# Xebec Adsorption Inc.

Condensed Interim Consolidated Financial Statements
*(Unaudited – Prepared by Management)*
**For the three-month and six-month periods ended**
**June 30, 2017 and 2016**
(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)

(expressed in Canadian dollars)

| | As at June 30, 2017 $ | As at December 31, 2016 $ |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash | 521,302 | 1,088,592 |
| Trade and other receivables | 4,112,122 | 2,449,441 |
| Inventories | 973,313 | 1,329,516 |
| Investment tax credits receivable | 27,987 | 47,953 |
| Other current assets | 105,000 | 188,297 |
| **Total current assets** | 5,739,724 | 5,103,799 |
| **Non-current assets** | | |
| Property, plant and equipment (Note 3) | 238,645 | 274,538 |
| Intangible assets (Note 4) | 149,916 | 190,743 |
| **Total non-current assets** | 388,561 | 465,281 |
| **Total assets** | 6,128,285 | 5,569,080 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Bank loan (note 5) | 595,000 | 755,000 |
| Trade payables and accrued liabilities | 2,271,730 | 3,623,259 |
| Deferred revenues | 143,525 | 942,575 |
| Term facility (note 6) | 2,000,000 | - |
| Current portion of long-term debt (note 7a)) | 22,673 | 22,112 |
| Current portion of government royalty program obligation (note 7b)) | 74,984 | 757,540 |
| Current portion of provisions | 38,008 | 209,133 |
| **Total current liabilities** | 5,145,920 | 6,309,619 |
| **Non-current liabilities** | | |
| Long-term debt (note 7a)) | 795,680 | 774,788 |
| Government royalty program obligation (note 7b)) | 531,714 | - |
| Obligation arising from shares issued by a subsidiary (note 8) | 3,711,454 | 3,582,135 |
| Government grants | - | 2,083 |
| Deferred rent | 151,708 | 138,516 |
| Provisions | 18,211 | 8,926 |
| **Total non-current liabilities** | 5,208,767 | 4,506,448 |
| **Total liabilities** | 10,354,687 | 10,816,067 |
| **Equity** | | |
| Equity attributable to shareholders of the Company | | |
| Share capital (note 9) | 19,407,391 | 19,318,856 |
| Contributed surplus | 2,967,137 | 2,996,621 |
| Equity component of convertible debentures (note 7a)) | 150,304 | 150,304 |
| Accumulated other comprehensive loss | (909,911) | (940,216) |
| Deficit | (25,841,323) | (26,772,552) |
| **Total equity** | (4,226,402) | (5,246,987) |
| **Total liabilities and equity** | 6,128,285 | 5,569,080 |

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

**Approved by the Board of Directors on August 25, 2017**

*(signed)* Kurt Sorschak Director

*(signed)* William Beckett Director

# Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Income (Loss)
(Unaudited)

(expressed in Canadian dollars)

| | For the 3 months period ended June 30, 2017 $ | 2016 $ | For the 6 months period ended June 30, 2017 $ | 2016 $ |
|---|---|---|---|---|
| **Revenue** (note 15) | 4,046,461 | 2,071,434 | 7,357,370 | 4,525,001 |
| **Cost of goods sold** | 2,430,283 | 1,539,590 | 4,307,721 | 3,633,613 |
| **Gross margin** | 1,616,178 | 531,844 | 3,049,649 | 891,388 |
| Research and development expenses | (56,887) | 43,648 | (44,286) | 100,396 |
| Selling and administrative expenses | 1,103,403 | 1,398,556 | 2,094,161 | 2,591,993 |
| Foreign exchange (gain) loss | 49,435 | 14,761 | 121,637 | 268,290 |
| (Gain) loss on conversion of shares issued by a subsidiary (note 8) | (40,048) | (94,324) | (32,056) | (301,284) |
| | 1,055,903 | 1,362,641 | 2,139,456 | 2,659,395 |
| Operating income (loss) | 560,275 | (830,797) | 910,193 | (1,768,007) |
| **Other income (charge)** | | | | |
| Finance income | (1,402) | (1,269) | (117,605) | (2,672) |
| Finance expense (note 12) | 202,500 | 156,302 | 96,570 | 277,742 |
| | 201,098 | 155,033 | (21,035) | 275,070 |
| **Income (loss) before income taxes** | 359,177 | (985,830) | 931,228 | (2,043,077) |
| Income taxes | - | - | - | - |
| **Net income (loss) for the period** | 359,177 | (985,830) | 931,228 | (2,043,077) |
| **Income (loss) per common share** | | | | |
| Basic and Diluted (note 9) | 0.01 | (0.02) | 0.02 | (0.05) |

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)

(expressed in Canadian dollars)

| | For the 3 months period ended June 30, 2017 $ | 2016 $ | For the 6 months period ended June 30, 2017 $ | 2016 $ |
|---|---|---|---|---|
| **Net income (loss) for the period** | 359,177 | (985,830) | 931,228 | (2,043,077) |
| **Other comprehensive income (loss)** | | | | |
| Cumulative translation adjustment | 204,045 | (265,259) | 30,305 | 131,501 |
| **Comprehensive income (loss) for the period** | 563,222 | (1,251,089) | 961,533 | (1,911,576) |

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

# Xebec Adsorption Inc.

Condensed Interim Consolidated Statement 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 component convertible debentures $** | **Total $** |
| **Balance – January 1, 2016** | 39,363,867 | - | 19,318,856 | 2,925,379 | (1,105,821) | (24,101,109) | - | (2,962,695) |
| Net loss for the period | - | - | - | - | - | (2,043,077) | - | (2,043,077) |
| Other comprehensive income | - | - | - | - | 131,501 | - | - | 131,501 |
| Comprehensive income (loss) for the period | - | - | - | - | 131,501 | (2,043,077) | - | (1,911,576) |
| Share-based compensation | - | - | - | 53,274 | - | - | - | 53,274 |
| **Balance – June 30, 2016** | 39,363,867 | - | 19,318,856 | 2,978,653 | (974,320) | (26,144,186) | - | (4,820,997) |
| **Balance – January 1, 2017** | 39,363,867 | - | 19,318,856 | 2,996,621 | (940,216) | (26,772,552) | 150,304 | (5,246,987) |
| Net gain (loss) for the period | - | - | - | - | - | 931,229 | - | 931,229 |
| Other comprehensive income | - | - | - | - | 30,305 | - | - | 30,305 |
| Comprehensive income (loss) for the period | - | - | - | - | 30,305 | 931,229 | - | 961,534 |
| Share issued from the exercise of options (note 10) | 1,140,500 | | 88,535 | (29,484) | | | - | 59,051 |
| **Balance – June 30, 2017** | 40,504,367 | - | 19,407,391 | 2,967,137 | (909,911) | (25,841,323) | 150,304 | (4,226,402) |

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

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

# Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Cash Flows
(Unaudited)

(expressed in Canadian dollars)

| | For the 3 months period ended June 30, 2017 $ | 2016 $ | For the 6 months period ended June 30, 2017 $ | 2016 $ |
|---|---|---|---|---|
| **Cash flows from** | | | | |
| **Operating activities** | | | | |
| Net income (loss) for the period | 359,177 | (985,830) | 931,228 | (2,043,077) |
| Items not affecting cash | | | | |
| Depreciation of property, plant and equipment (note 3) | 20,787 | 23,496 | 45,486 | 48,214 |
| Amortization of intangible assets (note 4) | 19,836 | 18,975 | 40,376 | 37,097 |
| Reversal of inventory write-down | (128,524) | (17,420) | (128,524) | (17,420) |
| Government grant | (833) | (1,250) | (2,083) | (2,500) |
| Accretion and revaluation of government royalty program obligation (note 7b)) | 7,395 | 24,760 | (105,842) | 33,499 |
| Accretion of the obligation arising from shares issued by a subsidiary (note 8) | 79,601 | 82,430 | 161,375 | 170,144 |
| Accretion of the convertible debenture (note 12) | 39,774 | - | 78,376 | - |
| Stock-based compensation expense (note 10) | - | 4,716 | - | 53,274 |
| Forgiveness of debt | (350,839) | - | (697,655) | - |
| Gain on revaluation of bad debt | (274,482) | - | (274,482) | - |
| Deferred rent | 6,596 | 6,596 | 13,192 | 13,192 |
| | (221,512) | (843,527) | 61,447 | (1,707,577) |
| Changes in non-cash working capital components related to operations (note 13) | (124,483) | 810,040 | (2,424,259) | 403,272 |
| | (97,029) | (33,487) | (2,362,812) | (1,304,305) |
| **Investing activities** | | | | |
| Acquisition of property, plant and equipment | (2,998) | (1,353) | (11,956) | (1,803) |
| Acquisition of intangible assets | (420) | (18,737) | (420) | (18,737) |
| | (3,418) | (20,090) | (12,376) | (20,540) |
| **Financing activities** | | | | |
| Increase (decrease) of bank loan | (50,000) | 80,000 | (160,000) | 350,000 |
| Term facility | 10,000 | - | 2,000,000 | - |
| Proceeds for issuance of share capital (note 10) | 83,535 | - | 88,535 | - |
| Repayment of long-term debt | (6,153) | - | (11,800) | - |
| Repayment of government royalty program obligation (note 7a)) | (15,000) | - | (45,000) | - |
| | 22,382 | 80,000 | 1,871,735 | 350,000 |
| **Net increase (decrease) in cash during the period** | (78,065) | 26,423 | (503,453) | (974,845) |
| **Cash – Beginning of period** | 819,532 | 1,913,534 | 1,088,592 | 2,717,965 |
| Effect of exchange rate changes on cash | (220,165) | (356,432) | (63,837) | (159,595) |
| **Cash and cash equivalent – End of period** | 521,302 | 1,583,525 | 521,302 | 1,583,525 |
| **Additional information** | | | | |
| Interest paid | 105,486 | 49,112 | 169,726 | 74,099 |

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

## 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.

### b) Liquidity risk assumption

The Company has realized an operating income of $910,193 had cash outflows from operations of $2,362,812 for the six-month period ended June 30, 2017 and finished the period with cash amounting to $521,302, a working capital of $593,804, and had access to credit facilities totalling $750,000 of which $595,000 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 2017 for which management believes the assumptions are reasonable. Achieving budgeted results is dependent on improving the volume of revenues in Canada, United States, Europe 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 2017 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.

These condensed interim consolidated financial statements were approved by the Company's Board of Directors on August 25, 2017.

## 2 Summary of significant accounting policies

a. 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 financial statements, and should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2016, as they follow the same accounting policies and methods of application, unless otherwise indicated.

b. Basis of consolidation

The financial statements of the Company consolidate the accounts of Xebec, its wholly-owned subsidiaries, Xebec Adsorption USA Inc. and Xebec Adsorption Europe SRL and its 70% owned subsidiary, Xebec Adsorption (Shanghai) Co. Ltd. All intercompany transactions and balances are eliminated on consolidation.

A subsidiary is an entity which Xebec controls by having the power to govern its financial and operating policies. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether Xebec controls another entity. The subsidiaries are fully consolidated from the date on which control was obtained, and will be de-consolidated from the date that control ceases.

c. Foreign currency

The accompanying consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated statement of loss and comprehensive loss within expenses. Non-monetary assets and liabilities are translated at historical rates, unless such assets and liabilities are carried at market value, in which case, they are translated at the exchange rate in effect at the date of the statement of financial position.

(expressed in Canadian dollars)

## 3 Property, plant and equipment

| | Machinery and equipment[1] $ | Office furniture and equipment $ | Computers $ | Moulds $ | Vehicles $ | Total $ |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| Balance at December 31, 2015 | 548,952 | 156,537 | 275,690 | 176,944 | 35,984 | 1,194,107 |
| Additions | 45,988 | 132 | 9,485 | - | - | 55,605 |
| Effect of movements in exchange rates | (17,048) | (8,957) | (14,330) | (10,367) | - | (50,702) |
| Balance at December 31, 2016 | 577,892 | 147,712 | 270,845 | 166,577 | 35,984 | 1,199,010 |
| Additions | 4,036 | 4,318 | 3,602 | - | - | 11,956 |
| Effect of movements in exchange rates | (2,899) | (930) | (1,207) | (825) | - | (5,861) |
| Balance at June 30, 2017 | 579,029 | 151,100 | 273,240 | 165,752 | 35,984 | 1,205,105 |
| **Accumulated depreciation** | | | | | | |
| Balance at December 31, 2015 | 342,427 | 127,067 | 245,528 | 120,706 | 35,984 | 871,712 |
| Depreciation | 50,011 | 10,427 | 16,933 | 17,414 | - | 94,785 |
| Effect of movements in exchange rates | (10,700) | (8,588) | (13,011) | (9,726) | - | (42,025) |
| Balance at December 31, 2016 | 381,738 | 128,906 | 249,450 | 128,394 | 35,984 | 924,472 |
| Depreciation | 24,370 | 4,726 | 7,802 | 8,588 | - | 45,486 |
| Effect of movements in exchange rates | (693) | (840) | (1,144) | (821) | - | (3,498) |
| Balance at June 30, 2017 | 405,415 | 132,792 | 256,108 | 136,161 | 35,984 | 966,460 |
| **Carrying Amount** | | | | | | |
| At December 31, 2016 | 196,154 | 18,806 | 21,395 | 38,184 | - | 274,538 |
| At June 30, 2017 | 173,614 | 18,308 | 17,132 | 29,591 | - | 238,645 |

(expressed in Canadian dollars)

## 4 Intangible assets

| | Other | Internally generated | |
|---|---|---|---|
| | Software $ | Development costs $ | Total intangible assets $ |
| **Cost** | | | |
| Balance at December 31, 2015 | 313,653 | 298,485 | 612,138 |
| Additions | 28,404 | 490 | 28,894 |
| Effect of movements in exchange rates | (14,865) | - | (14,865) |
| Balance at December 31, 2016 | 327,192 | 298,975 | 626,167 |
| Additions | - | 420 | 420 |
| Impairment | - | - | - |
| Effect of movements in exchange rates | (1,725) | - | (1,725) |
| Balance at June 30, 2017 | 325,467 | 299,395 | 624,862 |
| **Accumulated amortization** | | | |
| Balance at December 31, 2015 | 282,618 | 88,737 | 371,355 |
| Amortization for the year | 17,140 | 59,697 | 76,837 |
| Effect of movements in exchange rates | (12,768) | - | (12,768) |
| Balance at December 31, 2016 | 286,990 | 148,434 | 435,424 |
| Amortization for the year | 10,496 | 29,880 | 40,376 |
| Impairment | - | - | - |
| Effect of movements in exchange rates | (854) | - | (854) |
| Balance at June 30, 2017 | 296,632 | 178,314 | 474,946 |
| **Carrying amount** | | | |
| At December 31, 2016 | 40,202 | 150,541 | 190,743 |
| At June 30, 2017 | 28,835 | 121,081 | 149,916 |

For the six-month period ended June 30, amortization of $40,376 (2016 - $37,097) is included in the consolidated statement of loss: $10,325 (2016 - $7,042) in ‘cost of goods sold’ and $30,051 (2016 - $30,055) in ‘selling and administrative expenses’.
For the three-month period ended June 30, amortization of $19,836 (2016 - $18,975) is included in the consolidated statement of loss: $10,325 (2016 - $3,948) in ‘cost of goods sold’ and $9,511 (2016 - $15,027) in ‘selling and administrative expenses’.

(expressed in Canadian dollars)

## 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% (3.0% in 2016) per annum and are limited by certain margin requirements concerning trade and other receivables. These credit facilities were used up to $595,000 as at June 30, 2017 (2016 – $755,000).

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.

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

## 6 Term 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% annum. This interest is payable every month. This amount shall be repaid based on the completion of certain project milestones.

The Facility was used up to $2,000,000 as at June 30, 2017 (nil in 2016). No repayments were made in the last six months.

## 7 Long-term debt

a) Loans

| | **As at June 30, 2017** **$** | As at December 31, 2016 $ |
|---|---|---|
| Obligation under a capital lease, repayable in monthly installments of $1,607 including interest calculated at 13% maturing in October 2018, secured by equipment. | 30,320 | 42,120 |
| Unsecured Convertible debentures | 788,033 | 754,780 |
| Long-term debt | 818,353 | 796,900 |
| Less: Current portion | 22,673 | 22,112 |
| | 795,680 | 774,788 |

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 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 $59,316) was determined by deducting the fair value of the liability component from the principal amount of the financing. The fair value of the liability component was 790,380$ computes 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.

No debentures were converted by holders as at June 30, 2017.

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.

(expressed in Canadian dollars)

The following table summarizes the activity related to the government royalty program obligation during the six-month period ended June 30, 2017:

| | **2017** **$** | 2016 $ |
|---|---|---|
| Balance – January 1, | 757,540 | 724,041 |
| Accretion interest | (105,842) | 33,499 |
| Repayment | (45,000) | - |
| Balance – June 30, | 606,698 | 757,540 |
| Current portion | (74,984) | 757,540 |
| | 531,714 | - |

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

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
- $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.

## 8 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

(expressed in Canadian dollars)

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".

| | **2017**<br>**$** | 2016<br>$ |
|---|---|---|
| Balance – January 1st, | 3,582,135 | 3,583,808 |
| Accretion interest | 161,375 | 350,575 |
| Effect of exchange rate change on obligation | (32,056) | (352,248) |
| Balance – June 30, | 3,711,454 | 3,582,135 |
| Current portion | - | - |
| | 3,711,454 | 3,582,135 |

## 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 2017 and 2016.

(expressed in Canadian dollars)

c) Income (loss) per share

i) Basic

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

| | For the three-month period ended June 30, | | For the six-month period ended June 30, | |
|---|---|---|---|---|
| | **2017** **$** | **2016** **$** | **2017** **$** | **2016** **$** |
| Net income (loss) attributable to owners of the parent | 359,177 | (985,830) | 931,228 | (2,043,077) |
| Weighted average number of common shares in issue | 40,504,367 | 39,363,867 | 40,504,367 | 39,363,867 |
| | 0.01 | (0.02) | 0.02 | (0.05) |

## 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 5,904,580 common shares are available for grant. As at June 30, 2017, the maximum number of common shares available for issuance under all stock-based compensation arrangements is 5,904,580.

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. The vesting right acquisitions are either gradual and equal over four years, or at the grant date and are exercisable for three to seven years from the date of grant. Stock options for directors vest at the grant date and are exercisable for seven years from the grant date.

Stock option activity for the six-month periods ended June 30 is presented below:

(expressed in Canadian dollars)

| | **2017** | | 2016 | |
|---|---|---|---|---|
| | **Number of options** | **Weighted average exercise price $** | Number of options | Weighted average exercise price $ |
| Outstanding – January 1, | **5,855,337** | **0.11** | 4,390,337 | 0.16 |
| Granted | **-** | **-** | 1,500,000 | 0.05 |
| Exercised | **(1,140,500)** | **0.05** | - | - |
| Cancelled | **(5,000)** | **0.22** | (4,950) | 0.22 |
| Expired | **-** | **-** | - | - |
| Outstanding – June 30, | **4,709,837** | **0.12** | 5,885,387 | 0.13 |
| Exercisable – June 30, | **4,709,837** | **0.12** | 5,885,387 | 0.13 |

As at June 30, 2017, options outstanding and exercisable are as follows:

| Expiry date | Weighted-Average Exercise Price | Number of Options Outstanding | Weighted-Average Remaining life | Number of Options Vested |
|---|---|---|---|---|
| March 31, 2018 | $0.16 | 258,065 | 0.8 | 258,065 |
| August 11, 2018 | $0.22 | 232,272 | 1.1 | 232,272 |
| December 22, 2018 | $0.10 | 1,519,500 | 1.5 | 1,519,500 |
| April 25, 2021 | $0.15 | 100,000 | 3.8 | 100,000 |
| May 29, 2021 | $0.14 | 200,000 | 3.9 | 200,000 |
| September 22, 2021 | $0.12 | 2,000,000 | 4.2 | 2,000,000 |
| January 7, 2023 | $0.05 | 400,000 | 5.5 | 400,000 |
| | **$0.12** | **4,709,837** | **3.1** | **4,709,837** |

During the first six months ending June 30, 2017, the Company has granted 2,108,193 stock options (Q1 and Q2 2016: 1,500,000) at an exercise price of $0,18 (Q1and Q2 2016: $0.05). The granting of these stock options 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, which was approved in June 2017 and the approval of the TSX Venture Exchange. This approval was obtained on August 9, 2017.

(expressed in Canadian dollars)

## 11 Expenses by nature

| | For the three-month period ended June 30, | | For the six-month period ended June 30, | |
|---|---|---|---|---|
| | **2017** **$** | **2016** **$** | **2017** **$** | **2016** **$** |
| Employee salaries and benefits | 1,686,049 | 1,348,034 | 2,845,595 | 2,653,123 |
| Material | 1,312,776 | 831,535 | 2,397,703 | 2,024,620 |
| Rent and repairs and maintenance | 153,797 | 169,553 | 353,282 | 382,016 |
| Professional fees | 204,408 | 195,913 | 317,770 | 378,046 |
| Subcontract cost | 265,715 | 76,726 | 314,318 | 138,995 |
| Travel expenses | 147,870 | 144,044 | 280,947 | 278,423 |
| Office expense | 49,521 | 103,749 | 115,360 | 140,963 |
| Amortization | 40,623 | 42,471 | 85,862 | 85,311 |
| Bad Debt | (280,509) | - | (280,509) | - |
| Inventory Provision | (128,524) | - | (128,524) | - |
| Stock-based compensation | - | 4,716 | - | 53,274 |
| Other | 81,960 | 21,405 | 100,078 | 90,835 |
| | 3,533,686 | 2,938,146 | 6,401,882 | 6,225,606 |

(expressed in Canadian dollars)

## 12 Finance expenses

| | For the three-month period ended June 30, | | For the six-month period ended June 30, | |
|---|---|---|---|---|
| | 2017 $ | 2016 $ | 2017 $ | 2016 $ |
| Interest and bank charges | 25,142 | 9,183 | 51,431 | 19,678 |
| Interest on debt | 80,344 | - | 118,294 | - |
| Interest charges | 7,031 | 39,929 | 9,728 | 54,421 |
| Forgiveness of debt | (30,044) | | (322,634) | |
| Accretion of convertible debenture | 40,426 | - | 78,376 | - |
| Accretion and revaluation of government royalty program obligation (note 7b)) | - | 24,760 | - | 33,499 |
| Accretion of the obligation arising from shares issued by a subsidiary (note 8) | 79,601 | 82,430 | 161,375 | 170,144 |
| | 202,500 | 156,302 | 96,570 | 277,742 |

## 13 Supplemental Cash flow information

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

| | For the three-month period ended June 30, | | For the six-month period ended June 30, | |
|---|---|---|---|---|
| | 2017 $ | 2016 $ | 2017 $ | 2016 $ |
| Decrease (increase) in assets: | | | | |
| Trade and other receivables | (191,340) | (71,473) | (1,388,199) | 252,222 |
| Inventories | 614,150 | 105,244 | 484,727 | (267,248) |
| Investment tax credits receivable | (26,160) | - | 19,966 | 69,723 |
| Other current assets | (15,307) | 26,689 | 83,297 | (105) |
| Increase (decrease) in liabilities: | | | | |
| Trade payables, other payables and accrued liabilities | 192,658 | (56,822) | (653,875) | (419,489) |
| Deferred revenues | (390,162) | 1,021,421 | (799,050) | 997,310 |
| Other operating liabilities | (59,356) | (215,019) | (171,125) | (229,141) |
| | 124,483 | 810,040 | (2,424,259) | 403,272 |

(expressed in Canadian dollars)

## 14 Related party transactions

The following table presents a summary of the related party transactions during the three-month period ended June 30:

| | For the three-month period ended June 30, | | For the six-month period ended June 30, | |
|---|---|---|---|---|
| | 2017 $ | 2016 $ | 2017 $ | 2016 $ |
| Marketing and professional services expenses paid to companies controlled by members of the immediate family of an officer | 28,215 | 28,285 | 76,335 | 55,670 |

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.

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

| | For the three-month period ended June 30, | | For the six-month period ended June 30, | |
|---|---|---|---|---|
| | 2017 $ | 2016 $ | 2017 $ | 2016 $ |
| **Revenue** | | | | |
| France | 1,750,705 | - | 2,370,891 | - |
| United States | 678,859 | 973,024 | 2,210,377 | 1,983,368 |
| Canada | 835,145 | 693,100 | 1,505,675 | 1,394,208 |
| China | 680,716 | 107,881 | 686,762 | 248,502 |
| Other | 101,036 | 297,429 | 583,665 | 898,923 |
| | 4,046,461 | 2,071,434 | 7,357,370 | 4,525,001 |

Revenue summarized by business segment is as follows:

(expressed in Canadian dollars)

| | For the three-month period ended June 30, | | For the six-month period ended June 30, | |
|---|---|---|---|---|
| | 2017 $ | 2016 $ | 2017 $ | 2016 $ |
| **Business Segments** | | | | |
| Industrial Air and Gas | 1,357,140 | 1,412,321 | 2,507,525 | 2,684,591 |
| Clean Technology | 2,689,321 | 659,113 | 4,608,870 | 1,840,410 |
| Oil and Gas Processing | - | - | 240,975 | - |
| | 4,046,461 | 2,071,434 | 7,357,370 | 4,525,001 |

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

| | June 30, 2017 $ | December 31, 2016 $ |
|---|---|---|
| **Non-current assets** | | |
| Canada | 257,824 | 305,071 |
| Asia | 86,535 | 111,480 |
| United States | 44,202 | 48,730 |
| | 388,561 | 465,281 |

(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:

| June 30, 2017 | Loans and receivables | | Other financial liabilities | |
|---|---|---|---|---|
| | Carrying amount $ | Fair value $ | Carrying amount $ | Fair value $ |
| Cash | 521,302 | 521,302 | - | - |
| Trade and other receivables | 4,021,760 | 4,021,760 | - | - |
| Other current assets | 105,000 | 105,000 | | |
| Bank loan | - | - | 595,000 | 595,000 |
| Trade, other payables and accrued liabilities | - | - | 1,791,298 | 1,791,298 |
| Convertible debentures | - | - | 788,033 | 788,033 |
| Government royalty program obligation | - | - | 606,698 | 606,698 |
| Obligation arising from shares issued by a subsidiary | - | - | 3,711,454 | 3,711,454 |
| Term facility | - | - | 2,000,000 | 2,000,000 |

(expressed in Canadian dollars)

| **December 31, 2016** | **Loans and receivables** | | **Other financial liabilities** | |
|---|---|---|---|---|
| | **Carrying amount** **$** | **Fair value** **$** | **Carrying amount** **$** | **Fair value** **$** |
| Cash | 1,088,592 | 1,088,592 | - | - |
| Trade and other receivables | 2,323,611 | 2,323,611 | - | - |
| Other current assets | 100,819 | 100,819 | - | - |
| Bank loan | - | - | 755,000 | 755,000 |
| Trade, other payables and accrued liabilities | - | - | 3,118,064 | 3,118,064 |
| Convertible debentures | - | - | 754,780 | 754,780 |
| Government royalty program obligation | - | - | 757,540 | 757,540 |
| Obligation arising from shares issued by a subsidiary | - | - | 3,582,135 | 3,582,135 |

The carrying values of cash, trade and other receivables, trade and other payables, accrued liabilities and bank loan 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:

- Long-term debt (classified in level 2 of the fair value hierarchy): The Company's long-term debt 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.

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).