifier is driven in part by the growth in demand for refined petroleum products. A significant reduction in the demand for these fuels, as a result of such events as an economic recession in key markets in the US and China for example, could significantly impact our growth prospects. In addition, the rate at which our H-6200 hydrogen purifier is adopted in the refinery market is also subject to risk and uncertainty, and could have a material impact on the future profitability of the Company. We seek to mitigate these risks by diversifying our product portfolio. We have historically accomplished this by increasing the capacity and/or recovery of our systems, focusing on new markets such as hydrogen recovery, and modifying our product platforms to purify different product gas such as methane. Our fuel cell related products provide additional diversification.

In the longer term, there is significant uncertainty regarding the commercial viability of fuel cell technology and the adoption of fuel cell powered automobiles and power products. We seek to manage this risk by focusing on the sale of our existing commercial products in the nascent fuel cell market, and pacing our fuel cell related development programs to the level of engagement and funding received from of our fuel cell partners.

Regulatory Risk

Demand for our refinery related products is also driven in part by regulations mandating the reduction of sulphur levels in transportation fuels such as gasoline and diesel. Similarly, demand for our biomethane purification systems in certain jurisdictions is driven by local regulations that provide incentives for the production of renewable energy. In addition the expected demand for fuel cell technologies in the transportation sector is driven in part by local air pollution regulations and regulatory pressures to reduce greenhouse gas emissions. It is clear that a significant roll-back in any of these regulations could materially impact our growth prospects. Our strategy of diversifying our market opportunities into multiple markets is intended to minimize our exposure to regulatory risk in specific markets.

Partner Risk

A key component of our strategy is to partner with market leaders in the development, marketing and distribution of new products. We have developed close relationships with EMRE for its refinery and petrochemical related products, and also with Shell Hydrogen for the emerging hydrogen fueling market. Our current business and/or future prospects would be materially impacted if EMRE or Shell Hydrogen were to terminate their relationships with QuestAir. We have structured our key development agreements with these parties such that we are free to sell to third parties, and we seek to establish relationships with multiple customers in each of the markets that we target in order to mitigate this risk.

Financial Risk

We are currently a net consumer of cash, and we may have to raise additional capital in order to complete our long term product development and commercialization plans. It is possible that our future growth prospects could be significantly impacted if we are unable to raise additional capital on acceptable terms. In order to mitigate this risk, we have implemented a disciplined cash management strategy to limit cash consumption. In addition we are actively pursuing other forms of financial support such as partner funding in order to reduce our net cash requirements.

Key Personnel Risk

Our future growth depends in large part on our ability to recruit, train and retain key management and technical personnel. Competition for qualified personnel in our industry is intense, and it is possible that we may not be able to recruit suitable personnel into key positions in the future. We have implemented an innovative retention strategy in order to manage this risk, which includes active career development, and a recognition and compensation program that rewards both group and individual contributions and performance.

(expressed in Canadian dollars)

Balance Sheets

	As at December 31 2007	As at September 30 2007
ASSETS		
Current assets:		
Cash and cash equivalents (note 4)	$5,847,468	$5,726,245
Restricted cash (note 5)	256,717	340,802
Short-term investments (note 6)	62,048	3,060,447
Accounts receivable	2,859,478	1,412,983
Inventories	5,644,822	4,376,717
Prepaid expenses	97,569	256,378
	14,768,102	15,173,572
Long-term assets:		
Property, plant and equipment	1,683,645	1,703,872
Other long-term assets	182,080	175,080
	$16,633,827	$17,052,524
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$3,211,977	$2,791,139
Deferred revenue	6,201,616	4,546,584
Current portion of bank debt (note 7)	499,266	564,306
Current portion of obligations under capital lease	97,478	97,822
Derivatives (note 8)	1,933	75,874
	10,012,270	8,075,725
Long-term liabilities:		
Bank debt (note 7)	286,518	356,030
Obligation under capital lease	97,478	97,822
	10,396,266	8,529,577
Shareholders' equity:		
Share capital		
Authorized		
Unlimited common shares, voting, no par value		
Unlimited preferred shares, issuable in series, no par value		
Common shares (note 9a)	109,702,558	109,383,859
Contributed surplus (note 9b)	6,413,216	6,626,825
Deficit	(109,878,213)	(107,487,737)
	6,237,561	8,522,947
	$16,633,827	$17,052,524

Description of business and going concern (note 1)

(expressed in Canadian dollars)

Statements of Operations, Comprehensive Loss and Deficit

	For the three months ended December 31 2007	December 31 2006
Revenues	$1,567,925	$1,643,476
Cost of goods sold	1,319,736	1,360,069
Gross Profit	248,189	283,407
Operating expenses		
Research & development – net (note 11)	955,864	1,003,077
General and administration	885,568	760,257
Operations	437,618	290,322
Sales and marketing	401,576	500,075
Amortization	174,021	230,362
	2,854,647	2,784,093
Loss before undernoted	(2,606,458)	(2,500,686)
Other income		
Interest income	69,290	156,073
Other	146,692	119,948
	215,982	276,021
Loss and comprehensive loss for the period	(2,390,476)	(2,224,665)
Deficit – Beginning of period	(107,487,737)	(95,045,478)
Unrealized foreign exchange loss on derivatives	-	(24,847)
Deficit – End of period	$(109,878,213)	$(97,294,990)
Basic and diluted loss per share	$(0.05)	$(0.04)
Weighted average number of common shares outstanding	52,562,133	52,393,065

(expressed in Canadian dollars)

Statements of Cash Flows

	For the three months ended December 31 2007	December 31 2006
Cash flows from operating activities		
Loss for the period	$(2,390,476)	$(2,224,665)
Items not involving cash		
Amortization	174,021	230,362
Gain on sale of property, plant and equipment	-	(65)
Unrealized foreign exchange gain on derivatives (note 8)	(73,941)	(61,527)
Non-cash compensation expense	104,947	119,905
Foreign currency gain	(689)	-
	(2,186,138)	(1,935,990)
Changes in non-cash operating working capital		
Accounts receivables	(1,446,495)	(654,592)
Inventories	(1,268,105)	(553,870)
Prepaid expenses	151,809	117,851
Accounts payable and accrued liabilities (note 14)	420,838	(1,887,233)
Deferred revenue	1,655,032	1,070,600
	(486,921)	(1,907,244)
	(2,673,059)	(3,843,234)
Cash flows from investing activities		
Decrease in short-term investments	3,060,447	2,400,000
Increase in short-term investments	(62,048)	-
Purchase of property, plant and equipment (note 14)	(153,793)	(266,819)
Government grants and funding related to property, plant and equipment	-	5,435
Proceeds on sale or property, plant and equipment	-	65
Decrease in restricted cash	84,085	264,980
	2,928,691	2,403,661
Cash flows from financing activities		
Issuance of common shares on exercise of stock options	143	-
Increase in bank debt	7,250	248,505
Repayment of bank debt	(141,802)	(66,997)
	(134,409)	181,508
Increase (decrease) in cash and equivalents	121,223	(1,258,065)
Cash and equivalents – Beginning of period	5,726,245	11,018,800
Cash and equivalents – End of period	$5,847,468	$9,760,735

Notes to the financial statements

Unaudited (all dollar amounts expressed in Canadian dollars)

1. Description of business and going concern

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 hydrogen, oxygen and nitrogen for a wide variety of industries. The Company's products, which incorporate patented, proprietary technology, primarily target hydrogen and methane purification in a range of existing industrial and energy markets, including oil refinery and biogas processing applications, as well as emerging markets, such as fuel cell systems for distributed power generation and retail service stations that will provide hydrogen fuel for fuel-cell powered vehicles.

While the accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations, certain adverse conditions and events cast substantial doubt upon the validity of this assumption. The Company has not yet realized profitable operations and has relied on non-operational sources of financing to fund operations and, as at December 31, 2007, has an accumulated deficit of $109,878,213. The Company's ability to continue as a going concern will depend on management's ability to successfully execute its business plan. The Company may seek additional forms of financing, but cannot provide assurance that it will be successful in doing so. These financial statements do not include adjustments or disclosures that may result from the Company's inability to continue as a going concern. If the going concern assumption is not appropriate for these financial statements, then adjustments would be necessary in the carrying value of assets and liabilities, and the reported net losses and balance sheet classifications used, and such adjustments could be material.

2. Unaudited interim financial statements

The unaudited balance sheet and statement of shareholders' equity at December 31, 2007 and the unaudited interim statements of operations, comprehensive loss and deficit and cash flows for the three months ended December 31, 2007 and 2006, 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, 2007 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, 2007 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, 2007, 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, 2007 with the exception of capital disclosures.

CICA Handbook Section 1535 - Capital Disclosures requires an entity to disclose information to enable users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital. This Section is applicable to interim and annual financial statements relating to fiscal years on or after October 1, 2007. Disclosure requirements pertaining to 1535 are contained in note 9.

4. Cash and cash equivalents

Cash comprises unrestricted bank deposits, some of which are interest bearing. Cash equivalents consist of money market accounts and term deposits that are readily convertible to known amounts of cash within three months from their date of purchase. They are carried at fair value and are classified as held for trading.

5. Restricted cash

The Company is required to deposit cash with Comerica Bank as collateral 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, 2007 was $256,717 (September 30, 2007 - $340,802).

6. Short-term investments

The Company's short-term investments consist of term deposits classified as held to maturity for accounting purposes and carried on the balance sheet at amortized cost using the effective interest method. Investments with maturities of greater than 90 days and less than one year are classified as short-term investments.

7. Bank debt

In April 2005, the Company signed a credit agreement with Comerica Bank. This agreement was amended and restated in June 2007 as part of the annual renewal of these facilities. 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. Under the terms of the agreement, the Company must comply with financial covenants and certain other business terms.

As at December 31, 2007, the Company had drawn $785,784 (September 30, 2007 - $920,336) on the term loans net of repayments. Accrued interest payable as at December 31, 2007 was $1,587 (September 30, 2007 - $1,979) and is included in accounts payable and accrued liabilities. Total interest expense was $22,248 (December 31, 2006 - $9,661) for the quarter ended December 31, 2007. Draws can be made against the Tranche 3 term loan, to a maximum of US$1 million, prior to June 21, 2008. As at December 31, 2007, no amounts were drawn against the Tranche 3 term loan.

8. Derivatives

Included in the loss for the quarter ended December 31, 2007 is a $73,941 (December 31, 2006 - $61,527) unrealized foreign exchange gain on embedded derivatives. 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, 2007.

9. Shareholders' Equity

Changes to shareholders' equity for the three months ended December 31, 2006 and 2007 are presented below:

Unaudited (expressed in Canadian dollars)

	Common shares $	Contributed surplus $	Deficit $	Total shareholders' equity $	Comprehensive loss $
Balance at September 30, 2006	109,020,202	6,462,772	(95,045,478)	20,437,496	-
Net Loss	-	-	(2,224,665)	(2,224,665)	(2,224,665)
Adjustment to opening balance of unrealized foreign exchange loss on derivatives	-	-	(24,847)	(24,847)	
Stock-based compensation on fair value share options	-	119,905	-	119,905	
Balance at December 31, 2006	109,020,202	6,582,677	(97,294,990)	18,307,889	

Unaudited (expressed in Canadian dollars)

	Common shares $	Contributed surplus $	Deficit $	Total shareholders' equity $	Comprehensive loss $
Balance at September 30, 2007	109,383,859	6,626,825	(107,487,737)	8,522,947	-
Net Loss	-	-	(2,390,476)	(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	

(expressed in Canadian dollars)

a) Common shares – issued and outstanding

Authorized share capital consists of an unlimited number of common shares, of which 52,683,647 common shares were issued and outstanding as of December 31, 2007. During the quarter ended December 31, 2007, 143,160 common shares were issued on exercise of share options. An unlimited number of preferred shares are authorized, none of which are issued.

b) Contributed surplus

During the quarter ended December 31, 2007, $104,947 (December 31, 2006 - $119,905) of stock-based compensation on share options issued to employees under the fair value method was recorded in contributed surplus.

c) Comprehensive income (loss)

Comprehensive income (loss) is the increase or decrease in equity from sources other than owners and comprises net income and other revenues, expenses, gains and losses that, pursuant to Canadian GAAP, are excluded from net income (loss). The Company had no other comprehensive income or loss during the year; therefore, the comprehensive loss equals net loss of $2,390,476 (December 31, 2006 - $2,224,665) for the quarter ended December 31, 2007.

d) Capital Management

As an emerging developer, manufacturer and supplier of PSA systems, the Company is a net consumer of cash with limited access to debt financing. The majority of its capital is generated through the sale of shares. Additional capital resources consist of secured debt.

The Company's objective when managing capital is to safeguard its ability to continue as a going concern in order to provide return to shareholders and benefits for other stakeholders.

In order to maintain or adjust its capital structure, the Company may issue new shares or secure long-term debt facilities. The Company does not pay dividends.

Total capital is calculated as follows:

Unaudited	December 31 2007 $	September 30 2007 $
Bank debt	785,784	920,336
Equity	6,237,561	8,522,947
	7,023,345	9,443,283

The Company does not use financial ratios to manage capital, and it is not subject to any externally imposed capital requirements.

10. 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

(expressed in Canadian dollars)

("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. Upon adoption of the 2006 Plan, Common shares approved for issuance under all stock-based compensation arrangements increased from 5,507,637 to 5,915,603.

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. At December 31, 2007 2,907,382 (December 31, 2006 – 468,629) Common shares are available for issuance pursuant to awards made under the 2006 Plan. No other form of stock-based awards have been issued under the 2006 Plan as at December 31, 2007.

The Company calculated the fair value of each share option grant on the date of grant using the Black-Scholes option valuation model with the following weighted average assumptions:

	Three months ended December 31 2007
Dividend yield	0%
Expected volatility	59%
Risk-free interest rate	3.94%
Expected life of options	5 years

No options were issued under the Plan during the comparative quarter ended December 31, 2006,

Share option activity for the three months ended December 31, 2006 and 2007 is presented below:

Three months ended December 31, 2006	Number of Options	Weighted average exercise price	Expiry Dates
Outstanding – September 30, 2006 (3,413,604 share options exercisable)	4,937,059	$1.34	
Granted	-	-	
Exercised	-	-	
Expired	(32,658)	1.74	
Outstanding – December 31, 2006 (3,571,007 share options exercisable)	4,904,401	$1.34	Feb. 14, 2007 to Sep. 26, 2016

Three months ended December 31, 2007	Number of Options	Weighted average exercise price	Expiry Dates
Outstanding – September 30, 2007 (3,815,842 share options exercisable)	4,767,925	$1.32	
Granted	12,500	0.46	
Exercised	(143,160)	0.001	
Expired	(1,919,626)	1.36	
Outstanding – December 31, 2007 (1,915,703 share options exercisable)	2,717,639	$1.36	Feb. 28, 2008 to Sep. 26, 2016

(expressed in Canadian dollars)

11. Research and development

Unaudited	Three months ended December 31 2007	December 31 2006
Research and development costs	$955,864	$1,387,642
Government grants and funding from third parties under development agreements	-	(384,565)
	$955,864	$1,003,077

12. Commitments and contingencies

Technology Partnerships Canada ("TPC") Program

On June 6, 2003, the Company entered into an agreement with the Canadian Federal Minister of Industry under the TPC Program to receive financial contributions regarding the development and commercial exploitation of its Fast Cycle Pressure Swing Adsorption ("FCPSA") and Gas Management systems ("GMS").

Pursuant to the agreement, total project costs for the period from October 1, 2002 to September 30, 2007 will be shared, subject to certain contribution limits, such that the Minister's contribution will not exceed the lesser of 30% of eligible project costs and $9,600,000.

The agreement further provides that the Minister shall provide the Company with financial contributions based on the aforementioned limitations in exchange for:

i. the issuance of 192,308 transferable warrants convertible into common shares at a strike price of $3.88, exercisable for a term of five years, and
ii. repayable contributions to the Minister during the royalty period based on 1.165% of gross business revenues.

The Company has entered into negotiations with the Canadian Federal Minister of Industry to amend the TPC contribution agreement in respect of the Company's FCPSA and GMS development programs. The purposes of the amendment are to delete certain development milestones related to the GMS program, as the Company has determined that further development in this area is not warranted given current market conditions for such products, and to extend certain development milestones related to the FCPSA program to allow additional time for the Company to complete such milestones. Although a formal amendment to this agreement has not yet been completed, management expects to be successful in negotiating an amendment that will, among other things:

a) delete certain milestones related to the GMS program
b) extend and/or modify certain milestones related to the FCPSA program for a further 12 months, such that the work phase of the program would end on or about September 30, 2008
c) reduce the Minister's contribution limit towards eligible project costs to $8.14 million, being the amount received thus far by the Company
d) reduce the ceiling on the conditional repayments under the agreement to $18.8 million and extend the date by which the royalty period will end by 12 months
e) provide for an unconditional, one-time royalty payment of $500,000 to be paid on or before first anniversary of the effective date of the amendment.

(expressed in Canadian dollars)

Once an amendment has been executed, the minimum royalty would be reflected as an accrued liability in the Company's financial statements.

13. Segmented information

The Company's overall focus is on the development and commercialization of gas purification systems, being the Company's only segment.

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

Unaudited	Three months ended	
	December 31	December 31
Region	2007	2006
South America	$610,940	-
Europe	454,563	$1,016,278
United States	445,821	380,730
Asia	56,600	246,468

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

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

Unaudited	Three months ended	
	December 31	December 31
	2007	2006
Customer A	$610,940	-
Customer B	444,430	$1,268,557
Customer C	199,461	-
Customer D	160,027	-

14. Supplemental cash flow information

Unaudited	Three months ended	
	December 31	December 31
	2007	2006
Supplemental cash flow information:		
Cash paid for interest	15,595	11,043
Cash received for interest	101,083	128,436
Non-cash operating, investing and financing activities:		
Property, plant and equipment included in accrued liabilities	-	(250,444)