

## **Management Discussion and Analysis of Financial Condition and Results of Operations (As of May 31, 2006)**

*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 audited consolidated financial statements and accompanying notes for the years ended January 31, 2006 and January 31, 2005. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada (Canadian GAAP). 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).

### **Overview**

#### **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 and it is expected to continue to experience negative cash flows from operations in the coming fiscal year. The Company had a working capital deficiency of \$1,911,524 and a shareholders' deficiency of \$851,189 as at January 31, 2006.**

**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 is committed to the development and commercialization of new pharmaceutical products. It is developing a series of products for the treatment of cancer and other proliferative diseases based on its Sonolight and CDK platforms.

During the year ended January 31, 2006 (and subsequent thereto), the Company experienced numerous significant developments. Highlights are:

- a concentration of the Company's efforts on drug development, with a special focus on the Company's novel and proprietary photodynamic treatments for cancer and

other proliferative diseases.

- a divesting of non-core assets.
- the repatriation to Canada of more than U.S. \$1,000,000 cash from the Company's wind-up and dissolution of its former China subsidiary, Shanghai Altachem Pharma Biotechnology Ltd. ("SACP").
- the Company continued efforts to sell its Shanghai-based manufacturing facility.
- a reconstitution of the Company's Scientific Advisory Board.
- the receipt of positive China testing results for Bionex hand gel disinfectant.
- the initiation of a Phase I clinical trial for the Company's lead compound, SL017 (see Hypocrellin-Based Technologies, below), targeting Actinic Keratosis.
- the execution of a clinical trial agreement with a third party to commence further human clinical studies for the Company's lead compound, SL017, targeting the areas of hair removal and acne.
- the receipt of approval from the Australian Patent Office for the immunotherapy applications of hypocrellin derivatives.
- the election of the Company's Board of Directors, which includes the addition of two new Board members, Dr. Donald Rix, Chairman, MDS Metro Laboratory Services, and Mr. Richard H. Smith, former President and CEO, Dow AgroSciences Canada Inc.
- the receipt of shareholder and regulatory approval to change the Company's name to Quest PharmaTech Inc.
- the amendment of the Company's stock option plan from a fixed plan to a 10% rolling plan.
- During the year ended January 31, 2006, in a difficult financial market, the Company has received cash of approximately \$2.9 million from a combination of equity, debenture, debt financing, sale of non-core assets and government support programs and has thus been able to retire a significant amount of debt and begin to deploy new resources to program development.
- the clearance from Health Canada to initiate a Phase I clinical trial to investigate the topical application of the Company's lead photodynamic therapy (PDT) compound SL017 as a treatment for acne and hair removal.
- the sale of the Company's HIP technology back to the original inventor.

- the appointment, effective January 30, 2006, of Dr. Ragupathy Madiyalakan as Executive Chairman of the Company.
- the resignation, effective March 24, 2006, of Dr. David J. Cox as the Company's President and CEO. Dr. Cox continues to hold a position as Director on the Company's Board.
- the six month extension of the maturity of the Company's 8% \$1,000,000 convertible debenture, which is now due September 22, 2006.
- the receipt of bridge financing subsequent to year-end of \$200,000 at 6% from companies controlled by two of the Company's directors.

As a result of the strategic re-alignment described above, the Company is focusing on the sale of its remaining non-core assets to help cover drug and product development costs. Due to the sale or held for sale nature of the Company's non-core assets and technologies, this management discussion and analysis has been separated between continuing and discontinued operations. A summary of the Company's projects follows (in approximate order of resource allocation).

## **HYPOCRELLIN-BASED TECHNOLOGIES**

This technology platform is based on a unique, non-toxic family of photosensitizing and sonosensitizing compounds. The active ingredient is a derivative of Hypocrellin B ("HB"), a small molecular compound isolated from parasitic fungi on bamboo. Quest has formulated HB derivatives into a topical gel (SL017), and an injectable solution (SL052).

### **HB Topical - SL017**

This gel penetrates skin and can potentially be used to treat various skin conditions such as acne, actinic keratosis, psoriasis, etc. HB gels target a large patient population and will face comparatively less stringent regulatory requirements than injectable HB compounds. The Company is currently in a phase I clinical trial for actinic keratoses, with eight out of 12 patients enrolled. The Company is also in a phase I clinical trial for acne and hair removal, with ten out of 10 patients enrolled.

### **HB Injectable – SL052**

Quest has developed SL052, which may have utility in the photodynamic therapy treatment of prostate cancer. During 2004, the Company entered into an agreement with Dr. Ronald B. Moore, the Alberta Cancer Board and the Cross Cancer Institute to complete preclinical studies on SL052 prior to entering phase I clinical trials. Over the next year, the Company will continue to focus on the development of HB Injectable for prostate cancer and will incur additional costs associated with accumulating preclinical data to advance this technology into clinical trials.

Quest is also developing SL052 (SDT) for peritoneal carcinomatosis to demonstrate the proof-of-principle for a Sonodynamic Therapy approach for the treatment of cancer. The Company has identified peritoneal carcinomatosis as a suitable indication for such applications. The Company

is trying to identify a partner to undertake development of an ultrasound transducer suitable for abdominal and thoracic activation of the sonosensitizer, SL052, previously administered to the ascites fluid or pleural effusion of patients with advanced carcinomatosis.

## OTHER DRUG DEVELOPMENT PROGRAMS

### 2127 (formerly CDK Immunomodulator)

2127 is a novel immunomodulator with anti-cancer properties targeted to inhibit cyclin-dependant kinases (“CDKs”) functionality and prevent the growth of cancer cells. CDKs are the proteins that control the growth cycle of cancer cells. By using small molecule CDK inhibitors to disrupt the cycle of a cancer cell, the growth and spread of cancer can be stopped. During the prior year, the Company completed initial studies on 2127. Based upon results compared with other CDK inhibitors in its class, the Company is proceeding with patent applications to increase the value of this technology. Further development of 2127 is on hold pending receipt of additional Company funding.

### Selected Annual Financial Information

	January 31, 2006	January 31, 2005	January 31, 2004
	\$	\$	\$
Revenue from continuing operations	0	0	0
Revenue from discontinued operations	216,732	434,385	561,649
Loss before discontinued operations	(2,591,293)	(4,129,787)	(4,209,797)
Net loss for the year	(3,503,813)	(4,381,953)	(4,965,689)
Basic and diluted loss / share before discontinued operations	(0.06)	(0.11)	(0.12)
Basic and diluted loss / share	(0.08)	(0.12)	(0.14)
Total assets	1,454,191	4,040,140	6,786,261
Total debt	1,909,935	1,947,125	1,114,058

### Results of Operations

It is important to note that Quest’s net consolidated loss includes significant non-cash items. These non-cash items from continuing operations include amortization, options/shares issued as consideration for services and options issued to employees, future income taxes and gain/loss on sale of assets. For the years ended January 31, 2006 and January 31, 2005, amortization from continuing operations was \$116,393 and \$568,823 respectively, shares/options issued for services was \$61,885 and \$,269,500 respectively, options issued to employees was \$55,340 and \$86,680, respectively, future income taxes was nil and \$183,050, respectively, and (gain)/loss on sale of assets was \$(354) and \$7,518, respectively. Net consolidated loss for the year ended January 31, 2006 was \$3,503,813 or \$0.08 per share on a fully diluted basis as compared to a consolidated loss of \$4,381,953 or \$0.12 per share for the year ended January 31, 2005. After adjusting for non-cash items, cash flows used to fund continuing operations for the year ended January 31, 2006 were \$3,036,123 as compared to \$2,717,775 for the year ended January 31, 2005. Quest’s operations have significantly changed during the past two years. Significant items that affect the financial results of the Company and the comparability of these financial results with prior years are: the costs (especially the legal costs) associated with the Annual and Special Shareholders Meeting held in June, 2004; the sale of the contract manufacturing facility

in July, 2004; the costs associated with the departure of senior management and the settlement of various legal and other disputes during the year ended January 31, 2005; the Company's decision in February, 2005 to focus resources on oncology related technologies and to divest all non-core assets, which included a disengagement from China.

### Expenses

The following table identifies the changes in General and Administrative expense for the year ended January 31, 2006 compared to the year ended January 31, 2005.

General and administrative expense	2006	2005	Increase (decrease)
	\$	\$	\$
Salaries, wages and benefits	450,396	607,095	(156,699)
Other support costs	72,484	168,868	(96,384)
Consulting	169,408	117,400	52,008
Legal fees	68,359	364,040	(295,681)
Audit and accounting fees	95,715	111,021	(15,306)
Public company related costs	101,717	83,089	18,628
Rent	26,906	15,943	10,963
Travel	56,418	86,592	(30,174)
Insurance	27,838	87,662	(59,824)
Total general and administrative expense	1,069,241	1,641,710	(572,469)

Salaries, wages and benefits, other support costs and travel expenses have decreased due to the Company's cost containment efforts in 2006. Consulting costs increased due to the Company's increased use of outside consultants in 2006. Legal fees in 2006 have decreased due to a reduction in legal activity in 2006 compared to 2005. The increased legal activity in 2005 was related to the June 2004 Annual and Special General Meeting of shareholders.

The following table identifies the changes in research and development (R&D) expense for the year ended January 31, 2006 compared to the year ended January 31, 2005.

Research and development expense	2006	2005	Increase (decrease)
	\$	\$	\$
Salaries, wages and benefits	421,616	476,492	(54,876)
Sub-contract and consulting	279,313	791,581	(512,268)
Rent	148,757	178,808	(30,051)
Legal (patent prosecution)	130,849	196,101	(65,252)
Supplies	132,831	114,111	18,720
Other R&D costs	144,283	134,439	9,844
Total research and development expense	1,257,649	1,891,532	(633,883)

Except for supplies and other R&D, R&D expenses have decreased due to the Company's continuing efforts to cut costs where possible in order to conserve resources. Supplies have increased due to the purchase of materials in 2006 to conduct the Company's clinical trials.

## DISCONTINUED OPERATIONS

On July 30, 2004 the Company sold its assets relating to the contract manufacturing operations in Edmonton, Alberta, to Isodiagnostika Inc. The Company received proceeds of \$460,000 and realized a gain on sale of \$360,207.

On August 18, 2005, the Company received China government approval to wind-up and dissolve SACP and repatriate its remaining assets to Canada. This repatriation process was completed in September, 2005.

On September 2, 2005, the Company completed the dissolution of its inactive, wholly-owned subsidiary, Altachem Pharma (Barbados) Inc.

On October 28, 2005, the Company completed the wind-up and dissolution of 790563 Alberta Ltd. into its parent, Steroidogenesis Inhibitors Canada Inc.

As part of the Company's decision in February, 2005 to divest itself of its non-core assets, the Company has also presented the assets and liabilities of SHGP and the activity related to Accu-MAb, Bionex, Anticort and HIP as discontinued operations.

The following table identifies the activity in connection with the Company's discontinued operations for the year ended January 31, 2006 compared to the year ended January 31, 2005.

Discontinued operations	2006	2005	Increase (decrease)
	\$	\$	\$
Revenue	216,732	434,385	(217,653)
Direct costs	126,569	218,882	(92,313)
Gross Margin	90,163	215,503	(125,340)
General and administrative expenses	205,461	345,936	(140,475)
R&D Expenses	41,934	-	41,934
Amortization expense	179,985	429,852	(249,867)
Impairment charge	582,404	-	582,404
Interest expense	54,410	61,935	(7,525)
Interest income	(1,510)	(9,848)	(8,338)
Gain on disposal of assets	(60,000)	(360,206)	(300,206)
Income / (loss) from discontinued operations	(912,520)	(252,166)	660,356

### Manufacturing Operations:

The previous strategy of Quest's manufacturing operations was to provide positive cash flow to support drug and product development. However, net cash flowing from most of these activities has not met expectations so the Company has decided to divest all of these operations.

Therefore, on July 30, 2004, Quest sold the assets associated with its contract manufacturing operations in Edmonton, Alberta for the sum of \$460,000 to Isodiagnostika Inc. Quest's Edmonton, Alberta manufacturing facility was primarily used to manufacture breath test kits for Isodiagnostika Inc. under an agreement that was to expire in November 2007.

#### *Edmonton, Alberta Manufacturing Facility*

Quest continues to maintain a manufacturing facility located in Edmonton, Alberta to manufacture Accu-MAb™, a whooping cough test kit sold by Quest and which is profitable. This manufacturing facility is approximately 800 square feet, is equipped with clean room facilities and is certified compliant with internationally recognized quality systems standards, ISO 9001:2000 and ISO 13488 and CMDCAS (Health Canada's requirement for medical devices). The Company is in the process of selling its interest in the Accu-MAb technology.

#### *Shanghai, China Manufacturing Facility*

Shanghai Hua Gao Pharmaceutical Pellet Core Company Ltd. ("SHGP") is a wholly owned foreign subsidiary of Quest and is located in Shanghai, China. SHGP operates a 38,660 square foot manufacturing facility and 9,100 square feet of office space. SHGP has been audited and approved by the State Drug Administration in China and has been issued licenses by the Chinese Government to manufacture pharmaceutical pellet core and to manufacture Bionex disinfectant. The manufacturing facility is designed to produce high quality, low cost products that meet both domestic and export quality standards. SHGP currently manufactures pharmaceutical pellet core and has established a production line to manufacture Bionex hard surface disinfectant.

Included in the assets held for sale balance in the 2006 financial statements is the manufacturing facility owned by SHGP. This facility includes manufacturing equipment and buildings. The Company has written down the carrying value of SHGP's plant and equipment by \$582,404 to its estimate of the fair market value, less selling costs, of the SHGP assets.

As part of Quest's strategy to discontinue operations in China, Quest continues to search for a third party to purchase the SHGP assets.

The financial aspects of Quest's Chinese operations must be converted into Canadian dollars to prepare annual and quarterly financial statements. At January 31, 2006, SHGP is treated as an integrated operation and as a result, any foreign exchange gain or loss is included in income. Prior to the Company's dissolution of SACP, this company was also treated as an integrated operation. For the year ended January 31, 2006, a foreign exchange loss of \$13,839 compared to a foreign exchange loss of \$187,781 in the prior year has been recorded on the statement of operations. The foreign exchange loss for 2006 relates in part to the Company's losses on its net investment in China due to a decline in the value of the U.S. dollar and Chinese yuan relative to the Canadian dollar. Prior to November 1, 2003, the Company translated the accounts of SHGP, using the current rate method of accounting as it was considered to be a self-sustaining subsidiary. As a result of significant changes in the economic facts and circumstances, the Company re-classified SHGP as an integrated subsidiary and adopted the temporal method of accounting effective November 1, 2003. For the period when SHGP was treated as a self-sustaining subsidiary, the Company recorded a cumulative translation adjustment on the balance sheet of \$210,090.

#### Revenues:

Prior to July 30, 2004, Quest generated revenue from three sources: contract manufacturing of diagnostic test kits, sales of Accu-MAb™, a whooping cough diagnostic test kit and sales of pharmaceutical pellet core. On July 30, 2004 the Company has sold its assets relating to the

contract manufacturing operations in Edmonton, Alberta. As a result, the Company no longer generates revenue from contract manufacturing of diagnostic breath test kits. The Company is in the process of selling its interest in both the Accu-MAb technology and the pellet core business (SHGP). The following table identifies the changes in revenue for the year ended January 31, 2006 compared to the year ended January 31, 2005.

Revenue	2006	2005	Increase (decrease)
	\$	\$	\$
Contract manufacturing (discontinued operations)	0	221,556	(221,556)
Accu-MAb™ (discontinued operations)	155,948	141,092	14,856
Pharmaceutical pellet core (discontinued operations)	60,784	71,737	(10,953)
Total revenue from discontinued operations	216,732	434,385	(217,653)

Sales of Accu-MAb™ increased slightly during the year. The decrease in revenue in connection with the Company's contract manufacturing operation is due to the sale of the contract manufacturing facility in July, 2004.

### Summary of Quarterly Results

The following table presents unaudited selected financial information for each of the last eight quarters ended January 31, 2006.

	Year ended January 31, 2006				Year ended January 31, 2005			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	\$	\$	\$	\$	\$	\$	\$	\$
Revenue from continuing operations	-	-	-	-	-	-	-	-
Revenue from discontinued operations	66,503	41,820	62,993	45,416	246,800	74,498	54,593	58,494
Loss from continuing operations	(693,349)	(580,001)	(756,380)	(561,563)	(872,336)	(1,451,080)	(791,761)	(1,014,610)
Net loss for the period	(814,670)	(640,509)	(884,110)	(1,164,524)	(1,003,806)	(1,231,733)	(979,560)	(1,166,854)
Basic and diluted loss per share from continuing operations	(0.02)	(0.01)	(0.02)	(0.01)	(0.02)	(0.04)	(0.02)	(0.03)
Basic and diluted loss per share	(0.02)	(0.02)	(0.02)	(0.02)	(0.03)	(0.03)	(0.03)	(0.03)

The decrease in revenue after Q1, 2005 is due to a decrease in the amount of orders received from the Company's one contract manufacturing customer. Following the sale of the Company's contract manufacturing facility in July, 2004, there was no further revenue generated from contract manufacturing.

## **Stock-Based Compensation Expense**

During the year ended January 31, 2006, the Company granted a total of 1,491,000 (2005 – 1,594,000) stock options, as per the Company’s Stock Option Plan, including 1,006,000 (2005 – 394,000) to employees and 485,000 (2005 – 1,200,000) to non-employees. The fair value of these options, \$117,225, was recognized as an expense and credited to contributed surplus for the year ended January 31, 2006 (2005 – \$311,180).

## **Intangible Assets**

Intangible assets include proprietary rights, intellectual property and patent rights which have been acquired from third parties. Intangible assets are recorded at cost less accumulated amortization. The Company evaluates the recoverability of the carrying cost of proprietary rights and intellectual property annually and if the rights and intellectual property are not considered to be fully recoverable, a provision is recognized for the unrecoverable amount. For the year ended January 31, 2006, no provision for impairment in value has been recorded.

## **Capital Expenditures**

Expenditures on capital assets were \$12,990 for the year ended January 31, 2006 compared to \$32,637 for the prior year. Capital expenditures for the current and prior year relate primarily to the acquisition of scientific equipment. During the year ended January 31, 2006, the Company recorded a gain on disposal of property plant and equipment of \$354 (2005 – loss of \$7,518). The 2006 gain and 2005 loss relate to the disposition of surplus office furniture and R&D equipment.

## **Liquidity and Capital Resources**

As noted in the Overview section above, 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 January 31, 2006, cash and cash equivalents was \$15,505 as compared to \$1,799,155 at January 31, 2005.

The majority of the Company’s cash balance at January 31, 2005 was held by its Chinese subsidiary, SACP. During the year ended January 31, 2006, the Company received approval from the Chinese Authorities to wind-up and dissolve SACP and return its cash and technology assets to Canada. Final approval and completion of this process occurred in August and September, 2005, resulting in the repatriation to Canada of over U.S. \$1,000,000.

During the year ended January 31, 2006, the Company obtained \$75,000 of bridge financing in the form of an interest bearing loan from a director (see “Related Party Transactions” for further details). Also during the period, the Company repaid all of its bridge financing loans such that, at January 31, 2006, there were no interest bearing demand notes outstanding.

On March 23, 2005, the Company issued a \$1,000,000 principal amount 8% convertible debenture with a one year maturity to two arm's length parties. The debenture is collateralized by the Company's Sonolight technology, one of its core technologies. The debenture is repayable in blended monthly installments of \$6,667 with the balance, including accrued interest, due on March 22, 2006. The debenture may be converted into common shares of the Company at a price of \$0.45 per common share and may be redeemed at any time by the Company. Subsequent to year end, the Company extended the maturity date of the convertible debenture to September 22, 2006.

On March 7 and May 17, 2005, the Company completed the first and second tranche of a non-brokered private placement with the sale of 5,972,000 units for gross proceeds of \$1,493,000 (net proceeds of approximately \$1,432,000). Each unit is comprised of one common share and one-half share purchase warrant. Each whole warrant entitles the holder to acquire one additional common share at a price of \$0.45 at any time within one year of issuance. The proceeds from these private placements were used for general corporate purposes and for working capital.

During the year ended January 31, 2006, the Company recognized approximately \$217,000 of federal government assistance in the form of a National Research Council Industrial Research Assistance Program ("IRAP") grant to cover salaries and contractor fees related to the development of the Company's photodynamic therapy for prostate cancer, based on the Company's lead proprietary hypocrellin derivative. This funding is part of a \$295,000 grant the Company was eligible to receive up to March 31, 2006.

Also during the period, the Company was awarded a grant from Alberta Ingenuity Fund to cover salary expenditures related to the development of the Company's photodynamic therapy for prostate cancer. The \$110,000 grant is being received over a 24 month period commencing in May, 2005. \$39,000 of funding was recognized during the year ended January 31, 2006.

During the year ended January 31, 2006, the Company received approximately \$40,000 from Revenue Quebec related to scientific research and experimental development claims made for expenditures incurred in Danamedix Inc. in fiscal 2002 and 2003.

The Company has implemented a disciplined approach to containing costs and is focusing on programs aimed at achieving near-term goals. In that context, 5 staff whose services were deemed non-essential to meet the Company's goals in the near term were terminated in early November, 2005.

In January, 2006, the Company sold its interest in the HIP technology back to the original inventor for cash proceeds of \$60,000 plus possible future milestone payments.

On March 14, 2006, the Company obtained bridge financing of \$60,000 from a company controlled by Dr. Madiyalakan, the Company's Executive Chairman. This bridge financing is unsecured, has no fixed terms of repayment and carries an interest rate of 6% per annum, with interest payable monthly.

On March 21, 2006, the Company signed an amendment to the \$1,000,000 convertible debenture agreement to extend the maturity date of the convertible debenture from March 22, 2006 to September 22, 2006.

On April 10, 2006, the Company obtained bridge financing of \$90,000 from a company controlled by Dr. Madiyalakan. This bridge financing is unsecured, has no fixed terms of repayment and carries an interest rate of 6% per annum, with interest payable monthly.

On May 1, 2006, the Company obtained bridge financing of \$50,000 from a company controlled by Dr. Donald Rix, a director of the Company. This bridge financing is unsecured, has no fixed terms of repayment and carries an interest rate of 6% per annum, with interest payable monthly.

Quest's funding needs will vary as its drug development products move into and through clinical trials. The Company will seek additional capital through the sale of non-core assets, further equity financings, licensing arrangements and strategic partnerships.

Based on current operating budgets and assuming the ongoing divestiture of non-core assets including the repatriation and liquidation of assets from Quest's Chinese subsidiary, management believes that the capital resources of the Company should be sufficient to fund operations to the end of the second quarter of fiscal 2007.

The Company will seek additional capital through the sale of the remaining non-core assets, further equity financings, licensing arrangements involving its core technologies, strategic partnerships and/or financings from directors.

### **Contractual Obligations**

In the normal course of operations, Quest has entered into several contracts providing for the following payments over the following fiscal years:

	Payments due by year				
	Total	Within 1 year	2 – 3 years	4 – 5 years	After 5 years
	\$	\$	\$	\$	\$
<b>Core Technologies:</b>					
Operating leases	48,000	48,000	-	-	-
Research & development contracts	245,000	196,000	49,000	-	-
Sub-total	293,000	244,000	49,000	-	-
<b>Non-Core Assets:</b>					
Operating leases	936,000	-	28,000	14,000	894,000
Total contractual obligations	1,229,000	244,000	77,000	14,000	894,000

### **Related Party Transactions and Subsequent Events**

In January 2004, a company controlled by Mr. Warren Jackson, a former officer and director, advanced a short term loan of \$25,000 to the Company. This loan was a demand loan with no interest provisions attached. The loan was repaid in full in February 2004.

On February 27, 2004, Mr. Warren Jackson, a former officer/director, and Mr. Doug Jewell, a former officer/director, resigned their positions as officers and directors of the Company and its subsidiaries. Their resignations provided them with an agreed upon settlement. The settlement amounts which total \$95,000 are included in general and administrative expenses in fiscal 2005.

During the six month period ended July 31, 2004, the Company obtained bridge financing in the amount of \$650,000 from companies controlled by two former directors, Mr. Wayne Minion and Mr. Andrew Boddy. The bridge financing was payable on demand, carried an interest rate of 4% and originally was collateralized by cash held in SACP. In August, 2004, a statement of claim was filed by the two companies noted above, alleging non-payment of the bridge financing plus accrued interest. In December, 2004, a Consent Judgment was granted in connection with the Statement of Claim which required the Company to pay the bridge financing plus accrued interest of \$ 7,530 and legal costs of \$8,000. The Consent Judgment replaced the bridge financing and represented an unsecured claim against all of the assets of the Company. During the year ended January 31, 2006, the Company paid these obligations in full and subsequent to year end, the Company obtained a full release from the parties in connection with these matters.

During the year ended January 31, 2005, Company obtained bridge financing totaling \$284,000 from a director, Dr. Madi Madiyalakan, from a former director, Mr. Robert Sydenham and from a company controlled by Mr. Sydenham. All of the bridge financing was unsecured, had no fixed terms of repayment, and was non-interest bearing, except for an \$80,000 tranche which bore interest at 6.25% per annum. In September, 2004, the Company repaid \$20,000 of the bridge financing.

On February 8, 2005, the Company obtained additional bridge financing in the amount of \$75,000 from Dr. Madiyalakan. At that time, the Company converted all of Dr. Madiyalakan's loans and \$20,000 of legal expenses incurred by Dr. Madiyalakan on behalf of the Company to interest bearing notes (totaling \$225,000) at 6% per annum. During the year ended January 31, 2006, the Company repaid these obligations in full.

During the year ended January 31, 2005, the Company approved for reimbursement \$47,765 of legal expenses incurred by Dr. Madiyalakan and by Mr. Sydenham in connection with matters related to the 2004 Annual and Special Shareholder Meeting. These amounts are included in General and Administrative expenses.

During the year ended January 31, 2005, the Company settled a dispute with Mr. Warren Jackson. As part of the settlement, the Company paid damages of \$15,000 and legal costs of \$12,654. These amounts are included in General and Administrative expenses.

On August 8, 2005, the Company entered into an agreement with a company controlled by Dr. Madiyalakan to provide consulting services. The consulting agreement requires the Company to make monthly payments of \$7,500 and is for a term of 12 months.

Effective January 30, 2006, the Company announced the appointment, effective January 30, 2006, of Dr. Ragupathy Madiyalakan as Executive Chairman of the Company.

On March 14, 2006, the Company obtained bridge financing of \$60,000 from a company controlled by Dr. Madiyalakan. This bridge financing is unsecured, has no fixed terms of repayment and carries an interest rate of 6% per annum, with interest payable monthly.

On March 21, 2006, the Company signed an amendment to the \$1,000,000 convertible debenture agreement to extend the maturity date of the convertible debenture from March 22, 2006 to September 22, 2006.

On March 21, 2006, the Company filed a statement of Claim in the Court of Queen's bench against Steroidogenesis Inhibitors, Inc. (SI America) and Samaritan Pharmaceuticals, Inc., seeking a declaration from the courts that the licensing agreement between SI America and SI Canada, effective February 10, 1996, which granted SI Canada the exclusive right and license to manufacture, use, distribute and sell Anticort in Canada and elsewhere, is valid and in full force and effect.

Effective March 24, 2006, David, Cox, PhD resigned as CEO and President of the Company. As part of his remuneration, on February 1, 2005, Dr. Cox had received 800,000 stock options exercisable at \$0.31 vesting over three years. These options will expire on June 22, 2006. Dr. Cox remains as a director of the Company, and in that regard, on March 28, 2006, the Board approved the granting to Dr. Cox of 150,000 stock options exercisable at \$0.25, vesting immediately. This allocation will be subject to the approval of the TSX Venture Exchange.

On April 10, 2006, the Company obtained bridge financing of \$90,000 from a company controlled by Dr. Madiyalakan. This bridge financing is unsecured, has no fixed terms of repayment and carries an interest rate of 6% per annum, with interest payable monthly.

On May 1, 2006, the Company obtained bridge financing of \$50,000 from a company controlled by Dr. Donald Rix. This bridge financing is unsecured, has no fixed terms of repayment and carries an interest rate of 6% per annum, with interest payable monthly.

### **Application of Critical Accounting Policies**

The preparation of the Company's financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions. These may have an effect on the reported amounts of assets, liabilities, revenues and expenses. Actual results may vary from those estimated and the differences could be material. Following are the policies that management believes are critical and that require the use of judgment in their application.

#### *Intangible Assets*

Intangible assets include proprietary rights, intellectual property and patent rights which have been acquired from third parties. Intangible assets are recorded at cost less accumulated amortization. Following acquisition, the Company evaluates the prospective commercialization of the acquired intangible assets. Depending upon the results of the evaluation, the Company generally commences amortization of the assets over a period not to exceed five years.

Intangible assets are tested for impairment on an ongoing basis to help ensure that the carrying values are appropriate.

#### *Property, Plant and Equipment*

Property, plant and equipment are recorded at cost less accumulated amortization. Assets acquired under capital lease are carried at cost, being the present value of the minimum lease payments. Amortization of plant and equipment and assets acquired under capital lease is calculated over the estimated useful life. Assets are tested for impairment when there is a determination that the carrying value may not be recoverable.

#### *Foreign Currency Translation*

A portion of the Company's cash and cash equivalents and a significant amount of the Company's property, plant and equipment are held by the Company's Chinese subsidiary. These assets are denominated in U.S. dollars and Chinese yuan. In addition, the Company has a U.S. dollar denominated capital lease obligation. Because the accounts of the Company and its integrated foreign subsidiaries are translated using the temporal method of accounting, foreign exchange gains and losses are included as a charge to income during the year. This results in financial risk due to fluctuations in the value of the Canadian dollar relative to the U.S. dollar and the Chinese yuan. As well, the Company does not use derivative financial instruments to reduce its foreign exchange exposure.

#### *Stock-Based Compensation*

Effective February 1, 2002 the Company adopted the new CICA standard for stock-based compensation and other stock-based payments. As permitted by this standard, the Company has applied this change prospectively for new awards granted on or after February 1, 2002. Direct awards of shares to employees and non-employees, and stock option awards granted to non-employees are accounted for in accordance with the fair value method of accounting for stock-based compensation. Effective February 1, 2003, the Company has chosen to recognize, on a prospective basis and in accordance with the fair value method of accounting for stock-based compensation, compensation expense when stock options are granted to employees and directors under stock option plans with no cash or equity settlement features.

Under this policy, compensation expense for the granting of stock options is accounted for by a fair value based method using the Black-Scholes option pricing model. The model requires four highly subjective assumptions including stock price volatility and expected time until exercise which greatly affect the calculated values.

#### *Lease Accounting*

The Company has entered into a capital lease to purchase the office and manufacturing buildings, less the land, in which SHGP operates. This purchase has been accounted for as a capital lease and involved management's estimate of an appropriate discount rate to be applied to the future lease payments for purposes of determining the present value of the assets acquired.

## **Disclosure Controls and Procedures**

The management of Quest is responsible for establishing and maintaining disclosure controls and procedures for the Company and has designed such disclosure controls and procedures, or caused them to be designed under Quest management's supervision, to provide reasonable assurance that material information relating to the Company, including its consolidated subsidiaries, is made known to Quest management by others within those entities particularly during the period in which the annual filings are being prepared.

Quest management has evaluated the effectiveness of the Company's disclosure controls and procedures for the year ended January 31, 2006 and based on that evaluation, management has concluded that the disclosure controls and procedures are effective.

## **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 and it is expected to continue to experience negative cash flows from operations in the coming fiscal year. The Company had a working capital deficiency of \$1,911,524 and a shareholders' deficiency of \$851,189 as at January 31, 2006.

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.

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

The fair value of the obligation under capital lease, calculated at the present value of future contractual payments of principal and interest and discounted at the current market rate of interest available to the Company for debt instruments with similar terms and maturity, approximates the carrying value.

A portion of the Company's cash reserves are denominated in U.S. dollars and Chinese yuan. In addition, the Company has a U.S. dollar denominated capital lease obligation. These result in financial risk due to fluctuations in the value of the Canadian dollar relative to the U.S. dollar and the Chinese yuan. The Company does not use derivative financial instruments to reduce its foreign exchange exposure.

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.