

Xebec Adsorption Inc.

Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2014

(expressed in Canadian dollars)

The Condensed Interim Consolidated Financial Statements which are included in this Report have not been subject to a review by the Company's External Auditors.

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Financial Position (Unaudited)

(expressed in Canadian dollars)

	As at March 31, 2014 \$	As at December 31, 2013 \$
Assets		
Current assets		
Cash and cash equivalent	3,332,423	2,835,051
Restricted cash	145,386	-
Trade and other receivables	1,979,689	2,915,700
Inventories	1,535,630	1,539,180
Short-term portion of balance of sale	200,000	300,000
Investment tax credits receivable	50,000	137,760
Other current assets	638,447	559,001
Total current assets	7,881,575	8,286,692
Non-current assets		
Balance of sale	-	200,000
Property, plant and equipment (Note 3)	307,071	310,576
Intangible assets (Note 4)	767,212	809,513
Goodwill (Note 4)	142,616	142,616
Total non-current assets	1,216,899	1,462,705
Total assets	9,098,474	9,749,397
Liabilities		
Current liabilities		
Bank loan	370,000	370,000
Trade payables	3,169,843	3,429,420
Accrued liabilities	802,034	805,563
Deferred revenues	2,007,236	1,342,794
Current portion of long-term debt and obligation	67,309	67,176
Current portion of government royalty program obligation	262,743	259,636
Provisions	452,999	489,742
Total current liabilities	7,132,164	6,764,331
Non-current liabilities		
Long-term debt and obligation	27,348	50,476
Government royalty program obligation	519,756	586,825
Government assistance	15,833	17,083
Deferred rent	65,960	59,364
Provisions	281,538	312,330
Total non-current liabilities	910,435	1,026,078
Total liabilities	8,042,599	7,790,409
Equity		
Share capital	19,732,623	19,732,623
Contributed surplus	2,388,063	2,388,063
Accumulated other comprehensive loss	(352,738)	(313,486)
Deficit	(20,971,792)	(20,131,974)
Total equity	1,055,875	1,958,988
Total liabilities and equity	9,098,474	9,749,397

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Approved by the Board of Directors

(signed) Kurt Sorschak Director

(signed) Jean Bedard Director

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Income (Loss)

For the three-month period ended March 31, 2014 and 2013 (Unaudited)

(expressed in Canadian dollars)

	2014 \$	2013 \$
Revenue	2,627,228	3,824,939
Cost of goods sold	1,977,765	3,445,128
Gross margin	649,463	379,811
Research and development expenses	126,318	57,973
Selling and administrative expenses	1,424,763	1,442,183
Foreign exchange gain	(54,233)	(70,268)
	1,496,848	1,429,888
Operating Loss	(847,385)	(1,050,077)
Finance income	(6,104)	(4,629)
Finance expense (Note 7)	33,949	35,790
Finance costs – net	27,845	31,161
Net loss for the period	(875,230)	(1,081,238)
Loss attributable to:		
Shareholders of the Company	(839,818)	(1,110,884)
Non-controlling interest	(35,412)	29,646
	(875,230)	(1,081,238)
Loss per share		
Basic (Note 5)	(0.02)	(0.03)
Diluted (Note 5)	(0.02)	(0.03)

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Comprehensive Income (Loss)

For the three-month period ended March 31, 2014 and 2013 (Unaudited)

(expressed in Canadian dollars)

	2014 \$	2013 \$
Net loss for the period	(875,230)	(1,081,238)
Other comprehensive income		
Cumulative translation adjustment	(27,883)	(52,886)
Comprehensive loss for the period	<u>(903,113)</u>	<u>(1,134,124)</u>
Attributable to:		
Shareholders of the Company	(879,070)	(1,165,460)
Non-controlling interest	(24,043)	31,336
	<u>(903,113)</u>	<u>(1,134,124)</u>

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited)

(expressed in Canadian dollars)

	Number		Amount						
	Common shares	Warrants	Share capital – Common shares and warrants \$	Contributed surplus \$	Accumulated other comprehensive income (loss) \$	Deficit \$	Equity attributable to the Company \$	Non-controlling interest \$	Total \$
Balance – January 1, 2013	39,363,867	10,091,886	19,732,623	2,316,580	(48,870)	(20,528,866)	1,471,467	265,872	1,737,339
Net loss for the period	-	-	-	-	-	(1,110,884)	(1,110,884)	29,646	(1,081,238)
Other comprehensive loss	-	-	-	-	(54,576)	-	(54,576)	1,690	(52,886)
Comprehensive loss for the period	-	-	-	-	(54,576)	(1,110,884)	(1,165,460)	31,336	(1,134,124)
Share-based compensation	-	-	-	4,137	-	-	4,137	-	4,137
Balance – March 31, 2013	39,363,867	10,091,886	19,732,623	2,320,717	(103,446)	(21,639,750)	310,144	297,208	607,352
Balance – January 1, 2014	39,363,867	10,091,886	19,732,623	2,388,063	(313,486)	(20,131,974)	1,675,226	283,762	1,958,988
Net loss for the period	-	-	-	-	-	(839,818)	(839,818)	(35,412)	(875,230)
Other comprehensive income (loss)	-	-	-	-	(39,252)	-	(39,252)	11,369	(27,883)
Comprehensive loss for the period	-	-	-	-	(39,252)	(839,818)	(879,070)	(24,043)	(903,113)
Balance – March 31, 2014	39,363,867	10,091,886	19,732,623	2,388,063	(352,738)	(20,971,792)	796,156	259,719	1,055,875

Accumulated other comprehensive income relates solely to cumulative translation adjustments.

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Cash Flows

For the three-month period ended March 31, 2014 and 2013 (Unaudited)

(expressed in Canadian dollars)

	2014	2013
	\$	\$
Cash flows from		
Operating activities		
Net loss for the period	(875,230)	(1,081,238)
Items not affecting cash		
Amortization of property, plant and equipment	20,433	25,335
Amortization of intangible assets	42,365	42,297
Gain on debt forgiveness	(10,003)	(1,034)
Government assistance	(1,250)	(1,250)
Deferred rent	6,596	6,596
Accretion of government royalty program obligation	9,538	8,148
Stock-based compensation expense	-	4,137
	<u>(807,551)</u>	<u>(997,009)</u>
Net change in non-cash working capital balances related to operations (note 8)	1,146,102	452,132
	<u>338,551</u>	<u>(544,877)</u>
Investing activities		
Acquisition of property, plant and equipment	(16,066)	-
Proceeds from disposal of assets	-	4,918
Balance of sale	300,000	300,000
	<u>283,934</u>	<u>304,918</u>
Financing activities		
Increase of bank loan	-	225,148
Repayment of long-term debt	(22,995)	(25,301)
Repayment of government royalty program obligation	(73,500)	-
	<u>(96,495)</u>	<u>199,847</u>
Effect of exchange rate changes on cash	(28,618)	(55,126)
Increase (decrease) in cash and cash equivalent during the period	497,372	(95,238)
Cash and cash equivalent – Beginning of period	2,835,051	1,344,114
Cash and cash equivalent – End of period	<u>3,332,423</u>	<u>1,248,876</u>
Additional information		
Interest paid	24,411	27,579

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

March 31, 2014

(expressed in Canadian dollars)

1 Nature of business

a) Nature of business

Xebec Adsorption Inc. (“Xebec” or the “Company”) is a global provider which specializes in the design and manufacture of cost-effective, environmentally responsible, purification, separation, dehydration, and filtration equipment for gases and compressed air. Xebec’s main product lines are: Biogas Plants for the purification of biogas from agricultural digesters, landfill sites and waste water treatment plants, Natural Gas Dryers for NGV refuelling stations, Associated Gas Purification Systems which enable diesel displacement on drilling sites, and Hydrogen Purification Systems for fuel cell and industrial applications. The Company is incorporated and domiciled in Canada and is listed on the TSX Venture Exchange under the symbol XBC-V. The address of its registered office is 730 Industriel Boulevard, Blainville, Quebec, Canada.

b) Liquidity risk

The Company has realized an operating loss of \$847,385, had cash inflows from operations of \$338,551 for the period ended March 31, 2014 and finished the period with cash and cash equivalent amounting to \$3,332,423, working capital of \$749,411 and had access to credit facilities totalling \$1,500,000 of which only \$310,000 has been used. During the year, management undertook various initiatives and developed a plan to manage its operating and liquidity risks in light of prevailing economic conditions. Management is also currently seeking alternative financings for its operations. The Company has prepared a budget for 2014 for which management believes the assumptions are reasonable. Achieving budgeted results is dependent on improving the volume of revenues, delivering on sales and contracts schedules, meeting expected overall operating margin levels and controlling general and administrative costs. Management expects to meet its budget and to have enough liquidity to fund operations to at least beyond December 31, 2014.

The Company is thus faced with uncertainties that may have an impact on future operating results and liquidity. These uncertainties include reduced spending in biogas projects reflecting the weakness of the market, fluctuations in foreign currency rates and achieving the Company’s business plan goals as mentioned in the previous paragraph, which includes the development of a new business segment. While management believes it has developed planned courses of action to mitigate operating and liquidity risks, there is no assurance that management will be able to achieve its business plan and maintain the necessary liquidity level if events or conditions develop that are not consistent with management’s expectations, key budget assumptions for 2014 and planned courses of action. Therefore, the Company may require additional external funding and there is no assurance that it would be successful. It is possible that future changes in capital markets conditions could result in such funding not being available when required or at acceptable costs. The Company is unable to predict the possible effects, if any, of such uncertainties and the potential adjustments to the carrying values of assets and liabilities that could be needed should the Company have insufficient liquidity. Such adjustments could be material.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2014

(expressed in Canadian dollars)

2 Basis of preparation

These condensed consolidated interim financial statements, have been prepared in accordance with International Financial Reporting Standards (“IFRS”) applicable to the preparation of interim financial statement, including IAS 34 Interim Financial Reporting. The condensed consolidated interim financial statements do not include all of the information required for annual financial statements, and should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2013, as they follow the same accounting policies and methods of application, unless otherwise indicated. These consolidated interim financial statements were approved by the Board of Directors on May 29, 2013.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2014

(expressed in Canadian dollars)

3 Property, plant and equipment

	Machinery and equipment	Office furniture and equipment	Computers	Moulds	Vehicles	Total
Cost						
Balance at December 31, 2013	477,771	91,152	210,428	90,618	35,984	905,953
Additions	-	14,621	1,445	-	-	16,066
Effect of movements in exchange rates	1,309	872	1,243	1,083	-	4,507
Balance at March 31, 2014	479,080	106,645	213,116	91,701	35,984	926,526
Accumulated amortization						
Balance at December 31, 2013	232,740	85,668	179,425	72,355	25,189	595,377
Amortization	11,217	935	4,455	2,026	1,799	20,432
Effect of movements in exchange rates	836	852	1,128	830	-	3,646
Balance at March 31, 2014	244,793	87,455	185,008	75,211	26,988	619,455
Carrying Amount						
At December 31, 2013	245,031	5,484	31,003	18,263	10,795	310,576
At March 31, 2014	234,287	19,190	28,108	16,490	8,996	307,071

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

March 31, 2014

(expressed in Canadian dollars)

4 Intangible assets and goodwill

	Customer relations \$	Other Software \$	Internally generated Engineering drawings \$	Total intangible assets \$	Goodwill \$
Cost					
Balance at December 31, 2013	1,900,000	254,319	4,700	2,159,019	142,616
Effect of movements in exchange rates	-	1,148	-	1,148	-
Balance at March 31, 2014	1,900,000	255,467	4,700	2,160,167	142,616
Accumulated amortization					
Balance at December 31, 2013	1,108,333	236,473	4,700	1,349,506	-
Amortization of the period	39,584	2,782	-	42,366	-
Effect of movements in exchange rates	-	1,083	-	1,083	-
Balance at March 31, 2014	1,147,917	240,338	4,700	1,392,955	-
Carrying Amount					
At December 31, 2013	791,667	17,846	-	809,513	142,616
At March 31, 2014	752,083	15,129	-	767,212	142,616

Amortization of \$42,366 (2013 - \$42,297) is included in the consolidated statement of income (loss): \$669 (2013 - \$600) in 'cost of goods sold' and \$41,697 (2013 - \$41,697) in 'selling and administrative expenses'.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements
(Unaudited)

March 31, 2014

(expressed in Canadian dollars)

5 Share capital

Earnings (loss) per share

i) Basic

Basic loss per share is calculated by dividing the net income attributable to owners of the parent by the weighted average number of common shares in issue during the year.

	For the three- month ended March 31, 2014	For the three- month ended March 31, 2013
Net loss attributable to owners of the parent	(839,818)	(1,110,884)
Weighted average number of common shares in issue	<u>39,363,867</u>	<u>39,363,867</u>
	<u>(\$0.02)</u>	<u>(\$0.03)</u>

ii) Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding to assume conversion of all dilutive potential common shares. The Company has two categories of dilutive potential common shares: warrants and stock options. For both, a calculation is performed to determine the number of shares that could have been acquired at fair value (determined as the average market share price of the Company's outstanding shares for the period), based on the monetary value of the subscription rights attached to the warrants and stock options. The number of shares calculated below is compared with the number of shares that would have been issued assuming exercise of the warrants and stock options. For the periods ended March 31, the diluted net loss per share was the same as the basic net loss per share, since the effect of assumed exercise of share options and warrants to purchase common shares was anti-dilutive.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements
(Unaudited)

March 31, 2014

(expressed in Canadian dollars)

6 Expenses by nature

	For the three- month ended March 31, 2014 \$	For the three- month ended March 31, 2013 \$
Employee benefits	1,412,377	1,694,372
Material	1,209,270	2,183,228
Travel expenses	223,705	170,028
Rent and repairs and maintenance	155,645	210,603
Professional fees	138,511	180,989
Office expenses	111,794	103,781
Amortization	62,798	67,631
Subcontracts cost	51,727	103,657
Other	36,701	132,854
Commission	-	36,032
Stock-based compensation	-	4,136
	<u>3,402,528</u>	<u>4,887,311</u>

7 Finance expenses

	For the three- month ended March 31, 2014 \$	For the three- month ended March 31, 2013 \$
Interest and bank charges	8,500	19,505
Accretion and revaluation of government royalty program obligation	9,538	8,148
Interest charges	15,720	7,761
Interest on long-term debt	191	376
	<u>33,949</u>	<u>35,790</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

March 31, 2014

(expressed in Canadian dollars)

8 Supplemental Cash flow information

Net change in non-cash working capital balances related to operations consists of the following:

	For the three-month ended March 31, 2014 \$	For the three-month ended March 31, 2013 \$
Decrease (increase) in assets:		
Trade and other receivables	936,011	(12,283)
Inventories	3,359	46,795
Investment tax credits receivable	87,760	-
Restricted cash	(145,386)	-
Other current assets	(79,446)	(17,897)
Increase (decrease) in liabilities:		
Trade payables	(249,574)	418,400
Accrued liabilities	(3,529)	(86,270)
Deferred revenues	664,442	46,168
Other operating liabilities	(67,535)	57,219
	<u>1,146,102</u>	<u>452,132</u>

9 Related party transactions

The following table presents a summary of the related party transactions during the period:

	For the three- month ended March 31, 2014 \$	For the three- month ended March 31, 2013 \$
Marketing and professional services expenses paid to a company controlled by a member of the immediate family of an officer	26,600	22,658
Sales to entities controlled by a subsidiary manager	702,639	17,172

These transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

10 Segmented information

The Company has only one segment and specializes in the design and manufacture of filtration, purification, separation and dehydration equipment for gases and compressed air. The Company has four product lines and provides related engineering services.

Revenue summarized by country, as determined by location of the customers, is as follows:

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

March 31, 2014

(expressed in Canadian dollars)

	For the three- month ended March 31, 2014 \$	For the three- month ended March 31, 2013 \$
Revenue		
United States	741,514	614,134
Singapore	702,639	7,052
Canada	573,431	736,029
Korea	36,471	1,834,905
Other	573,173	632,819
	<hr/> 2,627,228	<hr/> 3,824,939

Revenue summarized by product line is as follows:

	For the three- month ended March 31, 2014 \$	For the three- month ended March 31, 2013 \$
Product line		
Gas purification	244,507	1,653,429
Natural gas dryers	1,360,266	1,001,000
Compressed gas filtration	955,130	955,412
Associated Gas	67,325	215,098
	<hr/> 2,627,228	<hr/> 3,824,939

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

	For the three- month ended March 31, 2014 \$	For the three- month ended March 31, 2013 \$
Customer A	702,639	-
Customer B	220,884	-
Customer C	-	1,108,386
Customer D	-	725,472
	<hr/> 923,523	<hr/> 1,833,858

The location of the Company's non-current assets by geographic region is as follows:

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2014

(expressed in Canadian dollars)

	March 31, 2014	December 31, 2013
	\$	\$
Non-current assets		
Canada	1,142,627	1,389,781
Asia	68,556	72,924
United States	5,717	-
	<hr/>	<hr/>
	1,216,900	1,462,705