

# **Xebec Adsorption Inc.**

Condensed Interim Consolidated Financial Statements  
(Unaudited – Prepared by Management)

**For the three-month period ended March 31, 2018  
and 2017**

(expressed in Canadian dollars)

These Unaudited Condensed Interim Consolidated Financial Statements have not  
been subject to a review by our independent Auditors.

# Xebec Adsorption Inc.

## Condensed Interim Consolidated Statements of Financial Position (Unaudited)

As at

(expressed in Canadian dollars)

	March 31 2018 \$	December 31 2017 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash	1,114,656	1,341,121
Trade and other receivables	4,305,012	4,133,259
Inventories	2,159,884	1,963,392
Investment tax credits receivable	15,943	15,943
Other current assets	215,661	260,157
<b>Total current assets</b>	<u>7,811,156</u>	<u>7,713,872</u>
<b>Non-current assets</b>		
Property, plant and equipment (Note 3)	215,524	208,632
Intangible assets (Note 4)	446,290	418,363
<b>Total non-current assets</b>	<u>661,814</u>	<u>626,995</u>
<b>Total assets</b>	<u>8,472,970</u>	<u>8,340,867</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank loan (Note 5)	310,000	-
Credit facility (Note 6)	1,321,112	1,437,912
Trade, other payables and accrued liabilities	3,709,044	3,585,755
Deferred revenue	1,425,939	720,996
Current portion of long-term debt (Note 7))	17,133	22,236
Current portion of government royalty program obligation (Note 7))	91,681	86,826
Current portion of provisions	13,944	16,689
<b>Total current liabilities</b>	<u>6,888,853</u>	<u>5,870,414</u>
<b>Non-current liabilities</b>		
Long-term debt (Note 7 a))	2,280,099	2,223,478
Government royalty program obligation (Note 7 b))	487,703	504,546
Obligation arising from shares issued by a subsidiary (Note 8)	4,245,551	3,912,314
Deferred rent	132,994	132,815
Provisions	9,104	5,601
Deferred tax liabilities	81,989	81,989
<b>Total non-current liabilities</b>	<u>7,237,440</u>	<u>6,860,743</u>
<b>Total liabilities</b>	<u>14,126,293</u>	<u>12,731,157</u>
<b>Equity</b>		
Share capital (Note 9)	19,703,836	19,703,836
Contributed surplus	3,434,681	3,339,740
Equity component of convertible debentures	291,389	291,389
Accumulated other comprehensive loss	(1,035,378)	(1,049,455)
Deficit	(28,047,851)	(26,675,800)
<b>Total equity</b>	<u>(5,653,323)</u>	<u>(4,390,290)</u>
<b>Total liabilities and equity</b>	<u>8,472,970</u>	<u>8,340,867</u>

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) Joseph Petrowski Director

# Xebec Adsorption Inc.

## Condensed Interim Consolidated Statements of Income (loss)

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

	<b>2018</b>	<b>2017</b>
	<b>\$</b>	<b>\$</b>
<b>Revenue</b> (Note 15)	3,214,808	3,310,909
<b>Cost of goods sold</b>	<u>2,434,392</u>	<u>1,877,438</u>
<b>Gross margin</b>	<u>780,416</u>	<u>1,433,471</u>
Research and development expenses	8,547	12,601
Selling and administrative expenses	1,514,101	990,758
Foreign exchange loss	82,020	73,875
Gain (loss) on conversion of shares issued by a subsidiary (Note 8)	<u>250,985</u>	<u>(344,256)</u>
	<u>1,855,653</u>	<u>732,978</u>
Operating income (loss)	<u>(1,075,237)</u>	<u>700,493</u>
<b>Other charge (income)</b>		
Finance income	(320)	(116,203)
Finance expenses (Note 12)	<u>297,134</u>	<u>244,646</u>
	<u>296,814</u>	<u>128,443</u>
<b>Income (loss) before income taxes</b>	(1,372,051)	572,050
Income taxes	<u>-</u>	<u>-</u>
<b>Net income (loss) for the period</b>	<u>(1,372,051)</u>	<u>572,050</u>
<b>Net income (loss) per share</b>		
Basic net income (loss) per share	<u>(0.03)</u>	<u>0.01</u>

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)  
(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

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	<b>2018</b> \$	<b>2017</b> \$
<b>Net income (loss) for the period</b>	(1,372,051)	572,050
<b>Other comprehensive income (loss)</b>		
Cumulative translation adjustment	<u>14,077</u>	<u>(173,739)</u>
<b>Comprehensive income (loss) for the period</b>	<u>(1,357,974)</u>	<u>398,311</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)

As at March 31, 2018 and December 31, 2017

(expressed in Canadian dollars)

	Number					Amount	
	Common shares	Share capital – Common shares \$	Contributed surplus \$	Accumulated other comprehensive income (loss) \$	Deficit \$	Equity Component of convertible debentures \$	Total \$
<b>Balance – January 1, 2017</b>	39,363,867	19,318,856	2,996,621	(940,216)	(26,772,552)	150,304	(5,246,987)
Net income for the period	-	-	-	-	96,752	-	96,752
Other comprehensive loss	-	-	-	(109,239)	-	-	(109,239)
Comprehensive loss for the period	-	-	-	(109,239)	96,752	-	(12,487)
Stock-based compensation expense	-	-	372,603	-	-	-	372,603
Issuance of convertible debentures (net of deferred tax liability of \$ 81,989)	-	-	-	-	-	186,177	186,177
Share issued from the exercise of options	1,140,500	88,535	(29,484)	-	-	-	59,051
Stock-based compensation expense (Note 10)	2,000,000	296,445	-	-	-	(45,092)	251,353
<b>Balance – December 31, 2017</b>	42,504,367	19,703,836	3,339,740	(1,049,455)	(26,675,800)	291,389	(4,390,290)
<b>Balance – January 1, 2018</b>	42,504,367	19,703,836	3,339,740	(1,049,455)	(26,675,800)	291,389	(4,390,290)
Net loss for the period	-	-	-	-	(1,372,051)	-	(1,372,051)
Other comprehensive income	-	-	-	14,077	-	-	14,077
Comprehensive loss for the period	-	-	-	14,077	(1,372,051)	-	(1,357,974)
Stock-based compensation (Note 10)	-	-	94,941	-	-	-	94,941
<b>Balance – March 31, 2018</b>	42,504,367	19,703,836	3,434,681	(1,035,378)	(28,047,851)	291,389	(5,653,323)

*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.

## Condensed Interim consolidated Statements of Cash Flows (Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

	2018	2017
	\$	\$
<b>Cash flows from</b>		
<b>Operating activities</b>		
Net income (loss) for the period	(1,372,051)	572,050
Items not affecting cash		
Depreciation of property, plant and equipment (Note 3)	20,362	24,699
Amortization of intangible assets (Note 4)	31,243	20,540
Reversal of inventory write-down	(45,201)	-
Government grant	-	(1,250)
Accretion finance expenses and gain on revaluation of government royalty program obligation (Note 7b))	7,012	(113,237)
Accretion of the obligation arising from shares issued by a subsidiary (Note 8)	82,252	431,697
Accretion of convertible debentures (Note 7 a))	57,870	38,602
Stock-based compensation expense (Note 10)	94,941	-
Reversal of trade payables	-	(346,816)
Deferred rent	179	6,596
	<u>(1,123,393)</u>	<u>632,881</u>
Change in non-cash working capital balances related to operations (Note 13)	<u>550,444</u>	<u>(2,201,927)</u>
	<u>(572,949)</u>	<u>(1,569,046)</u>
<b>Investing activities</b>		
Acquisition of property, plant and equipment	(23,113)	(8,958)
Acquisition of intangible assets	(57,978)	-
	<u>(81,091)</u>	<u>(8,958)</u>
<b>Financing activities</b>		
Increase (decrease) of bank loan	310,000	(110,000)
Increase (decrease) of credit facility (Note 10)	(116,800)	1,990,000
Proceeds from issuance of share capital (Note 17)	-	5,000
Repayment of long-term debt	(6,352)	(211)
Repayment of government royalty program obligation (Note 13b))	(19,000)	(30,000)
	<u>167,848</u>	<u>1,854,789</u>
<b>Net increase (decrease) in cash and cash equivalent during the period</b>	<u>(486,192)</u>	<u>276,785</u>
<b>Cash and cash equivalent – Beginning of period</b>	<u>1,341,121</u>	<u>1,088,592</u>
Effect of exchange rate changes on cash	<u>259,727</u>	<u>(545,845)</u>
<b>Cash and cash equivalent – End of period</b>	<u>1,114,656</u>	<u>819,532</u>
<b>Additional information</b>		
Interest paid	150,000	64,240

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)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

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### 1 Nature of business and liquidity risk

#### 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. The Company’s web site address is [www.xebec.com](http://www.xebec.com).

#### b) Going concern

The condensed interim consolidated financial statements have been prepared on the basis of the going concern assumption, meaning that the Company will be able to realize its assets and discharge its liabilities in the normal course of operations. The Company has realized an operating loss of (\$1,372,051) (an operating income of \$572,050 in 2017), had cash outflows from operations of \$ 572,949 for the three-month period ended March 31, 2018 (\$1,569,046 in 2017) , finished the period with cash amounting to \$1,114,656 (\$819,532 in 2017) and a working capital of \$922,303 (a negative working capital of \$117,563 in Q1, 2017) and had access to credit facilities totalling \$750,000 of which \$310,000 (\$645,000 in Q1, 2017) has been used (see Note 5). During the quarter, 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 2018 for which management believes the assumptions are reasonable. Achieving budgeted results is dependent on improving the volume of revenues, 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. 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 2018 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.**

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

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## **2 Summary of significant accounting policies**

### **Basis of presentation**

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 statements, and should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2017, as they follow the same accounting policies and methods of application, unless otherwise indicated.

### **Basis of consolidation**

These condensed interim consolidated financial statements include the accounts of the Company and its subsidiaries. Subsidiaries are entities controlled by the Company. Control is achieved when the Company:

- has power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Company has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Company considers all relevant facts and circumstances in assessing whether or not the Company's voting rights in an investee are sufficient to give it power, including:

- the size of the Company's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Company, other vote holders or other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Company has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

Intercompany transactions, balances and unrealized gains and losses on transactions between different entities within the Company are eliminated. Subsidiaries comprise Xebec Adsorption (Shanghai) Co.



# **Xebec Adsorption Inc.**

## **Notes to Condensed Interim Consolidated Financial Statements**

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

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(expressed in Canadian dollars)

Ltd., which is 70% owned, Xebec Adsorption USA Inc. (Houston) and Xebec Adsorption Europe SARL which are wholly owned. Subsidiaries are fully consolidated from the date on which control is obtained by the Company and are deconsolidated from the date that control ceases. The Company has the obligation to repurchase the Minority Shareholders' interest owned in Xebec Adsorption (Shanghai) Co. Ltd. under certain circumstances (see Note 8). Therefore, the accounts of Xebec Adsorption (Shanghai) Co. Ltd. are consolidated at 100% and the Minority Shareholders' interest is presented as a financial liability in these consolidated financial statements.

Changes in the Company's ownership interests in subsidiary that do not result in the Company losing control over the subsidiaries are accounted for as equity transactions or liability transactions depending on the conditions that these changes occurred. The carrying amounts of the Company's interests are adjusted to reflect the changes in their relative interests in the subsidiaries.

### **Foreign currency translation**

Functional and presentation currency:

Items included in the condensed interim financial statements of each entity consolidated in the Company group are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The condensed interim consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

The condensed interim financial statements of entities that have a functional currency different from that of the Company (foreign operations) are translated into Canadian dollars as follows: assets and liabilities – at the closing rate at the date of the statement of financial position, and income and expenses – at the average rate of the year (to the extent this is considered a reasonable approximation to actual rates). All resulting changes are recognized in other comprehensive income (loss) as cumulative translation adjustment.

### **Revenues from Contracts with Customers**

Since January 1, 2018, the Company is following IFRS 15. There is no material impact of this standard on its condensed interim consolidated financial statements.

### **Financial Instruments**

Since January 1, 2018, the Company is following IFRS 9. There is no material impact of this standard on its condensed interim consolidated financial statements.

# **Xebec Adsorption Inc.**

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

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(expressed in Canadian dollars)

### **Segment reporting**

The Company have many product lines classified into three segments according to the technology, the products functionalities and uses.

Clean Technology allows delivering of renewable gas for the production of fuel for a wide variety of applications, from fuel cells to the replacement of fossil fuels in transportation.

Industrial Compressed Air and Gas Treatment uses filtration technology to separate liquid droplets, particles or solid contaminants, and oil vapor out of air and gas flows. This segment distributes many types of Airdryers and provides OEM replacement parts and maintenance for aftermarket.

Oil and Gas segment focus on the commercialization of innovative membrane technology.

### **Accounting standards issued but not yet applied that have relevance to the Company**

In January 2016, IASB issued IFRS 16, “Leases”, which specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16’s approach to lessor accounting substantially unchanged from its predecessor, IAS 17. The standard will be mandatory for annual periods beginning on or after January 1, 2019. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

### 3 Property, plant and equipment

	Machinery and equipment <sup>(1)</sup>	Office furniture and equipment	Computers <sup>(1)</sup>	Moulds	Vehicles	Leasehold improvements	Total
	\$	\$	\$	\$	\$	\$	\$
<b>Cost</b>							
Balance at December 31, 2016	577,892	147,712	270,845	166,577	35,984	-	1,199,010
Additions	5,431	6,951	13,728	-	-	-	26,110
Effect of movements in exchange rates	(3,192)	(1,761)	550	(103)	-	-	(4,506)
Balance at December 31, 2017	580,131	152,902	285,123	166,474	35,984	-	1,220,614
Additions	-	-	2,663	-	-	20,450	23,113
Effect of movements in exchange rates	11,543	5,585	9,249	6,292	-	-	32,669
Balance at March 31, 2018	591,674	158,487	297,035	172,766	35,984	20,450	1,276,396
<b>Accumulated depreciation</b>							
Balance at December 31, 2016	381,738	128,906	249,450	128,394	35,984	-	924,472
Depreciation	46,208	9,154	15,224	16,998	-	-	87,584
Effect of movements in exchange rates	(72)	(387)	510	(125)	-	-	(74)
Balance at December 31, 2017	427,874	137,673	265,184	145,267	35,984	-	1,011,982
Depreciation	10,693	2,155	3,600	3,330	-	584	20,362
Effect of movements in exchange rates	7,988	5,419	8,827	6,294	-	-	28,528
Balance at March 31, 2018	446,555	145,247	277,611	154,891	35,984	584	1,060,872
<b>Carrying Amount</b>							
At December 31, 2017	152,257	15,229	19,939	21,207	-	-	208,632
At March 31, 2018	145,119	13,240	19,424	17,875	-	19,866	215,524

Depreciation of \$20,362 (2017 – \$23,746) is included in the consolidated statement of income (loss) for the three-month periods ended in March 31: \$14,743 (2017 – \$18,444) in cost of goods sold; and \$5,619 (2017 – \$5,302) in selling and administrative expenses.

Property, plant and equipment are pledged as security for the credit facilities (see Notes 5 and 6))

(1) including equipment under finance lease. The cost of equipment under finance lease amount to \$55,489 (\$45,988 in 2017) and the accumulated depreciation amount to \$2,177 (\$1,131 in 2017).

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

### 4 Intangible assets

	Other	Internally generated		Total intangible assets \$
	Software \$	Development costs \$	Engineering standardisation \$	
<b>Cost</b>				
Balance at December 31, 2016	327,192	298,975	-	626,167
Additions	-	2,084	306,618	308,702
Effect of movements in exchange rates	10,203	-	-	10,203
Balance at December 31, 2017	337,395	301,059	306,618	945,072
Additions	-	-	57,978	57,978
Effect of movements in exchange rates	11,177	-	-	11,177
Balance at March 31, 2018	348,572	301,059	364,596	1,014,227
<b>Accumulated amortization</b>				
Balance at December 31, 2016	286,990	148,434	-	435,424
Amortization for the year	20,629	59,696	-	80,325
Effect of movements in exchange rates	10,927	33	-	10,960
Balance at December 31, 2017	318,546	208,163	-	526,709
Amortization for the year	4,572	15,053	11,618	31,243
Effect of movements in exchange rates	9,985	-	-	9,985
Balance at March 31, 2018	333,103	223,216	11,618	567,937
<b>Carrying amount</b>				
At December 31, 2017	18,849	92,896	306,618	418,363
At March 31, 2018	15,469	77,843	352,978	446,290

Amortization of \$31,243 (2017 – \$20,297) is included in the consolidated statement of income (loss) for the three-month periods ended March 31: \$16,190 (2017 – \$5,269) in cost of goods sold; and \$15,053 (2017 – \$15,028) in selling and administrative expenses.

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

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### 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 3.0%, (6.45% in 2018) (5.7% in Q1, 2017) per annum and are limited by certain margin requirements concerning trade and other receivables. These credit facilities were used up to \$310,000 as at March 31, 2018 (2017 – nil).

The credit facilities are secured by a first ranking hypothec of \$5,000,000 on all movable property of the Company and are renewable annually.

The company has a guarantee facility of \$750,000 with Toronto-Dominion Bank of Canada.

### 6 Credit Facility

On December 12, 2016, the Company contracted a facility loan with Export Development Canada ("EDC") for an amount of \$2,000,000. This amount is available in four advances. The facility bears an interest of prime rate plus 6.3% (9.75% in 2018). This interest is payable every month. This amount shall be repaid based on the completion of certain project milestones.

The facility loan is secured by a second ranking hypothec in all present and future movable property of the Company.

The following table summarizes the activity related to the facility with EDC during the period ended:

	<b>March 31, 2018</b>	December 31, 2017
	\$	\$
Balance – Beginning of period	1,437,912	-
Addition	-	2,000,000
Repayment	(116,800)	(562,088)
Balance – End of period	<u>1,321,112</u>	<u>1,437,912</u>

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

### 7 Long-term debt

a) Loans

	As at March 31, 2018 \$	As at December 31, 2017 \$
Obligation under a capital lease, repayable in monthly instalments of \$1,607 including interest calculated at 13% maturing in October 2018, secured by equipment under finance lease.	13,478	18,669
Obligation under a capital lease, repayable in monthly instalments of \$352 including interest calculated at 12% maturing in September 2020, secured by equipment under finance lease.	9,315	10,475
Unsecured Convertible debentures	2,274,439	2,216,570
Long-term debt	2,297,232	2,245,714
Less: Current portion	17,133	22,236
	<u>2,280,099</u>	<u>2,223,478</u>

On November 16, 2017, the Company has completed an Unsecured Convertible Debentures (“Debentures”) financing for aggregate gross proceeds of \$2,024,149. The Debentures will reach maturity on November 15, 2019 and bearing an annual interest rate of 8%, convertible into common shares of the Company at a price of \$0.65 per share. The unpaid interests are convertible at the highest price of \$0.65 per common share or the fair value of the common share at the request of the debenture holder.

The Company used the residual value method to allocate the principal amount of the Debenture between the liability and the equity component. Under this method, the value of the equity component of \$86,177 (net of deferred tax liability of \$81,989) was determined by deducting the fair value of the liability component from the principal amount of the financing. The fair value of the liability component was \$1,626,594 computes as the present value of future principal and interest payments discounted at a rate of 17.50%. The effective interest method is used to measure the Debenture after the initial recognition.

On November 30, 2016, the Company has completed an Unsecured Convertible Debentures (“Debentures”) financing for aggregate gross proceeds of \$1,000,000. The Debentures will reach maturity on November 30, 2019 and bearing an annual interest rate of 9%, convertible into common shares of the Company at a price of \$0.15 per share. The unpaid interests are convertible

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

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at the highest price of \$0.15 per common share or the fair value of the common share at the request of the debenture holder.

The Company used the residual value method to allocate the principal amount of the Debenture between the liability and the equity component. Under this method, the value of the equity component of \$150,304 (net of deferred tax liability of \$59,316) was determined by deducting the fair value of the liability component from the principal amount of the financing. The fair value of the liability component was \$790,380 computed as the present value of future principal and interest payments discounted at a rate of 19.50%. The effective interest method is used to measure the Debenture after the initial recognition.

### b) Government royalty program obligation

In 2012, the Company signed a settlement agreement with Technology Partnership Canada (TPC) with regard to the Company's Fast Cycle Pressure Swing Adsorption and Gas Management systems and Pulsar Pressure Swing Adsorption project. The Company had to pay \$250,000 at the execution of the agreement and \$1,000,000 spread over four equal annual non-interest bearing payments, starting on January 31, 2013. Furthermore, the Company was liable to pay up to \$750,000 in contingent payments based on proceeds from the sale by the Company of its intellectual property. Upon closing of the transaction, the Company paid \$540,000 out of the \$750,000 total contingent-based payments. On October 23, 2012, the Company accrued another \$150,000 out of the \$750,000 total contingent based payments, following additional proceeds received, leaving a potential maximum amount to be paid of \$60,000 as at December 31, 2012.

In 2013, the Company realized the last milestone pursuant to the transaction and paid the remaining \$60,000. The Company renegotiated its payments terms with TPC, changing from an annual payment of \$250,000 to monthly payments of \$24,500 but adding an extra year to term.

In February 2017, a new amendment to this agreement was reached changing the preceding payments terms from monthly payments of \$24,500 to monthly payments of:

- \$29,505 upon execution including interest
- \$5,000 starting from March 1, 2017 to January 1, 2018
- \$7,000 starting from February 1, 2018 to January 1, 2019
- \$8,000 starting from February 1, 2019 to January 1, 2020
- \$10,000 starting from February 1, 2020 to January 1, 2021
- \$15,000 starting from February 1, 2021 to October 1, 2022
- \$20,000 on November 1, 2022 and December 1, 2022
- And the balance of \$22,540 on January 1, 2023.

The following table summarizes the activity related to the government royalty program obligation during the period ended:

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

	<b>March 31, 2018</b>	December 31, 2017
	<b>\$</b>	<b>\$</b>
Balance – Beginning of period	591,372	757,540
Gain on revaluation of government royalty program	-	(117,095)
Accretion finance expenses	7,012	25,927
Repayment	(19,000)	(75,000)
Balance – End of period	579,384	591,372
Current portion	(91,681)	(86,826)
	<u>487,703</u>	<u>504,546</u>

The carrying amount of the government royalty program obligation has been calculated by discounting the future cash flows at a 5% interest rate.

### 8 Obligation arising from shares issued by 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 (loss) under “Gain/Loss on conversion of shares issued by a subsidiary”.



# Xebec Adsorption Inc.

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(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

	<b>March 31, 2018</b>	December 31, 2017
	<b>\$</b>	<b>\$</b>
Balance – Beginning of period	3,912,314	3,582,135
Accretion interest	82,252	332,537
Effect of exchange rate change on obligation	250,985	(2,358)
Balance – End of period	<u>4,245,551</u>	<u>3,912,314</u>

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

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(expressed in Canadian dollars)

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### 9 Share Capital

a) The Company is incorporated under the Canada Business Corporations Act, and its authorized share capital consists of an unlimited number of common shares, without par value.

b) Share purchase warrants

There were no warrants issued in 2018 and 2017.

c) Income (loss) per share

i) Basic

Basic income (loss) per share is calculated using net income (loss) as the numerator and the weighted average number of shares as denominator. No adjustments to net income were necessary in 2018 and 2017.

	<b>2018</b>	<b>2017</b>
Net income (loss) attributable to shareholders of the Company	(1,372,051)	572,050
Weighted average number of shares used in basic income per share	<u>42,504,367</u>	<u>39,437,200</u>
Basic income (loss) per share	<u>(0.03)</u>	<u>0.01</u>

ii) Diluted

For the periods ended March 31, 2018 and 2017, convertible debentures and outstanding stocks options would have been anti-dilutive.

### 10 Stock options

The stock option plan allowed for the issuance of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards and other stock-based awards. Under the Plan, a fixed number of 7,892,773 common shares are available for grant. As at March 31, 2018, the maximum number of common shares available for issuance under all stock-based compensation arrangements is 2,078,743

Under the terms of the Xebec Adsorption Stock Option Plan, stock options are granted with an exercise price not less than the volume-weighted average trading price of the common shares for the five trading days prior to the date of grant. The terms and conditions for acquiring and exercising options are set by the Board of Directors. Stock options for employees vest no less than at grant date and no more than quarterly.

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

Stock option activity for the period ended March 31, is presented below:

	2018		2017	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Outstanding – Beginning of period	7,829,030	0.19	5,855,337	0.11
Granted	-	-	-	-
Exercised	-	-	(100,000)	0.05
Cancelled	(2,015,000)	-	-	-
Expired	-	-	-	-
Outstanding – End of period	5,814,030	0.21	5,755,337	0.11
Exercisable – End of period	4,588,169	0.14	5,755,337	0.11

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

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(expressed in Canadian dollars)

As at March 31, 2018, options outstanding and exercisable are as follows:

Expiry date	Weighted-Average Exercise Price	Number of Options Outstanding	Weighted-Average Remaining life	Number of Options exercisable
August 11, 2018	\$0.22	227,272	0.4	227,272
December 22, 2018	\$0.10	1,519,500	0.7	1,519,500
June 12, 2020	\$0.16	258,065	2.2	258,065
April 25, 2021	\$0.15	100,000	3.1	100,000
May 29, 2021	\$0.14	200,000	3.2	200,000
December 19, 2022	\$0.55	400,000	4.8	-
January 7, 2023	\$0.05	400,000	4.8	400,000
March 5, 2024	\$0.18	2,098,193	5.9	1,883,332
August 29, 2024	\$0.49	500,000	6.4	-
December 19, 2024	\$0.55	111,000	6.7	-
	<b>\$0.21</b>	<b>5,814,030</b>	<b>3.9</b>	<b>4,588,169</b>

As at March 31, 2017, options outstanding and exercisable are as follows:

Exercise price range \$	Options outstanding			Options exercisable	
	Number of options	Weighted average contractual life (years)	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
0.05 – 0.10	2,960,000	3.71	0.08	2,960,000	0.08
0.12 – 0.16	2,558,065	4.09	0.13	2,558,065	0.13
0.22	237,272	1.36	0.22	237,272	0.22
	<b>5,755,337</b>	<b>3.78</b>	<b>0.11</b>	<b>5,755,337</b>	<b>0.11</b>

On March 5, 2017, the Company granted 2,108,193 stock options to directors, officers and employees. The options are exercisable at \$0.18 per share, and expire on March 5, 2024. The options are subject to vesting criteria such that 1,095,000 shall vest on the grant date, 795,000 shall vest on March 5, 2018 and 218,193 shall vest on March 5, 2019. The grant of these stock options

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

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(expressed in Canadian dollars)

was conditional to the approval of the increase of the pool of the stock options of the Company by the shareholders at the Annual General Meeting and the TSX Venture Exchange. These approvals were obtained respectively on June 15, 2017 and August 9, 2017. The corresponding stock-based compensation amounted to \$354,118, which was estimated using the Black-Scholes Option Pricing Model with the following assumptions:

Risk-free interest rate	1.55%
Annualized volatility <sup>1</sup>	137%
Share price	\$0.18
Dividend rate	0.00%
Expected life of options	7 years

On August 29, 2017, the Company granted 500,000 stock options to an employee. The options are exercisable at \$0.49 per share, and expire on August 29, 2024. The options are subject to vesting criteria such that 20% shall vest on the first anniversary date and 20% shall vest every twelve months thereafter. The corresponding stock-based compensation amounted to \$227,026, which was estimated using the Black-Scholes Option Pricing Model with the following assumptions:

Risk-free interest rate	1.80%
Annualized volatility <sup>1</sup>	138%
Share price	\$0.49
Dividend rate	0.00%
Expected life of options	7 years

On December 19, 2017, the Company granted 511,000 stock options to directors. The options are exercisable at \$0.55 per share. 400,000 expire on December 19, 2022 and 111,000 expire on December 19, 2024. The options are subject to vesting criteria such that 33% shall vest on the first anniversary date and 33% shall vest every twelve months thereafter. The corresponding stock-based compensation amounted to \$252,250, which was estimated using the Black-Scholes Option Pricing Model with the following assumptions:

Risk-free interest rate	1.57%
Annualized volatility <sup>1</sup>	140%
Share price	\$0.55
Dividend rate	0.00%
Expected life of options	5 years

and,

<sup>1</sup> The expected volatility used was based on the historic volatility of the Company share price

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

Risk-free interest rate	1.77%
Annualized volatility <sup>1</sup>	138%
Share price	\$0.55
Dividend rate	0.00%
Expected life of options	7 years

In 2016, 1,100,000 options were granted to employees at weighted average fair value of \$0.05 and 400,000 options were granted to non-employees at a weighted average fair value of \$0.05.

During the three-month periods ended in March 31, the Company expensed \$94,941 (2017 – \$ -) which totally relates to stock options granted in 2017.

### 11 Expenses by nature

For the three-month periods ended:

	March 31, 2018 \$	March 31, 2017 \$
Employee salaries and benefits	1,626,318	1,213,772
Material	1,291,027	1,084,927
Subcontract cost	134,627	65,839
Professional fees	252,298	133,077
Rent and repairs and maintenance	210,121	230,407
Travel expenses	149,869	113,362
Stock-based compensation	94,941	-
Office expense	85,155	48,603
Amortization and depreciation	51,605	44,042
Advertising	65,050	21,685
Other	(8,616)	(17,729)
Bad Debt	(3,902)	(15,563)
Reversal of trade payables	-	(54,226)
	<u>3,948,493</u>	<u>2,868,196</u>

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

### 12 Finance expenses

For the three-month periods ended:

	March 31, 2018 \$	March 31, 2017 \$
Accretion of the obligation arising from shares issued by a subsidiary	82,252	431,697
Interest on convertible debentures	114,392	38,602
Interest and bank charges	25,395	25,129
Interest on short term debt	67,837	37,950
Accretion and revaluation of government royalty program obligation (Note 13b))	7,012	3,858
Interest on long term debt	246	-
Reversal of trade payables	-	(292,590)
	<u>297,134</u>	<u>244,646</u>

### 13 Supplemental Cash flow information

For the three-month periods ended March 31, net change in non-cash working capital balances related to operations consists of the following:

	2018 \$	2017 \$
Decrease (increase) in assets:		
Trade and other receivables	(171,753)	(1,196,859)
Inventories	(151,290)	(129,423)
Investment tax credits receivable	-	46,126
Other current assets	44,496	98,604
Increase (decrease) in liabilities:		
Trade payables, other payables and accrued liabilities	123,289	(499,718)
Deferred revenues	704,943	(408,888)
Provisions	759	(111,769)
	<u>550,444</u>	<u>(2,201,927)</u>

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

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### 14 Related party transactions

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

	2018	2017
	\$	\$
Marketing and professional services expenses paid to companies controlled by members of the immediate family of an officer	70,750	48,120

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

### 15 Segmented information

The Company has three business segments and specializes in the Industrial Compress Air and Gas Treatment, the Clean Technology and the Oil and Gas Processing.

For the three-month periods ended March 31, revenue summarized by country, as determined by location of the customers, is as follows:

	2018	2017
	\$	\$
<b>Revenue</b>		
France	1,087,082	620,186
United States	866,428	1,531,520
Canada	667,932	670,529
China	325,741	6,046
Other	267,625	482,628
	3,214,808	3,310,909



# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

### Incomes (losses) summarized by business segments are as follows:

For the three-month period ended March 31, 2018

	Clean Technology	Industrial Compressed Air and Gas treatment	Oil and gas Processing	Corporate	Total
	\$	\$	\$	\$	\$
Revenues	2,126,702	1,088,106	-	-	3,214,808
COGS	1,767,256	667,136	-	-	2,434,392
Gross margin	359,446	420,970	-	-	780,416
Gross Margin %	17%	39%	-	0%	24%
Research and Development expenses	8,547	-	-	-	8,547
Selling and administrative expenses	276,483	251,530	-	986,088	1,514,101
Foreign exchange loss (gain)	-	-	-	82,020	82,020
Gain on conversion of shares issued by a subsidiary	-	-	-	250,985	250,985
Financial income	-	-	-	(320)	(320)
Financial expense	-	-	-	297,134	297,134
Total expenses	285,030	251,530	-	1,615,907	2,152,467
Segment income (loss)	74,416	169,440	-	(1,615,907)	(1,372,051)

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

For the three-month period ended March 31, 2017

	Clean Technology	Industrial Compressed Air and Gas treatment	Oil and gas Processing	Corporate	Total
	\$	\$	\$	\$	\$
<b>Revenues</b>	1,919,549	1,150,385	240,975	-	3,310,909
<b>COGS</b>	1,175,432	701,707	299	-	1,877,438
<b>Gross margin</b>	744,117	448,678	240,676	-	1,433,471
<b>Gross Margin %</b>	39%	39%	100%	0%	43%
<b>Research and Development expenses</b>	12,601	-	-	-	12,601
<b>Selling and administrative expenses</b>	173,874	161,522	39,090	616,272	990,758
<b>Foreign exchange loss (gain)</b>	-	-	-	73,875	73,875
<b>Gain on conversion of shares issued by a subsidiary</b>	-	-	-	(344,256)	(344,256)
<b>Financial income</b>	-	-	-	(116,203)	(116,203)
<b>Financial expense</b>	-	-	-	244,646	244,646
<b>Total expenses</b>	186,475	161,522	39,090	474,334	861,421
<b>Segment income (loss)</b>	557,642	287,156	201,586	(474,334)	572,050

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

	As at March 31, 2018 \$	As at December 31, 2017 \$
<b>Non-current assets</b>		
Canada	558,624	520,491
Asia	63,583	66,570
United States	39,607	39,934
	661,814	626,995

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

### 16 Financial instruments

#### a. Measurement categories and fair values, including valuation methods and assumptions

The following tables show the carrying values and fair values of assets and liabilities by category as of:

March 31, 2018	Loans and receivables		Other financial liabilities	
	Carrying amount	Fair value	Carrying amount	Fair value
	\$	\$	\$	\$
Cash	1,114,656	1,114,656	-	-
Trade and other receivables	3,273,695	3,273,695	-	-
Other current assets	13,500	13,500	-	-
Bank loan	-	-	310,000	310,000
Credit facility	-	-	1,321,112	1,321,112
Trade, other payables and accrued liabilities	-	-	3,139,264	3,139,264
Convertible debentures	-	-	2,274,439	2,274,439
Government royalty program obligation	-	-	579,384	579,384
Obligation arising from shares issued by a subsidiary	-	-	4,245,551	4,245,551

# Xebec Adsorption Inc.

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

(expressed in Canadian dollars)

**December 31, 2017**

	<u>Loans and receivables</u>		<u>Other financial liabilities</u>	
	<b>Carrying amount</b>	<b>Fair value</b>	<b>Carrying amount</b>	<b>Fair value</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Cash	1,341,121	1,341,121	-	-
Trade and other receivables	3,094,761	3,094,761	-	-
Other current assets	13,500	13,500	-	-
Credit facility	-	-	1,437,912	1,437,912
Trade, other payables and accrued liabilities	-	-	3,032,213	3,032,213
Convertible debentures	-	-	2,216,570	2,216,570
Government royalty program obligation	-	-	591,372	591,372
Obligation arising from shares issued by a subsidiary	-	-	3,912,314	3,912,314

The carrying values of cash, trade and other receivables, trade and other payables, accrued liabilities, bank loan and credit facility approximate their fair value due to their short-term maturities. The methods and assumptions used in estimating the fair values of other financial assets and financial liabilities are as follows:

- Convertible debentures (classified in level 2 of the fair value hierarchy): The Company's convertible debentures carries fixed interest rates. The fair value of the Company's debt obligations has been calculated by discounting the future cash flows of the long-term debt at the interest rate of similar debt instruments.
- Government royalty program obligation (classified in level 2 of the fair value hierarchy): Fair value of the government royalty program obligation has been calculated by discounting the future cash flows at the interest rate for a similar loan in the market.
- Obligation arising from shares issued by a subsidiary (classified in level 2 of the fair value hierarchy): Fair value of the obligation arising from shares issued by a subsidiary has been calculated by computing an annualized return of 10% on the initial consideration
- The Company's financial instruments that are measured subsequent to initial recognition at fair value and financial instruments measured at amortized cost for which the fair value is disclosed are grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

Level 1 — Fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.

# **Xebec Adsorption Inc.**

## Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month periods ended March 31, 2018 and 2017

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(expressed in Canadian dollars)

Level 2 — Fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 — Fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

### **17 Events after the reporting period**

In May 2018, Xebec has signed an exclusive market development and commercialization agreement with Sapio Group. Under this agreement, Sapio is entering into a minimum purchase order commitment for multiple Xebec biogas upgrading plants for a total value of 33 million euros (51 CDN\$) to be delivered over three years.