

Xebec Adsorption Inc.

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

**For the three-month and six-month periods ended
June 30, 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)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

	As at June 30, 2018 \$	As at December 31, 2017 \$
Assets		
Current assets		
Cash	623,178	1,341,121
Trade and other receivables	7,278,959	4,133,259
Inventories	1,727,047	1,963,392
Investment tax credits receivable	37,934	15,943
Other current assets	190,636	260,157
Total current assets	<u>9,857,754</u>	<u>7,713,872</u>
Non-current assets		
Property, plant and equipment (Note 3)	202,923	208,632
Intangible assets (Note 4)	442,260	418,363
Total non-current assets	<u>645,183</u>	<u>626,995</u>
Total assets	<u>10,502,937</u>	<u>8,340,867</u>
Liabilities		
Current liabilities		
Bank loan (Note 5)	475,000	-
Credit facility (Note 6)	1,180,112	1,437,912
Trade, other payables and accrued liabilities	5,269,906	3,585,755
Deferred revenue	1,476,616	720,996
Current portion of long-term debt (Note 7)	11,460	22,236
Current portion of government royalty program obligation (Note 7)	94,582	86,826
Current portion of provisions	11,605	16,689
Total current liabilities	<u>8,519,281</u>	<u>5,870,414</u>
Non-current liabilities		
Long-term debt (Note 7 a))	1,844,829	2,223,478
Government royalty program obligation (Note 7 b))	470,722	504,546
Obligation arising from shares issued by a subsidiary (Note 8)	4,201,909	3,912,314
Deferred rent	133,173	132,815
Provisions	11,207	5,601
Deferred tax liabilities	81,989	81,989
Total non-current liabilities	<u>6,743,829</u>	<u>6,860,743</u>
Total liabilities	<u>15,263,110</u>	<u>12,731,157</u>
Equity		
Share capital (Note 9)	20,332,636	19,703,836
Contributed surplus	3,512,108	3,339,740
Equity component of convertible debentures	206,829	291,389
Accumulated other comprehensive loss	(1,079,629)	(1,049,455)
Deficit	(27,732,117)	(26,675,800)
Total equity	<u>(4,760,173)</u>	<u>(4,390,290)</u>
Total liabilities and equity	<u>10,502,937</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) Guy Saint-Jacques Director

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Income (loss)

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

	For the three-month period ended June 30,		For the six-month period ended June 30,	
	2018 \$	2017 \$	2018 \$	2017 \$
Revenue (Note 15)	6,555,447	4,046,461	9,770,255	7,357,370
Cost of goods sold	<u>4,481,550</u>	<u>2,430,283</u>	<u>6,915,942</u>	<u>4,307,721</u>
Gross margin	<u>2,073,897</u>	<u>1,616,178</u>	<u>2,854,313</u>	<u>3,049,649</u>
Research and development expenses	31,182	(56,887)	39,729	(44,286)
Selling and administrative expenses	1,608,535	1,103,403	3,122,636	2,094,161
Foreign exchange (gain) loss	(78,357)	49,435	3,663	121,637
Loss (gain) on conversion of shares issued by a subsidiary (Note 8)	<u>(128,177)</u>	<u>(40,048)</u>	<u>122,808</u>	<u>(32,056)</u>
	<u>1,433,183</u>	<u>1,055,903</u>	<u>3,288,836</u>	<u>2,139,456</u>
Operating income (loss)	<u>640,714</u>	<u>560,275</u>	<u>(434,523)</u>	<u>910,193</u>
Other charge (income)				
Finance income	(189)	(1,402)	(509)	(117,605)
Finance expenses (Note 12)	<u>325,169</u>	<u>202,500</u>	<u>622,303</u>	<u>96,570</u>
	<u>324,980</u>	<u>201,098</u>	<u>621,794</u>	<u>(21,035)</u>
Income (loss) before income taxes	315,734	359,177	(1,056,317)	931,228
Income taxes	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net income (loss) for the period	<u>315,734</u>	<u>359,177</u>	<u>(1,056,317)</u>	<u>931,228</u>
Net income (loss) per share				
Basic net income (loss) per share	<u>0.01</u>	<u>0.01</u>	<u>(0,02)</u>	<u>0.02</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 and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

	For the three-month period ended June 30,		For the six-month period ended June 30,	
	2018 \$	2017 \$	2018 \$	2017 \$
Net income (loss) for the period	315,734	359,177	(1,056,317)	931,228
Other comprehensive income (loss)				
Cumulative translation adjustment	<u>(44,251)</u>	<u>204,045</u>	<u>(30,174)</u>	<u>30,305</u>
Comprehensive income (loss) for the period	<u>271,483</u>	<u>563,222</u>	<u>(1,086,491)</u>	<u>961,533</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)

As at June 30, 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 \$
Balance – January 1, 2017	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
Balance – December 31, 2017	42,504,367	19,703,836	3,339,740	(1,049,455)	(26,675,800)	291,389	(4,390,290)
Balance – January 1, 2018	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	-	-	-	-	(1,056,317)	-	(1,056,317)
Other comprehensive loss	-	-	-	(30,174)	-	-	(30,174)
Comprehensive loss for the period	-	-	-	(30,174)	(1,056,317)	-	(1,086,491)
Share issued from conversion of debentures	3,553,845	580,000	-	-	-	(84,560)	495,440
Share issued from the exercise of options	287,272	48,800	-	-	-	-	48,800
Stock-based compensation (Note 10)	-	-	172,368	-	-	-	172,368
Balance – June 30, 2018	46,345,484	20,332,636	3,512,108	(1,079,629)	(27,732,117)	206,829	(4,760,173)

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 and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

	For the three-month period ended June 30,		For the six-month period ended June 30,	
	2018 \$	2017 \$	2018 \$	2017 \$
Cash flows from				
Operating activities				
Net income (loss) for the period	315,734	359,177	(1,056,317)	931,228
Items not affecting cash				
Depreciation of property, plant and equipment (Note 3)	19,536	20,787	39,898	45,486
Amortization of intangible assets (Note 4)	32,254	19,836	63,497	40,376
Reversal of inventory write-down	(46,304)	(128,524)	(91,505)	(128,524)
Government grant	-	(833)	-	(2,083)
Accretion finance expenses and gain on revaluation of govt. royalty program obligation (Note 7b))	6,920	7,395	13,932	(105,842)
Accretion of the obligation arising from shares issued by a subsidiary (Note 8)	84,535	79,601	166,787	161,375
Accretion of convertible debentures	60,806	39,774	118,676	78,376
Stock-based compensation expense (Note 10)	77,427	-	172,368	-
Reversal of trade payables	-	(350,839)	-	(697,655)
Reversal of allowance for doubtful accounts	-	(274,482)	-	(274,482)
Deferred rent	179	6,596	358	13,192
	<u>551,087</u>	<u>(221,512)</u>	<u>(572,306)</u>	<u>61,447</u>
Change in non-cash working capital balances related to operations (Note 13)	<u>(880,474)</u>	<u>124,483</u>	<u>(330,026)</u>	<u>(2,424,259)</u>
	<u>(329,387)</u>	<u>(97,029)</u>	<u>(902,332)</u>	<u>(2,362,812)</u>
Investing activities				
Acquisition of property, plant and equipment	(7,708)	(2,998)	(30,821)	(11,956)
Acquisition of intangible assets	(42,455)	(420)	(100,433)	(420)
Receipt of R&D tax credit	13,634	-	13,634	-
	<u>(36,529)</u>	<u>(3,418)</u>	<u>(117,620)</u>	<u>(12,376)</u>
Financing activities				
Increase (decrease) of bank loan	165,000	(50,000)	475,000	(160,000)
Increase (decrease) of credit facility (Note 6)	(141,000)	10,000	(257,800)	2,000,000
Proceeds from issuance of share capital (Note 9)	48,800	83,535	48,800	88,535
Repayment of long-term debt	(6,310)	(6,153)	(12,661)	(11,800)
Repayment of govt. royalty program obligation (Note 7b)	(21,000)	(15,000)	(40,000)	(45,000)
	<u>45,490</u>	<u>22,382</u>	<u>213,339</u>	<u>1,871,735</u>
Net decrease in cash and cash equivalent during the period	<u>(320,426)</u>	<u>(78,065)</u>	<u>(806,613)</u>	<u>(503,453)</u>
Cash and cash equivalent – Beginning of period	<u>1,114,656</u>	<u>819,532</u>	<u>1,341,121</u>	<u>1,088,592</u>
Effect of exchange rate changes on cash	<u>(171,052)</u>	<u>(220,165)</u>	<u>88,670</u>	<u>(63,837)</u>
Cash and cash equivalent – End of period	<u><u>623,178</u></u>	<u><u>521,302</u></u>	<u><u>623,178</u></u>	<u><u>521,302</u></u>
Additional information				
Interest paid	172,908	105,486	322,908	169,726

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 and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

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) 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, for the six-month period, an operating loss of \$434,523 in 2018 (an operating income of \$910,193 in 2017), had cash outflows from operations of \$902,332 for the six-month period ended June 30, 2018 (\$2,362,812 in 2017), finished the period with cash amounting to \$623,178 (\$521,302 in Q2 2017) and a working capital of \$1,338,473 (\$593,804 in Q2 2017). The company has access to credit facilities totalling \$750,000 of which \$475,000 (\$595,000 in Q2 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

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

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.

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.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

Intercompany transactions, balances and unrealized gains and losses on transactions between different entities within the Company are eliminated. Subsidiaries comprise Xebec Adsorption (Shanghai) Co. 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 and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

Segment reporting

The Company has 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 Air dryers 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 and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

3 Property, plant and equipment

	Machinery and equipment ⁽¹⁾ \$	Office furniture and equipment \$	Computers ⁽¹⁾ \$	Moulds \$	Vehicles \$	Leasehold improvements \$	Total \$
Cost							
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	7,708	-	2,663	-	-	20,450	30,821
Effect of movements in exchange rates	7,308	3,024	4,548	3,146	-	-	18,026
Balance at June 30, 2018	595,147	155,926	292,334	169,620	35,984	20,450	1,269,461
Accumulated depreciation							
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	21,236	4,304	6,506	6,683	-	1,169	39,898
Effect of movements in exchange rates	4,202	2,897	4,413	3,146	-	-	14,658
Balance at June 30, 2018	453,312	144,874	276,103	155,096	35,984	1,169	1,066,538
Carrying Amount							
At December 31, 2017	152,257	15,229	19,939	21,207	-	-	208,632
At June 30, 2018	141,835	11,052	16,231	14,524	-	19,281	202,923

Depreciation of \$39,898 (2017 – \$45,486) is included in the consolidated statement of income (loss) for the six-month period ended in June 30: \$29,280 (2017 – \$35,175) in cost of goods sold; and \$10,618 (2017 – \$10,311) in selling and administrative expenses.

Depreciation of \$19,536 (2017 - \$20,787) is included in the consolidated statement of income (loss) for the three-month period ended June 30: \$14,537 (2017 - \$15,778) in cost of goods sold; and \$4,999 (2017 - \$5,009) 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 \$56,428 (\$44,447 in 2017) and the accumulated depreciation amount to \$9,973 (\$2,593 in 2017).

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

4 Intangible assets

	Other	Internally generated		Total intangible assets
	Software \$	Development costs \$	Engineering standardisation \$	
Cost				
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	-	-	100,433	100,433
Disposals	-	-	(13,634)	(13,634)
Effect of movements in exchange rates	5,589	-	-	5,589
Balance at June 30, 2018	342,984	301,059	393,417	1,037,460
Accumulated amortization				
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	9,022	30,106	24,369	63,497
Effect of movements in exchange rates	4,994	-	-	4,994
Balance at June 30, 2018	332,562	238,269	24,369	595,200
Carrying amount				
At December 31, 2017	18,849	92,896	306,618	418,363
At June 30, 2018	10,422	62,790	369,048	442,260

Amortization of \$63,497 (2017 – \$40,376) is included in the consolidated statement of income (loss) for the six-month period ended June 30: \$30,253 (2017 – \$10,325) in cost of goods sold; and \$33,244 (2017 – \$30,051) in selling and administrative expenses.

Amortization of \$32,254 (2017 - \$19,836) is included in the consolidated statement of income (loss) for the three-month period ended June 30: \$14,063 (2017 - \$10,325) in cost of goods sold; and \$18,191 (2017 - \$9,511) in selling and administrative expenses.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(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%, (6.45% in 2018) (5.7% in Q2, 2017) per annum and are limited by certain margin requirements concerning trade and other receivables. These credit facilities were used up to \$475,000 as at June 30, 2018 (2017 – \$595,000).

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 \$2,750,000 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:

	June 30, 2018	December 31, 2017
	\$	\$
Balance – Beginning of period	1,437,912	-
Addition	-	2,000,000
Repayment	(257,800)	(562,088)
Balance – End of period	<u>1,180,112</u>	<u>1,437,912</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

7 Long-term debt

a) Loans

	As at June 30, 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.	7,760	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.	8,724	10,475
Unsecured Convertible debentures	1,839,805	2,216,570
Long-term debt	1,856,289	2,245,714
Current portion	(11,460)	(22,236)
	<u>1,844,829</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 \$186,177 (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 and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

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.

Some debentures were converted by holders as at June 30, 2018.

During the quarter, 3,553,845 common shares were issued as a result of the exercise of the conversion option by some of the debenture holders. The common shares issued included the carrying value of the liability component to the date of conversion. The conversion is a non-cash transaction and thus is excluded from the consolidated statement of cash flows.

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.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

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

	June 30, 2018	December 31, 2017
	\$	\$
Balance – Beginning of period	591,372	757,540
Gain on revaluation of government royalty program	-	(117,095)
Accretion finance expenses	13,932	25,927
Repayment	(40,000)	(75,000)
Balance – End of period	565,304	591,372
Current portion	(94,582)	(86,826)
	<u>470,722</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

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

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”.

	June 30, 2018	December 31, 2017
	\$	\$
Balance – Beginning of period	3,912,314	3,582,135
Accretion interest	166,787	332,537
Effect of exchange rate change on obligation	122,808	(2,358)
Balance – End of period	<u>4,201,909</u>	<u>3,912,314</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

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.

	For the three-month period ended June 30,		For the six-month period ended June 30,	
	2018 \$	2017 \$	2018 \$	2017 \$
Net income (loss) attributable to shareholders of the Company	315,734	359,177	(1,056,317)	931,228
Weighted average number of shares used in basic income per share	42,562,769	40,504,367	42,562,769	40,504,367
Basic income (loss) per share	0.01	0.01	(0.02)	0.02

ii) Diluted

For the periods ended June 30, 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 8,500,873 common shares are available for grant. As at June 30, 2018, the maximum number of common shares available for issuance under all stock-based compensation arrangements is 2,879,115

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

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

options are set by the Board of Directors. Stock options for employees vest no less than at grant date and no more than quarterly.

Stock option activity for the period ended June 30, is presented below:

	2018		2017	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Outstanding – January 1,	7,829,030	0.19	5,855,337	0.11
Granted	100,000	-	-	-
Exercised	(287,272)	-	(1,140,500)	0.05
Cancelled	(2,020,000)	-	(5,000)	0.22
Expired	-	-	-	-
Outstanding – June 30,	5,621,758	0.21	4,709,837	0.12
Exercisable – June 30,	4,295,897	0.14	4,709,837	0.12

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

As at June 30, 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	55,000	0.1	55,000
December 22, 2018	\$0.10	1,399,500	0.5	1,399,500
June 12, 2020	\$0.16	258,065	2.0	258,065
April 25, 2021	\$0.15	100,000	2.8	100,000
May 29, 2021	\$0.14	200,000	2.9	200,000
December 19, 2022	\$0.55	400,000	4.5	-
January 7, 2023	\$0.05	400,000	4.5	400,000
March 5, 2024	\$0.18	2,098,193	5.7	1,883,332
August 29, 2024	\$0.49	500,000	6.1	-
December 19, 2024	\$0.55	111,000	6.5	-
May 14, 2025	\$0.60	100,000	6.9	-
	\$0.22	5,621,758	3.9	4,295,897

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

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 exercisable
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

On May 14, 2018, the Company granted 100,000 stock options to an employee. The options are exercisable at \$0.60 per share and expire on May 14, 2025. 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 \$55,701, which was estimated using the Black-Scholes Option Pricing Model with the following assumptions:

Risk-free interest rate	2.30%
Annualized volatility ¹	133%
Share price	\$0.60
Dividend rate	0.00%
Expected life of options	7 years

During the six-month period ended in June 30, 2018, the Company expensed \$172,368 (2017 - nil) and during the three-month period ended in June 30, 2018, the Company expensed \$ 77,427 (2017 - nil) which totally relates to stock options granted in 2017 and 2018.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 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,	
	2018 \$	2017 \$	2018 \$	2017 \$
Employee salaries and benefits	1,723,900	1,686,049	3,350,218	2,845,595
Material	2,386,405	1,312,776	3,677,432	2,397,703
Subcontract cost	996,747	265,715	1,131,374	314,318
Professional fees	311,429	204,408	563,727	317,770
Rent and repairs and maintenance	193,198	153,797	403,319	353,282
Travel expenses	165,025	147,870	314,894	280,947
Stock-based compensation	77,427	-	172,368	-
Office expense	122,091	49,521	207,246	115,360
Amortization and depreciation	51,790	40,623	103,395	85,862
Advertising	28,152	-	93,202	-
Other	(4,345)	81,960	(12,961)	100,078
Bad Debt	38,266	(280,509)	34,364	(280,509)
Reversal of trade payables	-	-	-	-
Inventory Provision	-	(128,524)	-	(128,524)
	<u>6,090,085</u>	<u>3,533,686</u>	<u>10,038,578</u>	<u>6,401,882</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

12 Finance expenses

	For the three-month period ended June 30,		For the six-month period ended June 30,	
	2018	2017	2018	2017
	\$	\$	\$	\$
Accretion of the obligation arising from shares issued by a subsidiary	84,535	79,601	166,787	161,375
Interest on convertible debentures	116,590	40,426	230,982	78,376
Interest and bank charges	105,003	25,142	130,398	51,431
Interest on short term debt	12,008	7,031	79,845	9,728
Accretion and revaluation of government royalty program obligation (Note 7b)	6,920	-	13,932	-
Interest on long term debt	113	80,344	359	118,294
Reversal of trade payables	-	(30,044)	-	(322,634)
	<u>325,169</u>	<u>202,500</u>	<u>622,303</u>	<u>96,570</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

13 Supplemental Cash flow information

For the six-month period ended June 30, 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,	
	2018	2017	2018	2017
	\$	\$	\$	\$
Decrease (increase) in assets:				
Trade and other receivables	(2,973,947)	(191,340)	(3,145,700)	(1,388,199)
Inventories	479,141	614,150	327,851	484,727
Investment tax credits receivable	(21,991)	(26,160)	(21,991)	19,966
Other current assets	25,025	(15,307)	69,520	83,297
Increase (decrease) in liabilities:				
Trade payables, other payables and accrued liabilities	1,560,862	192,658	1,684,150	(653,875)
Deferred Revenues	50,672	(390,162)	755,621	(799,050)
Other operating liabilities	(236)	(59,356)	523	(171,125)
Provisions	(880,474)	124,483	(330,026)	(2,424,259)

14 Related party transactions

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

	For the three-month period ended June 30,		For the six-month period ended June 30,	
	2018	2017	2018	2017
	\$	\$	\$	\$
Marketing and professional services expenses paid to companies controlled by members of the immediate family of an officer	56,006	28,215	126,756	76,335

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.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

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 six-month period ended June 30, revenue summarized by country, as determined by location of the customers, is as follows:

Revenue	For the three-month period ended June 30,		For the six-month period ended June 30,	
	2018	2017	2018	2017
	\$	\$	\$	\$
Canada	1,848,338	835,145	2,516,270	1,505,675
United States	1,260,139	678,859	2,126,133	2,210,377
China	1,511,359	680,716	1,837,533	686,762
France	442,731	1,750,705	1,529,812	2,370,891
Italy	1,043,818	-	1,071,081	-
Other	449,072	101,036	689,426	583,665
	<u>6,555,457</u>	<u>4,046,461</u>	<u>9,770,255</u>	<u>7,357,370</u>

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

For the six-month period ended June 30, 2018

	Clean Technology	Industrial Compressed Air and Gas treatment	Oil and gas Processing	Corporate	Total
	\$	\$	\$	\$	\$
Revenues	6,311,815	3,458,440	-	-	9,770,255
COGS	4,723,235	2,192,707	-	-	6,915,942
Gross margin	1,588,580	1,265,733	-	-	2,854,313
Gross Margin %	25%	37%			29%
Research and Development expenses	39,729	-	-	-	39,729
Selling and administrative expenses	510,821	440,885	-	2,170,930	3,122,636
Foreign exchange loss	-	-	-	3,663	3,663
Loss on conversion of shares issued by a subsidiary	-	-	-	122,808	122,808
Financial income	-	-	-	(509)	(509)
Financial expense	-	-	-	622,303	622,303
Total expenses	550,550	440,885	-	2,919,195	3,910,630
Segment income (loss)	1,038,030	824,848	-	(2,919,195)	(1,056,317)

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

For the three-month period ended June 30, 2018

	Clean Technology	Industrial Compressed Air and Gas treatment	Oil and gas Processing	Corporate	Total
	\$	\$	\$	\$	\$
Revenues	4,185,113	2,370,334	-	-	6,555,447
COGS	2,955,979	1,525,571	-	-	4,481,550
Gross margin	1,229,134	844,763	-	-	2,073,897
Gross Margin %	29%	36%			32%
Research and Development expenses	31,182	-	-	-	31,182
Selling and administrative expenses	234,339	189,355	-	1,184,841	1,608,535
Foreign exchange gain	-	-	-	(78,357)	(78,357)
Gain on conversion of shares issued by a subsidiary	-	-	-	(128,177)	(128,177)
Financial income	-	-	-	(189)	(189)
Financial expense	-	-	-	325,169	325,169
Total expenses	265,521	189,355	-	1,303,287	1,758,163
Segment income (loss)	963,613	655,408	-	(1,303,287)	315,734

For the six-month period ended June 30, 2017

	Clean Technology	Industrial Compressed Air and Gas treatment	Oil and gas Processing	Corporate	Total
	\$	\$	\$	\$	\$
Revenues	4,608,870	2,507,525	240,975	-	7,357,370
COGS	2,976,386	1,331,335	-	-	4,307,721
Gross margin	1,632,484	1,176,190	240,975	-	3,049,649
Gross Margin %	35%	47%	100%		41%
Research and Development expenses	(44,286)	-	-	-	(44,286)
Selling and administrative expenses	427,465	409,469	124,363	1,132,864	2,094,161
Foreign exchange loss	-	-	-	121,637	121,637
Gain on conversion of shares issued by a subsidiary	-	-	-	(32,056)	(32,056)
Financial income	-	-	-	(117,605)	(117,605)
Financial expense	-	-	-	96,570	96,570
Total expenses	383,179	409,469	124,363	1,201,410	2,118,421
Segment income (loss)	1,249,305	766,721	116,612	(1,201,410)	931,228

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

For the three-month period ended June 30, 2017

	Clean Technology	Industrial Compressed Air and Gas treatment	Oil and gas Processing	Corporate	Total
	\$	\$	\$	\$	\$
Revenues	2,689,320	1,357,141	-	-	4,046,461
COGS	1,800,656	629,627	-	-	2,430,283
Gross margin	888,664	727,514	-	-	1,616,178
Gross Margin %	33%	54%			40%
Research and Development expenses	(56,887)	-	-	-	(56,887)
Selling and administrative expenses	253,591	247,947	85,273	516,592	1,103,403
Foreign exchange loss	-	-	-	49,435	49,435
Gain on conversion of shares issued by a subsidiary	-	-	-	(40,048)	(40,048)
Financial income	-	-	-	(1,402)	(1,402)
Financial expense	-	-	-	202,500	202,500
Total expenses	196,704	247,947	85,273	727,077	1,257,001
Segment income (loss)	691,960	479,567	(85,273)	(727,077)	359,177

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

	As at June 30, 2018 \$	As at December 31, 2017 \$
Non-current assets		
Canada	554,208	520,491
Asia	51,994	66,570
United States	38,981	39,934
	<u>645,183</u>	<u>626,995</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 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:

June 30, 2018	Loans and receivables		Other financial liabilities	
	Carrying amount	Fair value	Carrying amount	Fair value
	\$	\$	\$	\$
Cash	623,178	623,178		
Trade and other receivables	3,046,674	3,046,674		
Other current assets	13,500	13,500		
Bank loan			514,780	514,780
Credit facility			1,180,112	1,180,112
Trade, other payables and accrued liabilities			4,656,405	4,656,405
Convertible debentures			1,839,805	1,839,805
Government royalty program obligation			565,304	565,304
Obligation arising from shares Issued by a subsidiary			4,201,909	4,201,909

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

For the three-month and six-month periods ended June 30, 2018 and 2017

(expressed in Canadian dollars)

December 31, 2017

	<u>Loans and receivables</u>		<u>Other financial liabilities</u>	
	Carrying amount	Fair value	Carrying amount	Fair value
	\$	\$	\$	\$
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 carry 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 and six-month periods ended June 30, 2018 and 2017

(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 Event after the reporting period

Xebec Adsorption Inc. has obtained \$23 million of additional financial support from Export Development Canada (EDC), Canada's export credit agency. The financial support consist of a credit agreement worth \$11 million with two credit facilities, and a three year term consisting of a \$2 million working capital line and \$9 million Purchase Order (PO) facility. In addition, Xebec has also secured \$12 million bonding facility with EDC. The bonding facility will be used to support the issuance of multiple bank guarantees.

On July 24, 2018, the Minority Shareholders of Xebec Adsorption (Shanghai) Co. Ltd. and Xebec Adsorption Inc. agreed that Xebec Adsorption Inc. will pay the Minority Shareholders RMB 1 million per year including 2018 until the EDC loan expiry or latest up to December 31, 2020 (whichever is earlier). Xebec Adsorption Inc. will also fulfill its repurchase obligation according to the original agreement, by paying the full repurchase price in one lump sum either at EDC loan expiry or latest by December 31, 2020. The 2018 annual fee will be paid in the fourth quarter of 2018. The annual fees will be considered a deduction to the repurchase price at the time of repurchase.

On July 25, 2018, the Minority Shareholders of Xebec Adsorption (Shanghai) Co. Ltd, agreed that, for a period beginning on the date hereof up to the date that Export Development Canada has been repaid in full (including capital, interests and fees) under the EDC Financing Arrangement, it shall not exercise any of its divestment, refund, compensation and other equity repurchase rights.