Xebec Adsorption Inc.

Condensed Interim Consolidated Financial Statements
(Unaudited)
September 30, 2011
(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.

Interim Consolidated Statement of Financial Position
(Unaudited)

(expressed in Canadian dollars)

	As at September 30, 2011 $	As at December 31, 2010 $	As at January 1, 2010 $
Assets			
Current assets			
Cash and cash equivalents	-	2,262,273	5,447,702
Restricted cash	579,671	576,092	223,261
Trade and other receivables	3,829,024	2,603,261	3,105,834
Inventories	2,162,417	2,720,060	2,867,922
Income taxes recoverable	-	-	62,492
Investment tax credits receivable	75,000	103,489	80,843
Other current assets	313,226	100,846	183,564
Total current assets	6,959,338	8,366,021	11,971,618
Non-current assets			
Balance of sale	800,000	-	-
Loan to a joint venture	-	117,811	113,331
Property, plant and equipment	3,894,513	1,908,442	2,545,789
Intangible assets	4,095,366	4,483,897	5,222,797
Goodwill	618,718	342,616	342,616
Total non-current assets	9,408,597	6,852,766	8,224,533
Total assets	16,367,935	15,218,787	20,196,151
Liabilities			
Current liabilities			
Bank overdraft	87,364	-	-
Bank loan	500,000	500,000	496,900
Trade payables and accrued liabilities	5,727,499	7,089,760	4,586,203
Deferred revenues	3,246,746	2,331,802	146,228
Current portion of deferred gain on sale of property	151,788	-	-
Income taxes payable	-	8,286	-
Derivative financial instruments	-	-	96,645
Current portion of long-term debt and obligation	303,190	243,407	384,149
Current portion of government royalty program obligation	189,150	-	-
Provisions	185,000	1,036,095	141,309
Total current liabilities	10,390,737	11,209,350	5,851,434
Non-current liabilities			
Long-term debt	217,812	1,867,870	1,919,752
Government royalty program obligation	669,464	691,539	1,137,307
Government assistance	28,333	32,083	37,083
Deferred gain on sale of property	2,125,037	-	-
Obligation under finance lease	3,138,710	-	-
Provisions	268,170	304,034	694,674
Total non-current liabilities	6,447,526	2,895,526	3,788,816
Total liabilities	16,838,263	14,104,876	9,640,250
Shareholders' Equity			
Share capital	19,802,272	19,964,218	18,107,821
Contributed surplus	2,066,635	1,841,741	51,368
Accumulated other comprehensive income (loss)	(92,571)	72,622	-
Deficit	(22,231,212)	(20,764,670)	(7,603,288)
	(454,876)	1,113,911	10,555,901
Non-controlling interest	(15,452)	-	-
Total Equity	(470,328)	1,113,911	10,555,901
Total liabilities and shareholders' equity	16,367,935	15,218,787	20,196,151

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.

Interim Consolidated Statement of Loss
For the three and nine-month periods ended September 30, 2011 and 2010
(Unaudited)

(expressed in Canadian dollars)

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2011 $	2010 $	2011 $	2010 $
Revenue	2,945,291	3,955,714	11,504,851	10,088,981
Cost of goods sold	1,690,794	4,020,727	7,346,448	9,482,393
Gross margin	1,254,497	(65,013)	4,158,403	606,588
Research and development expenses	100,765	663,275	487,105	1,784,391
Selling and administrative expenses	1,229,249	2,311,017	4,922,014	7,666,357
Foreign exchange loss (gain)	36,409	(36,994)	(91,516)	25,920
Gain on revaluation of investment	(132,917)	-	(132,917)	-
	1,233,506	2,937,298	5,184,686	9,476,668
Finance income	(192)	(5,382)	(9,348)	(17,448)
Finance expense	229,350	149,421	449,607	467,219
Finance costs – net	229,158	144,039	440,259	449,771
Loss before income taxes	(208,167)	(3,146,350)	(1,466,542)	(9,319,851)
Income taxes	-	(9,418)	-	(9,418)
Net loss for the period	(208,167)	(3,136,932)	(1,466,542)	(9,310,433)
Profit (loss) attributable to:				
Owners of Xebec Adsorption Inc.	(231,781)	(3,136,932)	(1,490,156)	(9,310,433)
Non-controlling interest	23,614	-	23,614	-
	(208,167)	(3,136,932)	(1,466,542)	(9,310,433)
Loss per share				
Basic and diluted	(0.01)	(0.11)	(0.04)	(0.32)

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

Xebec Adsorption Inc.

Interim Consolidated Statement of Comprehensive Loss
(Unaudited)

(expressed in Canadian dollars)

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2011 **$**	**2010** **$**	**2011** **$**	**2010** **$**
Net loss for the period	(208,167)	(3,136,932)	(1,466,542)	(9,310,433)
Other comprehensive income (loss)				
Cumulative translation adjustment	(177,249)	14,213	(165,193)	36,823
Comprehensive loss for the period	(385,416)	(3,122,719)	(1,631,735)	(9,273,610)
Attributable to:				
Owners of Xebec Adsorption Inc.	(408,581)	(3,122,719)	(1,654,900)	(9,273,610)
Non-controlling interest	23,165	-	23,165	-
Comprehensive loss for the period	(385,416)	(3,122,719)	(1,631,735)	(9,273,610)

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

Xebec Adsorption Inc.

Interim Consolidated Statement of Changes in Shareholders' Equity
(Unaudited)

(expressed in Canadian dollars)

	Number		Amount				
	Common shares	Warrants	Share capital – Common shares and warrants $	Contributed surplus $	Accumulated other comprehensive income $	Deficit $	Total $
Balance – January 1, 2011	39,363,867	15,456,424	19,964,218	1,841,741	72,622	(20,764,670)	1,113,911
Net loss for the period	-	-	-	-	-	(1,466,542)	(1,466,542)
Other comprehensive income (net of tax)	-	-	-	-	(165,193)	-	(165,193)
Comprehensive loss for the period	-	-	-	-	(165,193)	(1,466,542)	(1,631,735)
Expired warrants	-	(4,798,288)	(161,946)	161,946	-	-	-
Share-based compensation	-	-	-	62,948	-	-	62,948
Balance – September 30, 2011	39,363,867	10,658,136	19,802,272	2,066,635	(92,571)	(22,231,212)	(454,876)
Balance – January 1, 2010	29,262,445	17,167,824	18,107,821	51,368	-	(7,603,346)	10,555,843
Net loss for the period	-	-	-	-	-	(9,310,433)	(9,310,433)
Other comprehensive income (net of tax)	-	-	-	-	36,823	-	36,823
Comprehensive loss for the period	-	-	-	-	36,823	(9,310,433)	(9,273,610)
Issuance of shares	9,536	(9,536)	7,343	-	-	-	7,343
Share-based compensation	-	-	-	19,689	-	-	19,689
Expired warrants		(12,360,000)	(1,782,259)	1,782,259	-	-	-
Balance – September 30, 2010	29,271,981	4,798,288	16,332,905	1,853,316	36,823	(16,913,779)	1,309,265

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

(expressed in Canadian dollars)

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2011	2010	2011	2010
	$	$	$	$
Cash flows generated from (used in)				
Operating activities				
Net loss for the period	(208,167)	(3,136,932)	(1,466,542)	(9,310,433)
Adjustments for:				
Depreciation of property, plant and equipment	80,082	162,038	305,851	486,326
Amortization of intangible assets	129,410	149,604	388,592	422,984
Loss on disposal of property, plant and equipment	1,733	-	1,733	-
Gain on debt forgiveness	(77,869)	-	(77,869)	-
Government assistance	(1,250)	-	(3,750)	-
Unrealized foreign exchange loss on derivative financial	-	-	-	(96,645)
Unrealized foreign exchange loss on loan to a joint venture and restricted cash	-	(9,820)	(1,603)	4,879
Gain on revaluation of investment	(132,917)	-	(132,917)	-
Accretion of government royalty program obligation	59,903	92,126	167,075	266,019
Share-based compensation expense	60,253	6,504	62,948	19,689
	(88,822)	(2,736,480)	(756,482)	(8,207,181)
Changes in items of working capital				
Trade and other receivables	(867,327)	(1,657,332)	(1,055,527)	(856,513)
Inventories	(137,326)	(55,823)	660,505	(322,206)
Other current assets	(261,335)	(8,274)	(210,552)	4,374
Investment tax credits receivable	-	(38,272)	28,489	(22,646)
Trade payables and accrued liabilities	(81,061)	1,437,993	(1,422,549)	2,293,048
Deferred revenues	859,990	780,635	595,420	2,202,263
Income taxes payable (recoverable)	-	29,855	(8,286)	62,492
Other operating liabilities	(295,756)	(8,025)	(888,114)	(430,277)
	(782,815)	480,757	(2,300,614)	2,930,535
Net cash used in operating activities	(871,637)	(2,255,723)	(3,057,096)	(5,276,646)
Investing activities				
Acquisition of property, plant and equipment	(692)	(1,287)	(692)	(96,469)
Government assistance	-	(1,250)	-	(3,750)
Proceeds from disposal of property, plant and equipment	2,462,076	-	2,470,504	-
Cash acquired on acquisition of a business	47,066	-	47,066	-
Decrease (increase) in restricted cash	(500,458)	(367,305)	(3,579)	(367,305)
Net cash used in investing activities	2,007,992	(369,842)	2,513,299	(467,524)
Financing activities				
Issuance of common shares	-	-	-	7,343
Increase in bank loan	-	790,000	-	790,000
Increase in long-term debt	-	-	9,568	181,101
Repayment of long-term debt	(1,663,464)	(99,557)	(1,728,133)	(292,214)
Repayment of government royalty program obligation	-	(41,459)	-	(124,376)
Net cash used in financing activities	(1,663,464)	648,984	(1,718,565)	561,854
Net decrease in cash and cash equivalents during the period	(527,109)	(1,976,581)	(2,262,362)	(5,182,316)
Cash and cash equivalents – Beginning of period	539,076	2,258,946	2,262,273	5,447,702
Exchange gains (losses) on cash and cash equivalents	(99,331)	18,681	(87,275)	35,660
Cash and cash equivalents – End of period	(87,364)	301,046	(87,364)	301,046
Additional information				
Income tax recovered	-	2,955	(8,286)	71,910
Interest paid	108,160	108,732	220,839	252,184

(expressed in Canadian dollars)

1 Nature of business and liquidity risk

a) Nature of business

Xebec Adsorption Inc. (the "Company") is a global provider of clean energy solutions to corporations and governments looking to reduce their carbon footprint. The Company was formed upon the amalgamation of Xebec Adsorption Inc. ("Xebec") and QuestAir Technologies Inc. ("QuestAir") on June 12, 2009. The Company is incorporated and domiciled in Canada. The address of its registered office is 730 Industriel Boulevard, Blainville, province of Quebec, (Canada).

b) Going concern

These condensed interim consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assume the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Company has incurred an operating loss of $1,466,542 for the nine-month period ended September 30, 2011 ($13,161,383 for the year ended December 31, 2010) and has a deficit of $22,231,212 and a negative working capital of $3,431,399 as at September 30, 2011 ($20,764,670 and $2,843,329 as at December 31, 2010). The current financial position indicates that there is doubt about the Company's ability to continue as a going concern.

The Company's ability to continue as a going concern is primarily dependent on its ability to generate sufficient future cash flows and raise capital to fund its operations and to settle its obligations on a timely basis.

On March 17, 2011, the Company signed a licence and engineering service agreement amounting to US$3,250,000, including an upfront payment of US$1,750,000. In addition, the Company undertook various initiatives such as a cost reduction and return to profitability program to manage its operations and liquidity risks in light of prevailing economic conditions. There is no assurance that such efforts will be successful. However, and as a result of this plan, as of September 30, 2011, the net loss for the period is $1,466,542, compared to a net loss of $9,310,433 for the corresponding period as at September 30, 2010. Operating activities, before changes in items of working capital, used $756,482 as of September 30, 2011 compared to a use of $8,207,181 for the corresponding period ended September 30, 2010.

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

(expressed in Canadian dollars)

2 Basis of presentation

These condensed interim consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 and IFRS 1. The accounting policies followed in these condensed interim financial statements are the same as those applied in the Company's condensed interim financial statements for the period ended March 31, 2011. Subject to certain transition elections disclosed in note 4, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position as at January 1, 2010 and throughout all periods presented as if these policies had always been in effect. Note 4 discloses the impact of the transition to IFRS on the Company's reported equity as at September 30, 2010 and comprehensive income for the three and nine months ended September 30, 2010, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010.

The accounting policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as of November 11, 2011, the date the Board of Directors approved the statements, and effective on December 31, 2011. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending December 31, 2011 could result in restatement of these condensed interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

The condensed interim consolidated financial statements should be read in conjunction with the Company's Canadian GAAP annual financial statements for the year ended December 31, 2010, and the Company's condensed interim financial statements for the quarter ended March 31, 2011 prepared in accordance with IFRS applicable to interim financial statements.

3 Significant accounting policies

Basis of measurement

These condensed interim consolidated financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial assets and financial liabilities to fair value, including derivative instruments.

Consolidation

These condensed interim consolidated financial statements include the accounts of the Company and its subsidiary, Xebec Adsorption (Shanghai) Co. Ltd. Since July 1st, 2011.They also include the accounts of Xebec Adsorption South East Asia PTE. Ltd., the first six-months have been accounted for using the proportionate consolidation method. All intercompany transactions, balances and unrealized gains and losses from intercompany transactions are eliminated on consolidation.

(expressed in Canadian dollars)

Subsidiaries are those entities which the Company controls by having the power to govern the financial and operating policies. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date on which control is obtained by the Company and are deconsolidated from the date that control ceases.

The Company's interests in jointly controlled entities are accounted for by proportionate consolidation. The Company combines its share of the joint ventures' individual income and expenses, assets and liabilities and cash flows on a line-by-line basis with similar items in the Company's financial statements. The Company recognizes the portion of gains or losses on the sale of assets by it to the joint venture that is attributable to the other venturers. The Company does not recognize its share of profits or losses from the joint venture that result from the Company's purchase of assets from the joint venture until it resells the assets to an independent party. However, a loss on the transaction is recognized immediately if the loss provides evidence of a reduction in the net realizable value of current assets, or an impairment loss.

Cash and cash equivalents

In the consolidated statement of cash flows, cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less and bank overdrafts. In the consolidated statement of financial position, bank overdrafts are shown in current liabilities.

Trade receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment.

Inventories

Inventories are stated at the lower of cost and net realizable value for raw materials, work in progress and finished goods. Costs of raw materials are determined on an average cost basis. Work in progress and finished goods include materials, direct labour and production overhead (based on normal operating capacity). Net realizable value is the estimated selling price less applicable selling expenses. Inventories are recorded net of any obsolescence provision.

A new assessment is made in each subsequent period when inventories are adjusted to net realizable value. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realizable value because of changed economic circumstances, the amount of the write-down is reversed (i.e., the reversal is limited to the amount of the original write-down) so that the new carrying amount is the lower of cost and the revised net realizable value.

(expressed in Canadian dollars)

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the statement of income during the period in which they are incurred.

The major categories of property, plant and equipment are depreciated on a straight-line basis as follows:

Building	20 years
Machinery and equipment	3 to 10 years
Office furniture and equipment	5 years
Computers	3 years
Moulds	5 years
Vehicles	5 years
Leasehold improvements	Lesser of economic life and term of lease

The Company allocates the amount initially recognized in respect of an item of property, plant and equipment to its significant parts and depreciates each such part separately. Residual values, method of depreciation and useful lives of the assets are reviewed annually and adjusted if appropriate.

Gains and losses on disposals of property, plant and equipment are determined by comparing the proceeds with the carrying amount of the asset and are included as part of other gains and losses in the statement of income.

Identifiable intangible assets

The Company's intangible assets include patents, customer relations, software and engineering drawings. These assets are capitalized and amortized on a straight-line basis in the statement of income over the period of their expected useful lives.

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

Impairment of non-financial assets

Property, plant and equipment and intangible assets are tested for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Long-lived assets that are not amortized are subject to an annual impairment test. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or CGUs). The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use (being the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

(expressed in Canadian dollars)

The Company evaluates impairment losses, other than goodwill impairment, for potential reversals when events or circumstances warrant such consideration.

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Company's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in "intangible assets". Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to CGUs for the purpose of impairment testing. The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the business combination in which the goodwill arose, identified according to operating segment.

Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

Provisions

Provisions for restructuring costs, warranties and legal claims, where applicable, are recognized in accrued liabilities when the Company has a present legal or constructive obligation as a result of past events. It is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted to present value where the effect is material. The Company performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts.

During the normal course of its operations, the Company assumes certain maintenance and repair costs under warranties offered on commercial equipment and biogas purification equipment. The warranties cover a period ranging from 12 to 18 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 costs and the associated labour costs are considered. Revisions are made when actual experience differs materially from historical experience.

(expressed in Canadian dollars)

Financial instruments

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously. At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

Cash and cash equivalents	Loans and receivables
Trade and other receivables	Loans and receivables
Restricted cash	Loans and receivables
Loan to a joint venture	Loans and receivables
Bank overdraft	Other financial liabilities
Trade payables and accrued liabilities	Other financial liabilities
Derivative financial instruments	Fair value through profit or loss
Long-term debt	Other financial liabilities
Government royalty program obligation	Other financial liabilities
Subordinated loan	Other financial liabilities

A financial asset or financial liability is classified at fair value through profit and loss if acquired principally for the purpose of selling or repurchasing in the short term. Derivatives are also included in this category unless they are designated as hedges. Financial assets and financial liabilities classified as fair value through profit or loss are measured at fair value at each reporting period with changes in fair value in subsequent periods included in net loss. Transaction costs are expensed in the statement of income. Financial assets and financial liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond 12 months of the statement of financial position date, which is classified as non-current.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

Other financial liabilities are initially measured at fair value and subsequently at amortized cost using the effective interest method. Financial liabilities are classified as current liabilities if payment is due within 12 months. Otherwise, they are presented as non-current liabilities.

The Company classifies derivative financial instruments and embedded derivatives as fair value through profit and loss, and values them at fair value at the end of each period with changes recorded in other income. The Company does not designate these derivative financial instruments as hedges.

(expressed in Canadian dollars)

Impairment of financial assets

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the Company recognizes an impairment loss.

The loss on financial assets carried at amortized cost is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized. Impairment losses on available-for-sale equity instruments are not reversed.

Embedded derivatives

Derivatives may be embedded in other financial and non-financial instruments (the "host instrument"). Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host instrument, the terms of the embedded derivative are the same as those of a stand-alone derivative, and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with subsequent changes recognized in the consolidated statement of comprehensive income.

In the course of its operations, the Company enters into certain contracts for the sale of non-financial items that are denominated in currencies other than the Canadian dollar. In cases where the foreign exchange component is not leveraged and does not contain an option feature and the contract is denominated in the functional currency of the counterparty, the embedded derivative is considered to be closely related and is not accounted for separately. If the contract is neither in Canadian currency nor the functional currency of the counterparty, the embedded foreign currency derivative is separated unless the non-functional item delivered under the contract is routinely denominated in the currency of the contract in international commerce or the currency the contract is denominated in is commonly used in the economic environment in which the transaction takes place.

Government royalty program obligations

The Company receives from time to time, from different government agencies, funding designed to promote economic growth, create jobs and wealth, and support sustainable development. In some of these arrangements, the Company has a contractual obligation to repay the contributions to the government agency, with repayments determined as a percentage of specified revenues over a contractually defined royalty period. Such arrangements are recognized as government royalty program obligations at initial recognition when the contribution is received. These obligations are estimated based on future projections, discounted using a rate that reflects the liability-specific risks. Over time, interest expense is recognized as a result of accretion of the long-term obligations, while royalty payments are recorded against the obligations. Subsequently, the government royalty program obligations are re-measured when the future projections initially used to measure the obligations are revised, using the original discount rate. Resulting changes in the carrying amount of these obligations are recognized in the consolidated statement of income as Finance costs.

(expressed in Canadian dollars)

Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from share capital.

Revenue recognition

The Company earns revenues mainly from the sale of natural gas dryers and hydrogen purification solutions ("commercial equipment"). The Company recognizes revenue on commercial equipment sales when it is probable that the economic benefits will flow to the Company and delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. These criteria are generally met at the time the product is shipped and delivered to the customer and, depending on the delivery conditions, title and risk have passed to the customer and acceptance of the product has been obtained. Provisions are established for estimated product returns and warranty costs at the time revenue is recognized. Cash received in advance of all of these revenue recognition criteria being met is recorded as deferred revenue.

Revenues from long-term production-type contracts such as biogas purification equipment and engineering service contracts are determined under the percentage-of-completion method whereby revenues are recognized based on the costs incurred to date in relation to the total expected costs of a contract (costs being composed mainly of materials). 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 recorded as deferred revenue.

The Company monitors its contracts with customers on a regular basis to determine if a loss is likely to occur. If a loss is anticipated on a contract, the entire estimated loss is recorded as a cost of sales in the year in which the loss becomes evident and reasonably estimable.

Revenues from licensing arrangements are recognized when it is probable that the economic benefits will flow to the Company and that the sales price is fixed or determinable, and collectability is reasonably assured. These criteria are generally met at the time the contract is signed and title and risk have passed to the customer.

Revenue is measured based on the price specified in the sales contract, net of discounts and estimated returns at the time of sale. Historical experience is used to estimate and provide for discounts and returns. The Company does not have any multiple element revenue arrangements.

Government assistance

Non-refundable grants relating to property, plant and equipment are accounted for as deferred government assistance and amortized on the same basis as the related assets.

Research and experimental development tax credits are recognized using the cost reduction method when there is reasonable assurance of their recovery. Investment tax credits are subject to the customary approvals by the pertinent tax authorities. Adjustments, if required, are reflected in the year when such assessments are received.

(expressed in Canadian dollars)

Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of income on a straight-line basis over the period of the lease.

Lease agreements where the Company has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments.

Each lease payment is allocated between the liability and finance charges. The interest element of the finance cost is charged to the statement of income over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. Assets acquired under finance leases are depreciated over the shorter of the useful life of the asset and the lease term.

Stock-based compensation plans

The Company grants stock options to certain employees. Stock options vest between two to four years (25% to 50% per year) and expire after seven years from the date of grant. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. Fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. The Black-Scholes model was developed to estimate the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, this model usually requires the input of assumptions, including expected stock price volatility. For options granted to directors, officers and employees of the Company, compensation expense is recognized over the tranche's vesting period by increasing contributed surplus based on the number of awards expected to vest. The number of awards expected to vest is reviewed at least annually. For options granted to non-employees, the transaction is measured with reference to the fair value of the goods or services when received. Related expense is recognized over the period in which the goods or services from the non-employees are received. A corresponding increase is recorded in contributed surplus 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.

Research and development expenses

Research expenses are charged to expenses as incurred. Development expenses are charged to expenses as incurred unless they meet criteria for deferral and amortization. To date, no development expenses have been deferred.

Income taxes

Income tax comprises current and deferred tax. Income tax is recognized in the statement of income except to the extent that it relates to items recognized directly in equity, in which case the income tax is also recognized directly in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

(expressed in Canadian dollars)

In general, deferred tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the statement of financial position date and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are presented as non-current.

Tax on income in interim periods is accrued using the tax rate that would be applicable to expected total annual earnings.

Earnings per share

Basic earnings per share ("EPS") is calculated by dividing the net loss for the period attributable to equity owners of the Company by the weighted average number of common shares outstanding during the year.

Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options, warrants and similar instruments is computed using the treasury stock method, which assumes that if all dilutive securities had been exercised at the later of the beginning of the year and the date of issuance, as the case may be, the proceeds would be used to purchase common shares of the Company at the average market value during the year.

Foreign currency translation

a) Functional and presentation currency

Items included in the financial statements of each consolidated entity in the Company group are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The interim consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

The financial statements of entities that have a functional currency different from that of the Company ("foreign operations") are translated into Canadian dollars as follows: assets and liabilities – at the closing rate at the date of the statement of financial position, and income and expenses – at the average rate of the period (as this is considered a reasonable approximation to actual rates). All resulting changes are recognized in other comprehensive income as cumulative translation adjustment.

When an entity disposes of its entire interest in a foreign operation, or loses control, joint control or significant influence over a foreign operation, the foreign currency gains or losses accumulated in other comprehensive income related to the foreign operation are recognized in profit or loss. If an entity disposes of part of an interest in a foreign operation which remains a subsidiary, a proportionate amount of foreign currency gains or losses accumulated in other comprehensive income related to the subsidiary is reallocated between controlling and non-controlling interests.

(expressed in Canadian dollars)

b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Generally, foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in currencies other than an operation's functional currency are recognized in the statement of income.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the steering committee that makes strategic decisions.

Accounting standards issued but not yet applied

International Financial Reporting Standard 9, *Financial Instruments* ("IFRS 9")

IFRS 9 was issued in November 2009 and contained requirements for financial assets. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39, *Financial Instruments: Recognition and Measurement*, for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments, and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income.

IFRS 9 is required to be applied for accounting periods beginning on or after January 1, 2013, with earlier adoption permitted. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

In May 2011, the IASB issued the following standards which have not yet been adopted by the Company: IFRS 10, *Consolidated Financial Statements*; IFRS 11, *Joint Arrangements*; IFRS 12, *Disclosure of Interests in Other Entities*; IAS 27, *Separate Financial Statements*; IFRS 13, *Fair Value Measurement*; and amended IAS 28, *Investments in Associates and Joint Ventures*. Each of the new standards is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The Company has not yet begun the process of assessing the impact that the new and amended standards will have on its consolidated financial statements or whether to early adopt any of the new requirements.

The following is a brief summary of the new standards.

IFRS 10 – Consolidated Financial Statements

(expressed in Canadian dollars)

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12, *Consolidation – Special Purpose Entities*, and parts of IAS 27, *Consolidated and Separate Financial Statements*.

IFRS 11 – Joint Arrangements

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation, the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities – Non-monetary Contributions by Venturers*.

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off-balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities.

IFRS 13 – Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

Amendments to other standards

In addition, there have been amendments to existing standards, including IAS 27, *Separate Financial Statements*, IAS 28, *Investments in Associates and Joint Ventures* and to IAS 1 - Presentation of Items of other comprehensive Income. IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13. IAS 1 has been amended to change the disclosure of items presented in Other Comprehensive Income ("OCI"), including a requirement to separate items presented in OCI into two groups based on whether or not they may be recycled to profit or loss in the future. This amendment is effective for years beginning on or after July 1, 2012.

(expressed in Canadian dollars)

Significant accounting judgments and estimation uncertainties

Critical accounting estimates and judgments

The Company makes estimates and assumptions concerning the future that will, by definition, seldom equal actual results. The following are the estimates and judgments applied by management that most significantly affect the Company's consolidated financial statements. These estimates and judgments have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

c) Critical accounting estimates

i) Property, plant and equipment

Management estimates the useful lives of property, plant and equipment based on the period during which the assets are expected to be available for use. The amounts and timing of recorded expenses for depreciation of property, plant and equipment for any period are affected by these estimated useful lives. The estimates are reviewed at least annually and are updated if expectations change as a result of physical wear and tear, technical or commercial obsolescence, and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's property, plant and equipment in the future.

ii) Goodwill

The Company tests annually whether goodwill has suffered any impairment. The recoverable amounts of CGUs have been determined based on value-in-use calculations. These calculations require the use of estimates.

No impairment charge was recorded during the period.

iii) Fair value of certain financial instruments, stock options, warrants and share awards

The fair value of financial instruments that are not traded in an active market (for example, stock options, warrants and share awards) is determined by using valuation techniques. The Company uses its judgment to select a variety of methods and make assumptions that are based mainly on market conditions existing at the end of each reporting period.

(expressed in Canadian dollars)

iv) Inventory obsolescence

Inventories must be valued at the lower of cost or net realizable value. A write-down of the inventory will occur when its estimated market value less applicable variable selling expenses is below its carrying amount. Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. This involves significant management judgment and is based on the Company's assessment of market conditions for its products determined by historical usage, estimated future demand and, in some cases, the specific risk of loss on specifically identified inventory. Any change in the assumptions used in assessing this valuation will impact the carrying amount of the inventory and have a corresponding impact on cost of sales.

v) Impairment of long-lived assets

Long-lived assets or cash generating units are reviewed for impairment upon the occurrence of events or changes in circumstances indicating that the carrying value of the assets may not be recoverable, as measured by comparing their carrying amounts to the recoverable amount, which is the higher of fair value less cost to sell, and estimated discounted future cash flows generated by their use and eventual disposal. Impairment, if any, is measured as the excess of the carrying amount of the asset or cash generating unit over its recoverable amount.

vi) Recognition of future income tax assets

A deferred tax asset shall be recognized for all deductible temporary differences and unused tax losses to the extent that it is probable that taxable profit will be available against which the deductible temporary difference and unused tax losses can be utilized. Therefore, the Company has to estimate the amount of future taxable profits expected to be available. Such estimates are made by tax jurisdiction on an undiscounted basis. Management exercises judgment to determine the extent to which realization of future taxable benefits is probable, considering factors such as the number of years to include in the forecast period and the history of taxable profits.

vii) Government royalty program obligations

Government royalty program obligations are recognized when the contributions, which can come from different government agencies, are received and the company has a contractual obligation to repay the contributions (refer to note 4 (iv) (e)) for a description of the programs). As repayments are determined based on a percentage of specified revenues over a contractually defined royalty period, these obligations are measured as the net present value of expected future royalties payable. The key assumptions used in the valuation of these obligations are the projected annual revenues and the discount rate amounting to 30%. Subsequent to initial recognition, the government royalty program obligations are re-measured when the projections of expected future royalties payable initially used to measure the obligations are revised, using the original discount rate.

(expressed in Canadian dollars)

4 Transition to IFRS

The effect of the Company's transition to IFRS, described in note 2, is summarized in this note as follows:

i) Transition elections

ii) Reconciliation of equity and comprehensive income as previously reported under Canadian GAAP to IFRS

iii) Adjustments to the statement of cash flows

iv) Additional IFRS information for the year ended December 31, 2010

i) Transition elections

The Company has applied the following transition exemptions to full retrospective application of IFRS:

	As described in note 4(ii)
Borrowing costs	(a)
Cumulative translation adjustment	(b)
Business combinations	(c)
Leases	(d)
Compound financial instruments	(e)

(expressed in Canadian dollars)

ii) Reconciliation of shareholders' equity and comprehensive loss as previously reported under Canadian GAAP to IFRS

		December 31, 2010			September 30, 2010			January 1, 2010		
	Note 4(ii)	Canadian GAAP $	Adjustment $	IFRS $	Canadian GAAP $	Adjustment $	IFRS $	Canadian GAAP $	Adjustment $	IFRS $
Assets										
Current assets										
Cash and cash equivalents		2,262,273	-	2,262,273	301,046	-	301,046	5,447,702	-	5,447,702
Trade and other receivables		2,603,261	-	2,603,261	3,962,347	-	3,962,347	3,105,834	-	3,105,834
Inventories		2,720,060	-	2,720,060	3,190,128	-	3,190,128	2,867,922	-	2,867,922
Income taxes recoverable		-	-	-	-	-	-	62,492	-	62,492
Investment tax credits receivable		103,489	-	103,489	103,489	-	103,489	80,843	-	80,843
Restricted cash		576,092	-	576,092	580,118	-	580,118	223,261	-	223,261
Current portion of loan to a joint venture		-	-	-	57,716	-	57,716	-	-	-
Other current assets		100,846	-	100,846	179,190	-	179,190	183,564	-	183,564
Total current assets		8,366,021	-	8,366,021	8,374,034	-	8,374,034	11,971,618	-	11,971,618
Non-current assets										
Loan to a joint venture		117,811	-	117,811	61,184	-	61,184	113,331	-	113,331
Property, plant and equipment	(g)	1,939,097	(30,655)	1,908,442	2,190,109	(33,067)	2,157,042	2,604,931	(59,142)	2,545,789
Intangible assets	(f)(i), (f)(iii), (g),	4,022,822	461,075	4,483,897	4,322,935	476,931	4,799,866	279,046	4,943,751	5,222,797
Goodwill	(f)(i), (f)(ii)	1,438,324	(1,095,708)	342,616	1,438,324	(1,095,708)	342,616	5,942,152	(5,599,536)	342,616
Total non-current assets		7,518,054	(665,288)	6,852,766	8,012,552	(651,844)	7,360,708	8,939,460	(714,927)	8,224,533
Total assets		15,884,075	(665,288)	15,218,787	16,386,586	(651,844)	15,734,742	20,911,078	(714,927)	20,196,151
Liabilities										
Current liabilities										
Bank overdraft		500,000	-	500,000	1,286,900	-	1,286,900	496,900	-	496,900
Trade payables and accrued liabilities	(f)(i), (f)(iii), (h)	8,594,752	(1,504,992)	7,089,760	7,449,994	(570,743)	6,879,251	5,578,505	(992,302)	4,586,203
Deferred revenues		2,331,802	-	2,331,802	2,348,491	-	2,348,491	146,228	-	146,228
Income taxes payable		8,286	-	8,286	-	-	-	-	-	-
Derivative financial instruments		-	-	-	-	-	-	96,645	-	96,645
Current portion of long-term debt		87,151	-	87,151	284,045	-	284,045	321,653	-	321,653
Current portion of subordinated loan		156,256	-	156,256	62,496	-	62,496	62,496	-	62,496
Provisions	(h)	-	1,036,095	1,036,095	-	-	-	-	141,309	141,309
Total current liabilities		11,678,247	(468,897)	11,209,350	11,431,926	(570,743)	10,861,183	6,702,427	(850,993)	5,851,434
Non-current liabilities										
Long-term debt		1,867,870	-	1,867,870	1,736,863	-	1,736,863	1,763,496	-	1,763,496
Government royalty program obligation	(f)(iii), (f)(iv)	-	691,539	691,539	-	1,279,008	1,279,008	-	1,137,307	1,137,307
Government assistance		32,083	-	32,083	33,333	-	33,333	37,083	-	37,083
Provisions	(h)	-	304,034	304,034	-	405,706	405,706	-	694,674	694,674
Subordinated loan		-	-	-	109,384	-	109,384	156,256	-	156,256
Total non-current liabilities		1,899,953	995,573	2,895,526	1,879,580	1,684,714	3,564,294	1,956,835	1,831,981	3,788,816
Total liabilities		13,578,200	526,676	14,104,876	13,311,506	1,113,971	14,425,477	8,659,262	980,988	9,640,250
Shareholders' Equity										
Share capital		19,964,218	-	19,964,218	16,332,905	-	16,332,905	18,107,821	-	18,107,821
Contributed surplus		1,841,741	-	1,841,741	1,853,316	-	1,853,316	51,368	-	51,368
Accumulated other comprehensive loss	(b), (g)	-	72,622	72,622	-	36,823	36,823	-	-	-
Deficit	(b), (f)(i), (f)(ii), (f)(iii), (f)(iv), (g)	(19,500,084)	(1,264,586)	(20,764,670)	(15,111,141)	(1,802,638)	(16,913,779)	(5,907,373)	(1,695,915)	(7,603,288)
Total shareholders' equity		2,305,875	(1,191,964)	1,113,911	3,075,080	(1,765,815)	1,309,265	12,251,816	(1,695,915)	10,555,901
Total liabilities and shareholders' equity		15,884,075	(665,288)	15,218,787	16,386,586	(651,844)	15,734,742	20,911,078	(714,927)	20,196,151

(expressed in Canadian dollars)

	Note 4 (ii)	For the three-month period ended September 30, 2010 Canadian GAAP $	Adjustment $	IFRS $	For the nine-month period ended September 30, 2010 Canadian GAAP $	Adjustment $	IFRS $
Revenue		3,955,714	-	3,955,714	10,088,981	-	10,088,981
Cost of goods sold	(f)(i), (f)(iii), (g), (j)	3,764,337	256,390	4,020,727	9,177,618	304,775	9,482,393
Gross margin		191,377	(256,390)	(65,013)	911,363	(304,775)	606,588
Research and development expenses		663,275	-	663,275	1,784,391	-	1,784,391
Selling and administrative expenses	(f)(i), (j)	2,255,766	55,251	2,311,017	7,364,889	301,468	7,666,357
Financial	(i)	93,198	(93,198)	-	307,607	(307,607)	-
Foreign exchange loss (gain)	(g)	(55,676)	18,682	(36,994)	(9,740)	35,660	25,920
Depreciation and amortization	(j)	307,074	(307,074)	-	677,402	(677,402)	-
		3,263,637	(326,339)	2,937,298	10,124,549	(647,881)	9,476,668
Finance income	(f)(iii), (f)(iv), (i)	-	(5,382)	(5,382)	-	(17,448)	(17,448)
Finance expenses	(f)(iii), (i)	-	149,421	149,421	-	467,219	467,219
Finance costs – net		-	144,039	144,039	-	449,771	449,771
Loss before income taxes		(3,072,260)	(74,090)	(3,146,350)	(9,213,186)	(106,665)	(9,319,851)
Income taxes		(9,418)	-	(9,418)	(9,418)	-	(9,418)
Net loss for the period		(3,062,842)	(74,090)	(3,136,932)	(9,203,768)	(106,665)	(9,310,433)
Other comprehensive income (net of tax)							
Cumulative translation adjustment	(b), (g)	-	14,213	14,213	-	36,823	36,823
Other comprehensive income for the period		-	14,213	14,213	-	36,823	36,823
Comprehensive income (loss) for the period		(3,062,842)	(59,877)	(3,122,719)	(9,203,768)	(69,842)	(9,273,610)

Explanatory notes

a) In accordance with IFRS transitional provisions, the Company elected to apply IFRS relating to borrowing costs prospectively from January 1, 2010. As such, Canadian GAAP balances relating to borrowing costs entered into before that date have been carried forward without adjustment.

b) In accordance with IFRS transitional provisions, the Company has elected to reset the cumulative translation adjustment account, which includes gains and losses arising from the translation of foreign operations, to zero at the date of transition to IFRS. Refer to note g) below for details.

c) In accordance with IFRS transitional provisions, the Company has elected to apply IFRS 3, *Business Combinations* prospectively from June 12, 2009. As such, Canadian GAAP balances relating to business combinations entered into before that date, including goodwill, have been carried forward without adjustment, and the reverse takeover transaction with QuestAir, which occurred on June 12, 2009, was adjusted to meet IFRS requirements. Refer to note f) below.

(expressed in Canadian dollars)

d) In accordance with IFRS transitional provisions, the Company has elected to apply IFRIC 4, *Determining Whether an Arrangement Contains a Lease,* based on the circumstances existing at the date of transition to IFRS, to all arrangements other than those entered into or modified since January 1, 2005, as such arrangements have already been assessed under requirements similar to those of IFRIC 4. No impact resulted from the review of arrangements.

e) In accordance with IFRS transitional provisions, the Company has elected not to apply retrospectively the requirement to separate liability and equity components of compound financial instruments to instruments for which the liability component was no longer outstanding on the transition date.

f) As at December 31, 2009, formal valuation of the tangible and intangible assets acquired and liabilities assumed through the QuestAir acquisition was not completed. Accordingly, the excess of the purchase price over the net book value of identifiable assets acquired was, at that time, preliminarily allocated to goodwill on the Canadian GAAP consolidated balance sheet. During the second quarter of 2010, the Company finalized the purchase price allocation pertaining to this acquisition.

   IFRS 3 requirements were applied to the QuestAir acquisition. As a result, the final fair values established in 2010 were used in accounting for that transaction when establishing the IFRS opening statement of financial position as at January 1, 2010 as, per IFRS 3, adjustments to preliminary or provisional estimates are required to be treated retrospectively as if the adjustment had been determined at the acquisition date.

   i) As at June 12, 2009, the acquisition date, the IFRS consolidated statement of financial position was adjusted to reflect the final allocation resulting in increases in accounts receivable of $466,699, in contract asset of $330,886, in customer relations of $1,900,000, in patents of $2,310,000, and in accounts payable and accrued liabilities of $9,238, and decreases in inventories and deferred revenue of $1,724,201 and $1,229,682 respectively. Consistent with these changes, goodwill has decreased by $4,503,828.

   ii) As per IFRS 3, transaction costs are required to be expensed as incurred. Consequently, goodwill further decreased by $1,095,708 with a corresponding entry in the retained earnings.

   iii) Prior to the acquisition date, QuestAir received, from a number of government agencies, such as Technology Partnerships Canada (“TPC”), funding designed to promote economic growth, create jobs and wealth, and support sustainable development. Funding was in the form of contributions determined as (a) a percentage of defined eligible costs; or (b) a maximum amount as specified in the government support agreement. In some of these arrangements, the Company has a contractual obligation to repay the contributions to the government agency, with repayments determined as a percentage of specified revenues over a contractually defined royalty period (refer to note 4(iv)(e)) below for a description of the programs).

(expressed in Canadian dollars)

Under Canadian GAAP, the Company records government contributions as a reduction of the related R&D program costs or as a reduction in the program's capitalized expenditures. A liability to repay the government contribution is recognized when conditions arise and the repayment thereof is reflected in the consolidated statement of comprehensive income when royalties become due. Under IFRS, such arrangements in which Xebec entered into do not qualify as government grants and should therefore be recognized as liabilities at initial recognition as they fall under the scope of IAS 39. Consequently, repayable government assistance arrangements are recognized as Government royalty program obligations when the contribution is received and is estimated based on future projections. Therefore, as at June 12, 2009, the acquisition date, the IFRS consolidated statement of financial position was adjusted to reflect the recognition of government royalty program obligations amounting to $989,013, with a corresponding entry to intangible assets. The obligations were measured based on projected revenues and corresponding royalty payments expected at the transaction date, using a discount rate of 30%. Following this change in accounting treatment, interest expense is recognized as a result of accretion of the long-term obligations, while royalty payments are recorded against the obligations instead of as an expense as under Canadian GAAP.

iv) In accordance with IAS 39, the government royalty program obligations are re-measured when the future projections used to measure the obligations are revised. Resulting changes in the carrying amount of these obligations are recognized in the consolidated statement of comprehensive income. Accordingly, as at December 31, 2010, the IFRS consolidated statement of financial position was adjusted to reflect the change in carrying value of government royalty program obligations amounting to $641,729 with a corresponding entry to finance income. The obligations were measured based on projected revenues and corresponding royalty payments expected at that date, using the original discount rate of 30%.

Total government royalty program obligations can be broken down as follows:

	December 31, 2010 $	**September 30, 2010 $**	**January 1, 2010 $**
Fast Cycle Pressure Swing Adsorption and Gas Management systems	579,278	1,176,823	1,055,110
Pulsar Pressure Swing adsorption project	112,261	102,185	82,197
	691,539	1,279,008	1,137,307

Refer to the tables below for the details of the impacts, resulting from the above described changes, on the IFRS opening consolidated statement of financial position and subsequent period presented.

(expressed in Canadian dollars)

g) Items included in the financial statements of the Company's subsidiaries and joint ventures must be measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). Under IFRS, indicators to consider for determining the functional currency of an entity are broken down into primary and secondary indicators. Under Canadian GAAP, there is no such hierarchy when assessing the factors for determining the measurement currency.

   Following the assessment of these indicators using the IFRS hierarchy, management concluded that the Company's subsidiary (Xebec Adsorption (Shanghai) Co. Ltd.) and joint venture (Xebec Adsorption South East Asia PTE. Ltd) should use the Chinese renminbi (yuan) and the Singapore dollar respectively as their functional currency to meet IFRS requirements as opposed to the Canadian dollar measurement currency used under Canadian GAAP. Accordingly, the Company has prepared an opening statement of financial position for these entities, as at January 1, 2010, using their respective functional currencies as if they had always been used.

   As the functional currency of the subsidiary and joint venture differs from that of the Company, the financial statements of these entities were translated, for consolidation purposes, into Canadian dollars as follows: assets and liabilities at the closing rate at the date of the statement of financial position, and income and expenses at the average rate of the period. All resulting changes were recognized in other comprehensive income as cumulative translation adjustment. However, as the Company elected, in accordance with IFRS transitional provisions, to reset the cumulative translation adjustment account to zero at the date of transition to IFRS (refer to note b) above), amounts that would have been recognized in the cumulative translation adjustment account prior to January 1, 2010 have been transferred to retained earnings at that date.

   Refer to the tables below for the details of the impacts, resulting from the above described changes, on the opening IFRS consolidated statement of financial position and subsequent period presented.

h) Under IFRS, warranty and other provisions, which were classified as accounts payable and accrued liabilities in Canadian GAAP consolidated financial statements have been reclassified as provisions as required by IAS 1, *Presentation of Financial Statements*. The reclassification on January 1, 2010, September 30, 2010 and December 31, 2010 amounts to $835,983, $405,706 and $1,340,129 respectively.

i) Under IFRS, finance income and finance expense are presented separately in the consolidated statement of income. Under Canadian GAAP, net interest expense was presented in the consolidated statement of income. Accordingly, finance income balances for the three and nine months periods ended September 30, 2010 and December 31, 2010 have been reclassified in finance income ($5,382, $17,448 and $17,829 respectively).

j) Under IFRS, expenses recognized in the statement of comprehensive income must be presented using a classification based on nature or function. The Company chose to use a presentation by function. Accordingly, amortization expense for the for the three and nine months periods ended September 30, 2010 and December 31, 2010 have been reclassified in cost of goods sold ($251,823, $511,648 and $565,615 respectively) and selling and administrative expenses ($55,251, $165,754 and $356,719 respectively).

(expressed in Canadian dollars)

Statement of financial position

	As at January 1, 2010					
	Canadian GAAP	Note 4(ii)				IFRS
		(f)(i), (f)(ii)	(f)(iii)	(b), (g)	(h)	
	$	$	$	$	$	$
Non-current assets						
Property, plant and equipment	2,604,931	-	-	(59,142)	-	2,545,789
Intangible assets	279,046	3,997,286	956,046	(9,581)	-	5,222,797
Goodwill	5,942,152	(5,599,536)	-	-	-	342,616
Current liabilities						
Trade payables and accrued liabilities	5,578,505	9,238	(165,557)	-	(835,983)	4,586,203
Provision	-	-	-	-	141,309	141,309
Non-current liabilities						
Government royalty program obligation	-	-	1,137,307	-	-	1,137,307
Provision	-	-	-	-	694,674	694,674
Shareholders' Equity						
Accumulated other comprehensive income	-	-	-	-	-	-
Retained earnings (deficit	(5,907,393)	(1,611,488)	(15,704)	(68,723)	-	(7,603,288)
Total Equity	12,251,816	(1,611,488)	(15,704)	(68,723)	-	10,555,901

(expressed in Canadian dollars)

Statement of financial position

	As at September 30, 2010					
	Canadian GAAP	Note 4(ii)				IFRS
	$	(f)(i), (f)(ii) $	(f)(iii) $	(b), (g) $	(h), (i), (j) $	$
Non-current assets						
Property, plant and equipment	2,190,109	-	-	(33,067)	-	2,157,042
Intangible assets	4,322,935	(425,429)	906,596	(4,236)	-	4,799,866
Goodwill	1,438,324	(1,095,708)	-	-	-	342,616
Current liabilities						
Trade payables and accrued liabilities	7,449,994	-	(165,037)	-	(405,706)	6,879,251
Non-current liabilities						
Government royalty program obligation	-	-	1,279,008	-	-	1,279,008
Provision	-	-	-	-	405,706	405,706
Shareholders' Equity						
Accumulated other comprehensive income	-	-	-	1,163	35,660	36,823
Deficit – Beginning of period	(5,907,373)	(1,611,488)	(15,762)	(68,723)	-	(7,603,346)
Net loss for the period	(9,203,768)	90,351	(191,613)	30,257	(35,660)	(9,310,433)
Total Equity	3,075,080	(1,521,137)	(207,375)	(37,303)	-	1,309,265

Statements of loss and comprehensive loss

	For the nine-month period ended September 30, 2010					
	Canadian GAAP	Note 4(ii)				IFRS
	$	(f)(i), (f)(ii) $	(f)(iii) $	(b), (g) $	(h), (i), (j) $	$
Cost of goods sold	9,177,618	(226,066)	49,450	(30,257)	511,648	9,482,393
Selling and administrative expenses	7,364,889	135,714	-	-	165,754	7,666,357
Financial	307,607	-	-	-	(307,607)	-
Foreign exchange loss	(9,740)	-	-	-	35,660	25,920
Amortization	677,402	-	-	-	(677,402)	-
Finance income	-	-	-	-	(17,448)	(17,448)
Finance expenses	-	-	142,164	-	325,055	467,219
Net loss for the period	(9,203,768)	90,352	(191,614)	30,257	(35,660)	(9,310,433)
Cumulative translation adjustment	-	-	-	1,163	35,660	36,823
Comprehensive loss	(9,203,768)	90,352	(191,614)	31,420	-	(9,273,610)

(expressed in Canadian dollars)

Statements of loss and comprehensive loss

	For the three-month period ended September 30, 2010					
	Canadian GAAP	Note 4(ii)				IFRS
		(f)(i), (f)(ii)	(f)(iii)	(b), (g)	(h), (i), (j)	
	$	$	$	$	$	$
Cost of goods sold	3,764,337	-	16,484	(11,917)	251,823	4,020,727
Selling and administrative expenses	2,255,766	-	-	-	55,251	2,311,017
Financial	93,198	-	-	-	(93,198)	-
Foreign exchange loss	(55,676)	-	-	-	18,682	(36,994)
Amortization	307,074	-	-	-	(307,074)	-
Finance income	-	-	-	-	(5,382)	(5,382)
Finance expenses	-	-	50,841	-	98,580	149,421
Net loss for the period	(3,062,842)	-	(67,325)	11,917	(18,682)	(3,136,932)
Cumulative translation adjustment	-	-	-	(4,469)	18,682	14,213
Comprehensive loss	(3,062,842)	-	(67,325)	7,448	-	(3,122,719)

(expressed in Canadian dollars)

Statement of financial position

	As at December 31, 2010					
	Canadian GAAP	Note 4(ii)				IFRS
		(f)(i), (f)(ii)	(f)(iii)	(b), (g)	(h), (i), (j)	
	$	$	$	$	$	$
Non-current assets						
Property, plant and equipment	1,939,097	-	-	(30,655)	-	1,908,442
Intangible assets	4,022,822	(425,429)	890,112	(3,608)	-	4,483,897
Goodwill	1,438,324	(1,095,708)	-	-	-	342,616
Current liabilities						
Trade payables and accrued liabilities	8,594,752	-	(164,863)	-	(1,340,129)	7,089,760
Provision	-	-	-	-	1,036,095	1,036,095
Non-current liabilities						
Government royalty program obligation	-	-	691,539	-	-	691,539
Provision	-	-	-	-	304,034	304,034
Shareholders' Equity						
Accumulated other comprehensive income	-	-	-	(3,281)	75,903	72,622
Deficit – Beginning of year	(5,907,373)	(1,611,488)	(15,704)	(68,723)	-	(7,603,288)
Net loss for the year	(13,592,711)	90,351	379,140	37,741	(75,903)	(13,161,382)
Total Equity	2,305,875	(1,521,137)	363,436	(34,263)	-	1,113,911

Statements of loss and comprehensive loss

	For the year ended December 31, 2010					
	Canadian GAAP	Note 4(ii)				IFRS
		(f)(i), (f)(ii)	(f)(iii)	(b), (g)	(h), (i), (j)	
	$	$	$	$	$	$
Cost of goods sold	13,226,426	(226,066)	65,934	(37,741)	565,615	13,594,168
Selling and administrative expenses	10,132,192	135,715	-	-	356,719	10,624,626
Financial	443,042	-	-	-	(443,042)	-
Foreign exchange gain	(206,710)	-	-	-	75,903	(130,807)
Amortization	922,334	-	-	-	(922,334)	-
Finance income	-	-	(641,729)	-	(17,829)	(659,558)
Finance expenses	-	-	196,655	-	460,871	657,526
Net loss for the year	(13,592,711)	90,351	379,140	37,741	(75,903)	(13,161,382)
Cumulative translation adjustment	-	-	-	(3,281)	75,903	72,622
Comprehensive loss	(13,592,711)	90,351	379,140	34,460	-	(13,088,760)

(expressed in Canadian dollars)

iii) Adjustments to the statement of cash flows

The transition from Canadian GAAP to IFRS had no significant impact on cash flows generated by the Company.

iv) Additional IFRS information for the year ended December 31, 2010

a) Investment in joint venture :

The following summarizes financial information about the Company's 40% share of the assets, liabilities, revenue and profit or loss of its unlisted joint venture, Xebec Adsorption South East Asia PTE. Ltd., for the year ended December 31, 2010.

	$
Assets	192,286
Liabilities	174,548
Revenues	437,904
Loss	(114,093)
Comprehensive loss	(117,965)
Proportionate interest in joint venture's commitments	27,473

In addition, there is a loan to the joint venture bearing interest of 7.93%, repayable by minimum annual instalments of $37,777 plus accrued and unpaid interest, and maturing in July 2012. An agreement was concluded giving a one-year moratorium on repayment of the loan, including interest.

There are no contingent liabilities relating to the Company's interest in the joint venture, and no contingent liabilities of the joint venture itself.