Technology Applied

ANNUAL REPORT 2007

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Highlights for Fiscal 2007

1st Quarter:

- First Latin American sale for hydrogen recovery from ethylene off-gas
- First M-3200 system installed in the digester gas market to recover pipeline-grade methane from anaerobic digester gas at a dairy farm in Michigan, USA.

2nd Quarter:

- Sale to Air Liquide to recover waste hydrogen from a petrochemical plant
- Two orders from Verdesis for Swiss biomethane purification plants
- First order for natural gas processing plant to meet the California Air Resources Board compressed natural gas (CNG) specifications

3rd Quarter:

- US$2.85M order for large scale biogas purification plant in Iowa, USA.
- Shipment of prototype H-6200 hydrogen purifier to ExxonMobil refinery

4th Quarter:

- First sale of biomethane purification system for CNG
- Cdn$1.2M order for an M-3100 system for purification of landfill gas for the University of New Hampshire's cogeneration facility
- First sale of large capacity H-3200 system for a hydrogen plant to be installed at a refinery in Montana, USA.

QuestAir's Technology is being applied in more than 100 commercial settings around the world.

Today, QuestAir's technology is applied globally, with over 100 systems sold to customers in Europe, North America, Latin America and Asia. We have successfully diversified our product offering, modifying our hydrogen purification systems to allow for methane purification, and increasing the capacity of our systems to serve a broader market. This product diversification, coupled with our track record for building competitive, reliable products, has driven our sales growth. In fiscal 2007, our sales order backlog grew over 119% to $11 million. This record level of sales activity for QuestAir bodes well for our future success, and demonstrates that we have moved into the commercial phase of our evolution.

From Bovine to Biogas

Although it is well-known that emissions from cars and planes are contributing to pollution around the world, even greater emissions are generated down on the farm. The Food and Agriculture Organization of the United Nations published a report in 2006 stating livestock are responsible for 18 per cent of greenhouse gas emissions, with 65 per cent of anthropogenic nitrous oxide coming directly from livestock manure.

About Biogas

Biogas is a renewable methane that can be produced as a by-product from the decomposition of cow manure and other agricultural wastes. Biogas typically contains approximately 50 per cent methane (also known as natural gas) and 30 to 40 per cent carbon dioxide. In both the United States and Europe, electricity generation has historically been the most common option for energy recovery from biogas.

More recently, the production of pipeline grade methane and the generation of transportation fuels in the form of compressed natural gas (CNG) or liquefied natural gas (LNG) using gas purification technology are increasingly attractive alternatives for project developers. The rising price of natural gas, energy security concerns in both North America and Europe, and increased demand for renewable energy are all driving the demand for recovery and reuse of biomethane.

Natural gas pipeline operators have strict specifications with respect to the carbon dioxide content of gas distributed through their pipelines. Carbon dioxide must typically be removed from biogas before it can be injected into the pipeline. Similarly, before biomethane can be used as a transportation fuel, the carbon dioxide must be removed from the gas before it is compressed or liquefied.

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A key step in upgrading biogas is the separation of carbon dioxide present in the gas. The QuestAir™ M-3100 and M-3200 PSA systems offer compact, low-cost carbon dioxide separation solutions for purification of biomethane from landfill gas, anaerobic digestion and waste water treatment facilities.

18%

A 2006 report from The Food and Agriculture Organization of the United Nations estimated that livestock are responsible for 18 per cent of global greenhouse gas emissions, a bigger share than that of transport.

Recent Progress

QuestAir is well underway on several projects in the European biogas market, where there are new government incentives for pipeline gas and CNG projects. QuestAir also continues to pursue new opportunities in the US biogas market, where there is significant growth potential in digester gas and increased interest in pipeline gas and CNG projects. Our recent progress with biomethane projects in these markets include:

- Installation of a multi-unit M-3100 system at the Rumpke Landfill in Cincinnati, USA, which will generate enough pipeline grade methane to fuel over 8,700 homes
- Installed an M-3200 system at a Michigan, USA, dairy farm in the first commercial facility in North America that can generate both pipeline-grade methane and electricity from animal wastes
- Received an order valued at US$ 2.85 million for a multi-unit M-3100 system to be installed at a large scale "community" anaerobic digester project in Iowa, USA
- Sold an M-3100 system for installation at the University of New Hampshire's gas-to-energy cogeneration facility, replacing fossil fuels with renewable, upgraded landfill gas
- Two orders for M-3200 systems to be installed in Switzerland in order to recover methane from anaerobic digestion of agricultural wastes. These system sales leverage Swiss government incentives to replace imported gas with locally-sourced biomethane
- The first sale of an M-3200 for use in a "bio-CNG" project that will generate CNG vehicle fuel from biogas for use by the City of Salzburg, Austria, bus fleet

Market Drivers:

- Rising natural gas prices makes biogas purification projects more economical
- Government incentives to replace imported gas with local, renewable energy
- Public demand for renewable energy and lower greenhouse gas emissions
- Concerns about agricultural and food industry waste management

Powering Up with Clean Hydrogen

The largest industrial market for purified hydrogen is oil refining. Hydrogen is used to process crude oil into refined fuels, such as gasoline and diesel, and for removing contaminants, such as sulphur, from these fuels. Total hydrogen consumption in oil refineries is estimated at 12.4 billion standard cubic feet per day, which equates to an average hydrogen consumption of 100-200 standard cubic feet per barrel of oil processed. As demand for petroleum-based products increases, demand for hydrogen will also increase.

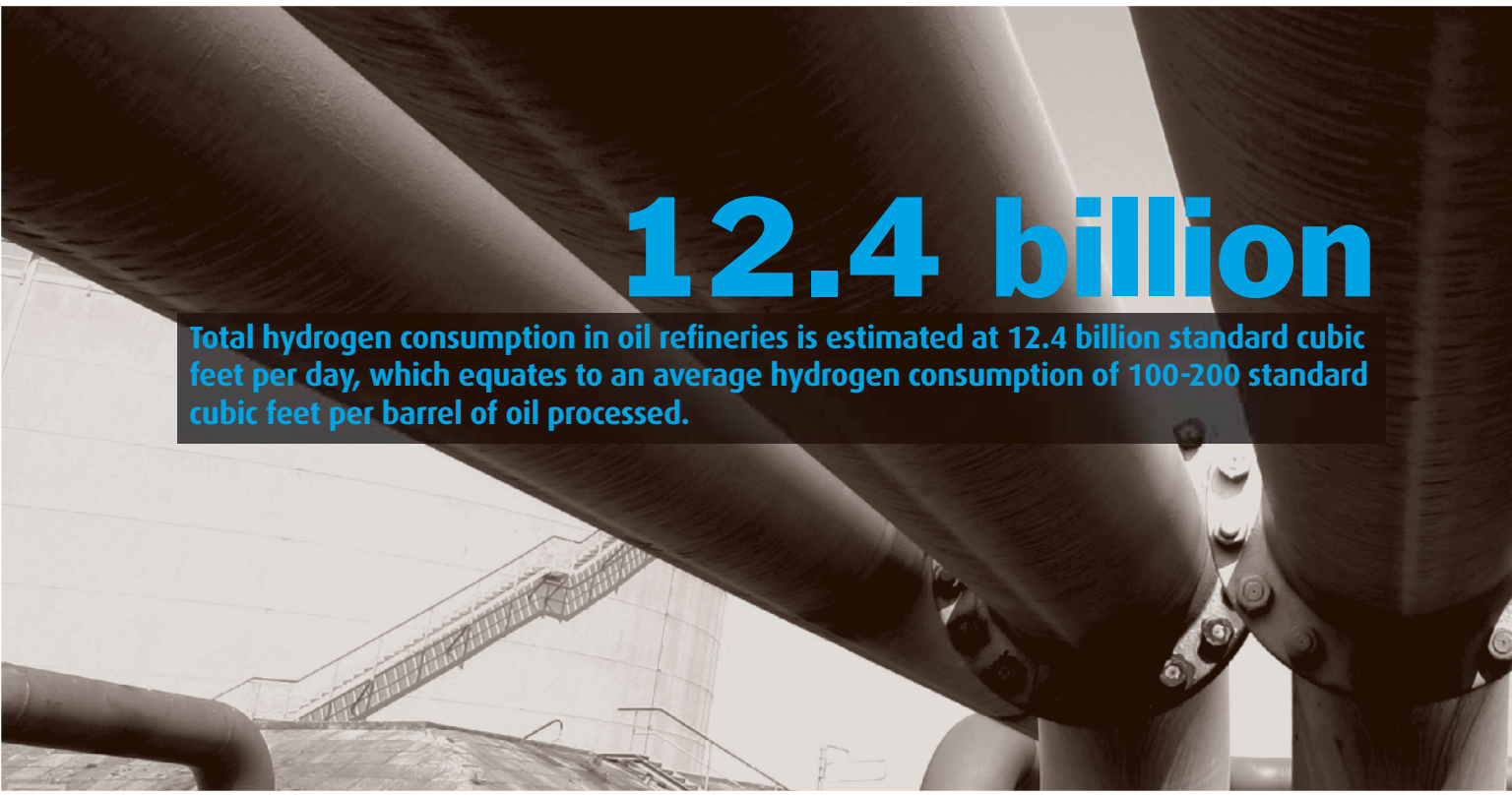
About Hydrogen

Hydrogen is used in a range of industries including chemical production, metal refining, food processing and oil refining. Depending on customer requirements, hydrogen is either delivered to customers as compressed or liquid hydrogen, or generated on-site from water using a process known as electrolysis or from natural gas using a process called reforming.

All of QuestAir's gas purification products employ a process known as pressure swing adsorption (PSA). QuestAir's standard commercial products utilize novel rotary valve architecture to increase the speed at which gas is purified compared to conventional PSA systems. Faster speed translates into smaller equipment, which contributes to lower capital and installation cost for our customers.

QuestAir's PSA systems are used in conjunction with on-site reforming systems to increase the purity of the hydrogen produced to the levels required for industrial applications.

Our PSAs can also be used to recapture hydrogen that is exhausted in industrial off-gas (waste) streams, allowing the purified hydrogen to be sold as a by-product or reused in the industrial application. The rising price of natural gas increases the demand for hydrogen recovery systems as customers strive to optimize their operating efficiency and lower costs.



Refinery Hydrogen Market

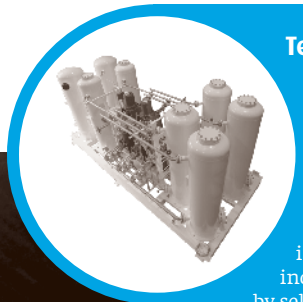
The overall increase in hydrogen demand is expected to drive sales for PSA systems used in large capacity hydrogen plants, and for recovering hydrogen within oil refineries. QuestAir is currently developing a large capacity, rapid cycle PSA in collaboration with ExxonMobil Research and Engineering Company (EMRE), for use in a range of refinery applications including hydrogen recovery from refinery off-gas streams. The QuestAir™ H-6200 product is expected to offer significant advantages over conventional PSA systems due to its relatively lower capital and installation costs, smaller equipment footprint and improved performance.

Recent Progress:

- First "large capacity" H-3200 hydrogen purifier sold for Cdn $1 million to be installed as part of a new hydrogen plant at an oil refinery in Montana, USA
- H-3100 PSA system sold to Air Liquide to recover waste hydrogen from a petrochemical plant in Odessa, Texas, USA
- H-3100 hydrogen purifier sold to recover hydrogen from ethylene cracker offgas at a polyethylene plant in Brazil
- Prototype H-6200 hydrogen purifier installed at an ExxonMobil refinery in France

Market Drivers:

- Higher natural gas prices drive demand for hydrogen recovery systems
- New emissions regulations increase demand for hydrogen to remove sulphur from transportation fuels
- Depletion of sweet, light crude oil means more hydrogen required to refine heavier crude oil
- Global growth in energy usage drives increased demand for hydrogen to meet the need of refineries



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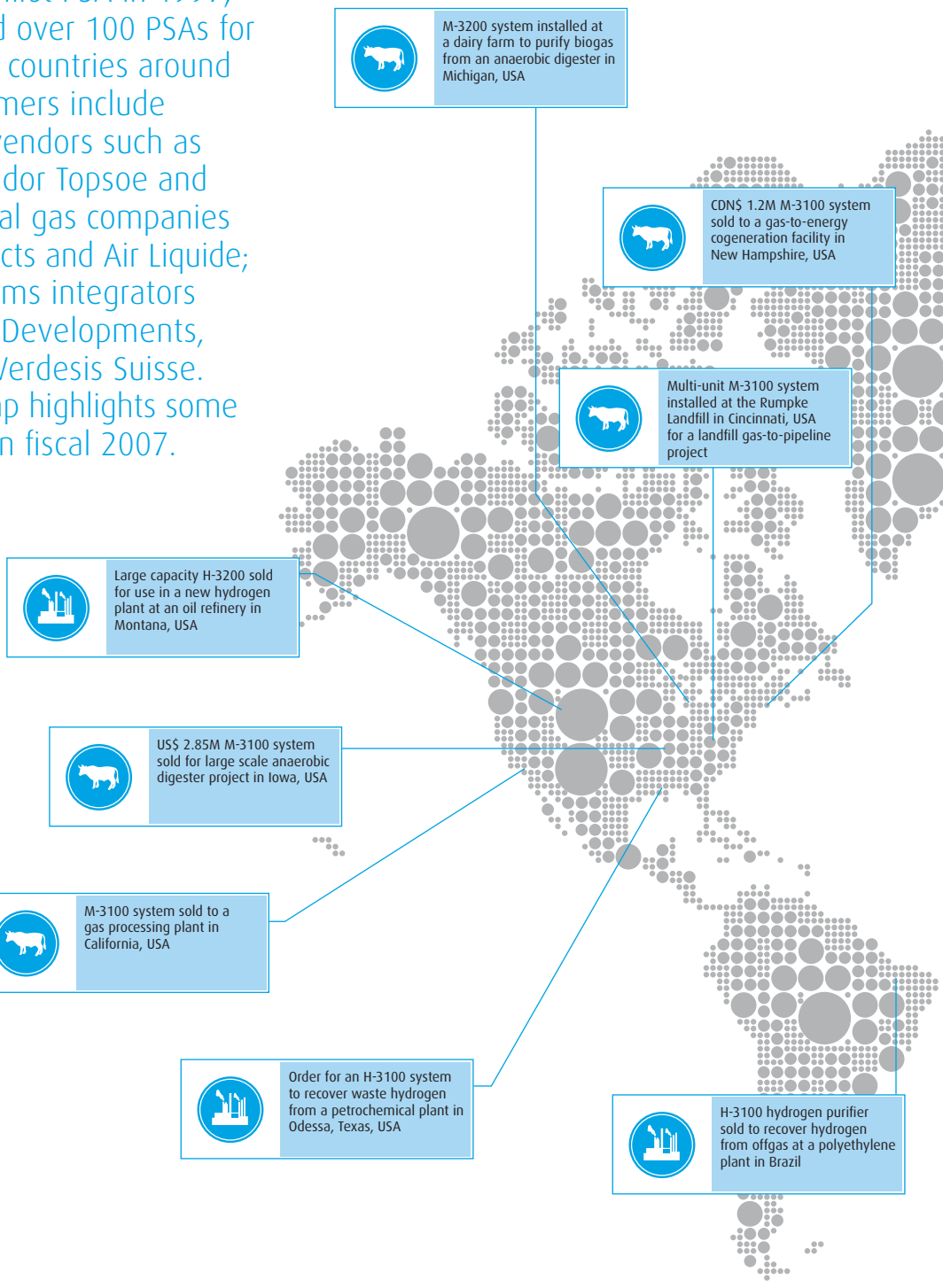
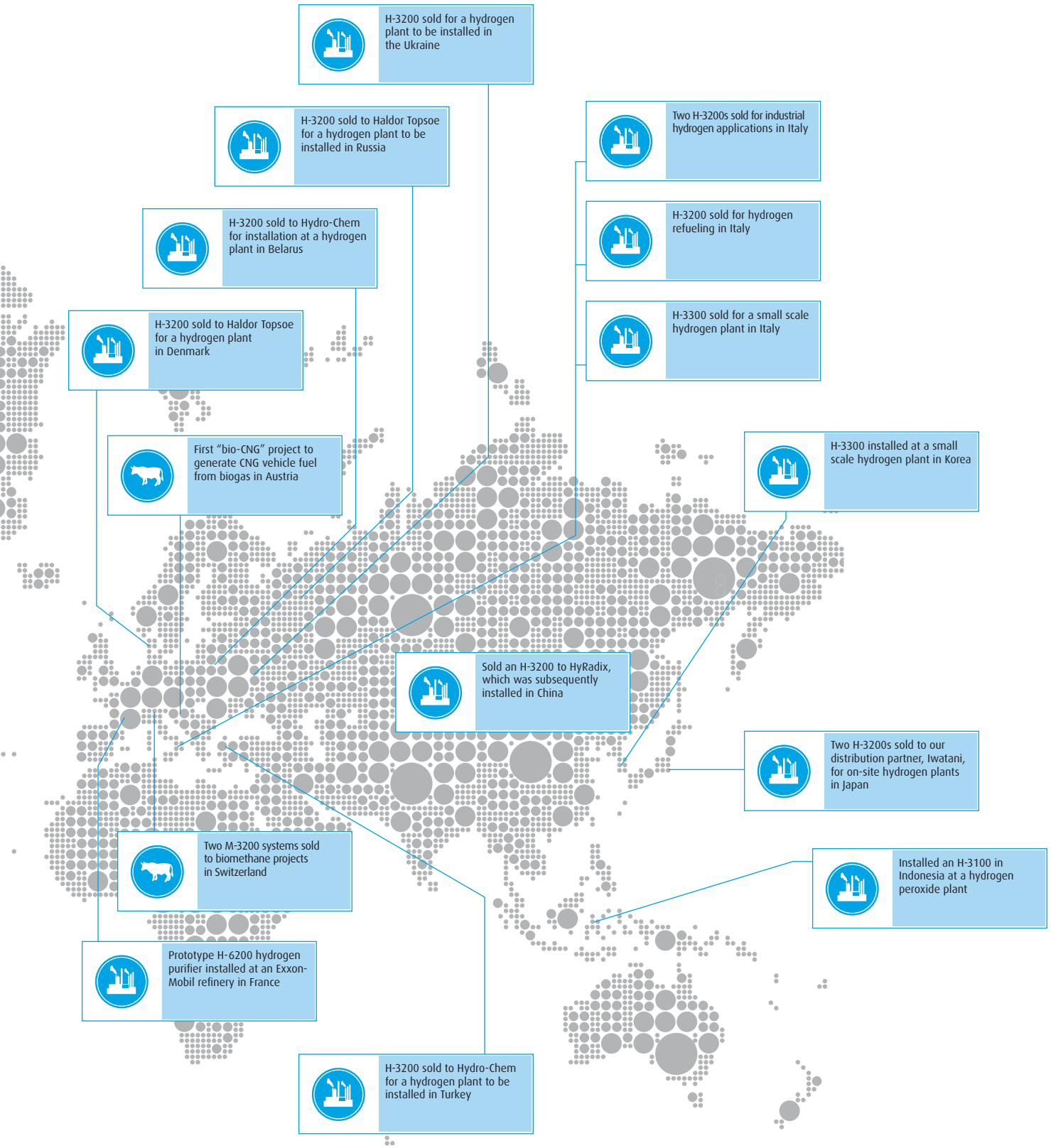
QuestAir sells its H-3100 and H-3200 systems into the industrial hydrogen markets for both on-site hydrogen generation and hydrogen recovery. QuestAir is increasing its market share in the industrial hydrogen markets by selling compact, skid mounted systems that offer lower capital costs and lower installation costs.

At the same time, QuestAir has increased its product capacity in order to serve a broader market. In fiscal 2007, QuestAir launched the large capacity H-3200 system in order to address the 5,000 to 15,000 normal cubic meter per hour (NCMH) capacity market, which is expected to help drive sales growth over the coming years.

QuestAir Around the Globe

Since selling our first PSA in 1997, QuestAir has sold over 100 PSAs for installation in 23 countries around the world. Customers include hydrogen plant vendors such as Hydro-Chem, Haldor Topsoe and HyRadix; industrial gas companies such as Air Products and Air Liquide; and biogas systems integrators such as Phase 3 Developments, SCS Energy and Verdesis Suisse. The following map highlights some of our activities in fiscal 2007.




H-3200 sold for a hydrogen plant to be installed in the Ukraine
H-3200 sold to Haldor Topsoe for a hydrogen plant to be installed in Russia
Two H-3200s sold for industrial hydrogen applications in Italy
H-3200 sold for hydrogen refueling in Italy
H-3200 sold to Hydro-Chem for installation at a hydrogen plant in Belarus
H-3300 sold for a small scale hydrogen plant in Italy
H-3200 sold to Haldor Topsoe for a hydrogen plant in Denmark
First "bio-CNG" project to generate CNG vehicle fuel from biogas in Austria
H-3300 installed at a small scale hydrogen plant in Korea
Sold an H-3200 to HyRadix, which was subsequently installed in China
Two H-3200s sold to our distribution partner, Iwatani, for on-site hydrogen plants in Japan
Two M-3200 systems sold to biomethane projects in Switzerland
Installed an H-3100 in Indonesia at a hydrogen peroxide plant
Prototype H-6200 hydrogen purifier installed at an Exxon-Mobil refinery in France
H-3200 sold to Hydro-Chem for a hydrogen plant to be installed in Turkey

QuestAir has entered a vital phase in our evolution as a commercial company.

Our company significantly increased the level of sales orders received in 2007, which reflects positively on the continued acceptance of our technology and the further expansion of our addressable markets. We are really encouraged by our continued success in the biogas processing market. We made great inroads in 2006 in the biogas processing market and were able to sustain that momentum this year. Biogas now represents almost 50 per cent of the value of our overall sales orders.

We also continued our success in the refinery and industrial hydrogen markets and had noteworthy orders for systems that will recover and purify hydrogen from off-gas sources. The hydrogen recovery market segment is expected to continue to grow as customers will look for cost effective solutions to produce additional hydrogen for their industrial requirements. Sales to the hydrogen recovery market segment will be part of QuestAir's success in 2008.

As part of our evolution to a fully commercial company, we have been adding resources to our sales, marketing and order-to-delivery functions to enable our continued growth. We have also maintained a core R&D capability which will allow us to continue to develop new products in areas where we see a unique value proposition for our technology and committed financial support from lead customers and partners.

Operating Review and 2008 Milestones

Discussions about our progress in 2007 need to start with sales orders received during the year. Sales orders increased 38 per cent year-over-year, reflecting both higher gas purification sales and an increase in the value of engineering service contracts received during the year. Collectively, these orders demonstrate the growing market acceptance of QuestAir's commercial PSA products, as well as the broad applicability of our product platforms in a range of industrial and energy-related markets. Overall, our backlog increased from approximately $5M at the start of the fiscal year to over $11M at year-end. We expect that the backlog will be substantially recognized as revenue by December 31, 2008.

The biogas market is extremely important for QuestAir, and we had many successes last year. The installation of an M-3200 system to recover pipeline-grade methane from an anaerobic digester at a dairy farm in Michigan is one of them. This project was the first application of QuestAir's technology in the digester gas market, which is emerging as a significant growth area in the United States. Another highlight was an order for an M-3200 system to recover pipeline-grade methane from anaerobic digester gas in Switzerland. This was our first sale into the European biogas market, which is also a potential growth market. We also received our largest commercial sale to date, valued at US$2.85 million, for a multi-unit M-3100 system. The system will be installed at a large-scale biogas purification plant in Iowa, USA, where community digesters will produce biomethane from organic waste delivered to the site from surrounding areas. Finally, we received an order valued at Cdn$1.2 million for an M-3100 methane recovery system that will be used by the University of New Hampshire in its new landfill gas-to-energy cogeneration facility.

Our core industrial hydrogen market also had many highlights in 2007. The sale of an H-3100 hydrogen purifier to a polyethylene plant in Brazil certainly qualified. This was our first sale into Latin America, and the recovery of ethylene cracker off-gas is an important source of waste hydrogen for reuse in the petrochemical industry. QuestAir will be targeting larger capacity applications in this market with the H-6200 hydrogen purifier in the future. Securing an order from Air Liquide U.S. for a system to recover waste hydrogen at a petrochemical plant in Texas was another example of our systems being used to recover and reuse waste hydrogen

Jonathan Wilkinson,
President & CEO

streams. Finally we received our first order, valued at Cdn$1.0 million, for the new large capacity H-3200 hydrogen purifier, which will be used to generate hydrogen at an oil refinery in Montana, USA. We expanded the capacity of our 9 bed H-3200 system in order to increase system throughput and open up new markets in the intermediate capacity range.

We also executed on many fronts throughout the year with ExxonMobil. We renewed our Joint Development Agreement (JDA) with EMRE, extending the exclusivity period of the research collaboration in the refinery and petrochemical markets for a further 3 years. Following the extension of the JDA, we completed two small funded research contracts with EMRE to assess the use of the H-6200 platform in a specific petrochemical separation, as well as for the processing of "sour" natural gas. June saw the shipment of our H-6200 prototype to an ExxonMobil refinery in France, which was the culmination of a significant amount of groundbreaking work since 2003. The H-6200 system has been commissioned and is being used in a commercial application at the refinery. Data generated from the field test will be used to help secure commercial orders for H-6200 units to other refineries. Finally, we received a US$1.8M engineering services contract from EMRE for the third phase of a project aimed at developing a compact onboard hydrogen generator for use in a range of transportation applications.

The year however was challenging from a financial perspective. Revenue declined slightly from the previous year. This was primarily because engineering service contract revenue fell 61% as a result of a lower volume of contracts in backlog for the first 9 months of the fiscal year.

Gross profit also declined year-over-year. We incurred additional costs related to the construction of the prototype plant, resulting in a loss of $1.9M on the prototype plant. We also restructured the organization to reflect a more commercially focused company. This resulted in a one-time restructuring charge of $0.6M. Increasing our gross profit and controlling costs more effectively will remain key objectives for QuestAir in 2008 and beyond.

Each year we set a number of operational milestones to map our anticipated progress over the coming year, and to provide our investors with a means to evaluate our performance towards creating shareholder value. Our milestones for 2008 are:

1. Enhance commercial footprint in the biogas market

Biomethane purification is expected to be one of the principal growth drivers of the Company over the next 3 years. QuestAir looks to increase its penetration of this market by securing orders from at least three new customers and by signing at least one distribution agreement with a biogas developer.

2. Grow industrial hydrogen business

In fiscal 2007, we commenced the sale of our large capacity H-3200 system in order to compete in the intermediate capacity market for hydrogen systems. In fiscal 2008, we expect to sell a greater number of larger capacity systems, which in turn will increase the average dollar value per hydrogen PSA sold.

3. Secure first purchase order for a commercial H-6200 hydrogen purifier

With the prototype plant now up and running, QuestAir expects to be able to leverage this demonstration site to secure the first commercial order for an H-6200 hydrogen purifier.

4. Increase recognized revenue to between $9 and $10 million

Recognized revenue is expected to increase to between $9 and $10 million in fiscal 2008. This growth primarily reflects the strong increase in sales order backlog that was achieved during fiscal 2007.

5. Manage cash used in operations and capital expenditures to less than $8 million

Cash used in operations and capital expenditures is expected to be less than $8 million, reduced from $10.5 million in fiscal 2007. Cash will primarily be used to fund operations with capital expenditures accounting for approximately $1.0 million of the expected use of cash.

Fiscal 2008 will be a critical year for QuestAir. Key for us will be the completion of the testing for the H-6200 prototype, subsequent commercial launch and our first commercial order. This product provides oil refineries with a solution to the growing demand for hydrogen in oil refining as well as offering a unique tool to increase refinery productivity.

We also expect the success that we have experienced with our commercial products to continue. We are well positioned in both the industrial hydrogen and biogas markets, and will build on the momentum and market acceptance for these products.

I look forward to reporting to you over the next year on our accomplishments and milestones achieved.

Sincerely,

Jonathan Wilkinson
President & CEO

Accounting

Management Discussion and Analysis

For Year Ended September 30, 2007

The following management discussion and analysis ("MD&A"), dated December 12, 2007 (with the exception of the 'Outstanding Share Data', which is dated November 30, 2007) should be read in conjunction with the Company's audited financial statements and related notes therein that are prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). All financial information is stated in Canadian dollars, unless otherwise stated. Additional information regarding QuestAir Technologies Inc. ("QuestAir" or "the Company"), 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. Forward looking statements generally can be identified by the use of forward looking terminology such as "may", "will", "expect", "intend", "anticipate", "plan", "foresee", "believe" or "continue" or the negatives of these terms or variations of them or similar terminology. These forward looking statements include references to the future success of our business, technology, and market opportunities. By their nature, forward looking statements require QuestAir to make assumptions and are subject to important known and unknown risks and uncertainties, which may cause QuestAir's actual results in future periods to differ materially from forecasted results. While QuestAir considers its assumptions to be reasonable and appropriate based on current information available, there is a risk that they may not be accurate. These forward looking 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 general economic conditions, risks associated with revenue growth, operating results, industry factors and QuestAir's general business environment, risks associated with doing business with partners, risks involved with the development new products and technology, financing risks, such as risks relating to liquidity and access to capital markets, and risks relating to competition, among other factors. For a more detailed description of the risks that affect QuestAir's future growth, results and performance, readers are referred to the section on 'Risks and Uncertainties' in this MD&A and the description of risk factors in QuestAir's Annual Information Form for the year ended September 30, 2007 filed at www.sedar.com. Readers are cautioned that the foregoing list of factors that may affect future growth, results and performance is not exhaustive and undue reliance should not be placed on such forward looking statements which speak only to the date they were made. We disclaim any 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.

OUR VISION, STRATEGY AND CORE BUSINESS

Vision and Strategy

QuestAir's strategic goal is to become a leader in the development, manufacture and supply of pressure swing adsorption ("PSA") gas purification systems for refinery, industrial, energy and fuel cell markets. Our strategy to achieve this goal has the following key elements:

1. Reach profitability through sales into existing biomethane, industrial hydrogen and refinery hydrogen markets;
2. Leverage key relationships with market leaders such as ExxonMobil Research and Engineering ("EMRE") and Shell Hydrogen;
3. Pursue opportunities that leverage QuestAir's product platforms;
4. Play an active role in the emerging hydrogen economy; and
5. Pursue disciplined cash management.

Core Business

QuestAir is an emerging developer and supplier of advanced gas purification systems. Our products target a range of existing energy and industrial markets, including oil refining, natural gas processing and biogas processing, as well as emerging markets such as hydrogen fueling stations that support fuel cell powered vehicles.

Our compact, modular gas purification products incorporate proprietary PSA technology, and offer significant economic and operational benefits over conventional PSA technology including reduced capital, installation and operating costs. Our proprietary technology is protected by 59 granted patents covering 26 distinct inventions and 66 pending patent applications covering 20 distinct inventions in the United States, Canada, and certain European, Asian, and other countries.

QuestAir has approximately 70 employees located at our facility and corporate headquarters in Burnaby, Canada. We market and support our products on a global basis from our Burnaby location.

Products, Markets & Customers

Commercial Products: We currently sell a range of commercial PSA systems for use in on-site hydrogen plants for industrial markets, purification of methane from biogas from agricultural waste and municipal landfills, and demonstration hydrogen stations for refueling fuel cell vehicles. Since 1997 we have sold more than 100 PSA systems to over 45 customers in North America, Latin America, Asia and Europe.

We market and distribute our products directly to customers, but we also have non-exclusive distribution agreements with leading hydrogen plant vendors including Iwatani International, Mitsubishi Kakoki Kaisha and KTI Technip, and an agreement to supply our H-3200 hydrogen purifiers to HyRadix Inc., a leading developer of hydrogen generators for industrial and hydrogen fueling markets. We also have a manufacturing license agreement for our hydrogen purifiers with Hydro-Chem, a leading global supplier of hydrogen plants in the intermediate capacity range, and a supply agreement with Nuvera Fuel Cells for our smaller capacity H-3300 hydrogen purifiers.

Products under development – Oil Refining: We are currently developing second generation 'rapid cycle' PSA technology which we believe will offer further reductions in size and cost relative to both our current commercial products and our competitors' products. Our second generation products will also be scalable to much higher capacities than our current products, allowing us to compete in larger, higher value markets.

The first of these second generation products is the large capacity H-6200 PSA, which is being developed in collaboration with EMRE for use in a range of potential applications in the oil refining and petrochemical industries. A prototype of the H-6200 hydrogen purifier (the "prototype plant") is being field tested at an ExxonMobil refinery in France. Data from this test will be used to help market this product to other refineries around the world.

Demand for hydrogen in oil refineries is expected to grow by up to 10% per year through to 2010, driven by regulations requiring reduced levels of sulphur in diesel fuel, increased processing of "heavier" crude feed stocks, and the global increase in demand for petroleum products. The H-6200 hydrogen purifier is expected to provide refineries with a cost-effective solution to this growth in hydrogen demand by recovering hydrogen from hydrogen-containing waste streams within refineries. In addition, it is expected that the H-6200 hydrogen purifier can be integrated with existing hydrotreating equipment in order to debottleneck production, allowing refineries to process more oil and improve their operational efficiency.

In 2006 we signed a marketing agreement with EMRE that covers the marketing of the H-6200 hydrogen purifier to third party customers in the oil refining industry. The agreement outlines the roles that each party will play in the marketing process, and how the commercial gain from the sales of the product will be shared between QuestAir and EMRE.

We also are exploring the extension of rapid cycle technology into other high value markets including various petrochemical separations and the processing of contaminated natural gas.

Products under development – Fuel Cells: We currently market our commercial PSA products for use in hydrogen refueling stations that support fuel cell vehicles. To date we have sold 17 systems into demonstration hydrogen stations located in the US, Asia and Canada. Key customers in this emerging market include Chevron, Iwatani International and Hydrogenics Corporation.

We are also collaborating with EMRE on the development of an on-board hydrogen generator for potential use in a range of transportation markets including fuel cell powered utility equipment, auxiliary power units for a wide range of vehicles, and fuel cell powered buses. The hydrogen generator should offer a unique, compact, efficient solution to generate hydrogen directly on board the vehicle itself from a range of readily available hydrocarbon fuels such as diesel and gasoline.

Key Market Drivers

We believe that there are a number of key market drivers that will have an important impact on QuestAir's long term prospects and our ability to create shareholder value:

- Increased global demand for refined petroleum products, combined with increased supplies of heavier 'sour' crude oil, which together have driven the demand for hydrogen in the oil refining industry.
- Government regulations mandating reduced sulphur levels in transportation fuels, which have also driven the demand for hydrogen in the oil refining industry to desulphurize crude oil feedstocks.
- Elevated prices of crude oil and natural gas, which has focused attention on technologies for increasing the efficiency of the refining processes, and for processing unexploited reserves of contaminated natural gas. Higher natural gas prices are also contributing to the move towards purifying "renewable" sources of natural gas, such as biomethane from anaerobic digestion of agricultural waste and landfill gas.
- Environmental concerns regarding local air pollution and global warming, which collectively have prompted the development of renewable energy sources such as biomethane, as well as clean, efficient power generation and transportation technologies such as fuel cells.

Key Performance Indicators

Management uses a number of key performance indicators to monitor and assess the implementation of our strategy and the achievement of our goals. These performance indicators include both quantitative and qualitative measures of performance, as follows:

- *Sales Bookings and Backlog:* QuestAir recognizes revenue from the sale of gas purification systems and engineering service contracts. While revenue from the sale of long-term production type contracts and engineering service contracts is recognized on a percentage-of-completion basis over the life of the contract, revenue from the sale of our commercial gas purification systems is only recognized once the systems

have been installed, commissioned and accepted by the customer[1]. Given the typical lead times of 6-12 months between receipt of an order for a gas purification system and installation and commissioning, recognized revenues do not give a current view of our commercial performance. Consequently, we monitor sales bookings and changes in backlog as more current measures of our commercial performance. Sales bookings are defined as signed orders supported by a firm purchase order, while backlog represents the future revenue from signed orders that have not yet been recognized as revenue.

- *Cash Burn:* We balance the need to conserve cash in order to limit dilution arising from potential future equity financings with the need to invest in the future growth of our business, which requires investments in research and development, sales and marketing activities and manufacturing capacity. We monitor 'cash used in operations and capital requirements' as a measure of our operational cash burn. It should be noted that this is a non-GAAP measure, and a reconciliation to GAAP measures is provided in the 'Liquidity and Capital Resources' section of the MD&A.
- *Progress Against Key Product Development Timelines and Milestones:* The timing and technical progress of our key development programs, including the refinery program with EMRE, will have a critical impact on our future revenue growth and profitability. Consequently we closely monitor progress made in each development program relative to key program milestones and timelines.
- *Product Delivery On Time and On Budget:* QuestAir tracks its performance against expected delivery dates and product costs for each unit delivered to customers. On time delivery is a key contributor to customer satisfaction and timely recognition of revenue. Monitoring the costs for each product sold allows us to closely track expected margins to actual and thereby detect costing issues promptly.
- *Patents & Intellectual Property:* QuestAir's competitive advantage is driven in large part by our technical leadership and strong intellectual property position. We monitor the breadth and quality of our patent portfolio relative to those of our competitors as an important measure of our technical competitive advantage.

Resources and Capabilities

We have the following resources and capabilities at our disposal in order to execute our growth strategy:

- *Non Capital Resources:* A significant portion of our sustainable competitive advantage is derived from our proprietary PSA technology and strong suite of intellectual property. Our technology leadership and the value proposition of our products are driven directly by the innovation and technical expertise of our employees, and consequently, our human resources are our most critical non-capital resource.
- *Financial Resources:* At September 30, 2007, QuestAir had cash resources and short term investments totaling of $8.8 million, in addition to a $2.0 million credit facility with Comerica Bank. At the forecast cash burn rate, we have sufficient financial resources to fund our operations for at least the next 12 months.
- *Systems and Processes:* We evaluate our management and control systems against evolving corporate governance regulations and guidelines. We follow a rigorous product management process to manage our key development programs to ensure that all new products meet customer specifications, quality requirements and delivery timelines. In addition, the relevant components of our commercial PSA products are certified to the standards of the Canadian Standards Association (CSA) and Underwriters Laboratory (UL), and conform to the legal requirements of the European Union (CE).
- *Partnerships with market leaders:* A key element of our strategy is to leverage the resources, technical expertise and distribution channels of our development partners and customers. We have established strong partnerships and working relationships with market leaders including EMRE, Shell Hydrogen, Chevron as well as our distribution and licensing partners Iwatani, Mitsubishi, KTI Technip, Hydro-Chem, HyRadix and Nuvera. We believe that these relationships are a source of competitive advantage for QuestAir.

BUSINESS OVERVIEW

We made the following progress in our commercial and development activities during fiscal 2007:

- The prototype H-6200 hydrogen purifier was shipped to an ExxonMobil refinery in France. Subsequent to the end of the fiscal year, the installation and start-up of the prototype plant was completed. The prototype plant is currently undergoing field testing at the refinery, in order to generate additional data to assist with the marketing of the H-6200 to other refineries. Following completion of the test, the prototype plant is expected to remain in ongoing commercial operations at this refinery site.
- During the year, QuestAir completed the installation and commissioning of our PSAs at two landmark biogas projects. The multi-unit M-3100 system was successfully started up at the Rumpke Sanitary Landfill near Cincinnati, Ohio. This system was installed as part of an expansion of

1 Refer to the 'Critical Accounting Policies and Estimates' section of the MD&A for an overview of QuestAir's revenue recognition policy.

the landfill's biomethane recovery plant. QuestAir's PSA units are being used to purify landfill gas up to pipeline grade methane. We also successfully commissioned an M-3200 system to recover pipeline grade methane generated from animal waste at a dairy farm in Fennville, Michigan. Our M-3200 system was installed as part of a plant that generates pipeline-grade methane as well as electrical power from anaerobic digester gas.

- Sales orders received during the year increased 38%, reflecting both higher gas purification sales and an increase in the value of engineering service contracts received during the year. Growth in gas purification sales was driven by biomethane purification system sales, which accounted for 47% of the total value of gas purification sales received during the year. An engineering service contract valued at US$1.8 million that was received in the fourth quarter resulted in the growth in engineering service contracts during the year.
- We received our largest commercial sale to date, for a multi-unit M-3100 system valued at US$2.85 million. The system will be installed at a large scale biogas purification plant in Iowa, which will generate biogas from organic waste that will be delivered to the plant from surrounding areas.
- We successfully penetrated the European biogas purification market in fiscal 2007. In the second quarter, we received two orders for M-3200 systems that will be used in Switzerland to purify biomethane from anaerobic digesters for injection into a natural gas pipeline. Later in the fiscal year, we sold our first M-3200 to produce compressed natural gas ("CNG") vehicle fuel from biogas. The biogas will be generated from anaerobic digestion of agricultural waste, and the resulting bio-CNG will be used to fuel a bus fleet in the City of Salzburg, Austria.
- During the fourth quarter, we received an order from SCS Energy valued at $1.2 million for an M-3100 methane recovery system that will be used by the University of New Hampshire in its new landfill gas-to-energy cogeneration facility. QuestAir's M-3100 will increase the energy content of landfill gas used to generate electricity in a turbine generator.
- We received an order for an M-3100 system that will be used to meet the California Air Resources Board CNG specification for natural gas. By separating carbon dioxide, water, ethane, propane and heavier hydrocarbons from natural gas to meet the strict quality specifications of the gas customer, our system will increase the production capacity of the gas processing plant, allowing the customer to produce additional gas from several wells that are currently curtailed.
- During the year, we received 2 orders for systems that will recover and purify hydrogen from off-gas at petrochemical plants. The first such sale was also our first sale into Latin America, where the H-3100 system will be installed at a facility in São Paulo, Brazil. The purified hydrogen will be used in the production of polyethylene. In addition, Air Liquide purchased an H-3100 system to recover waste hydrogen from a petrochemical plant in Odessa, Texas. The purified hydrogen will be reused in the production process, and any excess will be compressed for sale to merchant gas customers.
- QuestAir received the first order for its new large capacity H-3200 hydrogen purifier, which will be used to generate hydrogen at an oil refinery in Montana. QuestAir expanded the capacity of its 9 bed H-3200 system in 2007 in order to open up new markets for QuestAir in the intermediate capacity range of the on-site hydrogen plant market. This first order is valued at approximately $1.0 million.

The following progress was made towards the achievement of QuestAir's 2007 milestones:

Milestone	Progress
1. Complete the installation and start-up of the prototype H-6200 hydrogen purifier at an ExxonMobil refinery	Shipment of the prototype occurred later than originally expected. The prototype arrived at the ExxonMobil refinery during the fiscal year, and the installation and start-up of the prototype plant was completed in October 2007.
2. Receive the first purchase order for a commercial H-6200 hydrogen purifier	Significant marketing efforts continued throughout the year, however a purchase order for a commercial H-6200 system was not received due in part to the delay in the H-6200 prototype test at the ExxonMobil refinery.
3. Sign an agreement to extend the H-6200 platform into a new market	Progress was made in this regard, with the extension of the joint development agreement with EMRE which allows for funded development of a product extension of the H-6200 into a new market. In addition, small scoping studies which evaluated the possibility of extending the H-6200 technology into another market were completed during the year. Efforts were subsequently redirected to completing the manufacture and installation of the prototype H-6200 hydrogen purifier, such that this milestone was not completed during the fiscal year.
4. Secure first purchase order for a methane purification system in the European biogas market	This milestone was achieved in the second quarter with the receipt of a purchase order for an M-3200 system for installation in a Swiss biomethane purification plant.
5. Increase recognized revenue to between $9 and $10 million	In May 2007 management indicated that recognized revenue would be lower than originally expected due to delays in receipts of engineering service contracts. Accordingly, management revised its recognized revenue guidance to $7 to $8 million for the fiscal year. This revised guidance was met.
6. Manage cash used in operations and capital expenditures to between $7 and $8 million	In May 2007 management indicated that cash used in operations and capital expenditures would be higher than originally expected due to lower revenue from engineering service contracts, increased costs to complete the prototype plant, and a reorganization charge that was incurred in the third quarter. Accordingly, management revised its cash burn guidance to $10 to $12 million for the fiscal year. This revised guidance was met.

FINANCIAL OVERVIEW

The financial highlights for the year ended September 30, 2007 are noted below:

- Revenue was $7,012,166 for the year, decreased by $545,927, or 7% compared to fiscal 2006. Although revenue from gas purification systems was up 9% year over year, total revenue fell year over year due to less revenue being recognized from engineering service contracts in the current year.
- Sales order backlog at September 30, 2007 was $11,053,765, an increase of $6,009,873, or 119%, from September 30, 2006. This is the highest level of backlog in the Company's history. Growth in backlog was driven by increases in both gas purification sales and engineering service contracts.
- Cash used by operations and capital requirements was $10,525,458 for the year, increased by $1,094,779 compared to fiscal 2006. The increase in cash burn was driven by increased costs on the prototype plant, less cash from engineering service contracts, and a reorganization charge that was incurred during fiscal 2007.
- Net loss was $12,417,412 ($0.24 per share) for the year, increased $2,154,494 or 21% from $10,262,918 ($0.24 per share) in fiscal 2006. The increase in net loss year over year was driven by lower gross profit as well as higher administrative and research and development expenses during fiscal 2007.

Selected Financial Information

The following is selected information on QuestAir's financial performance for the past three fiscal years:

	For the years ended September 30,		
($'000 except loss per share data)	**2007**	**2006**	**2005**
Revenue	**7,012**	7,558	6,292
Net research and development expenses	**5,514**	5,092	5,734
General and administrative expenses	**3,992**	3,311	3,427
Net loss	**(12,417)**	(10,263)	(9,517)
Loss per share	**(0.24)**	(0.24)	(0.31)
Total assets	**17,053**	27,682	16,213
Total long-term liabilities	**454**	533	434
Backlog (unaudited)	**11,054**	5,044	3,008

QuestAir's revenues have fluctuated over the past three years as a result of timing of revenue recognition on sales of gas purification systems, as well as fluctuations in the amount of revenue recognized from the sale of the prototype plant and from engineering service contracts, both of which are recognized on a percentage-of-completion basis. The fluctuation in revenue over this time period has been accompanied by continued growth in sales order backlog, reflecting the growth in the total volume of business for the Company. Backlog increased 119% during fiscal 2007 as a result of strong growth in purchase orders for commercial equipment, including several orders for methane purification systems. Hydrogen systems sales increased during the year as well, both for hydrogen generation plants and for hydrogen recovery from off-gas. Also contributing to the increase in backlog during the year was an engineering service order received from EMRE to initiate the third phase of the project to develop an on-board hydrogen generator.

The fluctuation in net research and development ("R&D") expenses over the past three years relates in part to the transition of resources from development to commercial activities, including the construction of the prototype plant being sold to an ExxonMobil refinery. In addition, funding under the Technology Partnerships Canada ("TPC") program, which is deducted from gross R&D expenditures in each of the last three years, fell during fiscal 2007 as the contribution agreement neared the end of its contractual end date. (See 'Results of Operations' below.)

General and Administrative ("G&A") expenses have also fluctuated over the past three years. G&A expenses were elevated in fiscal 2005 as a result of increased expenses related to QuestAir's public listing. The decrease in G&A expenses in fiscal 2006 includes reductions in stock based compensation expenses, as certain options became fully vested during the period. The subsequent increase in G&A expenses in fiscal 2007 relates to severance and termination benefits due to the reorganization of operations that took place in the third quarter in order to focus resources on commercial activities and reduce R&D expenses.

Net loss increased in each of the past two years due to lower gross profits in 2006 and 2007, resulting primarily from losses being recognized on the sale of the prototype plant in each of these fiscal years (see 'Results of Operations'). In addition, the higher G&A and R&D expenses in fiscal 2007 contributed to the higher loss compared to fiscal 2006.

Total assets have fluctuated over the past three years, and include funds raised from QuestAir's initial public offering ("IPO") in fiscal 2005 and the subsequent equity offering in fiscal 2006 as discussed in 'Use of Proceeds from our Pubic Offerings'.

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:

	For the years ended September 30, 2007	2006
Gas purification systems	**6,322,595**	5,808,488
Engineering service contracts	**689,571**	1,749,605
Total revenue	**7,012,166**	7,558,093

Total recognized revenue for fiscal 2007 was $7,012,166 compared to $7,558,093 for the prior year. Revenue from gas purification systems was up 9% year over year, while revenue from engineering service contracts fell 61% in the current year. The increase in revenue from gas purification systems for fiscal 2007 resulted from increased sales of commercial PSA systems including an M-3100 methane recovery system for use in the landfill gas processing market, and revenue recognized towards the construction of the prototype being demonstrated at an ExxonMobil refinery. For accounting purposes, the sale of the prototype plant is treated as a long-term production-type contract, and is therefore recognized on a percentage-of-completion basis in accordance with GAAP.

The decrease in revenue from engineering service contracts for fiscal 2007 resulted from a lower volume of engineering service contracts in backlog for the first 9 months of the fiscal year compared to the prior year. This resulted in reduced levels of work on engineering service contracts and less revenue from such contracts. In the fourth quarter, a large engineering service contract from EMRE was received, which will be recognized into revenue as work progresses throughout fiscal 2008.

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

QuestAir's sales order backlog is defined as future revenue from signed contracts that have not yet been recognized as revenue. The following table provides an analysis of the changes in our sales order backlog for the years ended September 30, 2007 and 2006.

(Unaudited)	For the year ended September 30, 2007			For the year ended September 30, 2006		
	Gas Purification Systems	Engineering Service Contracts	Total	Gas Purification Systems	Engineering Service Contracts	Total
Opening Balance	**4,908,298**	**135,594**	**5,043,892**	2,239,778	767,770	3,007,548
Bookings	**10,802,921**	**2,809,275**	**13,612,196**	8,642,200	1,226,020	9,868,220
Revenue Recognized	**(6,322,595)**	**(689,571)**	**(7,012,166)**	(5,808,488)	(1,749,605)	(7,558,093)
Adjustments[2]	**(433,989)**	**(156,168)**	**(590,157)**	(165,192)	(108,591)	(273,783)
Ending Balance	**8,954,635**	**2,099,130**	**11,053,765**	4,908,298	135,594	5,043,892

The total sales order backlog increased by $6,009,873, or 119%, during fiscal 2007. The increase in backlog over the fiscal year was driven by orders valued at $10,802,921 related to gas purification systems, and $2,809,275 for engineering service orders. During the year we received several orders for our methane purification products, including an order valued at approximately US$2,850,000 for an M-3100 system to upgrade anaerobic digester gas created from organic waste to pipeline quality methane. We also received an order valued at approximately $1,200,000 for an M-3100 methane recovery system for use in a landfill gas-to-energy project. Orders for hydrogen purification products were also strong, and included two orders valued at approximately $600,000 each for H-3100 systems to recover waste hydrogen from petrochemical plants. Engineering service contracts bookings include an order valued at approximately $1,800,000 from EMRE related to the development of a compact rapid cycle PSA unit for use in a benchtop on-board hydrogen generator. A negative adjustment was made to sales order backlog as a result of foreign exchange fluctuations during the year.

We currently expect that the backlog as of September 30, 2007 will be substantially recognized as revenue by December 31, 2008.

Gross Profit

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

	For the years ended September 30, 2007	2006
Revenue	**7,012,166**	7,558,093
Cost of goods sold	**6,973,668**	6,432,954
Gross Profit	**38,498**	1,125,139
Gross Margin (%)	**0.5%**	14.9%

The decrease in gross profit for fiscal 2007 compared to the prior year resulted from the recognition of an estimated loss of $1,912,663 on the prototype plant being sold to an ExxonMobil refinery. $1,367,742 of this amount has already been incurred for salary and travel expenses related to expediting suppliers and site visits. The balance of the loss, $544,921, represents an updated estimate of future costs related to the prototype plant, of which $121,676 is management's estimated loss to be incurred to complete the installation and commissioning of the prototype plant (which is expected to be completed in the first quarter of fiscal 2008), and $423,245 is a warranty provision. In fiscal 2006, we recognized an initial loss on the prototype plant of $419,172, being management's best estimate of the anticipated future loss at that time. This amount has been incurred by the Company. (See also 'Use of Estimates' and 'Warranty Provision' under 'Critical Accounting Policies and Estimates'.)

Excluding the ExxonMobil prototype plant, gross margin on commercial equipment and engineering services combined was $1,951,161, or 36% in fiscal 2007 compared to $1,544,311 or 40% in the prior fiscal year. Margins are expected to fluctuate from year to year depending on the mix of revenues recognized from engineering service contracts which typically contribute higher margins, and gas purification systems.

Sales and Marketing

Sales and marketing expenses were $2,051,248 for fiscal 2007, an increase of 6% compared to $1,938,537 for the prior year. The increase in sales and marketing expenses for fiscal 2007 was attributed to an increased level of sales activities compared to the prior year.

Research and Development

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

	For the years ended September 30, 2007	2006
Gross R&D Expenditure	**5,888,966**	6,907,360
Government & Partner Funding	**(374,929)**	(1,815,186)
Net R&D Expenditure	**5,514,037**	5,092,174

The 15% reduction in gross R&D expenditures for fiscal 2007 compared to the prior year was due to a reduction in the amount of R&D undertaken as resources were redirected towards supporting our commercial sales efforts and the construction of the prototype plant. Government funding, which is recognized as a reduction in R&D expenses when collection is reasonably probable, fell during fiscal 2007 as the TPC contribution agreement neared completion (see also 'Contingent Off-Balance Sheet Financing Arrangements').

2 Includes adjustments for fluctuations in foreign currency exchange rates.

General and Administrative

G&A expenses were $3,992,040 for fiscal 2007, an increase of 21% from $3,311,188 for the prior year. The increase in G&A expenses for the year related to severance costs and termination benefits of $564,030 related to the restructuring of our operations being recognized in the third quarter of fiscal 2007. The balance of the increase in fiscal 2007 is related to increases in consulting, regulatory fees and training costs, partially offset by reductions in investor relations, accounting and legal fees.

Stock-based compensation expense was $458,067 for fiscal 2007, a decrease of 7% from $492,302 for the prior year. Stock-based compensation expenses were higher for the prior year due to a stock compensation charge related to the repricing of certain options at the time of our IPO in fiscal 2005.

Amortization

Amortization expenses were $850,833 for fiscal 2007 compared to $1,223,788 for the prior year. The decrease in amortization expenses was a result of certain capital assets becoming fully amortized during the year.

Other Income and Expense

Other income and expense netted to an expense of $47,752 for fiscal 2007 compared to income of $177,630 in the prior year. Losses from foreign exchange fluctuations and unrealized losses on embedded derivatives were only partially offset by interest income in the current year.

Net Loss

Net loss for fiscal 2007 was $12,417,412 ($0.24 per share) compared to $10,262,918 ($0.24 per share) for the prior year. The increase in the net loss for the year was primarily a result of reduced gross profit and higher G&A and net R&D expenses.

Loss per share is calculated based on the weighted average number of common shares outstanding through the year. Loss per share was unchanged for the year as a result of an increase in the weighted average number of common shares outstanding compared to the prior year (refer to 'Outstanding Share Data').

Capital Expenditures

Capital expenditures net of government funding and proceeds on sale ("Net CAPEX") for fiscal 2007 were $412,249 compared to $1,052,668 for the prior year. Net CAPEX was higher in fiscal 2006 resulting from leasehold improvements made to new hydrogen testing facilities and expenditures on a demonstration landfill gas processing plant installed at the Vancouver Landfill.

It is expected that capital expenditures will fluctuate from year to year depending on the requirements of specific product development programs and administrative needs.

Use of Proceeds from our Public Offerings

We disclosed our expectations regarding the use of the net proceeds of our IPO in our prospectus dated December 14, 2004. In addition, we disclosed our expectations regarding the use of the net proceeds of our subsequent equity offering in our prospectus dated May 23, 2006. Net cash proceeds from the IPO were $11,694,571, while net cash proceeds from the equity offering were $18,410,751. As at September 30, 2007, we had used $20,977,828 of this amount to fund our operating activities. Funds from the equity offering in the amount of $9,127,494 remain available for the uses described in the prospectuses, and we intend to use these funds as described in the prospectuses. Circumstances may arise, however, which may result in a reallocation of funds for sound business reasons.

The table below compares the estimated use of proceeds disclosed in our December 2004 IPO prospectus to the actual results as at September 30, 2007.

Use of proceeds noted in Prospectus	Prospectus Comment	Actual Use to September 30, 2007
Sales and Marketing: Approximately 20%	To drive sales growth and expand the Company's market channels	21%
Research and Development: Approximately 40%	To develop and commercialize products for the Company's industrial hydrogen and fuel cell related markets	51%
Capital Expenditures: Approximately 30%		10%
Working capital, general corporate purposes and selective acquisitions or investments: Approximately 10%	In conjunction with funds from operations, used for new products, technologies and businesses that expand, complement or are otherwise related to the Company's existing business.	18%

The table below compares the estimated use of proceeds disclosed in our May 2006 prospectus to the actual results as at September 30, 2007.

Use of proceeds noted in Prospectus	Prospectus Comment	Actual Use to September 30, 2007
Sales and Marketing: Approximately 25%	To drive sales growth and expand the Company's market channels	19%
Research and Development: Approximately 40%	To develop and commercialize products for the Company's hydrogen, methane and fuel cell related markets	52%
Capital Expenditures: Approximately 15%		4%
Working capital, general corporate purposes: Approximately 20%	In conjunction with funds from operations, for working capital and general corporate purposes.	25%

The proportion of spending on working capital and general corporate purposes was higher than expected as a result of costs associated with the reorganization of operations during the year as well as increased costs associated with the prototype plant. This increase was offset by lower-than-expected spending on capital assets, as investments in manufacturing related equipment have not yet been required.

SUMMARY OF QUARTERLY RESULTS

(Unaudited, $ '000 except loss per share data)	2007 Sep 30	Jun 30	Mar 31	2006 Dec 31	Sep 30	Jun 30	Mar 31	2005 Dec 31
Total Revenues	**880**	**3,616**	**873**	**1,643**	2,697	1,193	2,796	872
Gas Purification Systems	**709**	**3,333**	**858**	**1,423**	2,530	574	2,483	221
Eng. Service Contracts	**171**	**283**	**15**	**220**	167	619	313	651
% Gross Margin	**(14%)**	**34%**	**(156%)**	**18%**	3%	40%	(7%)	87%
R&D (net)	**1,173**	**1,561**	**1,540**	**1,240**	1,330	1,236	1,253	1,273
General & Administrative	**841**	**1,325**	**987**	**839**	835	776	902	798
Net Loss	**2,979**	**2,559**	**4,654**	**2,225**	2,724	2,135	3,336	2,068
Net Loss per share	**(0.06)**	**(0.05)**	**(0.09)**	**(0.04)**	(0.05)	(0.05)	(0.09)	(0.06)
Net CAPEX	**15**	**37**	**99**	**261**	302	354	66	331
Cash used in Operations & Net CAPEX	**2,947**	**2,264**	**1,210**	**4,105**	3,508	1,876	1,724	2,322
Backlog	**11,054**	**7,136**	**7,513**	**5,819**	5,044	4,976	5,840	5,702
Gas Purification Systems	**8,955**	**6,660**	**7,078**	**5,697**	4,908	4,570	4,815	4,359
Eng. Service Contracts	**2,099**	**476**	**435**	**122**	136	406	1,025	1,343

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

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

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

G&A expenses have varied quarter by quarter, largely as a result of quarterly variations in legal, regulatory and investor relations costs, and specific to the quarter ended June 30, 2007, severance and termination benefits associated with the restructuring of our operations.

Review of the Fourth Quarter ended September 30, 2007

Total revenues for the quarter ended September 30, 2007 were $879,856, decreased by 67% from $2,696,596 for the same period in 2006. Revenues in the fourth quarter of fiscal 2006 were much higher due to a greater amount of revenue recognized on a percentage-of-completion basis towards

the construction of the prototype plant. Sales order backlog was $11,053,765 at September 30, 2007, increased 55% from $7,135,798 at June 30, 2007, reflecting a large dollar value of new purchase orders received in the fourth quarter. Cash used in operations and capital expenditures for the quarter ended September 30, 2007 was $2,947,642, decreased by 16% from $3,508,457 in the same period in 2006. Cash used in operations decreased by $265,142 compared to the same period in 2006, driven by increases in deferred revenue from customer deposits on commercial equipment sales. Net CAPEX decreased by $295,673 compared to the same period in 2006, reflecting investments in leasehold improvements for new hydrogen testing facilities in the prior year. The net loss for the quarter ended September 30, 2007 was $2,979,389, increased 9% from $2,724,580 in the same period in 2006.

CASH FLOWS, LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

Cash and cash equivalents were $5,726,245 at September 30, 2007, decreased by $5,292,555 from $11,018,800 at September 30, 2006. This decrease in cash and cash equivalents during the year was driven by cash inflows from investing activities of $4,842,856, offset by cash outflows from operating and financing activities of $10,113,209 and $22,202 respectively.

Cash used by operations for the year ended September 30, 2007 was $10,113,209, compared to $8,378,011 for the prior year. The increase in cash used by operations for the year was driven by cash outflow increases resulting from the increased loss for the year, as well as a decrease in accounts payable. This was partially offset by an increase in deferred revenue and a decrease in amortization.

Cash provided by investing activities for the year ended September 30, 2007 was $4,842,856, compared to $9,606,626 of cash used in the prior year. The increase in cash provided by investing activities for the year primarily related to the maturity of $4,339,553 of short term investments made in the prior year. The increase in cash provided by investing activities was also attributed to a decrease in the amount of restricted cash set aside to secure letters of credit with customers.

Cash used by financing activities was $22,202 for the year ended September 30, 2007, compared to a cash inflow of $18,691,614 for the prior year. The cash inflow in the prior year resulted primarily from net cash proceeds raised from our common share offering which closed on May 31, 2006.

As noted in the 'Key Performance Indicators' section, 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 year ended September 30, 2007 was $10,525,458, compared to $9,430,679 for the prior year. 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:

	For the years ended September 30, 2007	2006
Cash used in Operating Activities	**(10,113,209)**	(8,378,011)
Add: purchase of property, plant and equipment ("PP&E")	**(426,729)**	(1,155,334)
Add: government grants and funding related to PP&E	**5,434**	96,791
Add: proceeds from sale of PP&E	**9,046**	5,875
Cash used in Operations and Capital Requirements	**(10,525,458)**	(9,430,679)
Reconciliation to GAAP Statements of Cash Flow:		
Add: Short term investments	**4,339,553**	(7,400,000)
Add: restricted cash	**915,552**	(1,153,958)
Add: Cash from Financing Activities	**(22,202)**	18,691,614
Increase in Cash and Cash Equivalents	**(5,292,555)**	706,977

The increase in cash burn for the year ended September 30, 2007 compared to the prior year resulted primarily from increased operational losses, partially offset by decreased net capital expenditures.

Liquidity and Capital Resources

Since incorporation, we have financed our operations through cash generated from commercial sales, the issuance of equity and funding received from government and strategic partners. At September 30, 2007 cash and short-term investments were $8,786,692, compared to $18,418,800 at September 30, 2006. Not included in cash and short term investments at September 30, 2007 was $340,802 of restricted cash to secure letters of credit with customers.

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

Credit Facilities

During fiscal 2005, we signed a credit facilities agreement with Comerica Bank. This agreement is amended and restated each year as part of the annual renewal of these facilities, most recently in June 2007. The amended credit facilities include

a US$1 million accounts receivable line of credit and a US$1 million term loan, in addition to amounts outstanding under the prior term loan agreements. Both facilities are secured by the assets of the Company with certain exceptions. As at September 30, 2007, we had drawn $920,336 against the term loans net of repayments, and no funds have been drawn under either of the amended credit facilities. We expect to use the equipment line to fund capital expenditures and we may use the accounts receivable line to fund working capital requirements from time to time. We are in compliance with all of our bank covenants.

Contractual Obligations

The following table lists our contractual obligations at September 30, 2007. We expect to fund these expenditures out of our cash reserves, current accounts receivables and future progress payments not yet invoiced related to orders in backlog:

(Unaudited)	Payments due by Period				
	Total	**In the next year**	**2-3 years**	**4-5 years**	**After 5 years**
Bank debt	920,336	564,306	356,030	-	-
Capital leases	195,644	97,822	97,822	-	-
Operating leases	749,329	513,331	169,998	66,000	-
Purchase obligations[3]	3,170,860	3,170,860	-	-	-
Total contractual obligations	5,036,169	4,346,319	623,850	66,000	-

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:

Technology Partnerships Canada

On June 6, 2003, we were awarded a $9,600,000 conditionally repayable loan from TPC, a funding program administered by Industry Canada. At September 30, 2007, we had received $8,140,443 against this loan. These funds are repayable in the form of annual royalties under certain conditions. The project completion date under the agreement is September 30, 2007. Subsequent to fiscal year end, we entered into negotiations with TPC to amend this agreement to, among other things, eliminate certain development milestones, extend the program completion date for certain other milestones, and reduce the contribution amount and the associated royalties. Details of the expected amendment are contained in note 18 of the Company's audited financial statements for fiscal 2007. There can be no assurance that an amendment will be agreed to by the parties, or that any further funds will be available to support additional development activities. Amounts drawn under this contribution agreement are subject to final audit by Industry Canada.

We entered into a similar funding arrangement with TPC on March 31, 1999 and received a total of $4,762,503 in funding from March 1999 to July 2002. The funding is also repayable under certain conditions. The repayment obligations and total royalty repayments made to date for these funding programs are listed below:

Funding Award Date	Description	Royalties	Term	Royalty Payments to Date
June 6, 2003	Fast Cycle Pressure Swing Adsorption & Gas Management Systems Program	Annual royalties of 1.165% of gross business revenues	The royalty period began on October 1, 2005 and will end on September 30, 2013 if the cumulative royalties reach a ceiling of $23.6 million. If the royalties are less than $23.6 million by September 30, 2013, the royalty period will continue until the earlier of September 30, 2021 or until a cumulative royalty ceiling of $23.6 million is reached.	Payments: FY07: $88,052 Accrued for future payment: $210,468
March 31, 1999	Pulsar Pressure Swing Adsorption Program	Annual royalties of 1.8% of gross project revenues and fuel cell related products	Royalty period extends to the later of the date of payment of all amounts due to the Minister and 2015. The maximum cumulative repayment is $8.75 million	Payments: FY07: $14,699 FY06: $ 6,960 FY05: $10,698 Total Cumulative payments: $47,651 Accrued for future payment: $7,839

3 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.

Department of Natural Resources Efficiency and Alternative Energy Program

On January 4, 2005, we were awarded a grant for $225,000 from the Government of Canada under the Department of Natural Resources Efficiency and Alternative Energy Program. On January 6, 2004, we received a similar funding award of $193,944 under the same funding program. Both funding awards are repayable under certain conditions. The repayment obligations and total royalty repayments made to date for these funding programs are listed below:

Funding Award Date	Description	Royalties	Term	Royalty Payments to Date
January 4, 2005	Development of structured adsorbent for the production of high purity hydrogen	Annual royalties of 0.12% of gross project revenues	Royalty period starts on date of first gross project revenues and extends to March 31, 2015, to a maximum cumulative repayment of $225,000, whichever occurs first.	Payments: $0 Accrued for future payment: $0
January 6, 2004	Development of a device that increases the efficiency of a High Temperature Fuel Cell system	Annual royalties of 0.12% of gross project revenues	Royalty period starts on date of first gross project revenues and extends to March 31, 2014, to a maximum cumulative repayment of $193,944, whichever occurs first.	Payments: $0 Accrued for future payment: $0

OUTSTANDING SHARE DATA

Common Shares Outstanding

On May 31, 2006 we completed an offering of common shares, issuing 14,815,000 common shares from treasury. As a result of the issuance of shares, our authorized share capital consists of an unlimited number of common shares, of which 52,542,453 common shares were issued and outstanding as of November 30, 2007. 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 years:

	For the years ended September 30, 2007	2006
Weighted Average Common Shares Outstanding	52,473,306	42,426,280

The average number of common shares outstanding increased for the year ended September 30, 2007 compared to the prior year as a result the issuance of 14,815,000 new common shares upon the closing of our equity offering on May 31, 2006.

Stock Options and Warrants Outstanding

As at September 30, 2007 there were 4,767,925 stock options outstanding of which 3,815,842 were exercisable. Included in the exercisable options are 1,885,381 options with an average exercise price of $1.38 and 221,223 options that were issued in lieu of salary or bonus with an exercise price of $0.001 that will expire on or before December 31, 2007. As at September 30, 2007 there were 192,308 warrants outstanding, unchanged from the prior year. These warrants have an exercise price of $3.88 each and expire June 6, 2008.

RELATED PARTY TRANSACTIONS

In fiscal 2006, QuestAir had a consulting agreement with Dr. Denis Connor, Chairman of the Company, for consulting services related our government relations activities. Under this agreement, Dr. Connor received $18,000 in fees during the quarter ended December 31, 2005, at which time the contract terminated.

SUBSEQUENT EVENTS

Subsequent to the end of fiscal 2007, we announced that the prototype plant has been successfully started-up at the ExxonMobil refinery in France. The prototype H-6200 hydrogen purifier is currently undergoing testing at the refinery, in order to provide additional data to assist with the marketing of the H-6200 to other refineries around the world. This is a major milestone in the development of this rapid cycle PSA for refinery applications, which we have been developing with EMRE since 2003.

OUTLOOK

Fiscal 2008 will be an important year for QuestAir with the commercialization of our H-6200 hydrogen purifier in the oil refining market. The data that we collect from the field test at the ExxonMobil refinery in France should help us in securing our first sale of a fully commercial H-6200 system in the oil refining market. We also expect to see continued growth in the sale of gas purifiers in the industrial hydrogen and biogas markets.

QuestAir's operational and financial milestones for the remainder of fiscal 2008 are:

1. *Enhance our commercial footprint in the biogas market.* Biomethane purification is expected to be one of the principal growth drivers of the Company in the next 3 years. In fiscal 2008, we look to increase our penetration of this market by securing orders from at least 3 new customers and by signing at least one distribution agreement with a biogas developer.
2. *Grow our industrial hydrogen business.* In fiscal 2007, we commenced the sale of our large capacity H-3200 system in order to compete in the intermediate capacity market for hydrogen systems. In fiscal 2008, we expect to sell a greater number of larger capacity systems, which in turn will increase the average dollar value per hydrogen PSA sold.
3. *Secure first purchase order for a commercial H-6200 hydrogen purifier.* With the prototype plant now up and running, we expect to be able to lever this demonstration site to secure our first commercial order for an H-6200 hydrogen purifier.
4. *Increase recognized revenue to between $9 and $10 million.* Recognized revenue is expected to increase to between $9 and $10 million in fiscal 2008. This growth primarily reflects the strong increase in backlog that was achieved during fiscal 2007. However, not all of the orders in backlog are expected to be recognized as revenue during the fiscal year. Our increased focus on selling larger units has extended the time between receipt of order and recognition of revenue. In addition, customer schedules for equipment commissioning affect timing of revenue recognition. Two large orders that were received in the fourth quarter of fiscal 2007 are not expected to be recognized as revenue in fiscal 2008.
5. *Manage cash used in operations and capital expenditures to less than $8 million.* Cash used in operations and capital expenditures is expected to be less than $8 million, reduced from $10.5 million in fiscal 2007. Cash will primarily be used to fund operations, with capital expenditures accounting for approximately $1.0 million of the expected use of cash.

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.

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 contract 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 years ended September 30, 2007 and 2006 there were no material adjustments to long-term production type contracts 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 year ended September 30, 2007, raw materials on hand of $895,988 includes $50,300 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. During fiscal 2007, a warranty provision of $423,245 was recorded and included in the estimated loss on the prototype

plant. This represents management's estimate of the possible future costs to repair and/or service the prototype plant, based on prior experience with test equipment and newly developed systems (rather than standard commercial equipment). Should this or any other warranty estimates prove to be incorrect, we may incur costs different from those provided for in our warranty provision. In each of fiscal 2007 and 2006, actual warranty costs incurred were less than the provision recorded.

CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

Financial Instruments, Hedges and Comprehensive Income

On October 1, 2006, QuestAir adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Sections 3855, *Financial Instruments – Recognition and Measurement*; 3865, *Hedges*; 1530, *Comprehensive Income*; and 3251, *Equity,* as well as the revised Section 3861, *Financial Instruments – Disclosure and Presentation*. These sections specify when a financial instrument or non-financial derivative is to be recognized on the balance sheet; require a financial instrument or non-financial derivative to be measured at fair value or using cost-based measures; establish how gains and losses are to be recognized and presented, including introducing comprehensive income; specify how hedge accounting should be applied; and establish new disclosures about an entity's accounting for designated hedging relationships and the methods and assumptions applied in determining fair values. QuestAir elected to adopt all of these new standards retrospectively without restatement. Management is of the opinion that if any restatement of comparative financial statements was required, its effect would be minor.

Under these new standards, embedded derivatives typically arise when the currency of our sales orders is different from both the functional currencies of QuestAir and our international customers, and such derivatives are recognized as either assets or liabilities on the balance sheet at fair value. All gains and losses (realized or unrealized) from such derivatives are recognized in the income statement in the period in which they occur.

We have implemented the following classifications for our financial instruments:

(i) Short-term liquid investments included in cash and cash equivalents have been classified as held-for-trading and short-term investments have been classified as held to maturity.

(ii) The Company's accounts receivable are measured at amortized cost.

(iii) The Company's accounts payable and accrued liabilities have been classified as other financial liabilities and are measured at amortized cost.

(iv) The Company's debt has been classified as held-to-maturity and is measured at amortized cost.

Financial assets and liabilities classified as held-for-trading are measured at fair value at each reporting period with changes in fair value in subsequent periods included in net earnings. Certain sales contracts contain embedded derivatives which have been classified as held-for trading. Held to maturity assets are measured at amortized cost.

QuestAir does not use hedge accounting at this time, as management determined that the nature of its operations would not allow for effective hedges to be implemented.

Financial Instruments Disclosures

The Accounting Standards Board of the CICA issued Handbook Section 3862, *Financial Instrument – Disclosures,* which revises and enhances the current disclosure requirement related to financial instruments. The new standard places increased emphasis on disclosures about risks associated with both recognized and unrecognized financial instruments and how these risks are managed. This new standard comes into effect for fiscal years beginning on or after October 1, 2007. On September 30, 2007, the Company early adopted this new standard, as well as Section 3863, *Financial Instruments – Presentation,* which carries forward the presentation requirements from section 3861 unchanged.

Capital Disclosures

The CICA issued Handbook Section 1535, *Capital Disclosures,* which establishes standards for disclosing information about an entity's capital and how it is managed. These changes come into effect for fiscal years beginning on or after October 1, 2007; accordingly, QuestAir will adopt this new standard in fiscal 2008. As this standard relates only to disclosure requirements, this section will not have any impact on our financial results.

Accounting Changes

The CICA has issued section 1506, *Accounting Changes,* which establishes criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and correction of errors. As a result, changes in accounting policies are only permitted when required by a primary source of GAAP or when the change will result in reliable and more relevant information. These changes come into effect for fiscal years beginning on or after January 1, 2007; accordingly, QuestAir will adopt this new standard in fiscal 2008. 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 QuestAir will adopt this new standard in fiscal 2009. The Company is assessing the impact this standard will have on its financial statements.

Financial Statement Preparation

The CICA has revised section 1400, *General Standards of Financial Statement Presentation,* which requires management to make an assessment of, and disclose material uncertainties related to, the ability of an entity to continue as a going concern. This new standard 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.

DISCLOSURE CONTROLS AND PROCEDURES

The Company maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the Canadian Securities Administrators rules and forms. The Company evaluated its disclosure controls and procedures as defined under Multilateral Instrument 52-109 for the year ended September 30, 2007. This evaluation was performed by the Chief Executive Officer and the Chief Financial Officer with the assistance of other Company employees to the extent necessary and appropriate. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

INTERNAL CONTROLS AND PROCEDURES

The Company maintains a set of internal controls over financial reporting which have been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP. The Company evaluated the design of its internal controls and procedures as defined under Multilateral Instrument 52-109 for the year ended September 30, 2007. This evaluation was performed by the Chief Executive Officer and the Chief Financial Officer with the assistance of other Company employees to the extent necessary and appropriate. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design of these internal controls and procedures was effective.

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

RISKS & UNCERTAINTIES

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

Technology and Competitive Risks

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

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

Market Risks

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

In the longer term, there is significant uncertainty regarding the commercial viability of fuel cell technology and the adoption

of fuel cell powered automobiles and power products. We seek to manage this risk by focusing on the sale of our existing commercial products in the nascent fuel cell market, and pacing our fuel cell related development programs to the level of engagement and funding received from of our fuel cell partners.

Regulatory Risk

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

Partner Risk

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

Financial Risk

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

Key Personnel Risk

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

Management's Responsibility for Financial Reporting

The accompanying financial statements of QuestAir Technologies Inc. and all the information in this Annual Report are the responsibility of management and have been approved by the Board of Directors.

The financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgements. Management has determined such amounts on a reasonable basis in order to ensure that the financials statements are presented fairly in all material respects. Management has prepared the financial information presented elsewhere in the Annual Report and has ensured that it is consistent with that in the financial statements. QuestAir Technologies Inc. endeavours to maintain systems of internal accounting and administrative controls of high quality, consistent with reasonable cost. Such systems are necessary to provide reasonable assurance that the financial information is relevant, reliable and accurate and that the Company's assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out this responsibility principally through its Audit Committee. The Audit Committee meets periodically with management, as well as the external auditors, to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues, to satisfy itself that each party is properly discharging its responsibilities, and to review the Annual Report, the financial statements and the external auditors' report. The Committee reports its findings to the Board for consideration when approving the financial statements for issuance to the shareholders. The Committee also considers, for review by the Board and approval by the shareholders, the engagement or re-appointment of external auditors.

The Company's financial statements have been audited by PricewaterhouseCoopers LLP, the external auditors, in accordance with generally accepted auditing standards on behalf of the shareholders. PricewaterhouseCoopers LLP have full and free access to the Audit Committee.

Jonathan Wilkinson
President & Chief Executive Officer

Sherry Tryssenaar
Vice President Finance and Administration &
Chief Financial Officer

Auditors' Report

To the Shareholders of QuestAir Technologies Inc.

We have audited the balance sheets of **QuestAir Technologies Inc.** as at September 30, 2007 and 2006 and the statements of operations, comprehensive loss and deficit, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants
Vancouver, British Columbia
December 12, 2007

Balance Sheets

As at September 30, 2007 and 2006

(expressed in Canadian dollars)	2007 $	2006 $
ASSETS		
Current assets		
Cash and cash equivalents	**5,726,245**	11,018,800
Restricted cash (note 3)	**340,802**	1,256,354
Short-term investments	**3,060,447**	7,400,000
Accounts receivable	**1,412,983**	1,476,024
Grants and funding receivables	**-**	454,597
Inventories (note 4)	**4,376,717**	3,510,508
Prepaid expenses	**256,378**	337,335
	15,173,572	25,453,618
Long-term assets		
Property, plant and equipment (note 5)	**1,703,872**	2,103,626
Other long-term assets	**175,080**	125,000
	17,052,524	27,682,244
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (note 6)	**2,791,139**	4,413,717
Deferred revenue	**4,546,584**	1,946,781
Current portion of bank debt (note 7)	**564,306**	351,398
Current portion of obligations under capital lease (note 8)	**97,822**	-
Derivatives (note 9)	**75,874**	-
	8,075,725	6,711,896
Long-term liabilities		
Bank debt (note 7)	**356,030**	532,852
Obligations under capital lease (note 8)	**97,822**	-
	8,529,577	7,244,748
SHAREHOLDERS' EQUITY		
Share capital (note 10)		
Authorized		
Unlimited common shares, voting, no par value		
Unlimited preferred shares, issuable in series, no par value		
Common shares	**109,383,859**	109,020,202
Contributed surplus (note 10)	**6,626,825**	6,462,772
Deficit	**(107,487,737)**	(95,045,478)
	8,522,947	20,437,496
	17,052,524	27,682,244

Nature of operations and going concern (note 1)
Commitments and contingencies (note 14)
Subsequent event (note 18)

Approved by the Board of Directors

Director

Director

See accompanying notes to financial statements.

Statements of Operations, Comprehensive Loss and Deficit

For the years ended September 30, 2007 and 2006

(expressed in Canadian dollars)	2007 $	2006 $
Revenues	**7,012,166**	7,558,093
Cost of goods sold	**6,973,668**	6,432,954
Gross profit	**38,498**	1,125,139
Operating expenses		
Research and development - net (note 12)	**5,514,037**	5,092,174
General and administration	**3,992,040**	3,311,188
Sales and marketing	**2,051,248**	1,938,537
Amortization	**850,833**	1,223,788
	12,408,158	11,565,687
Loss before undernoted	**(12,369,660)**	(10,440,548)
Other income (expense)		
Interest income	**522,524**	378,872
Other expense	**(570,276)**	(201,242)
	(47,752)	177,630
Loss and comprehensive loss for the year	**(12,417,412)**	(10,262,918)
Deficit - Beginning of year	**(95,045,478)**	(84,782,560)
Unrealized foreign exchange loss on derivatives (note 10)	**(24,847)**	-
Deficit - End of year	**(107,487,737)**	(95,045,478)
Basic and diluted loss per share (note 16)	**(0.24)**	(0.24)

See accompanying notes to financial statements.

Statements of Shareholders' Equity

For the years ended September 30, 2007 and 2006

(expressed in Canadian dollars)	Common shares $	Contributed surplus $	Accumulated other comprehensive income (loss) $	Deficit $	Total shareholders' equity $	Comprehensive Loss $
Balance - September 30, 2005	89,774,802	6,647,129	-	(84,782,560)	11,639,371	-
Net loss	-	-	-	(10,262,918)	(10,262,918)	(10,262,918)
Issuance of common shares as a result of public offering - net of share issuance costs of $1,589,499	18,410,750	-	-	-	18,410,750	
Exercise of share options	157,991	-	-	-	157,991	
Stock-based compensation allocated to common shares on exercise of share options	676,659	(676,659)	-	-	-	
Stock-based compensation on fair value share options	-	492,302	-	-	492,302	
Balance - September 30, 2006	109,020,202	6,462,772	-	(95,045,478)	20,437,496	-
Net loss	-	-	-	(12,417,412)	(12,417,412)	(12,417,412)
Adjustment to opening balance of unrealized foreign exchange loss on embedded derivatives	-	-	-	(24,847)	(24,847)	
Total comprehensive loss	-	-	-	-	-	(12,417,412)
Exercise of share options	69,643	-	-	-	69,643	
Stock-based compensation allocated to common shares on exercise of share options	294,014	(294,014)	-	-	-	
Stock-based compensation on fair value share options	-	458,067	-	-	458,067	
Balance - September 30, 2007	109,383,859	6,626,825	-	(107,487,737)	8,522,947	

See accompanying notes to financial statements.

Statements of Cash Flows

For the years ended September 30, 2007 and 2006

(expressed in Canadian dollars)	2007 $	2006 $
Cash flows from operating activities		
Loss for the year	**(12,417,412)**	(10,262,918)
Items not involving cash		
Amortization	**850,833**	1,223,788
(Gain) loss on sale of property, plant and equipment	**(412)**	8,619
Unrealized foreign exchange loss on derivatives	**51,027**	-
Non-cash compensation expense	**458,067**	492,302
Foreign currency (gain) loss	**(32,489)**	503
	(11,090,386)	(8,537,706)
Changes in non-cash operating working capital		
Accounts, grants and funding receivables	**517,638**	(361,454)
Inventories	**(866,209)**	(1,546,335)
Prepaid expenses	**30,877**	(162,579)
Accounts payable and accrued liabilities	**(1,304,932)**	1,885,385
Deferred revenue	**2,599,803**	344,678
	977,177	159,695
	(10,113,209)	(8,378,011)
Cash flows from investing activities		
Increase in short-term investments	**(3,060,447)**	(7,400,000)
Decrease in short-term investments	**7,400,000**	-
Purchase of property, plant and equipment	**(426,729)**	(1,155,334)
Government grants and funding related to property, plant and equipment	**5,434**	96,791
Proceeds on sale of property, plant and equipment	**9,046**	5,875
Decrease (increase) in restricted cash	**915,552**	(1,153,958)
	4,842,856	(9,606,626)
Cash flows from financing activities		
Issuance of common shares	**-**	20,000,250
Share issue costs	**-**	(1,589,499)
Issuance of common shares on exercise of stock options	**69,642**	157,991
Repayment of obligations under capital lease	**(127,930)**	(110,860)
Repayment of bank debt	**(426,674)**	(197,749)
Term loan advance	**462,760**	431,481
	(22,202)	18,691,614
(Decrease) increase in cash and cash equivalents	**(5,292,555)**	706,977
Cash and cash equivalents - Beginning of year	**11,018,800**	10,311,823
Cash and cash equivalents - End of year	**5,726,245**	11,018,800

Supplemental cash flow information (note 17)

See accompanying notes to financial statements.

Notes to Financial Statements

September 30, 2007 and 2006
(expressed in Canadian dollars)

1. NATURE OF OPERATIONS 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 September 30, 2007, has an accumulated deficit of $107,487,737. The Company's ability to continue as a going concern will depend on management's ability to successfully execute its business plan. The Company may seek additional forms of financing, but cannot provide assurance that it will be successful in doing so. These financial statements do not include adjustments or disclosures that may result from the Company's inability to continue as a going concern. If the going concern assumption is not appropriate for these financial statements, then adjustments would be necessary in the carrying value of assets and liabilities, and the reported net losses and balance sheet classifications used, and such adjustments could be material.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

Use of estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Assessments of the valuation of stock-based compensation, accrued warranty costs, revenue from long-term contracts, revenue from engineering service contracts and losses related to contracts are significant areas requiring the use of estimates. Actual results could differ from these estimates.

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.

Short-term investments

The Company's 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.

Inventories

Inventories are recorded at the lower of cost and replacement cost for raw materials and supplies and at the lower of cost and net realizable value for work-in-progress and finished goods. Costs of raw materials are determined on an average cost basis. Work-in-progress and finished goods include materials, direct labour and production overhead. Inventories are recorded net of any obsolescence provision.

Property, plant and equipment

Property, plant and equipment are recorded at cost (net of third-party funding) less accumulated amortization. Amortization is computed using the straight-line method over an asset's estimated useful life at the following rates:

Test equipment	20%
Computer equipment	30%
Leasehold improvements	lease term
Lab and warehouse equipment	20%
Manufacturing equipment	33%
Office equipment	20%
Furniture and fixtures	20%

Impairment of long-lived assets

Long-lived assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company tests the recoverability of long-lived assets based on future undiscounted cash flows expected to result from the use of the related assets to be realized on sale. An impairment loss is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

Revenue recognition
The Company recognizes revenue on commercial equipment sales when title has transferred, the customer has accepted the product, there is persuasive evidence of an arrangement, collection is probable and the price is fixed or determinable. Provisions are established for estimated product returns and warranty costs at the time revenue is recognized. The Company records deferred revenue when cash is received in advance of all of these revenue recognition criteria being met.

Revenues 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 contract costs incurred. Costs and estimated profit on contracts in progress in excess of amounts billed are reflected as work-in-progress. Cash received in advance of revenues being recognized on contracts is classified as deferred revenue.

The Company regularly monitors its contracts with customers to determine if a loss is likely to occur. If a loss is anticipated on a contract, the entire estimated loss is recorded as a cost of sales and a reduction in work-in-progress in the period in which the loss becomes evident and reasonably estimable.

Warranty costs
The Company provides for future warranty costs on products sold based on management's best estimates of such costs, taking into account past experience and the nature of the contracts.

Research and development costs
Research costs are expensed as incurred. Development costs are expensed as incurred unless they meet certain criteria under Canadian GAAP for deferral and amortization, which relate primarily to technological feasibility, identified future markets of the product, and availability of resources to complete the project. The Company has determined that none of its development costs to date have met these criteria.

Government assistance
Government assistance is recorded when receipt is reasonably assured as either a reduction of the cost of the applicable assets or a credit to the applicable expenses incurred in the statement of operations, comprehensive loss and deficit as determined by the terms and conditions of agreements under which the assistance is provided to the Company. A liability is recorded when repayment of the assistance is considered probable.

Foreign currency translation
Transactions denominated in foreign currencies are translated into Canadian dollars at the rate prevailing at the time of the transactions. Monetary assets and liabilities denominated in a foreign currency are translated into Canadian dollars at the current rates in effect at the balance sheet date. The resulting exchange gains and losses are recognized in the statement of operations, comprehensive loss and deficit.

Stock-based compensation plans
The Company accounts for stock options using the fair value method calculated using the Black-Scholes option pricing model. For options granted to directors, officers and employees, the compensation cost is measured at fair value at the date of grant and is expensed to operations over the award's vesting period. For options granted to non-employees, the fair value is measured when performance is complete, a performance commitment is made or the options are fully vested and non-forfeitable, whichever is earliest, and the expense is recognized over the period in which the goods or services from the non-employees are received. A corresponding increase in contributed surplus is recorded when stock options are expensed. When stock options are exercised, capital stock is credited by the sum of the consideration paid and the related portion previously recorded in contributed surplus. The effects of forfeitures are accounted for as they occur.

Income taxes
The Company follows the asset and liability method of accounting for income taxes. Under this method, future income taxes are recognized for the future income tax consequences attributable to differences between the financial statement carrying values and their respective income tax bases (temporary differences) and for the benefit of loss carry-forwards. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period that includes the substantial enactment date. Future income tax assets are evaluated, and if realization is not considered to be more likely than not, a valuation allowance is provided.

Financial instruments
Recognition and measurement
On October 1, 2006, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Sections 3855 "Financial Instruments - Recognition and Measurement", 3861 "Financial Instruments - Disclosure and Presentation", 3865 "Hedges", 1530 "Comprehensive Income", and 3251 "Equity", for fiscal years beginning on or after October 1, 2006 retrospectively without restatement.

Section 3855 establishes standards for the recognition and measurement of all financial instruments, provides a characteristics-based definition of a derivative financial instrument, provides criteria to be used to determine when a financial instrument should be recognized, and provides criteria to be used when a financial instrument is to be extinguished. Under this standard, all financial instruments are required to be measured at fair value on initial recognition. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, held-to-maturity, available-for-sale, loans and receivables, or other financial liabilities. The Company has implemented the following classifications for its financial instruments:

a) Short-term liquid investments included in cash and cash equivalents have been classified as held-for-trading and short-term investments have been classified as held-to-maturity.
b) The Company's accounts receivable are measured at amortized cost.
c) The Company's accounts payable and accrued liabilities have been classified as other financial liabilities and are measured at amortized cost.
d) The Company's debt has been classified as other financial liabilities.

Financial assets and liabilities classified as held-for-trading are measured at fair value at each reporting period with changes in fair value in subsequent periods included in net earnings. Certain sales contracts contain embedded derivatives that have been classified as held-for-trading. Held-to-maturity assets are measured at amortized cost.

(i) Derivative financial instruments and embedded derivatives:
In accordance with Section 3855, the Company classifies derivative financial instruments that have not been designated as hedges for accounting purposes and embedded derivatives as held-for trading, and values them at fair value each period with changes recorded in other income. The embedded derivatives relate to the foreign exchange component of certain sales contracts the Company enters into during the regular course of business (notes 9 and 10(c)). The Company has not designated any derivative financial instruments as hedges.

(ii) Comprehensive income:
Section 1530 establishes standards for reporting and displaying comprehensive income. Comprehensive income is defined as the change in equity (net assets) from transactions and other events from non-owner sources. Other comprehensive income is defined as revenues, expenses, gains and losses that, in accordance with primary sources of GAAP, are recognized in comprehensive income, but excluded from net income. No comprehensive income was recorded by the Company during the year.

(iii) Financing charges:
Financing charges that reflect the cost to obtain new debt financing are expensed as incurred. Financing charges that reflect the cost to obtain new equity financing are deducted from net proceeds as incurred.

The impact of adopting these new standards is as described in note 10(c).

Disclosures and presentation

CICA Handbook Section 3862, "Financial Instruments - Disclosures", provides standards for disclosures about financial instruments, including disclosures about fair value and the credit, liquidity and market risks associated with the financial instruments. CICA Handbook Section 3863, "Financial Instruments - Presentation", establishes standards for presentation of financial instruments and non-financial derivatives. Sections 3862 and 3863 supersede Section 3861.

Comparative amounts

Comparative amounts have been reclassified, where necessary, to conform to the presentation adopted in the current year.

3. RESTRICTED CASH

During 2007, the Company was 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. In addition, TD Bank required a restricted deposit to secure corporate credit card debt in the prior year. Restricted cash at September 30, 2007 of $340,802 (2006 - $1,256,354) relates to letters of credit of $340,802 (2006 - $1,196,889) and corporate credit card security of $nil (2006 - $59,465).

4. INVENTORIES

	2007 $	2006 $
Raw materials and supplies	**895,988**	502,472
Work-in-progress	**2,317,754**	2,604,919
Finished goods	**1,162,975**	403,117
	4,376,717	3,510,508

5. PROPERTY, PLANT AND EQUIPMENT

	2007		
	Cost $	Accumulated amortization $	Net $
Test equipment	**3,159,623**	**2,856,693**	**302,930**
Computer equipment	**2,262,737**	**1,848,571**	**414,166**
Leasehold improvements	**2,369,348**	**1,856,096**	**513,252**
Lab and warehouse equipment	**2,468,956**	**2,033,946**	**435,010**
Manufacturing equipment	**1,920,074**	**1,896,995**	**23,079**
Office equipment	**266,434**	**257,573**	**8,861**
Furniture and fixtures	**207,805**	**201,231**	**6,574**
	12,654,977	**10,951,105**	**1,703,872**

	2006		
	Cost $	Accumulated amortization $	Net $
Test equipment	3,298,337	2,711,364	586,973
Computer equipment	2,251,760	2,092,415	159,345
Leasehold improvements	2,401,764	1,787,215	614,549
Lab and warehouse equipment	2,803,570	2,122,673	680,897
Manufacturing equipment	1,978,529	1,929,429	49,100
Office equipment	277,564	267,137	10,427
Furniture and fixtures	203,719	201,384	2,335
	13,215,243	11,111,617	2,103,626

As at September 30, 2007, assets under capital lease with a cost of $356,065 (2006 - $353,651) and accumulated amortization of $57,860 (2006 - $329,756) are included in property, plant and equipment. Amortization expense for assets under capital lease recorded in the statement of operations, comprehensive loss and deficit for the year ended September 30, 2007 was $57,860 (2006 - $106,095).

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	2007 $	2006 $
Trade payables	**1,474,541**	3,462,599
Wages and benefits	**723,322**	467,741
Warranty provision	**473,475**	179,130
Accounting and legal costs	**119,000**	174,530
Taxes payable (GST, PST and VAT)	**801**	129,717
	2,791,139	4,413,717

7. BANK DEBT

In April 2005, the Company signed a credit facilities 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.

The line of credit is limited to 80% of eligible accounts receivable, subject to certain restrictions. This credit facility is payable upon demand. The variable interest rate for the line of credit is prime plus 0.50%. Interest is payable monthly, and the line of credit is renewable annually. As at September 30, 2007, no amounts were drawn against this facility.

The variable interest rate of the term loans is prime plus 0.75%. Interest on Tranche 1 is initially payable monthly, with 36 equal payments of principal plus interest payable beginning October 22, 2005. Interest on Tranche 2 and 3 is initially payable monthly, with 30 equal payments of principal plus interest payable beginning January 22, 2007 and 2008, respectively. As at September 30, 2007, the Company had drawn $920,336 (2006 - $884,250) on the term loans net of repayments.

	2007 $	2006 $
Current portion of bank debt	**564,306**	351,398
Long-term portion of bank debt	**356,030**	532,852
	920,336	884,250

Accrued interest payable as at September 30, 2007 was $1,979 (2006 - $3,399) and is included in accounts payable and accrued liabilities. The effective interest rate of the term loans was 7.05% for the year ended September 30, 2007. Total interest expense was $58,599 (2006 - $39,794) for the year ended September 30, 2007. Draws can be made against the Tranche 3 term loan, to a maximum of US$1 million, prior to June 21, 2008. As at September 30, 2007, no amounts were drawn against the Tranche 3 term loan.

8. OBLIGATIONS UNDER CAPITAL LEASE

In April 2007, the Company entered into a computer software license under a capital lease that expires in 2009 and bears an implied annual interest rate of 8.1%. Interest paid during 2007 related to obligations under capital lease was $nil (2006 - $6,243), and $5,753 was accrued in 2007. At September 30, 2007, future minimum lease payments under capital leases are $195,644 (2006 - $nil).

9. FINANCIAL INSTRUMENTS

As indicated in note 2 of the financial statements, the Company adopted CICA Sections 3855 and 3865 on October 1, 2006. Section 3855 expanded on Section 3860 by prescribing when a financial instrument is to be recognized on the balance sheet and at what amount and how gains and losses are recognized. More specifically, the adoption of this section has resulted in the requirement for the Company to mark to market all financial derivative instruments outstanding at the end of the reporting period.

a) Embedded derivatives

To comply with Section 3855, the Company had to review all contracts in place at October 1, 2006 to identify non-

financial derivatives. The Company chose to review all contracts in place on October 1, 2006 that were entered into after October 1, 2002 for any embedded derivatives within these contracts to determine if any such embedded derivatives needed to be accounted for separately at fair value from the base contract. The Company has concluded that embedded derivatives existed in certain sales contracts denominated in currencies other than that of the Company and its international customers.

Adoption of Section 3855 has given rise to the initial recognition of unrealized losses on embedded derivatives. These amounts have been calculated and labelled as transitional balances and have been recognized in the opening deficit of the Company. Effective October 1, 2006, these embedded derivatives were marked-to-market at each reporting date with the unrealized gain/loss charged to other expense with a corresponding offset amount recorded in the balance sheet. Included in the loss for the year ended September 30, 2007 is a $51,027 unrealized foreign exchange loss on such embedded derivatives. This loss 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 September 30, 2007.

b) Risks

The Company, through its financial assets and liabilities, is exposed to various risks. The following analysis provides a measurement of risks as at September 30, 2007:

i) Credit risk

Credit risk is the risk that the Company will incur a loss due to the failure by its customers or other parties to meet their contractual obligations. Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company limits its exposure to credit risk by placing its cash and cash equivalents and short-term investments with high credit quality financial institutions.

Given the nature of the Company's sales contracts, there is a concentration of accounts receivable, with its largest customer representing 57% of the balance at September 30, 2007. Nevertheless, the Company believes that its accounts receivable credit risk is limited due to the credit quality of the customers comprising the Company's customer base. Credit risk is also limited by the structure of the Company's sales contracts. Typically, milestone payments valued at 80% of the contract value are collected prior to shipment. There have not been any write-offs related to bad debts for the last five fiscal years. In light of this, the allowance for doubtful accounts is $nil at September 30, 2007 and 2006. At September 30, 2007, 9.5% of trade receivables were outstanding for more than 90 days, while over 90% were for less than 90 days. The maximum amount of credit risk exposure is limited to the carrying amount of the balances in the financial statements.

ii) Foreign exchange risk

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Company is exposed to foreign exchange risk on its cash, cash equivalent, short-term investment and accounts receivable balances, as well as its obligations under capital leases and accounts payable.

Predominantly all of the Company's sales are in United States dollars or Euros and are converted to Canadian dollars at the time of revenue recognition. For the year ended September 30, 2007, the Canadian value of United States dollar denominated sales was $6,008,402 (2006 - $5,896,343) and Euro denominated sales was $763,948 (2006 - $1,491,613). The Company does not hold or issue financial instruments to manage its exposure to currency rate fluctuations relating to sales; however, it does maintain cash balances in foreign currencies sufficient to meet obligations to foreign suppliers, in effect providing a natural hedge. Periodically, excess balances of foreign currency are converted to local currency to meet Canadian dollar cash requirements.

At September 30, 2007, the Canadian/U.S. foreign exchange rate was 1.0052 and the Canadian/Euro rate was 0.7049. Assuming that all other variables remain constant, an increase of $0.05 in the Canadian dollar would have following impact on the ending balances of certain balance sheet items at September 30, 2007, with the net foreign exchange gain or loss directly impacting comprehensive loss for fiscal 2007:

	Net change in US$ balances $	Net change in Euro balances $	Total net change in foreign currency balances $
Financial assets			
Cash and cash equivalents	(27,243)	(82,258)	(109,501)
Short-term investments	(106,058)	-	(106,058)
Trade accounts receivable	(59,062)	(1,829)	(60,891)
Financial liabilities			
Accounts payable and accrued liabilities	26,183	1,292	27,475
Obligations under capital lease	9,270	-	9,270
Net foreign exchange loss	(156,910)	(82,795)	(239,705)

iii) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Company is exposed to interest risk on its bank debt, for which the interest rates charged fluctuate based on the bank prime rate. Bank debt at September 30, 2007 is $920,336. Interest is compounded daily at prime plus 0.75%. If the interest rate on the bank debt had been 50-basis points higher (lower), related to the bank debt outstanding during fiscal 2007, comprehensive loss would have been $445 higher (lower).

iv) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its obligations as they fall due. The following are the contractual maturities of financial liabilities as at September 30, 2007:

	Contractual cash flows $	0 to 12 months $	12 to 24 months $	After 24 months $
Financial liabilities				
Accounts payable and accrued liabilities	2,791,139	2,791,139	-	-
Bank debt	920,336	564,306	334,604	21,426
Obligations under capital lease	195,644	97,822	97,822	-
	3,907,119	3,453,267	432,426	21,426

It is the Company's intention to meet these obligations through the collection of current accounts receivable, future progress payments not yet invoiced related to orders in backlog and from current cash, cash equivalent and short-term investment resources. If current resources and cash generated from operations are insufficient to satisfy its obligations, the Company may seek to sell additional equity or to arrange debt or other financing. In addition, the Company has available lines of credit and term loans of US$2 million that were not used during fiscal 2007.

v) Fair values

The carrying value of short-term investments, restricted cash, accounts receivable, accounts payable and accrued liabilities and bank debt approximate fair value due to their short-term nature.

10. SHAREHOLDERS' EQUITY

a) Common shares - issued and outstanding

Authorized share capital consists of an unlimited number of common shares, of which 52,540,487 (2006 - 52,393,065) common shares were issued and outstanding as of September 30, 2007. During the year ended September 30, 2007, 147,422 (2006 - 270,444) common shares were issued on exercise of share options. An unlimited number of preferred shares are authorized, none of which are issued.

b) Contributed surplus

During the year ended September 30, 2007, $458,067 (2006 - $492,302) of stock-based compensation on share options issued to employees under the fair value method was recorded in contributed surplus.

c) Deficit

Effective October 1, 2006, the Company adopted new valuation principles required for financial instruments. In accordance with CICA Handbook Section 3855, "Financial Instruments - Recognition and Measurement", the difference between the previous carrying amount and fair value of derivatives other than those that are designated and effective hedging items is recognized as an adjustment to the balance of deficit at the beginning of the fiscal year in which this section is initially applied. An adjustment to deficit of $24,847 was made to reflect the difference between the carrying amount (being $nil) and the fair value of embedded derivatives in sales contracts at September 30, 2006. (Also see note 9.)

d) 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 $12,417,412 (2006 - $10,262,918) for the year ended September 30, 2007.

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.

All option agreements entered into under the 2004 Plan will continue to be governed by the terms of the 2004 Plan; however, the Company will not grant any new options under the 2004 Plan and will grant future options solely under the 2006 Plan. 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 (10 years under the 2004 Plan) from the date of grant. At September 30, 2007, 1,000,256 (2006 - 437,921) common shares are available for issuance pursuant to awards made under the 2006 Plan. No other form of stock-based awards has been issued under the 2006 Plan as at September 30, 2007.

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

	2007	2006
Dividend yield	0%	0%
Expected volatility	52%	56%
Risk-free interest rate	4.27%	4.04%
Expected life of options	5 years	5 years

Share option activity since September 30, 2005 is presented below:

	Options	Weighted average exercise price $
Outstanding - September 30, 2005 (3,082,400 share options exercisable)	4,826,860	1.38
Granted	735,674	1.09
Exercised	(270,444)	0.58
Forfeited	(355,031)	1.91
Outstanding - September 30, 2006 (3,413,604 share options exercisable)	4,937,059	1.34
Granted	281,566	1.08
Exercised	(147,422)	0.47
Forfeited	(303,278)	1.80
Outstanding - September 30, 2007 (3,815,842 share options exercisable)	4,767,925	1.32

	Options outstanding - September 30, 2007			Options exercisable - September 30, 2007	
Exercise price range $	Number of stock options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price $	Number of stock options exercisable	Weighted average exercise price $
0.001	231,223	0.29	0.001	231,223	0.001
0.55 - 0.93	1,295,967	1.18	0.82	1,049,496	0.83
1.00 - 1.40	1,154,086	2.95	1.13	751,927	1.08
1.62 - 1.75	1,940,835	4.59	1.75	1,637,382	1.75
3.10	100,719	0.26	3.10	100,719	3.10
5.00	45,095	0.25	5.00	45,095	5.00
	4,767,925	3.64	1.32	3,815,842	1.33

The Company did not issue share options with an exercise price less than the estimated fair market value of a common share on the grant date for the year ended September 30, 2007 (2006 - nil). In 2007, the Company issued 281,566 (2006 - 735,674) share options with an exercise price equal to the fair market value of a common share on the grant date. These options had a weighted average exercise price of $1.08 (2006 - $1.09) and a weighted average fair value of $0.61 (2006 - $0.56). During 2007, $458,067 (2006 - $492,302) of stock compensation expense has been charged to the statement of operations, comprehensive loss and deficit related to the vesting of stock option awards and modifications made during and prior to September 30, 2007.

Share purchase warrants

As at September 30, 2007, 192,308 transferable share purchase warrants, issued as part of the agreement with the Canadian Federal Minister of Industry under the Technology Partnerships Canada ("TPC") Program, remain outstanding (note 14(c)). These warrants are convertible into common shares at an exercise price of $3.88 and are exercisable until June 6, 2008.

12. RESEARCH AND DEVELOPMENT

	2007 $	2006 $
Research and development costs	**5,888,966**	6,907,360
Government grants and funding from third parties under development agreements	**(374,929)**	(1,815,186)
	5,514,037	5,092,174

13. INCOME TAXES

a) Effective tax rate

The income tax provision (recovery) differs from the amount that would be computed by applying the combined federal and provincial statutory income tax rates of 34.12% (2006 - 34.12%) to income before income taxes. The reasons for the differences are as follows:

	2007 $	2006 $
Computed tax recovery	**(4,237,000)**	(3,502,000)
Increase (decrease) resulting from		
Permanent and other differences	**266,000**	329,000
Expiry of prior year losses	**1,663,000**	739,000
Share issuance costs	**-**	(542,000)
Change in valuation allowance	**2,314,000**	2,976,000
Other	**(6,000)**	-
Provision for income taxes	**-**	-

b) Future tax assets and liabilities

	2007 $	2006 $
Share issuance costs	**764,000**	1,103,000
Non-capital loss carry-forwards	**14,814,000**	14,003,000
Scientific research and experimental development expenses	**7,627,000**	7,149,000
Non-refundable provincial tax credits	**1,158,000**	1,075,000
Reserves	**1,713,000**	726,000
Property, plant and equipment	**1,545,000**	1,251,000
Total future tax assets before valuation allowance	**27,621,000**	25,307,000
Valuation allowance	**(27,621,000)**	(25,307,000)
Net future tax asset	**-**	-

In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. As management believes there is sufficient uncertainty regarding the realization of future tax assets, a full valuation allowance has been provided.

The Company has non-capital losses carried forward of approximately $43,417,000, which are available to reduce taxable income of future years, the benefit of which has not been recorded in the accounts, and which expire as follows:

	$
2008	6,129,000
2009	3,965,000
2010	8,379,000
2014	4,897,000
2015	5,885,000
2026	6,913,000
2027	7,249,000
	43,417,000

The Company has scientific research and experimental development expenses of $22,353,000 (2006 - $20,951,000) that are available to be carried forward indefinitely and deducted against future taxable income otherwise calculated.

c) As of September 30, 2007, the Company also has investment tax credits of approximately $8,357,000 (2006 - $7,697,016) available to offset future Canadian federal and provincial income taxes payable. The investment tax credits expire commencing 2007. The potential benefit of the investment tax credits has not been recognized in the accounts.

14. COMMITMENTS AND CONTINGENCIES

a) Leases

At September 30, 2007, the Company is committed to make the following minimum operating lease payments related to premises and office equipment:

	$
2008	513,331
2009	91,332
2010	78,666
2011 and thereafter	66,000
	749,329

b) Letters of credit

During 2007, the Company had banks issue letters of credit on its behalf to meet its performance obligations on customer contracts and to secure future payments to a vendor. At September 30, 2007, $340,802 (2006 - $1,158,479) of these letters of credit is outstanding with varying expiry dates extending to July 20, 2009.

c) TPC Programs

Fast Cycle Pressure Swing Adsorption and Gas Management systems

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 and Gas Management systems.

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 Company has received contributions aggregating $8,140,443 up to September 30, 2007 (2006 - $7,760,083). Of this amount, $6,925,248 (2006 - $6,550,322) has been allocated against research and development expenses, $715,195 (2006 - $709,761) has been allocated against the cost of property, plant and equipment, and $500,000 (2006 - $500,000) is reflected as share purchase warrants. For the year ended September 30, 2007, $374,929 (2006 - $1,806,436) has been allocated against research and development expenses and $5,434 (2006 - $96,791) has been allocated against the cost of property, plant and equipment.

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

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

The royalty period began on October 1, 2005 and will end on September 30, 2013 if the cumulative royalties reach a ceiling of $23,620,000. If the cumulative royalties are less than $23,620,000 by September 30, 2013, the royalty period will continue until the earlier of September 30, 2021 or until a cumulative royalty ceiling of $23,620,000 is reached. Cumulative repayments of $88,052 (2006 - $nil) have been made to September 30, 2007. Any amounts ultimately determined to be repayable are accrued as a liability when determinable. As of September 30, 2007, $210,468 (2006 - $146,800) has been accrued as a liability. Under the agreement, royalties are due on January 31 of each year, beginning in 2007.

Pulsar Pressure Swing Adsorption project

On March 31, 1999, 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 Pulsar Pressure Swing Adsorption project.

Pursuant to the agreement, total project costs for the period from October 1, 1998 to March 31, 2002 were to be shared, subject to annual contribution limits, such that the Minister's contribution would not exceed the lesser of 35% of eligible project costs and $4,947,330.

The Company received contributions aggregating $4,762,503. The agreement further provides that the contributions are repayable solely based on a royalty of 1.8% of gross project revenues and revenues from fuel-cell related products to a maximum cumulative repayment of $8.75 million. Cumulative repayments of $47,651 (2006 - $32,952) have been made to September 30, 2007. Any amounts ultimately determined to be repayable are accrued as a liability when the project revenues are known and reasonably estimable. As of September 30, 2007, $7,839 (2006 - $13,273) has been accrued as a liability. The agreement terminates on the later of the date of payment of all amounts due to the Minister and 2015.

d) Natural Resources Canada Agreement

In January 2005, the Company received a grant from the Government of Canada under the Department of Natural Resources Efficiency and Alternative Energy Program to support the development of structured adsorbent that will possess enhanced properties to assist in high purity hydrogen separation. Total funding received by the Company of $225,000 was recorded as a credit of $85,349 to research and development and a credit of $139,651 to property, plant and equipment in fiscal 2005. The agreement provides that the Minister shall provide the Company with financial contributions based on the aforementioned limitations and such contributions are repayable solely based on 0.12% of gross project revenues through March 31, 2015, to a maximum cumulative repayment of $225,000, whichever occurs first. Any amounts ultimately determined to be repayable are accrued as a liability when the project revenues are known and reasonably estimable. To date, no such project revenue has been recorded.

In January 2004, the Company received a grant from the Government of Canada under the Department of Natural Resources Efficiency and Alternative Energy Program to support the development of a device that increases the efficiency of a High Temperature Fuel Cell system and permits the co-production of hydrogen. Total funding received by the Company of $193,944 was recorded as a credit of $142,350 to research and development and a credit of $51,594 to property, plant and equipment in fiscal 2004. The agreement provides that the Minister shall provide the Company with financial contributions based on the aforementioned limitations and such contributions are repayable solely based on 0.12% of gross project revenues through March 31, 2014, to a maximum cumulative repayment of $193,944, whichever occurs first. Any amounts ultimately determined to be repayable are accrued as a liability when the project

revenues are known and reasonably estimable. To date, no such project revenue has been recorded.

e) Exxon Mobil Research and Engineering Company
Effective October 2003, the Company entered into a multi-year Joint Development Agreement with Exxon Mobil Research and Engineering Company ("EMRE") to evaluate specific projects and to develop, commercialize and market purification products for a range of refinery and petrochemical applications. Under this agreement, the Company is granted certain exclusive rights to inventions in the field of adsorption based separation or enrichment and EMRE is granted certain exclusive rights to inventions in the field of petroleum and petrochemical processes. The agreement further details how costs for development projects are shared between the parties, and provides for revenue sharing between the parties should resulting products be commercialized for one or more applications.

In May 2006, the Company entered into a multi-year commercialization agreement (the "Commercialization Agreement") with EMRE for the marketing and commercialization of the H-6200 hydrogen purifier, the first product developed under the Joint Development Agreement. Under the terms of the Commercialization Agreement, EMRE will lead the marketing of the H-6200 hydrogen purifier to oil refineries and petrochemical plants. The Company retains sole responsibility for negotiating and executing agreements with customers, as well as for manufacturing and order fulfillment. The Company will pay EMRE a portion of the commercial gain from the sale of H-6200 hydrogen purifier units and any associated lease of adsorbent beds based on EMRE's contribution to the research, development and commercialization of the H-6200 hydrogen purifier product.

f) Director and officer indemnification
The Company's directors and officers are covered under a directors' and officers' insurance policy. The aggregate limit of liability applicable to those insured directors and officers under the policy is $10 million. Under this policy, the Company has reimbursement coverage to the extent that the Company has indemnified a director or officer in excess of a deductible of $250,000 for each loss related to securities claims and $100,000 for other losses. The Company's bylaws also provide for the indemnification of the directors and officers from and against liability and costs in respect of any action or suit against them in connection with the execution of their duties of office, subject to certain limitations.

g) Severance and termination benefits
The Company restructured its operations in May 2007 to increase the focus on commercial activities and decrease research and development expenses. Severance costs and termination benefits included in general and administration expenses total $564,030, of which $534,793 has been paid and $29,237 is payable prior to the end of the fiscal 2008.

15. SEGMENTED INFORMATION

The Company's overall focus is on developing and commercializing 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:

	2007 $	2006 $
Revenue		
United States	**4,783,197**	2,289,881
Europe	**1,654,977**	3,812,670
Asia	**447,220**	1,040,685
Canada	**126,772**	414,857
	7,012,166	7,558,093

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

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

	2007 $	2006 $
Customer A	**2,573,252**	5,337,481
Customer B	**2,315,727**	-
Customer C	**-**	839,742

16. LOSS PER SHARE

Loss per share is calculated using the weighted average number of common shares outstanding for the year of 52,473,306 (2006 - 42,426,280). Outstanding share options and warrants to purchase common shares were not included in the computation of diluted loss per share as their impact is anti-dilutive.

17. SUPPLEMENTAL CASH FLOW INFORMATION

	2007 $	2006 $
Supplemental cash flow information		
Cash paid for interest	**60,422**	45,416
Cash received for interest	**601,312**	255,787
Non-cash operating, investing and financing activities		
Issuance of common shares on exercise of stock options	**294,014**	676,659
Property, plant and equipment included in accrued liabilities	**-**	317,645
Property, plant and equipment reallocated to inventory	**-**	18,297

18. SUBSEQUENT EVENT

Subsequent to year-end, the Company entered into negotiations with the Canadian Federal Minister of Industry to amend the TPC contribution agreement in respect of the Company's Fast Cycle Pressure Swing Adsorption ("FCPSA") and Gas Management systems ("GMS") development programs (see also note 14(c)). The purposes of the amendment are to delete certain development milestones related to the GMS program, as the Company has determined that further development in this area is not warranted given current market conditions for such products, and to extend certain development milestones related to the FCPSA program to allow additional time for the Company to complete such milestones. Although a formal amendment to this agreement has not yet been completed, management expects to be successful in negotiating an amendment that will, among other things:

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

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

Corporate Information

Trading Symbols and Exchanges

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AIM (London Stock Exchange Plc.): QAR

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Jonathan Wilkinson, Director, President and CEO

Sherry Tryssenaar, Director, Vice President, Finance & Administration and CFO

R. Terry Blaney, Director

Keith D. McLeod, Director

Michael Rosenberg, Director

John Shakeshaft, Director

17 Trees preserved for the future
50.5 lbs water-borne waste not created
7438 gallons waste water flow saved
823 lbs solid waste not generated
1621 lbs net greenhouse gases prevented
12,403,200 BTU's energy not consumed