

Xebec Adsorption Inc.

Interim Consolidated Financial Statements
(Unaudited)
September 30, 2010

Xebec Adsorption Inc.
Interim Consolidated Balance Sheet
(Unaudited)

	As at September 30, 2010 \$	As at December 31, 2009 \$
Assets		
Current assets		
Cash	301,046	5,447,702
Accounts receivable	3,962,347	3,105,834
Inventories	3,190,128	2,867,922
Prepaid expenses	179,190	183,564
Income taxes recoverable	-	62,492
Investment tax credits receivable	103,489	80,843
Restricted cash	580,118	223,261
Current portion of loan to a joint venture	57,716	37,777
	<u>8,374,034</u>	<u>12,009,395</u>
Loan to a joint venture , bearing interest at 7.93%, repayable by minimum annual instalments of \$79,940 plus accrued and unpaid interest, maturing on July 1, 2012	61,184	75,554
Property, plant and equipment	2,190,109	2,604,931
Intangible assets (note 6)	4,322,935	279,046
Goodwill (notes 5 and 6)	1,438,324	5,942,152
	<u>16,386,586</u>	<u>20,911,078</u>
Liabilities		
Current liabilities		
Bank loan (notes 1(b) and 7)	1,286,900	496,900
Accounts payable and accrued liabilities	7,449,994	5,578,505
Deferred revenues	2,348,491	146,228
Derivative financial instruments	-	96,645
Current portion of long-term debt	284,045	321,653
Current portion of subordinated loan	62,496	62,496
	<u>11,431,926</u>	<u>6,702,427</u>
Long-term debt	1,736,863	1,763,496
Government assistance	33,333	37,083
Subordinated loan	109,384	156,256
	<u>13,311,506</u>	<u>8,659,262</u>
Shareholders' Equity		
Share capital	16,167,905	17,942,821
Contributed surplus	2,018,316	216,368
Deficit	(15,111,141)	(5,907,373)
	<u>3,075,080</u>	<u>12,251,816</u>
	<u>16,386,586</u>	<u>20,911,078</u>
Going concern (note 1(b))		

See notes to interim consolidated financial statements.

Approved by the Board of Directors

_____ Director

_____ Director

Xebec Adsorption Inc.

Interim Consolidated Statement of Loss and Comprehensive Loss

(Unaudited)

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2010 \$	2009 \$	2010 \$	2009 \$
Revenue	3,955,714	5,924,603	10,088,981	14,935,238
Cost of goods sold (note 5)	3,764,337	4,183,758	9,177,618	9,736,510
Gross margin	191,377	1,740,845	911,363	5,198,728
Operating expenses				
Selling and administrative	2,255,766	2,077,305	7,364,889	5,310,228
Research and development (note 8)	663,275	682,257	1,784,391	881,732
Financial	93,198	44,199	307,607	160,629
Foreign exchange loss (gain)	(55,676)	25,217	(9,740)	227,375
Amortization	307,074	240,816	677,402	428,285
	3,263,637	3,069,794	10,124,549	7,008,249
Loss before income taxes	(3,072,260)	(1,328,949)	(9,213,186)	(1,809,521)
Provision for (recovery of) income taxes				
Current	(9,418)	(4,054)	(9,418)	8,348
Future	-	(112,200)	-	(122,615)
	(9,418)	(116,254)	(9,418)	(114,267)
Net loss and comprehensive loss for the period	(3,062,842)	(1,212,695)	(9,203,768)	(1,695,254)
Net loss per share				
Basic and diluted	(0.10)	(0.06)	(0.31)	(0.13)

See notes to interim consolidated financial statements.

Xebec Adsorption Inc.

Interim Consolidated Statement of Retained Earnings (Deficit)

(Unaudited)

For the nine-month period ended September 30, 2010

	Number			Amount				Total \$
	Warrants	Common shares	Preferred shares	Common shares and warrants \$	Preferred shares \$	Contributed surplus \$	Retained earnings (deficit) \$	
Balance – January 1, 2009	5,868,108	8,638,496	300,000	100	300,000	-	825,041	1,125,141
Net loss for the period	-	-	-	-	-	-	(482,559)	(482,559)
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
Balance – June 30, 2009	12,360,000	20,677,045	-	12,221,523	-	26,767	342,482	12,590,772
Net loss for the period	-	-	-	-	-	-	(6,249,855)	(6,249,855)
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)
Stock-based compensation	-	-	-	-	-	24,601	-	24,601
Balance – December 31, 2009	17,167,824	29,262,445	-	17,942,821	-	216,368	(5,907,373)	12,251,816
Net loss for the period	-	-	-	-	-	-	(9,203,768)	(9,203,768)
Issuance of shares	(9,536)	9,536	-	7,343	-	-	-	7,343
Stock-based compensation	-	-	-	-	-	19,689	-	19,689
Expiration of warrants, May 13, 2010	(12,360,000)	-	-	(1,782,259)	-	1,782,259	-	-
Balance – September 30, 2010	4,798,288	29,271,981	-	16,167,905	-	2,018,316	(15,111,141)	3,075,080

* 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 September 30,		For the nine-month period ended September 30,	
	2010 \$	2009 \$	2010 \$	2009 \$
Cash flows from				
Operating activities				
Net loss for the period	(3,062,842)	(1,212,695)	(9,203,768)	(1,695,254)
Items not affecting cash				
Purchase price allocation adjustment (note 5)	-	-	303,066	-
Amortization of property, plant and equipment	170,019	224,487	511,291	382,382
Amortization of intangible assets	137,055	16,329	166,111	45,903
Unrealized foreign exchange loss (gain) on derivative financial instruments	-	118,512	(96,645)	256,704
Unrealized foreign exchange loss (gain) on loan to a joint venture and restricted cash	(9,820)	-	4,879	-
Stock-based compensation expense	6,504	136,065	19,689	379,095
Future income taxes	-	(112,200)	-	(122,615)
	(2,759,084)	(829,502)	(8,295,377)	(753,785)
Changes in non-cash working capital components relating to operations				
Accounts receivable	(1,657,332)	(729,748)	(856,513)	1,210,678
Inventories	(55,823)	1,419,548	(322,206)	924,522
Prepaid expenses	(8,274)	(125,511)	4,374	(201,707)
Investment tax credits receivable	(38,272)	(40,000)	(22,646)	87,508
Accounts payable and accrued liabilities	1,429,794	(1,471,187)	1,862,251	(1,520,141)
Deferred revenues	780,635	(1,150,771)	2,202,263	(795,446)
Income taxes payable (recoverable)	29,855	(10,548)	62,492	(261,063)
	480,583	(2,108,217)	2,930,015	(555,649)
	(2,278,501)	(2,937,719)	(5,365,362)	(1,309,434)
Investing activities				
Acquisition of property, plant and equipment	(1,287)	(24,645)	(96,469)	(197,919)
Acquisition of intangible assets	-	(4,313)	-	(8,911)
Transaction costs paid on acquisition of a business	-	(47,174)	-	(1,115,250)
Cash acquired on acquisition of a business	-	-	-	5,122,028
Loan to a joint venture	-	(136,980)	-	(136,980)
Government assistance	(1,250)	-	(3,750)	(1,250)
	(2,537)	(213,112)	(100,219)	3,661,718
Financing activities				
Issuance of common shares	-	-	7,343	-
Increase (decrease) in bank loan	790,000	(26,114)	790,000	(1,131,677)
Long-term debt	-	76,797	181,101	101,804
Repayment of long-term debt	(99,557)	(69,924)	(292,214)	(194,124)
Payment of obligations under capital leases	-	(3,275)	-	(9,634)
Decrease (increase) in restricted cash	(367,305)	63,942	(367,305)	148,582
	323,138	41,426	318,925	(1,085,049)
Increase (decrease) in cash during the period	(1,957,900)	(3,109,405)	(5,146,656)	1,267,235
Cash – Beginning of period	2,258,946	4,927,017	5,447,702	550,377
Cash – End of period	301,046	1,817,612	301,046	1,817,612

See notes to interim consolidated financial statements.

Xebec Adsorption Inc.

Notes to Interim Consolidated Financial Statements

(Unaudited)

September 30, 2010

1 Nature of business and going concern

- a) Xebec Adsorption Inc. (the “Company”) is a provider specialized in the design, engineering and manufacturing of innovative gas solutions and services in the process of transforming raw gases into marketable sources of clean energy mainly used as transportation fuel. It results from 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 include the accounts of QuestAir from June 12, 2009 (note 5).

- b) Going concern

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Company has incurred an operating loss of \$9,203,768 for the nine-month period ended September 30, 2010 and has a deficit of \$15,111,141 as at September 30, 2010. The current financial position indicates that there is substantial doubt about the Company’s ability to continue as a going concern.

The Company’s ability to continue as a going concern is primarily dependent on its ability to generate sufficient future cash flows and to obtain additional financing to fund its operations and to settle its obligations on a timely basis. On November 2, 2010, management concluded a share offering which provided the Company with gross proceeds of \$3,796,754 (note 12). In addition, the Company undertook various initiatives, such as announcing temporary layoffs, and is currently developing a restructuring plan to manage its operations and liquidity risks in light of prevailing economic conditions. The Company expects to seek additional financing over the next months and to implement its restructuring plan. In addition, the Company’s credit facilities with the Royal Bank of Canada and Export Development of Canada matured on October 31, 2010. On November 11, 2010, the Company received confirmation from the Royal Bank of Canada that the credit facilities have been extended under the same terms and conditions until January 15, 2011. Management is currently negotiating an amendment to provide for an extension of the credit facility with Export Development of Canada. There is no assurance that such efforts will be successful.

These consolidated financial statements do not reflect the adjustments to the carrying values of assets and liabilities, the reported expenses and the balance sheet classifications that would be necessary if the Company were unable to continue as a going concern, and these adjustments could be material.

Depending on the outcome of its restructuring plan, the Company may have to record an impairment charge with respect to its long-lived assets and/or goodwill. Such charges, if any, will be recorded in the fourth quarter.

Xebec Adsorption Inc.

Notes to Interim Consolidated Financial Statements

(Unaudited)

September 30, 2010

2 Basis of presentation

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). 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.

3 Significant accounting policies

Basis of consolidation

These unaudited interim consolidated financial statements include the accounts of the Company and its subsidiaries, Xebec Adsorption (Shanghai) Co. Ltd. and Xebec Adsorption UK Limited, which was incorporated on April 13, 2010. They also include the Company’s portion of the accounts of a joint venture, Xebec Adsorption South East Asia Pte. Ltd., accounted for using the proportionate consolidation method.

Intangible assets

Intangible assets comprise customer relations, patents, software and engineering drawings which are accounted for at cost and are amortized over their expected benefit to future periods.

Engineering drawings, which consist of engineering costs incurred to develop product plans, and software are amortized using the straight-line method over three years. Customer relations are amortized using the straight-line method over a period of seven years. Patent costs are amortized using the straight-line method over 15 years.

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 stand-alone 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)

September 30, 2010

5 Business combination

Pursuant to the arrangement between Xebec and QuestAir, the shareholders of Xebec (the “Vendors”) sold all of the issued and outstanding shares in the capital of Xebec to QuestAir in exchange for up to an aggregate of 15,241,976 common shares in the capital of QuestAir and 6,180,000 warrants of QuestAir. As a result of this transaction, the Vendors have received enough common shares of QuestAir to affect a reverse takeover of QuestAir. Accordingly, the consolidated financial statements of the Company reflect the accounts of QuestAir from June 12, 2009. The comparative financial statements included in these consolidated financial statements are those of Xebec. Subsequent to that transaction, QuestAir and Xebec have amalgamated and have continued as one corporation under the name of Xebec Adsorption Inc.

At the time of closing of the arrangement, the Vendors were issued 9,407,727 common shares, resulting in the Vendors initially controlling 45% of the outstanding common shares of the amalgamated company. The Vendors may increase their holdings in the amalgamated company by up to 5,834,249 common shares, resulting in an increase in the Vendors’ holdings from 45% to 57% pursuant to the earn-out provisions contained in the combination agreement if certain adjusted EBITDA performance targets are achieved by the amalgamated company following completion of the arrangement (in respect of the 2009 and 2010 fiscal years). These shares issued by QuestAir on completion of the arrangement are currently held in escrow.

The acquisition is accounted for using the purchase method of accounting. This method requires the determination of the aggregate purchase price, estimated at \$13,043,898, for the net assets of QuestAir and allocation of this amount to assets acquired and liabilities assumed based on their estimated fair value.

Xebec Adsorption Inc.

Notes to Interim Consolidated Financial Statements

(Unaudited)

September 30, 2010

During the second quarter, the Company finalized the purchase price allocation pertaining to this acquisition. The final allocation noted below, completed by management with the assistance of an independent valuator, resulted in increases in accounts receivable of \$466,699, in contract asset of \$330,886, in customer relations of \$1,900,000, in patents of \$2,310,000, and in accounts payable and accrued liabilities of \$9,238, and decreases in inventories and deferred revenue of \$1,724,201 and \$1,229,682 respectively. As a result of these changes, goodwill decreased by \$4,503,828 and an adjustment of \$303,066 was recorded to the cost of goods sold. The excess of the purchase price over the net identifiable assets acquired has been allocated to goodwill on the consolidated balance sheet.

	\$
Assets acquired	
Cash and cash equivalents	5,122,028
Accounts receivable – net	1,922,000
Contract asset	330,886
Inventories	487,481
Prepaid expenses	173,354
Property, plant and equipment	939,223
Customer relations	1,900,000
Patents	2,310,000
Goodwill	1,438,324
Restricted cash	62,600
	<hr/>
Total assets	14,685,896
Liabilities assumed	
Accounts payable and accrued liabilities	1,416,665
Deferred revenues	225,333
	<hr/>
Total liabilities	1,641,998
	<hr/>
Net assets acquired	13,043,898
Consideration	
11,269,318 Common shares	10,139,164
6,180,000 Warrants	1,782,259
199,347 Options	26,767
	<hr/>
	11,948,190
Acquisition costs	1,095,708
	<hr/>
	13,043,898
	<hr/>

Xebec Adsorption Inc.

Notes to Interim Consolidated Financial Statements

(Unaudited)

September 30, 2010

The consideration excludes a portion of the fair value of 70,183 unvested options.

The estimated fair value of the warrants was established using the Black-Scholes option pricing model with the following assumptions: exercise price of \$2.15, risk-free interest rate of 1.40%, expected volatility of 100% and expected life of two years.

6 Intangible assets

	As at September 30, 2010		
	Cost	Accumulated depreciation	Net amount
	\$	\$	\$
Software	406,590	189,256	217,334
Patents*	2,310,000	38,500	2,271,500
Customer relations*	1,900,000	67,857	1,832,143
Engineering drawings	4,700	2,742	1,958
	4,621,290	298,355	4,322,935
	As at December 31, 2009		
	Cost	Accumulated depreciation	Net amount
	\$	\$	\$
Software	406,590	130,677	275,913
Engineering drawings	4,700	1,567	3,133
	411,290	132,244	279,046

* During the nine-month period ended September 30, 2010, the Company allocated an amount of \$4,210,000 (note 5) from goodwill to intangible assets as a result of the finalization of the purchase price allocation.

Xebec Adsorption Inc.

Notes to Interim Consolidated Financial Statements

(Unaudited)

September 30, 2010

7 Bank loan

As at September 30, 2010, the Company had access to credit facilities in the amount of \$1,300,000 which bore interest at the Company's bank's prime rate plus 2.50% per annum and which were limited by certain margin requirements concerning accounts receivable. In addition, the Company had access to credit facilities in the amount of \$500,000 which bore interest at the Company's bank's prime rate plus 2.5% per annum and which were limited by certain requirements concerning pre-shipment costs. The bank loan was secured by a first ranking hypothec of \$4,000,000 on all movable property of the Company and was renewable annually upon certain conditions. As at September 30, 2010, the unused amount was approximately \$260,000 for the first credit facility and \$3,100 for the second facility. As well, the Company had access to a revolving demand facility by way of letters of credit and letters of guarantee amounting to \$750,000. As at September 30, 2010, the unused portion of this demand facility was approximately \$590,000. The credit facilities with the Royal Bank of Canada and Export Development of Canada matured on October 31, 2010. On November 11, 2010, the Company received confirmation from the Royal Bank of Canada that the credit facilities have been extended under the same terms and conditions until January 15, 2011. Management is currently negotiating an amended agreement with Export Development of Canada.

8 Research and development expenses

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2010 \$	2009 \$	2010 \$	2009 \$
Research and development expenses	752,781	828,848	1,900,597	1,186,458
Government grants	(51,234)	(106,591)	(53,734)	(154,720)
Research and development tax credits	(38,272)	(40,000)	(62,472)	(150,006)
	<u>663,275</u>	<u>682,257</u>	<u>1,784,391</u>	<u>881,732</u>

Xebec Adsorption Inc.

Notes to Interim Consolidated Financial Statements

(Unaudited)

September 30, 2010

9 Supplementary cash flow information

	<u>For the three-month period ended September 30,</u>		<u>For the nine-month period ended September 30,</u>	
	2010 \$	2009 \$	2010 \$	2009 \$
Interest paid	93,945	47,253	237,397	145,423
Income taxes paid	-	860	-	28,211
Income taxes received	39,273	-	66,624	-

10 Segmented information

The Company has only one segment and specializes in the design and manufacture of filtration, purification, separation and dehydration equipment for gases. 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:

	<u>For the three-month period ended September 30,</u>		<u>For the nine-month period ended September 30,</u>	
	2010 \$	2009 \$	2010 \$	2009 \$
North America	2,491,966	2,436,608	5,734,112	5,556,874
Europe	39,622	249,892	1,412,506	740,482
Asia	1,348,692	1,000,105	2,751,506	1,084,369
Middle East	73,890	363,680	178,190	4,476,924
South America	1,544	1,874,318	12,667	3,076,589
	<u>3,955,714</u>	<u>5,924,603</u>	<u>10,088,981</u>	<u>14,935,238</u>

Xebec Adsorption Inc.

Notes to Interim Consolidated Financial Statements

(Unaudited)

September 30, 2010

Revenue summarized by product line is as follows:

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2010 \$	2009 \$	2010 \$	2009 \$
Natural gas dryers	1,655,499	2,822,147	4,398,305	9,405,361
Compressed gas filtration	816,517	882,581	2,647,201	2,156,021
Air dryers	95,286	128,831	315,914	967,186
Gas purification	1,388,412	1,487,252	2,622,311	1,580,324
Engineering services	-	603,792	105,250	826,346
	<u>3,955,714</u>	<u>5,924,603</u>	<u>10,088,981</u>	<u>14,935,238</u>

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

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2010 \$	2009 \$	2010 \$	2009 \$
Customer A	641,096	-	1,445,527	-
Customer B	32,178	1,888,935	1,142,817	3,091,206
Customer C	908,225	2,011	980,977	4,465
Customer D	747,316	-	938,673	-
Customer E	-	854,167	21,680	854,167
	<u>2,328,815</u>	<u>2,745,113</u>	<u>4,529,674</u>	<u>3,949,838</u>

The location of the Company's property, plant and equipment, intangible assets and goodwill by geographic region is as follows:

	As at September 30, 2010 \$	As at December 31, 2009 \$
Canada	7,665,360	8,357,870
Asia	286,008	468,259
	<u>7,951,368</u>	<u>8,826,129</u>

Xebec Adsorption Inc.

Notes to Interim Consolidated Financial Statements

(Unaudited)

September 30, 2010

11 Comparative figures

Certain comparative figures have been reclassified to conform to the current year's presentation.

12 Subsequent events

On November 2, 2010, the Company concluded a share offering for 9,491,886 units ("Units") at a price of \$0.40 per Unit, for gross proceeds of \$3,796,754. Each Unit consists of one common share and one common share purchase warrant ("Warrant"). The Warrants entitle the holder to acquire one common share at a price of \$0.45 until November 1, 2015, subject to adjustment under the indenture governing the Warrants. The Warrants are subject to an accelerated expiry if, at any time after December 31, 2010, the published closing trade price of the common shares on the Toronto Stock Exchange is equal or superior to \$0.75 for any 20 consecutive trading days, in which event the Company may give the holder written notice that the Warrants will expire at the close of business day on the thirtieth day from the receipt of such notice. The Agents received a commission relating to the offering in the form of an aggregate of 600,000 Units and as additional consideration, the Agents were granted non-transferable options to purchase 566,250 common shares at an exercise price of \$0.40 per share, subject to adjustment, until May 2, 2012.