

Xebec Adsorption Inc.

Condensed Interim Consolidated Financial Statements

(Unaudited)

September 30, 2014

(expressed in Canadian dollars)

The Condensed Interim Consolidated Financial Statements which are included in this Report have not been subject to a review by the Company's External Auditors.

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Financial Position (Unaudited)

(expressed in Canadian dollars)

	As at September 30, 2014 \$	As at December 31, 2013 \$
Assets		
Current assets		
Cash	828,715	2,835,051
Restricted cash	149,311	-
Trade and other receivables	3,158,670	2,915,700
Inventories	1,490,606	1,539,180
Short-term portion of balance of sale	200,000	300,000
Investment tax credits receivable	-	137,760
Other current assets	766,201	559,001
Total current assets	6,593,503	8,286,692
Non-current assets		
Balance of sale	-	200,000
Property, plant and equipment (note 3)	371,205	310,576
Intangible assets (note 4)	684,855	809,513
Goodwill (note 4)	142,616	142,616
Total non-current assets	1,198,676	1,462,705
Total assets	7,792,179	9,749,397
Liabilities		
Current liabilities		
Bank loan	133,298	370,000
Trade payables	3,830,995	3,429,420
Accrued liabilities	746,329	805,563
Deferred revenues	1,317,704	1,342,794
Current portion of long-term debt and obligation	52,717	67,176
Current portion of government royalty program obligation	371,785	259,636
Provisions	105,012	489,742
Total current liabilities	6,557,840	6,764,331
Non-current liabilities		
Long-term debt and obligation	8,354	50,476
Government royalty program obligation	383,570	586,825
Government assistance	13,333	17,083
Deferred rent	79,152	59,364
Provisions	184,055	312,330
Total non-current liabilities	668,464	1,026,078
Total liabilities	7,226,304	7,790,409
Equity		
Share capital	19,732,623	19,732,623
Contributed surplus	2,445,109	2,388,063
Accumulated other comprehensive loss	(531,785)	(313,486)
Deficit	(21,338,753)	(20,131,974)
Total equity	307,194	1,675,226
Total liabilities and equity	7,792,179	9,749,397

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

Approved by the Board of Directors

(signed) Kurt Sorschak Director

(signed) Jean Bedard Director

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Income (Loss)

For the three-month and nine-month periods ended September 30, 2014 and 2013

(Unaudited)

(expressed in Canadian dollars)

	2014 \$	2013 \$	2014 \$	2013 \$
Revenue	4,325,242	1,929,497	10,473,509	8,499,037
Cost of goods sold	<u>2,703,182</u>	<u>1,419,961</u>	<u>7,219,862</u>	<u>7,161,785</u>
Gross margin	<u>1,622,060</u>	<u>509,536</u>	<u>3,253,647</u>	<u>1,337,252</u>
Research and development expenses	36,702	62,982	121,074	41,358
Selling and administrative expenses	1,429,486	1,231,772	4,448,785	4,130,410
Foreign exchange (gain) loss	(237,553)	58,009	(169,393)	(155,302)
Gain on disposition of assets	<u>-</u>	<u>(1,336,038)</u>	<u>-</u>	<u>(1,836,038)</u>
	<u>1,228,635</u>	<u>16,725</u>	<u>4,400,466</u>	<u>2,180,428</u>
Operating Income (Loss)	<u>393,425</u>	<u>492,811</u>	<u>(1,146,819)</u>	<u>(843,176)</u>
Finance income	(3,283)	(29,566)	(14,679)	(38,507)
Finance expense (note 7)	<u>26,815</u>	<u>31,204</u>	<u>111,203</u>	<u>166,981</u>
Finance costs – net	<u>23,532</u>	<u>1,638</u>	<u>96,524</u>	<u>128,474</u>
Net income (loss) for the period	<u>369,893</u>	<u>491,173</u>	<u>(1,243,343)</u>	<u>(971,650)</u>
Earnings (loss) attributable to:				
Shareholders of the Company	370,407	498,992	(1,206,779)	(987,969)
Non-controlling interest	<u>(514)</u>	<u>(7,819)</u>	<u>(36,564)</u>	<u>16,319</u>
	<u>369,893</u>	<u>491,173</u>	<u>(1,243,343)</u>	<u>(971,650)</u>
Earnings (loss) per share				
Basic (note 5)	0.01	0.01	(0.03)	(0.03)
Diluted (note 5)	<u>0.01</u>	<u>0.01</u>	<u>(0.03)</u>	<u>(0.03)</u>

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

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Comprehensive Income (Loss)
For the three-month and nine-month periods ended September 30, 2014 and 2013
(Unaudited)

(expressed in Canadian dollars)

	2014 \$	2013 \$	2014 \$	2013 \$
Net income (loss) for the period	369,893	491,173	(1,243,343)	(971,650)
Other comprehensive (loss) income				
Cumulative translation adjustment	<u>(339,221)</u>	<u>52,507</u>	<u>(206,816)</u>	<u>(129,233)</u>
Comprehensive income (loss) for the period	<u>30,672</u>	<u>543,680</u>	<u>(1,450,159)</u>	<u>(1,100,883)</u>
Attributable to:				
Shareholders of the Company	24,801	554,739	(1,425,078)	(1,119,252)
Non-controlling interest	<u>5,871</u>	<u>(11,059)</u>	<u>(25,081)</u>	<u>18,369</u>
	<u>30,672</u>	<u>543,680</u>	<u>(1,450,159)</u>	<u>(1,100,883)</u>

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

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Changes in Equity

(Unaudited)

(expressed in Canadian dollars)

	Number		Amount						
	Common shares	Warrants	Share capital – Common shares and warrants \$	Contributed surplus \$	Accumulated other comprehensive loss \$	Deficit \$	Equity attributable to the Company \$	Non-controlling interest \$	Total \$
Balance – January 1, 2013	39,363,867	10,091,886	19,732,623	2,316,580	(48,870)	(20,528,866)	1,471,467	265,872	1,737,339
Net loss for the period	-	-	-	-	-	(987,969)	(987,969)	16,319	(971,650)
Other comprehensive (loss) income	-	-	-	-	(131,283)	-	(131,283)	2,050	(129,233)
Comprehensive income (loss) for the period	-	-	-	-	(131,283)	(987,969)	(1,119,252)	18,369	(1,100,883)
Share-based compensation	-	-	-	71,483	-	-	71,483	-	71,483
Balance – September 30, 2013	39,363,867	10,091,886	19,732,623	2,388,063	(180,153)	(21,516,835)	423,698	284,241	707,939
Balance – January 1, 2014	39,363,867	10,091,886	19,732,623	2,388,063	(313,486)	(20,131,974)	1,675,226	283,762	1,958,988
Net loss for the period	-	-	-	-	-	(1,206,779)	(1,206,779)	(36,564)	(1,243,343)
Other comprehensive (loss) income	-	-	-	-	(218,299)	-	(218,299)	11,483	(206,816)
Comprehensive loss for the period	-	-	-	-	(218,299)	(1,206,779)	(1,425,078)	(25,081)	(1,450,159)
Share-based compensation	-	-	-	57,046	-	-	57,046	-	57,046
Balance – September 30, 2014	39,363,867	10,091,886	19,732,623	2,445,109	(531,785)	(21,338,753)	307,194	258,681	565,875

Accumulated other comprehensive loss relates solely to cumulative translation adjustments.

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

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Cash Flows

For the three-month and nine-month periods ended September 30, 2014 and 2013

(Unaudited)

(expressed in Canadian dollars)

	2014 \$	2013 \$	2014 \$	2013 \$
Cash flows from				
Operating activities				
Net income (loss) for the period	369,893	491,173	(1,243,343)	(971,650)
Items not affecting cash				
Amortization of property, plant and equipment	26,060	22,816	68,821	73,301
Amortization of intangible assets	42,572	42,324	127,501	126,933
Gain on disposition of intangible assets	-	(1,336,038)	-	(1,836,038)
Gain on debt forgiveness	-	-	(12,624)	(1,034)
Government assistance	(1,250)	(1,250)	(3,750)	(3,750)
Deferred rent	6,596	6,596	19,788	19,788
Accretion and revaluation of government royalty program obligation	8,279	8,631	26,894	85,304
Stock-based compensation expense	37,687	522	57,046	71,483
	<u>489,837</u>	<u>(765,226)</u>	<u>(959,667)</u>	<u>(2,435,663)</u>
Changes in non-cash working capital components relating to operations (note 8)	<u>(569,298)</u>	<u>(964,626)</u>	<u>(641,543)</u>	<u>(513,307)</u>
	<u>(79,461)</u>	<u>(1,729,852)</u>	<u>(1,601,210)</u>	<u>(2,948,970)</u>
Investing activities				
Acquisition of property, plant and equipment	(72,313)	-	(126,907)	(25,323)
Acquisition of intangible assets	(5,302)	-	(2,651)	-
Proceeds from disposal of assets	-	1,336,087	-	1,841,005
Balance of sale	-	-	300,000	300,000
	<u>(77,615)</u>	<u>1,336,087</u>	<u>170,442</u>	<u>2,115,682</u>
Financing activities				
Increase (decrease) of bank loan	7,665	-	(236,702)	333,048
Repayment of long-term debt	(23,060)	(25,389)	(56,581)	(63,531)
Repayment of government royalty program obligation	78,000	-	(69,000)	(60,000)
	<u>62,605</u>	<u>(25,389)</u>	<u>(362,283)</u>	<u>209,517</u>
Effect of exchange rate changes on cash	<u>(346,635)</u>	<u>53,892</u>	<u>(213,285)</u>	<u>(136,010)</u>
Decrease in cash during the period	<u>(441,106)</u>	<u>(365,262)</u>	<u>(2,006,336)</u>	<u>(759,781)</u>
Cash – Beginning of period	<u>1,269,821</u>	<u>949,595</u>	<u>2,835,051</u>	<u>1,344,114</u>
Cash – End of period	<u>828,715</u>	<u>584,333</u>	<u>828,715</u>	<u>584,333</u>
Additional information				
Interest paid	18,535	22,542	84,308	81,534

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

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

September 30, 2014

(expressed in Canadian dollars)

1 Nature of business

a) Nature of business

Xebec Adsorption Inc. (“Xebec” or the “Company”) is a global provider which specializes in the design and manufacture of cost-effective, environmentally responsible, purification, separation, dehydration, and filtration equipment for gases and compressed air. Xebec’s main product lines are: Biogas Plants for the purification of biogas from agricultural digesters, landfill sites and waste water treatment plants, Natural Gas Dryers for NGV refuelling stations, Associated Gas Purification Systems which enable diesel displacement on drilling sites, and Hydrogen Purification Systems for fuel cell and industrial applications. The Company is incorporated and domiciled in Canada and is listed on the TSX Venture Exchange under the symbol XBC-V. The address of its registered office is 730 Industriel Boulevard, Blainville, Quebec, Canada.

b) Liquidity risk

The Company has realized an operating loss of \$1,146,819, had cash outflows from operations of \$1,601,210 for the period ended September 30, 2014 and finished the period with cash amounting to \$828,715, a working capital of \$35,663 and no access to credit facilities. The company is also in default of its covenants under government royalty program. During the year, management undertook various initiatives and developed a plan to manage its operating and liquidity risks in light of prevailing economic conditions. Management is also currently seeking alternative financings for its operations. The Company has prepared a revised budget and forecast for 2014 for which management believes the assumptions are reasonable. Achieving budgeted results is dependent on improving the volume of revenues, delivering on sales and contracts 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 December 31, 2014.

The Company is thus faced with uncertainties that may have an impact on future operating results and liquidity. These uncertainties include reduced spending in biogas projects reflecting the weakness of the market, 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 2014 and planned courses of action. Therefore, the Company may require additional external funding and there is no assurance that it would be successful. It is possible that future changes in capital markets conditions could result in such funding not being available when required or at acceptable costs. The Company is unable to predict the possible effects, if any, of such uncertainties and the potential adjustments to the carrying values of assets and liabilities that could be needed should the Company have insufficient liquidity. Such adjustments could be material.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

September 30, 2014

(expressed in Canadian dollars)

2 Basis of preparation

These condensed consolidated interim financial statements, have been prepared in accordance with International Financial Reporting Standards (“IFRS”) applicable to the preparation of interim financial statement, including IAS 34 Interim Financial Reporting. The condensed consolidated interim financial statements do not include all of the information required for annual financial statements, and should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2013, as they follow the same accounting policies and methods of application, unless otherwise indicated. These consolidated interim financial statements were approved by the Board of Directors on October 27, 2014.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

September 30, 2014

(expressed in Canadian dollars)

3 Property, plant and equipment

	Machinery and equipment	Office furniture and equipment	Computers	Moulds	Vehicles	Total
Cost						
Balance at December 31, 2013	477,771	91,152	210,428	90,618	35,984	905,953
Additions	-	47,063	12,835	67,036	-	126,934
Effect of movements in exchange rates	4,302	3,032	4,450	3,559	-	15,343
Balance at September 30, 2014	482,073	141,247	227,713	161,213	35,984	1,048,230
Accumulated amortization						
Balance at December 31, 2013	232,740	85,668	179,425	72,355	25,189	595,377
Amortization	33,542	7,755	18,666	7,503	5,397	72,863
Effect of movements in exchange rates	3,025	2,864	(91)	2,987	-	8,785
Balance at September 30, 2014	269,307	96,287	198,000	82,845	30,586	677,025
Carrying Amount						
At December 31, 2013	245,031	5,484	31,003	18,263	10,795	310,576
At September 30, 2014	212,766	44,960	29,713	78,368	5,398	371,205

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

September 30, 2014

(expressed in Canadian dollars)

4 Intangible assets

	Customer relations \$	Other Software \$	Internally generated Engineering drawings \$	Total intangible assets \$	Goodwill \$
Cost					
Balance at December 31, 2013	1,900,000	254,319	4,700	2,159,019	142,616
Additions	-	2,651	-	2,651	-
Effect of movements in exchange rates	-	3,862	-	3,862	-
Balance at September 30, 2014	1,900,000	260,832	4,700	2,165,532	142,616
Accumulated amortization					
Balance at December 31, 2013	1,108,333	236,473	4,700	1,349,506	-
Amortization of the period	118,750	8,751	-	127,501	-
Effect of movements in exchange rates	-	3,670	-	3,670	-
Balance at September 30, 2014	1,227,083	248,894	4,700	1,480,677	-
Carrying Amount					
At December 31, 2013	791,667	17,846	-	809,513	142,616
At September 30, 2014	672,917	11,938	-	684,855	142,616

For the nine-month period ended September 30, amortization of \$127,501 (2013 - \$126,933) is included in the consolidated statement of income (loss): \$2,411 (2012 - \$3,604) in “cost of goods sold” and \$125,090 (2013 - \$123,329) in “selling and administrative expenses”.

For the three-month period ended September 30, amortization of \$42,572 (2013 - \$42,324) is included in the consolidated statement of income (loss): \$875 (2013 - \$627) in “cost of goods sold” and \$41,697 (2013 - \$41,697) in “selling and administrative expenses”.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

September 30, 2014

(expressed in Canadian dollars)

5 Share capital

Earnings (loss) per share

i) Basic

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

	<u>For the three-month period ended September 30,</u>		<u>For the nine-month period ended September 30,</u>	
	<u>2014</u>	<u>2013</u>	<u>2013</u>	<u>2012</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
Net income (loss) attributable to owners of the parent	370,407	498,992	(1,206,779)	(987,969)
Weighted average number of common shares in issue	<u>39,363,867</u>	<u>39,363,867</u>	<u>39,363,867</u>	<u>39,363,867</u>
	<u>0.01</u>	<u>0.01</u>	<u>(0.03)</u>	<u>(0.03)</u>

ii) Diluted

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

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

September 30, 2014

(expressed in Canadian dollars)

	<u>For the three-month period ended September 30,</u>		<u>For the nine-month period ended September 30,</u>	
	<u>2014</u>	<u>2013</u>	<u>2014</u>	<u>2013</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
Net income (loss) attributable to owners of the parent	370,407	498,992	(1,206,779)	(987,969)
Weighted average number of common shares in issue	39,363,867	39,363,867	39,363,867	39,363,867
Dilutive effect of stock options	2,280,000	2,400,000	2,280,000	-
Diluted weighted average number of shares	41,643,867	41,763,867	41,643,867	39,363,867
	0.01	0.01	(0.03)	(0.03)
Items excluded from the calculation of diluted net income per share because the exercise price was greater than the average market price of the common shares or due to their anti-dilutive effect				
Stock options	2,165,901	1,965,554	2,165,901	4,365,554
Warrants (number of equivalent shares)	4,541,349	4,541,349	4,541,349	4,541,349

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

September 30, 2014

(expressed in Canadian dollars)

6 Expenses by nature

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2014	2013	2014	2013
	\$	\$	\$	\$
Material	1,786,828	717,074	4,604,835	3,632,893
Employee benefits	1,435,021	1,158,659	4,439,666	4,393,810
Travel expenses	217,857	137,163	672,872	557,309
Rent and repairs and maintenance	147,175	176,686	459,331	510,783
Professional fees	164,093	98,893	433,974	455,214
Office expense	113,398	94,730	355,513	295,345
Subcontracting costs	150,417	85,013	421,906	776,814
Amortization	68,632	65,140	196,323	200,234
Stock-based compensation	37,687	521	57,046	71,483
Commission	-	-	47,052	36,032
Other	11,560	117,854	(19,871)	362,278
	<u>4,132,668</u>	<u>2,651,733</u>	<u>11,668,647</u>	<u>11,292,195</u>

7 Finance expenses

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2014	2013	2014	2013
	\$	\$	\$	\$
Interest and bank charges	76	7,661	45,341	44,924
Interest charges	18,333	14,625	38,490	35,752
Accretion and revaluation of government royalty program obligation	8,280	8,630	26,895	85,303
Interest on long-term debt	126	288	477	1,002
	<u>26,815</u>	<u>31,204</u>	<u>111,203</u>	<u>166,981</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

September 30, 2014

(expressed in Canadian dollars)

8 Supplemental Cash flow information

Net change in non-cash working capital balances related to operations consists of the following:

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2014 \$	2013 \$	2014 \$	2013 \$
Decrease (increase) in assets:				
Trade and other receivables	(978,726)	(1,285,442)	(242,970)	(706,462)
Inventories	(137,066)	(287,812)	48,383	(264,517)
Other current assets	52,923	72,046	(207,200)	(76,313)
Investment tax credits receivable	155,000	-	137,760	(223,635)
Restricted cash	-	-	(145,386)	-
Increase (decrease) in liabilities:				
Trade payables	370,929	410,637	365,199	529,721
Accrued liabilities	125,150	(209,268)	(59,234)	(103,261)
Deferred revenues	178,600	355,595	(25,090)	331,842
Other operating liabilities	(336,108)	(20,382)	(513,005)	(682)
	<u>(569,298)</u>	<u>(964,626)</u>	<u>(641,543)</u>	<u>(513,307)</u>

9 Related party transactions

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

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2014 \$	2013 \$	2014 \$	2013 \$
Marketing and professional services expenses paid to companies controlled by members of the immediate family of an officer	27,930	25,840	83,275	76,618
Sales to entities controlled by a subsidiary manager	<u>1,119,716</u>	<u>93,669</u>	<u>1,972,759</u>	<u>329,987</u>

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

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

September 30, 2014

(expressed in Canadian dollars)

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 and compressed air. The Company has four product lines and provides related engineering services.

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

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2014 \$	2013 \$	2014 \$	2013 \$
Revenue				
United States	1,040,788	833,729	3,191,341	2,216,688
China	1,279,246	240,952	2,268,266	712,216
Singapore	1,281,280	94,908	2,134,323	340,114
Canada	464,250	445,445	1,477,432	1,614,261
Other	259,678	314,463	1,402,147	3,615,758
	<u>4,325,242</u>	<u>1,929,497</u>	<u>10,473,509</u>	<u>8,499,037</u>

Revenue summarized by product line is as follows:

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2014 \$	2013 \$	2014 \$	2013 \$
Product line				
Natural gas dryers	1,860,462	813,229	4,389,805	3,058,740
Compressed gas filtration	974,747	774,755	2,857,227	2,783,268
Gas purification	1,228,195	341,513	2,256,527	2,429,181
Associated Gas	261,838	-	969,950	227,848
	<u>4,325,242</u>	<u>1,929,497</u>	<u>10,473,509</u>	<u>8,499,037</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

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(expressed in Canadian dollars)

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

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2014	2013	2014	2013
	\$	\$	\$	\$
Customer A	1,281,280	94,908	2,134,323	322,745
	<u>1,281,280</u>	<u>94,908</u>	<u>2,134,323</u>	<u>322,745</u>

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

	September 30, 2014	December 31, 2013
	\$	\$
Non-current assets		
North America	1,133,696	1,389,781
Asia	64,980	72,924
	<u>1,198,676</u>	<u>1,462,705</u>