

## **Management Discussion and Analysis of Financial Condition and Results of Operations (As of June 23, 2008)**

*This MD&A contains projections and other forward-looking statements regarding future events. Such statements are predictions, which may involve known and unknown risks, uncertainties and other factors, which could cause the actual events or results and company plans and objectives to differ materially from those expressed. For information concerning factors affecting the Company's business, the reader is referred to the documents that the Company files from time to time with applicable Canadian securities and regulatory authorities.*

This discussion and analysis of the results of operations of Quest PharmaTech Inc. (“Quest” or the “Company”) should be read in conjunction with the unaudited consolidated financial statements and accompanying notes for the three months ended April 30, 2008 and the audited consolidated financial statements for the years ended January 31, 2008 and January 31, 2007. This discussion and analysis provides an update to the discussion and analysis prepared for the year ended January 31, 2008. The unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada (Canadian GAAP) and have not been reviewed by the Company’s auditors. This discussion and analysis provides information on the operations of Quest on a consolidated basis. All amounts are expressed in Canadian dollars unless otherwise noted and references to the term “year” refer to the fiscal year ended January 31<sup>st</sup>. Additional information related to the Company is on SEDAR at [www.sedar.com](http://www.sedar.com).

### **Q1, 2009 Development Highlights:**

- **Received approval for a research grant for up to \$200,000 of funding to develop the Company’s ultrasound technology for the treatment of cancer**
- **Sold the Bionex technology to a third party for gross proceeds of \$400,000, comprised of cash, shares and future royalties**
- **Announced positive results from Phase I clinical trial of the Company’s photodynamic therapy for Actinic Keratosis**

### **Overview**

Quest PharmaTech is committed to build shareholder value through discovery, development and commercialization of new pharmaceutical products. It is developing a series of products for the treatment of cancer and dermatological conditions, based on its SonoLight Technology platform.

The patented SonoLight Technology is based on a unique non-toxic family of photosensitizing and sonosensitizing, small molecular weight compounds called Hypocrellin, isolated from a parasitic fungi that grows on bamboo trees in China. Quest is developing these compounds as

drugs, as well as developing novel means of activating and delivering them to target tissues. Quest's products are expected to offer high selectivity and efficacy with minimal side effects.

### **Products under Development:**

**Dermatology:** The Company's lead product, **SL017**, is a topical formulation indicated for dermatology applications. The utility of SL017 with Intense Pulsed Light has already been demonstrated for hair removal applications in a Phase I clinical trial. The Company has initiated a 100 patient clinical trial for the same indication and the results are anticipated during the last quarter of calendar 2008. Use of SL017 with a light-based hair removal device is likely to overcome some of the limitations associated with the light treatment alone. In addition, SL017 has undergone a Canadian Phase I clinical trial for Actinic Keratosis and is also being evaluated for acne treatment in a pre-clinical study.

**Oncology:** A second product from the SonoLight platform, SL052, is an injectable formulation that is in late-stage pre-clinical development for prostate cancer treatment. SL052 will be delivered directly to the prostate by a unique delivery system thereby maximizing drug uptake and minimizing side effects. The animal studies done so far at the Cross Cancer Institute in Edmonton, Alberta indicate that SL052 has potential to destroy cancerous tumors on the prostate while limiting collateral damage to healthy tissue. SL052 is scheduled to enter a Phase I clinical trial during the second half of calendar 2008.

### **Products under Discovery:**

**Immuno Photodynamic Therapy:** Our research has shown that photodynamic therapy can augment the therapeutic effects of immunomodulators such as antibodies, antigens, cytokines and immunoadjuvants in cancer patients. With a strong intellectual property position to use SL052 with immunotherapy, the Company has signed a collaborative research agreement with the BC Cancer Agency to investigate the therapeutic and mechanistic aspects of anti-tumor effect achieved in mice by treatment combining photodynamic therapy based on SL052 with various immunotherapeutic agents.

**Sonodynamic Therapy:** Sonodynamic therapy (SDT) involves the administration of non-toxic pharmaceutical agents which may be activated deep within the body, by ultrasound, which is in itself non-toxic. The goal of SDT is to provide effective and specific eradication or control of tumors, while minimizing or eliminating toxicity and morbidity to the remainder of the patient. The Company has initiated a discovery program to develop an adjuvant therapy to standard treatment for peritoneal and/or thoracic carcinomatosis, commonly consequential to a variety of late-stage malignancies. The treatment involves introduction of a non-toxic sonosensitizer to the peritoneal or thoracic space during routine therapeutic drainage of ascitic fluid or of pleural effusion, respectively. The sonosensitized tumor cells and micrometastases will be selectively destroyed by exposure to ultrasound energy applied to the exterior of the abdomen or thorax.

## Strategic Partners

**Marketing Partner for Asia:** Quest has entered into a license agreement with KMH Co., Ltd ("KMH") to market the Company's hair removal product, SL017, in Asia. KMH is a publicly traded (KRX Stock Market: KRX), Korea-based healthcare company committed to the development, manufacture and commercialization of healthcare products and cosmetics. Under the terms of the agreement, KMH will be responsible for product registration, marketing, sales and distribution of SL017 for hair removal applications in Asia and to pay a royalty to Quest based on product sales. In addition, KMH will invest up to \$1,500,000 in Quest. KMH has already invested \$500,000.

**Strategic Partner for Dermatology:** Paramount BioSciences, LLC, has acquired multinational rights to Quest's proprietary SonoLight technology for dermatology applications. Paramount BioSciences is a global drug development and healthcare investment firm with a portfolio of life-sciences-focused companies. Under the terms of the agreement, Paramount BioSciences is responsible for dermatology-related development and commercialization activities outside of Canada. Quest will receive licensing fees and potential future milestone payments in excess of US\$35 million plus royalties on sales.

**Partner for Manufacturing Development:** Quest PharmaTech and the Alberta Research Council (ARC) have formed a strategic alliance to develop fermentation based technologies to manufacture Hypocrellin B, one of the essential ingredients for the SonoLight Technology. The ARC will undertake research to develop a semi-synthetic method for the manufacture of Hypocrellin B. If the project is successful, Quest will receive an exclusive license to the developed technology from the ARC to manufacture and commercialize HB based products, including SL017 for dermatology and SL052 for oncology applications.

**Oncology Partner:** Quest has signed an agreement with a multinational technology development company (the Investor) to receive \$3,000,000 to develop oncology products based on its SonoLight Technology. Under the terms of the agreement, Quest has already received \$1,000,000; and the balance of \$2,000,000 to be paid within the next six months. In return for this non-equity funding, the Investor will receive 35 percent of all future net revenue from the commercialization of Quest's oncology products. This agreement does not preclude Quest from out-licensing the oncology applications of the SonoLight Technology to a third party.

## Financial Results

Net consolidated income for the three month period ended April 30, 2008 was \$74,809 or \$0.00 per share as compared to a consolidated loss of \$137,373 or \$0.00 per share for the three month period ended April 30, 2007. Research and development expenditures totaled \$302,192 while general and administrative expenses were \$123,342 for the same period. As of April 30, 2008, the Company had cash and cash equivalents of \$1,046,918. The Company also has debt of \$500,000 in the form of a convertible debenture (exercisable at \$0.25 and due on March 22, 2009).

On a forward going basis, the Company anticipates to receive \$2,000,000 in licensing fees to develop oncology products based on its SonoLight Technology. The Company may receive an additional \$1,000,000 equity investment from KMH Co., Ltd. upon reaching specific milestones

related to SL017 for hair removal applications. The Company also expects to receive up to \$200,000 in a research grant to offset the costs to develop its ultrasound activation technology.

Currently, the Company has 4,800,000 outstanding share purchase warrants exercisable at \$ 0.20 and expiring in September, 2008. If exercised, these warrants would generate up to \$960,000 of additional funding for the Company.

## Results of Operations

Net consolidated income for the three months ended April 30, 2008 was \$74,809 or \$0.00 per share on a fully diluted basis as compared to a consolidated loss of \$137,373 or \$0.00 per share for the three months ended April 30, 2007. After adjusting for non-cash items, cash flows (used in) provided by continuing operations for the three months ended April 30, 2008 were (\$305,134) as compared to \$70,305 for the three months ended April 30, 2007.

### Revenues:

The following table identifies the changes in revenue for the three month period ended April 30, 2008 compared to the three month period ended April 30, 2007.

Revenue	2008	2007	Increase (decrease)
	\$	\$	\$
License fees	500,000	166,005	333,995
Market distribution rights	2,000	2,000	-
Total revenue from operations	502,000	168,005	333,995

### License Fees

During the three month period ended April 30, 2008, the Company recognized license fee revenue of \$500,000 for oncology applications.

The oncology license agreement requires the Company to pay royalties on all future net revenue from the commercialization of the Company's oncology products. Under the terms of the agreement, the Company is required to use commercially reasonable efforts to initiate a Phase I clinical trial for photodynamic therapy treatment of prostate cancer. The Company is recognizing the license fee in relation to the costs incurred with these efforts and has recognized \$500,000 of the license fee for the three month period ended April 30, 2008.

## Expenses

The following table identifies the changes in general and administrative expense for the three month period ended April 30, 2008 compared to the three month period ended April 30, 2007.

General and administrative expense	2008	2007	Increase (decrease)
	\$	\$	\$
Salaries, wages and benefits	79,213	47,341	31,872
Other support costs	6,768	14,522	(7,754)
Consulting	12,500	81,000	(68,500)
Legal fees	582	4,633	(4,051)
Public company related costs	10,081	17,181	(7,100)
Rent	2,812	1,797	1,015
Travel	6,835	747	6,088
Insurance	3,575	4,610	1,035
Total general and administrative expense	123,342	171,831	(48,489)

Overall, general and administrative costs have decreased during the three month period in 2008 compared to 2007, due primarily to a decrease in consulting fees and business development costs. Salary costs have increased during the three month period in 2008 compared to 2007 due to salary increases for the Company's corporate executives.

The following table identifies the changes in research and development (R&D) expense for the three month period ended April 30, 2008 compared to the three month period ended April 30, 2007.

Research and development expense	2008	2007	Increase (decrease)
	\$	\$	\$
Salaries, wages and benefits	50,125	83,551	(33,426)
Sub-contract, consulting and clinical trials	208,878	27,132	181,747
Rent	6,561	2,695	3,866
Legal (patent prosecution)	22,932	8,819	14,113
Supplies	4,005	4,756	(751)
Other R&D costs	9,691	10,417	(727)
<b>Gross research and development expense</b>	<b>302,192</b>	<b>137,370</b>	<b>164,822</b>
Less			
NRC-IRAP funding	-	(13,340)	(13,340)
Alberta Ingenuity funding	-	(12,000)	(12,000)
<b>Research and development expense (net)</b>	<b>302,192</b>	<b>112,030</b>	<b>190,162</b>

Overall, R&D expenses have increased during the three month period in 2008 compared to 2007 due to an increase in activity with the Company's clinical trials. Most of this increase is reflected in subcontract, consulting and clinical trial costs which have increased by more than \$180,000. Salary costs have decreased due to a reduction in R&D staff in 2008 compared to the three month period in 2007.

## **Discontinued Operations**

As part of the Company's decision in February, 2005 to divest itself of its non-core assets, the Company has presented the activities related to non-core assets as discontinued operations.

During the three month period ended April 30, 2008, the Company recognized a disposal gain of \$8,750 related to the signing of a technology transfer agreement for the sale of the Bionex Technology to a third party. Under the terms of the agreement, the Company will receive cash of \$50,000, certain share consideration and certain future royalties upon the successful commercialization of Bionex related products.

## **Stock-Based Compensation Expense**

During the three month period ended April 30, 2008, the Company granted a total of nil (for the three month period ended April 30, 2007 – nil) stock options, as per the Company's Stock Option Plan.

## **Deferred Revenue**

The Company has recorded deferred revenue (current portion \$258,000 and long term portion \$99,667) in connection with amounts received for market distribution rights and license fees that relate to future periods. \$250,000 relates to the Company's oncology license agreement and will be recognized in the second quarter. The remaining \$107,667 (\$8,000 current and \$99,667 long term) relates to the market distribution rights for Asian hair removal and is being recognized over a remaining 13.5 year period.

## **Outstanding Share Data**

As at June 23, 2008, there were 68,197,580 common shares issued and outstanding, 3,884,000 stock options and 4,800,000 share purchase warrants.

## **Financial Instruments**

**Fair Value** - Given their short-term maturity, the fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and the convertible debenture approximate the carrying value.

**Foreign Currency Risk** - The Company has assets and liabilities that are denominated in foreign currencies and that are exposed to the financial risk of earnings fluctuation arising from changes in foreign exchange rates and the degree of volatility of those rates. The Company does not currently use derivative instruments to reduce its exposure to foreign currency risk.

**Credit Risk** – Financial instruments that subject the Company to credit risk consist primarily of accounts receivable. At April 30, 2008, approximately 79% of accounts receivable were due from one organization.

## **Liquidity and Capital Resources**

As noted in the Risks and Uncertainties section below, the Company's ability to continue as a going concern is uncertain and is dependent upon its ability to raise additional capital to successfully complete its research and development programs, commercialize its technologies, conduct clinical trials and receive regulatory approval for its products.

At April 30, 2008, cash and cash equivalents was \$1,046,918 as compared to \$1,305,802 at January 31, 2008.

Cash used in operating activities was \$296,440 for the three month period ended April 30, 2008 compared to \$706,695 for the three month period ended April 30, 2007.

The Company negotiated an extension to the maturity date of the \$500,000 convertible debenture which is now due March 22, 2009. The interest rate and conversion rate remain unchanged at 9% per annum and \$0.25 per common share, respectively.

In December, 2007, the Company announced that it had entered into an agreement with a third party to license the oncology applications of the Company's SonoLight technology. As consideration, the Company received an initial payment of \$1,000,000. \$2,000,000 of additional payments are expected to be received in 2 equal installments over the next 6 months.

The Company may also receive future funding upon reaching specific milestones related to the strategic partnerships with KMH Co., Ltd. and with Paramount BioSciences.

The Company also expects to receive a research grant of up to \$200,000 during the next 15 months to offset the costs to develop its ultrasound activation technology.

On May 7, 2008, the Company announced the sale of its interest in the Bionex Technology to a third party. This transaction will provide a minimum of \$50,000 of funding to the Company.

The Company continues to implement a disciplined approach to containing costs and is focusing on programs aimed at achieving near-term goals.

Quest's funding needs will vary as its drug development products move into and through clinical trials. Based on current operating budgets and assuming the ongoing divestiture of non-core assets, management believes that the capital resources of the Company should be sufficient to fund operations into the first quarter of fiscal 2010.

The Company will seek additional capital through equity financings, licensing arrangements involving its core technologies and strategic partnerships.

## **Demand Notes and Related Party Transactions**

There were no related party transactions during the three month period ended April 30, 2008.

## **Disclosure Controls and Procedures**

The management of Quest is responsible for establishing and maintaining disclosure controls and procedures for the Company and is continuing with the implementation of disclosure controls and procedures, to provide reasonable assurance that material information relating to the Company, including its consolidated subsidiaries, is made known to Quest management particularly during the period in which the filings are being prepared.

## **Internal Control Over Financial Reporting**

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. Management has taken steps to improve the procedures and provide maintenance related to an effective design for the Company's internal controls and procedures over financial reporting.

Management continues to note weaknesses in internal controls over financial reporting including those related to the limited number of accounting staff members resulting in a lack of segregation of duties.

Management will continue with the implementation of procedures aimed at minimizing the risk of material error in its financial reporting and will seek outside expertise when the need arises.

## **Risks and Uncertainties**

Going concern uncertainty - The Company's financial statements have been prepared on a going concern basis which presumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Company has experienced significant operating losses and cash outflows from operations since its inception. The Company's ability to continue as a going concern is uncertain and is dependent upon its ability to raise additional capital to successfully complete its research and development programs, commercialize its technologies and conduct clinical trials and receive regulatory approvals for its products. It is not possible at this time to predict the outcome of these matters.

Quest's proprietary technologies are in various stages of development and some technologies have not received regulatory approval to begin clinical trials. It will be necessary for the Company to produce sufficient preclinical data in order to receive regulatory approval to begin clinical trials. There is no assurance that regulatory approval will be received to begin clinical trials. For the proprietary technologies that have received regulatory approval to begin clinical trials, future success will depend upon the ability of the Company to move the products through clinical trials, the effect and safety of these products, the timing and cost to receive regulatory and marketing approvals and the filing and maintenance of patent claims.

Quest's proprietary technologies have exposure to risks associated with commercialization. Even after product approval is obtained, there is no assurance that the Company will have a sufficient market for its products or the working capital required for commercialization.

The Company maintains clinical trial liability and product liability insurance; however, it is possible that this coverage may not provide full protection against all risks.

The Company may be exposed to risks associated with malfunctioning equipment, catastrophic events and other events within and outside of the Company's control. The Company maintains insurance believed to be adequate to cover any eventuality, but there is no guarantee that coverage will be sufficient for all purposes.

To a large degree, the Company's success is dependant upon attracting and retaining key management and scientific personnel to further the Company's drug development programs. There is a risk that required personnel may not be available to the Company when needed and, as a result, this may have a negative impact on the Company.

Quest must continue to raise additional capital through the exercise of stock options and warrants, issuing new share capital through equity financing, licensing arrangements and/or strategic partnerships. The Company's ability to raise additional capital will depend upon the progress of moving its drug development products into and through clinical trials and the strength of the equity markets, which are uncertain. There can be no assurance that additional capital will be available.