



News Release

QuestAir Reports First Quarter 2006 Results

For Immediate Release

31 January, 2006

BURNABY, B.C. - QuestAir Technologies Inc. ("QuestAir" or "the Company"; AIM: QAR; TSX: QAR) reported today its financial and operational results for the first quarter of fiscal 2006, ended December 31, 2005. All amounts are in Canadian dollars unless otherwise noted.

First Quarter Highlights

- Receipt of purchase orders totaling \$1.8 million from ExxonMobil Research and Engineering Company ("EMRE") to kick-off the construction of a prototype hydrogen purifier to be demonstrated at an ExxonMobil refinery in 2006.
- Revenues of \$0.9 million, and a 90% increase in the Company's sales order backlog from \$3.0 million at September 30, 2005 to \$5.7 million at December 31, 2005.
- Cash used in operations and capital requirements of \$2.3 million (Q1 FY05: \$2.0 million), in line with the Company's cash burn guidance of \$8.5-9.5 million for fiscal 2006.
- A reduction in the net loss to \$2.1 million (Q1 FY05: \$2.5 million), driven by increased gross margins for the quarter.
- Orders received for two H-3200 hydrogen purifiers for use in hydrogen fueling stations in Korea and the BC Hydrogen HighwayTM.
- Receipt of a \$1.4 million engineering services contract from EMRE to continue the development of an on-board hydrogen generator for use in a range of transportation markets.

Jonathan Wilkinson, President and CEO of QuestAir, said:

"We are very pleased with progress achieved in our key development program with ExxonMobil. Construction has begun on the prototype hydrogen purifier to be demonstrated at an ExxonMobil refinery later in the year, and the program is transitioning from the development phase to commercialization."

"We are also pleased with the 90% growth in our sales order backlog over the first quarter, which positions us well for good revenue growth over the remainder of fiscal 2006".

Operating Review

During the quarter, excellent progress was made in the program being undertaken with EMRE to develop a large capacity hydrogen purification system for use in oil refineries

and petrochemical plants. The Company received purchase orders totaling \$1.8 million from EMRE, kicking-off construction of a prototype hydrogen purifier to be tested at an ExxonMobil refinery in 2006. QuestAir expects to receive the final purchase orders related to the prototype plant upon the successful completion of an ExxonMobil program review.

QuestAir maintained its position as the leading supplier of hydrogen purification systems in the emerging hydrogen infrastructure market. During the quarter, the Company received orders for two H-3200 hydrogen purifiers to be included in demonstration hydrogen fueling stations in Korea and British Columbia, Canada. In the Canadian station, QuestAir's H-3200 will recover and purify waste hydrogen from a sodium chlorate manufacturing plant, producing purified hydrogen to power a fleet of hydrogen-fueled vehicles. By-product hydrogen from industrial facilities such as this has the potential to provide an important source of low-cost hydrogen to support the commercialization of fuel cell and hydrogen-fueled vehicles.

Also during the quarter, the Company received a \$1.4 million engineering services contract from EMRE covering the second phase of a program to develop a compact hydrogen generator for use in a range of transportation markets. The objective of the overall program is to develop a compact device to generate hydrogen on-board a vehicle from a range of readily available fuels such as diesel, gasoline and compressed natural gas. Target markets for the product include potential earlier term fuel cell markets such as utility vehicles and transit buses, and auxiliary power units for vehicles such as heavy-duty trucks and military vehicles. This program demonstrates the unique capability of QuestAir's proprietary pressure swing adsorption ("PSA") technology to scale down to extremely compact devices suitable for use on-board a vehicle.

Outlook

Commenting on the outlook for the remainder of fiscal 2006, Jonathan Wilkinson said:

"We are very optimistic regarding our prospects for the second quarter, and we expect to achieve a number of key milestones in our refinery program with ExxonMobil. We are presently negotiating an agreement with EMRE for the marketing of the large capacity hydrogen purifier, and we expect to sign this agreement during the second quarter of fiscal 2006. In addition, we expect EMRE to complete their program review during the second quarter, with the final purchase orders for the prototype plant following shortly thereafter."

Q1 2006 Financial Results

Revenues decreased by 10% to \$0.9 million for the quarter ended December 31, 2005 compared to the same period in 2004. However, gross profit improved to \$0.8 million for the quarter (Q1 FY05: \$0.3 million) due to a greater proportion of revenue recognized from high margin engineering service contracts. Key expenditures, including sales and marketing, research and development and general and administrative expenditures were

largely unchanged from the same period in 2004. The net loss for the quarter ended December 31, 2005 was \$2.1 million (\$0.06 per share), reduced from \$2.5 million (\$0.29 per share) for the same period in 2004.

Operating Results

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

| (Unaudited, \$ '000) | Three months ended December 31, | |
|-------------------------------|---------------------------------|------|
| | 2005 | 2004 |
| Gas purification systems | 221 | 998 |
| Engineering service contracts | 651 | - |
| Total revenue | 872 | 998 |

The reduction in revenue from gas purification systems resulted from a drop in the number of PSA systems delivered and commissioned during the quarter compared to the same period in 2004. Revenue from a large one-off order of H-3200 PSA systems was recognized during the quarter ended December 31, 2004, while no comparable multi-system order was delivered during the current quarter. Engineering service contract revenue increased for the quarter as a result of work completed on the refinery development program with EMRE. No significant work was completed on this program during the comparable period in 2004.

Fluctuations in the timing of receipt of new sales orders and the recognition of revenue are to be expected in the industrial markets that the Company currently serves. Consequently management believes that both recognized revenue and changes in the Company's sales order backlog should be monitored together to determine the strength of QuestAir's commercial operations. QuestAir's sales order backlog is defined as future revenue from signed gas purification system sales and engineering service contracts that have not yet been recognized by the Company.

The following table provides a breakdown of the Company's sales order backlog at December 31, 2005, September 30, 2005, June 30, 2005, March 31, 2005, and December 31, 2004:

| (Unaudited, \$ '000) | December 31, | September 30, | June 30, | March 31, | December 31, |
|---------------------------|--------------|---------------|----------|-----------|--------------|
| | 2005 | 2005 | 2005 | 2005 | 2004 |
| Gas purification systems | 4,359 | 2,240 | 1,848 | 3,623 | 4,102 |
| Eng. service contracts | 1,343 | 768 | 1,623 | 1,733 | 1,398 |
| Total sales order backlog | 5,702 | 3,008 | 3,471 | 5,356 | 5,500 |

The following table provides an analysis of the changes in the Company's sales order backlog for the quarter ended December 31, 2005:

| (Unaudited, \$ '000) | For the three months ended December 31, 2005 | | |
|--------------------------|--|-------------------------------|-------|
| | Gas Purification Systems | Engineering Service Contracts | Total |
| Opening Balance | 2,240 | 768 | 3,008 |
| Bookings | 2,352 | 1,226 | 3,578 |
| Revenue Recognized | (221) | (651) | (872) |
| Adjustments [†] | (12) | 0 | (12) |
| Ending Balance | 4,359 | 1,343 | 5,702 |

† Adjustments include adjustments for fluctuations in foreign currency exchange rates as well as cancelled orders.

The total sales order backlog increased by \$2.7 million, or 90%, during the quarter. The key driver of this increase was the receipt of orders valued at \$1.8 million from ExxonMobil for a compressor to be included in the prototype PSA plant to be tested at an Exxon refinery in 2006. In addition, the Company received a \$1.4 million order from EMRE to support the development of an on-board hydrogen generator for use in a range of transportation markets. This contract included both engineering services and the delivery of prototype equipment, and 80% of the contract value was allocated to 'Engineering Service Contract' backlog, with the balance allocated to 'Gas Purification System' backlog. A small adjustment was also made to the Company's sales order backlog as a result of fluctuations in foreign exchange rates during the quarter.

The Company expects that the backlog as of December 31, 2005 will be substantially recognized as revenue by the fourth quarter of calendar 2006.

The following table provides a calculation of the Company's gross profit for the reported periods:

| (Unaudited, \$ '000) | Three months ended December 31, | |
|----------------------|---------------------------------|-------|
| | 2005 | 2004 |
| Sales | 872 | 998 |
| Cost of goods sold | 118 | 652 |
| Gross Profit | 754 | 346 |
| Gross Margin (%) | 86.5% | 34.6% |

The increase in percentage gross margin for the quarter ended December 31, 2005 compared to the same period in 2004 was due to an increase in the proportion of revenues recognized from engineering service contracts, which typically contribute high gross margins. It is expected that margins will fluctuate from quarter to quarter depending on the mix of revenues recognized from engineering service contracts and gas purification systems.

Sales and marketing expenses were \$0.4 million for the quarter ended December 31, 2005; unchanged from the same period in 2004.

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

| (Unaudited, \$ '000) | Three months ended December 31, | |
|-----------------------|---------------------------------|-------|
| | 2005 | 2004 |
| Gross R&D Expenditure | 1,746 | 1,682 |
| Government Funding | 473 | 408 |
| Net R&D Expenditure | 1,273 | 1,274 |

Gross R&D expenditures for the quarter increased by 4% compared to the same period in 2004. Government funding increased by 16% due to an increase in the proportion of R&D undertaken on the refinery development program with EMRE, which is eligible for funding from Technology Partnerships Canada. Consequently, net R&D expenditures for the quarter ended December 31, 2005 remained unchanged from the same period in 2004.

General and Administrative (“G&A”) expenses were \$0.8 million for the quarter ended December 31, 2005, unchanged from the same period in 2004. Employee stock-based compensation expense was \$0.1 million for the quarter, compared to \$0.3 million for the same period in 2004. Stock-based compensation expenses were higher for the quarter ended December 31, 2004 due to a stock compensation charge related to the repricing of certain options at the time of QuestAir’s Initial Public Offering.

Capital expenditures (“CAPEX”), net of Government funding, for the quarter ended December 31, 2005 were \$0.3 million, compared to \$0.03 million for the same period in 2004. The increase in CAPEX for the quarter was driven by expenditures on the demonstration landfill gas processing plant currently being commissioned at the Vancouver Landfill, located in BC Canada. It is expected that capital expenditures will fluctuate from quarter to quarter depending on the requirements of specific product development programs and administrative needs.

Liquidity and Capital Resources

At December 31, 2005 cash and short term investments were \$8.1 million, compared to \$10.4 million at September 30, 2005.

Cash used by operations and capital requirements for the quarter ended December 31, 2005 was \$2.3 million, compared to \$2.0 million for the same period in 2004. The increase in operational cash burn for the quarter compared to the same period in 2004 resulted mainly from increased capital expenditures related to the landfill gas demonstration project at the Vancouver Landfill.

During fiscal 2005, the Company secured a US\$3 million (\$3.5 million) credit facility from Comerica Bank. The credit facility is comprised of a US\$1 million accounts receivable credit line and a US\$2 million term loan. As at December 31, 2005, the Company had drawn \$0.6 million against the term loan net of repayments. The Company is in compliance with all of its bank covenants.

In June 2003, the Company was awarded a \$9.6 million conditionally repayable loan from Technology Partnerships Canada, a funding program administered by Industry Canada. At December 31, 2005 the Company had claimed \$6.4 million against this loan.

At December 31, 2005, QuestAir's had 37,362,637 common shares issued and outstanding. In addition, the Company had 4,796,957 options to purchase common shares, and 622,308 warrants outstanding at that date.

Consolidated Balance Sheets

| (expressed in Canadian dollars) | As at December 31, 2005 | As at September 30, 2005 |
|---|-------------------------------|--------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 8,095,595 | \$ 10,414,219 |
| Accounts receivable - net of allowance for doubtful accounts of \$nil (September 30, 2005 - \$nil) | 1,264,831 | 1,075,255 |
| Grants and funding receivables | 976,903 | 493,913 |
| Inventories | 2,507,136 | 1,945,876 |
| Prepaid expenses | 226,116 | 299,757 |
| | <u>13,070,581</u> | <u>14,229,020</u> |
| Property, plant and equipment | 1,940,316 | 1,984,014 |
| | <u>\$ 15,010,897</u> | <u>\$ 16,213,034</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$ 1,885,307 | \$ 2,210,686 |
| Deferred revenue | 2,667,997 | 1,602,103 |
| Current portion of bank debt | 216,839 | 216,839 |
| Current portion of obligations under capital lease | 110,357 | 110,357 |
| | <u>4,880,500</u> | <u>4,139,985</u> |
| Bank debt | 415,609 | 433,678 |
| | <u>5,296,109</u> | <u>4,573,663</u> |
| Shareholders' Equity: | | |
| Share capital | | |
| Authorized | | |
| Unlimited common shares, voting, no par value | | |
| Unlimited preferred shares, issuable in series, no par value | | |
| Common shares | 89,861,388 | 89,774,802 |
| Contributed surplus | 6,703,830 | 6,647,129 |
| Deficit | <u>(86,850,430)</u> | <u>(84,782,560)</u> |
| | <u>9,714,788</u> | <u>11,639,371</u> |
| | <u>\$ 15,010,897</u> | <u>\$ 16,213,034</u> |

Consolidated Statements of Operations and Deficit

| (expressed in Canadian dollars) | For the three months ended | |
|---|----------------------------|------------------------|
| | December 31, 2005 | December 31, 2004 |
| Revenues | \$ 871,773 | \$ 998,095 |
| Cost of goods sold | 117,801 | 652,567 |
| Gross Profit | <u>753,972</u> | <u>345,528</u> |
| Operating expenses | | |
| Research and development - net | 1,272,579 | 1,273,762 |
| General and administration | 798,386 | 796,821 |
| Sales and marketing | 380,135 | 416,148 |
| Amortization | 374,632 | 361,421 |
| | <u>2,825,732</u> | <u>2,848,152</u> |
| Loss before undernoted | <u>(2,071,760)</u> | <u>(2,502,624)</u> |
| Other income (expense) | | |
| Interest income | 50,641 | 24,180 |
| Other income (expense) | (46,751) | (44,775) |
| | <u>3,890</u> | <u>(20,595)</u> |
| Loss for the period | (2,067,870) | (2,523,219) |
| Deficit – Beginning of period | (84,782,560) | (73,560,609) |
| Deficit – End of period | <u>\$(86,850,430)</u> | <u>\$ (76,083,828)</u> |
| Basic and diluted loss per share | \$ (0.06) | \$ (0.29) |
| Weighted average number of common shares outstanding | 37,337,298 | 8,789,484 |

Consolidated Statements of Cash Flows

| (expressed in Canadian dollars) | For the three months ended | |
|--|----------------------------|----------------------|
| | December 31, 2005 | December 31, 2004 |
| Cash flows from operating activities | | |
| Loss for the period | \$ (2,067,870) | \$ (2,523,219) |
| Items not involving cash | | |
| Amortization | 374,632 | 361,421 |
| Non-cash compensation expense | 121,571 | 258,629 |
| | <u>(1,571,667)</u> | <u>(1,903,169)</u> |
| Changes in non-cash operating working capital | | |
| Accounts, grants and funding receivables | (672,567) | (499,672) |
| Inventories | (561,260) | (159,330) |
| Prepaid expenses | 73,641 | (326,531) |
| Accounts payable and accrued liabilities | (325,378) | 94,432 |
| Deferred revenue | 1,065,894 | 830,620 |
| | <u>(419,670)</u> | <u>(60,481)</u> |
| | <u>(1,991,337)</u> | <u>(1,963,650)</u> |
| Cash flows from investing activities | | |
| Purchase of property, plant and equipment | (363,775) | (40,615) |
| Government grants and funding related to property, plant and equipment | 32,842 | 10,656 |
| | <u>(330,933)</u> | <u>(29,959)</u> |
| Cash flows from financing activities | | |
| Issuance of common shares | - | 15,050,000 |
| Share issue costs | - | (1,818,459) |
| Issuance of common shares on exercise of stock options | 21,716 | - |
| Repayment of bank debt | (18,070) | - |
| Deferred charges | - | (353,208) |
| | <u>3,646</u> | <u>12,878,333</u> |
| Increase (decrease) in cash and equivalents | (2,318,624) | 10,884,724 |
| Cash and equivalents – Beginning of period | 10,414,219 | 6,691,923 |
| Cash and equivalents – End of period | <u>\$ 8,095,595</u> | <u>\$ 17,576,647</u> |

Notes to the financial statements

1. United States generally accepted accounting principles

The Company follows generally accepted accounting principles in Canada (Canadian GAAP), which are different in certain respects from those applicable in the United States (U.S. GAAP). The significant differences between Canadian GAAP and U.S. GAAP with respect to the Company's consolidated financial statements are described below, however, disclosures that would otherwise be required under U.S. GAAP have not been provided. There are no reconciling items in the consolidated statements of operations or cash flows for the three months ended December 31, 2005 and 2004.

Consolidated balance sheets

| | December 31, 2005 | | September 30, 2005 | |
|----------------------|------------------------|-----------------|------------------------|-----------------|
| | Canadian GAAP \$ | U.S. GAAP \$ | Canadian GAAP \$ | U.S. GAAP \$ |
| Shareholders' equity | | | | |
| Common shares | 89,861,388 | 81,406,622 | 89,774,802 | 81,320,036 |
| Contributed surplus | 6,703,830 | 5,382,702 | 6,647,129 | 5,326,001 |

Consolidated statements of deficit

| | December 31, 2005 \$ | December 31, 2004 \$ |
|---|----------------------------|----------------------------|
| Deficit - Beginning of period under Canadian GAAP | (84,782,560) | (73,560,609) |
| Accumulated accretion on preferred shares under Canadian GAAP | 13,631,542 | 13,631,542 |
| Accumulated accretion on preferred shares under U.S. GAAP | (5,437,441) | (5,388,661) |
| Accumulated stock-based compensation under U.S. GAAP | (208,460) | (208,460) |
| Gain on preferred share conversion under U.S. GAAP | 1,790,253 | - |
| Deficit - Beginning of period under U.S. GAAP | (75,006,666) | (65,526,188) |
| Loss for the period under Canadian and U.S. GAAP | (2,067,870) | (2,523,219) |
| Deficit - End of period under U.S. GAAP | (77,074,536) | (68,049,407) |
| Loss per share - Canadian and U.S. GAAP | (0.06) | (0.29) |

a) Reconciliation of deficit under Canadian and U.S. GAAP

Prior to the Company's initial public offering, the Company had various classes of preferred shares outstanding which were treated differently under Canadian and U.S. GAAP due to the specific share provisions of each class. These differences resulted in permanent differences in the accumulated accretion expenses contained in the deficit

under Canadian and U.S. GAAP. In addition, the Class C preferred shares were treated as debt under U.S. GAAP, but were treated as equity under Canadian GAAP. When the Class C preferred shares were converted to common shares coincident with the Company's initial public offering, the different accounting treatment of these shares resulted in a gain on settlement of debt being recorded for U.S. GAAP purposes, versus an increase in contributed surplus under Canadian GAAP. This gain of \$1,790,253 is a permanent difference between the deficit under Canadian and U.S. GAAP. The above Consolidated Statements of Deficit adjust for these differences resulting from the preferred shares.

b) Reconciliation of shareholder's equity

When the preferred shares were converted to common shares coincident with the Company's initial public offering, the differences in the values of the preferred shares due to differences in accumulated accretion between Canadian and U.S. GAAP resulted in different values being transferred into the common shares account under Canadian and U.S. GAAP. The values of the Class A and B preferred shares included a combined accumulated accretion of \$13,631,542 under Canadian GAAP versus \$5,176,776 under U.S. GAAP. The difference between these values is the difference between the common share accounts under Canadian and U.S. GAAP.

Similarly, the different accounting treatment for the Class C preferred shares resulted in a difference between the contributed surplus accounts under Canadian and U.S. GAAP. Under Canadian GAAP, the Class C preferred shares were treated as equity, and no accretion expense was required due to the share provisions of this class of shares. However, the conversion of the Class C preferred shares resulted in an increase to contributed surplus of \$1,790,253 under Canadian GAAP. Conversely, under U.S. GAAP, accretion charges of \$260,665 increased the fair value of the debt recorded in respect of the Class C preferred shares, which remained in the contributed surplus account once such shares were converted to common shares on the initial public offering. The remaining difference between contributed surplus under Canadian and U.S. GAAP relates to the accumulated stock based compensation expense of \$208,460 that was recorded under U.S. GAAP in April 2002, but was not required to be expensed under Canadian GAAP.

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About QuestAir Technologies Inc.

QuestAir Technologies, Inc. is a developer and supplier of proprietary gas purification systems for several large international markets, including existing markets such as oil refining, biogas production and natural gas processing, and emerging markets such as fuel cell power plants and fuel cell vehicle refueling stations. QuestAir is based in Burnaby, British Columbia and its shares trade on the AIM Market of the London Stock Exchange Plc. and on the Toronto Stock Exchange under the symbol "QAR".

Forward-looking statements

Certain statements in this press release may constitute “forward-looking” statements which involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. When used in this press release, such statements use such words as “anticipate”, “believe”, “plan”, “estimate”, “expect”, “intend”, “may”, “will” and other similar terminology. These statements reflect current expectations regarding future events and operating performance and speak only as of the date of this press release. Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not such results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements.

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