

# **Xebec Adsorption Inc.**

Interim Consolidated Financial Statements  
(Unaudited)  
**For the three-month period ended  
March 31, 2010**

**Xebec Adsorption Inc.**  
Interim Consolidated Balance Sheet  
(Unaudited)

	As at March 31, 2010 \$	As at December 31, 2009 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash	5,132,067	5,447,702
Accounts receivable	1,829,009	3,105,834
Inventories	3,053,646	2,867,922
Prepaid expenses	192,637	183,564
Income taxes recoverable	29,855	62,492
Investment tax credits receivable	65,217	80,843
Restricted cash	206,997	223,261
Current portion of loan to a joint venture	45,980	37,777
	10,555,408	12,009,395
<b>Loan to a joint venture</b> , bearing interest at 7.93%, repayable by minimum annual installments of \$79,940 plus accrued and unpaid interest, maturing on July 1, 2012	64,373	75,554
<b>Property, plant and equipment</b>	2,413,471	2,604,931
<b>Intangible assets</b>	263,094	279,046
<b>Goodwill</b>	5,951,390	5,942,152
	19,247,736	20,911,078
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank loan	487,692	496,900
Accounts payable and accrued liabilities	4,984,690	5,578,505
Deferred revenues	2,170,920	146,228
Derivative financial instruments (note 5)	172,963	96,645
Current portion of long-term debt	321,653	321,653
Current portion of subordinated loan	62,496	62,496
	8,200,414	6,702,427
<b>Long-term debt</b>	1,791,654	1,763,496
<b>Government assistance</b>	35,833	37,083
<b>Subordinated loan</b>	140,632	156,256
	10,168,533	8,659,262
<b>Shareholders' Equity</b>		
<b>Share capital</b>	17,942,821	17,942,821
<b>Contributed surplus</b>	222,966	216,368
<b>Deficit</b>	(9,086,584)	(5,907,373)
	9,079,203	12,251,816
	19,247,736	20,911,078

See notes to interim consolidated financial statements.

**Approved by the Board of Directors**

\_\_\_\_\_ Director

\_\_\_\_\_ Director

# Xebec Adsorption Inc.

Interim Consolidated Statement of Income (Loss) and Comprehensive Income (Loss)  
(Unaudited)

For the three-month period ended March 31, 2010

	<b>2010</b>	<b>2009</b>
	\$	\$
<b>Revenue</b>	1,991,650	4,707,379
<b>Cost of goods sold</b>	1,670,043	2,820,739
<b>Gross margin</b>	321,607	1,886,640
<b>Operating expenses</b>		
Selling and administrative	2,487,171	1,373,022
Research and development, net of research and development tax credits of \$24,200 (2009 – \$64,696) and government grants of \$1,250 (2009 – \$1,250)	542,892	73,747
Financial	91,110	69,480
Foreign exchange loss (gain)	164,935	(11,098)
Amortization of property, plant and equipment	198,758	45,624
Amortization of intangible assets	15,952	35,585
	3,500,818	1,586,360
<b>Income (loss) before income taxes</b>	(3,179,211)	300,280
<b>Provision for income taxes</b>		
Current	-	45,000
Future	-	60,602
	-	105,602
<b>Net income (loss) and comprehensive income (loss)</b>	(3,179,211)	194,678
<b>Income (loss) per share</b>		
Basic and diluted	(0.11)	0.02

See notes to interim consolidated financial statements.

# Xebec Adsorption Inc.

## Interim Consolidated Statement of Changes in Shareholders' Equity

(Unaudited)

For the three-month period ended March 31, 2010

	Number			Amount				Total \$
	Warrants	Common shares	Preferred shares	Common shares & warrants \$	Preferred shares \$	Contributed surplus \$	Retained earnings (deficit) \$	
<b>Balance – January 1, 2009</b>	5,868,108	8,638,496	300,000	100	300,000	-	825,041	1,125,141
Net income for the period	-	-	-	-	-	-	194,678	194,678
<b>Balance – March 31, 2009</b>	5,868,108	8,638,496	300,000	100	300,000	-	1,019,719	1,319,819
Conversion of preferred shares*	311,892	769,231	(300,000)	300,000	(300,000)	-	-	-
Deemed issuance of shares and warrants on reverse takeover transaction	6,180,000	11,269,318	-	11,921,423	-	26,767	-	11,948,190
Issuance of shares and warrants – Private placement, November 25, 2009	4,807,824	8,585,400	-	6,439,050	-	-	-	6,439,050
Financing costs – Private placement, November 25, 2009	-	-	-	(717,752)	-	165,000	-	(552,752)
Net loss for the period	-	-	-	-	-	-	(6,927,092)	(6,927,092)
Stock-based compensation	-	-	-	-	-	24,601	-	24,601
<b>Balance – December 31, 2009</b>	17,167,824	29,262,445	-	17,942,821	-	216,368	(5,907,373)	12,251,816
Net loss for the period	-	-	-	-	-	-	(3,179,211)	(3,179,211)
Stock-based compensation	-	-	-	-	-	6,598	-	6,598
<b>Balance – March 31, 2010</b>	17,167,824	29,262,445	-	17,942,821	-	222,966	(9,086,584)	9,079,203

\* These represent the shares and warrants issued to the shareholders of Xebec on reverse takeover.

See notes to interim consolidated financial statements.

# Xebec Adsorption Inc.

## Interim Consolidated Statement of Cash Flows (Unaudited)

For the three-month period ended March 31, 2010

	2010 \$	2009 \$
<b>Cash flows from</b>		
<b>Operating activities</b>		
Net income (loss) for the period	(3,179,211)	194,678
Items not affecting cash		
Amortization of property, plant and equipment	198,758	45,624
Amortization of intangible assets	15,952	35,585
Unrealized foreign exchange loss (gain) on derivative financial instruments	76,318	(19,578)
Unrealized foreign exchange loss on loan to a joint venture and restricted cash	19,242	-
Stock-based compensation expense	6,598	4,324
Future income taxes	-	60,602
	<u>(2,862,343)</u>	<u>321,235</u>
Changes in non-cash working capital components relating to operations		
Accounts receivable	1,276,825	1,418,578
Inventories	(185,724)	416,922
Prepaid expenses	(9,073)	82,654
Income taxes recoverable	32,637	37,873
Investment tax credits receivable	15,626	(64,696)
Accounts payable and accrued liabilities	(603,053)	(1,645,150)
Deferred revenues	2,024,692	364,479
	<u>2,551,930</u>	<u>610,660</u>
	<u>(310,413)</u>	<u>931,895</u>
<b>Investing activities</b>		
Acquisition of property, plant and equipment	(7,298)	(140,469)
Acquisition of intangible assets	-	(230,139)
Government assistance	(1,250)	(1,250)
	<u>(8,548)</u>	<u>(371,858)</u>
<b>Financing activities</b>		
Decrease in bank loan	(9,208)	(860,030)
Increase in long-term liabilities	99,867	25,007
Repayment of long-term debt	(87,333)	(73,048)
	<u>3,326</u>	<u>(908,071)</u>
<b>Decrease in cash during the period</b>	<u>(315,635)</u>	<u>(348,034)</u>
<b>Cash – Beginning of period</b>	<u>5,447,702</u>	<u>550,377</u>
<b>Cash – End of period</b>	<u>5,132,067</u>	<u>202,343</u>
Supplemental cash flow information (note 6)		

See notes to interim consolidated financial statements.

# Xebec Adsorption Inc.

## Notes to Interim Consolidated Financial Statements

(Unaudited)

March 31, 2010

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### 1 Nature of business and liquidity risk

#### a) Nature of business

Xebec Adsorption Inc. (the “company”) is a global provider of clean energy solutions to corporations and governments looking to reduce their carbon footprints. The company was formed upon the amalgamation of Xebec Adsorption Inc. (“Xebec”) and QuestAir Technologies Inc. (“QuestAir”) on June 12, 2009. The comparative financial statements are those of Xebec and the financial statements reflect the accounts of QuestAir from June 12, 2009.

#### b) Liquidity risk

Although the company has incurred an operating loss of \$3,179,211 and had cash outflows from operations of \$310,413 for the three-month period ended March 31, 2010, the company finished the period with cash amounting to \$5,132,067 and working capital of \$2,354,994, and had access to unused credit facilities totalling \$720,000. During the fourth quarter of 2009, management concluded a share offering which provided the company with net proceeds of \$5,886,298. The company also undertook various initiatives and developed a plan to manage its operating and liquidity risks in light of prevailing economic conditions. The company has prepared a budget for the 12 months ending March 31, 2011 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. Management expects to meet its budget and to have enough liquidity to fund operations to at least beyond March 31, 2011.

The company is thus faced with uncertainties that may have an impact on future operating results and liquidity. These uncertainties include reduced spending in renewable energy projects, reflecting the weakness in the economy, fluctuations in foreign currency rates and achieving the company’s business plan goals as mentioned in the previous paragraph, which includes the development of a new business segment. While management believes it has developed planned courses of action to mitigate operating and liquidity risks, there is no assurance that management will be able to achieve its business plan and maintain the necessary liquidity level if events or conditions develop that are not consistent with management’s expectations, key budget assumptions for 2010 and planned courses of action. Therefore, the company may require additional external funding and there is no assurance that such efforts would be successful. It is possible that future changes in capital market conditions could result in such funding not being available when required. The company is unable to predict the possible effects, if any, of such uncertainties and the potential adjustments to the carrying values of assets and liabilities that could be needed should the company have insufficient liquidity. Such adjustments could be material.

# **Xebec Adsorption Inc.**

Notes to Interim Consolidated Financial Statements

(Unaudited)

**March 31, 2010**

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## **2 Basis of presentation**

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). The same accounting policies have been used as described in the company’s latest annual consolidated financial statements. However, these unaudited interim consolidated financial statements do not include all disclosures required under Canadian GAAP for annual consolidated financial statements and accordingly should be read in conjunction with the company’s latest annual consolidated financial statements and the notes thereto. In the opinion of management, these unaudited interim consolidated financial statements contain all the adjustments considered necessary.

Certain comparative figures have been reclassified to conform to the presentation adopted in the current period.

## **3 Significant accounting policies**

### **Basis of consolidation**

These unaudited interim consolidated financial statements include the accounts of the Company and its subsidiary, Xebec Adsorption (Shanghai) Co. Ltd. They also include the company’s portion of the accounts of a joint venture accounted for using the proportionate consolidation method.

## **4 Recently issued accounting standard**

In December 2009, the Emerging Issues Committee (“EIC”) of the Canadian Institute of Chartered Accountants issued Abstract EIC-175, “Multiple Deliverable Revenue Arrangements”, which requires a vendor to allocate arrangement consideration at the inception of an arrangement to all deliverables using the relative selling price method. EIC-175 also changes the level of evidence of the standalone selling price required to separate deliverables when more objective evidence of the selling price is not available. Given the requirement to use the relative selling price method of allocating arrangement consideration, EIC-175 prohibits the use of the residual method. EIC-175 may be applied prospectively and is applicable to revenue arrangements with multiple deliverables entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011, with early adoption permitted. The company is evaluating the impact that this guidance may have on its consolidated financial statements.

# Xebec Adsorption Inc.

## Notes to Interim Consolidated Financial Statements

(Unaudited)

March 31, 2010

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### 5 Derivative financial instruments

The company has engaged in a sales contract with a foreign counterparty for which the contract is denominated in a currency other than the Canadian dollar or the functional currency of the foreign party. As at March 31, 2010, the fair market value of the bifurcated embedded derivative was a liability of \$172,963 and the change in fair value from the prior period amounting to \$76,318 was included in the foreign exchange gain on the statement of income (loss) and comprehensive income (loss). This bifurcated embedded derivative has a nominal value of €765,660.

### 6 Supplementary cash flow information

	<b>For the three-month period ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
Interest paid	68,208	74,527
Income taxes paid	-	27,351
Income taxes received	(27,351)	-

### 7 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 four product lines and provides related engineering services.

Revenue summarized by geographic area, as determined by the location of the customer, is as follows:

	<b>For the three-month period ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
Middle East	81,693	2,517,769
North America	1,117,234	1,691,982
Asia	533,788	7,038
Europe	258,935	490,590
	<b>1,991,650</b>	<b>4,707,379</b>



# Xebec Adsorption Inc.

Notes to Interim Consolidated Financial Statements  
(Unaudited)

March 31, 2010

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Revenue summarized by product line is as follows:

	<b>For the three-month period ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
Natural gas dryers	478,034	3,520,588
Compressed gas filtration	971,746	594,283
Air dryers	123,145	592,508
Gas purification	313,475	-
Engineering services	105,250	-
	<hr/>	<hr/>
	1,991,650	4,707,379
	<hr/>	<hr/>

Major customers representing 10% or more of total sales are as follows:

	<b>For the three-month period ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
Customer A	-	1,791,280
Customer B	-	538,827
Customer C	252,800	-
	<hr/>	<hr/>
	252,800	2,330,107
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The location of the company's capital assets and goodwill by geographic region is as follows:

	<b>As at March 31, 2010</b>	<b>As at December 31, 2009</b>
	<b>\$</b>	<b>\$</b>
Canada	8,213,664	8,357,870
Asia	414,291	468,259
	<hr/>	<hr/>
	8,627,955	8,826,129
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