Xebec Adsorption Inc.

Management's Discussion and Analysis
For the three and six-month periods ended June 30, 2012

August 2, 2012

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

ABOUT THIS MANAGEMENT DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis ("MD&A") provides a review of the results of operations, financial conditions and cash flows of Xebec for three-month and six-month periods ended June 30, 2012. This discussion should be read in conjunction with the information contained in the Company's unaudited consolidated financial statements and related notes for the second quarter of 2012, as well as with the audited consolidated financial statements and related notes for the year ended December 31, 2011. Additional information, including our annual information form (AIF), can be found on SEDAR at www.sedar.com.

The financial information presented herein has been prepared on the basis of International Financial Reporting Standards (IFRS) for financial statements and is expressed in Canadian dollars unless otherwise stated.

The information contained in this MD&A and certain other sections of this report also includes some figures that are not performance measures consistent with IFRS, such as earnings (loss) before amortization, financial expenses, other items and income taxes ("EBITDA"). The Company uses EBITDA because this measure enables management to assess the Company's operational performance. This measure is a widely accepted financial indicator of a company's ability to repay and assume its debt. Investors should not regard it as an alternative to operating revenues or cash flows, or a measure of liquidity. As this measure is not established in accordance with IFRS, it might not be comparable to those of other companies.

The information contained in this Management's Report accounts for any major event occurring up to August 2, 2012, the date on which the Board of Directors approved the consolidated financial statements and Management's Report for the period ended June 30, 2012. It presents the Company's status and business context as they were, to management's best knowledge, at the time this report was written.

FORWARD-LOOKING STATEMENTS

This Management Discussion and Analysis ("MD&A") contains forward-looking statements, including statements regarding the future success of the Company's business, technology, and market opportunities. Forward-looking statements typically contain words such as "believes", "expects", "anticipates", "continues", "could", "indicates", "plans", "will", "intends", "may", "projects", "schedules", "would" or similar expressions suggesting future outcomes or events, although not all forward-looking statements contain these identifying words. Examples of such statements include, but are not limited to, statements concerning: (i) actions expected to be undertaken to achieve the Company's strategic goals; (ii) the key market drivers impacting the Company's success; (iii) intentions with respect to future biogas development work; (iv) expectations regarding business activities and orders that may be received in fiscal 2012 and beyond; (v) trends in, and the development of, the Company's target markets; (vi) the Company's market opportunities; (vii) the benefits of the Company's products, (viii) the intention to enter into agreements with partners; (ix) future outsourcing; (x) expectations regarding competitors; (xi) the expected impact of the described risks and uncertainties; (xii) intentions with respect to the payment of dividends; (xiii) the management of the Company's liquidity risks in light of the prevailing economic conditions; (xiv) the Company's cost reduction plan; and (xv) the search for additional financing over the next months. These statements are neither promises nor guarantees, but involve known and unknown risks and uncertainties that may cause the Company's actual results, level of activity or performance to be materially different from any future results, levels of activity or performance expressed in or implied by these forward-looking statements. These risks include, generally, risks related to revenue growth, operating results, industry and products, technology, competition, the economy and other factors described in detail in Xebec's Annual Information Form for the year ended December 31, 2011 under the heading "Risk Factors" which is available on SEDAR at www.sedar.com and on Xebec's website at www.xebecinc.com.

Although the forward-looking statements contained herein are based upon what management believes to be current and reasonable assumptions, the Company cannot assure readers that actual results will be consistent with these forward-looking statements. Examples of such assumptions include, but are not limited to: (i) trends in certain market segments and the economic climate generally; (ii) the pace and outcome of technological development; (iii) the identity and expected actions of competitors and customers; and (iv) the value of the Canadian dollar. The forward-looking statements contained herein are made as of the date of this MD&A and are expressly qualified in their entirety by this cautionary statement. Except to the extent required by law, the Company undertakes no obligation to publicly update or revise any forward-looking statements contained herein.

DESCRIPTION OF THE BUSINESS

CORPORATE OVERVIEW

Xebec Adsorption Inc. ("Xebec" or "the Company") is a Canadian global provider and integrator specialized in the design, engineering and manufacturing of innovative gas solutions and services in the process of transforming raw gases into marketable sources of clean energy. As such, Xebec's strategy is focused on establishing leadership positions in 4 key market and business segments where demand for biogas upgrading, natural gas purification, associated gas purification and hydrogen purification is growing. Headquartered in Montreal (QC), Xebec also operates two manufacturing facilities in Montreal and Shanghai, Sales and services facilities in Vancouver (BC) as well as a sales and distribution network in North America, and Asia. Xebec (www.xebecinc.com) trades on the Toronto Stock Exchange ("TSX") under the symbol XBC.

Xebec's products and services are an essential part of a growing industry of transforming raw gases into marketable sources of clean energy:

** The higher utilization rate of farmland as an energy resource could increase the share of manure, agricultural crops and by-products to 85%, leaving organic waste a 10% and WWTF's a 5% share*

Source: Biomass Magazine, Global Water Intelligence, American Biogas Council, Frost And Sullivan, European Biomass Association, Eurostat, Iowa State University

Xebec's head office is in Blainville, Quebec in a 41,753 square foot manufacturing facility in which 70 people are currently employed. The Blainville operation houses corporate finance, sales for natural gas and biogas purification products, aftermarket support, global supply chain, operational engineering, manufacturing of gas separation and purification equipment and service and maintenance support.

As part of the Intellectual Property Transaction disclosed hereafter in the Recent Development section, Xebec has transferred 9 employees and the ownership of its technology center and test laboratory located in Burnaby and Surrey, as well as equipment located in British Columbia. Xebec has maintained the employment of 3 engineers dedicated to sales and service support for Canadian and US west coast customers.

Xebec's Asian 20,451 square foot manufacturing facility is located in the Song Jiang district of Shanghai, China. This facility employs 27 people and is responsible for product engineering and assembly using components manufactured in the greater Shanghai industrial area. The facility also provides shared services including supply chain and engineering support to Xebec's head office. Xebec China is also responsible for sales of Xebec's products, marketing, technical and after-sales support for the Asian and South East Asian markets.

Xebec opened in the first quarter of 2009 along with Angstrom a regional sales office in Singapore. Xebec Singapore is responsible for sales of Xebec's products, marketing, technical and after-sales support for primarily the South East Asian markets. Xebec Singapore currently employs 3 people.

MARKETS

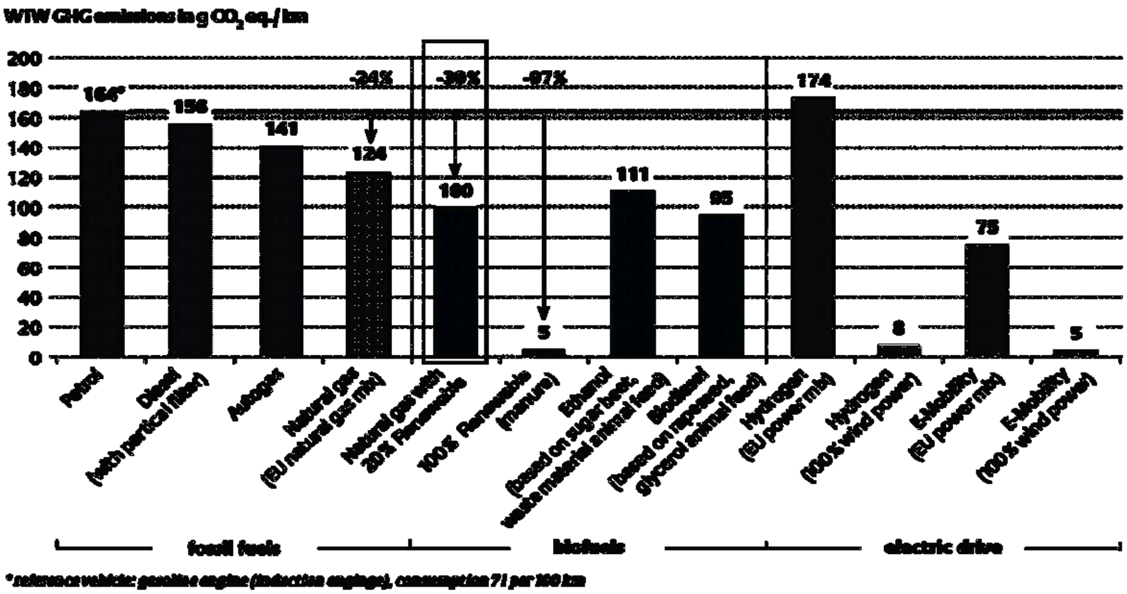
Xebec mainly targets 4 key market and business segments focused on gaseous fuels used for transportation:

1- Biogas upgrading plants
2- Natural gas dehydration for NGV refueling stations
3- Hydrogen pressure swing adsorption ("PSA ") for hydrogen recovery
4- Associated gas purification

Xebec's current strategy is based on a number of key market drivers and global macro trends driving the demand for Natural Gas and Renewable Gas as a low carbon cleaner energy source of transportation fuel, amongst them are:

- The abundance and low cost of Natural Gas;
- The rising price of oil and need for greater energy independence and security;
- Climate Changes and the urgent need to reduce greenhouse gas emission (GHG);
- Gas flaring reduction targets;
- The growing government commitments to renewable energy;
- Diesel displacement in favor of natural gas for transportation; and
- Technological advancements.

These market drivers are anticipated to fuel demand for renewable gas. GHG reduction targets make renewable gas a good solution for a lower carbon emissions economy in transportation, therefore creating new business opportunities for Xebec.



COMPETITION

Xebec faces competition within its target markets primarily from other manufacturers of biogas purification, natural gas, associated gas and hydrogen purification equipment. The natural gas and biogas purification and separation market has not yet seen considerable consolidation, unlike other industrial or renewable industries. Most competitors of Xebec today are small to medium companies working in niche segments of the natural gas and biogas business.

BGX Solutions: In the emerging biogas purification market, Xebec expects to compete with manufacturers of competing technologies including membrane separation, amine and water wash systems, as well as advanced and conventional adsorption based systems for the purification of biogas. These competitors include, Acrion Technologies Inc., Cirmac International BV, Lackeby Water Group (PURAC), Guild Associates Inc, MT-Biomethan GMBH, Carbotech AC GmbH, Haase Energietechnik AG, Ros Roca Group, Flotech/Greenlane, Yit Vatten Och Misjoteknik, Air Liquide, MalmBerg Water AB and A.R.C. Technologies Corp.

NGX Solutions: In the natural gas dryer market Xebec competes with a number of companies who manufacture gas dryers. These companies include SPX Corp., Parker Hannifin Corporation, Aircel Corp., PSB Industries Inc., Xi’An Unionfilter Purification Equipment Co. Ltd., Zander Aufbereitungstechnik GmbH and Tecno Project Industriale s.r.l.

H2X Solutions: In the hydrogen purification market, Xebec's competition includes Air Liquide, HydroChem, Linde and Air Products.

AGX Solutions: In the associated gas market, Xebec’s competition includes several membrane equipment suppliers.

STRATEGY AND OBJECTIVES

Xebec seeks to become a leader in the development, manufacture and supply of integrated biogas upgrading plants to either pipeline or vehicle-fuel grade renewable natural gas. Biogas is a methane-containing renewable energy source created primarily by the decomposition of organic waste.

Xebec's continues to manage its cost structure and working capital, while increasing its revenue. Xebec intends to actively pursue and implement the following measures:

1. Standardize product offering with strong focus on smaller to medium gas flows, where Xebec's solutions offer inherent size and cost benefits;
2. Xebec has monetized some its intellectual property portfolio and created additional liquidity to complete its restructuring plan implemented during its 2011 fiscal year;
3. Enforce and implement tight cost control measures on all general and administrative costs;
4. Maintain regional sales, service and support infrastructure for Xebec's key markets to strengthen Xebec's sales abilities and support products and systems in the market place;
5. Execution and operational excellence, allowing Xebec to deliver products and solutions at the best price, on time and on budget while meeting or exceeding targeted gross margins;
6. Leverage key relationships with leading channel partners and project developers to penetrate target markets;
7. Continue to proactively address and manage its liquidity and working capital requirements. Xebec's delivery cycle for biogas plants can be 8 to 12 months. The management and funding of working capital is key to the success of the Company, and is currently being addressed.

RECENT DEVELOPMENTS

On June 26, The Company received its second purchase order for a BGX kinetic landfill gas separation system from China's Golden Green Environmental Engineering & Technical Co. Ltd. (Golden Green). The system will be installed in early 2013 at a landfill in Anshan City. The upgraded landfill gas will be compressed and used as renewable fuel in the transportation sector.

On June 19, the Company signed a co-operative marketing & teaming agreement with Primoris Services Corporation (NASDAQ:PRIM) ("Primoris") to jointly promote and sell a novel proprietary process solution for the associated gas, shale gas and upstream off-gases markets. This process incorporates intellectual property from both Organizations and will be marketed to customers that are involved in exploration and production (E&P), which operate stranded wells or gas processing operations.

On June 5th, the Company received a purchase order valued at CAD $2.05M for an H-3200 fast-cycle Pressure Swing Adsorption (PSA) hydrogen purification unit from Deok-Yang Company Ltd., the leading hydrogen supplier in South Korea.

On May 7th, the Company has successfully completed its initial phase testing for removal of high levels of nitrogen (N2) and oxygen (O2) in landfill and waste water treatment digester gas. The completion of this new phase test program has allowed the Company to increase its N2, O2 removal capability, and has validated the performance of high nitrogen and oxygen removal of up to 15% nitrogen in the feed biogas.

On April 23rd, The Company received its first order for a BGX advanced kinetic landfill gas separation system, which will be installed in early 2013 at a landfill in northern China's Liaoning province. The Company has entered into an exclusive agreement with this leading Chinese environmental engineering firm for the potential delivery of 14 additional upgrading systems over the next 48 months. The value of these medium sized upgrading systems will be in the range of $1.7 million to $5.5 million each, depending on the landfill gas flow rates and gas composition.

On March 22nd, 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 & 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$8,350,000. The transaction is also subject to payments for the achievement of certain conditions to be met within the next 24 months. The Company also entered into a license agreement with Air Products allowing the Company to continue to sell its systems, in the biogas, hydrogen, natural gas and associated gas purification markets

On March 22nd, 2012, the Company signed a settlement agreement with Industry Canada for the Government royalty program obligation under TPC (Technology Partnership Canada) with regards to its *Fast Cycle Pressure Swing Adsorption and Gas Management systems* and *Pulsar Pressure Swing Adsorption project*. Under this settlement, the Company paid $250,000 at the execution of the agreement with Air Products and will reimburse the remaining balance of $1,000,000 spread over four equal annual payments of $250,000. Furthermore, the Company has to pay up to $750,000 in contingent payments based on cumulative funds generated from the license or sale by the Company of its intellectual property.

On January 25, 2012, Xebec announced a $2.2 million order for a second order of a Biogas upgrading plant in South Korea.

CURRENT BACKLOG

The order backlog is calculated considering contracts received and considered as firm orders.

Current backlog as of

Product Line: In million of $	**August 2, 2012**	May 10, 2012	March 30, 2012	November 11, 2011
Natural Gas Dryers	**2,5**	1,1	0,8	2,0
Gas Purification	**9,7**	9,5	9,6	3,0
Others	**0,9**	0,6	0,7	2,1
Consolidated Backlog	**13,1**	11,2	11,1	7,1

Major projects included in the current backlog:

North America:

Name	Type	Location	Commissioning
Fortis BC	Biogas upgrading plant	British Columbia, Canada	H2-2012

Europe:

Name	Type	Location	Commissioning
Biogas project developer	Waste Biogas to Biomethane	Austria	H1-2013

Asia

Name	Type	Location	Commissioning
Grasim Industries limited	PSA System	India	H2-2012
Deok-Yang Company Ltd	PSA System	South Korea	H1-2013
Potlatch Inc.	Biogas upgrading plant	South Korea	H1-2013
Golden Green	Biogas upgrading plant	China	H1-2013
Golden Green #2	Biogas upgrading plant	China	H1-2013
Heilongjiang Loonggas	Biogas upgrading plant	China	H2-2013

OVERALL PERFORMANCE

Revenues for the three-month period ended June 30, 2012 were $4.2 million, compared to $4.5 million for the corresponding period of the previous year. Significant working capital deficiencies throughout the year 2011 and the first quarter of 2012 have hindered the Company results by slowing down the delivery of its projects and products. The Company had a slow start in the second quarter because of the aforementioned issues but new hires combined with the cash infusion from its transaction with Air Products allowed the Company to start deliveries to customers. Margins were up by 7% for three-month period ended June 30, 2012 compared to the same period of the previous year. The Company is now operating at full capacity. The closing of the intellectual property transaction on March 22nd resulted in a gain of disposition of assets of $5.4 million. The money received served to fund the current working capital requirements.

The Company signed a settlement agreement with 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 payments. Furthermore, the Company is liable to pay up to $750,000 in contingent payments based on cumulative funds generated from the license or sale by the Company of its intellectual property. With the funds generated from the intellectual property transaction, the Company paid $540,000 in contingent payments. This is an important achievement, since the Company might have had to repay up to $8,7 million with regards to the Pulsar Pressure Swing Adsorption project and a 0,5% royalty on gross business revenues until September 20, 2022 for the Fast Cycle Pressure Swing Adsorption and Gas Management systems. This resulted in a $0.7 million loss on revaluation in the first quarter as this debt was not entirely accrued yet and is subject to timely revaluation.

The Company realized a net loss of $0.5 million for the three-month period ended June 30, 2012, compared to a net loss of $1.0 million for the same period last year. This represents a reduction of 50% of the loss compared to the same quarter of the previous year.

In the short and medium term, the future for renewable energy remains very positive. Green energy initiatives are on the agendas of municipal, provincial and federal governments worldwide. Corporations and consumers are increasingly looking for cost efficients green energy solutions to protect the environment and reduce their carbon footprint Management believes that Xebec, with its complementary product lines, strong customer relationships, global footprint and low-cost opportunities in manufacturing and supply chain, is well positioned to respond to this growing demand.

The Company's immediate efforts are primarily focused on maintaining its market and technological leading positions, addressing and managing its liquidity and working capital requirements. Xebec is well positioned to capture market share in the expanding biogas upgrading market.

SELECTED ANNUAL INFORMATION

In millions of $	Three months ended June 30, 2012	2011	% of Change	Six months ended June 30, 2012	2011	% of Change
Revenues	**4.2**	4.5	-6.7%	**5.7**	8.6	-33.0%
Gross margin (%)	**26.8%**	19.7%		**14.8%**	33.9%	
EBITDA	**(0.4)**	(0.7)		**3.8**	(0.6)	
Net income (loss)	**(0.5)**	(1.0)	50.0%	**2.7**	(1.2)	-325.0%
Net income (loss) per share - basic and diluted ($/share)	**(0.01)**	(0.03)		**0.07**	(0.03)	
Total assets (as of **June 30** and December 31)				**10.0**	10.3	
Total long-term financial liabilities (as of **June 30** and December 31)				**1.4**	1.3	

FINANCIAL HIGHLIGHTS OF THE SECOND QUARTER 2012

- Revenues of $4.2 million in the second quarter of 2012, a 6.7% decrease compared to $4.5 million in the second quarter of 2011.
- Gross margins of 26.8% in the second quarter of 2012, a 7.1 points increase compared to 2011.
- Net loss of $0.5 million in the second quarter of 2012 compared to a net loss of $1.0 million in the second quarter of 2011.
- Loss per share of $0.01 in the second quarter of 2012 compared to a loss per share of $0.03 in the second quarter of 2011.
- Order backlog of $13.1 million as at August 2, 2012 a 14.9% increase compared to $11.4 million as at August 11, 2011.

RESULTS OF OPERATIONS

Revenues

Customer location

In millions of $	Three months ended June 30, 2012	2011	Six months ended June 30, 2011	2010
Canada	**1.3**	0.3	**1.9**	0.7
United States	**0.5**	2.8	**1.0**	5.9
India	**0.9**	-	**1.0**	-
Japan	**0.6**	-	**0.7**	0.1
China	**0.4**	-	**0.4**	-
Thailand	**0.3**	-	**0.3**	-
Korea	**-**	0.2	**0.1**	0.3
Malaysia	**0.1**	-	**0.1**	-
Singapore	**-**	0.6	**0.1**	0.7
Other	**0.1**	0.6	**0.1**	0.9
Total	**4.2**	4.5	**5.7**	8.6

Product Line

In millions of $	Three months ended June 30, 2012	2011	Six months ended June 30, 2012	2011
Gas purification	**2.5**	1.8	**3.0**	2.9
Natural gas dryers	**0.8**	1.8	**1.2**	2.1
Engineering services	**-**	0.4	**0.4**	1.1
Compressed gas filtration	**0.8**	0.5	**1.0**	0.9
Licensing	**-**	-	**-**	1.5
Air dryers	**0.1**	-	**0.1**	0.1
Total	**4.2**	4.5	**5.7**	8.6

For the second quarter of 2012, total revenues amounted to $4.2 million, compared to $4.5 million for the second quarter of 2011. For the six-month period ended June 30, 2012, total revenues amounted to $5.7 million compared to $8.6 million for the corresponding period. The revenue for natural gas dryers decreased due to the working capital deficiencies from Q1. The engineering services revenues were nil since the Nuvera engineering agreement was transferred to Air Product as part of the IP transaction. Moreover, the licensing revenue of 2011 was not recurrent. Compressed gas filtration and gas purification revenues increased for both the three and six-month period reflecting is working capital improvement and fast tracking of its order backlog.

Net income (loss)

Net loss for the three-month period ended June 30, 2012 was $0.5 million, or $0.01 per share, compared to a net loss of $1.0 million, or $0.03 per share, for the same period in 2011, reflecting primarily an increase in gross margin of $0.2 million combined with a decrease in selling and administrative of $0.2 million due to cost reduction measures.

Net income for the six-month period ended June 30, 2012 was $2.7 million, or $0.07 per share, compared to a net loss of $1.2 million, or $0.03 per share, for the same period in 2011, reflecting primarily a $5.4 million gain on the sale of its IP portfolio to Air Products and cost reduction of $0.9 million for selling and administrative expenses due to a decrease of professional fees and payroll. However, it was reduced by a $2.0 million gross margin reduction and an increase in financial expenses of $0.6 million due to the loss on the revaluation of the Technology Partnerships Canada program.

Gross Profit

In millions of $	Three months ended June 30, 2012	2011	Six months ended June 30, 2012	2011
Revenues	**4.2**	4.5	**5.7**	8.6
Cost of Goods Sold	**3.1**	3.6	**4.9**	5.7
Gross Profit*	**1.1**	0.9	**0.8**	2.9
Gross Margin (%)	**26.8%**	19.7%	**14.8%**	33.9%

* Gross Profit is a non-IFRS financial measure.

For the second quarter of 2012, the gross margin amounted to $1.1 million compared to $0.9 million for the same period in 2011.

For the six-month period ended June 30, 2012, the total gross margin amounted to $0.8 million, compared to $2.9 million for the same period last year. The decrease in gross margin is mainly explained by a 33% sale decrease that included a non-recurring licensing revenue of $1,5M at 100% gross margin.

EBITDA

	Three months ended June 30,		Six months ended June 30,	
In millions of $	**2012**	2011	**2012**	2011
Net income (loss)	**(0.5)**	(1.0)	**2.7**	(1.2)
Depreciation of property	**-**	0.1	**0.1**	0.2
Amortization of intangible assets	**0.1**	0.1	**0.2**	0.2
Share-based compensation expense	**-**	-	**-**	-
Finance cost net	**-**	0.1	**0.8**	0.2
EBITDA (loss)	**(0.4)**	(0.7)	**3.8**	(0.6)

* EBTDA is a non-IFRS financial measure.

We report on our EBITDA (Income from operations before depreciation and amortization and special charges). EBITDA is not a performance measure defined under IFRS and is not considered an alternative to income from operations or net (loss) earnings in the context of measuring Company's performance. EBITDA does not have a standardized meaning and is therefore not likely to be comparable with similar measures used by other publicly traded companies.

The EBITDA reached $(0.4) million in the second quarter of 2012 compared to $(0.7) million for the same period last year. The improvement in the EBITDA is explained by the better margins realized on the gas purification and gas compression sales that were hindered in the previous quarters due to our working capital deficiencies.

For the six-month period ended June 30, 2012, the EBITDA reached $3.8 million, compared to $(0.6) million for the same period last year. The improvement in the EBITDA is the result of the gain on disposition of the IP portfolio to Air Products and lower overhead expenses due to the implementation of cost control measures.

Selling and Administrative

Selling and administrative expenses were $1.6 million in the second quarter of 2012 compared to $1.8 million for the same period last year. For the six-month period ended June 30, 2012, the selling and administrative expenses were $2.8 million, compared to $3.7 million for the same period last year. The decrease in selling and administrative expenses is the result of the company's restructuring and the implementation of cost control measures and the reduction of salary expenses and professional fees. Moreover, the company had to pay a non-recurring $0.1 million in recruiting fees to rebuild its engineering team that will be non-recurring.

Research and Development

Research and development expenses, net of research and tax credits were $(0,01) million in the second quarter of 2012, compared to $0,03 million for the same period in 2011. For the six-month period ended June 30, 2012, the research and development expenses were $0.02 million, compared to $0.38 million for the same period last year.

The decrease is explained by the reduced headcount in research and development department. Most employees are now assigned to production. Nonetheless, the Company is maintaining its research capability through various partnerships with public and private research labs.

Financial

Financial expenses decreased for the three-month period ended June 30, 2012 to $0.02 million, from $0.1 million for the same period in 2011. The decreased is explained by the reimbursement of most of the debt at the end of Q1-2012.

For the six-month period ended June 30, 2012, the financial expenses increased to $0.8 million, from $0.2 million for the same period last year. The increase in financial expenses is due to the loss on revaluation of the Technology Partnerships Canada program (See "Contingent Off-Balance-Sheet Financing Arrangements" below for more details) due to the settlement agreement between the Company and Industry Canada.

Foreign Exchange Loss

In the second quarter of 2012, the Company had a foreign exchange gain of $22,450 compared to a foreign exchange gain of $19,465 for the second quarter of 2011

The increase in foreign exchange gain (loss) is due to the slight depreciation of the Canadian dollar over the US currency over the same period.

For the six-month period ended June 30, 2012, foreign exchange loss was $17,733 compared to a gain of $127,925 for the same period last year.

SUMMARY OF QUARTERLY RESULTS

In millions of $ (except per share data)	**IFRS**							
	2012		**2011**				**2010**	
	Q2	Q1	Q4	Q3*	Q2	Q1	Q4	Q3
Revenues	**4.2**	1.5	2.7	2.9	4.5	4.1	3.4	4.0
Net income (loss)	**(0.5)**	3.2	(2.0)	1.7	(1.0)	(0.2)	(3.9)	(3.1)
Earnings (loss) per share basic and diluted	**(0.01)**	0.08	(0.02)	0.02	(0.03)	-	(0.11)	(0.11)

*restated

Given the nature and early stage of Xebec's business, there are no apparent seasonal or other discernible trends at this time.

LIQUIDITY AND CAPITAL RESOURCES

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

in millions of $	Three months ended June 30,			Six months ended June 30,		
Cash flow from (used in)	**2012**	2011	Change	**2012**	2011	Change
Operating activities	**(3.5)**	(1.1)	(2.4)	**(5.4)**	(2.2)	(3.2)
Investing activities	**(0.1)**	0.8	(0.9)	**8.3**	0.5	7.8
Financing activities	**-**	-	-	**(1.4)**	-	(1.4)

The recent sale and license back transaction of the Company's intellectual property portfolio together with the proceeds received from that transaction, provides the Company with the sufficient funding to support its operations for at least the next fiscal year.

Operating activities

In the second quarter of 2012, the operating activities used $3.5 million of cash, compared to $1.1 million for the same period in 2011. The increase in used of cash is mainly due to the increase in account receivable. For the six-month period ended June 30, 2012 operating activities used $5.4 million of cash, compared to $2.2 million for the same period last year. The decrease of $3.2 million is mainly explained by the decrease of gross margin by $2.2 million and an increase in account receivable which used $0.9 million more than the corresponding period.

Investing activities

Investing activities used $0.1 million of cash in the second quarter of 2012, compared to a cash inflow of $0.8 million for the corresponding second quarter of 2011. The decrease of $0.9 million is explained by the reduction in restricted cash in 2011 that no longer applies in 2012. For the six-month period ended June 30, 2012 investing activities generated $8.3 million of cash, compared to $0.5 million for the same period last year. The increase is mainly explained by the disposition of the assets related to the transaction with Air Products.

Financing activities

In the second quarter of 2012, the financing activities used $12,234, compared to $19,305 for the same period of 2011. For the six-month period ended June 30, 2012 financing activities used $1.4 million of cash, compared to $55,101 for the same period last year. The decrease in financing is explained by the repayments of the bank loan of $0.5 million and Investment Quebec's long term debt of $0.1 million upon closing of the sale of assets to Air Products. The Company reached a settlement agreement with The Technology Partnerships Canada program and a repayment of $0.8 million has been made.

Financial Position

As of June 30, 2012, the Company had $2.0 million of cash on hand and $1.2 million of long-term debt outstanding, of which $0.3 million is due within one year.

As at June 30, 2012, the Company had credit facilities in the amount of $1.3 million with the Royal Bank of Canada which bore interest at the Company's bank's prime rate plus 2.50% per annum and which were limited by certain margin requirements concerning accounts receivable. The Company had also a revolving demand facility by way of letters of credit and letters of guarantee amounting to $750,000. However, as at June 30, 2012, the Company was not allowed to draw on these facilities and they are currently being renegotiated.

In addition, the Company had access to credit facilities in the amount of $500,000 with Royal bank of Canada which were guaranteed by Export Development of Canada and bore interest at the Company's bank's prime rate plus 2.5% per annum and were limited by certain requirements concerning pre-shipment costs. These credit facilities were not used as at June 30, 2012.

The bank loan is secured by a first ranking hypothec of $4,000,000 on all movable property of the Company.

The credit facilities with the Royal Bank of Canada matured on October 31, 2010 and have been verbally extended under certain conditions on an "as needed" basis. The agreement with Export Development of Canada had been extended under the same terms and conditions until April 30, 2012 and is currently being renegotiated.

The following table is a summary of the contractual obligations including payments due for each of the next five years and thereafter:

	Payments Due by Period			
In millions of $	**Total**	1 year	2-5 years	Beyon 5 years
Long Term Debt	**1.2**	0.3	0.9	-
Operating Leases	**4.8**	0.5	1.3	3.0
Software licences agreements	**0.6**	0.2	0.4	-
Total Contractual Obligations	**6.6**	1.0	2.6	3.0

There have been no significant changes in the contractual obligations of the Company since its MD&A for the three and twelve-month period ended December 31, 2011 issued on March 30, 2012.

OUTSTANDING SHARE DATA

The authorized share capital of the Company consists of an unlimited number of common shares and an unlimited number of preferred shares.

As at June 30, 2012 and August 2, 2012, Xebec had 39,363,867 common shares issued.

Share Purchase Warrants Outstanding

As at June 30, 2012, 10,091,886 Share Purchase Warrants were outstanding and entitle the holder to acquire one Common Share at a price of $0.45 per share until November 2nd 2015.

The 10,091,886 warrants are subject to an accelerated expiry if, at any time after December 31, 2010, the published closing trade price of the Common Shares on the TSX is equal or superior to $0.75 for any 20 consecutive trading days, in which event Xebec may give the holder a written notice that the warrants will expire at 5:00 p.m. (Toronto Time) on the 30^{th} day from the receipt of such notice.

Stock Options Outstanding

the Company plan (the "Plan"), which allows for the issuance of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards and other stock-based awards. Under the Plan, common shares approved for issuance under all stock-based compensation arrangements are limited to the greater of 591,560 or 10% of the common shares issued and outstanding. As at June 30, 2012, the maximum number of common shares available for issuance under all stock-based compensation arrangements is 3,936,387.

Under the terms of the Plan, stock options are granted with an exercise price not less than the volume weighted average trading price of the common shares on the TSX for the five trading days prior to the date of grant. Stock options generally vest quarterly over four years and are exercisable for seven years from the date of grant.

As at June 30, 2012, the Company had 3,464,889 options outstanding under the plan with a weighted average exercise price of $0.19.

FINANCIAL AND OTHER INSTRUMENTS

Credit Risk

Credit risk is the risk of an unexpected loss if a customer or third party fails to meet its contractual obligations. The Company's primary credit risk is its cash and outstanding trade accounts receivable. The carrying amount of its outstanding trade accounts receivable represents the Company's estimate of its maximum credit exposure. The Company regularly monitors its credit risk exposure and takes steps such as employing credit-approval procedures, establishing credit limits, using credit assessments and monitoring practices to mitigate the likelihood of these exposures from resulting in an actual loss. An allowance for doubtful accounts amounting to $197,370 (2011 – $194,273) was established, based on prior experience and an assessment of current financial conditions of customers as well as the general economic environment. In the case where an allowance for doubtful accounts provision is recorded and a receivable balance is considered uncollectible, it is written off against the allowances for doubtful accounts. Bad debt expense amounted to $(1,362) for second quarter in 2012 and $18,638 for the period ended June 30, 2012 (corresponding period in 2011 respectively – $ (56,047) and $(26,379)). As at June 30, 2012, the Company's three largest trade debtors accounted for 29% (17%, 6% and 6%) of the total accounts receivable balance (2011 – 28% (11%, 9% and 8%)).

Currency Risk

Some assets and liabilities are exposed to foreign exchange fluctuations. The Company does not use financial instruments to reduce this risk.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of financial instruments will fluctuate as market interest rates change. The Company does not use financial instruments to reduce this risk.

The Company is exposed to interest rate risk on its bank debt, both short-term and long-term, for which the interest rates charged fluctuate based on the bank prime rate. The short-term bank loan as at June 30, 2012 is nil (2011 - $500,000) and the long-term debt that is subject to the variability of the interest rate fluctuation is $ nil (2011 - $ nil).

If the interest rate on the bank debt had been 50 basis points higher (lower), related to the bank loan as at June 30, 2012, net loss would have been nil for the second quarter of 2012 and $625 for the six-month period ended June 30, 2012 (corresponding period 2011 –$625 and $1250 respectively) higher (lower).

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In our 2011 annual consolidated financial statements and notes thereto, as well as in our 2011 Annual MD&A, we have identified the accounting policies and estimates that are critical to the understanding of our business operations and our results of operations

Recent Accounting Pronouncements

(i) IFRS 9, Financial Instruments, issued in November 2009, is mandatory for accounting periods beginning after January 1, 2015 and addresses classification and measurement of financial assets. It 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. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, Financial Instruments – Recognition and Measurement, except that fair value changes due to credit risk for liabilities designated at fair value through profit or loss are generally recorded in other comprehensive income. IFRS 9 is applicable to the Company for the year beginning on January 1, 2015, with earlier application permitted.

(ii) IFRS 10, Consolidated Financial Statements, requires an entity to consolidate an investee when it has power over the investee, 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.

(iii) IFRS 11, Joint Arrangements, 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.

(iv) IFRS 12, Disclosure of Interests in Other Entities, establishes disclosure requirements for interests in other entities such as subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosures that address the nature of, and risks associated with, an entity's interests in other entities.

(v) IFRS 13, Fair Value Measurement, is a comprehensive standard for fair value measurement and disclosure 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. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures.

(vi) IAS 1, Presentation of Financial Statements, has been amended to require entities to separate items presented in other comprehensive income into two groups, based on whether or not items may be recycled in the future. Entities that choose to present other comprehensive income items before tax will be required to show the amount of tax related to the two groups separately.

Related party transactions

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

	For the three-month ended June 30,		For the six-month ended June 30,	
	2012	2011	2012	2011
	$	$	$	$
Marketing and professional services expenses accrued to companies controlled by members of the immediate family of an officer	23,658	14,583	35,633	14,583
Sales to a shareholder of a subsidiary (a joint venture partner in 2011)	15,666	15,655	18,413	40,604
Accrued interest to a joint venture partner	-	433	-	854
Accrued interest on a loan from a Company director	867	-	1,678	-

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

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining disclosure controls and procedures ("DC&P") designed to provide reasonable assurance that the information we are required to disclose in our annual filings, interim filings and other reports (the "reports") filed or submitted under the applicable securities legislation is recorded, processed, summarized and reported within the time periods specified in the applicable securities legislation. DC&P include, without limitation, controls and procedures designed to ensure that the information required to be disclosed by an issuer in the reports filed or submitted under the applicable securities legislation is accumulated and communicated to the issuer's management, including its Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

As at June 30, 2012, an evaluation was carried out, under the supervision of and with the participation of our management, including the President and Chief Executive Officer and the Chief Financial Officer, of the design and effectiveness of our disclosure controls and procedures as defined under NI 52-109. This evaluation was based on the framework set forth in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Upon such review, the Chief Executive Officer and the Chief Financial Officer determined that there were material weaknesses in the design of our DC&P. However, the DC&P deficiencies we identified did not result in adjustments to our annual or any interim consolidated financial statements for fiscal 2012 and 2011. We have identified the following material weaknesses:

Entity Level Controls

We did not maintain a completely effective control environment as defined in accordance with COSO control framework. Specifically, we do not have comprehensive procedure manuals to clearly communicate management's and employees' roles and responsibilities in our internal control over financial reporting. To mitigate the risk, management relies heavily on manual procedures and detection controls, management meetings, quarterly reviews of financial statements of our subsidiaries. These manual procedures were performed during the interim periods ended June 30, 2012 and 2011.

Internal Control over Financial Reporting

Our internal control over financial reporting ("ICFR") includes, among others, those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS, and that our receipts and expenditures are being made only in accordance with authorization of our management; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

We carried out an evaluation of our ICFR, under the supervision of and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer as to the material weaknesses relating to the design of our ICFR as of June 30, 2012. This evaluation was based on the Internal Control-Integrated Framework issued by the COSO. The evaluation considered the procedures designed to ensure that information required to be disclosed by the Company in reports filed or submitted under the applicable securities legislation is recorded, processed, summarized and reported in the time periods specified in the rules and forms of the applicable securities legislation and communicated to our management as appropriate to allow discussions regarding required disclosure. Upon such review, our Chief Executive Officer and Chief Financial Officer have determined that there existed material weaknesses in the design of our ICFR. The ICFR weaknesses we identified did not result in adjustments to our interim consolidated financial statements for the second quarters of 2012 and 2011. Following our assessment, we identified the following material weaknesses

Information Technology General Controls

We did not adequately maintain effective control over access to our accounting system within our accounting department. In addition, the backup tapes were not periodically tested to ensure their accuracy and there is no information technology strategic plan and no business continuity plan. There is also no periodic review performed on the security logs for failed logins. We are actually in the process of implementing controls over program development and program changes.

The potential ability for someone to improperly access and change accounting records is mitigated by the fact that management relies heavily on manual procedures and detection controls, and quarterly reviews of financial statements by management and by the Audit Committee.

Segregation of Duties

We have deficient controls within our accounting department over segregation of duties inherent to the department's size. Specifically, as a result of the limited number of personnel in the accounting department, certain financial personnel had incompatible duties that allowed for the creation, review and processing of certain financial data without independent review and authorization. To mitigate the risk, our management relies heavily on manual procedures and detection controls, regular management meetings, as well as reviews of our financial statements and of our subsidiaries. These manual procedures were performed for the periods ended June 30, 2012 and 2011.

Remediation of Material Weaknesses in Internal Control over Financial Reporting and Disclosure Controls

We have initiated the following actions to address the material weaknesses in our DC&P and ICFR identified as of June 30, 2012.

Entity Level Controls

Our Management has taken an active role in responding to the deficiencies identified, including overseeing management's implementation of the remedial measures described below.

Information Technology General Controls

We will implement enhanced information technology policies and procedures specifically with regard to inventory controls and to the system's change management, program development, access over end-of-period process spreadsheets, IT operations and related monitoring. We will implement new procedures that will overcome the accounting system inventory controls and access deficiencies. We will also develop and implement a global information technology strategic plan and a business continuity plan.

Inadequate Segregation of Duties

We will continue to use appropriate measures to restrict or independently monitor systems access and properly assign job roles and responsibilities to employees to ensure the proper segregation of duties where feasible. As the Company grows, we will expand the number of individuals involved in the accounting function.

We realize that some of the above weaknesses are inherent to a company of our size. Nevertheless, we believe in and are committed to establishing rigorous DC&P and ICFF. It will take time to put in place the rigorous controls and procedures desired by our management and Board of Directors. We cannot at this time estimate how long it will take to complete the steps identified above. Our management will continue to evaluate the effectiveness of our overall control environment and will continue to refine existing controls as they, in conjunction with our Audit Committee, Chief Executive Officer and Chief Financial Officer, think necessary. Again, the control deficiencies which we identified did not result in adjustments to our interim consolidated financial statements for the second quarter of 2012 or any previous periods, except for the restatement of our third quarter 2011.

Other than the remediation efforts discussed above and the implementation of the Company's' ICFR, there have been no changes in our ICFR that occurred since the beginning of the interim period ended June 30, 2012 that have materially affected or are reasonably likely to materially affect our ICFR. Our management, including our Chief Executive Officer and our Chief Financial Officer, has discussed these issues and remediation efforts with our Audit Committee.

We will provide updates on the remediation plan in our quarterly and annual management's reports.

It should be noted that while our management believes that current disclosure and internal controls and procedures provide a reasonable level of assurance, it cannot be expected that existing disclosure controls and procedures or internal financial controls will prevent all human errors and circumvention or overriding of the controls and procedures. A control system, no matter how well conceived or operated, can provide only reasonable assurance, not absolute, that the objectives of the control system are met.

RISKS AND UNCERTAINTIES

An investment in our securities involves a high degree of risk and should be considered speculative due to the nature of our business and the businesses of our subsidiaries and their current respective stage of development. Before making any decision to purchase or to sell any of our securities, you should carefully consider the complete statement of the risk factors and uncertainties described in the Management's Report and Annual Information Form for fiscal 2011. The Company is pursuing an ongoing risk review and management process.