QuestAir Technologies Inc.

Second 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 May 15, 2008 relates to our interim financial statements for the second quarter of fiscal 2008, being the three and six month periods ended March 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 ("GAAP"). All financial information is 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 receipt of shareholder and listing approval for the Company's subscription receipt offering that closed on May 13,2008; (ii) the expected use of funds drawn under the Company's credit facilities; (iii) the Company's priorities for the months following the date of this MD&A; (iv) the expectation that the supply agreement signed with Verdesis Suisse will drive further sales growth in the European marketplace; (v) management's belief that the operating performance and robustness of the H-6200 prototype plant will bode well for future sales of the H-6200 hydrogen purifier; (vi) the expectation that marketing activities for the H-6200 will support the Company's objective of securing the first commercial order for an H-6200 during this fiscal year; (vii) the expected impact of the new engineering services contract signed with EMRE on the Company's performance; (viii) the expected impact of the cost-cutting measures announced during the quarter; and (ix) the expected recognized revenue for the Company's full fiscal year. 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 those factors described in detail herein commencing on page 13.

The forward-looking statements contained herein are also based on assumptions that management believes are reasonable, including but not limited to, assumptions regarding: (i) growth in the biogas market generally; (ii) the expected expenses of the Company going forward; and (iii) EMRE fulfilling its obligations under the terms of the engineering services contract referred to above. Although management believes that these assumptions are current and reasonable, the Company cannot assure readers that actual results will be consistent with the forward-looking statements contained in this MD&A. 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. 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 set forth in the forward-looking statements.

Business Overview

A detailed overview of our 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.

Significant Developments

QuestAir made the following progress during the second quarter of fiscal 2008:

- During the second quarter, the testing of the prototype H-6200 hydrogen purifier (the "prototype plant") at an ExxonMobil refinery in France was successfully completed. We believe that, with the success of the prototype test, QuestAir and ExxonMobil Research & Engineering ("EMRE") have reached the stage that we can take the H-6200 hydrogen purifier to the refinery market.

- On March 3, 2008, we announced that we had signed an agreement valued at $6.3 million with EMRE to allow for the further development and commercialization of our rapid-cycle pressure swing adsorption ("PSA") technology. The agreement builds on the rapid cycle development programs that we have conducted over the past four years, and on the successful testing of the prototype plant at an Exxon Mobil refinery in France. Under the agreement, EMRE will pay QuestAir $6.3 million over two years in order to advance the commercialization of the H-6200 hydrogen purifier and progress development in the field of on-board reforming of liquid hydrocarbon fuels to hydrogen for mobile fuel cell applications.

- In conjunction with the announcement of the new agreement with EMRE, we announced revised financial guidance for fiscal 2008 and cost saving measures to better utilize our cash resources and to further improve our financial outlook. The new agreement with EMRE is expected to have a significant impact on our financial performance. Recognized revenue for fiscal 2008 is now expected to be in the range of $11 million to $12 million, compared to guidance of $9 million to $10 million provided by management on December 12, 2007. Cash used in operations and capital expenditures for fiscal 2008 is expected to be in the range of $6.5 million to $7.5 million, compared to prior guidance of less than $8 million.

- Coincident with issuing the revised guidance, we announced measures to reduce our operating expenses. The cost-cutting measures include the elimination of 13 full time positions, representing 18% of our workforce on the date of the announcement. The reorganization has been completed and is expected to result in annualized savings of $1.25 million. We recognized a restructuring charge of approximately $450,000 during the quarter ending March 31, 2008 as a result of the reorganization.

- We announced on February 18, 2008 that we had received an order valued at approximately $1 million for an H-3100 hydrogen PSA system from Iwatani International Corporation, Japan's leading supplier of merchant hydrogen. The PSA will be used in a new hydrogen recovery project at an undisclosed location in Japan.

- On March 11, 2008, we announced that we had signed an agreement to supply our methane purification products to Verdesis Suisse SA ("Verdesis"), a leading European supplier of integrated plants that produce renewable pipeline or vehicle fuel grade methane from biogas. Under the terms of the supply agreement, QuestAir's methane PSA systems will be integrated into Verdesis's biogas enrichment plants, which are supplied to developers and owners of projects that produce biogas from agricultural and municipal wastes or to gas utilities operating natural gas grids. To date, we have announced contracts to supply our M-3200 PSAs to four Verdesis projects in Switzerland which upgrade biogas for injection into the natural gas grid.

- Subsequent to quarter end, we announced the closing of an underwritten offering of subscription receipts for gross proceeds of $9 million. Each subscription receipt is automatically exchangeable into a unit consisting of one common share and one common share purchase warrant upon receipt of shareholder and listing approvals, which are expected to be obtained on or before June 17, 2008. (See 'Subsequent Event')

Financial Overview

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

- Revenue was $2,298,448 for the quarter, increased by $1,425,702, or 163% compared to the same period in fiscal 2007. Revenue for the half year was $3,866,373, increased by $1,350,151, or 54% from $2,516,222 for the same period last year.
- We ended the second quarter with our highest sales order backlog since our inception. At March 31, 2008 sales order backlog was $16,022,374, increased by $5,881,808, or 58% from December 31, 2007.
- Cash used by operations and capital requirements was $2,166,074 for the quarter, increased by $956,377, or 79% compared to the same period in fiscal 2007. Cash used by operations and capital requirements for the half year was $4,992,926, a decrease of 6% or $321,324 compared to the same period in fiscal 2007.
- Net loss was $2,057,403 ($0.04 per share) for the quarter, decreased by $2,587,115, or 56% compared to the same period in fiscal 2007. Net loss for the half year decreased to $4,447,879 ($0.08 per share) from $6,869,183 ($0.13 per share) for the same period in 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 March 31,		Six months ended March 31,	
	2008	2007	2008	2007
Gas purification systems	1,348,139	857,708	2,710,950	2,280,553
Engineering service contracts	950,309	15,038	1,155,423	235,669
Total revenue	2,298,448	872,746	3,866,373	2,516,222

Total recognized revenue for the second quarter of fiscal 2008 increased to $2,298,448 compared to $872,746 for the same period in fiscal 2007. Total recognized revenue for the half year was $3,866,373 compared to $2,516,222 for the same period in fiscal 2007. Revenue from gas purification systems increased by $490,431 for the quarter and $430,397 for the half year, and revenue from engineering service contracts increased by $935,271 for the quarter and $919,754 for the half year compared to the same periods in fiscal 2007. This increase in revenue reflects our higher sales order backlog compared to the prior periods.

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.

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 three and six months ended March 31, 2008.

(Unaudited)	For the three months ended March 31, 2008			For the six months ended March 31, 2008		
	Gas Purification Systems	Engineering Service Contracts	Total	Gas Purification Systems	Engineering Service Contracts	Total
Opening Balance	8,143,859	1,996,707	10,140,566	8,954,635	2,099,130	11,053,765
Bookings	1,084,749	6,350,000	7,434,749	1,595,058	6,457,200	8,052,258
Revenue	(1,348,139)	(950,309)	(2,298,448)	(2,710,950)	(1,155,423)	(3,866,373)
Adjustments[1]	510,169	235,338	745,507	551,895	230,829	782,724
Ending Balance	8,390,638	7,631,736	16,022,374	8,390,638	7,631,736	16,022,374

The total sales order backlog increased by $5,881,808 or 58%, during the second quarter of fiscal 2008, as the dollar value of new bookings exceeded revenue recognized in the quarter. Included in bookings during the quarter is a new agreement valued at $6,350,000 with EMRE to allow for the further development and commercialization of our rapid-cycle PSA technology. We expect that 45 to 50% of the sales order backlog as of March 31, 2008 will be recognized as revenue by September 30, 2008, with the balance being recognized in future fiscal years.

Gross Profit

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

(Unaudited)	Three months ended March 31,		Six months ended March 31,	
	2008	2007	2008	2007
Sales	2,298,448	872,746	3,866,373	2,516,222
Cost of goods sold	1,256,753	2,244,476	2,576,489	3,604,545
Gross Profit	1,041,695	(1,371,730)	1,289,884	(1,088,323)
Gross Margin (%)	45.3%	(157.2%)	33.4%	(43.3%)

There was a significant increase in gross margin for the quarter and half year ended March 31, 2008 compared to the same period in fiscal 2007. Low gross margins in the relevant 2007 periods were the result of losses related to the prototype plant that was sold to an ExxonMobil refinery. Revenue from the prototype plant was fully recognized at the end of the first quarter of fiscal 2008, allowing the gross margin to return to more normal levels in the quarter ended March 31, 2008. In any given quarter, gross margins fluctuate depending on the mix of revenues from engineering service contracts, which tend to produce higher margins, and commercial equipment. Nevertheless, management expects the current year to date gross margin to be more in line with our expected gross margin for the balance of the fiscal year.

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 March 31		Six months ended March 31,	
	2008	2007	2008	2007
Gross R&D Expenditure	933,699	1,347,995	1,889,563	2,735,637
Less: Government Funding	-	-	-	(384,565)
Net R&D Expenditure	933,699	1,347,995	1,889,563	2,351,072

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

The 31% reduction in gross R&D expenditures for the quarter and half year ended March 31, 2008 compared to the same periods in fiscal 2007 was due to a reduction in the level of R&D activities in the current year, reflecting the Company's shift towards commercial activities.

Operations
This is the first fiscal year 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 dedicated to commercial activities and to 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 $430,189 for the second quarter of fiscal 2008, an increase of 78% from $242,093 for the same period in fiscal 2007. For the half year ended March 31, 2008, operations expenses were $867,807, increased by 63% compared to $532,415 for the same period in fiscal 2007. The increase in operating expenses is primarily due to the addition of human resources to the department.

Other Operating Expenses
Other operating expenses include general and administrative ("G&A"), sales and marketing, and amortization expenses. Total other operating expenses increased $187,639 or 11% in the quarter and $158,110 or 5% for the half year ended March 31, 2008 compared to the same periods in fiscal 2007. G&A expenses increased due to a restructuring charge of approximately $450,000 being incurred in the most recent quarter. This was offset by reductions in both amortization and sales and marketing expenses compared to the prior periods.

Other Income / (Expenses)
Other income was $121,496 for the second quarter of fiscal 2008 compared to other expense of $13,633 in the same period in fiscal 2007. For the half year ended March 31, 2008 other income was $337,478 compared to $262,388 for the same period in fiscal 2007. Lower interest income was offset by increased foreign exchange gains in the current quarter and half year compared to the same periods in fiscal 2007.

Net Loss
Net loss for the quarter ended March 31, 2008 was $2,057,403 ($0.04 per share) compared to $4,644,518 ($0.09 per share) for the same period in fiscal 2007. Net loss for the half year ended March 31, 2008 was $4,447,879 ($0.08 per share) compared to $6,869,183 ($0.13 per share) for the same period in fiscal 2007. The decrease in the net loss for the quarter and half year was a result of increased gross profits compared to the same periods in fiscal 2007.

Loss per share is calculated based on the weighted average number of common shares outstanding during the quarter and half year. The decrease in the loss per share for the quarter and half year ended March 31, 2008 was a result of a decrease in the net loss compared to the same periods in fiscal 2007.

Capital Expenditures
Capital expenditures net of government funding and proceeds on sale ("Net CAPEX"), for the second quarter of fiscal 2008 was $86,788 compared to $99,448 for the same period in fiscal 2007. Net CAPEX for the half year ended March 31, 2008 was $240,581 compared to $360,482 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)	2008	2007				2006		
	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30
Total Revenues	2,298	1,568	880	3,616	873	1,643	2,697	1,193
Gas Purification Systems	1,348	1,363	709	3,333	858	1,423	2,530	574
Eng. Service Contracts	950	205	171	283	15	220	167	619
% Gross Margin	45%	16%	(15%)	34%	(157%)	17%	3%	39%
R&D (net)	934	956	1,025	1,424	1,348	1,003	1,158	1,075
General & Administrative	1,190	886	772	1,233	903	760	767	713
Net Loss	2,057	2,390	2,989	2,559	4,644	2,225	2,724	2,135
Net Loss per share	(0.04)	(0.05)	(0.06)	(0.05)	(0.09)	(0.04)	(0.05)	(0.05)
Net CAPEX	87	154	15	37	99	261	302	354
Cash used in Operations & Net CAPEX	2,166	2,827	2,947	2,264	1,210	4,105	3,508	1,876
Backlog	16,022	10,141	11,054	7,136	7,513	5,819	5,044	4,976
Gas Purification Systems	8,390	8,144	8,955	6,660	7,078	5,697	4,908	4,570
Eng. Service Contracts	7,632	1,997	2,099	476	435	122	136	406

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 recognized revenue from the sale of the prototype plant over the eight quarters ended December 31, 2007. 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 fluctuated over the past eight quarters, reflecting an end in offsetting government funding as at December 31, 2006. Reductions in net R&D for the three most recent quarters reflects a reduction of R&D activities as the Company's focus has shifted more towards commercial activities.

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 and March 31, 2008, severance and termination benefits associated with the restructuring of our operations.

Cash Flows, Liquidity and Capital Resources

Cash Flows

Cash and cash equivalents were $3,635,283 at March 31, 2008, reduced from $5,847,468 at December 31, 2007 and $5,726,245 at September 30, 2007.

Cash used by operations for the second quarter of fiscal 2008 was $2,079,286, compared to $1,110,534 for the same period in fiscal 2007. Although the loss from operations was lower in the current quarter, cash usage in the prior period was less due to significant changes in non-cash working capital in the second quarter of fiscal 2007. In the current period, inventory increased in order to fulfill customer orders in backlog. Accounts payable and accrued liabilities decreased as payments related to inventory and other commitments were processed. These increases in uses of cash during the current quarter were partially offset by a decrease in accounts receivable, reflecting progress payments received by customers for orders in backlog. For the half year ended March 31, 2008, cash used by operations was $4,752,345 compared to $4,953,768 for the same period in fiscal 2007. Reduced losses in the current period were offset by higher inventory levels and less proceeds from deferred revenue compared to the prior period.

Cash used by investing activities for the second quarter of fiscal 2008 was $86,788, compared to $471,737 for the same period in fiscal 2007. The decrease in cash outflows from investing activities related to an increase in restricted cash in the prior quarter, to secure customer orders. Cash from investing activities for the half year ended March 31, 2008 was $2,841,903, compared to $1,931,924 for the same period in fiscal 2007. The increase in cash inflows from investing activities in the current period related to an increase in the maturity of short-term investments converted to cash and cash equivalents compared to the prior period.

Cash used in financing activities was $46,111 for the second quarter of fiscal 2008 compared to $53,961 for the same period in fiscal 2007, relatively unchanged. Cash used in financing activities for the half year ended March 31, 2008 was $180,520 compared to proceeds of $127,547 for the same period in fiscal 2007. The cash outflow in the current period resulted from increased 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 compared to only $153,629 in the current period.

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 second quarter of fiscal 2008 was $2,166,074, compared to $1,209,697 for the same period in fiscal 2007. Cash used by operations and capital requirements for the half year ended March 31, 2008 was $4,992,926 compared to $5,314,250 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 March 31, 2008	2007	Six months ended March 31, 2008	2007
Cash used in Operating Activities	(2,079,286)	(1,110,534)	(4,752,345)	(4,953,768)
Add: purchase of property, plant and equipment ("PP&E")	(86,788)	(99,448)	(240,581)	(366,267)
Add: government grants and funding related to PP&E	-	-	-	5,435
Add: proceeds from sale of PP&E	-	285	-	350
Cash used in Operations and Capital Requirements	(2,166,074)	(1,209,697)	(4,992,926)	(5,314,250)
Reconciliation to GAAP Statements of Cash Flow:				
Add: Short-term investments	-	-	2,998,399	2,400,000
Add: restricted cash	-	(372,574)	84,085	(107,594)
Add: Cash from Financing Activities	(46,111)	(53,961)	(180,520)	127,547
Increase in Cash and Cash Equivalents	(2,212,185)	(1,636,232)	(2,090,962)	(2,894,297)

The increase in cash burn for the current quarter compared to the same period in fiscal 2007 reflects the increase in cash used in operating activities discussed above. The decrease in cash burn for the half year ended March 31, 2008 was primarily due to reduced losses and net capital expenditures compared to the same period in fiscal 2007.

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

March 31, 2008 cash and short-term investments were $3,697,331, compared to $5,909,516 at December 31, 2007. Not included in cash and short term investments at March 31, 2008 and December 31, 2007 was $256,717 of restricted cash to secure letters of credit with customers.

On May 13, 2008, we announced the closing of an underwritten offering of subscription receipts for gross proceeds of $9 million (See 'Subsequent Event'). Funds from this offering are not included in the cash balances as at March 31, 2008.

Our cash resources will be used to promote sales and fulfill orders for our 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.

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 March 31, 2008, we had drawn $786,548 against the term loans net of repayments, including $146,379 drawn under the current 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. We are in compliance with all of our bank covenants.

Contractual Obligations

The following table lists our contractual obligations at March 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)	Payments due by Period				
	Total	In the next year	2-3 years	4-5 years	After 5 years
Bank debt	786,548	481,651	304,897	-	-
Capital leases	201,879	100,939	100,940	-	-
Operating leases	492,663	302,331	157,332	33,000	-
Purchase obligations[2]	2,195,950	2,195,950	-	-	-
Total contractual obligations	3,677,040	3,080,871	563,169	33,000	-

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 or half year ended March 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 52,683,647 common shares were issued and outstanding as of April 30, 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 March 31,		Six months ended March 31,	
	2008	2007	2008	2007
Weighted Average Common Shares Outstanding	52,683,647	52,442,386	52,622,558	52,417,454

The average number of common shares outstanding increased for the quarter and half year ended March 31, 2008 compared to the same periods in fiscal 2007 as a result of the issuance of 143,160 common shares on the exercise of stock options in the first quarter of fiscal 2008.

Stock Options and Warrants Outstanding

As at April 30, 2008 there were 2,650,838 stock options outstanding with an average exercise price of $1.30, of which 2,080,249 were exercisable. As at April 30, 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.

Subsequent Event

On May 13, 2008, we announced the closing of an underwritten offering of subscription receipts for gross proceeds of $9 million. Each subscription receipt is automatically exchangeable into a unit consisting of one common share and one common share purchase warrant upon receipt of shareholder and listing approvals, which are expected to be obtained on or before June 17, 2008. We have also granted the underwriters an over-allotment option to purchase a further $1.35 million worth of subscription receipts exercisable for 30 days from closing. The offering is subject to certain conditions, including but not limited to, the receipt of all necessary regulatory approvals including approvals of the Toronto Stock Exchange and the AIM. We expect that such approvals will be received and the conditions will be met on or around June 17, 2008.

Outlook

Our priorities for the next few months include continuing to expand and grow our biomethane gas processing business, working to secure the first commercial order of an H-6200 hydrogen purifier, and reducing our operating costs and cash burn.

We are continuing our efforts to increase our penetration in the biomethane market. During the quarter, we signed a supply agreement with Verdesis Suisse, which is expected to drive further sales growth in the European marketplace. We are also seeing growing interest in and development of the North American biogas market. Subsequent to quarter end, we announced that we will be supplying an M-3200 for a biomethane to vehicle fuel project in California. The project will be integrated by Phase 3 Renewables LLC ("Phase 3"). This is the third sale we have made to Phase 3 for North American biogas projects.

Field testing of the H-6200 prototype plant at an Exxon Mobil refinery in France was successfully completed in March 2008. The unit demonstrated its ability to effectively recover hydrogen from refinery gas streams and return purified hydrogen for plant applications. The operating performance and robustness of the prototype plant under various conditions bode well for future sales of the H-6200 hydrogen purifier. EMRE and QuestAir are using the data from the prototype test to market the H-6200 to both ExxonMobil and third party refineries. These activities are expected to support our objective of securing the first commercial order for an H-6200 hydrogen purifier during this fiscal year.

During the quarter we announced a new engineering services contract with EMRE, which will provide $6.3 million over the next two years against specific deliverables. This contract will allow us to further reduce our net R&D expenses, which is one of the key operating costs of the Company. The funding under this program will also reduce our cash burn going forward.

Also during the quarter, we announced cost-cutting measures aimed at further reducing our operating expenses. Staffing reductions were focused largely on further reducing R&D expenditures and are expected to save the Company $1.25 million per year.

As a result of the new EMRE contract and the reductions in headcount, on March 3, 2008 we revised our guidance for fiscal 2008. We now expect recognized revenue for the full fiscal year to be in the range of $11 to $12 million (up from $9 to $10 million), and cash used in operations and capital expenditures to be in the range of $6.5 to $7.5 million (compared to less than $8 million).

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 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 March 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 March 31, 2008, raw materials on hand of $930,845 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 March 31, 2008 and 2007, 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, we have adopted this new standard effective October 1, 2007. As this standard relates only to disclosure requirements, this section does not have an 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, we have adopted this new standard 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.

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 comes into effect for fiscal years beginning on or after January 1, 2008; accordingly we will adopt this new standard on October 1, 2008. We are assessing the impact this standard will have on 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). These recommendations are effective for the Company beginning October 1, 2008. Goodwill and intangible assets that are not assets as defined by GAAP will be derecognized and charged to the equity of the Company at that date. We are evaluating the effect of these recommendations on our financial statements.

Internal Controls and Procedures

There were no changes in our internal control over financial reporting that occurred during the most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

Risks & Uncertainties

A detailed explanation of the risk factors that 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:

Competitive Risks
The H-6200 hydrogen purifier incorporating QuestAir's second generation PSA technology completed a field test at a refinery in March, 2008. The successful completion of this field test reduces the technology risks and uncertainties regarding this product. However, 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 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 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 recognition and compensation program that rewards both group and individual contributions and performance.

(expressed in Canadian dollars)

Balance Sheets

	As at March 31 2008	As at September 30 2007
ASSETS		
Current assets:		
Cash and cash equivalents (note 5)	$3,635,283	$5,726,245
Restricted cash (note 6)	256,717	340,802
Short-term investments (note76)	62,048	3,060,447
Accounts receivable	1,728,020	1,412,983
Inventories	6,324,162	4,376,717
Prepaid expenses	212,731	256,378
Derivatives (note 8)	623	-
	12,219,584	15,173,572
Deferred charges	268,000	-
Property, plant and equipment	1,591,181	1,703,872
Other long-term assets	182,080	175,080
	$14,260,845	$17,052,524
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$2,773,417	$2,791,139
Deferred revenue	6,243,722	4,546,584
Current portion of bank debt (note 9)	481,651	564,306
Current portion of obligations under capital lease	100,939	97,822
Derivatives (note 8)	-	75,874
	9,599,729	8,075,725
Long term liabilities:		
Bank debt (note 9)	304,897	356,030
Obligation under capital lease	100,940	97,822
	10,005,566	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 10a)	109,702,558	109,383,859
Contributed surplus (note 10b)	6,488,337	6,626,825
Deficit	(111,935,616)	(107,487,737)
	4,255,279	8,522,947
	$14,260,845	$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		For the six months ended	
	March 31 2008	March 31 2007	March 31 2008	March 31 2007
Revenues	$2,298,448	$872,746	$3,866,373	$2,516,222
Cost of goods sold	1,256,753	2,244,476	2,576,489	3,604,545
Gross profit	1,041,695	(1,371,730)	1,289,884	(1,088,323)
Operating expenses				
Research and development – net (note 12)	933,699	1,347,995	1,889,563	2,351,072
General and administration (note 13b)	1,189,821	902,657	2,075,389	1,662,914
Operations	430,189	242,093	867,807	532,415
Sales and marketing	487,634	564,960	889,210	1,065,035
Amortization	179,251	201,450	353,272	431,812
	3,220,594	3,259,155	6,075,241	6,043,248
Loss before undernoted	(2,178,899)	(4,630,885)	(4,785,357)	(7,131,571)
Other income (expense)				
Interest income	31,462	140,059	100,752	296,132
Other	90,034	(153,692)	236,726	(33,744)
	121,496	(13,633)	337,478	262,388
Loss and comprehensive loss for the period	(2,057,403)	(4,644,518)	(4,447,879)	(6,869,183)
Deficit – Beginning of period	(109,878,213)	(97,294,990)	(107,487,737)	(95,070,325)
Deficit – End of period	$(111,935,616)	$(101,939,508)	$(111,935,616)	$(101,939,508)
Basic and diluted loss per share	$(0.04)	$(0.09)	$(0.08)	$(0.13)
Weighted average number of common shares outstanding	52,683,647	52,442,386	52,622,558	52,417,454

(expressed in Canadian dollars)

Statements of Cash Flows

	For the three months ended March 31 2008	March 31 2007	For the six months ended March 31 2008	March 31 2007
Cash flows from operating activities				
Loss for the period	$(2,057,403)	$(4,644,518)	$(4,447,879)	$(6,869,183)
Items not involving cash				
Amortization	179,251	201,450	353,272	431,812
Gain on sale of property, plant and equipment	-	(285)	-	(350)
Unrealized foreign exchange (gain) loss on derivatives (note 8)	(2,557)	71,367	(76,498)	9,840
Non-cash compensation expense	75,121	125,543	180,068	245,448
Foreign currency loss	6,923	-	6,234	-
	(1,798,665)	(4,246,443)	(3,984,803)	(6,182,433)
Changes in non-cash operating working capital				
Accounts, grants and funding receivables	1,131,458	848,538	(315,037)	193,946
Inventories	(679,341)	181,175	(1,947,446)	(372,695)
Prepaid expenses	(115,162)	(214,742)	36,647	(96,891)
Accounts payable and accrued liabilities (note 15)	(659,682)	1,202,534	(238,844)	(684,699)
Deferred revenue	42,106	1,118,404	1,697,138	2,189,004
	(280,621)	3,135,909	(767,542)	1,228,665
	(2,079,286)	(1,110,534)	(4,752,345)	(4,953,768)
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 15)	(86,788)	(99,448)	(240,581)	(366,267)
Government grants and funding related to property, plant and equipment	-	-	-	5,435
Proceeds on sale of property, plant and equipment	-	285	-	350
Decrease in restricted cash	-	-	84,085	-
Increase in restricted cash	-	(372,574)	-	(107,594)
	(86,788)	(471,737)	2,841,903	1,931,924
Cash flows from financing activities				
Issuance of common shares on exercise of stock options	-	58,788	143	58,788
Deferred charges (note 15)	(46,876)	-	(46,876)	-
Issuance of bank debt	146,379	-	153,629	248,505
Repayment of bank debt	(145,614)	(112,749)	(287,416)	(179,746)
	(46,111)	(53,961)	(180,520)	127,547
Decrease in cash and equivalents	(2,212,185)	(1,636,232)	(2,090,962)	(2,894,297)
Cash and equivalents – Beginning of period	5,847,468	9,760,735	5,726,245	11,018,800
Cash and equivalents – End of period	$3,635,283	$8,124,503	$3,635,283	$8,124,503

Supplemental cash flow information (note 15)

Notes to the financial statements

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 March 31, 2008, has an accumulated deficit of $111,935,616. The Company's ability to continue as a going concern will depend on management's ability to successfully execute its business plan and secure additional forms of financing. Subsequent to the quarter ended March 31, 2008, the Company completed a financing which is subject to certain conditions, including shareholder approval, as more particularly described in note 16, subsequent event. 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 March 31, 2008 and the unaudited interim statements of operations, comprehensive loss and deficit and cash flows for the three and six months ended March 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, 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 and six months ended March 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, 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 10d.

4. Future accounting changes

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 comes into effect for fiscal years beginning on or after January 1, 2008; accordingly QuestAir will adopt this new standard in fiscal 2009. The Company is assessing the impact this standard will have on its financial statements.

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). These recommendations are effective for the Company beginning January 1, 2009. Goodwill and intangible assets that are not assets as defined by GAAP will be derecognized and charged to the equity of the Company at that date. The Company is evaluating the effect of these recommendations on its financial statements.

5. 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.

6. 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 March 31, 2008 was $256,717 (September 30, 2007 - $340,802).

7. 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.

8. Derivatives

Included in the loss for the quarter ended March 31, 2008 is an unrealized foreign exchange gain on embedded derivatives of $2,557 (March 31, 2007 - $71,367 loss). Included in the loss for the six months ended March 31, 2008 is an unrealized foreign exchange gain on embedded derivatives of $76,498 (March 31, 2007 - $9,840 loss). 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 March 31, 2008.

9. 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 March 31, 2008, the Company had drawn $786,548 (September 30, 2007 - $920,336) on the term loans net of repayments. Accrued interest payable as at March 31, 2008 was $1,824 (September 30, 2007 - $1,979) and is included in accounts payable and accrued liabilities. Total interest expense was $13,477 (March 31, 2007 - $17,055) for the quarter ended March 31, 2008. Draws can be made against the Tranche 3 term loan, to a maximum of US$1 million, prior to June 21, 2008. As at March 31, 2008, $146,379 was drawn against the Tranche 3 term loan.

10. Shareholders' equity

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

(expressed in Canadian dollars)

For the three months ended March 31, 2008

	Common shares $	Contributed surplus $	Deficit $	Total shareholders' equity $	Comprehensive loss $
December 31, 2007	109,702,558	6,413,216	(109,878,213)	6,237,561	-
Net Loss	-	-	(2,057,403)	(2,057,403)	(2,057,403)
Exercise of share options	-	-	-	-	
Stock-based compensation allocated to common shares on exercise of share options	-	-	-	-	
Stock-based compensation on fair value share options	-	75,121	-	75,121	
March 31, 2008	109,702,558	6,488,337	(111,935,616)	4,255,279	

For the three months ended March 31, 2007

	Common shares $	Contributed surplus $	Deficit $	Total shareholders' equity $	Comprehensive loss $
December 31, 2006	109,020,202	6,582,677	(97,294,990)	18,307,889	-
Net Loss	-	-	(4,644,518)	(4,644,518)	(4,644,518)
Exercise of share options	58,788	-	-	58,788	
Stock-based compensation allocated to common shares on exercise of share options	214,385	(214,838)	-	-	
Stock-based compensation on fair value share options	-	125,543	-	125,543	
March 31, 2007	109,293,375	6,493,835	(101,939,508)	13,847,702	

For the six months ended March 31, 2008

	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	-	-	(4,447,879)	(4,447,879)	(4,447,879)
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	-	180,068	-	180,068	
March 31, 2008	109,702,558	6,488,337	(111,935,616)	4,255,279	

(expressed in Canadian dollars)

				For the six months ended March 31, 2007	
	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	-	-	(6,869,183)	(6,869,183)	(6,869,183)
Adjustment to opening balance of unrealized foreign exchange loss on derivatives	-	-	(24,847)	(24,847)	
Exercise of share options	58,788	-	-	58,788	
Stock-based compensation allocated to common shares on exercise of share options	214,385	(214,385)	-	-	
Stock-based compensation on fair value share options	-	245,448	-	245,448	
March 31, 2007	109,293,375	6,493,835	(101,939,508)	13,847,702	

a) Common shares – issued and outstanding

Authorized share capital consists of an unlimited number of common shares, of which 52,683,647 (March 31, 2007 – 52,503,920) common shares were issued and outstanding as of March 31, 2008. There were no common shares issued on exercise of share options during the quarter ended March 31, 2008 (March 31, 2007 – 110,855). An unlimited number of preferred shares are authorized, none of which are issued.

b) Contributed surplus

During the quarter ended March 31, 2008, $75,121 (March 31, 2007 - $125,543) 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 $2,057,403 (March 31, 2007 - $4,644,518) for the quarter ended March 31, 2008 and $4,447,879 (March 31, 2007 - $6,869,183) for the six months ended March 31, 2008.

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.

(expressed in Canadian dollars)

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:

	March 31 2008 $	September 30 2007 $
Bank debt	786,548	920,336
Equity	4,255,279	8,522,947
	5,041,827	9,443,283

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

11. 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. 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 March 31, 2008 2,933,161 (March 31, 2007 – 900,583) 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 March 31, 2008.

The Company calculated the minimum 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:

		Six months ended
	March 31 2008	March 31 2007
Dividend yield	0%	0%
Expected volatility	64%	61%
Risk-free interest rate	2.69%	4.08%
Expected life of options	2.3 years	5 years

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

(expressed in Canadian dollars)

Three months ended March 31, 2008	Number of Options	Weighted average exercise price	Expiry Dates
Outstanding – December 31, 2007 (1,915,703 share options exercisable)	2,717,639	$1.36	
Granted	145,000	0.24	
Exercised	-	-	
Forfeited	(170,779)	1.34	
Outstanding – March 31, 2008 (2,122,639 share options exercisable)	2,691,860	$1.30	Apr. 3, 2008 to Sep. 26, 2016

Six months ended March 31, 2008	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	157,500	0.26	
Exercised	(143,160)	0.001	
Forfeited	(2,090,405)	1.36	
Outstanding – March 31, 2008 (2,122,639 share options exercisable)	2,691,860	$1.30	Apr. 3, 2008 to Sep. 26, 2016

12. Research and development

	Three months ended		Six months ended	
	March 31 2008	March 31 2007	March 31 2008	March 31 2007
Research and development costs	$933,699	$1,347,995	$1,889,563	$2,735,637
Government funding	-	-	-	(384,565)
	$933,699	$1,347,995	$1,889,563	$2,351,072

13. Commitments and contingencies

a) 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

(expressed in Canadian dollars)

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:

1) delete certain milestones related to the GMS program
2) 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
3) reduce the Minister's contribution limit towards eligible project costs to $8.14 million, being the amount received thus far by the Company
4) 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
5) 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.

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

b) Severance and termination benefits

The Company restructured its operations during the quarter ended March 31, 2008 in order to reduce operating expenditures. Severance costs and termination benefits included in general and administration expenses total $455,487, of which $194,487 has been paid and $261,000 is payable prior to the end of fiscal 2008.

14. 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:

	Three months ended		Six months ended	
Region	March 31 2008	March 31 2007	March 31 2008	March 31 2007
United States	$1,561,937	$841,296	$2,007,758	$1,222,026
Europe	710,596	(125,109)	1,165,160	891,169
Asia	20,915	109,787	77,515	356,255
Canada	5,000	46,772	5,000	46,772
South America	-	-	610,940	-

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

(expressed in Canadian dollars)

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

Unaudited	Three months ended March 31 2008	Three months ended March 31 2007	Six months ended March 31 2008	Six months ended March 31 2007
Customer A	$950,309	$127,462	$1,394,739	$1,396,018
Customer B	389,273	-	389,273	-
Customer C	262,886	-	422,913	-
Customer D	-	-	610,940	-
Customer E	-	164,221	-	-
Customer F	-	370,840	-	386,726

15. Supplemental cash flow information

Unaudited	Three months ended March 31 2008	Three months ended March 31 2007	Six months ended March 31 2008	Six months ended March 31 2007
Supplemental cash flow information:				
Cash paid for interest	$34,464	$17,556	$50,060	$28,599
Cash received for interest	41,103	87,635	239,190	216,071
Non-cash operating, investing and financing activities:				
Deferred charges included in accrued liabilities	221,122	-	221,122	-
Property, plant and equipment included in accrued liabilities	-	(53,813)	-	(304,258)

16. Subsequent event

On May 13, 2008, the Company announced the closing of an underwritten offering of subscription receipts for gross proceeds of $9 million. Each subscription receipt is automatically exchangeable into a unit consisting of one common share and one common share purchase warrant upon receipt of shareholder and listing approvals, which is required to be obtained on or before June 17, 2008. The Company has also granted the underwriters an over-allotment option to purchase a further $1.35 million worth of subscription receipts exercisable for 30 days from closing. The offering is subject to certain conditions, including but not limited to, the receipt of all necessary regulatory approvals including approvals of the Toronto Stock Exchange and the AIM. Management expects that such approvals will be received and the conditions will be removed no later than June 17, 2008.