Management's Discussion and Analysis **November 20, 2009**

This Management's Discussion and Analysis ("MD&A") for Alternative Fuel Systems (2004) Inc. ("AFS" or the "Company") should be read in conjunction with the audited financial statements & the accompanying MD&A for the year ended December 31, 2008 and the unaudited interim financial statements for the nine months ended September 30, 2009 and the notes contained therein.

Operating results

Sales revenue	Three months ended September 30			Nine months ended September 30		
($ thousand, except %)	2009	2008	Change	2009	2008	Change
Pressure regulators	58	735	(677)	705	1,763	(1,058)
Engine management systems	294	278	16	619	470	149
Ignition systems and other parts	36	116	(80)	115	286	(171)
Subtotal product sales	**388**	**1,129**	**(741)**	**1,439**	**2,519**	**(1,080)**
Engineering services	41	116	(75)	309	124	185
Total	**429**	**1,245**	**(816)**	**1,748**	**2,643**	**(895)**
Gross margin on product sales	42%	47%	(5%)	43%	46%	(3%)

The significant decrease in revenue for the third quarter of 2009 versus the same period in 2008 was due to decreased sales of natural gas pressure regulators. As previously disclosed, early in 2009 the Company's largest customer for regulators discontinued production of the vehicle that used AFS products.

Sales of engine management systems were somewhat higher in Q3 of 2009 versus Q3 of 2008 as shipments to customers in India ramped up. It should be noted that inventory of finished engine controllers more than doubled to about $275,000 in the three months ended September 30, 2009 versus inventory of these products at the end of June, 2009. This increase was the result of several large shipments that were ready to go at the end of September, but which were delayed until October due to factors outside of AFS's control. Had these two orders been shipped prior to September 30, 2009, revenue for the third quarter would have been higher by approximately 20%.

The decrease of 5% in gross margin in Q3 – 2009 versus the same period of 2008 was primarily due to a write down of $13,370 of spare parts inventory, which have been determined unlikely to be sold.

Engineering services revenue in Q3 was lower than recorded in the same quarter of 2008 due to timing of the end of certain projects. Nevertheless, engineering services revenue year-to-date is still well ahead of that recorded in the first nine months of 2008.

Historical summary financial information for the prior 8 quarters:

($ thousand, except per share amounts)	**2009**			**2008**				**2007**
	Q3	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**
Gross revenue	429	659	666	1,253	1,251	828	584	523
Net income (loss)	(110)	149	(107)	200	277	37	(20)	(96)
Net income (loss) per share	(0.00)	0.01	(0.01)	0.01	0.02	0.00	(0.00)	(0.01)

The variations in gross revenue are primarily the result of change in volumes of natural gas pressure regulator sales as well as variations in sales of engine management systems. In Q3 of 2009, pressure regulator sales were down significantly compared to those recorded in the same quarter of the prior year. Sales of engine management systems increased to slightly offset this decline.

Operating and administrative expenses	**Three months ended September 30**			**Nine months ended September 30**		
($ thousand, except % change)	**2009**	**2008**	**Change**	**2009**	**2008**	**Change**
Engineering & product development	144	138	6	438	419	19
Administrative & other	95	114	(19)	316	354	(38)
Sales & marketing	46	49	(3)	148	143	5
Total	**285**	**301**	**(16)**	**902**	**916**	**14**

The decrease in administration and other expenses for the three months ended September 30, 2009 versus 2008 was primarily due to a decrease in consulting expenses of $12,000.

Similarly, the nine month decrease in administrative and other expenses was also primarily due to a decrease in consulting expenses of approximately $20,000, a $10,000 decrease in stock exchange fees and a $5,000 decrease in general office expenses due to less employees (10 employees in 2009 versus 16 in the same period of 2008).

For the three months ended September 30, 2009, employee wages and benefits accounted for 83 % or $235,856 (2008-78% or $235,666) of the total operating and administrative expenses recognized. This increase was primarily due to small salary increases issued in the latter part of Q3 of 2008.

For the nine months ended September 30, 2009, employee wages and benefits accounted for 81% or $732,239 (2008-74% or $683,697) of the total operating and administrative expenses recognized. This increase was primarily due to the same factors discussed above.

The Company currently has 10 full time employees with consultants, distributors and agents in Europe, Asia and India.

Other expenses

For the three months ended September 30, 2009, stock-based compensation expense was $12,990 (2008 - $20,352). For the nine months ended September 30, 2009, stock based compensation expense was $39,781 (2008 - $28,889).

Compensation of Executive and Directors

The following table sets forth all compensation and awards paid by the Company to executive officers for the nine months ended September 30:

Named Executive Officer	September 30	Salary ($)	Bonus ($)	Other Compensation ($)
Jim F. Perry, President, Chief Executive Officer and Chief Financial Officer	**2009**	128,250	NIL	(1)
	2008	123, 000	NIL	(1)

(1) The value of perquisites and other personal benefits did not exceed the lesser of $50,000 or 10% of the total of annual salary and bonus of the Named Executive Officer.

In addition to the above, the President and Chief Executive Officer participates in the Company's stock-based compensation plan:

Name	Shares acquired on exercise (#)	Aggregate value realized ($)	Options at quarter end (#)		Value of In the Money options at quarter end[1] ($)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Jim F. Perry	Nil	Nil	283,600	34,400	30,856	-

(1) Value is calculated based upon the difference between the exercise price of the options and the 10-day average closing price of the Common Shares on the Exchange of $0.233 as at September 30, 2009.

The non-employee directors of the corporation receive a payment of $350 per Board of Directors meeting attended in person, as well as reimbursement of expenses to attend the meeting. No other cash compensation is paid to the directors. During the third quarter, no cash or other compensation was paid to the directors of the Company.

Financial Position

The following table outlines the changes in the balance sheet from December 31, 2008 to September 30, 2009:

	Change ($)	Change (%)	Explanation
Cash and short-term investments	136,940	9.7%	See statements of cash flow.
Accounts receivable	(334,336)	(69.3%)	Decreased due to collection of all balances outstanding as at December 31, 2008, offset by new receivables related to current revenue. Approximately 82% of the Q3 2009 accounts receivable balance related to one major customer.
Prepaid expenses and deposits	(30,743)	(50.3%)	Decrease due to the monthly amortization of the prepaid balance.
Inventory	(81,926)	(9.0%)	Decrease due to inventory being consumed in production, combined with decreased new purchases to match decreased regulator production volumes. This was partially offset by increase in electronic controller inventory that was ready to ship at quarter end.
Property, plant and equipment	(17,278)	(9.1%)	Net decrease due to purchases of production tooling and shop equipment of $15,084 offset by amortization of $32,362.
Intangible assets	(15,346)	(85.0%)	Net decrease due to amortization of $15,346.
Accounts payable & accrued liabilities	(237,738)	(51.4%)	Decrease due to the payment of Q4 2008 outstanding payables combined with significantly fewer purchases for inventory to meet less production demand in Q3 of 2009 versus Q4 of 2008.
Advances from customers	(76,551)	(27.4%)	In order to mitigate the risk inherent in providing customized engineering and product development work, the Company generally requires a deposit on all new large orders before work commences. In Q3, 82% of these advances were from one customer.
Capital stock	-	-	No change to report.
Contributed surplus	39,781	7.4%	Change from December 31, 2008 due solely to impact of stock-based compensation expense of $39,781.
Deficit	68,181	10.3%	The decrease in the deficit is due to the impact of the Q3 2009 year to date net loss of ($68,181).

Net income and cash flow

AFS reported a net loss for the quarter ended September 30, 2009 of ($110,149) or ($0.00) per share on a basic and diluted basis. The net income in the comparable quarter in 2008 was $277,266 or $0.020 per share. Offsetting this net loss was an overall increase in working capital in the third quarter of 2009 of $95,262 compared with an increase in working capital of $52,505 in the same quarter of 2008. The increase in working capital in the third quarter of 2009 was primarily due to an decrease in accounts receivable of $112,421, a decrease in prepaid expenses and deposits of $5,105 and an increase in accounts payable and accrued liabilities of $32,534. These were offset by an increase in inventory of $18,196 and a decrease in advances from customers of $36,602.

Cash flow from operations for the third quarter of 2009 was $13,953 versus a cash flow of $366,194 in the third quarter of 2008. Excluding the change non-cash items such as amortization and stock-based compensation expense of ($7,583), this change of ($352,241) was due to the change in working capital during the three months of $42,757 offset by a ($387,415) decrease in net income in the third quarter of 2009 versus the third quarter of 2008.

Capital stock

The following common shares and stock options were outstanding as of September 30, 2009:

	Number	$
Common shares	16,998,080	$2,453,006
	Outstanding	**Exercisable**
Stock options	1,312,500	1,145,300

During the quarter ended September 30, 2009, no stock options were exercised.

Commitments and contingent liabilities

During the third quarter ended September 30, 2009, there were no material changes in the contractual obligations or contingent liabilities as previously disclosed in the audited December 31, 2008 financial statements.

Liquidity and capital resources

For the three months ended September 30, 2009 there was a total increase in cash of $13,953. Excluding non-cash transactions such as amortization of $15,850 and stock-based compensation expense of $12,990 this three month increase was primarily due to an increase in working capital of 95,262 offset by a loss from operations of ($110,149).

For the nine months ended September 30, 2009 there was a total increase in cash of $136,940 from the December 31, 2008 balance. Excluding non-cash transactions such as amortization of $47,708 and stock-based compensation expense of $39,781, this increase was primarily due to an increase in working capital of $132,716 offset by purchases of equipment totaling ($15,084) and a loss from operations of ($68,181).

The current business environment is very uncertain. Commodity price fluctuations, credit restrictions and capital market volatility have combined to make forecasting a challenge. As a result, the Company is focusing on controlling costs and preserving capital, while working with its customers to bring new projects into production. Currently, the Company has no outstanding debt, had a cash balance of more than $1.5 million at the end of the quarter and as at September 30, 2009, the Company's capital resources included total working capital of about $2.1 million. As part of the Company's management of liquidity and capital resources, discretionary spending and the cash burn rate are monitored to proactively manage the cash and working capital position of the Company. Management anticipates that this level of resources will be sufficient to allow the Company to continue to grow the business without having to finance or incur debt.

Future business direction

As announced in a Press Release on January 23, 2009, AFS was informed by its European representative that the major vehicle manufacturer (the "OEM") that was purchasing the bulk of the Company's natural gas pressure regulators planned to discontinue the production of the vehicle that uses those products. The production halt has since occurred. As a result, sales of pressure regulators are down significantly compared to prior periods

AFS is concentrating on growing the engine management system side of its business to try and compensate for the decline in regulator sales. This growth has already been seen in the results for the third quarter of 2009. Much of the increase has been from customers in India, where the world economic downturn adversely affected car and truck sales in the last quarter of 2008 and the first quarter of 2009. However, it appears that sales in the light commercial vehicle market segment, where most AFS engine controllers are sold, have continued to rebound in the third quarter of 2009. If this pattern continues, growth in engine controller revenues could result.

Critical accounting estimates

There are no changes to our critical accounting estimates in the three months ended September 30, 2009.

Business Risks

Our risk factors are consistent with the Company's MD&A for the year ended December 31, 2008.

Adoption of New Accounting Standards

The CICA has issued the following new Handbook Section that was effective for the Company beginning January 1, 2009. Section 3064, "Goodwill and Intangible Assets," deals with the accounting treatment of internally developed intangibles and the recognition of such assets. The adoption of this standard did not have a material effect on the Company's financial statements.

Adoption of International Financial Reporting Standards

In 2006, the CICA Accounting Standards Board (AcSB) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, the AcSB confirmed in

February 2008 that International Financial Reporting Standards (IFRS) will replace Canadian GAAP in 2011 for profit-orientated Canadian publicly accountable enterprises. As the Company will be required to report its results in accordance with IFRS starting in 2011, the Company is assessing the potential impacts of the changeover accordingly.

Disclosure controls update

The company is required to comply with Multilateral Instrument 52-109 “Certification of Disclosure in Issuer’s Annual and Interim Filings”. This instrument requires that the Company disclose in the interim MD&A any changes in the Company’s internal control over financial reporting that occurred during the most recent interim period that has materially affected or is reasonably likely to materially affect, the Company’s internal control over financial reporting. The Company confirms that no such changes occurred during the three months ended September 30, 2009.

Forward-looking statements

Certain statements in this MD&A including but not limited to (i) statements that may contain words such as "anticipate", "could", "expect", "seek", "may", “might”, "intend", "will", "believe", "should", "project", "forecast", "plan" and similar expressions, including the negatives thereof, (ii) statements that are based on current expectations and estimates about the markets in which the Company operates and (iii) statements of belief, intentions and expectations about developments, results and events that will or may occur in the future, constitute "forward-looking statements" and are based on certain assumptions and analysis made by the Company. Forward-looking statements in this MD&A specifically include, but are not limited to, statements with respect to future business opportunities, nature and timing thereof; business strategy; expansion and growth of the Company’s business and operations and other such matters as the case may be. Such forward-looking statements are subject to important risks, uncertainties and assumptions which are difficult to predict and that may affect the Company’s operations, including, but not limited to: the impact of general economic conditions; industry conditions; customer base changes; financial market conditions; government and regulatory developments; oil and natural gas product supply, demand and pricing; foreign exchange rates; competition; market conditions in the countries where the Company operates; and the Company’s ability to attract and retain qualified personnel. The Company’s actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do transpire or occur, what benefits or disadvantage the Company may derive there from. Except as required by applicable securities laws, the Company undertakes no intention or obligation to update or revise any forward-looking statements.

All forward-looking statements contained in this document are expressly qualified by this cautionary statement. Further information about the factors affecting forward-looking statements is available in the Company’s current financial statements and other documents that the Company files from time to time with securities regulatory authorities. Copies of these documents are available without charge from the Company or electronically on the internet on the Company’s SEDAR profile at **www.sedar.com .**