

Xebec Adsorption Inc.

Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2013

(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 March 31, 2013 \$	As at December 31, 2012 \$
Assets		
Current assets		
Cash	1,248,876	1,344,114
Trade and other receivables	3,949,029	3,936,746
Inventories	1,615,699	1,662,494
Short-term portion of balance of sale	300,000	200,000
Investment tax credits receivable	75,000	75,000
Other current assets	442,999	425,102
Total current assets	7,631,603	7,643,456
Non-current assets		
Balance of sale	200,000	600,000
Property, plant and equipment (Note 3)	341,819	369,976
Intangible assets (Note 4)	936,105	978,258
Goodwill (Note 4)	142,616	142,616
Total non-current assets	1,620,540	2,090,850
Total assets	9,252,143	9,734,306
Liabilities		
Current liabilities		
Bank loan	392,100	166,952
Trade payables	4,216,857	3,799,491
Accrued liabilities	1,058,269	1,144,539
Deferred revenues	1,114,155	1,067,987
Current portion of long-term debt and obligation	66,786	76,474
Current portion of government royalty program obligation	618,544	365,959
Provisions	49,452	161,692
Total current liabilities	7,516,163	6,783,094
Non-current liabilities		
Long-term debt and obligation	102,036	117,649
Government royalty program obligation	470,416	714,853
Government assistance	20,833	22,083
Deferred rent	39,576	32,980
Provisions	495,767	326,308
Total non-current liabilities	1,128,628	1,213,873
Total liabilities	8,644,791	7,996,967
Equity (Deficiency)		
Share capital	19,732,623	19,732,623
Contributed surplus	2,320,717	2,316,580
Accumulated other comprehensive loss	(103,446)	(48,870)
Deficit	(21,639,750)	(20,528,866)
	310,144	1,471,467
Non-controlling interest	297,208	265,872
Total equity	607,352	1,737,339
Total liabilities and equity	9,252,143	9,734,306

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

Approved by the Board of Directors

(signed) Kurt Sorchak Director

(signed) John Shakeshaft Director

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Income (Loss)

For the three-month period ended March 31, 2013 and 2012 (Unaudited)

(expressed in Canadian dollars)

	2013 \$	2012 \$
Revenue	3,824,939	1,529,658
Cost of goods sold	3,445,128	1,809,124
Gross margin	379,811	(279,466)
Research and development expenses	57,973	26,072
Selling and administrative expenses	1,442,183	1,164,132
Foreign exchange (gain) loss	(70,268)	40,183
Gain on disposition of assets	-	(5,445,961)
	1,429,888	(4,215,574)
Operating Income (Loss)	(1,050,077)	3,936,108
Finance income	(4,629)	(42)
Finance expense (Note 7)	35,790	770,032
Finance costs – net	31,161	769,990
Net income (loss) for the period	(1,081,238)	3,166,118
Earnings (loss) attributable to:		
Shareholders of the Company	(1,110,884)	3,181,530
Non-controlling interest	29,646	(15,412)
	(1,081,238)	3,166,118
Earnings (loss) per share		
Basic (Note 5)	(0.03)	0.08
Diluted (Note 5)	(0.03)	0.08

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 period ended March 31, 2013 and 2012 (Unaudited)

(expressed in Canadian dollars)

	2013 \$	2012 \$
Net income (loss) for the period	(1,081,238)	3,166,118
Other comprehensive income		
Cumulative translation adjustment	(52,886)	50,332
Comprehensive income (loss) for the period	<u>(1,134,124)</u>	<u>3,216,450</u>
Attributable to:		
Shareholders of the Company	(1,165,460)	3,231,853
Non-controlling interest	31,336	(15,403)
	<u>(1,134,124)</u>	<u>3,216,450</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 (Deficiency)

(Unaudited)

(expressed in Canadian dollars)

	Number		Amount						
	Common shares	Warrants	Share capital – Common shares and warrants \$	Contributed surplus \$	Accumulated other comprehensive income (loss) \$	Deficit \$	Equity attributable to the Company \$	Non-controlling interest \$	Total \$
Balance – January 1, 2012	39,363,867	10,658,136	19,802,272	2,168,550	(71,521)	(22,211,793)	(312,492)	5,371	(307,121)
Net loss for the period	-	-	-	-	-	3,181,530	3,181,530	(15,412)	3,166,118
Other comprehensive income	-	-	-	-	50,323	-	50,323	9	50,332
Comprehensive income (loss) for the period	-	-	-	-	50,323	3,181,530	3,231,853	(15,403)	3,216,450
Share-based compensation	-	-	-	47,847	-	-	47,847	-	47,847
Balance – March 31, 2012	39,363,867	10,658,136	19,802,272	2,216,397	(21,198)	(19,030,263)	2,967,208	(10,032)	2,957,176
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 income (loss) for the period	-	-	-	-	-	(1,110,884)	(1,110,884)	29,646	(1,081,238)
Other comprehensive income (net of tax)	-	-	-	-	(54,576)	-	(54,576)	1,690	(52,886)
Comprehensive income (loss) for the period	-	-	-	-	(54,576)	(1,110,884)	(1,165,460)	31,336	(1,134,124)
Share-based compensation	-	-	-	4,137	-	-	4,137	-	4,137
Balance – March 31, 2013	39,363,867	10,091,886	19,732,623	2,320,717	(103,446)	(21,639,750)	310,144	297,208	607,352

Accumulated other comprehensive income 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 period ended March 31, 2013 and 2012 (Unaudited)

(expressed in Canadian dollars)

	2013	2012
	\$	\$
Cash flows from		
Operating activities		
Net income (loss) for the period	(1,081,238)	3,166,118
Items not affecting cash		
Amortization of property, plant and equipment	25,335	65,562
Amortization of intangible assets	42,297	117,443
Gain on disposition of assets	-	(5,445,961)
Gain on debt forgiveness	(1,034)	(27,930)
Government assistance	(1,250)	(1,250)
Deferred rent	6,596	6,596
Accretion and revaluation of government royalty program obligation	8,148	736,577
Stock-based compensation expense	4,137	47,847
	<u>(997,009)</u>	<u>1,334,998</u>
Changes in non-cash working capital components relating to operations		
Trade and other receivables	(12,283)	1,233,026
Inventories	46,795	(55,588)
Other current assets	(17,897)	64,480
Trade payables	418,400	(1,691,465)
Accrued liabilities	(86,270)	(199,440)
Deferred revenues	46,168	119,775
Other operating liabilities	57,219	(40,301)
	<u>452,132</u>	<u>(569,513)</u>
	<u>(544,877)</u>	<u>(1,904,511)</u>
Investing activities		
Acquisition of intangible assets	-	(52,677)
Proceeds from disposal of assets	4,918	8,414,519
Balance of sale	300,000	-
	<u>304,918</u>	<u>8,361,842</u>
Financing activities		
Increase (decrease) of bank loan	225,148	(500,000)
Repayment of long-term debt	(25,301)	(123,670)
Repayment of government royalty program obligation	-	(788,401)
	<u>199,847</u>	<u>(1,412,071)</u>
Effect of exchange rate changes on cash	(55,126)	52,440
Increase (decrease) in cash during the period	<u>(95,238)</u>	<u>5,097,700</u>
Cash – Beginning of period	<u>1,344,114</u>	<u>389,090</u>
Cash – End of period	<u>1,248,876</u>	<u>5,486,790</u>
Additional information		
Interest paid	27,579	33,455

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)

March 31, 2013

(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 Toronto Stock Exchange under the symbol XBC. The address of its registered office is 730 Industriel Boulevard, Blainville, Quebec, Canada.

b) Liquidity risk

The Company has realized an operating loss of \$1,050,077, had cash outflows from operations of \$544,877 for the period ended March 31, 2013 and finished the period with cash amounting to \$1,248,876, working capital of \$115,440 and had access to credit facilities totalling \$1,500,000 of which only \$392,100 has been used. The Company is currently in breach of its TPC agreement but obtained a two months extension. During the fourth quarter of 2012, 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 such as asset-based lending facilities. The Company has prepared a budget for 2013 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, 2013.

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 2013 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)

March 31, 2013

(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, 2012, 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 May 9, 2013.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

March 31, 2013

(expressed in Canadian dollars)

3 Property, plant and equipment

	Machinery and equipment	Office furniture and equipment	Computers	Moulds	Vehicles	Leasehold improvements	Total
Cost							
Balance at December 31, 2012	446,738	98,960	226,716	82,367	35,984	9,542	900,307
Disposals	(4,230)	(14,531)	(20,099)	-	-	(9,458)	(48,318)
Effect of movements in exchange rates	2,269	1,455	2,304	1,908	-	(84)	7,852
Balance at March 31, 2013	444,777	85,884	208,921	84,275	35,984	-	859,841
Accumulated amortization							
Balance at December 31, 2012	186,049	79,436	185,335	51,977	17,992	9,542	530,331
Amortization	10,474	4,278	4,602	4,181	1,799	-	25,334
Disposals	(3,160)	(11,625)	(19,157)	-	-	(9,458)	(43,400)
Effect of movements in exchange rates	1,351	1,232	2,021	1,237	-	(84)	5,757
Balance at March 31, 2013	194,714	73,321	172,801	57,395	19,791	-	518,022
Carrying Amount							
At December 31, 2012	260,689	19,524	41,381	30,390	17,992	-	369,976
At March 31, 2013	250,063	12,563	36,120	26,880	16,193	-	341,819

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2013

(expressed in Canadian dollars)

4 Intangible assets

	Customer relations \$	Other Software \$	Internally generated Engineering drawings \$	Total intangible assets \$	Goodwill \$
Cost					
Balance at December 31, 2012	1,900,000	245,573	4,700	2,150,273	142,616
Additions	-	-	-	-	-
Disposals	-	-	-	-	-
Effect of movements in exchange rates	-	2,023	-	2,023	-
Balance at March 31, 2013	1,900,000	247,596	4,700	2,152,296	142,616
Accumulated amortization					
Balance at December 31, 2012	950,000	217,315	4,700	1,172,015	-
Amortization of the period	39,584	2,713	-	42,297	-
Disposals	-	-	-	-	-
Effect of movements in exchange rates	-	1,879	-	1,879	-
Balance at March 31, 2013	989,584	221,907	4,700	1,216,191	-
Carrying Amount					
At December 31, 2012	950,000	28,258	-	978,258	142,616
At March 31, 2013	910,416	25,689	-	936,105	142,616

Amortization of \$42,297 (2012 - \$117,443) is included in the consolidated statement of income (loss): \$600 (2012 - \$49,430) in 'cost of goods sold' and \$41,697 (2012 - \$68,013) in 'selling and administrative expenses'.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2013

(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.

	For the three- month ended March 31, 2013	For the three- month ended March 31, 2012
		\$
Net income (loss) attributable to owners of the parent	(1,110,884)	3,181,530
Weighted average number of common shares in issue	39,363,867	39,363,867
	<u>(\$0.03)</u>	<u>\$0.08</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. For the period ended March 31, 2013, the diluted net loss per share was the same as the basic net loss per share, since the effect of assumed exercise of share options and warrants to purchase common shares was anti-dilutive.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2013

(expressed in Canadian dollars)

	For the three- month ended March 31, 2013	For the three- month ended March 31, 2012
	\$	\$
Net income attributable to owners of the parent	-	3,181,530
Weighted average number of common shares in issue	-	39,363,867
Dilutive effect of stock options	-	2,620,000
Diluted weighted average number of shares	-	41,983,867
	-	\$0.08
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		
Warrants (number of equivalent shares)	-	403,082
	-	4,767,849

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2013

(expressed in Canadian dollars)

6 Expenses by nature

	For the three- month ended March 31, 2013 \$	For the three- month ended March 31, 2012 \$
Material	2,183,228	549,877
Employee benefits	1,694,372	1,500,537
Rent and repairs and maintenance	210,603	233,902
Professional fees	180,989	39,400
Travel expenses	170,028	113,690
Other	132,854	36,871
Office expense	103,781	137,385
Subcontracting costs	103,657	130,506
Amortization	67,631	183,241
Commission	36,032	-
Stock-based compensation	4,136	47,847
	<u>4,887,311</u>	<u>2,973,256</u>

7 Finance expenses

	For the three-month ended March 31, 2013 \$	For the three-month ended March 31, 2012 \$
Interest and bank charges	19,505	13,391
Accretion and revaluation of government royalty program obligation	8,148	738,176
Interest charges	7,761	16,328
Interest on long-term debt	376	2,137
	<u>35,790</u>	<u>770,032</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2013

(expressed in Canadian dollars)

8 Related party transactions

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

	For the three-month ended March 31, 2013 \$	For the three-month ended March 31, 2012 \$
Marketing and professional services expenses paid to companies controlled by members of the immediate family of an officer	22,658	11,975
Sales to entities controlled by a Company director	17,172	2,747
Accrued interest on loan from a Company director	-	811

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

9 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 ended March 31, 2013 \$	For the three-month ended March 31, 2012 \$
Revenue		
Korea	1,834,905	154,461
Canada	736,029	602,449
United States	614,134	548,801
Other	639,871	223,947
	<u>3,824,939</u>	<u>1,529,658</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2013

(expressed in Canadian dollars)

Revenue summarized by product line is as follows:

Product line	For the three-month ended March 31, 2013 \$	For the three-month ended March 31, 2012 \$
Gas purification	1,653,429	450,609
Natural gas dryers	1,001,000	426,056
Compressed gas filtration	955,412	185,025
Engineering services	-	426,974
Associated Gas	215,098	-
Air dryers	-	40,994
	<hr/>	<hr/>
	3,824,939	1,529,658

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

	For the three-month ended March 31, 2013 \$	For the three-month ended March 31, 2012 \$
Customer A	1,108,386	-
Customer B	725,472	6,863
	<hr/>	<hr/>
	1,833,858	6,863

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

Non-current assets	March 31, 2013 \$	December 31, 2012 \$
Canada	1,527,115	1,982,855
Asia	93,425	107,995
	<hr/>	<hr/>
	1,620,540	2,090,850

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements
(Unaudited)

March 31, 2013

(expressed in Canadian dollars)

10 Subsequent events

- a) On April 28, 2013, the Company received additional proceeds of \$0.5 million pursuant to its intellectual property transaction of March 22, 2012