Xebec Adsorption Inc.

Management Discussion and Analysis
For the three-month and nine-month periods ended
September 30, 2009

Additional information relating to the Company can be found on SEDAR at www.sedar.com.

The following management discussion and analysis ("MD&A"), dated November 12, 2009, relates to our interim consolidated financial statements for the three-month and nine-month periods ended September 30, 2009. The MD&A should be read in conjunction with the Company's interim consolidated financial statements and related notes therein that are prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP").

All financial information is stated in Canadian dollars, unless otherwise indicated. Additional information regarding Xebec Adsorption Inc. ("Xebec" or "the Company") can be found on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

Management prepared this MD&A taking into account all available information as at November 12, 2009. The consolidated financial statements and the MD&A were reviewed by the Audit Committee and approved by the Board of Directors of Xebec Adsorption Inc.

Forward Looking Statements

This MD&A contains forward-looking statements, including statements regarding the future success of our business, technology, and market opportunities. Forward-looking statements typically contain words such as "believes", "expects", "anticipates", "continue", "could", "indicates", "plans", "will", "intends", "may", "projects", "schedule", "would" or similar expressions suggesting future outcomes or events, although not all forward-looking statements contain these identifying words. Examples of such statements include, but are not limited to, statements concerning: (i) expectations regarding the Company's future success in the biogas and other markets; (ii) the key market drivers and other factors that are expected to impact the Company's performance; (iii) future financial results; (iv) the expected actions of the third parties described herein; and (vi) the business and financial outlook of the Company, for fiscal 2009. In addition, this MD&A contains financial outlook information that is intended to provide general guidance for readers based on management's current estimates, but which is based on numerous assumptions that may prove to be incorrect and, therefore, such financial outlook information should not be relied upon by readers. These statements are neither promises nor guarantees, but involve known and unknown risks and uncertainties that may cause our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed in or implied by these statements. These risks include, but are not limited to, risks related to revenue growth, operating results, industry and products, technology, competition, foreign exchange rates, general economic conditions and those factors described in detail herein under the heading 'Risks & Uncertainties'.

The forward-looking statements contained herein are also based on assumptions that management believes are current and reasonable, including but not limited to, assumptions regarding: (i) trends in certain market segments and the economic climate generally; (ii) the financial strength of our customers; and (iii) the value of the Canadian dollar. The Company cannot assure readers that actual results will be consistent with the statements contained in this MD&A. The forward-looking statements and financial outlook information contained herein are made as of the date of this MD&A and are expressly qualified in their entirety by this cautionary statement. Except to the extent required by law, the Company undertakes no obligation to publicly update or revise any such statements to reflect any change in our expectations or in events, conditions, or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those described herein.

ABOUT XEBEC ADSORPTION INC.

Xebec Adsorption Inc. is a global provider of clean energy solutions to corporations and governments looking to reduce their carbon footprints. With more than 1300 customers worldwide, Xebec designs, engineers and manufactures innovative products that transform raw gases into marketable sources of clean energy. Xebec's strategy is focused on establishing leadership positions in markets where demand for biogas upgrading, natural gas dehydration and hydrogen purification is growing. Headquartered in Montreal (QC), Xebec is a global company with two state-of-the-art manufacturing facilities in Montreal and Shanghai, a R&D facility in Vancouver (BC) as well as a sales and distribution network in North America, Asia and Europe. Xebec (www.xebecinc.com) trades on the TSX under the symbol XBC.

Xebec resulted from the amalgamation with QuestAir Technologies Inc. ("QuestAir") on June 12, 2009. The comparative financial statements for 2008 are those of Xebec and the financial statements for 2009 reflect the accounts of QuestAir from June 12, 2009.

The unaudited interim consolidated financial statements include the accounts of the wholly-owned subsidiary, Xebec Adsorption Shanghai Co. LTD. ("Xebec China"). They also include the Company's 40% portion of the accounts of Xebec Adsorption South East Asia PTE. LTD. ("Xebec Singapore"), a joint venture accounted for using the proportionate consolidation method.

SIGNIFICANT EVENTS

Business Combination

Pursuant to the combination agreement 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 received enough common shares of QuestAir to effect a reverse takeover of QuestAir. Accordingly, the financial statements of the Company reflect the accounts of QuestAir from June 12, 2009. The comparative financial statements included in these unaudited interim 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 for the years ending December 31, 2009 and 2010 are achieved by the amalgamated company following completion of the arrangement. 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 $13,115,250, for the net assets of QuestAir and allocation of this amount to assets acquired and liabilities assumed based on their estimated fair value.

The following table represents the estimated fair value of the assets acquired and liabilities assumed on the effective acquisition date. The excess of the purchase price over the net identifiable assets acquired is preliminarily allocated to goodwill on the unaudited interim consolidated balance sheet. Management intends to complete a formal valuation of the tangible and intangible assets acquired and liabilities assumed, including tax loss carryforwards amounting to $20.8 million, in order to finalize allocation of the total purchase price.

	$
Assets acquired	
Cash and cash equivalents	5,122,028
Accounts receivable – net	1,455,301
Inventories	2,438,766
Prepaid expenses	173,354
Property, plant and equipment	939,223
Goodwill	5,898,025
Restricted cash	62,600
Total assets	16,089,297
Liabilities assumed	
Accounts payable and accrued liabilities	1,519,032
Deferred revenues	1,455,015
Total liabilities	2,974,047
Net assets acquired	13,115,250
Consideration	
11,269,318 Common shares, 6,180,000 warrants and 199,347 stock options	12,000,000
Acquisition costs	1,115,250
	13,115,250

Following the completion of the transaction with QuestAir on June 12, 2009, the Company began the process of executing its restructuring plan to realize potential synergies. Going forward, the Burnaby (BC) facility will remain focused on research and development as well as engineering service contracts. All manufacturing, together with most sales and administration, will be centralized at the Blainville (QC) facility, resulting in a reduction of 18 people in the Burnaby (BC) workforce. Management expects the integration plan to be completed by the end of 2009. As part of capitalizing on the available synergies, Andrew Hall, the former CEO of QuestAir, and currently VP, Sales and Business Development of Xebec, has relocated to China and taken over full responsibility for the further successful development of our business in Asia/Pacific. The Asian/Pacific region offers Xebec excellent growth opportunities in the industrial and clean tech area.

Xebec, the merged company, brings together complementary gas purification technologies, global distribution networks in high growth markets in North America, Asia and Europe, and low-cost manufacturing and supply chain capabilities. The Company will immediately leverage all available synergies to expand its market share in clean energies, such as natural gas dehydration, biogas upgrading and hydrogen purification.

Proposed Private Placement
Subsequent to quarter end, Xebec announced on November 4, 2009 that it had engaged Canaccord Adams to proceed with a private placement to raise approximately $5,000,000 through the issuance of units at a price of $0.75 per unit. Xebec has granted Canaccord an over-allotment option to sell up to an additional number of units equal to the lesser of the over-allocation position and 15% of the size of the units offering, at the same offering price, exercisable at any time, in whole or in part, up to 30 days from the closing of the offering.

The offering shall close on or before November 24, 2009. The proceeds will be used for working capital and general corporate purposes.

REVIEW OF OPERATIONS

The following review of Xebec's financial results for the nine month period ended September 30, 2009 include the results of its wholly-owned subsidiary, Xebec Adsorption Shanghai Co. LTD. ("Xebec China"), which commenced operations in the fourth quarter of 2008. In January 2009, Xebec, through its affiliate Xebec Adsorption South East Asia PTE. LTD. ("Xebec Singapore"), opened a regional sales office in Singapore to serve its Southeast Asian customers and support its planned expansion in the region.

Financial Overview

- Revenue for the third quarter was $5,924,603 in 2009 compared to $2,685,507 in 2008. For the nine months, revenue was $14,935,238 in 2009 compared to $9,405,969 in 2008.
- Net loss was $1,212,695 or $0.06 per share for the third quarter of 2009, compared to net income of $50,096 or $0.01 per share a year earlier. Net loss for the nine months was $1,695,254 or $0.13 per share, compared to a net loss of $258,318 or $0.03 per share in 2008.
- Cash at September 30, 2009 amounted to $1,817,612.

Results of Operations

Revenues
Customer location

(Unaudited)	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Middle East	363,680	-	4,476,924	-
North America	2,436,608	1,662,727	5,556,874	6,443,885
South America	1,874,318	-	3,076,589	-
Europe	249,892	790,400	740,482	2,584,000
Asia	1,000,105	232,380	1,084,369	378,084
Revenue	$5,924,603	$2,685,507	$14,935,238	$9,405,969

Product line

(Unaudited)	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Natural Gas Dryers	2,822,147	1,718,803	9,405,361	6,291,693
Compressed Gas Filtration	882,581	594,979	2,156,021	2,272,555
Air Dryers	128,831	371,725	967,186	841,721
Gas Purification	1,487,252	-	1,580,324	-
Engineering Services	603,792	-	826,346	-
Revenue	$5,924,603	$2,685,507	$14,935,238	$9,405,969

Revenue for the third quarter was $5,924,603 in 2009 compared to $2,685,507 in 2008. The year over year increase is attributable primarily to the full-quarter contribution from QuestAir, which merged with Xebec on June 12, 2009, adding revenues from gas purification units and engineering services. The remainder of the revenue increase is attributable to natural gas dryers and compressed gas filtration units, driven by stronger demand in North America and South America.

For the nine months, revenue was $14,935,238 in 2009 compared to $9,405,969 in 2008. The 2009 revenues include sales from our Shanghai facility, which commenced operations in the last quarter of 2008, as well as revenues from gas purification and engineering services from QuestAir since June 12, 2009.

The total sales order backlog as of September 30, 2009 was approximately $5.3 million.

Gross Profit

(Unaudited)	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Revenue	5,924,603	2,685,507	14,935,238	9,405,969
Cost of Goods Sold	3,935,499	1,713,135	9,330,117	6,417,428
Gross Profit	1,989,104	972,372	5,605,121	2,988,541
Gross Margin (%)	34%	36%	38%	32%

Gross margin was 34% for the third quarter, compared with 38% for the year to date. The decrease reflects a slightly lower contribution from our low-cost facility in Shanghai during the third quarter, as well as the additional expenses related to moving some manufacturing from Burnaby to Blainville following the merger with QuestAir. Since the completion of the transaction on June 12, 2009, the Company has undertaken a restructuring plan that will be completed by the end of 2009.

Profits and corresponding margin are expected to fluctuate from quarter to quarter, depending on revenue mix.

Selling and Administrative

For the quarter ended September 30, 2009, selling and administrative expenses were $3,005,251 compared to $840,563 for the same period in 2008. For the nine-month period, selling and administrative expenses were $6,595,782 in 2009 compared to $2,869,158 in 2008.

The year-over-year increase is attributable to the full-quarter impact of QuestAir; the additional expense of the Shanghai facility that commenced operations in the fourth quarter of 2008; the addition of the Singapore sales office in the first quarter of 2009; generally higher levels of business development activity to support planned growth; and the additional costs associated with being a public company.

Selling and administrative expenses for the quarter and the nine months ended September 30, 2009 include amounts of $123,025 and $352,602, respectively, for share award expense related to the performance-based share awards issued with the QuestAir transaction that was concluded on June 12, 2009.

Financial

Financial expense decreased to $46,769 in the third quarter and $163,200 in the nine months ended September 30, 2009, from $72,239 and $254,439 in the corresponding periods of 2008, as a result of lower interest rates and a reduction in long-term debt.

Foreign Exchange Loss

The foreign exchange loss was $25,217 in the third quarter and $227,375 in the nine months ended September 30, 2009, compared to gains of $41,466 and $3,737 in the corresponding periods of the previous year. The year-over-year change was primarily due to the strengthening of the Canadian dollar in 2009, resulting in a decrease of $118,512 in the fair market value of derivative financial assets for the quarter ended September 30, 2009. The derivative financial assets relate to Euro-denominated contracts with a foreign counterparty.

Amortization

Amortization expense increased to $240,816 in the third quarter and $428,285 in the nine months ended September 30, 2009, from $37,280 and $98,515 in the corresponding periods of 2008, reflecting the addition of the manufacturing facility in China in the fourth quarter of 2008.

Net Loss

Net loss for the quarter ended September 30, 2009 was $1,212,695 or $0.06 per share, compared to net income of $50,096 or $0.01 per share in 2008. Net loss for the nine months was $1,695,254 or $0.13 per share, compared to $258,318 or $0.03 per share in 2008. The net loss for the quarter and the nine months ended September 30, 2009 includes amounts of $123,025 and $352,602, respectively, for share award expense related to the performance-based share awards issued with the QuestAir transaction that was concluded on June 12, 2009.

Summary of Quarterly Results

	Year ending December 31, 2009			Year ended December 31, 2008				Year ended December 31, 2007
			Restated	Restated	Restated	Restated		
	Sept 30 $	June 30 $	March 31 $	Dec. 31 $	Sept. 30 $	June 30 $	March 31 $	Dec. 31 $
Revenues	5 924 603	4 303 256	4 707 379	7 434 653	2 685 507	4 699 156	2 021 306	2 421 718
Net income (loss)	(1 212 695)	(677 237)	194 677	1 104 476	50 096	200 724	(509 138)	(464 882)
Earnings (loss) per share basic and diluted	(0.06)	(0.06)	0.02	0.13	0.01	0.02	(0.06)	(0.05)

Given the early stage of Xebec's development, fluctuations occur in operating results from quarter to quarter and this trend is expected to continue for the foreseeable future.

Balance Sheet Items

Assets

Total assets as at September 30, 2009 were $20,424,575, compared with $10,674,035 at December 31, 2008. At the end of September 30, 2009, cash amounted to $1,817,612 compared with $550,377 as at December 31, 2008. Inventories increased to $4,094,121 from $2,579,877 as at December 31, 2008. Goodwill amounted to $5,898,025 as at September 30, 2009. These increases result from the completion of the transaction with QuestAir on June 12, 2009 as described in note 5 of the financial statements.

Liabilities

Total liabilities at September 30, 2009 were $8,615,593 compared with $9,548,894 as at December 31, 2008. The decrease is mainly due to a repayment of $1,131,677 in the bank loan.

Equity
Xebec's net equity as at September 30, 2009 was $11,808,982, reflecting an increase of $12,000,000 in share capital following the transaction with QuestAir. Contributed surplus of $379,095 is mainly share award expense related to performance-based share awards.

Credit Facilities
The Company has access to credit facilities in the amount of $1,500,000, which bear interest at the Company's bank's prime rate plus 0.60% per annum. The Company also has access to credit facilities in the amount of $208,906, which bear interest at the Company's bank's prime rate plus 3.55% per annum. These credit facilities are limited by certain margin requirements concerning accounts receivable.

In addition, the Company has access to credit facilities in the amount of $500,000, which bear interest at the Company's bank's prime rate plus 1.50% per annum and are limited by certain requirements concerning pre-shipment costs. The bank loan is secured by a first ranking hypothec of $4,500,000 on all moveable property. The Company must also comply with certain covenants requiring a minimum current ratio and maximum funded debt to tangible net worth. As at September 30, 2009, the Company is in compliance with the covenants.

As well, the Company also has access to a revolving demand facility in the amount of $1,000,000 by way of letters of credit and letters of guarantee.

Xebec's credit facilities and financing agreements mature on various dates. There can be no assurance that such credit facilities or financing agreements will be renewed or refinanced, or if renewed or refinanced, that the renewal or refinancing will occur on equally favourable terms to Xebec. Xebec's ability to continue operating may be adversely affected if Xebec is not able to renew its credit facilities or arrange refinancing, or if such renewal or refinancing, as the case may be, occurs on terms materially less favourable to Xebec than at present. Xebec's current credit facilities and financing agreements impose covenants and obligations on Xebec. There is a risk that such loans may go into default if there is a breach in complying with such covenants and obligations, which could result in the lenders realizing on their security and causing the shareholders to lose some or all of their investment.

Cash Flows

The Company's cash flows from operating, investing and financing activities, as reflected in the consolidated statements of cash flows, are summarized in the following table:

(in thousands of Canadian dollars)	For the three-month periods ended September 30,		
	2009	**2008**	**Change**
	$	$	$
Cash provided by operating activities	(2,938)	(1,477)	(1,461)
Cash provided (used) by investing activities	(213)	(296)	83
Cash provided (used) by financing activities	41	1,293	(1,252)

(in thousands of Canadian dollars)	For the nine-month periods ended September 30,		
	2009	**2008**	**Change**
	$	$	$
Cash provided by operating activities	(1,309)	(2,211)	902
Cash provided (used) by investing activities	3,662	(381)	4,043
Cash provided (used) by financing activities	(1,085)	2,054	(3,139)

LIQUIDITY AND CAPITAL RESOURCES

Xebec's growth is financed through a combination of working capital, borrowings under existing credit facilities, increasing long-term debt wherever suitable, and issuing equity as appropriate.

The Company has incurred an operating loss of $1,695,254 and had cash outflows from operations of $1,309,434 for the nine-month period ended September 30, 2009. However, at September 30, 2009, the Company has shareholders' equity of $11,808,982, working capital of $4,867,606, cash amounting to $1,817,612 and has access to unused credit facilities totaling approximately $1,100,000. During the last quarter, management 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 preliminary budget for 2010 for which management believes the assumptions are reasonable. Achieving budgeted results is dependant upon improving the volume of revenues, renewing important contracts and reducing general and administrative costs. Based on its business plan, management expects to meet its budget and to have enough liquidity to fund operations to at least September 30, 2010.

In addition, to mitigate those risks, the Company announced on November 4, 2009 a private placement of approximately $5,000,000 through the issuance of 6,666,700 units at a price of $0.75 per unit, consisting of one common share and one half of a warrant. Although there is no assurance, Management expects that the offering will close on or about November 24, 2009 and intends to use the proceeds for working capital and general corporate purposes.

<u>Contingent Off-Balance Sheet Financing Arrangements</u>

Prior to the transaction on June 12, 2009, QuestAir received funding contributions from various programs of the Canadian Government to support the development and commercialization of our gas purification technology. The Company did not enter into any new contingent off-balance sheet financing arrangements during the quarter ended September 30, 2009.

A summary of these funding arrangements is provided in the tables below:

Technology Partnerships Canada (TPC)

At September 30, 2008, QuestAir had received $8,139,937 under a conditionally repayable loan under the TPC funding program, through an agreement administered by Industry Canada. These funds are repayable in the form of annual royalties under certain conditions. During the year, QuestAir finalized negotiations with TPC to amend this agreement to, among other things, eliminate certain development milestones, extend the program completion date for certain other milestones, and reduce the contribution amount and the associated royalties. Amounts drawn under this contribution agreement are subject to final audit by Industry Canada. QuestAir entered into a similar funding arrangement with TPC in 1999 and received a total of $4,762,503 in funding from March 1999 to July 2002. The funding is also repayable under certain conditions. The repayment obligations and total royalty repayments made to date for these funding programs are listed below:

Funding Award Date	Description	Royalties	Term	Royalty Payments to Date
June 6, 2003	Fast Cycle Pressure Swing Adsorption	Annual royalties of 1.165% of gross business revenues	The royalty period began on October 1, 2005 and will end on the earlier of September 30, 2022 or until a cumulative royalty ceiling of $18.8 million is reached.	Total cumulative payments: $797,767 Accrued for future payment: $163,100
March 31, 1999	Pulsar Pressure Swing Adsorption Program	Annual royalties of 1.8% of gross project revenues and fuel cell related products	Royalty period extends to the later of the date of payment of all amounts due to the Minister and 2015. The maximum cumulative repayment is $8.75 million.	Total cumulative payments: $56,726 Accrued for future payment: $0

Department of Natural Resources Efficiency and Alternative Energy Program
In 2005, QuestAir were awarded a grant for $225,000 from the Government of Canada under the Department of Natural Resources Efficiency and Alternative Energy Program. In 2004, QuestAir received a similar funding award of $193,944 under the same funding program. Both funding awards are repayable under certain conditions. The repayment obligations and total royalty repayments made to date for these funding programs are listed below:

Funding Award Date	Description	Royalties	Term	Royalty Payments to Date
January 4, 2005	Development of structured adsorbent for the production of high purity hydrogen	Annual royalties of 0.12% of gross project revenues	Royalty period starts on date of first gross project revenues and extends to March 31, 2015, to a maximum cumulative repayment of $225,000, whichever occurs first.	Total cumulative payments: $5,592 Accrued for future payment: $0
January 6, 2004	Development of a device that increases the efficiency of a high temperature fuel cell system	Annual royalties of 0.12% of gross project revenues	Royalty period starts on date of first gross project revenues and extends to March 31, 2014, to a maximum cumulative repayment of $193,944, whichever occurs first.	Total cumulative payments: $0 Accrued for future payment: $0

Outstanding Share Data

Common Shares
Pursuant to the accounting standards applicable to reverse takeovers, a total of 8,638,496 common shares were deemed to be issued and outstanding prior to the transaction. On June 12, 2009, upon conversion of 300,000 preferred shares of former Xebec Adsorption, 769,231 common shares were issued to a shareholder of Xebec. On June 12, 2009 upon the reverse takeover, an additional 11,269,318 common shares, representing the common shares historically issued to the shareholders of QuestAir, were deemed to have been issued by the Company.

As at September 30, 2009, the Company had 20,677,045 common shares issued and outstanding. As a result of the business combination (described in note 5 of the financial statements), the Company also issued 5,834,249 common shares, which are held in escrow as at September 30, 2009. These shares could be released to the former Xebec shareholders on the achievement of specified financial targets. These targets will be measured at December 31, 2009 and 2010. Consequently, these shares are considered restricted share awards that are issued but not outstanding. Stock-based compensation is recorded based on management’s best estimate of the ultimate achievement of the financial targets over the vesting periods, namely until December 31, 2009 and 2010.

Pursuant to the transaction, the authorized share capital of the Company consists of an unlimited number of common shares and an unlimited number of preferred shares. No preferred shares are issued.

As at November 12, 2009, the number of common shares issued was 26,511,294, including 5,834,249 common shares held in escrow, described above.

Share Purchase Warrants Outstanding

As at September 30, 2009, 12,360,000 warrants were outstanding, of which 12,180,000 warrants entitle the holder to acquire one additional common share per warrant at a price of $2.15 until May 13, 2010. The remaining 180,000 warrants entitle the holder to acquire one common share per warrant at a price of $1.50 until May 13, 2010. The ability to exercise the 6,180,000 warrants issued on the reverse takeover transaction is contingent on the exercise of the remaining pre-existing warrants.

Stock Options Outstanding

Upon the reverse takeover, the Company assumed QuestAir's stock option plan (the "Plan"), which allows for the issuance of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards and other stock-based awards. Under the Plan, common shares approved for issuance under all stock-based compensation arrangements are limited to the greater of 591,560 and 10% of the common shares issued and outstanding. As at September 30, 2009, the maximum number of common shares available for issuance under all stock-based compensation arrangements is 2,468,685.

Under the terms of the 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. Stock options generally vest quarterly over four years and are exercisable for seven years from the date of grant.

As at September 30, 2009, the Company had 152,386 options outstanding under the plan with a weighted average exercise price of $5.24.

Outlook

The market conditions in the last half of 2009 remain generally challenging. Financing for renewable energy projects continues to be constrained and the overall pace of new orders for products, particularly those with long lead times, is slower than anticipated.

Despite the generally soft conditions in our target markets, we are pleased to report that North American sales of our natural gas dehydration equipment continue to be strong. As well our Shanghai facility continues to generate steady growth in sales since commencing operations in the last quarter of 2008. Our Shanghai facility offers the advantage of manufacturing high-quality products at a low cost, which should contribute to a sustained improvement in gross margins in the future.

With our order backlog currently at $5.3 million, our immediate efforts are focused on the acceleration of new business development, as well as the alignment of our cost structure with our current level of sales. By the end of the fourth quarter, we expect to complete the realization of all potential synergies with QuestAir, which should have a positive impact on our results going forward. These cost savings, together with the proceeds of our announced private placement, will help us to execute our global sales strategy in 2010 and beyond.

In the short to medium term, we remain convinced that the future for renewable energy is positive. Increasingly, green energy initiatives are moving up the agendas of municipal and federal governments worldwide, as well as corporations looking to reduce their carbon footprint. We are confident that Xebec, with its complementary product lines, strong customer relationships, global footprint and low-cost manufacturing and supply chain, is well positioned to respond to this growing demand.

Critical Accounting Policies and Estimates

Critical Accounting Estimates

Financial statements prepared in accordance with Canadian GAAP require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Warranty Provision

During the normal course of its operations, Xebec assumes certain maintenance and repair costs under warranties offered on dryers and filters. The warranties cover a period ranging from twelve to eighteen months. A liability for the expected cost of the warranty-related claims is established when the product is delivered and completed. In estimating the warranty liability, historical material replacement cost and the associated labour costs are considered. Revisions are made when actual experience differs materially from historical experience.

Revenue Recognition

Revenues from long term production-type contracts and engineering service contracts are determined under the percentage-of-completion method whereby revenues are recognized on a pro rata basis in relation to contract costs incurred. Costs and estimated profit on contracts in progress in excess of amounts billed are reflected as work-in-progress. Cash received in advance of revenues being recognized on contracts is classified as deferred revenue.

Stock-based Compensation Plans

The Company accounts for stock options using the fair value method calculated using the Black-Scholes option pricing model. For options granted to directors, officers and employees, the compensation cost is measured at fair value at the date of grant and is expensed to operations over the award's vesting period. For options granted to non-employees, the fair value is measured when performance is complete, a performance commitment is made or the options are fully vested and non-forfeitable, whichever is earliest, and the expense is recognized over the period in which the goods or services from the non-employees are received. A corresponding increase in contributed surplus is recorded when stock options are expensed. When stock options are exercised, capital stock is credited by the sum of the consideration paid and the related portion previously recorded in contributed surplus. The effects of forfeitures are accounted for as they occur.

Foreign Operations

The Company's foreign operations are defined as integrated and are translated using the temporal method. Under this method, monetary assets and liabilities are translated into Canadian dollars at the rate of exchange prevailing at the balance sheet date and non-monetary assets and liabilities at rates prevailing at the transactions dates. Revenues and expenses (other than amortization, which is translated at the rate applicable to the related asset) are translated at average rates for the year. Gains and losses arising on translation are included in the statement of earnings for the period.

Changes in Accounting Policies Including Initial Adoption

On January 1, 2009, the Company adopted Canadian Institute of Chartered Accountants ("CICA") Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Other Intangible Assets", and which resulted in (i) the withdrawal of Section 3450, "Research and Development Costs" and Emerging Issues Committee Abstract 27, "Revenues and Expenditures During the Pre-operating Period", and (ii) the amendment of Accounting Guideline 11, "Enterprises in the Development Stage". This new standard provides guidance on the recognition of intangible assets in accordance with the definition of an asset and the criteria for asset recognition, whether those assets are separately acquired or internally developed, as well as clarification on the application of the concept of matching revenues and expenses. The adoption of Section 3064 eliminated the deferral of start-up costs, which are now recognized as an expense when they are incurred. Consequently, the Company adjusted opening retained earnings as if the new rules had always been applied in the past and the prior period figures have been restated. As well, the Company made reclassifications in order to present certain assets, mainly software, as intangible assets instead of presenting them as property, plant and equipment.

As a result of the adoption of these new rules, the following tables summarize the adjustments that were recorded in the unaudited interim consolidated financial statements:

	As at December 31, 2008 $
Balance sheet	
Increase (decrease) in	
Property, plant and equipment	(143,619)
Intangible assets	(446,022)
Future income tax liabilities	16,424
Retained earnings	(573,217)

International Financial Reporting Standards (IFRS)
The AcSB announced that accounting standards in Canada are to converge with IFRS. The changeover date from current Canadian GAAP to IFRS has been established as January 1, 2011. While IFRS use a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policy which must be addressed.

A diagnostic assessment will be initiated before the end of 2009 to examine the extent of the impact that the conversion may have on financial reporting, business processes and information systems. The Company's current plan is aimed in particular at identifying the differences between IFRS and the Company's current accounting policies, as well as assessing the impact of various accounting alternatives offered pursuant to IFRS. In addition, a high level assessment of the Company's Information Technology Systems and tax processes will be conducted. The financial impact of the transition to IFRS cannot be reasonably estimated at this time, however, there may be changes in accounting policies and these may impact the Company's financial statements.

In January 2009, the CICA issued the following new Handbook sections:

i) Section 1582, "Business Combinations", which replaces Section 1581, "Business Combinations". The Section establishes standards for the accounting for a business combination. It provides the Canadian equivalent to the IFRS standard, IFRS 3 (Revised), "Business Combinations". The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier application is permitted. The Company is currently evaluating the impact of the adoption of this new Section on the consolidated financial statements.

ii) Section 1601, “Consolidated Financial Statements”, and Section 1602, “Non-controlling Interests”, which together replace Section 1600, “Consolidated Financial Statements”, Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS standard, IAS 27 (Revised), “Consolidated and Separate Financial Statements”. The Sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted as of the beginning of a fiscal year. The Company is currently evaluating the impact of the adoption of these new Sections on the consolidated financial statements.

Disclosure Controls and Procedures

In order for the Company to comply with its disclosure requirements under applicable securities laws [NI 52-109], the Company and its consolidated subsidiaries must maintain controls and procedures that are designed to provide reasonable assurances that material information disclosed in this MD&A and related financial statements is properly recorded, processed, summarized and reported in a timely manner to the Board of Directors and the Audit Committee.

The Company’s management has evaluated the effectiveness of the Company’s disclosure controls and procedures. Based upon the results of that evaluation, the Company’s Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, the Company’s disclosure controls and procedures were effective to provide reasonable assurance that the information required to be disclosed in reports it files is recorded, processed, summarized and reported within the appropriate time periods and forms.

Furthermore, a formal Disclosure Policy and Procedures is now before the Board of Directors for review and approval. Adoption is expected in the year ending December 31, 2009, following which a formal Disclosure Committee will be established to oversee corporate disclosures, and the Disclosure Policy and Procedures will be communicated to senior management and implemented throughout the Company. This process will be completed in 2010.

Internal Control over Financial Reporting

The Company’s management, under the direction and supervision of the Chief Executive Officer and Chief Financial Officer, is also responsible for establishing and maintaining internal control over financial reporting (ICFR). These controls are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

The Company’s management has evaluated the effectiveness of the Company’s ICFR as of September 30, 2009 and has concluded, based on its evaluation that certain controls within its ICFR were not effective for the quarter ended September 30, 2009. Specifically, the Company did not have sufficient accounting documentation, policy, procedures or segregation of duties for certain transaction cycles.

To address the above issues, the Company is recruiting additional financial staff at the head office to oversee the financial reporting, and consulted with tax advisors on various issues. The Company continues to determine other appropriate remediation plans, such as reviewing the organizational structure of the accounting group, to strengthen its resources to reflect the Company’s growth. The Company is also executing its formal documented evaluation process to evaluate compliance of ICFR for the purposes of National Instrument 52-109. This evaluation process will be completed in 2010.

The Company believes that the lack of formal internal control over financial reporting has been mitigated by the active involvement of senior management and the Board of Directors in all the affairs of the Company; open lines of communication within the Company; the present levels of activities and transactions within the Company being readily transparent; and the thorough review of the Company's financial statements by management and the Board of Directors. The Company has also consulted with an independent professional firm on the development of formal IFRS processes, to be executed in 2010.

The Company's management believes that the consolidated financial statements for the period ended September 31, 2009, to which this MD&A relates, correctly presents in all material aspects the Company's financial position, results of operations and cash flows for the period covered therein.

Risks and Uncertainties

The Company's ability to generate revenue and profit from operations is subject to a number of risks. The risks and uncertainties described below are not the only ones Xebec faces. Additional risks and uncertainties, including those that the Company is not aware of now or that management may believe are currently not material, may also adversely affect the ability to generate a viable business. The risk factors presented below are divided into categories of risks impacting Xebec's internal and external environment. Specific risks within each category are listed in approximate order of seriousness, from most to least serious.

Xebec has a limited operating history and it may be difficult to assess its business and future prospects
Xebec commenced operations in June 2007 following the management buy-out of the assets and business of Xebec Inc., and since that time, Xebec has been engaged in the development, manufacture, and supply of compressed air and gas products. For the year ended December 31, 2008, Xebec's sales totaled approximately $16.8 million and $14.9 million for the nine-month period ended September 30, 2009. Xebec's historical operating data may be of limited value in evaluating Xebec's future prospects.

Potential fluctuations in financial results make financial forecasting difficult
Xebec expects its revenues, expenses, cash flows, and other operating results to vary significantly from quarter-to-quarter. Sales and margins may be lower than anticipated due to general economic conditions and market-related factors, product quality, performance and safety issues, and competitive factors. Expenditures and cash receipts may also vary due to the timing of such expenditures and cash collections from customers, government entities, and other entities providing funding to Xebec. As a result, comparisons of revenues, expenses, cash flows, and other operating results may not be meaningful.

Xebec depends upon a limited number of customers for potential revenue due to the nature of its markets
To date, a small number of customers have accounted for a majority of Xebec's revenues and Xebec expects that they will continue to do so for the foreseeable future. For the nine-month period ended September 30, 2009, sales to two principal customers accounted for approximately 26% of Xebec's total revenue. For the year ended December 31, 2008, sales to two principal customers accounted for approximately 32% of Xebec's total revenue.

Xebec sells its products to a limited number of customers, some of which may experience financial difficulty, which may result in bad debt for Xebec
The current financial crisis can be expected to affect the ability of some of Xebec's customers to pay their invoices in a timely fashion. Xebec sells to customers of varying financial strengths in various geographic locations. Some of these customers, particularly smaller companies with limited financial resources, may be unable to pay their invoices when they become due. This risk is amplified by the current liquidity crisis and general decline in global economies which is calling into question the sustainability of some of Xebec's customers. Xebec mitigates this risk through its standard contract terms for significant equipment sales, which require payment of the majority of the contract value prior to shipment. Nevertheless, it is possible that some of Xebec's

customers will default on certain amounts owing. Account receivable insurance provided by Export Development Canada and Sinosure in China may only partially protect Xebec from potential losses resulting from such commercial risks if customers refuse to pay or are in default.

Xebec anticipates undergoing a period of continuing growth in its business, the scope of its operations and the number of its employees, and its failure to manage this growth could cause its results to fluctuate and harm its business

Xebec anticipates undergoing a period of growth in the scope of its operations and in the number of its employees. Xebec may be unable to manage its growth effectively, and its failure to do so could have a material adverse effect on its operating results and cause its results to fluctuate. As part of its growth strategy Xebec may introduce new products, increase its outsourcing capacity and develop additional customer and distributor relationships. Expansion will likely place a strain on its senior management team, key and technical personnel, its business operations and other resources. Xebec's ability to manage growth will depend in part on its ability to continue to enhance its manufacturing and management information systems. It may be difficult to increase manufacturing or outsourcing capacity in a timely fashion if customer demands increase in ways that Xebec did not anticipate. Any inability to manage growth could result in shipment delays and cancellation of customer orders.

Xebec may be unable to pursue its long term development and commercialization plans and may have to forego attractive business opportunities

Xebec may require additional capital to fund its operations and to acquire or invest in complementary businesses or products or obtain the right to use complementary technologies. Xebec may be unable to raise additional capital or may not be able to do so on acceptable terms to pursue its long-term development and commercialization plans. Either of these outcomes could adversely affect the ability of Xebec to respond to competitive pressures or prevent Xebec from conducting all or a portion of its planned operations. The development and commercialization of its products could be delayed or discontinued if Xebec is unable to fund its research and product development activities or the continued development of its manufacturing capabilities. In addition, it may be forced to reduce its sales and marketing efforts or forego attractive business opportunities.

Xebec's strategy for the sale of its products depends upon developing key relationships with a number of customers who will incorporate its products and technologies into theirs

Other than with respect to a limited number of specific markets, the success of Xebec's business depends on its ability to develop relationships with parties who will integrate Xebec's products and technologies into their products. The ability of Xebec to sell its products and technologies to its target markets depends to a significant extent upon its partners' worldwide sales and distribution network and service capabilities.

Xebec has foreign currency risk

The majority of Xebec's revenues are in U.S. dollars and Euros, while a significant portion of the operating expenses are in Canadian dollars and Chinese Yuan. Foreign exchange gains and losses are included in results from operations. A large decline in the U.S. dollar, the Euro or Chinese Yuan relative to the Canadian dollar could impair revenues, margins, and other financial results. Xebec has not entered into foreign exchange contracts to hedge against gains and losses from foreign currency fluctuations.

Xebec will need to recruit, train and retain key management and other qualified personnel to successfully expand its business

Xebec's future success will depend in large part upon its ability to recruit and retain experienced research and development, engineering, manufacturing, operating, sales and marketing, customer service, and management personnel. If Xebec does not attract and retain such personnel, it may not be able to expand its business. Competition for qualified personnel in its industry is intense. Even if Xebec invests significant resources to recruit, train, and retain qualified personnel, Xebec may not be successful in its efforts. Xebec's success also depends upon the continuing contribution of its key management, research, product development, engineering, marketing, and manufacturing personnel, many of whom would be difficult to replace.

Xebec currently faces and will continue to face significant competition from other developers and manufacturers of air and gas purification systems

Xebec competes with a number of companies that manufacture conventional air and gas purification equipment and other competing technologies. New developments in technology may adversely affect the development or sale of some or all of Xebec's products and technologies, or make its products and technologies uncompetitive or obsolete. Other companies, many of which have substantially greater resources than Xebec does, are currently engaged in the development of products and technologies that are similar to, and competitive with, many of its products and technologies. Xebec's competition includes numerous companies located throughout the world, some of which may have advantages over Xebec in terms of government incentives, labour, component costs and technology. Each of these competitors has the potential to capture market share in Xebec's target markets, which could harm its position in the industry. New competitors may also emerge and entire product lines may be threatened by new technologies or market trends which reduce the commercial viability of Xebec's product lines. In addition, Xebec's customers could potentially become its competitors if they decide to develop and manufacture their own gas purification systems. As the markets for air and gas purification systems develop, other large industrial companies may enter these fields and compete with Xebec. These large industrial companies may have research and development, manufacturing, marketing and sales resources necessary to deliver air and gas purification systems more quickly and effectively than Xebec does. Xebec may not be able to compete effectively with all of these competitors, which could adversely affect its business, financial condition and results of operations.

Protection of Technology and Development

There can be no assurances that Xebec will meet its targeted development or integration timelines, secure components at reasonable prices such that it will be able to offer its products and technologies at competitive pricing, or that Xebec can continue to enhance and improve the functionality and features of its technologies. In addition, Xebec depends on its ability to develop and maintain proprietary aspects of its technology, if and when required. Xebec's products incorporate complex technology and software. Accordingly, they may contain errors that could be detected at any point. Such errors could materially and adversely affect Xebec's reputation, or that of its customers and partners, resulting in claims and/or significant costs to Xebec, and/or cause customers and other parties to abandon Xebec and impair its ability to market and sell its products in the future.

Xebec is dependent upon third party suppliers for materials and components for its products

Xebec relies upon third party suppliers to provide materials and components for its products. A supplier's failure to provide materials or components in a timely manner, or to provide materials and components that meet Xebec's quality, quantity or cost requirements, or its inability to obtain substitute materials and components in a timely manner or on terms acceptable to Xebec, may harm Xebec's ability to manufacture its products. To the extent that Xebec is unable to develop and patent its own technology and manufacturing processes, and to the extent that the processes, which its suppliers use to manufacture materials and components, are proprietary, Xebec may be unable to obtain comparable materials or components from alternative suppliers, and that could adversely affect its ability to produce commercially viable products.

Xebec is subject to a variety of governmental regulations

Xebec is subject to a variety of federal, provincial, state, local and international laws and regulations relating namely to the environment, health and safety, export controls, currency exchange, labour and employment and taxation, namely in Canada, China and Singapore. These laws and regulations are complex, change frequently and have tended to become more stringent over time. Failure to comply with these laws and regulations may result in a variety of administrative, civil and criminal enforcement measures, including assessment of monetary penalties, imposition of remedial requirements and issuance of injunctions as to future compliance. From time to time, as part of Xebec's operations, including newly acquired operations, Xebec may be subject to compliance audits by regulatory authorities in the various countries in which it operates.

Risk factors related to Xebec's target markets are exposed to recessionary risk
The current financial crisis and possible global recession may result in lost or delayed sales orders, as many of Xebec's existing and targeted customers may cut back their proposed capital spending in the face of economic uncertainty and limited access to project financing. This would impact the ability of Xebec to grow its business, and as a result sales orders may be lower than expected. Any decrease in sales would negatively impact Xebec's cash flows and other financial results. Different air and gas purification markets and different geographies may be impacted to different extents, making it difficult to forecast the likely impact.

Volatility of oil and natural gas prices
Xebec's systems represent a significant potential capital cost to Xebec's existing and target customers and their ability to purchase Xebec's products is dependent upon factors which affect energy industries. Xebec's existing and target customers' results of operations and financial condition are dependent on the prices they receive for oil, natural gas and renewable natural gas. Oil and natural gas prices have fluctuated widely during recent years and are determined by local and worldwide supply and demand factors, including actions by the Organization of Petroleum Exporting Countries, weather conditions, the U.S. dollar exchange rate, transportation, competition, and general economic conditions as well as conditions in other oil producing regions, which are beyond Xebec's control. Any material decline in oil or natural gas prices could have a material adverse effect on Xebec's existing and target customers' operations, financial condition, and the amount they spend on new capital equipment and the development of new technology, which could have a material adverse effect on Xebec's existing and target customers' ability to purchase Xebec's products. In addition, Xebec's prospects would be adversely affected should the cost of natural gas fall to levels where production of natural gas becomes uneconomic.

Risks with conducting business in international markets
Xebec conducts business in many geographic markets outside Canada. Changes in local economic or political conditions, namely in China, could have a material adverse effect on Xebec's business, financial condition, results of operations and cash flows. Additional risks inherent in Xebec's international business activities include the following:

- difficulties in managing international operations, including Xebec's ability to timely and cost effectively execute projects;
- unexpected changes in regulatory requirements;
- training and retaining qualified personnel in international markets;
- inconsistent product regulation or sudden policy changes by foreign agencies or governments;
- the burden of complying with multiple and potentially conflicting laws; tariffs and other trade barriers that may restrict Xebec's ability to enter new markets;
- governmental actions that result in the deprivation of contract rights, including possible law changes, and other difficulties in enforcing contractual obligations;
- foreign currency exchange rate risks;
- difficulty in collecting international accounts receivable;
- potentially longer receipt of payment cycles;
- changes in political and economic conditions in the countries in which Xebec conducts business, including the nationalization of energy related assets, civil uprisings, riots, kidnappings and terrorist acts;
- potentially adverse tax consequences or tax law changes;

- restrictions on repatriation of earnings or expropriation of property without fair compensation;
- the geographic, time zone, language and cultural differences among personnel in different areas of the world; and
- difficulties in establishing new international offices and risks inherent in establishing new relationships in foreign countries. In addition, Xebec may expand its business into international markets where Xebec has not previously conducted business. The risks inherent in establishing new business ventures, especially in international markets where local customs, laws and business procedures present special challenges, may affect Xebec's ability to be successful in these ventures or avoid losses that could have a material adverse effect on Xebec's business, financial condition, results of operations and cash flows.

Specific risks with Xebec's sales to Iran

Our business relationships in Iran are subject to numerous risks and uncertainties associated with doing business in Iran. These risks include, among other things, political, social and economic instability, civil uprisings, riots, terrorism, kidnapping, the taking of property without fair compensation and governmental actions that may restrict payments or the movement of funds or result in the deprivation of contract rights. Any of these risks, including the possibility of military intervention, could adversely impact Xebec's business relationships in Iran and could affect the timing and decrease the amount of revenue Xebec may realize, directly or indirectly, from its business relationships in Iran. Iran is subject to Canadian export control and economic sanction legislation. Such legislation may also give rise to certain risks and uncertainties for Xebec in the context of its business and operations. If Xebec is unable to continue to generate revenue from its Iranian customers, it may be required to find alternative sources of revenue, which could potentially adversely impact Xebec's financial condition or results of operations.

Insurance

Xebec's operations are subject to risks inherent in the compressed air and gas purification sectors. Xebec subscribes for insurance in amounts which it considers appropriate in the circumstances and having regard to industry norms. Xebec may become liable with respect to risks in respect of which it cannot obtain insurance or for which it chooses not to obtain insurance as a result of high premiums or for other reasons, or for damages which exceed the maximum coverage provided for in the insurance policies.

Environmental Risks

All phases of the oil and natural gas business, and of the processing of organic wastes, are subject to environmental regulation pursuant to a variety of Canadian federal, provincial, state and municipal laws and regulations, as well as international conventions (collectively, "Environmental Legislation").

Environmental Legislation imposes, among other things, restrictions, liabilities, and obligations in connection with the generation, handling, storage, transportation, treatment, and disposal of hazardous substances and waste, and in connection with spills, releases, and emissions of various substances to the environment. Environmental Legislation also requires that wells, facility sites, and other properties associated with oil and natural gas operations be operated, maintained, abandoned, and reclaimed to the satisfaction of applicable regulatory authorities. In addition, certain types of operations, including exploration and development projects and significant changes to certain existing projects, may require the submission and approval of environmental impact assessments. Compliance with Environmental Legislation can require significant expenditures and failure to comply with Environmental Legislation may result in the imposition of fines, penalties and liability for clean up costs and damages. Changes in Environmental Legislation due to, namely, climate change concerns, may require, among other things, reductions in emissions to the air from Xebec's existing and target customers' operations and result in increased capital expenditures. Future changes in Environmental Legislation could occur and result in stricter standards and enforcement, larger fines and liability, and increased capital expenditures and operating costs, which could have a material adverse effect on Xebec's existing and target customers' ability to purchase Xebec's products.

Foreign Subsidiaries and Affiliates

Xebec conducts some operations through foreign subsidiaries and affiliates, and significant assets are held in such entities. Accordingly any limitation on the transfer of cash or other assets between the parent corporation and such entities, or among such entities, could restrict Xebec's ability to fund its operations efficiently. Any such limitations, or the perception that such limitations may exist in the future, could have an adverse impact upon the Xebec's valuation and stock price.

Xebec's directors and officers may have conflicts of interest

Certain of the directors and officers of Xebec also serve as directors and/or officers of other companies involved in the air and gas compression industry and/or in the renewable energy industry and consequently there exists the possibility for such directors and officers to be in a position of conflict.