

Xebec Adsorption Inc.

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

**For the three-month and nine-month periods ended
September 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 September 30, 2017 \$	As at December 31, 2016 \$
Assets		
Current assets		
Cash	363,543	1,088,592
Trade and other receivables	5,954,075	2,449,441
Inventories	567,573	1,329,516
Investment tax credits receivable	15,943	47,953
Other current assets	86,843	188,297
Total current assets	<u>6,987,977</u>	<u>5,103,799</u>
Non-current assets		
Property, plant and equipment (Note 3)	229,447	274,538
Intangible assets (Note 4)	131,126	190,743
Total non-current assets	<u>360,573</u>	<u>465,281</u>
Total assets	<u>7,348,550</u>	<u>5,569,080</u>
Liabilities		
Current liabilities		
Bank loan (note 5)	670,000	755,000
Trade payables and accrued liabilities	2,413,070	3,623,259
Deferred revenues	847,375	942,575
Term facility (note 6)	1,813,512	-
Current portion of long-term debt (note 7a))	27,498	22,112
Current portion of government royalty program obligation (note 7b))	80,868	757,540
Current portion of provisions	16,133	209,133
Total current liabilities	<u>5,868,456</u>	<u>6,309,619</u>
Non-current liabilities		
Long-term debt (note 7a))	562,897	774,788
Government royalty program obligation (note 7b))	518,214	-
Obligation arising from shares issued by a subsidiary (note 8)	3,719,265	3,582,135
Government grants	-	2,083
Deferred rent	158,304	138,516
Provisions	76,276	8,926
Total non-current liabilities	<u>5,034,956</u>	<u>4,506,448</u>
Total liabilities	<u>10,903,412</u>	<u>10,816,067</u>
Equity		
Equity attributable to shareholders of the Company		
Share capital (note 9)	19,703,836	19,318,856
Contributed surplus	3,259,364	2,996,621
Equity component of convertible debentures (note 7a))	105,212	150,304
Accumulated other comprehensive loss	(875,142)	(940,216)
Deficit	(25,748,132)	(26,772,552)
Total equity	<u>(3,554,862)</u>	<u>(5,246,987)</u>
Total liabilities and equity	<u>7,348,550</u>	<u>5,569,080</u>

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

Approved by the Board of Directors on November 28, 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 September 30,		For the 9 months period ended September 30,	
	2017 \$	2016 \$	2017 \$	2016 \$
Revenue (note 15)	4,129,381	1,795,796	11,486,751	6,320,797
Cost of goods sold	<u>2,428,479</u>	<u>1,518,703</u>	<u>6,736,200</u>	<u>5,152,317</u>
Gross margin	<u>1,700,902</u>	<u>277,093</u>	<u>4,750,551</u>	<u>1,168,480</u>
Research and development expenses	2,925	(20,727)	(41,361)	79,669
Selling and administrative expenses	1,488,582	704,691	3,582,743	3,296,684
Foreign exchange (gain) loss	113,084	(34,698)	234,721	233,592
Gain on insurance claim	(132,344)	-	(132,344)	
(Gain) loss on conversion of shares issued by a subsidiary (note 8)	<u>(74,122)</u>	<u>18,154</u>	<u>(106,178)</u>	<u>(283,130)</u>
	<u>1,398,125</u>	<u>667,420</u>	<u>3,537,581</u>	<u>3,326,815</u>
Operating income (loss)	<u>302,777</u>	<u>(390,327)</u>	<u>1,212,970</u>	<u>(2,158,335)</u>
Other income (charge)				
Finance income	6,992	(262)	(110,613)	(2,935)
Finance expense (note 12)	<u>202,593</u>	<u>116,236</u>	<u>299,163</u>	<u>393,978</u>
	<u>209,585</u>	<u>115,974</u>	<u>188,550</u>	<u>391,043</u>
Income (loss) before income taxes	<u>93,192</u>	<u>(506,301)</u>	<u>1,024,420</u>	<u>(2,549,378)</u>
Income taxes	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net income (loss) for the period	<u>93,192</u>	<u>(506,301)</u>	<u>1,024,420</u>	<u>(2,549,378)</u>
Income (loss) per common share Basic and Diluted (note 9)	<u>0.00</u>	<u>(0.01)</u>	<u>0.02</u>	<u>(0.06)</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)

(expressed in Canadian dollars)

	For the 3 months period ended September 30,		For the 9 months period ended September 30,	
	2017	2016	2017	2016
	\$	\$	\$	\$
Net income (loss) for the period	93,192	(506,301)	1,024,420	(2,549,378)
Other comprehensive income (loss)				
Cumulative translation adjustment	<u>34,769</u>	<u>(28,676)</u>	<u>65,074</u>	<u>102,825</u>
Comprehensive income (loss) for the period	<u>127,961</u>	<u>(534,977)</u>	<u>1,089,494</u>	<u>(2,446,553)</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

(Unaudited)

(expressed in Canadian dollars)

	Number						Amount
	Common shares	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	-	-	-	-	(2,549,378)	-	(2,549,378)
Other comprehensive income	-	-	-	102,825	-	-	102,825
Comprehensive income (loss) for the period	-	-	-	102,825	(2,549,378)	-	(2,446,553)
Share-based compensation	-	-	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)
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	-	-	-	-	1,024,420	-	1,024,420
Other comprehensive income	-	-	-	65,074	-	-	65,074
Comprehensive income (loss) for the period	-	-	-	65,074	1,024,420	-	1,089,494
Share-based compensation	-	-	292,227	-	-	-	292,227
Share issued from the exercise of options (note 10)	1,140,500	88,535	(29,484)	-	-	-	59,051
Conversion of convertible debenture	2,000,000	296,445	-	-	-	(45,092)	251,353
Balance – September 30, 2017	42,504,367	19,703,836	3,259,364	(875,142)	(25,748,132)	105,212	(3,554,862)

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 September 30,		For the 9 months period ended September 30,	
	2017	2016	2017	2016
	\$	\$	\$	\$
Cash flows from				
Operating activities				
Net income (loss) for the period	93,192	(506,301)	1,024,420	(2,549,378)
Items not affecting cash				
Depreciation of property, plant and equipment (note 3)	20,730	23,078	66,216	71,262
Amortization of intangible assets (note 4)	20,102	19,464	60,478	56,561
Reversal of inventory write-down	-	-	(128,524)	(17,420)
Government grant	-	(1,250)	(2,083)	(3,750)
Accretion and revaluation of government royalty program obligation (note 7b))	7,384	-	(98,458)	33,499
Accretion of the obligation arising from shares issued by a subsidiary (note 8)	81,933	83,238	243,308	253,382
Accretion of the convertible debenture (note 12)	41,131	-	119,507	-
Stock-based compensation expense (note 10)	292,227	4,896	292,227	58,170
Forgiveness of debt	-	-	(697,655)	-
Gain on revaluation of bad debt	-	-	(274,482)	-
Reimbursement from insurance claim	(132,344)	-	(132,344)	-
Deferred rent	6,596	6,596	19,788	19,788
	<u>430,951</u>	<u>(370,279)</u>	<u>492,398</u>	<u>(2,077,886)</u>
Changes in non-cash working capital components related to operations (note 13)	<u>(450,354)</u>	<u>(83,864)</u>	<u>(2,874,612)</u>	<u>319,409</u>
	<u>19,403</u>	<u>(454,143)</u>	<u>(2,382,214)</u>	<u>(1,758,478)</u>
Investing activities				
Acquisition of property, plant and equipment	(14,154)	(6,579)	(26,110)	(8,382)
Acquisition of intangible assets	(1,664)	(490)	(2,084)	(19,227)
	<u>(15,818)</u>	<u>(7,069)</u>	<u>(28,194)</u>	<u>(27,609)</u>
Financing activities				
Increase (decrease) of bank loan	75,000	(25,000)	(85,000)	325,000
Term facility	(186,488)	-	1,813,512	-
Proceeds for issuance of share capital (note 10)	-	-	88,535	-
Repayment of long-term debt	(6,377)	-	(18,177)	-
Repayment of government royalty program obligation (note 7b))	(15,000)	-	(60,000)	-
	<u>(132,865)</u>	<u>(25,000)</u>	<u>1,738,870</u>	<u>325,000</u>
Net increase (decrease) in cash during the period	<u>(168,086)</u>	<u>(486,212)</u>	<u>(671,538)</u>	<u>(1,461,087)</u>
Cash – Beginning of period	<u>521,302</u>	<u>1,583,525</u>	<u>1,088,592</u>	<u>2,717,965</u>
Effect of exchange rate changes on cash	10,327	(11,219)	(53,511)	(170,784)
Cash and cash equivalent – End of period	<u>363,543</u>	<u>1,086,094</u>	<u>363,543</u>	<u>1,086,094</u>
Additional information				
Interest paid	79,020	32,998	248,745	107,097

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)

(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) Liquidity risk assumption

The Company has realized an operating income of \$1,212,970 had cash outflows from operations of \$2,382,214 for the nine-month period ended September 30, 2017 and finished the period with cash amounting to \$363,543, a working capital of \$1,119,521, and had access to credit facilities totalling \$750,000 of which \$670,000 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 2017 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 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 November 28, 2017.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(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, 2016, as they follow the same accounting policies and methods of application, unless otherwise indicated.

Convertible debentures

Convertible debentures are separated into their debt and equity components. The value of the debt component of the debentures is determined, at the time of issuance, by discounting the future interest obligations and the principal payment due at maturity, using a discount rate which represents the estimated borrowing rate available to the Company for similar debentures having no conversion rights. The remaining portion of the gross proceeds of the debentures issued is presented as an option to convert the debentures in equity net of the tax implications, and the attributed amount remains over the term of the related convertible debentures. Convertible debenture issue costs are applied against the two components on a pro rata basis of the allocated proceeds of issue. The debt component presented in the consolidated statements of financial position increases over the term of the debenture to the full face value of the outstanding debenture at maturity. The difference, that is, the accretion on convertible debentures, is presented as implicit interest expense with the result that adjusted interest expense reflects the effective yield of the debt component of the debentures. Upon conversion of the debentures into common shares by the holders, both of the above-mentioned components are transferred to share capital. If a conversion option is not exercised at the expiry of the convertible debentures, the equity component of the convertible debentures is transferred to contributed surplus.

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

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(expressed in Canadian dollars)

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.

3 Property, plant and equipment

	Machinery and equipment	Office furnitu re 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	5,431	5,750	14,929	-	-	26,110
Effect of movements in exchange rates	(7,824)	(2,897)	(4,072)	(2,785)	-	(17,578)
Balance at September 30, 2017	575,499	150,565	281,702	163,792	35,984	1,207,542
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	35,320	6,940	11,077	12,879	-	66,216
Effect of movements in exchange rates	(3,258)	(2,655)	(3,892)	(2,788)	-	(12,593)
Balance at September 30, 2017	413,800	133,191	256,635	138,485	35,984	978,095
Carrying Amount						
At December 31, 2016	196,154	18,806	21,395	38,184	-	274,538
At September 30, 2017	161,699	17,374	25,067	25,307	-	229,447

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(expressed in Canadian dollars)

4 Intangible assets

	<u>Other</u>	<u>Internally generated</u>	
	<u>Software</u>	<u>Development costs</u>	<u>Total intangible assets</u>
	\$	\$	\$
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	-	2,084	2,084
Impairment	-	-	-
Effect of movements in exchange rates	(5,016)	-	(5,016)
Balance at September 30, 2017	322,176	301,059	623,235
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	15,673	44,805	60,478
Impairment	-	-	-
Effect of movements in exchange rates	(3,793)	-	(3,793)
Balance at September 30, 2017	298,870	193,239	492,109
Carrying amount			
At December 31, 2016	40,202	150,541	190,743
At September 30, 2017	23,306	107,820	131,126

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(expressed in Canadian dollars)

For the nine-month period ended September 30, amortization of \$60,478 (2016 - \$56,561) is included in the consolidated statement of loss: \$15,170 (2016 - \$10,976) in 'cost of goods sold' and \$45,308 (2016 - \$45,585) in 'selling and administrative expenses'.

For the three-month period ended September 30, amortization of \$20,102 (2016 - \$19,464) is included in the consolidated statement of loss: \$4,845 (2016 - \$4,270) in 'cost of goods sold' and \$15,257 (2016 - \$15,194) 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 3.2% (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 \$670,000 as at September 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 following table summarizes the activity related to the facility with EDC during the nine-month period ended September 30, 2017:

	2017	2016
	\$	\$
Balance – January 1,	-	-
Addition	2,000,000	-
Repayment	(186,488)	-
Balance – June 30,	1,813,512	-

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(expressed in Canadian dollars)

7 Long-term debt

a) Loans

	As at September 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.	23,943	42,120
Obligation under a capital lease, repayable in monthly installments of \$352 including interest calculated at 12% maturing in September 2020, secured by equipment.	11,327	-
Unsecured Convertible debentures	555,125	754,780
Long-term debt	590,395	796,900
Less: Current portion	27,498	22,112
	<u>562,897</u>	<u>774,788</u>

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.

Some debentures were converted by holders as at September 30, 2017.

During the quarter, 2,000,000 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.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

(expressed in Canadian dollars)

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.

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

	2017 \$	2016 \$
Balance – January 1,	757,540	724,041
Accretion interest	(98,458)	33,499
Repayment	(60,000)	-
Balance – September 30,	599,082	757,540
Current portion	(80,868)	757,540
	518,214	-

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.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(expressed in Canadian dollars)

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 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	2016
	\$	\$
Balance – January 1 st ,	3,582,135	3,583,808
Accretion interest	243,308	350,575
Effect of exchange rate change on obligation	(106,178)	(352,248)
Balance – September 30,	3,719,265	3,582,135
Current portion	-	-
	<u>3,719,265</u>	<u>3,582,135</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(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 2017 and 2016.

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.

	<u>For the three-month period ended September 30,</u>		<u>For the nine-month period ended September 30,</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
Net income (loss) attributable to owners of the parent	93,192	(506,301)	1,024,420	(2,549,378)
Weighted average number of common shares in issue	<u>40,613,063</u>	<u>39,363,867</u>	<u>39,907,510</u>	<u>39,363,867</u>
	<u>0.002</u>	<u>(0.01)</u>	<u>0.02</u>	<u>(0.06)</u>

10 Stock options

The stock option plan allowed for the issuance of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards and other stock-based awards. Under the Plan, a fixed number of 7,892,773 common shares are available for grant. As at September 30, 2017, the maximum number of common shares available for issuance under all stock-based compensation arrangements is 574,743.

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

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(Unaudited)

(expressed in Canadian dollars)

Stock option activity for the nine-month periods ended September 30 is presented below:

	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	2,608,193	0.23	1,500,000	0.05
Exercised	(1,140,500)	0.05	-	-
Cancelled	(5,000)	0.22	(4,950)	0.22
Expired	-	-	-	-
Outstanding – September 30,	7,318,030	0.16	5,885,387	0.13
Exercisable – September 30,	7,318,030	0.16	5,885,387	0.13

As at September 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	.05	258,065
August 11, 2018	\$0.22	232,272	.09	232,272
December 22, 2018	\$0.10	1,519,500	1.1	1,519,500
April 25, 2021	\$0.15	100,000	3.6	100,000
May 29, 2021	\$0.14	200,000	3.7	200,000
September 22, 2021	\$0.12	2,000,000	4.0	2,000,000
January 7, 2023	\$0.05	400,000	5.3	400,000
March 5, 2024	\$0.18	2,108,193	6.4	1,095,000
August 29, 2024	\$0.49	500,000	6.9	-
	\$0.16	7,318,030	4.1	5,804,837

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

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

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(expressed in Canadian dollars)

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

Risk-free interest rate	1.55%
Annualized volatility ¹	137%
Dividend rate	0.00%
Expected life of options	7 years

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

Risk-free interest rate	1.80%
Annualized volatility ¹	138%
Dividend rate	0.00%
Expected life of options	7 years

During the nine months ended September 30, 2017, the Company expensed \$292,227 (September 30, 2016 – \$58,170) which totally relates to stock options granted in 2017. The unamortized share-based payments balance of \$288,917 (2014 – \$3,085) will be recognized during the current year (\$67,528) and the next fiscal year (2018 – \$135,177; 2019 – \$52,712; 2020 – \$25,223; 2021 – \$8,277).

¹ The expected volatility used was based on the historic volatility of the Company share price

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(expressed in Canadian dollars)

11 Expenses by nature

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2017 \$	2016 \$	2017 \$	2016 \$
Employee salaries and benefits	1,356,732	968,275	4,202,327	3,621,398
Material	1,737,599	761,694	4,135,302	2,786,315
Rent and repairs and maintenance	192,007	164,482	545,289	546,498
Professional fees	192,538	(16,428)	510,308	361,619
Travel expenses	127,183	136,809	408,130	415,232
Stock-based compensation	292,227	4,895	292,227	58,170
Office expense	65,951	38,652	181,311	179,615
Subcontract cost	(144,418)	41,801	169,900	180,795
Amortization	40,832	42,542	126,694	127,823
Bad Debt	(58,480)	-	(338,989)	-
Inventory Provision	-	-	(128,524)	-
Other	114,890	80,672	214,968	171,536
	<u>3,917,061</u>	<u>2,223,394</u>	<u>10,318,943</u>	<u>8,449,001</u>

12 Finance expenses

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2017 \$	2016 \$	2017 \$	2016 \$
Interest and bank charges	20,369	13,618	71,800	33,296
Interest on debt	58,651	-	176,945	-
Interest charges	509	19,380	10,237	73,801
Forgiveness of debt	-	-	(322,634)	-
Accretion of convertible debenture	41,131	-	119,507	-
Accretion and revaluation of government royalty program obligation (note 7b))	-	-	-	33,499
Accretion of the obligation arising from shares issued by a subsidiary (note 8)	81,933	83,238	243,308	253,382
	<u>202,593</u>	<u>116,236</u>	<u>299,163</u>	<u>393,978</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(expressed in Canadian dollars)

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 September 30,		For the nine-month period ended September 30,	
	2017	2016	2017	2016
	\$	\$	\$	\$
Decrease (increase) in assets:				
Trade and other receivables	(1,709,611)	310,968	(3,097,809)	563,190
Inventories	405,739	(384,238)	890,466	(651,486)
Investment tax credits receivable	12,044	-	32,010	69,723
Other current assets	18,154	20,337	101,453	20,232
Increase (decrease) in liabilities:				
Trade payables, other payables and accrued liabilities	141,343	(25,395)	(512,533)	(444,883)
Deferred revenues	703,850	255,123	(95,200)	1,252,432
Other operating liabilities	(21,873)	(260,659)	(192,999)	(489,800)
	<u>(450,354)</u>	<u>(83,864)</u>	<u>(2,874,612)</u>	<u>319,408</u>

14 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,	
	2017	2016	2017	2016
	\$	\$	\$	\$
Marketing and professional services expenses paid to companies controlled by members of the immediate family of an officer	<u>23,821</u>	<u>28,006</u>	<u>100,156</u>	<u>83,676</u>

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)

(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.

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

	<u>For the three-month period ended September 30,</u>		<u>For the nine-month period ended September 30,</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
	\$	\$	\$	\$
Revenue				
France	1,422,890	-	3,793,781	-
United States	393,345	644,790	2,603,722	2,628,158
Canada	591,301	836,286	2,096,976	2,230,494
China	553,171	250,056	1,239,933	498,558
Other	1,168,674	64,664	1,752,339	963,587
	<u>4,129,381</u>	<u>1,795,796</u>	<u>11,486,751</u>	<u>6,320,797</u>

Revenue summarized by business segment is as follows:

	<u>For the three-month period ended September 30,</u>		<u>For the nine-month period ended September 30,</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
	\$	\$	\$	\$
Business Segments				
Industrial Compress Air and Gas Treatment	969,066	900,817	3,476,591	3,585,408
Clean Technology	2,173,637	894,979	6,782,507	2,735,389
Oil and Gas Processing	986,678	-	1,227,653	-
	<u>4,129,381</u>	<u>1,795,796</u>	<u>11,486,751</u>	<u>6,320,797</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(expressed in Canadian dollars)

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

	September 30, 2017	December 31, 2016
	\$	\$
Non-current assets		
Canada	244,160	305,071
Asia	75,295	111,480
United States	41,118	48,730
	<u>360,573</u>	<u>465,281</u>

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:

	September 30, 2017		Other	
	Loans and receivables		financial liabilities	
	Carrying amount	Fair value	Carrying amount	Fair value
	\$	\$	\$	\$
Cash	363,543	363,543	-	-
Trade and other receivables	5,907,039	5,907,039	-	-
Other current assets	86,843	86,843	-	-
Bank loan	-	-	670,000	670,000
Trade, other payables and accrued liabilities	-	-	1,962,065	1,962,065
Convertible debentures	-	-	555,125	555,125
Government royalty program obligation	-	-	518,214	518,214
Obligation arising from shares issued by a subsidiary	-	-	3,719,265	3,719,265
Term facility	-	-	1,813,512	1,813,512

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December 31, 2016

	<u>Loans and receivables</u>		<u>Other financial liabilities</u>	
	<u>Carrying amount</u>	<u>Fair value</u>	<u>Carrying amount</u>	<u>Fair value</u>
	\$	\$	\$	\$
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.

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Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

(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 Subsequent event

On November 16, the Company announces the closing of a non-brokered private placement, in the amount of \$2,024,149, of 8% convertible unsecured debentures of the Corporation maturing twenty-four months from the date of closing of the private placement.