

Xebec Adsorption Inc.

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

**For the three-month and nine-month periods ended
September 30, 2016 and 2015**
(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 September 30, 2016 \$	As at December 31, 2015 \$
Assets		
Current assets		
Cash	1,086,094	2,717,965
Trade and other receivables	1,873,969	2,437,159
Inventories	1,810,746	1,141,840
Investment tax credits receivable	47,953	117,676
Other current assets	138,623	158,856
Total current assets	4,957,385	6,573,496
Non-current assets		
Property, plant and equipment (Note 3)	252,172	322,395
Intangible assets (Note 4)	201,270	240,783
Total non-current assets	453,442	563,178
Total assets	5,410,827	7,136,674
Liabilities		
Current liabilities		
Bank loan (note 5)	700,000	375,000
Trade payables	2,721,653	3,105,172
Accrued liabilities	732,192	793,556
Deferred revenues	1,932,434	680,003
Current portion of government royalty program obligation	757,540	243,207
Provisions	222,226	698,561
Total current liabilities	7,066,045	5,895,499
Non-current liabilities		
Government royalty program obligation	-	480,834
Obligation arising from shares issued by a subsidiary (note 6)	3,554,059	3,583,808
Government assistance	3,333	7,083
Deferred rent	131,920	112,132
Provisions	6,548	20,013
Total non-current liabilities	3,695,860	4,203,870
Total liabilities	10,761,905	10,099,369
Equity		
Share capital (note 7)	19,318,856	19,318,856
Contributed surplus	2,983,549	2,925,379
Accumulated other comprehensive loss	(1,002,996)	(1,105,821)
Deficit	(26,650,487)	(24,101,109)
Total equity	(5,351,078)	(2,962,695)
Total liabilities and equity	5,410,827	7,136,674

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

Approved by the Board of Directors on November 28, 2016

(signed) Kurt Sorschak Director

(signed) William Beckett Director

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Loss

For the three-month and nine-month periods ended September 30, 2016 and 2015

(Unaudited)

(expressed in Canadian dollars)

	For the 3 months period ended September 30,		For the 9 months period ended September 30,	
	2016 \$	2015 \$	2016 \$	2015 \$
Revenue	1,795,796	2,048,683	6,320,797	7,349,931
Cost of goods sold	1,518,703	1,614,352	5,152,317	5,995,234
Gross margin	277,093	434,331	1,168,480	1,354,697
Research and development expenses	(20,727)	225,525	79,669	222,812
Selling and administrative expenses	704,691	1,350,677	3,296,684	3,651,924
Foreign exchange (gain) loss	(34,698)	(209,671)	233,592	(429,634)
(Gain) loss on conversion of shares issued by a subsidiary (note 6)	18,154	26,436	(283,130)	26,436
	667,420	1,392,967	3,326,815	3,471,538
Operating Loss	(390,327)	(958,636)	(2,158,335)	(2,116,841)
Other income (charge)				
Finance income	(262)	(344)	(2,935)	(14,665)
Finance expense	116,236	33,928	393,978	97,064
	115,974	33,584	391,043	82,399
Loss before income taxes	(506,301)	(992,220)	(2,549,378)	(2,199,240)
Income taxes	-	-	-	8,750
Net loss for the period	(506,301)	(992,220)	(2,549,378)	(2,207,990)
Weighted average number of common shares outstanding	39,363,867	39,363,867	39,363,867	39,363,867
Loss per common share				
Basic and Diluted	(0.01)	(0.03)	(0.07)	(0.06)

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

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Comprehensive Loss

For the three-month and nine-month periods ended September 30, 2016 and 2015

(Unaudited)

(expressed in Canadian dollars)

	For the 3 months period ended September 30,		For the 9 months period ended September 30,	
	2016 \$	2015 \$	2016 \$	2015 \$
Net loss for the period	(506,301)	(992,220)	(2,549,378)	(2,207,990)
Other comprehensive income (loss)				
Cumulative translation adjustment	<u>(28,676)</u>	<u>(207,125)</u>	<u>102,825</u>	<u>(464,605)</u>
Comprehensive loss for the period	<u>(534,977)</u>	<u>(1,199,345)</u>	<u>(2,446,553)</u>	<u>(2,672,595)</u>
Attributable to:				
Shareholders of the Company	(534,977)	(1,184,904)	(2,446,553)	(2,672,563)
Non-controlling interest	<u>-</u>	<u>(14,441)</u>	<u>-</u>	<u>(32)</u>
	<u>(534,977)</u>	<u>(1,199,345)</u>	<u>(2,446,553)</u>	<u>(2,672,595)</u>

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

For the three-month periods ended September 30

(expressed in Canadian dollars)

	Number		Amount						
	Common shares	Warrants	Share capital – Common shares and warrants \$	Contributed surplus \$	Accumulated other comprehensive income (loss) \$	Deficit \$	Equity attributable to the Company \$	Non-controlling interest \$	Total \$
Balance – January 1, 2015	39,363,867	10,091,886	19,732,623	2,460,146	(606,685)	(20,914,588)	671,496	257,795	929,291
Net loss for the period	-	-	-	-	-	(2,207,958)	(2,207,958)	(32)	(2,207,990)
Other comprehensive income (loss) (1)	-	-	-	-	(464,605)	-	(464,605)	-	(464,605)
Comprehensive income (loss) for the period	-	-	-	-	(464,605)	(2,207,958)	(2,672,563)	(32)	(2,672,595)
Share-based compensation	-	-	-	40,182	-	-	40,182	-	40,182
Dissolution of a subsidiary	-	-	-	-	-	-	-	(257,763)	(257,763)
Balance – September 30, 2015	39,363,867	10,091,886	19,732,623	2,500,328	(1,071,290)	(23,122,546)	(1,960,885)	-	(1,960,885)
Balance – January 1, 2016	39,363,867	-	19,318,856	2,925,379	(1,105,821)	(24,101,109)	(2,962,695)	-	(2,962,695)
Net loss for the period	-	-	-	-	-	(2,549,378)	(2,549,378)	-	(2,549,378)
Other comprehensive income (1)	-	-	-	-	102,825	-	102,825	-	102,825
Comprehensive income (loss) for the period	-	-	-	-	102,825	(2,549,378)	(2,446,553)	-	(2,446,553)
Share-based compensation	-	-	-	58,170	-	-	58,170	-	58,170
Balance – September 30, 2016	39,363,867	-	19,318,856	2,983,549	(1,002,996)	(26,650,487)	(5,351,078)	-	(5,351,078)

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

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Cash Flows

For the three-month and nine-month periods ended September 30, 2016

and 2015

(Unaudited)

(expressed in Canadian dollars)

	For the 3 months period ended September 30,		For the 9 months period ended September 30,	
	2016	2015	2016	2015
	\$	\$	\$	\$
Cash flows from				
Operating activities				
Net loss for the period	(506,301)	(992,220)	(2,549,378)	(2,207,990)
Items not affecting cash				
Depreciation of property, plant and equipment	23,078	25,231	71,262	81,364
Amortization of intangible assets	19,464	37,710	56,561	114,664
Reversal of inventory write-down	-	(41,356)	(17,420)	(41,356)
Gain on debt forgiveness	-	-	-	(190,092)
Government assistance	(1,250)	(1,250)	(3,750)	(3,750)
Accretion and revaluation of government royalty program obligation	-	9,228	33,499	11,581
Accretion of the obligation arising from shares issued by a subsidiary (note 6)	83,238	-	253,382	-
Stock-based compensation expense	4,896	12,888	58,170	40,182
Deferred rent	6,596	6,596	19,788	19,788
	<u>(370,279)</u>	<u>(938,447)</u>	<u>(2,077,886)</u>	<u>(2,170,883)</u>
Changes in non-cash working capital components related to operations (note 10)	<u>(83,864)</u>	<u>1,160,197</u>	<u>319,408</u>	<u>1,665,302</u>
	<u>(454,143)</u>	<u>221,750</u>	<u>(1,758,478)</u>	<u>(505,581)</u>
Investing activities				
Acquisition of property, plant and equipment	(6,579)	(49,239)	(8,382)	(71,133)
Acquisition of intangible assets	(490)	(26,564)	(19,227)	(26,564)
	<u>(7,069)</u>	<u>(75,803)</u>	<u>(27,609)</u>	<u>(97,697)</u>
Financing activities				
Restricted cash	-	69,206	-	214,592
Increase (decrease) of bank loan	(25,000)	(45,000)	325,000	248,563
Obligation arising from preferred shares issued by a Subsidiary	-	3,423,075	-	3,423,075
Repayment of long-term debt	-	(8,334)	-	(42,132)
Repayment of government royalty program obligation	-	(14,999)	-	(29,459)
	<u>(25,000)</u>	<u>3,423,948</u>	<u>325,000</u>	<u>3,814,639</u>
Net increase (decrease) in cash during the period	<u>(486,212)</u>	<u>3,569,895</u>	<u>(1,461,087)</u>	<u>3,211,361</u>
Cash – Beginning of period	<u>1,583,525</u>	<u>390,550</u>	<u>2,717,965</u>	<u>1,008,421</u>
Effect of exchange rate changes on cash	<u>(11,219)</u>	<u>(439,001)</u>	<u>(170,784)</u>	<u>(698,338)</u>
Cash and cash equivalent – End of period	<u>1,086,094</u>	<u>3,521,444</u>	<u>1,086,094</u>	<u>3,521,444</u>
Additional information				
Interest paid	32,998	19,973	107,097	67,481

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)

September 30, 2016

(expressed in Canadian dollars)

1 Nature of operations

a) Nature of operations

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

The Company has realized an operating loss of \$2,158,335, had cash outflows from operations of \$1,758,478 for the period ended September 30, 2016 and finished the period with cash amounting to \$1,086,094, a working capital deficit of \$2,108,660, and had access to credit facilities totalling \$750,000 of which \$700,000 has been used (see note 5). During the year, management undertook various initiatives and developed a plan to manage its operating and liquidity risks in light of prevailing economic conditions. Management is also currently seeking alternative financings for its operations. The Company has prepared a budget for 2016 for which management believes the assumptions are reasonable. Achieving budgeted results is dependent on improving the volume of revenues in Canada, United States and China, delivering on sales and contract schedules, meeting expected overall operating margin levels and controlling general and administrative costs.

The Company is thus faced with uncertainties that may have an impact on future operating results and liquidity. These uncertainties include fluctuations in foreign currency rates and achieving the Company’s business plan goals as mentioned in the previous paragraph. While management believes it has developed planned courses of action to mitigate operating and liquidity risks, there is no assurance that management will be able to achieve its business plan and maintain the necessary liquidity level including accessing liquidities from China if events or conditions develop that are not consistent with management’s expectations, key budget assumptions for 2016 and planned courses of action. Therefore, the Company may require additional external funding, and there is no assurance that it would be successful. Future changes in capital markets conditions could result in such funding not being available when required or at acceptable costs. The Company is unable to predict the possible effects, if any, of such uncertainties and the potential adjustments to the carrying values of assets and liabilities that could be needed, should the Company have insufficient liquidity. Such adjustments could be material.

These condensed interim consolidated financial statements were approved by the Company’s Board of Directors on November 28, 2016.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

September 30, 2016

(expressed in Canadian dollars)

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, 2015, 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.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

September 30, 2016

(expressed in Canadian dollars)

3 Property, plant and equipment

	Machinery and equipment	Office furniture and equipment	Computers	Moulds	Vehicles	Total
Cost						
Balance at December 31, 2015	548,952	156,537	275,690	176,944	35,984	1,194,107
Additions	-	132	8,250	-	-	8,382
Effect of movements in exchange rates	(13,910)	(7,506)	(11,567)	(8,458)	-	(41,441)
Balance at September 30, 2016	535,042	149,163	272,373	168,486	35,984	1,161,048
Accumulated depreciation						
Balance at December 31, 2015	342,427	127,067	245,528	120,706	35,984	871,712
Depreciation	37,713	7,929	12,507	13,113	-	71,262
Effect of movements in exchange rates	(8,588)	(7,093)	(10,525)	(7,892)	-	(34,098)
Balance at September 30, 2016	371,552	127,903	247,510	125,927	35,984	908,876
Carrying Amount						
At December 31, 2015	206,525	29,470	30,162	56,238	-	322,395
At September 30, 2016	163,490	21,260	24,863	42,559	-	252,172

4 Intangible assets

	Other	Internally generated	Total
	Software	Development costs	intangible assets
	\$	\$	\$
Cost			
Balance at December 31, 2015	313,653	298,485	612,138
Additions	18,737	490	19,227
Effect of movements in exchange rates	(11,880)	-	(11,880)
Balance at September 30, 2016	320,510	298,975	619,485
Accumulated amortization			
Balance at December 31, 2015	282,618	88,737	371,355
Amortization for the year	11,788	44,773	56,561
Effect of movements in exchange rates	(9,701)	-	(9,701)
Balance at September 30, 2016	284,705	133,510	418,215
Carrying amount			
At December 31, 2015	31,035	209,748	240,783
At September 30, 2016	35,805	165,465	201,270

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

September 30, 2016

(expressed in Canadian dollars)

For the nine-month period ended September 30, amortization of \$56,561 (2015 - \$114,664) is included in the consolidated statement of loss: \$10,976 (2015 - \$7,739) in 'cost of goods sold' and \$45,585 (2015 - \$106,925) in 'selling and administrative expenses'.

For the three-month period ended September 30, amortization of \$19,464 (2015 - \$37,710) is included in the consolidated statement of loss: \$4,270 (2015 - \$2,538) in 'cost of goods sold' and \$15,194 (2015 - \$35,172) in 'selling and administrative expenses'.

5 Bank loan

The Company has access to credit facilities in the amount of \$750,000 with Toronto-Dominion Bank of Canada which are guaranteed by Export Development Canada, and bear interest at the Toronto-Dominion's prime rate plus 2.5% per annum and are limited by certain margin requirements concerning trade and other receivables. These credit facilities were used up to \$700,000 as at September 30, 2016.

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

6 Obligation arising from shares issued by a subsidiary

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

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

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

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

September 30, 2016

(expressed in Canadian dollars)

	Q3-2016
	\$
Balance – Beginning of year	3,583,808
Accretion interest	253,382
Effect of exchange rate change on obligation	(283,131)
Balance – End of period	3,554,059
Current portion	-
	<u>3,554,059</u>

7 Share capital

a. Share issuance

The Company's authorized share capital consists of an unlimited number of common shares without par value.

b. Earnings (loss) per share

i) Basic

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

	For the three-month		For the nine-month	
	period ended September 30,		period ended September	
	2016	2015	2016	2015
	\$	\$	\$	\$
Net income (loss) attributable to owners of the parent	(534,977)	(1,184,904)	(2,446,553)	(2,672,563)
Weighted average number of common shares in issue	<u>39,363,867</u>	<u>39,363,867</u>	<u>39,363,867</u>	<u>39,363,867</u>
	<u>(0.01)</u>	<u>(0.03)</u>	<u>(0.07)</u>	<u>(0.06)</u>

ii) Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding to assume conversion of all dilutive potential common shares. The Company has two categories of dilutive potential common shares: warrants and stock options. For both, a calculation is performed to determine the number of shares that could have been acquired at fair value (determined as the average market share price of the Company's outstanding shares for the period), based on the monetary value of the

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

September 30, 2016

(expressed in Canadian dollars)

subscription rights attached to the warrants and stock options. The number of shares calculated below is compared with the number of shares that would have been issued assuming exercise of the warrants and stock options. For the periods ended September 30, 2016 and 2015, the diluted net loss per share was the same as the basic net loss per share, since the effect of assumed exercise of share options and warrants to purchase common shares was anti-dilutive.

c. 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 September 30, 2016, 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 years ended September 30 is presented below:

	Number of Options	Weighted-Average Exercise Price
Balance – January 1, 2015	5,838,402	\$ 0.18
Cancelled	(1,443,065)	\$ 0.24
Balance – September 30, 2015	4,395,337	\$ 0.16
Balance – January 1, 2016	4,390,337	\$ 0.16
Granted	1,500,000	\$ 0.05
Expired	(15,000)	\$ 12.00
Cancelled	(10,000)	\$ 0.22
Balance – September 30, 2016	5,865,337	\$ 0.11

(1) During the three month periods ended September 30, 2015, no stock options were granted, cancelled or have expired. During the three month periods ended September 30, 2016, 15,000 stock options have expired and 5,000 stock options were cancelled.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

September 30, 2016

(expressed in Canadian dollars)

At September 30, 2016, the following options were outstanding and exercisable:

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	1.5	258,065
August 11, 2018	\$0.22	247,272	1.9	247,272
December 22, 2018	\$0.10	1,560,000	2.2	1,560,000
April 25, 2021	\$0.15	100,000	4.6	100,000
May 29, 2021	\$0.14	200,000	4.7	200,000
September 22, 2021	\$0.12	2,000,000	4.9	2,000,000
January 7, 2023	\$0.05	1,500,000	6.3	1,500,000
	\$0.11	5,865,337	4.3	5,865,337

8 Expenses by nature

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2016 \$	2015 \$	2016 \$	2015 \$
Employee salaries and benefits	968,275	1,022,531	3,621,398	3,931,451
Material	761,694	930,156	2,786,315	3,395,415
Rent and repairs and maintenance	164,482	158,185	546,498	506,897
Professional fees	(16,428)	139,151	361,619	415,397
Travel expenses	136,809	159,804	415,232	463,994
Office expense	38,652	49,282	179,615	171,755
Subcontract cost	41,801	61,669	180,795	159,191
Amortization	42,542	62,941	127,823	196,028
Stock-based compensation	4,895	12,888	58,170	40,182
Commission	-	-	-	-
Other	80,672	368,422	171,536	366,847
	<u>2,223,394</u>	<u>2,965,029</u>	<u>8,449,001</u>	<u>9,647,158</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

September 30, 2016

(expressed in Canadian dollars)

9 Finance expenses

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2016	2015	2016	2015
	\$	\$	\$	\$
Interest and bank charges	13,618	12,440	33,296	43,366
Interest and bank charges	-	7,533	-	24,023
Accretion and revaluation of government royalty program obligation	-	9,229	33,499	24,857
Accretion of the obligation arising from shares issued by a subsidiary (note 6)	83,238	4,726	253,382	4,726
Interest charges	19,380	-	73,801	-
Interest on long-term debt	-	-	-	92
	<u>116,236</u>	<u>33,928</u>	<u>393,978</u>	<u>97,064</u>

10 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 September 30,		For the nine-month period ended September 30,	
	2016	2015	2016	2015
	\$	\$	\$	\$
Decrease (increase) in assets:				
Trade and other receivables	310,968	18,619	563,190	812,693
Investment tax credits receivable	-	(31,800)	69,723	(51,523)
Other current assets	20,337	260,393	20,232	283,968
Increase (decrease) in liabilities:				
Trade payables	187,374	247,444	(383,519)	(279,579)
Accrued liabilities	(212,769)	42,792	(61,364)	151,602
Deferred revenues	255,123	726,966	1,252,432	400,667
Other operating liabilities	(260,659)	25,852	(489,800)	(38,556)
	<u>(83,864)</u>	<u>1,160,197</u>	<u>319,408</u>	<u>1,665,302</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements
(Unaudited)

September 30, 2016

(expressed in Canadian dollars)

11 Financial instruments

Fair value

The Company's financial instruments consist of cash, receivables and accounts payable and accrued liabilities. The carrying values of these financial instruments approximate their fair values due to their short-term maturity.

Financial risk management

The Company's activities expose it to a variety of financial risks including credit risk, liquidity risk and market risk.

Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Financial instruments that potentially subject the Company to credit risk consist of cash and receivables. The carrying amount of the financial assets recorded in the financial statements, net of any allowance for losses, represents the maximum exposure to credit risk.

The Company deposits its cash with a high credit quality major Canadian financial institution as determined by ratings agencies. Receivables are mainly customers receivable and sales tax receivable.

To reduce credit risk, the Company regularly reviews the collectability of its receivables, and establishes an allowance based on its best estimate of potentially uncollectible amounts. The Company historically has not had difficulty collecting its receivables.

Liquidity risk

Liquidity risk represents the risk that the Company will not be able to meet its financial obligations as they fall due. The Company mitigates liquidity risk through its capital structure and by continuously monitoring actual and projected cash flows.

The Board of Directors reviews the Company's operating and capital budgets, as well as any material transactions outside of the ordinary course of business.

Market risk

Market risk is the risk of loss that may arise from changes in market factors, such as interest rates, and foreign currency risk.

(a) Interest rate risk

Interest rate risk is the Company's exposure to increase or decrease in financial instruments value caused by fluctuations in interest rates.

(b) Foreign currency risk

The Company has significant foreign assets, liabilities and sales; accordingly, the Company is exposed to significant foreign currency risk.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

September 30, 2016

(expressed in Canadian dollars)

12 Related party transactions

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

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2016 \$	2015 \$	2016 \$	2015 \$
Marketing and professional services expenses paid to companies controlled by members of the immediate family of an officer	28,006	27,447	83,676	82,037
Sales to entities controlled by a subsidiary manager	-	39,794	-	882,900
	<u>28,006</u>	<u>67,241</u>	<u>83,676</u>	<u>964,937</u>

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

13 Segmented information

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

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

Revenue	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2016 \$	2015 \$	2016 \$	2015 \$
United States	644,790	581,176	2,628,158	2,562,252
Canada	836,286	653,816	2,230,494	1,869,063
China	250,056	413,645	498,558	1,159,170
Singapore	15,660	368,148	412,415	1,210,626
Other	49,004	31,898	551,172	548,820
	<u>1,795,796</u>	<u>2,048,683</u>	<u>6,320,797</u>	<u>7,349,931</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

September 30, 2016

(expressed in Canadian dollars)

Revenue summarized by product line is as follows:

Product line	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2016 \$	2015 \$	2016 \$	2015 \$
Purification	836,983	1,089,340	2,735,389	4,446,501
Compressed gas filtration	958,813	959,343	3,585,408	2,903,430
Generation	-	-	-	-
	<u>1,795,796</u>	<u>2,048,683</u>	<u>6,320,797</u>	<u>7,349,931</u>

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

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2016 \$	2015 \$	2016 \$	2015 \$
Customer A	235,759	15,855	738,571	15,855
Customer B	9,022	39,794	403,642	882,900
	<u>244,781</u>	<u>55,649</u>	<u>1,142,213</u>	<u>898,755</u>

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

	September 30, 2016 \$	December 31, 2015 \$
Non-current assets		
Canada	335,788	431,173
Asia	113,923	127,353
United States	3,731	4,652
	<u>453,442</u>	<u>563,178</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

September 30, 2016

(expressed in Canadian dollars)

14 Contingency

The Company was party to various ongoing and pending litigation along with other contingencies arising out of the normal course of business. As a result, management had provisioned for estimated damages in current portion of provision. A settlement was made during the quarter ended September 30, 2016 and a reversal of \$220,000 was recorded.

15 Subsequent event

On November 15, the Company announces its intention to carry out a non-brokered private placement in the amount of \$1,000,000, of 9% convertible unsecured debentures of the Corporation maturing thirty-six months from the date of closing of the private placement.