

Xebec Adsorption Inc.

Condensed Interim Consolidated Financial Statements
(Unaudited)

March 31, 2016

(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, 2016 \$	As at December 31, 2015 \$
Assets		
Current assets		
Cash	1,913,534	2,717,965
Trade and other receivables	2,113,464	2,437,159
Inventories	1,514,332	1,141,840
Investment tax credits receivable	47,953	117,676
Other current assets	185,650	158,856
Total current assets	5,774,933	6,573,496
Non-current assets		
Property, plant and equipment (note 3)	292,617	322,395
Intangible assets (note 4)	221,134	240,783
Total non-current assets	513,751	563,178
Total assets	6,288,684	7,136,674
Liabilities		
Current liabilities		
Bank loan (note 5)	645,000	375,000
Trade and other payables	2,577,053	3,105,172
Accrued liabilities	959,008	793,556
Deferred revenues	655,895	680,003
Current portion of government royalty program obligation	732,780	243,207
Current portion of provisions	684,647	698,561
Total current liabilities	6,254,380	5,895,499
Non-current liabilities		
Government royalty program obligation	-	480,834
Obligation arising from shares issued by a subsidiary (note 6)	3,464,562	3,583,808
Government grant	5,833	7,083
Deferred rent	118,728	112,132
Provisions	19,805	20,013
Total non-current liabilities	3,608,928	4,203,870
Total liabilities	9,863,308	10,099,369
Equity		
Equity attributable to shareholders of the Company		
Share capital (note 7)	19,318,856	19,318,856
Contributed surplus	2,973,937	2,925,379
Accumulated other comprehensive loss	(709,061)	(1,105,821)
Deficit	(25,158,356)	(24,101,109)
Total equity	(3,574,624)	(2,962,695)
Total liabilities and equity	6,288,684	7,136,674

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) William Beckett Director

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Loss

For the three-month period ended March 31, 2016 and 2015 (Unaudited)

(expressed in Canadian dollars)

	2016 \$	2015 \$
Revenue	2,453,567	3,096,691
Cost of goods sold	2,094,023	2,417,226
Gross margin	359,544	679,465
Research and development expenses	56,748	10,059
Selling and administrative expenses	1,193,437	1,049,698
Foreign exchange loss (gain)	253,529	(356,603)
Gain on conversion of shares issued by a subsidiary (note 6)	(206,960)	-
	1,296,754	703,131
Operating Loss	(937,210)	(23,666)
Other income (charge)		
Finance income	(1,403)	(2,428)
Finance expense (note 9)	121,440	23,642
	120,037	21,214
Net loss before income taxes	(1,057,247)	(44,880)
Income tax expense	-	8,750
Net loss for the period	(1,057,247)	(53,630)
Loss per share		
Basic (note 7)	(0.03)	(0.00)
Diluted (note 7)	(0.03)	(0.00)

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

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Comprehensive Loss

For the three-month period ended March 31, 2016 and 2015 (Unaudited)

(expressed in Canadian dollars)

	2016	2015
	\$	\$
Net loss for the period	(1,057,247)	(53,630)
Other comprehensive income (loss)		
Cumulative translation adjustment	396,760	(308,903)
Comprehensive loss for the period	<u>(660,487)</u>	<u>(362,533)</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, 2015	39,363,867	10,091,886	19,732,623	2,460,146	(606,685)	(20,914,588)	671,496	257,795	929,291
Net loss for the period	-	-	-	-	-	(53,630)	(53,630)	-	(53,630)
Other comprehensive income (loss)	-	-	-	-	(322,826)	-	(322,826)	13,923	(308,903)
Comprehensive income (loss) for the period	-	-	-	-	(322,826)	(53,630)	(376,456)	13,923	(362,533)
Share-based compensation	-	-	-	13,606	-	-	13,606	-	13,606
Balance – March 31, 2015	39,363,867	10,091,886	19,732,623	2,473,752	(929,511)	(20,968,218)	308,646	271,718	580,364
Balance – January 1, 2016	39,363,867	-	19,318,856	2,925,379	(1,105,821)	(24,101,109)	(2,962,695)	-	(2,962,695)
Net loss for the period	-	-	-	-	-	(1,057,247)	(1,057,247)	-	(1,057,247)
Other comprehensive income	-	-	-	-	396,760	-	396,760	-	396,760
Comprehensive income (loss) for the period	-	-	-	-	396,760	(1,057,247)	(660,487)	-	(660,487)
Share-based compensation	-	-	-	48,558	-	-	48,558	-	48,558
Balance – March 31, 2016	39,363,867	-	19,318,856	2,973,937	(709,061)	(25,158,356)	(3,574,624)	-	(3,574,624)

Accumulated other comprehensive income (loss) relates solely to cumulative translation adjustments.

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

Xebec Adsorption Inc.

Consolidated Statement of Changes in Shareholders' Equity For the years ended December 31, 2011 and 2010

(expressed in Canadian dollars)

	2016 \$	2015 \$
Cash flows from		
Operating activities		
Net loss for the period	(1,057,247)	(53,630)
Items not affecting cash		
Depreciation of property, plant and equipment	24,718	28,291
Amortization of intangible assets	18,122	38,480
Gain on debt forgiveness	-	(168,066)
Government grant	(1,250)	(1,250)
Deferred rent	6,596	6,596
Accretion and revaluation of government royalty program obligation	8,739	6,431
Accretion of the obligation arising from shares issued by a subsidiary (note 6)	87,714	-
Stock-based compensation expense	48,558	13,606
	<u>(864,050)</u>	<u>(129,542)</u>
Change in non-cash working capital balances related to operations (note 10)	<u>(406,768)</u>	<u>(176,008)</u>
	<u>(1,270,818)</u>	<u>(305,550)</u>
Investing activities		
Acquisition of property, plant and equipment	<u>(450)</u>	<u>(13,269)</u>
	<u>(450)</u>	<u>(13,269)</u>
Financing activities		
Decrease (increase) in restricted cash	-	145,386
Increase (decrease) of bank loan	270,000	(136,437)
Repayment of long-term debt	-	(23,134)
	<u>270,000</u>	<u>(14,185)</u>
Net increase (decrease) in cash during the period	<u>(1,001,268)</u>	<u>(333,004)</u>
Cash – Beginning of period	2,717,965	1,008,421
Effect of exchange rate changes on cash	196,837	(311,905)
Cash – End of period	<u>1,913,534</u>	<u>363,512</u>
Additional information		
Interest paid	24,987	17,211

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

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Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Cash Flows

For the three-month period ended March 31, 2016 and 2015 (Unaudited)

(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 and 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 natural gas 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 (TSXV) 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 \$937,210, had cash outflows from operations of \$1,270,818 for the period ended March 31, 2016 and finished the period with cash amounting to \$1,913,534, a working capital deficit of \$479,447, and had access to credit facilities totalling \$750,000 of which \$645,000 has been used (see note 5). 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 2016 for which management believes the assumptions are reasonable. Achieving budgeted results is dependent on improving the volume of revenues in Canada, United States and China, delivering on sales and contract schedules, meeting expected overall operating margin levels and controlling general and administrative costs.

The Company is thus faced with uncertainties that may have an impact on future operating results and liquidity. These uncertainties include 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 including accessing liquidities from China if events or conditions develop that are not consistent with management’s expectations, key budget assumptions for 2016 and planned courses of action. Therefore, the Company may require additional external funding, and there is no assurance that it would be successful. 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.

Condensed Interim Consolidated Statements of Cash Flows

For the three-month period ended March 31, 2016 and 2015 (Unaudited)

(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, 2015, 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 30, 2016.

3 Property, plant and equipment

	Machinery and equipment	Office furniture and equipment	Computer s	Moulds	Vehicle s	Total
Cost						
Balance at December 31, 2015	548,952	156,537	275,690	176,944	35,984	1,194,107
Additions	-	-	450	-	-	450
Effect of movements in exchange rates	(10,178)	(5,661)	(8,487)	(6,189)	-	(30,515)
Balance at March 31, 2016	538,774	150,876	267,653	170,755	35,984	1,164,042
Accumulated depreciation						
Balance at December 31, 2015	342,427	127,067	245,528	120,706	35,984	871,712
Depreciation	12,723	3,517	4,061	4,417	-	24,718
Effect of movements in exchange rates	(6,276)	(5,259)	(7,697)	(5,773)	-	(25,005)
Balance at March 31, 2016	348,874	125,325	241,892	119,350	35,984	871,425
Carrying Amount						
At December 31, 2015	206,525	29,470	30,162	56,238	-	322,395
At March 31, 2016	189,900	25,551	25,761	51,405	-	292,617

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Cash Flows

For the three-month period ended March 31, 2016 and 2015 (Unaudited)

(expressed in Canadian dollars)

4 Intangible assets and goodwill

	Other	Internally generated	
	Software	Development costs	Total intangible assets
	\$	\$	\$
Cost			
Balance at December 31, 2015	313,653	298,485	612,138
Additions	-	-	-
Effect of movements in exchange rates	(8,610)	-	(8,610)
Balance at March 31, 2016	305,043	298,485	603,528
Accumulated amortization			
Balance at December 31, 2015	282,618	88,737	371,355
Amortization for the year	3,198	14,924	18,122
Effect of movements in exchange rates	(7,083)	-	(7,083)
Balance at March 31, 2016	278,733	103,661	382,394
Carrying amount			
At December 31, 2015	31,035	209,748	240,783
At March 31, 2016	26,310	194,824	221,134

Amortization of \$18,122 (2015 - \$38,480) is included in the consolidated statement of income (loss): \$3,094 (2015 - \$2,604) in 'cost of goods sold' and \$15,028 (2015 - \$35,876) in 'selling and administrative expenses'.

5 Bank loan

The Company has access to credit facilities in the amount of \$750,000 with Toronto-Dominion Bank of Canada which are guaranteed by Export Development Canada, and bear interest at the Toronto-Dominion's prime rate plus 2.5% per annum and are limited by certain margin requirements concerning trade and other receivables. These credit facilities were used up to \$645,000 as at March 31, 2016.

The credit facilities are secured by a first ranking hypothec of \$2,000,000 on all movable property of the Company and are renewable annually.

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Cash Flows

For the three-month period ended March 31, 2016 and 2015 (Unaudited)

(expressed in Canadian dollars)

6 Obligation arising from shares issued by a subsidiary

In September 2015, as a result of a Sino-foreign equity joint venture agreement, Xebec Adsorption (Shanghai) Co. Ltd., a subsidiary of Xebec Adsorption Inc. (“Xebec”), issued 1,714,285 common shares, representing a 30% participation, to Shanghai Chengyi New Energy Venture Capital Co. Ltd. (28.26%), an investment subsidiary of Shanghai based Shenergy Group, Shanghai Zhiyi Enterprise Management Consulting Co. Ltd. (0.1%) and Shanghai Liuhuan Investment Co. Ltd. (1.64%), a company held by a group of employees of Xebec Adsorption (Shanghai) Co. Ltd., (collectively the “Minority Shareholders”) for a net cash consideration of \$3,423,075 (RMB 16,370,515).

Pursuant to this agreement, Xebec has the obligation to repurchase the Minority Shareholders’ interest in Xebec Adsorption (Shanghai) Co. Ltd., for a consideration of no less than the initial investment and annualized return of 10% if a) the achievement of specific financial targets were not achieved in any given year prior to December 31, 2020, or b) should the Minority Shareholders not divest by December 31, 2020 and should the Minority Shareholders exercise their put option with respect to a) or b) as mentioned above.

Xebec recorded the proceeds from this transaction, as a financial liability in these consolidated financial statements. The obligation to repurchase and the related annualized return is presented under “Obligation arising from shares issued by a subsidiary”. The conversion of the financial liability denominated in the functional currency of our subsidiary Xebec Adsorption (Shanghai) Co. Ltd. (RMB) will be converted at the exchange rate at the end of each reporting period with gain and losses presented in the statement of income under “Gain/Loss on conversion of shares issued by a subsidiary”.

	Q1-2016
	\$
Balance – Beginning of year	3,583,808
Accretion interest	87,714
Effect of exchange rate change on obligation	(206,960)
Balance – End of period	3,464,562
Current portion	-
	<u>3,464,562</u>

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Cash Flows

For the three-month period ended March 31, 2016 and 2015 (Unaudited)

(expressed in Canadian dollars)

7 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, 2016	For the three- month ended March 31, 2015
		\$
Net loss attributable to owners of the parent	(1,057,247)	(53,630)
Weighted average number of common shares in issue	<u>39,363,867</u>	<u>39,363,867</u>
	<u>(\$0.03)</u>	<u>(\$0.00)</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.

Condensed Interim Consolidated Statements of Cash Flows

For the three-month period ended March 31, 2016 and 2015 (Unaudited)

(expressed in Canadian dollars)

8 Expenses by nature

	For the three- month ended March 31, 2016	For the three- month ended March 31, 2015
	\$	\$
Salaries	1,305,089	1,318,532
Material	1,193,085	1,357,726
Rent and repairs and maintenance	212,463	140,292
Professional fees	182,133	142,866
Travel expenses	134,379	160,599
Subcontracts cost	62,269	53,728
Stock-based compensation	48,558	13,606
Amortization	42,840	66,771
Office expenses	37,214	170,054
Other	69,430	42,727
	<u>3,287,460</u>	<u>3,466,901</u>

9 Finance expenses

	For the three- month ended March 31, 2016	For the three- month ended March 31, 2015
	\$	\$
Interest and bank charges	10,495	9,852
Accretion and revaluation of government royalty program obligation (note 6)	8,739	6,431
Accretion of the obligation arising from shares issued by a subsidiary	87,714	-
Interest charges	14,492	7,305
Interest on long-term debt	-	54
	<u>121,440</u>	<u>23,642</u>

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Cash Flows

For the three-month period ended March 31, 2016 and 2015 (Unaudited)

(expressed in Canadian dollars)

10 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, 2016 \$	For the three-month ended March 31, 2015 \$
Decrease (increase) in assets:		
Trade and other receivables	323,695	(320,204)
Inventories	(372,492)	171,394
Investment tax credits receivable	69,723	-
Other current assets	(26,794)	(10,636)
Increase (decrease) in liabilities:		
Trade payables	(528,119)	(62,994)
Accrued liabilities	165,452	147,510
Deferred revenues	(24,111)	(112,580)
Other operating liabilities	(14,122)	11,502
	<u>(406,768)</u>	<u>(176,008)</u>

11 Related party transactions

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

	For the three- month ended March 31, 2016 \$	For the three- month ended March 31, 2015 \$
Marketing and professional services expenses paid to a company controlled by a member of the immediate family of an officer	27,385	26,980
Sales to entities controlled by a subsidiary manager	-	638,101

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

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Cash Flows

For the three-month period ended March 31, 2016 and 2015 (Unaudited)

(expressed in Canadian dollars)

12 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:

	For the three-month ended March 31, 2016	For the three-month ended March 31, 2015
	\$	\$
Revenue		
United States	1,010,344	950,403
Canada	701,108	779,753
Singapore	332,740	637,494
China	140,621	456,617
Other	268,754	272,424
	<hr/> 2,453,567	<hr/> 3,096,691

Revenue summarized by product line is as follows:

	For the three-month ended March 31, 2016	For the three-month ended March 31, 2015
	\$	\$
Product line		
Purification	1,181,297	2,091,542
Filtration	1,272,270	1,005,149
Generation	-	-
	<hr/> 2,453,567	<hr/> 3,096,691

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Cash Flows

For the three-month period ended March 31, 2016 and 2015 (Unaudited)

(expressed in Canadian dollars)

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

	For the three- month ended March 31, 2016 \$	For the three- month ended March 31, 2015 \$
Customer A	321,000	587,737
Customer B	330,389	-

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

	March 31, 2016 \$	December 31, 2015 \$
Non-current assets		
Canada	398,481	431,173
Asia	111,241	127,353
United States	4,029	4,652
	<u>513,751</u>	<u>563,178</u>

13 Subsequent events

In April 2016, the Company obtained a new guarantee facility amounting to \$750,000 with Toronto-Dominion Bank, guaranteed by Export Development Canada and secured by a first ranking hypothec of \$2,000,000 on all movable property of the Company and is renewable annually.