

Xebec Adsorption Inc.

Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2012

(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

(expressed in Canadian dollars)

	As at March 31, 2012 \$	As at December 31, 2011 \$
Assets		
Current assets		
Cash	5,486,790	389,090
Trade and other receivables	1,211,818	2,444,842
Inventories	1,420,848	1,365,260
Investment tax credits receivable	75,000	75,000
Other current assets	264,812	329,292
Total current assets	<u>8,459,268</u>	<u>4,603,484</u>
Non-current assets		
Balance of sale	800,000	800,000
Property, plant and equipment (note 4)	332,800	548,671
Intangible assets (note 5)	1,153,986	3,988,317
Goodwill (note 5)	142,616	342,616
Total non-current assets	<u>2,429,402</u>	<u>5,679,604</u>
Total assets	<u>10,888,670</u>	<u>10,283,088</u>
Liabilities		
Current liabilities		
Bank loan (note 3)	-	500,000
Trade payables and accrued liabilities (note 10)	3,824,505	5,743,340
Deferred revenues	2,476,770	2,506,474
Current portion of long-term debt and obligation (note 3)	74,157	141,786
Current portion of Government royalty program obligation (note 3)	208,137	195,949
Provisions	95,000	156,000
Total current liabilities	<u>6,678,569</u>	<u>9,243,549</u>
Non-current liabilities		
Loan from a related party (note 10)	23,835	23,562
Long-term debt and obligation (note 3)	180,688	236,729
Government royalty program obligation (note 3)	688,960	752,972
Government assistance	25,833	27,083
Deferred rent	13,192	6,596
Provisions	320,417	299,718
Total non-current liabilities	<u>1,252,925</u>	<u>1,346,660</u>
Total liabilities	<u>7,931,494</u>	<u>10,590,209</u>
Equity (Deficiency)		
Share capital	19,802,272	19,802,272
Contributed surplus	2,216,397	2,168,550
Accumulated other comprehensive loss	(21,198)	(71,521)
Deficit	(19,030,263)	(22,211,793)
Total equity	<u>2,967,208</u>	<u>(312,492)</u>
Total liabilities and equity	<u>10,888,670</u>	<u>10,283,088</u>

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)

(Unaudited)

(expressed in Canadian dollars)

	For the three-month period ended March 31, 2012 \$	For the three-month period ended March 31, 2011 \$
Revenue	1,529,658	4,051,531
Cost of goods sold	1,809,124	2,037,473
Gross margin	(279,466)	2,014,058
Research and development expenses (note 8)	26,072	351,680
Selling and administrative expenses	1,164,132	1,883,933
Foreign exchange loss (gain)	40,183	(108,460)
Gain on disposition of assets (note 3)	(5,445,961)	-
	(4,215,574)	2,127,153
Operating Income (Loss)	3,936,108	(113,095)
Finance income	(42)	(3,593)
Finance expense (note 9)	770,032	117,038
Finance costs – net	769,990	113,445
Net income (loss) for the period	3,166,118	(226,540)
Earnings (loss) attributable to:		
Shareholders of the Company	3,181,530	(226,540)
Non-controlling interest	(15,412)	-
	3,166,118	(226,540)
Earnings (loss) per share		
Basic and diluted (note 6)	0.08	(0.00)

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) (Unaudited)

(expressed in Canadian dollars)

	For the three-month period ended March 31, 2012 \$	For the three-month period ended March 31, 2011 \$
Net income (loss) for the period	3,166,118	(226,540)
Other comprehensive income		
Cumulative translation adjustment	50,332	27,117
Comprehensive income (loss) for the period	<u>3,216,450</u>	<u>(199,423)</u>
Attributable to:		
Shareholders of the Company	3,231,853	(199,423)
Non-controlling interest	<u>(15,403)</u>	<u>-</u>
	<u>3,216,450</u>	<u>(199,423)</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, 2011	39,363,867	15,456,424	19,964,218	1,841,741	72,622	(20,764,670)	1,113,911	-	1,113,911
Net loss for the period	-	-	-	-	-	(226,540)	(226,540)	-	(226,540)
Other comprehensive income (net of tax)	-	-	-	-	27,117	-	27,117	-	27,117
Comprehensive income (loss) for the period	-	-	-	-	27,117	(226,540)	(199,423)	-	(199,423)
Share-based compensation	-	-	-	425	-	-	425	-	425
Balance – March 31, 2011	39,363,867	15,456,424	19,964,218	1,842,166	99,739	(20,991,210)	914,913	-	914,913
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 income (loss) for the period	-	-	-	-	-	3,181,530	3,181,530	(15,412)	3,166,118
Other comprehensive income (net of tax)	-	-	-	-	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

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 (Unaudited)

(expressed in Canadian dollars)

	For the three-month period ended March 31, 2012 \$	For the three-month period ended March 31, 2011 \$
Cash flows from		
Operating activities		
Net income (loss) for the period	3,166,118	(226,540)
Items not affecting cash		
Amortization of property, plant and equipment	65,562	117,139
Amortization of intangible assets	117,443	129,394
Gain on disposition of assets (note 3)	(5,445,961)	-
Gain on debt forgiveness	(27,930)	-
Government assistance	(1,250)	(1,250)
Unrealized foreign exchange loss on loan to a joint venture and restricted cash	273	588
Accretion and revaluation of government royalty program obligation	736,577	51,836
Stock-based compensation expense	47,847	425
	<u>(1,341,321)</u>	<u>71,592</u>
Changes in non-cash working capital components relating to operations		
Trade and other receivables	1,233,026	266,264
Inventories	(55,588)	(360,528)
Investment tax credits receivable	-	100,816
Other current assets	64,480	21,745
Trade payables and accrued liabilities	(1,918,835)	(1,182,352)
Deferred revenues	119,775	392,969
Income taxes payable (recoverable)	-	(8,286)
Other operating liabilities	(40,301)	(382,557)
	<u>(597,443)</u>	<u>(1,151,929)</u>
	<u>(1,938,764)</u>	<u>(1,080,337)</u>
Investing activities		
Acquisition of intangible assets	(52,677)	-
Proceeds from disposal of assets (note 3)	8,414,519	8,428
Decrease in restricted cash	-	(321,408)
	<u>8,361,842</u>	<u>(312,980)</u>
Financing activities		
Repayment of bank loan	(500,000)	-
Increase in long-term debt	-	9,568
Repayment of long-term debt	(123,670)	(45,364)
Repayment of government royalty program obligation	(788,401)	-
	<u>(1,412,071)</u>	<u>(35,796)</u>
Effect of exchange rate changes on cash	86,693	28,330
Increase (decrease) in cash during the period	5,011,007	(1,400,783)
Cash – Beginning of period	389,090	2,262,273
Cash – End of period	5,486,790	861,490
Additional information		
Income tax recovered	-	-
Interest paid	33,455	51,157

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, 2012

(expressed in Canadian dollars)

1 Nature of business

Xebec Adsorption Inc. (“Xebec” or the “Company”) is a global provider of clean energy solutions to corporations and governments looking to reduce their carbon footprint. The Company is incorporated and domiciled in Canada and listed on the Toronto Stock Exchange. The address of its registered office is 730 Industriel Boulevard, Blainville, Quebec, Canada.

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, 2011, 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 10, 2012.

3 Gain on disposition of assets

On March 22, 2012, the Company sold to Air Products and Chemicals Inc. (“Air Products”) its intellectual property (“IP”) portfolio, including the patents and patent applications relating to its gas separation technology. In this transaction, the Company has also transferred ownership of its research and development facilities in Burnaby and Surrey, as well as other equipment located in British Columbia.

Pursuant to this transaction, The Company has received aggregate gross proceeds of CAD\$8,600,000 and net proceeds of approximately CAD\$8,415,000. This agreement also foresees future proceeds related to the achievement of certain conditions to be met by Xebec within the next 24 months. With the net proceeds received, the Company reimbursed its bank loan of \$500,000 and its subordinated loan of \$83,700.

The Company has also entered into a license agreement with Air Products allowing it to continue using the gas separation technology to sell its systems, predominantly in the biogas, natural gas and associated gas purification markets.

The Company will utilize its non-capital losses carried forward to offset the taxable gain resulting from this sale.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

March 31, 2012

(expressed in Canadian dollars)

The following table summarizes the gain on disposition of assets:

	March 31, 2012
	\$
Gross proceeds	8,600,000
Transaction fees	<u>(185,461)</u>
Net proceeds	8,414,519
Goodwill disposition	(200,000)
Carrying value of assets	(2,918,037)
Others	<u>149,479</u>
Gain on disposition of assets	<u>5,445,961</u>

In conjunction with the closing of the IP transaction, the Company signed a settlement agreement with Technology Partnership Canada (“TPC”) with regard to its Fast Cycle Pressure Swing Adsorption and Gas Management systems and Pulsar Pressure Swing Adsorption project. The Company had to pay \$250,000 at the execution of the agreement and \$1,000,000 spread over four equal annual non-interest bearing payments. Furthermore, the Company is liable to pay up to \$750,000 in contingent payments based on cumulative funds generated from the sale by the Company of its intellectual property. Upon closing of the transaction, the company paid \$540,000 out of the \$750,000 total contingent based payments.

The following table summarizes the activity related to the government royalty program obligation during the period:

Balance- Beginning of period	948,921
Accretion interests	55,896
Loss on revaluation	682,280
Repayment	<u>(790,000)</u>
Balance- End of period	897,097

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

March 31, 2012

(expressed in Canadian dollars)

4 Property, plant and equipment

	Machinery and equipment	Office furniture and equipment	Computers	Moulds	Vehicles	Leasehold improvements	Total
Cost							
Balance at December 31, 2011	742,821	107,230	338,157	67,648	71,968	663,023	1,990,847
Disposals (note 3)	(363,788)	(11,911)	(155,863)	-	-	(415,523)	(947,085)
Effect of movements in exchange rates	(1,824)	(1,048)	(1,484)	(1,256)	-	(4,317)	(9,929)
Balance at March 31, 2012	377,209	94,271	180,810	66,392	71,968	243,183	1,033,833
Accumulated amortization							
Balance at December 31, 2011	445,861	71,076	324,639	38,897	21,590	540,113	1,442,176
Amortization	22,911	5,092	4,148	3,321	3,598	26,492	65,562
Disposals (note 3)	(312,993)	(10,641)	(155,863)	-	-	(319,103)	(798,600)
Effect of movements in exchange rates	(870)	(715)	(1,478)	(723)	-	(4,319)	(8,105)
Balance at March 31, 2012	154,909	64,812	171,446	41,495	25,188	243,183	701,033
Carrying Amount							
At December 31, 2011	296,960	36,154	13,518	28,751	50,378	122,910	548,671
At March 31, 2012	222,300	29,459	9,364	24,897	46,780	-	332,800

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2012

(expressed in Canadian dollars)

5 Intangible assets

	Patents	Customer relations	Other Software	Internally generated Engineering drawings	Total intangible assets	Goodwill
	\$	\$	\$	\$	\$	\$
Cost						
Balance at December 31, 2011	3,315,985	1,900,000	214,074	4,700	5,434,759	342,616
Additions	52,677	-	-	-	52,677	-
Disposals (note 3)	(3,368,662)	-	-	-	(3,368,662)	(200,000)
Effect of movements in exchange rates	-	-	(1,506)	-	(1,506)	-
Balance at March 31, 2012	-	1,900,000	212,568	4,700	2,117,268	142,616
Accumulated amortization						
Balance at December 31, 2011	549,835	678,572	213,335	4,700	1,446,442	-
Amortization of the period	49,275	67,857	311	-	117,443	-
Disposals (note 3)	(599,110)	-	-	-	(599,110)	-
Effect of movements in exchange rates	-	-	(1,493)	-	(1,493)	-
Balance at March 31, 2012	-	746,429	212,153	4,700	963,282	-
Carrying Amount						
At December 31, 2011	2,766,150	1,221,428	739	-	3,988,317	342,616
At March 31, 2012	-	1,153,571	415	-	1,153,986	142,616

Amortization of \$117,443 (2011 - \$129,394) is included in the consolidated statement of income(loss): \$49,430 (2011 - \$57,800) in 'cost of goods sold' and \$68,013 (2011 - \$71,594) in 'selling and administrative expenses'.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2012

(expressed in Canadian dollars)

6 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 period ended March 31, 2012 \$	For the period ended March 31, 2011 \$
Net income (loss) attributable to owners of the parent	3,166,118	(226,540)
Weighted average number of common shares in issue	<u>39,363,867</u>	<u>39,363,867</u>
	<u>\$0.08</u>	<u>\$(0.00)</u>

ii) Diluted

Diluted loss 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 above is compared with the number of shares that would have been issued assuming exercise of the warrants and stock options.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2012

(expressed in Canadian dollars)

7 Expenses by nature

	For the three- month ended March 31, 2012 \$	For the three- month ended March 31, 2011 \$
Employee benefits	1,500,537	1,403,897
Stock-based compensation	47,847	425
Material	549,877	1,232,036
Subcontracting costs	130,506	89,250
Professional fees	39,400	421,806
Travel expenses	113,690	168,643
Rent and repairs and maintenance	233,902	233,379
Office expense	137,385	142,588
Amortization	183,241	234,565
Other	36,871	(5,183)
	<u>2,973,256</u>	<u>3,921,406</u>

8 Research and development expenses

	For the three- month ended March 31, 2012 \$	For the three- month ended March 31, 2011 \$
Research and development expenses	27,322	352,930
Government grants	(1,250)	(1,250)
	<u>26,072</u>	<u>351,680</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2012

(expressed in Canadian dollars)

9 Finance expenses

	For the three-month ended March 31, 2012 \$	For the three-month ended March 31, 2011 \$
Interest and bank charges	13,391	9,735
Interest on bank loan	-	8,826
Interest on long-term debt and subordinated loan	2,137	27,232
Interest charges	16,328	7,409
Other finance charges – TPC	738,176	63,836
	<u>770,032</u>	<u>117,038</u>

10 Related party transactions

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

	For the three-month ended March 31, 2012 \$	For the three-month ended March 31, 2011 \$
Marketing and professional services expenses accrued to companies controlled by members of the immediate family of an officer	11,975	-
Sales to a shareholder of a subsidiary (a joint venture partner in 2011)	2,747	24,949
Accrued interest to a joint venture partner	-	421
Accrued interest on a loan from a Company director	811	-
	<u>15,533</u>	<u>25,370</u>

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

11 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:

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2012

(expressed in Canadian dollars)

	For the three-month ended March 31, 2012 \$	For the three-month ended March 31, 2011 \$
Revenue		
Canada	602,449	357,054
United States	548,801	3,131,061
Korea	154,461	57,915
Japan	79,511	75,664
India	61,832	-
Singapore	46,789	142,020
Other	35,815	287,817
	<hr/>	<hr/>
	1,529,658	4,051,531
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Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements

(Unaudited)

March 31, 2012

(expressed in Canadian dollars)

Revenue summarized by product line is as follows:

Product line	For the three-month ended March 31, 2012 \$	For the three-month ended March 31, 2011 \$
Natural gas dryers	426,056	294,779
Gas purification	450,609	1,101,000
Compressed gas filtration	185,025	448,386
Engineering services	426,974	642,111
Licensing	-	1,464,887
Air dryers	40,994	100,368
	<u>1,529,658</u>	<u>4,051,531</u>

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

	For the three-month ended March 31, 2012 \$	For the three-month ended March 31, 2011 \$
Customer A	367,966	-
Customer B	331,535	1,464,887
	<u>699,501</u>	<u>1,464,887</u>

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

Non-current assets	March 31, 2012 \$	December 31, 2011 \$
Canada	2,328,470	5,563,424
Asia	100,932	116,180
	<u>2,429,402</u>	<u>5,679,604</u>