Xebec Adsorption Inc.

Consolidated Financial Statements
December 31, 2009

PricewaterhouseCoopers
LLP/s.r.l./s.e.n.c.r.l.
Chartered Accountants
1250 René-Lévesque Boulevard West
Suite 2800
Montréal, Quebec
Canada H3B 2G4
Telephone +1 514 205 5000
Facsimile +1 514 876 1502

March 29, 2010

Auditors' Report

To the Shareholders of
Xebec Adsorption Inc.

We have audited the consolidated balance sheet of **Xebec Adsorption Inc.** as at December 31, 2009 and the consolidated statement of income (loss) and comprehensive income (loss), changes in shareholder's equity and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2009 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at December 31, 2008 and for the year then ended, prior to the adjustments for the change in accounting policy for start-up costs as described in note 3 of the consolidated financial statements, were audited by other auditors who expressed an opinion without reservation on those statements in their report dated March 6, 2009. We have audited the adjustments made to the consolidated financial statements as at December 31, 2008 and in our opinion, such adjustments, in all material respects, are appropriate and have been properly applied.

PricewaterhouseCoopers LLP[1]

[1] Chartered accountant auditor permit No. 15492

Xebec Adsorption Inc.

Consolidated Balance Sheet

As at December 31, 2009

	2009 $	2008 $ (Restated-note 3)
Assets		
Current assets		
Cash	5,447,702	550,377
Accounts receivable	3,105,834	4,538,842
Inventories (note 6)	2,867,922	2,579,877
Prepaid expenses	183,564	221,143
Income taxes receivable	62,492	-
Investment tax credits receivable	80,843	258,785
Current portion of the loan to a joint venture	37,777	-
Derivative financial assets (note 11)	-	229,906
	11,786,134	8,378,930
Loan to a joint venture, bearing interest at 7.93%, repayable by minimum annual instalments of $37,777 plus accrued and unpaid interest and maturing on July 1, 2012	75,554	-
Property, plant and equipment (note 7)	2,604,931	1,822,209
Intangible assets (note 8)	279,046	148,319
Restricted cash (note 9)	223,261	324,577
Goodwill (note 5)	5,942,152	-
	20,911,078	10,674,035
Liabilities		
Current liabilities		
Bank loan (note 10)	496,900	1,760,931
Accounts payable and accrued liabilities	5,578,505	4,320,860
Deferred revenues	146,228	679,938
Income taxes payable	-	268,194
Current portion of long-term debt (note 13)	321,653	230,186
Current portion of subordinated loan (note 15)	62,496	-
Future income taxes (note 20)	-	99,070
Derivative financial liabilities (note 11)	96,645	-
	6,702,427	7,359,179
Long-term debt (note 13)	1,763,496	1,874,087
Government assistance (note 14)	37,083	42,083
Subordinated loan (note 15)	156,256	250,000
Future income taxes (note 20)	-	23,545
	8,659,262	9,548,894
Shareholders' Equity		
Share capital (note 16)	17,942,821	300,100
Contributed surplus	216,368	-
Retained earnings (deficit)	(5,907,373)	825,041
	12,251,816	1,125,141
	20,911,078	10,674,035

The accompanying notes are an integral part of the consolidated financial statements.

Approved by the Board of Directors

(s) Kurt Sorschak Director *(s) Peter Paul Praxmarer* Director

Xebec Adsorption Inc.

Consolidated Statement of Income (Loss) and Comprehensive Income (Loss)

For the year ended December 31, 2009

	2009 $	2008 $ (Restated-note 3)
Revenues	18,693,788	16,840,622
Cost of goods sold (note 6)	14,462,614	10,700,381
Gross margin	4,231,174	6,140,241
Operating expenses		
Research and development (note 18)	1,080,638	108,865
Selling and administrative	8,783,201	4,754,017
Financial (note 19)	233,862	348,106
Foreign exchange loss (gain)	518,319	(239,402)
Amortization	527,389	194,381
	11,143,409	5,165,967
Income (loss) before income taxes	(6,912,235)	974,274
Provision for (recovery of) income taxes (note 20)		
Current	(57,206)	249,746
Future	(122,615)	72,576
	(179,821)	322,322
Net income (loss) and comprehensive income (loss) for the year	(6,732,414)	651,952
Income (loss) per share		
Basic and diluted	(0.42)	0.08

The accompanying notes are an integral part of the consolidated financial statements.

Xebec Adsorption Inc.

Consolidated Statement of Changes in Shareholders' Equity

For the year ended December 31, 2009

	Number			Amount				
	Warrants	**Common shares**	**Preferred shares**	**Common shares & warrants $**	**Preferred shares $**	**Contributed surplus $**	**Retained earnings (deficit) $ (Restated- note 3)**	**Total $**
Balance – January 1, 2008 – As previously reported [1]	5,868,108	8,638,496	300,000	100	300,000	-	206,301	506,401
Restatement – Change in accounting policy (note 3)	-	-	-	-	-	-	(33,212)	(33,212)
Balance – January 1, 2008 – As restated	5,868,108	8,638,496	300,000	100	300,000	-	173,089	473,189
Net income for the year – As restated	-	-	-	-	-	-	651,952	651,952
Adjusted balance – January 1, 2009	5,868,108	8,638,496	300,000	100	300,000	-	825,041	1,125,141
Conversion of preferred shares[1]	311,892	769,231	(300,000)	300,000	(300,000)	-	-	-
Deemed issuance of shares and warrants on reverse takeover transaction (note 5)	6,180,000	11,269,318	-	11,921,423	-	26,767	-	11,948,190
Issuance of shares and warrants – Private placement, November 25, 2009 (note 16 c)	4,807,824	8,585,400	-	6,439,050	-	-	-	6,439,050
Financing costs – Private placement, November 25, 2009	-	-	-	(717,752)		165,000	-	(552,752)
Net loss for the year	-	-	-	-	-	-	(6,732,414)	(6,732,414)
Stock-based compensation	-	-	-	-	-	24,601	-	24,601
Balance – December 31, 2009	17,167,824	29,262,445	-	17,942,821	-	216,368	(5,907,373)	12,251,816

(1) These represent the shares and warrants issued to the shareholder's of Xebec on reverse takeover note 5.

The accompanying notes are an integral part of the consolidated financial statements.

Xebec Adsorption Inc.

Consolidated Statement of Cash Flows

For the year ended December 31, 2009

	2009 $	2008 $ (Restated-note 3)
Cash flows from		
Operating activities		
Net income (loss) for the year	(6,732,414)	651,952
Items not affecting cash		
Amortization of property, plant and equipment	465,261	145,435
Amortization of intangible assets	62,128	48,946
Unrealized foreign exchange loss (gain) on derivative financial assets	326,551	(229,906)
Stock-based compensation expense (notes 16 b) and 17)	24,601	-
Future income taxes	(122,615)	72,576
	(5,976,488)	689,003
Changes in non-cash working capital components relating to operations		
Accounts receivable	2,888,309	(3,281,660)
Inventories	1,923,637	(1,525,746)
Prepaid expenses	210,933	74,515
Investment tax credits receivable	177,942	(258,785)
Accounts payable and accrued liabilities	(149,782)	3,009,198
Deferred revenues	(1,988,725)	209,398
Income taxes receivable/payable	(330,686)	222,580
	(3,244,860)	(861,497)
Investing activities		
Acquisition of property, plant and equipment	(308,760)	(624,402)
Acquisition of intangible assets	(192,855)	(113,372)
Transaction costs paid on acquisition of a business (note 5)	(1,095,708)	-
Cash acquired on acquisition of a business (note 5)	5,122,028	-
Loan to a joint venture	(134,208)	-
Government assistance	(5,000)	(5,000)
	3,385,497	(742,774)
Financing activities		
Issuance of capital stock and warrants	6,439,050	-
Issuance costs of shareholders' equity instruments	(552,752)	-
Increase (decrease) in bank loan	(1,264,031)	1,760,931
Loan to a joint venture	20,877	-
Long-term debt	289,402	193,387
Repayment of long-term debt	(326,788)	(102,100)
Payment of obligations under capital leases	(12,986)	(11,981)
Restricted cash	163,916	(64,382)
	4,756,688	1,775,855
Increase in cash during the year	4,897,325	171,584
Cash – Beginning of year	550,377	378,793
Cash – End of year	5,447,702	550,377

Supplemental cash flow information (note 21)

The accompanying notes are an integral part of the consolidated financial statements.

1 Nature of operations and liquidity risk

a) Nature of operations

Xebec Adsorption Inc. (the “company”) is a global provider of clean energy solutions to corporations and governments looking to reduce their carbon footprints. The company was formed upon the amalgamation of Xebec Adsorption Inc. (“Xebec”) and QuestAir Technologies Inc. (“QuestAir”) on June 12, 2009. The comparative financial statements are those of Xebec and the financial statements reflect the accounts of QuestAir from June 12, 2009 (note 5).

b) Liquidity risk

Although the company has incurred an operating loss of $6,732,414 and had cash outflows from operations of $3,244,860 for the year ended December 31, 2009, the company finished the year with cash amounting to $5,447,702, working capital of $5,083,707 and had access to unused credit facilities totalling $1,500,000. During the fourth quarter of 2009, management concluded a share offering which provided the company with net proceeds of $5,886,298, the company also undertook various initiatives and developed a plan to manage its operating and liquidity risks in light of prevailing economic conditions. The company has prepared a budget for 2010 for which management believes the assumptions are reasonable. Achieving budgeted results is dependent on improving the volume of revenues, delivering on sales and contracts schedules, meeting expected overall operating margin levels and controlling general and administrative costs. Management expects to meet its budget and to have enough liquidity to fund operations to at least beyond December 31, 2010.

The company is thus faced with uncertainties that may have an impact on future operating results and liquidity. These uncertainties include reduced spending in renewable energy projects reflecting the weakness in the economy, fluctuations in foreign currency rates and achieving the company’s business plan goals as mentioned in the previous paragraph, which includes the development of a new business segment. While management believes it has developed planned courses of action to mitigate operating and liquidity risks, there is no assurance that management will be able to achieve its business plan and maintain the necessary liquidity level if events or conditions develop that are not consistent with management’s expectations, key budget assumptions for 2010 and planned courses of action. Therefore, the company may require additional external funding and there is no assurance that it would be successful. It is possible that future changes in capital markets conditions could result in such funding not being available when required. The company is unable to predict the possible effects, if any, of such uncertainties and the potential adjustments to the carrying values of assets and liabilities that could be needed should the company have insufficient liquidity. Such adjustments could be material.

2 Basis of presentation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). Certain comparative figures have been reclassified to conform to the presentation adopted for the year ended December 31, 2009.

3 Significant accounting policies

Basis of consolidation

These consolidated financial statements include the accounts of the company and its subsidiary, Xebec Adsorption (Shanghai) Co. Ltd. They also include the company's portion of the accounts of a joint venture, Xebec Adsorption South East Asia PTE. Ltd., accounted for using the proportionate consolidation method.

Use of estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions, which affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the useful life of assets, inventory obsolescence, impairment of long-lived assets and goodwill, valuation allowance with respect to future income taxes, fair value of certain financial instruments, stock options, warrants and share awards. Actual results could differ from those estimates.

Inventories

Inventories are recorded 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. Inventories are recorded net of any obsolescence provision.

A new assessment is made of net realizable value in each subsequent period. 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 the cost and the revised net realizable value.

Property, plant and equipment

Property, plant and equipment are accounted for at cost. Amortization is based on their estimated useful life using a straight-line basis at the following rates:

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

3 Significant accounting policies (continued)

Impairment of long-lived assets

Long-lived assets are tested for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. The company tests the recoverability of long-lived assets based on future undiscounted cash flows expected to result from the use of the related assets to be realized upon sale. An impairment loss is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

Intangible assets

Intangible assets are comprised of software and engineering drawings which are accounted for at cost.

Engineering drawings consist of engineering costs incurred to develop product plans, and are amortized using the straight-line method over three years which represents their expected benefit to future periods. Software is amortized using the straight-line method over three years which represents its expected benefit to future periods.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired in a business acquisition. Goodwill is not amortized.

On an annual basis, or more frequently if events or circumstances indicate that goodwill may be impaired, management reviews the carrying amount of goodwill for possible impairment by conducting a two-step test. In the first step, fair value of the reporting unit, as determined under an accepted valuation method, is compared to its carrying value. If the fair value is less than the carrying value, the second step is conducted whereby the fair value of goodwill is determined on the same basis as a business combination. If the fair value of goodwill is less than its carrying value, goodwill is written down to its estimated fair value. The company has elected to carry out its annual impairment test in June of each year for all of its reporting units.

Goodwill is assigned as at the date of the business combination to the reporting unit expected to benefit from the business combination.

Revenue recognition

The company recognizes revenue on commercial equipment sales when title has transferred, the customer has accepted the product, there is persuasive evidence of an arrangement, collection is probable and the price is fixed or determinable. Provisions are established for estimated product returns and warranty costs at the time revenue is recognized. The company records deferred revenue when cash is received in advance of all of these revenue recognition criteria being met.

3 Significant accounting policies (continued)

Revenue recognition (continued)

Revenues from long-term production-type contracts 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 mainly composed of labour hours). 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 classified 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 and a reduction in work-in-progress in the period in which the loss becomes evident and reasonably estimable.

Government assistance

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

Research and experimental development tax credits are recognized when there is reasonable assurance of their recovery using the cost reduction method. 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.

Warranty provision

During the normal course of its operations, the company assumes certain maintenance and repair costs under warranties offered on dryers and filters. 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.

Income taxes

The company uses the liability method to record income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and are measured using substantively enacted rates in effect when the differences are expected to reverse. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period that includes the substantial enactment date. Future income tax assets are evaluated and if realization is not considered to be more likely than not, a valuation allowance is provided.

3 Significant accounting policies (continued)

Earnings per share

Basic earnings per share is determined using the weighted average number of common shares outstanding during the year.

Diluted earnings per share is determined using the weighted average number of common shares outstanding during the year, plus the effects of dilutive securities such as stock options. Diluted earnings per share is calculated using the treasury stock method, which assumes that if all dilutive securities had been exercised at the later of the beginning of the year or 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

The company uses the temporal method to translate its foreign currency transactions.

Monetary assets and liabilities in foreign currencies are translated into Canadian dollars at the exchange rate prevailing at the end of the year. Non-monetary assets and liabilities are translated at historical rates and transactions included in earnings are translated at exchange rates in effect at the date of transaction.

The company's integrated foreign operations are translated using the temporal method. Under this method, monetary assets and liabilities are translated into Canadian dollars at the rate of exchange prevailing at the balance sheet date and non-monetary assets and liabilities at rates prevailing at the transaction date. Revenues and expenses (other than amortization, which is translated at the rate applicable on the date of the acquisition of the related assets) are translated at average rates for the year. Gains and losses arising on translation are included in the statement of income (loss) for the year.

Stock-based compensation plans

The company accounts for stock options using the fair value method calculated 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, the compensation cost is measured at fair value at the date of grant and is expensed to operations over the award's vesting period. For options granted to non-employees, the fair value is measured when performance is complete, a performance commitment is made or the options are fully vested and non-forfeitable, whichever is earliest, and the expense is recognized over the period in which the goods or services from the non-employees are received. A corresponding increase in contributed surplus is recorded 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 generally accepted accounting criteria for deferral and amortization. To date, no development expenses have been deferred.

3 Significant accounting policies (continued)

Financial instruments

The company classifies its financial instruments as follows:

Cash	held for trading
Accounts receivable	loans and receivables
Derivative financial assets	held for trading
Loan to a joint venture	loans and receivables
Restricted cash	held for trading
Bank loan	other financial liabilities
Accounts payable and accrued liabilities	other financial liabilities
Loan from a shareholder of the joint venture	other financial liabilities
Long-term debt	other financial liabilities
Subordinated loan	other financial liabilities

Financial assets and liabilities classified as held for trading are measured at fair value at each reporting period with changes in fair value in subsequent periods included in net earnings. Loans and receivables assets and other financial liabilities are initially measured at fair value and subsequently at amortized cost using the effective interest method.

The company classifies derivative financial instruments which have not been designated as hedges for accounting purposes and embedded derivatives as held for trading, and values them at fair value each period with changes recorded in other income. The company does not designate these derivative financial instruments as hedges.

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 statements of income and comprehensive income and retained earnings as an element of foreign exchange gain or loss.

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.

3 Significant accounting policies (continued)

Changes in accounting policies

On January 1, 2009, the company adopted Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Other Intangible Assets", and which resulted in (i) the withdrawal of Section 3450, "Research and Development Costs", and Emerging Issues Committee Abstract 27, "Revenues and Expenditures During the Pre-operating Period", and (ii) the amendment of Accounting Guideline 11, "Enterprises in the Development Stage". This new standard provides guidance on the recognition of intangible assets in accordance with the definition of an asset and the criteria for asset recognition, whether those assets are separately acquired or internally developed, as well as clarification on the application of the concept of matching revenues and expenses. The adoption of Section 3064 eliminated the deferral of start-up costs, which are now recognized as an expense when they are incurred. Consequently, the company adjusted opening retained earnings as if the new rules had always been applied in the past and the prior period figures have been restated. As well, the company made reclassifications in order to present certain assets, mainly software, as intangible assets instead of presenting them as property, plant and equipment.

As a result of the adoption of these new rules, the following table summarizes the adjustments that were recorded in the consolidated balance sheet as at December 31, 2008 and to the statement of income for the year then ended:

	$
Balance sheet	
Increase (decrease) in	
Property, plant and equipment	(143,619)
Intangible assets	(446,022)
Future income tax liabilities	16,424
Retained earnings	(573,217)
Statement of income	
Increase (decrease) in	
Amortization of property, plant and equipment	(44,839)
Amortization of intangible assets	2,206
Cost of goods sold	130,408
Selling and administrative	468,654
Future income taxes	(16,424)
Net income for the year	(540,005)
Income per share – Basic and diluted	(0.06)

On January 20, 2009, the company adopted recommendation of the Emerging Issues Committee Abstract 173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities" (EIC – 173) issued by the CICA. This Abstract clarifies that an entity's own credit risk and the credit risk of its counterparty should be taken into consideration in determining the fair value of financial assets and liabilities. The prospective adoption of this standard had no material impact on the company's consolidated financial statements.

3 Significant accounting policies (continued)

Changes in accounting policies (continued)

In June 2009, the company adopted the amendments to Handbook Section 3862, “Financial Instruments – Disclosures”, issued by the CICA. The amendments improved disclosures about fair value measurements of financial instruments, including the relative reliability of the inputs used in those measurements and liquidity risk, in light of concerns that the nature and extent of liquidity risk requirements were unclear and difficult to apply. The amendments to Section 3862 apply to annual financial statements relating to fiscal years ending after September 30, 2009. The prospective adoption of this Section had no measurable impact on the company’s consolidated financial statements. The additional disclosure requirements are presented in note 27.

4 Recently issued accounting standards

In January 2009, the CICA issued three new accounting standards: Section 1582, “Business Combinations”; Section 1601, “Consolidated Financial Statements”; and Section 1602, “Non-controlling Interests”, to converge the accounting for business combinations and the reporting of non-controlling interests to International Financial Reporting Standards (“IFRS”).

Business combinations

Section 1582 replaces Section 1581, “Business Combinations”, and establishes new guidance on the recognition and measurement of all assets and all liabilities of the acquired business at fair value. Non-controlling interests are measured at either their fair value or at their proportionate share of the fair value of identifiable assets and liabilities. The measurement of consideration given now includes the fair value of any contingent consideration as of the acquisition date, and subsequent changes in fair value of the contingent consideration classified as a liability are recognized in income. Acquisition-related costs are excluded from the purchase price and are expensed as incurred. In addition, restructuring costs related to a business combination are no longer part of the purchase price equation and are expensed as incurred. Section 1582 applies prospectively to business combinations realized in or subsequent to the first annual reporting period beginning on or after January 1, 2011. Early adoption is permitted. The company is evaluating the impact of the adoption of this new Section on its consolidated financial statements.

Consolidated financial statements and non-controlling interests

Section 1601 and Section 1602, which together replace Section 1600, “Consolidated Financial Statements”, establish new guidance on accounting for non-controlling interests and for transactions with non-controlling interests. The new sections require that non-controlling interests be presented as a separate component of shareholders’ equity. In the statements of income, net income is calculated before non-controlling interests and is then attributed to shareholders and non-controlling interests. In addition, changes in the company’s ownership interest in a subsidiary that do not result in a loss of control are now accounted for as equity transactions. These sections apply to interim and annual consolidated financial statements relating to financial years beginning on or after January 1, 2011, and are required to be adopted concurrently with Section 1582. Early adoption is permitted. The company is evaluating the impact of the adoption of this new Section on its consolidated financial statements.

5 Business combination

Pursuant to the arrangement between Xebec and QuestAir, the shareholders of Xebec (the "Vendors") sold all of the issued and outstanding shares in the capital of Xebec to QuestAir in exchange for up to an aggregate of 15,241,976 common shares in the capital of QuestAir and 6,180,000 warrants of QuestAir. As a result of this transaction, the Vendors have received enough common shares of QuestAir to affect a reverse takeover of QuestAir. Accordingly, the financial statements of the company reflect the accounts of QuestAir from June 12, 2009. The comparative financial statements included in these consolidated financial statements are those of Xebec. Subsequent to that transaction, QuestAir and Xebec have amalgamated and have continued as one corporation under the name of Xebec Adsorption Inc.

At the time of closing of the arrangement, the Vendors were issued 9,407,727 common shares, resulting in the Vendors initially controlling 45% of the outstanding common shares of the amalgamated company. The Vendors may increase their holdings in the amalgamated company by up to 5,834,249 common shares, resulting in an increase in the Vendors' holdings from 45% to 57% pursuant to the earn-out provisions contained in the combination agreement if certain adjusted EBITDA performance targets are achieved by the amalgamated company following completion of the arrangement (in respect of the 2009 and 2010 fiscal years). These shares issued by QuestAir on completion of the arrangement are currently held in escrow (note 16 c)).

The acquisition is accounted for using the purchase method of accounting. This method requires the determination of the aggregate purchase price, estimated at $13,043,898, for the net assets of QuestAir and allocation of this amount to assets acquired and liabilities assumed based on their estimated fair value.

The following table represents the estimated fair value of the assets acquired and liabilities assumed on the effective acquisition date. The excess of the purchase price over the net identifiable assets acquired is preliminarily allocated to goodwill on the consolidated balance sheets. Within twelve months of the date of acquisition, Management intends to complete a formal valuation of the tangible and intangible assets acquired and liabilities assumed, including tax loss carry-forwards amounting to $42.2 million, in order to finalize allocation of the total purchase price.

5 Business combination (continued)

	$
Assets acquired	
Cash and cash equivalents	5,122,028
Accounts receivable – net	1,455,301
Inventories	2,211,682
Prepaid expenses	173,354
Property, plant and equipment	939,223
Goodwill	5,942,152
Restricted cash	62,600
Total assets	15,906,340
Liabilities assumed	
Accounts payable and accrued liabilities	1,407,427
Deferred revenues	1,455,015
Total liabilities	2,862,442
Net assets acquired	13,043,898
Consideration	
11,269,318 Common Shares	10,139,164
6,180,000 Warrants	1,782,259
199,347 options	26,767
	11,948,190
Acquisition costs	1,095,708
	13,043,898

The consideration excludes a portion of the fair value of 70,183 unvested options.
Subsequent to the closing, additional acquisition costs of $27,632 have been added to the purchase price allocation, resulting in an increase of goodwill for the same amount.
The estimated fair value of the warrants was established using the Black-Scholes option pricing model with the following assumptions: exercise price of $2.15, risk-free interest rate of 1.40%, expected volatility of 100% and expected life of two years.

6 Inventories

	2009 $	2008 $
Raw materials	1,970,017	1,880,618
Work in progress	868,663	699,259
Finished goods	29,242	-
	2,867,922	2,579,877

Cost of goods sold is mainly composed of cost of inventories and includes an amount for the write-down of inventory to the lower of cost and net realizable value of $355,012 ($59,573 in 2008).

7 Property, plant and equipment

			2009
	Cost **$**	**Accumulated amortization** **$**	**Net** **$**
Land	173,180	-	173,180
Building	981,353	126,436	854,917
Machinery and equipment	787,495	138,125	649,370
Office furniture and equipment	120,595	27,234	93,361
Computers	325,812	149,622	176,190
Moulds	201,871	36,438	165,433
Leasehold improvements	678,358	206,060	472,298
	3,268,664	683,915	2,584,749
Machinery and equipment under capital leases	24,967	4,785	20,182
	3,293,631	688,700	2,604,931

			2008 **(restated-note3)**
	Cost **$**	**Accumulated amortization** **$**	**Net** **$**
Land	173,180	-	173,180
Building	981,353	77,368	903,985
Machinery and equipment	310,109	33,945	276,164
Office furniture and equipment	62,498	5,422	57,076
Computers	126,205	24,451	101,754
Moulds	79,094	2,462	76,632
Leasehold improvements	254,895	43,947	210,948
	1,987,334	187,595	1,799,739
Machinery and equipment under capital leases	24,967	2,497	22,470
	2,012,301	190,092	1,822,209

8 Intangible assets

			2009
	Cost	**Accumulated amortization**	**Net**
	$	**$**	**$**
Software	406,590	130,677	275,913
Engineering drawing	4,700	1,567	3,133
	411,290	132,244	279,046

			2008 (restated-note3)
	Cost	**Accumulated amortization**	**Net**
	$	**$**	**$**
Software	212,580	68,961	143,619
Engineering drawing	4,700	-	4,700
	217,280	68,961	148,319

9 Restricted cash

Restricted cash consists of amounts which are restricted for specific purposes under certain contractual obligations. Restricted cash is not expected to become unrestricted within the next 12 months.

10 Bank loan

The company has access to credit facilities in the amount of $1,500,000 which bear interest at the company's bank prime rate plus 0.60% per annum and are limited by certain margin requirements concerning accounts receivable. In addition, the company has access to credit facilities in the amount of $500,000 which bear interest at the company's bank prime rate plus 1.50% per annum and are limited by certain requirements concerning pre-shipment costs. The bank loan is secured by a first ranking hypothec of $4,000,000 on all movable property of the company and is renewable annually upon certain conditions. The company must also comply with covenants requiring a minimum current ratio and maximum funded debt to tangible net worth. As at December 31, 2009, the company is in compliance with these covenants. As at year-end, the unused amount is approximately $1,500,000 for the first credit facility and $3,100 for the second facility. As well, the company has access to a revolving demand facility by way of letters of credit and letters of guarantee amounting to $1,000,000. As at December 31, 2009, the unused portion of this demand facility is approximately $922,000 ($869,000 in 2008).

11 Derivative financial assets/liabilities

The company has entered into a sales contract with a foreign counterparty for which the contract is denominated in a currency other than the Canadian dollar and the functional currency of the foreign party. As at December 31, 2009, the fair market value of the bifurcated embedded derivatives was a liability of $96,645 (an asset of $229,906 in 2008) and the change in fair value from the prior year amounting to $326,551 was included in the foreign exchange gain (loss) on the statements of income (loss) and comprehensive income (loss).

12 Joint venture

The following is a summary of the company's proportionate share in the assets, liabilities, revenues, expenses, and cash flows of the joint venture, included in the consolidated financial statements:

	2009 **$**
Current assets	179,263
Total assets	207,133
Current liabilities	92,926
Total liabilities	203,275
Revenue	177,187
Expenses	382,234
Net loss	(205,047)
Cash flows from:	
Operations	(224,216)
Financing	319,254
Investment	(34,494)

13 Long-term debt

	2009 $	2008 $
Term loan, matures June 2023, bears annual interest at the bank's floating base rate plus 0.75%, and is secured by a first ranking hypothec on all present and future movable and immovable property. It is repayable in monthly instalments of $8,900 plus interest.	1,441,800	1,548,600
Revolving term loan, matures March 2011, bears annual interest at the bank's base rate plus 3.55 %, and is secured by a first ranking hypothec on all present and future movable. It is repayable in monthly instalments of $8,704 plus interest.	130,566	-
Term loan, matures June 2013, bears annual interest at the bank's floating base rate plus 0.75%, and is secured by a first ranking hypothec on all present and future movable and immovable property. It is repayable in monthly instalments of $6,700 plus interest.	281,400	361,800
Term loan, matures July 2013, bears annual interest at the bank's floating base rate plus 2.50%, and is secured by a first ranking hypothec on all present and future movable and immovable property. It is repayable in monthly instalments of $2,500 plus interest.	107,500	137,500
Loan from Canada Economic Development for a maximum of $137,500, matures August 2016, bears no interest and is repayable in monthly instalments of $1,156. The first instalment is due 24 months after the project completion date.	55,489	-
Loan from Canada Economic Development for a maximum of $100,000, matures February 2015, bears no interest and is repayable in eight semi-annual instalments of $8,549. The first instalment is due 24 months after the project completion date.	68,394	43,387
Obligations under capital lease bearing interest at 6%, repaid in full in December 2009.	-	12,986
	2,085,149	2,104,273
Less: Current portion	321,653	230,186
	1,763,496	1,874,087

The aggregate capital repayments of long-term debt in subsequent years will be:

		$
Fiscal year ending	2010	321,653
	2011	251,863
	2012	238,923
	2013	195,471
	2014	137,771
	2015 - 2023	939,468
		2,085,149

14 Government assistance

The company accounted for a $50,000 non-refundable capital asset grant as deferred government assistance, of which $5,000 was recognized in income during the year.

15 Subordinated loan

This loan from Investissement Québec matures on June 2013, bears annual interest commencing on June 2009 at the lender's floating rate plus 2%, and is secured by a movable and immovable hypothec on all present and future property of the company ranking after those mentioned in note 13. The loan is repayable in capital monthly instalments of $5,208. The company must also comply with covenants requiring a minimum current ratio and maximum funded debt to tangible net worth. As at December 31, 2009, the company is in compliance with these covenants.

16 Share capital

a) The company is incorporated under the Canada Business Corporations Act and authorized share capital consists of an unlimited number of common and preferred shares, without par value.

b) Share purchase warrants – Issued and outstanding

As at December 31, 2009, 17,167,824 warrants are outstanding for a total amount of $1,947,259, of which 12,180,000 warrants entitle the holder to acquire one additional common share per warrant at a price of $2.15 until May 13, 2010 and 180,000 warrants entitle the holder to acquire one common share per warrant at a price of $1.50 until May 13, 2010. The remaining 4,807,824 warrants are described in the note below. The ability to exercise the 6,180,000 warrants issued on the reverse takeover transaction is contingent on the exercise of the remaining pre-existing warrants (note 5).

c) As a result of the business combination (note 5), the company issued 5,834,249 common shares which are held in escrow as at December 31, 2009. These shares could be released to former Xebec shareholders on the achievement of specified financial targets. These targets are measured at December 31, 2009 and 2010. Consequently, these shares are considered restricted share awards that are issued but not outstanding. The expense related to these awards is recorded based on management's best estimate of the ultimate achievement of the financial targets over the vesting periods, namely until December 31, 2009 and 2010. For this year and as at December 31, 2009, no expense was recorded for these awards.

d) Loss per share is calculated using the weighted average number of common shares outstanding of 16,147,705 for the year ended December 31, 2009 (8,638,496 in 2008). Outstanding share options and warrants to purchase common shares were not included in the computation of diluted income (loss) per share as their impact is anti-dilutive.

16 Share capital (continued)

e) On November 25, 2009 the company concluded a share offering for 8,585,400 of its common shares at a price of $0.75 per share, for gross proceeds of $6,439,050. Each common share consists of one common share and one half of one common share purchase warrant ("Warrant"). The net proceeds from the issuance after underwriting fees and offering expenses amounted to $5,886,298. The warrants entitle the holder to acquire one common share at a price of $1.10 until May 25, 2011. The warrants are subject to an accelerated expiry if, at any time after December 31, 2009, the published closing trade price of the common shares on the Toronto Stock Exchange ("TSX") is equal or superior to $1.60 for any 20 consecutive trading days, in which event the company may give the holder a written notice that the warrants will expire at 5:00 p.m. on the thirtieth day from the receipt of such notice. Using the residual value method, the estimated value of the warrants issued is $nil. An additional 515,124 warrants were issued to the agent and entitle the holder to acquire one common share per warrant at a price of $0.77 per share until May 25, 2011. Using the Black-Scholes option pricing model, the estimated fair value of the warrants issued is $165,000. The assumptions used are as follows: exercise price as noted above, risk-free interest rate of 0.93%, expected volatility of 100% and expected life of 18 months. This amount is included in share issue expenses.

17 Stock options

Upon the reverse takeover, the company assumed QuestAir's stock option 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 and 10% of the common shares issued and outstanding. As at December 31, 2009, the maximum number of common shares available for issuance under all stock-based compensation arrangements is 2,696,839.

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 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.

Stock option activity since December 31, 2008, is presented below:

	Number of options	Weighted average exercise price $	Expiry dates
Outstanding – December 31, 2008	-	-	
Assumed upon the closing of the reverse takeover	199,347	5.79	
Expired	(60,295)	6.48	
Outstanding – December 31, 2009 (116,874 options exercisable)	139,052	5.49	January 8, 2010 to September 26, 2016

17 Stock options (continued)

As at December 31, 2009, options outstanding in the Plan and options exercisable are as follows:

	Options outstanding – December 31, 2009			Options exercisable – December 31, 2009	
Exercise price range $	**Number of options outstanding**	**Weighted average remaining contractual life (years)**	**Weighted average exercise price $**	**Number of options exercisable**	**Weighted average exercise price $**
0.44–2.40	87,267	3.50	1.34	80,834	1.39
4.60–6.90	2,940	4.33	6.07	2,362	6.29
9.00–13.90	36,889	5.89	11.47	21,587	11.00
16.20–17.50	11,956	4.96	17.22	12,091	17.22
	139,052	4.27	5.49	116,874	4.90

18 Research and development expenses

	2009 $	2008 $
Research and development expenses	1,499,032	430,989
Government grants	(332,790)	(52,917)
Research and development tax credits	(85,604)	(269,207)
	1,080,638	108,865

19 Financial expenses

	2009 $	2008 $
Interest and bank charges	41,463	92,789
Interest on bank loan	55,919	57,875
Interest on long-term debt and subordinated loan	136,480	197,444
	233,862	348,108

20 Income taxes

a) Income tax expense

Income taxes included in the statement of operations are as follows:

	2009 $	2008 $ (Restated-note 3)
Current income tax expense	(57,206)	249,746
Future income tax expense	(122,615)	72,576
	(179,821)	322,322

b) Effective tax rate

The company's effective income tax rate differs from the statutory federal and provincial income tax rate in Canada. This difference arises from the following:

	2009 %	2008 % (Restated-note 3)
Combined statutory rate applied to pre-tax income	30.86	26.17
Difference between Canadian statutory rates and the rate applicable to the foreign subsidiary	(0.36)	0.52
Non-deductible items	(2.09)	7.22
Valuation allowance	(20.77)	-
Impact of reduction in income tax rates on future income taxes	(3.71)	-
Other	(1.33)	(0.83)
Effective income tax rate	2.60	33.08

20 Income taxes (continued)

c) Future income tax assets and liabilities

	2009 $	2008 $ (Restated-note 3)
Future income tax assets		
Property, plant and equipment	142,559	-
Intangible assets	79,925	-
Financing costs	313,759	-
Net operating losses carried-forward	13,233,128	-
Scientific research and development expenses	6,387391	-
Tax credits	6,871,600	-
Other	212,189	-
	27,240,551	-
Future income tax liabilities		
Derivative assets	-	(61,477)
Property, plant and equipment	-	(23,545)
Tax credits	-	(37,593)
	-	(122,615)
	27,240,551	(122,615)
Valuation allowance	(27,240,551)	-
Net future income tax assets (liabilities)	-	(122,615)
Current portion	-	(99,070)
Long-term portion	-	(23,545)
	-	(122,615)

In assessing the realizability of future income tax assets, management considers whether it is more likely than not that some portion or all of the future income tax assets will be realized. The ultimate realization of future income tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. As management believes there is sufficient uncertainty regarding the realization of future income tax assets, a full valuation allowance has been provided.

Most of this valuation allowance relates to the future income tax asset balance of QuestAir at acquisition date. When a future income tax asset acquired in a business combination is not recognized at the date of acquisition, any subsequent recognition of the tax benefit would first reduce any goodwill related to the acquisition to zero, then reduce any unamortized intangible assets related to the acquisition to zero, and finally reduce income tax expense, resulting in an increase in net earnings.

20 Income taxes (continued)

d) Other

The company has non-capital losses carried forward in Canada of approximately $49,900,000 which are available to reduce taxable income in future years, the benefit of which has not been recorded in the accounts, and which expire as follows:

	$
2014	4,900,000
2015	5,900,000
2025	6,900,000
2026	7,200,000
2027	6,800,000
2028	10,500,000
2029	7,700,000
	49,900,000

The company also has non-capital losses carried forward in Singapore of approximately $205,000, which are available to reduce taxable income in future years for an unlimited future period.

The company has scientific research and experimental development expenses of approximately $23,800,000 which are available to be carried forward indefinitely and deducted against future taxable income otherwise calculated.

As at December 31, 2009, the company also has investment tax credits of approximately $8,300,000 available to offset future Canadian federal and provincial income taxes payable. The potential benefit of the investment tax credits has not been recognized in the accounts and expires as follows:

	$
2010	870,000
2011	240,000
2012	510,000
2013	270,000
2014	410,000
2015	360,000
2016	260,000
2017	160,000
2018	100,000
2019	470,000
2020	910,000
2021	240,000
2022	920,000
2023	480,000
2024	740,000
2025	650,000
2026	410,000
2027	240,000
2029	60,000
	8,300,000

21 Supplementary information to statements of cash flows

Cash flows from operating activities include the following amounts:

	2009 **$**	**2008** **$**
Interest paid	239,605	245,031
Income taxes paid	27,351	16,296
	266,956	261,327

22 Commitments and contingencies

a) Leases

As at December 31, 2009, the company is committed under the terms of various operating leases with various expiration dates, primarily for the rent of premises and office equipment. Minimum lease payments due in the next years are as follows:

		$
Fiscal year ending	2010	630,508
	2011	412,182
	2012	133,669
	2013	25,187
		1,201,546

b) TPC Program

The agreements under the TPC Program will be amended to reflect the transaction completed in June 2009 (note 5).

Fast Cycle Pressure Swing Adsorption and Gas Management systems

On June 6, 2003, QuestAir entered into an agreement with the Industry Canada under the TPC Program to receive financial contributions regarding the development and commercial exploitation of its Fast Cycle Pressure Swing Adsorption ("FCPSA") and Gas Management systems ("GMS").

Pursuant to the agreement, total project costs for the period from October 1, 2002 to September 30, 2007 were to be shared, subject to certain contribution limits, such that the Ministry's contribution would not exceed the lesser of 30% of eligible project costs and $9,600,000.

The agreement further provides that the Ministry shall provide QuestAir with financial contributions based on the aforementioned limitations in exchange for:

i. the issuance of 19,230 transferable warrants convertible into common shares at a strike price of $38.80, exercisable for a term of five years (which warrants expired unexercised), and
ii. repayable contributions to the Ministry during the royalty period based on 1.165% (0.471% from October 1, 2009 thereafter) of gross business revenues.

22 Commitments and contingencies (continued)

b) TPC Program (continued)

During the year ended December 31, 2008, QuestAir entered into an Amendment Agreement with Industry Canada to amend the TPC contribution agreement in respect of QuestAir's FCPSA and GMS development programs. The Amendment Agreement:

iii. deleted certain milestones related to the GMS program
iv. extended certain milestones related to the FCPSA program, such that the work phase of the program will end on September 30, 2008
v. reduced the Ministry's contribution limit towards eligible project costs to $8.14 million, being the amount received thus far by QuestAir
vi. reduced the ceiling on the conditional repayments under the agreement to $18.8 million and extended the date by which the royalty period will end by 12 months to September 30, 2022, and
vii. provided for an unconditional, one-time royalty payment of $0.5 million paid in 2008.

Cumulative repayments of $797,967 have been made to December 31, 2009. Any amounts ultimately determined to be repayable are accrued as a liability when the project revenues are known and reasonably estimable and recorded as royalty expense. As at December 31, 2009, $165,557 has been accrued as a liability.

Pulsar Pressure Swing Adsorption project

On March 31, 1999, QuestAir entered into an agreement with the Industry Canada under the TPC Program to receive financial contributions regarding the development and commercial exploitation of its Pulsar Pressure Swing Adsorption project.

Pursuant to the agreement, total project costs for the period from October 1, 1998 to March 31, 2002 were to be shared, subject to annual contribution limits, such that the Ministry's contribution would not exceed the lesser of 35% of eligible project costs and $4,947,330.

QuestAir received contributions aggregating $4,762,503. The agreement further provides that the contributions are repayable solely based on a royalty of 1.8% of gross project revenues and revenues from fuel cell related products to a maximum cumulative repayment of $8.75 million. Cumulative repayments of $56,736 have been made to December 31, 2009. Any amounts ultimately determined to be repayable are accrued as a liability when the project revenues are known and reasonably estimable and recorded as royalty expense. As at December 31, 2009, no amount has been accrued as a liability. The agreement terminates on the later of the date of payment of all amounts due to the Ministry and 2015.

22 Commitments and contingencies (continued)

c) Natural Resources Canada Agreement

In January 2005, QuestAir received a grant of $225,000 from the Government of Canada under the Department of Natural Resources Efficiency and Alternative Energy Program to support the development of structured adsorbent that will possess enhanced properties to assist in high purity hydrogen separation. The agreement provides that such contributions are repayable solely based on 0.12% of gross project revenues through March 31, 2015, to a maximum cumulative repayment of $225,000, whichever occurs first. Cumulative repayments of $5,592 have been made to December 31, 2009. Any amounts ultimately determined to be repayable are accrued as a liability when the project revenues are known and reasonably estimable and recorded as royalty expense.

In January 2004, QuestAir received a grant of $193,944 from the Government of Canada under the Department of Natural Resources Efficiency and Alternative Energy Program to support the development of a device that increases the efficiency of a High Temperature Fuel Cell system and permits the co-production of hydrogen. The agreement provides that such contributions are repayable solely based on 0.12% of gross project revenues through March 31, 2014, to a maximum cumulative repayment of $193,944, whichever occurs first. Any amounts ultimately determined to be repayable are accrued as a liability when the project revenues are known and reasonably estimable and recorded as royalty expense. To date, no such project revenue has been recorded.

23 Contingent liabilities

As at December 31, 2009, the company had an unpaid account receivable of $317,800 for which the company sent a demand letter. In return, the customer filed a counterclaim in the amount of $729,533 if the file was not resolved to the satisfaction of the parties. The company is contesting this counterclaim and, in the opinion of management, this counterclaim is without merit. As of the date of this report, neither the outcome nor the amount of possible settlement can be foreseen. Therefore, no amount has been provided for in these consolidated financial statements with respect to such claim.

24 Related party transactions

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

	2009 **$**	**2008** **$**
Marketing and professional services expenses paid to companies controlled by members of the immediate family of a shareholder	161,020	100,704

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

25 Capital management

The company's objective when managing capital is to utilize short-term funding sources to manage its working capital requirements and fund capital expenditures required to execute its operating and strategic plans. The company has changed its strategy regarding the management of its capital structure since the last financial year by acquiring access to short-term credit facilities to finance its expansion overseas.

The company's capital structure is composed of the following:

	2009 $	2008 $
Cash	(5,447,702)	(550,377)
Bank loan	496,900	1,760,931
Subordinated loan	218,752	250,000
Long-term debt	2,085,149	2,104,273
	(2,646,901)	3,564,827
Shareholders' equity	12,251,816	1,125,141
	9,604,915	4,689,968

During the year, the capital of the company has been significantly affected by the acquisition described in note 5 and the share offering described in note 16 e). The company is not subject to any capital requirements imposed by regulators; however, the company must adhere to certain financial covenants related to the terms of its bank loan and subordinated loan. As at December 31, 2009, the company was in compliance with the required financial covenants.

26 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 geographic area, as determined by the location of the customer, is as follows:

	2009 $	2008 $
Revenue		
North America	7,959,832	8,478,059
South America	3,757,598	-
Middle East	4,541,472	3,833,899
Asia	1,694,200	850,217
Europe	740,686	3,678,447
	18,693,788	16,840,622

26 Segmented information (continued)

Revenue summarized by product line is as follows:

	2009 $	2008 $
Product line		
Natural gas dryers	11,141,555	12,201,939
Compressed gas filtration	3,019,412	3,645,071
Air dryers	1,246,072	993,612
Gas purification	1,831,512	-
Engineering services	1,455,237	-
	18,693,788	16,840,622

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

	2009 $	2008 $
Customers		
Customer A	3,757,598	-
Customer B	3,106,227	1,863,250
Customer C	511,382	3,465,600
	7,375,207	5,328,850

The location of the company’s property, plant and equipment, intangible assets and goodwill by geographic region is as follows:

	2009 $	2008 $ (Restated-note 3)
Property, plant and equipment, intangible assets and goodwill		
Canada	8,357,870	1,420,013
Asia	468,259	550,515
	8,826,129	1,970,528

27 Financial 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 credit approval procedures, establishing credit limits, utilizing credit assessments and monitoring practices to mitigate the likelihood of these exposures from resulting in an actual loss. This year, a provision of $392,042 was taken for allowance for doubtful accounts as determined by management's best estimate, 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 $222,967 in 2009 ($155,999 in 2008). As at December 31, 2009, the company's three largest trade debtors accounted for 33 % (21%, 7% and 5 %) of the total accounts receivable balance, compared to 75% in 2008 (39%, 26% and 10 %) .

Details of accounts receivable were as follows:

	2009 $	2008 $
Current trade receivables	997,964	3,140,066
Trade receivables past due by:		
1-30 days	315,532	712,384
31-60 days	182,429	50,238
61-90 days	164,200	95,632
Over 90 days	1,233,182	13,879
Total trade receivables	2,893,307	4,012,199
Allowances for doubtful accounts	(392,042)	-
Other receivables	604,569	526,643
Total accounts receivable	3,105,834	4,538,842

The company's cash is maintained at major financial institutions; therefore, the company considers the risk of non-performance on these instruments to be remote. To date, the company has not incurred any losses related to these instruments.

Currency risk

The company realizes approximately 64% of its sales and 54% of its purchases in foreign currency. Consequently, some assets and liabilities are exposed to foreign exchange fluctuations. As at December 31, 2009, the following amounts are shown in US dollars, Euros, Renminbis, British pounds and Singapore dollars and converted into Canadian dollars. The company does not use financial instruments to reduce this risk.

Management does not believe that the impact of foreign exchange fluctuations will be significant and, therefore, has not provided a sensitivity analysis of the impact of fluctuations on net loss and comprehensive loss.

27 Financial instruments (continued)

Currency risk (continued)

	2009 US Dollars	2009 Euro	2009 Renminbi	2009 British Pounds	2009 Singapore Dollars
Cash	569,032	436	2,351,045	-	68,624
Accounts receivable	593,566	414,098	6,827,861	-	106,855
Restricted cash	15	128,700	-	-	-
Accounts payable	(66,277)	(506,021)	(10,479,976)	(30,073)	(182,307)
	1,096,336	37,213	(1,301,070)	(30,073)	(6,828)
Total Canadian Dollar	1,152,250	55,819	(199,454)	(50,878)	(5,092)

	2008 US Dollars	2008 Euro	2008 Renminbi
Cash	439,728	4,029	42,371
Accounts receivable	379,597	1,772,950	276,752
Restricted cash	-	128,700	-
Accounts payable	(127,476)	(12,374)	(10,361,398)
	691,849	1,893,305	(10,042,275)
Total Canadian Dollar	842,672	3,227,328	(1,802,588)

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 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 December 31, 2009 is $496,900 ($1,760,931 in 2008) and the long-term debt that is subject to the variability of the interest rate fluctuation is $1,961,266 ($2,047,900 in 2008). The annual interest is the bank prime rate plus 0.60%. If the interest rate on the bank debt had been 50 basis points higher (lower), related to the bank debt outstanding during fiscal 2009, net loss/income would have been $12,300 ($21,800 in 2008) higher (lower).

27 Financial instruments (continued)

Liquidity risk

Liquidity risk is the risk that the company will not be able to meet its financial obligations as they come due.

The following are the contractual maturities of financial liabilities as at December 31, 2009:

	Carrying amount $	Contractual cash flow $	0 to 12 months $	13 to 24 months $	Thereafter $
Financial liabilities					
Accounts payable and accrued liabilities	5,578,505	5,578,505	5,578,505	-	-
Bank loan	496,900	496,900	496,900	-	-
Total long-term debt	2,303,901	2,853,420	484,844	396,700	1,971,876
Derivative financial liabilities	96,645	96,645	96,645	-	-
	8,475,951	9,025,470	6,656,894	396,700	1,971,876

The following are the contractual maturities of financial liabilities as at December 31, 2008:

	Carrying amount $	Contractual cash flow $	0 to 12 months $	13 to 24 months $	Thereafter $
Financial liabilities					
Accounts payable and accrued liabilities	4,320,860	4,320,860	4,320,860	-	-
Bank loan	1,760,931	1,760,931	1,760,931	-	-
Total long-term debt	2,354,273	3,526,634	487,581	447,806	2,591,246
	8,436,064	9,608,425	6,569,372	447,806	2,591,246

Contractual interest amounts that are on floating interest rates are established based on the spot rates as at the respective balance sheet date.

The company's development is financed through a combination of borrowing under the existing credit facilities, the issuance of debt and the issuance of equity.

It is the company's intention to meet its obligations through the collection of accounts receivable and the receipt of future progress payments on amounts not yet invoiced, as well as from current cash (note 1 b)).

27 Financial instruments (continued)

Fair value

Amendments to CICA Handbook Section 3862, “Financial Instruments – Disclosures”, establish a fair value hierarchy which requires the company to maximize the use of observable inputs when measuring fair value. The company primarily applies the market approach for recurring fair value measurements. The Section describes three input levels that may be used to measure fair value:

Level 1 – Unadjusted quoted prices in active markets for identical assets of liabilities. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
Level 2 – Quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Financial instruments whose carrying value approximate fair value

Cash, accounts receivable, bank loan and accounts payable and accrued liabilities are financial instruments whose fair value approximates their carrying value due to their short-term maturity. The input level used by the company to measure the fair value of its cash is Level 1.

Derivative financial instruments

The fair value of derivative financial instruments approximates the amounts for which the financial instruments could be exchanged between willing parties, based on current market data for similar instruments. As estimates must be used to determine fair value, the latter must not be interpreted as being realizable in the event of an immediate settlement of the instruments.

The fair value of the derivative liabilities effective as at December 31, 2009, amounts to $96,645. The input level used by the company to measure the fair value of its derivative liabilities is Level 2.

Other

The fair value of the loan to a joint venture and of the long-term debt, including the subordinated loan, approximates their carrying value due to their variable interest rates or current market rates as regards of instruments with fixed rates.