QuestAir Technologies Inc.

Third 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 August 6, 2008 relates to our interim financial statements for the third quarter of fiscal 2008, being the three and nine months ended June 30, 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 expectation that QuestAir will participate in two clean energy projects that are being partially funded by the British Columbia Government, and that contract negotiations related to these projects will result in sales orders for the Company at a future date; (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 investments to expand the product offering, grow commercial adoption of QuestAir's products and open up markets such as biomethane purification will be successful and will build shareholder value; (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 commercial orders of H-6200 hydrogen purifiers, and the expected timing of receipt of such orders; (vii) the expected impact of the engineering services contract signed with EMRE in March 2008 on the Company's performance; (viii) the expected impact of the cost-cutting measures announced earlier in the fiscal year on future periods; (ix) management's belief that growth drivers in the biogas purification market remain strong; (x) the expected growth in biomethane purification product sales, and the expectation that QuestAir will undertake initial full scope biogas projects in fiscal 2009; (xi) management's belief that the future prospects for the business remain positive; (xii) the expected recognized revenue for the Company's full fiscal year; and (xiii) the expected cash used in operations and capital requirements for the 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 14.

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 third quarter of fiscal 2008:

- We sold a total of six H-3200 pressure swing adsorption ("PSA") units to three customers during the quarter. This included an H-3200 PSA that was sold to Hydro-Chem for a new hydrogen plant in Mexico, which will supply hydrogen to a new steel plant being constructed by POSCO.
- Phase 3 Renewables LLC purchased an M-3200 PSA to be integrated into a biogas upgrading plant at a dairy farm in California. The biomethane from this plant will be used to fuel heavy-duty milk trucks once it becomes operational, which is expected to be in the fall of 2008. This will be the first commercial scale plant in North America to produce renewable biomethane vehicle fuel from agricultural waste.
- During the quarter, QuestAir raised gross proceeds of $9,000,000 from an equity offering of subscription receipts, which were converted into common shares and share purchase warrants.
- Also during the quarter, we completed a share consolidation on a ten old shares for one new share basis. All share data contained in this MD&A and in the associated interim financial statements for the period ended June 30, 2008 are reported on a consolidated basis.
- Subsequent to quarter end the British Columbia Government announced funding for several clean energy projects. QuestAir expects to supply full scope biogas upgrading systems into two of these projects, upgrading methane from a sewage treatment plant in one project and from agricultural waste in the other. Assuming these projects proceed as planned, and contractual negotiations are completed as anticipated, these projects will become sales bookings for QuestAir in fiscal 2009.

Financial Overview

The financial highlights for the three and nine months ended June 30, 2008 are noted below:

- Revenue for the nine months ended June 30, 2008 was $6,567,935, an increase of $435,624, or 7% from $6,132,311 for the same period last year. For the quarter ended June 30, 2008, revenue was $2,701,562 a decrease of $914,526, or 25% compared to the same period in fiscal 2007.
- We ended the third quarter with a sales order backlog of $14,502,466, a decrease of $1,519,908, or 9% from $16,022,374 at March 31, 2008 when backlog was at its highest level since our inception.

- Cash used by operations and capital requirements for the nine months ended June 30, 2008 was $5,505,013, a decrease of 27% or $2,072,802 compared to the same period in fiscal 2007. For the quarter ended June 30, 2008, cash used by operations and capital requirements decreased significantly to $512,087 compared to $2,263,565 in the same period in fiscal 2007. The 77% reduction in cash usage compared to the prior period was a result of significant cash inflows from the new engineering services contract with ExxonMobil Research and Engineering ("EMRE") that was entered into in March 2008, as well as lower operating costs following the restructuring that took place in the second quarter of fiscal 2008.

- Net loss for the nine months ended June 30, 2008 decreased 36% to $6,030,126 ($1.08 per share) from $9,428,387 ($1.80 per share) for the same period in 2007. For the quarter ended June 30, 2008, net loss was $1,582,247 ($0.25 per share), decreased by $976,957, or 38% 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 June 30,		Nine months ended June 30,	
	2008	2007	2008	2007
Gas purification systems	1,300,189	3,333,135	4,011,139	5,613,689
Engineering service contracts	1,401,373	282,953	2,556,796	518,622
Total revenue	2,701,562	3,616,088	6,567,935	6,132,311

Revenue from engineering services contracts increased significantly in each of the three months and nine months ended June 30, 2008 compared to the same periods in fiscal 2007. This reflects the higher level of engineering service contracts in backlog, and a corresponding higher level of activity to complete these contracts, compared to the prior periods. This trend is expected to continue for several quarters as a result of the $6.3 million engineering services contract with EMRE that was entered into in March 2008, which will elevate the revenue recognized from engineering service contracts until it is completed in December 2009. Revenue from gas purification systems decreased by $2,032,946 for the quarter and $1,602,550 for the nine months ended June 30, 2008 compared to the same periods in fiscal 2007, relating to fluctuations in the timing of revenue recognition of our commercial products which is based on timing of customer acceptance.

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 the nine months ended June 30, 2008.

(Unaudited)	For the three months ended June 30, 2008			For the nine months ended June 30, 2008		
	Gas Purification Systems	Engineering Service Contracts	Total	Gas Purification Systems	Engineering Service Contracts	Total
Opening Balance	8,390,638	7,631,736	16,022,374	8,954,635	2,099,130	11,053,765
Bookings	1,304,748	-	1,304,748	2,899,806	6,457,200	9,357,006
Revenue	(1,300,189)	(1,401,373)	(2,701,562)	(4,011,139)	(2,556,796)	(6,567,935)
Adjustments[1]	(67,218)	(55,876)	(123,094)	484,677	174,953	659,630
Ending Balance	8,327,979	6,174,487	14,502,466	8,327,979	6,174,487	14,502,466

The total sales order backlog decreased by $1,519,908 or 9% during the third quarter of fiscal 2008, as the dollar value of revenue recognized exceeded new bookings in the quarter. Included in bookings for the quarter was an order for an H-3200 for use in a new hydrogen plant to be constructed by Hydro-Chem, and an order for an M-3200 for use in the “Biomethane for Vehicle Fuel” project located at the Hilarides Dairy in California. We expect that approximately 30% to 35% of the sales order backlog as of June 30, 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 June 30,		Nine months ended June 30,	
	2008	2007	2008	2007
Revenue	2,701,562	3,616,088	6,567,935	6,132,311
Cost of goods sold	1,631,305	2,393,370	4,207,794	5,997,915
Gross Profit	1,070,257	1,222,718	2,360,141	134,396
Gross Margin (%)	39.6%	33.8%	35.9%	2.2%

Gross profit decreased by $152,461 or 12% during the third quarter of fiscal 2008 compared to $1,222,718 for the same period in fiscal 2007, reflecting the decrease in recognized revenue in the current quarter compared to the third quarter of fiscal 2007. However, our percentage gross margin increased during the quarter, largely due to the increase in revenue from engineering service contracts compared to the prior period. There was a significant increase in gross profit for the nine months ended June 30, 2008 of $2,225,745 compared to the same period in fiscal 2007. Low gross profit for the prior period was the result of losses related to the prototype H-6200 hydrogen purifier (“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 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.

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 June 30		Nine months ended June 30,	
	2008	2007	2008	2007
Gross R&D Expenditure	411,245	1,424,228	2,300,809	4,159,865
Less: Government Funding	-	-	-	(384,565)
Net R&D Expenditure	411,245	1,424,228	2,300,809	3,775,300

The 71% reduction in net R&D expenditures for the quarter and 39% reduction in the nine months ended June 30, 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

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

activities. R&D expenses during the quarter were further reduced compared to the prior period as human resources that formerly completed development activities were redeployed towards completing work on engineering service contracts with EMRE.

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 $291,334 for the third quarter of fiscal 2008, an increase of 45% from $201,139 for the same period in fiscal 2007. For the nine months ended June 30, 2008, operations expenses were $1,159,141, increased by 58% compared to $733,553 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 decreased $641,719 or 31% in the quarter and $483,612 or 9% for the nine months ended June 30, 2008 compared to the same periods in fiscal 2007. G&A expenses were lower in the current quarter due to a restructuring charge of approximately $560,800 being incurred in the third quarter of fiscal 2007. Sales and marketing expenses declined in both the quarter and nine months ended June 30, 2008 compared to the prior period primarily due to lower variable costs associated with a reduction in gas purification equipment sales orders. Amortization expenses in the quarter and nine months ended June 30, 2008 fell due to less investment in new capital equipment compared to the prior periods.

Other Income / (Expenses)

Other expense was $545,140 for the third quarter of fiscal 2008 compared to $110,051 in the same period in fiscal 2007. For the nine months ended June 30, 2008, other expense was $207,662 compared to other income of $152,337 for the same period in fiscal 2007. During the quarter we recorded a one-time, unconditional royalty expense of $495,037 related to the amendment of our agreement with Technology Partnerships Canada ("TPC"). This was in addition to the regular royalty expense that we incur in respect of our agreements with TPC. As well, higher foreign exchange and derivative gains were offset by lower interest income in the current periods compared to the same periods in fiscal 2007.

Net Loss

Net loss for the quarter ended June 30, 2008 was $1,582,247 ($0.25 per share) compared to $2,559,204 ($0.49 per share) for the same period in fiscal 2007. Net loss for the nine months ended June 30, 2008 was $6,030,126 ($1.08 per share) compared to $9,428,387 ($1.80 per share) for the same period in fiscal 2007. The decrease in the net loss for the quarter was a result of decreased R&D and G&A expenses discussed previously. The decrease for the nine months ended June 30, 2008 was primarily a result of increased gross profits and reduced R&D expenses 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 the nine months ended June 30, 2008. The decrease in the loss per share for the quarter and the nine months ended June 30, 2008 was a result of a decrease in the net loss compared to the same periods in fiscal 2007 and an increase in the weighted average number of common shares outstanding upon completion of our equity financing in June 2008.

QuestAir Pure Innovations™

Capital Expenditures

Capital expenditures net of government funding and proceeds on sale (“Net CAPEX”), for the third quarter of fiscal 2008 was $45,449 compared to $36,842 for the same period in fiscal 2007. Net CAPEX for the nine months ended June 30, 2008 was $286,030 compared to $397,324 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	
	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30
Total Revenues	2,702	2,298	1,568	880	3,616	873	1,643	2,697
Gas Purification Systems	1,300	1,348	1,363	709	3,333	858	1,423	2,530
Eng. Service Contracts	1,402	950	205	171	283	15	220	167
% Gross Margin	40%	45%	16%	(15%)	34%	(157%)	17%	3%
R&D (net)	411	934	956	1,025	1,424	1,348	1,003	1,158
General & Administrative	769	1,190	886	772	1,233	903	760	767
Net Loss	1,582	2,057	2,390	2,989	2,559	4,644	2,225	2,724
Net Loss per share	(0.25)	(0.39)	(0.45)	(0.57)	(0.49)	(0.89)	(0.42)	(0.52)
Net CAPEX	45	87	154	15	37	99	261	302
Cash used in Operations & Net CAPEX	512	2,166	2,827	2,947	2,264	1,210	4,105	3,508
Backlog	14,502	16,022	10,141	11,054	7,136	7,513	5,819	5,044
Gas Purification Systems	8,328	8,390	8,144	8,955	6,660	7,078	5,697	4,908
Eng. Service Contracts	6,174	7,632	1,997	2,099	476	435	122	136

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, 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 four 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 $10,720,881 at June 30, 2008, increased from $3,635,283 at March 31, 2008 and $5,726,245 at September 30, 2007. The increase in cash and cash equivalents was a result of the equity offering that was completed during the quarter ended June 30, 2008.

Cash used by operations for the third quarter of fiscal 2008 was $466,638, compared to $2,226,723 for the same period in fiscal 2007. Our loss from operations was lower in the current quarter, and significant changes in non-cash working capital contributed to the decrease in cash used in operations compared to the same period in fiscal 2007. In the current period, inventory increased in order to fulfill customer orders in backlog. This increase in use of cash was offset by an increase in accounts payable and accrued liabilities, a decrease in accounts receivable, and an increase in deferred revenue reflecting progress payments invoiced and received from customers for orders in backlog. For the nine months ended June 30, 2008, cash used by operations was $5,218,983 compared to $7,180,491 for the same period in fiscal 2007. Reduced losses and higher proceeds from deferred revenue in the current period were partially offset by higher inventory levels compared to the prior period.

Cash used by investing activities for the third quarter of fiscal 2008 was $203,449, compared to cash provided by investing activities of $5,581,351 for the same period in fiscal 2007. The decrease in cash inflows from investing activities related to the absence of any short-term investments or restricted cash being converted to cash and cash equivalents in the current quarter as in the prior period. Cash provided by investing activities for the nine months ended June 30, 2008 was $2,638,454, compared to $7,513,275 for the same period in fiscal 2007. The decrease in cash inflows from investing activities in the current period related to decreases in the maturity of short-term investments and restricted cash being converted to cash and cash equivalents compared to the prior period.

Cash provided by financing activities was $7,755,685 for the third quarter of fiscal 2008 compared to cash usage of $17,328 for the same period in fiscal 2007. Cash provided by financing activities for the nine months ended June 30, 2008 was $7,575,165 compared to $110,219 for the same period in fiscal 2007. The cash inflow in the current three and nine month periods resulted from net proceeds from our equity offering of $7,956,828, offset by reductions in our bank debt and capital lease obligations.

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 third quarter of fiscal 2008 was $512,087, compared to $2,263,565 for the same period in fiscal 2007. Cash used by operations and capital requirements for the nine months ended June 30, 2008 was $5,505,013 compared to $7,577,815 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 June 30, 2008	Three months ended June 30, 2007	Nine months ended June 30, 2008	Nine months ended June 30, 2007
Cash used in Operating Activities	(466,638)	(2,226,723)	(5,218,983)	(7,180,491)
Add: purchase of property, plant and equipment (“PP&E”)	(45,449)	(48,539)	(286,030)	(414,806)
Add: government grants and funding related to PP&E	-	-	-	5,435
Add: proceeds from sale of PP&E	-	11,697	-	12,047
Cash used in Operations and Capital Requirements	(512,087)	(2,263,565)	(5,505,013)	(7,577,815)

Reconciliation to GAAP Statements of Cash Flow:				
Add: Short-term investments	-	4,939,554	2,998,398	7,339,554
Add: restricted cash	(158,000)	678,639	(73,915)	571,045
Add: Cash from Financing Activities	7,755,685	(17,328)	7,575,166	110,219
Increase in Cash and Cash Equivalents	7,085,598	3,337,300	4,994,636	443,003

The significant decreases in cash burn for the current quarter and nine months compared to the same periods in fiscal 2007 reflects management efforts to decrease operating costs as part of the reorganization that took effect in March 2008. In addition, the $6.3 million engineering service contract with EMRE that was entered into in March 2008 has reduced our R&D expenses and contributed significantly to cash inflows, which decreased cash used in operating activities during the most recent quarter.

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 June 30, 2008 cash and short-term investments were $10,782,929, compared to $3,697,331 at March 31, 2008. Not included in cash and short term investments at June 30, 2008 was $414,717 of restricted cash to secure letters of credit with customers ($256,717 at March 31, 2008).

During the quarter, we raised gross proceeds of $9,000,000 through the offering of 60,000,000 subscription receipts and the completion of the exchange of each subscription receipt into one unit consisting of one common share and one common share purchase warrant. Net proceeds from the offering were $7,918,882 after share issuance costs of $1,264,718 (including $183,600 of non-cash expenses).

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 2008. The amended credit facilities include a US$1 million accounts receivable line of credit and a US$1 million term loan, in addition to amounts outstanding under the prior term loan agreements. Both facilities are secured by the assets of the Company with certain exceptions. As at June 30, 2008, we had drawn $640,933 against the prior term loans net of repayments. We expect to use the equipment line to fund capital expenditures and we may use the accounts receivable line to fund working capital requirements from time to time. At July 31, 2008 we are in compliance with all of our bank covenants.

Contractual Obligations

The following table lists our contractual obligations at June 30, 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	640,933	486,214	154,719	-	-
Capital leases	99,473	99,473	-	-	-
Operating leases	694,856	279,463	371,349	40,044	-
Purchase obligations[2]	1,689,160	1,689,160	-	-	-
Total contractual obligations	3,124,422	2,554,310	526,068	40,044	-

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. One of the funding agreements with TPC was amended in the most recent quarter. The amending agreement is discussed in the notes to our interim financial statements for the period ended June 30, 2008. We did not enter into any new contingent off-balance sheet financing arrangements during the quarter or nine months ended June 30, 2008.

Outstanding Share Data

Common Shares Outstanding

Our authorized share capital consists of an unlimited number of common shares, of which 11,268,318 common shares were issued and outstanding as of July 31, 2008. We also have an unlimited number of preferred shares authorized, none of which are issued.

On May 13, 2008, we completed an offering of subscription receipts, which were automatically converted into common shares and share purchase warrants following receipt of shareholder approval of the offering on June 16, 2008. On June 27, 2008, we completed a common share consolidation on a 10 for 1 basis, reducing the number of common shares outstanding from 112,683,647 to 11,268,318. All share data in this MD&A and in the associated financial statements for the period ended June 30, 2008 are reported on a consolidated basis and the basic and diluted earnings per share have been adjusted retroactively for all periods presented to reflect the common share consolidation.

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

(Unaudited)	Three months ended June 30,		Nine months ended June 30,	
	2008	2007	2008	2007
Weighted Average Common Shares Outstanding	6,257,376	5,251,939	5,592,752	5,245,143

The average number of common shares outstanding increased for the quarter and the nine months ended June 30, 2008 compared to the same periods in fiscal 2007 as a result of the issuance of 6,000,000 common shares in the third quarter of fiscal 2008.

Stock Options and Warrants Outstanding

As at July 31, 2008 there were 383,247 stock options outstanding with an average exercise price of $8.01, of which 201,098 were exercisable. As at July 31, 2008 there were 6,180,000 warrants outstanding compared to 192,308 in the prior period, which expired in the current quarter. The outstanding warrants were issued in conjunction with the equity offering and expire on May 13,

[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.

2010. Of the warrants issued during the quarter, 6,000,000 have an exercise price of $2.15 and 180,000 have an exercise price of $1.50.

Outlook

On March 3, 2008 we revised our financial guidance for fiscal 2008, stating that recognized revenue for the full fiscal year is expected to be in the range of $11 to $12 million, and that cash used in operations and capital expenditures is expected to be in the range of $6.5 to $7.5 million. Based on current estimates, we expect that recognized revenue will be within the guidance range, and that cash used in operations and capital expenditures for the full fiscal year will be towards the high end of the range ($7.5 million). Variables that can affect the amount of revenue recognized include timing of cash receipts on equipment sales and costs incurred on engineering service contracts (which affects the percentage of completion calculations). Similarly, our cash used in operations and capital expenditures estimates may be impacted by variables such as timing of cash receipts and disbursements, and the level and timing of receipt of new sales orders.

Going forward, we will continue to focus on core opportunities in our key markets in order to build value for shareholders. We will make targeted investments to expand our product offering, grow the commercial adoption of our products and open up important markets such as biomethane purification. This must be balanced with the need for ongoing prudent financial management. Our priorities for the remainder of fiscal 2008 include growing our sales of biomethane and hydrogen purification equipment, marketing full scope biogas solutions, and continuing to carefully control our operating costs.

Sales orders of gas purification equipment for the first nine months of fiscal 2008 and for the third quarter in particular have been below our expectations, in part due to delays in certain projects that were expected to begin earlier. During the final quarter of the fiscal year, we will be working to secure additional orders of gas purification equipment, including in the biogas upgrading market where we continue to see significant market potential for our products.

Although we expect to meet our financial guidance for the year, the lower than expected level of sales orders will make it difficult for us to meet our goal of growing our industrial hydrogen business in fiscal 2008. Our objective to increase the number of hydrogen system sales is unlikely to be met, as we have not secured as many orders of larger PSAs as we anticipated at the beginning of the year.

With respect to the H-6200 hydrogen purifier, in March of this year QuestAir successfully completed field testing of a prototype H-6200 at an ExxonMobil refinery in France. 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. We are presently working with our partner, EMRE, to market the H-6200 to both ExxonMobil and third party refineries. Commercial prospects for this product remain positive. However, the fact that the prototype test ended only in March coupled with a lengthy sales cycle in the refinery environment means that we now expect the first commercial order for an H-6200 to be received in fiscal 2009.

Management remains optimistic regarding future prospects for our business. Growth drivers in the biogas market remain strong. We expect to see growth in product sales into this market, and to undertake initial full scope biogas projects in fiscal 2009. Additionally, the H-6200 hydrogen purifier has now moved well beyond the testing phase and we expect to see commercial sales of the H-6200 commence in fiscal 2009. Finally, we expect that measures we undertook earlier in fiscal 2008 to reduce our operating costs will continue to benefit the company in future fiscal years.

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 June 30, 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 June 30, 2008, raw materials on hand of $988,462 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 June 30, 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.

International Financial Reporting Standards

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

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 rollback 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.

QuestAir Technologies Inc.
Unaudited Interim Financial Statements
June 30, 2008 and 2007
(expressed in Canadian dollars)

Balance Sheets

Unaudited (expressed in Canadian dollars)	As at June 30 2008	As at September 30 2007
ASSETS		
Current assets:		
Cash and cash equivalents (note 5)	$10,720,881	$5,726,245
Restricted cash (note 6)	414,717	340,802
Short-term investments (note7)	62,048	3,060,447
Accounts receivable	1,491,517	1,412,983
Inventories	6,978,688	4,376,717
Prepaid expenses	222,681	256,378
	19,890,532	15,173,572
Property, plant and equipment	1,455,378	1,703,872
Other long-term assets	182,080	175,080
	$21,527,990	$17,052,524
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$2,978,418	$2,791,139
Deferred revenue	7,137,568	4,546,584
Current portion of bank debt (note 9)	486,214	564,306
Current portion of obligation under capital lease	99,473	97,822
Derivatives (note 8)	-	75,874
	10,701,673	8,075,725
Long term liabilities:		
Bank debt (note 9)	154,719	356,030
Obligation under capital lease	-	97,822
	10,856,392	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)	115,363,615	109,383,859
Contributed surplus (note 10)	8,825,846	6,626,825
Deficit	(113,517,863)	(107,487,737)
	10,671,598	8,522,947
	$21,527,990	$17,052,524
Description of business (note 1)		
Commitments and contingencies (note 13)		

Statements of Operations, Comprehensive Loss and Deficit

Unaudited (expressed in Canadian dollars)	For the three months ended June 30 2008	June 30 2007	For the nine months ended June 30 2008	June 30 2007
Revenues	$2,701,562	$3,616,088	$6,567,935	$6,132,311
Cost of goods sold	1,631,305	2,393,370	4,207,794	5,997,915
Gross profit	1,070,257	1,222,718	2,360,141	134,396
Operating expenses				
Research and development – net (note 12)	411,245	1,424,228	2,300,809	3,775,300
General and administration (note 13b)	768,556	1,233,181	2,843,944	2,896,095
Operations	291,334	201,139	1,159,141	733,553
Sales and marketing	454,978	603,677	1,344,188	1,668,713
Amortization	181,251	209,646	534,523	641,459
	2,107,364	3,671,871	8,182,605	9,715,120
Loss before undernoted	(1,037,107)	(2,449,153)	(5,822,464)	(9,580,724)
Other income (expense)				
Interest income	41,856	118,833	142,608	414,965
Royalty expense	(511,823)	(39,475)	(615,608)	(102,186)
Other	(75,173)	(189,409)	265,338	(160,442)
	(545,140)	(110,051)	(207,662)	152,337
Loss and comprehensive loss for the period	(1,582,247)	(2,559,204)	(6,030,126)	(9,428,387)
Deficit – Beginning of period	(111,935,616)	(101,939,508)	(107,487,737)	(95,070,325)
Deficit – End of period	$(113,517,863)	$(104,498,712)	$(113,517,863)	$(104,498,712)
Basic and diluted loss per share	$(0.25)	$(0.49)	$(1.08)	$(1.80)
Weighted average number of common shares outstanding (note 10a)	6,257,376	5,251,939	5,592,752	5,245,143

Statements of Cash Flows

Unaudited (expressed in Canadian dollars)	For the three months ended		For the nine months ended	
	June 30 2008	June 30 2007	June 30 2008	June 30 2007
Cash flows from operating activities				
Loss for the period	$(1,582,247)	$(2,559,204)	$(6,030,126)	$(9,428,387)
Items not involving cash				
Amortization	181,251	209,646	534,523	641,459
Gain on sale of property, plant and equipment	-	(2,213)	-	(2,564)
Unrealized foreign exchange (gain) loss on derivatives (note 8)	249	56,059	(76,249)	65,899
Non-cash compensation expense	79,684	104,986	259,752	350,434
Foreign currency loss (gain)	-	(18,605)	6,234	(18,605)
	(1,321,063)	(2,209,331)	(5,305,866)	(8,391,764)
Changes in non-cash operating working capital				
Accounts receivable	236,877	49,554	(78,160)	243,500
Inventories	(654,525)	797,027	(2,601,971)	424,332
Prepaid expenses	(9,950)	127,697	26,697	30,806
Accounts payable and accrued liabilities (note 15)	388,176	57,588	149,332	(627,111)
Deferred revenue	893,847	(1,049,258)	2,590,985	1,139,746
	854,425	(17,392)	86,883	1,211,273
	(466,638)	(2,226,723)	(5,218,983)	(7,180,491)
Cash flows from investing activities				
Decrease in short-term investments	-	4,939,554	3,060,447	7,339,554
Increase in short-term investments	-	-	(62,048)	-
Purchase of property, plant and equipment (note 15)	(45,449)	(48,539)	(286,030)	(414,806)
Government grants and funding related to property, plant and equipment	-	-	-	5,435
Proceeds on sale of property, plant and equipment	-	11,697	-	12,047
(Increase) decrease in restricted cash	(158,000)	678,639	(73,915)	571,045
	(203,449)	5,581,351	2,638,454	7,513,275
Cash flows from financing activities				
Proceeds from financing (note 10a)	9,000,000	-	9,000,000	-
Share issuance cost	(996,296)	-	(1,043,172)	-
Issuance of common shares on exercise of stock options	-	9,097	143	67,885
Repayment of capital lease	(102,405)	(127,930)	(102,405)	(127,930)
Issuance of bank debt	-	214,254	153,629	462,759
Repayment of bank debt	(145,614)	(112,749)	(433,030)	(292,495)
	7,755,685	(17,328)	7,575,165	110,219
Increase in cash and cash equivalents	7,085,598	3,337,300	4,994,636	443,003
Cash and cash equivalents – Beginning of period	3,635,283	8,124,503	5,726,245	11,018,800
Cash and cash equivalents – End of period	$10,720,881	$11,461,803	$10,720,881	$11,461,803

Supplemental cash flow information (note 15)

Notes to the financial statements

1. Description of business

QuestAir Technologies Inc. (the "Company"), a federally incorporated Canadian company, is an emerging developer, manufacturer and supplier of advanced pressure swing adsorption ("PSA") gas purification systems. PSA systems are used extensively in the production of 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.

The Company has not yet realized profitable operations and has relied on non-operational sources of financing to fund its operations. The Company raised additional capital to finance its operations in fiscal 2008. The Company's ultimate success and the recoverability of long-lived assets will depend on its ability to successfully execute its business plan.

2. Unaudited interim financial statements

The unaudited balance sheet as at June 30, 2008 and the unaudited interim statements of operations, comprehensive loss and deficit and cash flows for the three and nine months ended June 30, 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 nine months ended June 30, 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 the Company will adopt this new standard in fiscal 2009. The Company is assessing the impact this standard will have on its financial statements.

The CICA issued Section 3064, Goodwill and Intangible Assets, which establish standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets (including internally developed intangible assets). These recommendations are effective for the Company beginning October 1, 2008. 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 impact this standard will have 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 June 30, 2008 was $414,717 (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 three months ended June 30, 2008 is an unrealized foreign exchange loss on embedded derivatives of $249 (June 30, 2007 - $56,059). Included in the loss for the nine months ended June 30, 2008 is an unrealized foreign exchange gain on embedded derivatives of $76,249 (June 30, 2007 - $65,899 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 June 30, 2008.

(expressed in Canadian dollars)

9. Bank debt

In April 2005, the Company signed a credit agreement with Comerica Bank. This agreement was amended and restated in June 2008 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 (Tranche 4) to finance equipment purchases, in addition to amounts outstanding under prior term loan agreements. The interest rate on Tranche 4 is 1.75% above the Prime Rate compared to 0.75% above the Prime Rate for the prior term loans. 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 of June 30, 2008, The Company is in compliance with the financial covenants.

As at June 30, 2008, the Company had drawn $640,933 (September 30, 2007 - $920,336) on the term loans net of repayments. Accrued interest payable as at June 30, 2008 was $1,291 (September 30, 2007 - $1,979) and is included in accounts payable and accrued liabilities. Total interest expense was $10,314 (June 30, 2007 - $15,481) for the three months ended June 30, 2008. Draws can be made against the Tranche 4 term loan, to a maximum of US$1 million, prior to June 19, 2009. As at June 30, 2008, no funds were drawn against the Tranche 4 term loan.

10. Shareholders' equity

Changes to shareholders' equity for the three and nine months ended June 30, 2007 and 2008 are presented below:

Unaudited

For the three months ended June 30, 2008

	Common shares $	Contributed surplus $	Deficit $	Total shareholders' equity $	Comprehensive loss $
March 31, 2008	109,702,558	6,488,337	(111,935,616)	4,255,279	-
Net Loss	-	-	(1,582,247)	(1,582,247)	(1,582,247)
Issuance of common shares, net of financing costs	5,661,057	-	-	5,661,057	
Issuance of warrants, net of financing costs	-	2,257,825	-	2,257,825	
Stock-based compensation on fair value share options	-	79,684	-	79,684	
June 30, 2008	115,363,615	8,825,846	(113,517,863)	10,671,598	

(expressed in Canadian dollars)

Unaudited

For the three months ended June 30, 2007

	Common shares $	Contributed surplus $	Deficit $	Total shareholders' equity $	Comprehensive loss $
March 31, 2007	109,293,375	6,493,835	(101,939,508)	13,847,702	-
Net Loss	-	-	(2,559,204)	(2,559,204)	(2,559,204)
Exercise of share options	9,097	-	-	9,097	
Stock-based compensation allocated to common shares on exercise of share options	57,182	(57,182)	-	-	
Stock-based compensation on fair value share options	-	104,986	-	104,986	
June 30, 2007	109,359,654	6,541,639	(104,498,712)	11,402,581	

Unaudited

For the nine months ended June 30, 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	-	-	(6,030,126)	(6,030,126)	(6,030,126)
Issuance of common shares, net of financing costs	5,661,057	-	-	5,661,057	
Issuance of warrants net, of financing costs	-	2,257,825	-	2,257,825	
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	-	259,752	-	259,752	
June 30, 2008	115,363,615	8,825,846	(113,517,863)	10,671,598	

(expressed in Canadian dollars)

Unaudited

For the nine months ended June 30, 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	-	-	(9,428,387)	(9,428,387)	(9,428,387)
Adjustment to opening balance of unrealized foreign exchange loss on derivatives	-	-	(24,847)	(24,847)	
Exercise of share options	67,885	-	-	67,885	
Stock-based compensation allocated to common shares on exercise of share options	271,567	(271,567)	-	-	
Stock-based compensation on fair value share options	-	350,434	-	350,434	
June 30, 2007	109,359,654	6,541,639	(104,498,712)	11,402,581	

a) Common shares – issued and outstanding

During the three months ended June 30, 2008, the Company completed an equity offering issuing 60,000,000 subscription receipts for gross proceeds of $9,000,000. Each subscription receipt was exchanged for one common share of the Company stock and one common share purchase warrant. The Company subsequently consolidated its issued and outstanding share capital on a 1 new share for 10 old shares basis. After giving effect to the share consolidation, each whole warrant will entitle the holder to acquire one additional common share at a price of $2.15 per share until May 13, 2010. A fair value of $2,413,361 was recognized by the Company as the proceeds for the warrants. Total share issuance costs for the financing was $1,264,718 including non cash costs of $183,600, of which $925,582 was allocated to common shares and $339,136 was allocated to warrants.

The fair value of warrants was estimated as at the date the equity offering was priced, using the Black-Scholes option-pricing model with the following weighted-average assumptions:

Dividend yield	0.0%
Expected volatility	65%
Risk-free interest rate	2.8%
Expected average warrant term (years)	2.00

After giving effect to the equity offering and share consolidation, authorized share capital consists of an unlimited number of common shares, of which 11,268,318 (June 30, 2007 – 5,253,049) common shares were issued and outstanding as of June 30, 2008. No common shares were issued on exercise of share options during the three months ended June 30, 2008 (June 30, 2007 – 2,657). An unlimited number of preferred shares are authorized, none of which are issued. The basic and diluted earnings per share have been adjusted retroactively for all periods presented to reflect the common share consolidation.

(expressed in Canadian dollars)

b) Contributed surplus

During the three months ended June 30, 2008, $79,684 (June 30, 2007 - $104,986) of stock-based compensation on share options issued to employees under the fair value method was recorded in contributed surplus. As noted above, a fair value of $2,074,225 was recognized by the Company as proceeds for the warrants net of financing costs of $339,136, which is included in the balance of contributed surplus as at June 30, 2008.

c) Comprehensive loss

Comprehensive loss is the decrease in equity from sources other than owners and comprises net loss and other revenues, expenses, gains and losses that, pursuant to Canadian GAAP, are excluded from net loss. The Company had no other comprehensive gains or losses during the year; therefore, the comprehensive loss equals net loss of $1,582,247 (June 30, 2007 - $2,559,204) for the three months ended June 30, 2008 and $6,030,126 (June 30, 2007 - $9,428,387) for the nine months ended June 30, 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.

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	June 30 2008 $	September 30 2007 $
Bank debt	640,933	920,336
Equity	10,671,598	8,522,947
	11,312,531	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. Under the 2006 Plan, Common shares approved for issuance under all stock-based compensation arrangements are limited to the greater of 591,560 and 10% of the

(expressed in Canadian dollars)

Common shares issued and outstanding. After the equity offering was completed in the three months ended June 30, 2008, the maximum number of Common shares available for issuance under all stock-based compensation arrangements increased to 1,126,831.

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. In the three months ended June 30, 2008, 156,060 (June 30, 2007 -1,500) options were issued. Included were 144,860 options, vesting over two years and exercisable for five years, issued to non-executive employees. At June 30, 2008 713,588 (June 30, 2007 – 102,533) 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 June 30, 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:

Unaudited		Nine months ended
	June 30 2008	June 30 2007
Dividend yield	0%	0%
Expected volatility	70%	60%
Risk-free interest rate	3.33%	4.09%
Expected life of options	3.1 years	5 years

Share option activity for the three and nine months ended June 30, 2008 is presented below:

Unaudited Three months ended June 30, 2008	Number of Options	Weighted average exercise price	Expiry Dates
Outstanding – March 31, 2008 (212,264 share options exercisable)	269,186	$13.00	
Granted	156,060	1.41	
Exercised	-	-	
Forfeited	(41,061)	15.59	
Outstanding – June 30, 2008 (201,556 share options exercisable)	384,185	$8.02	Jul. 30, 2008 to Sep. 26, 2016

Unaudited Nine months ended June 30, 2008	Number of Options	Weighted average exercise price	Expiry Dates
Outstanding – September 30, 2007 (381,584 share options exercisable)	476,792	$13.20	
Granted	171,810	1.52	
Exercised	(14,316)	0.01	
Forfeited	(250,101)	13.90	
Outstanding – June 30, 2008 (201,556 share options exercisable)	384,185	$8.02	Jul. 30, 2008 to Sep. 26, 2016

(expressed in Canadian dollars)

12. Research and development

Unaudited	Three months ended June 30 2008	Three months ended June 30 2007	Nine months ended June 30 2008	Nine months ended June 30 2007
Research and development costs	$411,245	$1,424,228	$2,300,809	$4,159,865
Government funding	-	-	-	(384,565)
	$411,245	$1,424,228	$2,300,809	$3,775,300

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 were to be shared, subject to certain contribution limits, such that the Minister's contribution would 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 19,230 transferable warrants convertible into common shares at a strike price of $38.80, exercisable for a term of five years (which warrants expired unexercised), and
ii. repayable contributions to the Minister during the royalty period based on 1.165% of gross business revenues.

During the three months ended June 30, 2008, the Company entered into an Amendment Agreement 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 Amendment Agreement:

1) deleted certain milestones related to the GMS program
2) extended certain milestones related to the FCPSA program, such that the work phase of the program will end on September 30, 2008
3) reduced the Minister's contribution limit towards eligible project costs to $8.14 million, being the amount received thus far by the Company
4) reduced the ceiling on the conditional repayments under the agreement to $18.8 million and extended the date by which the royalty period will end by 12 months to September 30, 2022
5) provided for an unconditional, one-time royalty payment of $0.5 million to be paid on or before November 28, 2008.

b) Severance and termination benefits

The Company restructured its operations during the three months ended March 31, 2008 in order to reduce operating expenditures. Severance costs and termination benefits included in general and administration expenses total $458,604, of which $380,236 has been paid and $78,368 is payable prior to the end of fiscal 2008.

(expressed in Canadian dollars)

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:

Unaudited	Three months ended		Nine months ended	
	June 30	June 30	June 30	June 30
Region	2008	2007	2008	2007
United States	$2,200,070	$3,015,502	$4,207,828	$4,237,528
Europe	474,021	429,621	1,639,181	1,320,790
Asia	26,071	90,965	103,586	447,220
Canada	1,400	80,000	6,400	126,772
South America	-	-	610,940	-

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		Nine months ended	
	June 30	June 30	June 30	June 30
	2008	2007	2008	2007
Customer A	$1,401,373	$734,933	$2,796,112	$2,130,951
Customer B	-	-	599,792	-
Customer C	-	-	297,572	-
Customer D	-	2,209,919	-	2,209,919

15. Supplemental cash flow information

Unaudited	Three months ended		Nine months ended	
	June 30	June 30	June 30	June 30
	2008	2007	2008	2007
Cash paid for interest	$23,937	$14,755	$73,997	$43,354
Cash received for interest	38,083	292,278	277,273	508,349
Non-cash operating, investing and financing activities:				
Financing costs included in accrued liabilities	37,946	-	37,946	-
Non-cash financing costs	183,600	-	183,600	-
Property, plant and equipment included in accrued liabilities	-	(10,388)	-	(314,645)