Xebec Adsorption Inc.

Consolidated Financial Statements
December 31, 2010 and 2009

PRICEWATERHOUSECOOPERS

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March 31, 2011

Independent Auditor's Report

To the Shareholders of
Xebec Adsorption Inc.

We have audited the accompanying consolidated financial statements of Xebec Adsorption Inc. and its subsidiary, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of loss and comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Xebec Adsorption Inc. and its subsidiary as at December 31, 2010 and 2009 and the results of their operations and their cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Emphasis of matter

Without qualifying our opinion, we draw attention to note 1(b) in the consolidated financial statements, which describes matters and conditions that indicate the existence of a material uncertainty that may cast significant doubt about Xebec Adsorption Inc.'s ability to continue as a going concern.

PricewaterhouseCoopers LLP[1]

[1] Chartered accountant auditor permit No. 15492

Xebec Adsorption Inc.

Consolidated Balance Sheets

As at December 31, 2010 and 2009

	2010 $	2009 $
Assets		
Current assets		
Cash	2,262,273	5,447,702
Accounts receivable	2,603,261	3,105,834
Inventories (note 6)	2,720,060	2,867,922
Prepaid expenses	100,846	183,564
Income taxes recoverable	-	62,492
Investment tax credits receivable	103,489	80,843
Restricted cash (note 10)	576,092	223,261
	8,366,021	11,971,618
Loan to a joint venture (note 13)	117,811	113,331
Property, plant and equipment (note 7)	1,939,097	2,604,931
Intangible assets (note 8)	4,022,822	279,046
Goodwill (notes 5 and 9)	1,438,324	5,942,152
	15,884,075	20,911,078
Liabilities		
Current liabilities		
Bank loan (note 11)	500,000	496,900
Accounts payable and accrued liabilities	8,594,752	5,578,505
Deferred revenues	2,331,802	146,228
Income taxes payable	8,286	-
Derivative financial instruments (note 12)	-	96,645
Current portion of long-term debt (note 14)	87,151	321,653
Current portion of subordinated loan (note 16)	156,256	62,496
	11,678,247	6,702,427
Long-term debt (note 14)	1,867,870	1,763,496
Government assistance (note 15)	32,083	37,083
Subordinated loan (note 16)	-	156,256
	13,578,200	8,659,262
Shareholders' Equity		
Share capital (note 17)	19,964,218	18,107,821
Contributed surplus	1,841,741	51,368
Deficit	(19,500,084)	(5,907,373)
	2,305,875	12,251,816
	15,884,075	20,911,078

Going concern (note 1(b))

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

Approved by the Board of Directors

___________________________________ Director ___________________________________ Director

Xebec Adsorption Inc.

Consolidated Statements of Changes in Shareholders' Equity

For the years ended December 31, 2010 and 2009

	Number			Amount				
	Warrants	**Common shares**	**Preferred shares**	**Share capital – Common shares and warrants $**	**Preferred shares $**	**Contributed surplus $**	**Retained earnings (deficit) $**	**Total $**
Balance – January 1, 2009	5,868,108	8,638,496	300,000	100	300,000	-	825,041	1,125,141
Net loss for the year						-	(6,732,414)	(6,732,414)
Conversion of preferred shares	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
Private placement, November 25, 2009 (note 17(e))								
Shares and warrants issued to investors	4,292,700	8,585,400	-	6,439,050	-	-	-	6,439,050
Warrants issued to agent	515,124	-	-	165,000	-	-	-	165,000
Financing costs				(717,752)	-	-	-	(717,752)
Stock-based compensation						24,601	-	24,601
Balance – December 31, 2009	17,167,824	29,262,445	-	18,107,821	-	51,368	(5,907,373)	12,251,816
Net loss for the year						-	(13,592,711)	(13,592,711)
Exercise of warrants	(9,536)	9,536	-	7,343	-	-	-	7,343
Expiration of warrants, May 13, 2010	(12,360,000)	-	-	(1,782,259)	-	1,782,259	-	-
Private placement, November 2, 2010 (note 17(e))								
Shares and warrants issued to investors	9,491,886	9,491,886	-	3,796,754	-	-	-	3,796,754
Shares and warrants issued to agent	1,166,250	600,000	-	309,649	-	-	-	309,649
Financing costs				(475,090)	-	-	-	(475,090)
Stock-based compensation						8,114	-	8,114
Balance – December 31, 2010	15,456,424	39,363,867	-	19,964,218	-	1,841,741	(19,500,084)	2,305,875

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

Xebec Adsorption Inc.

Consolidated Statements of Loss and Comprehensive Loss

For the years ended December 31, 2010 and 2009

	2010 $	2009 $
Revenues	13,475,211	18,693,788
Cost of goods sold (note 6)	13,226,426	14,462,614
Gross margin	248,785	4,231,174
Operating expenses		
Research and development (note 19)	2,550,638	1,080,638
Selling and administrative	10,132,192	8,738,521
Financial (note 20)	443,042	278,542
Foreign exchange loss (gain)	(206,710)	518,319
Amortization	922,334	527,389
	13,841,496	11,143,409
Loss before income taxes	(13,592,711)	(6,912,235)
Recovery of income taxes		
Current	-	(57,206)
Future	-	(122,615)
	-	(179,821)
Net loss and comprehensive loss for the year	(13,592,711)	(6,732,414)
Loss per share		
Basic and diluted (note 17(d))	(0.44)	(0.42)

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

Xebec Adsorption Inc.

Consolidated Statements of Cash Flows

For the years ended December 31, 2010 and 2009

	2010 $	2009 $
Cash flows from		
Operating activities		
Net loss for the year	(13,592,711)	(6,732,414)
Items not affecting cash		
Purchase price allocation adjustment (note 5)	303,066	-
Amortization of property, plant and equipment	640,110	465,261
Amortization of intangible assets	282,224	62,128
Loss on disposal of intangible assets	184,000	-
Loss on disposal of property, plant and equipment	117,036	-
Unrealized foreign exchange loss (gain) on derivative financial instruments	(96,645)	326,551
Unrealized foreign exchange loss on loan to a joint venture and restricted cash	9,994	-
Stock-based compensation expense	8,114	24,601
Future income taxes	-	(122,615)
	(12,144,812)	(5,976,488)
Changes in non-cash working capital components relating to operations		
Accounts receivable	502,573	2,888,309
Inventories	147,862	1,923,637
Prepaid expenses	82,718	210,933
Investment tax credits receivable	(22,646)	177,942
Accounts payable and accrued liabilities	3,007,009	(149,782)
Deferred revenues	2,185,574	(1,988,725)
Income taxes	70,778	(330,686)
	5,973,868	2,731,628
	(6,170,944)	(3,244,860)
Investing activities		
Acquisition of property, plant and equipment	(94,612)	(308,760)
Acquisition of intangible assets	-	(192,855)
Proceeds from disposal of property, plant and equipment	3,300	-
Transaction costs paid on acquisition of a business	-	(1,095,708)
Cash acquired on acquisition of a business	-	5,122,028
Loan to a joint venture	-	(134,208)
Government assistance	(5,000)	(5,000)
Decrease (increase) in restricted cash	(367,305)	163,916
	(463,617)	3,549,413
Financing activities		
Issuance of common shares	3,804,097	6,439,050
Issuance costs of shareholders' equity instruments	(165,441)	(552,752)
Increase (decrease) in bank loan	3,100	(1,264,031)
Loan to joint venture	-	20,877
Long-term debt	181,101	289,402
Repayment of long-term debt	(373,725)	(326,788)
Payment of obligations under capital leases	-	(12,986)
	3,449,132	4,592,772
Increase (decrease) in cash during the year	(3,185,429)	4,897,325
Cash – Beginning of year	5,447,702	550,377
Cash – End of year	2,262,273	5,447,702

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

1 Nature of operations and going concern

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 footprint. The Company was formed upon the amalgamation of Xebec Adsorption Inc. ("Xebec") and QuestAir Technologies Inc. ("QuestAir") on June 12, 2009. The consolidated financial statements reflect the accounts of QuestAir from June 12, 2009 (note 5).

b) Going concern

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assume the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Company has incurred an operating loss of $13,592,711 for the year ended December 31, 2010 and has a deficit of $19,500,084 and a negative working capital of $3,312,226 as at December 31, 2010. The current financial position indicates that there is substantial doubt about the Company's ability to continue as a going concern.

The Company's ability to continue as a going concern is primarily dependent on its ability to generate sufficient future cash flows to fund its operations and to settle its obligations on a timely basis. On November 2, 2010, management concluded a share offering which provided the Company with gross proceeds of $3,796,754 (note 17(f)). On March 17, 2011, the Company signed a licence and engineering service agreement amounting to US$3,250,000, including an upfront payment of US$1,750,000 (note 29). In addition, the Company undertook various initiatives, such as announcing temporary layoffs and adopting a cost reduction plan to manage its operations and liquidity risks in light of prevailing economic conditions. There is no assurance that such efforts will be successful.

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

2 Basis of presentation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). Certain figures in 2009 have been reclassified to conform to the presentation adopted for the year ended December 31, 2010.

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 of net realizable value is made 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 writedown is reversed (i.e., the reversal is limited to the amount of the original writedown) so that the new carrying amount is the lower of 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 on a straight-line basis over the following periods:

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

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 and the amount to be realized upon their disposal. 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 comprise patents, customer relations, software and engineering drawings which are accounted for at cost and amortized over their expected benefit to future periods.

Patent costs are amortized using the straight-line method over 15 years. Customer relations are amortized using the straight-line method over a period of seven years. Engineering drawings, consisting of engineering costs incurred to develop product plans, and software are amortized using the straight-line method over a period of three years.

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 earns revenues mainly from the sale of natural gas dryers and hydrogen purification solutions ("commercial equipment"). The Company recognizes revenue on commercial equipment sales when 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. Delivery is considered to have occurred when the product is shipped to the customer or when the customer approves the satisfactory acceptance test. Provisions are established for estimated product returns and warranty costs at the time revenue is recognized. Cash received in advance of all of these revenue recognition criteria being met is recorded as deferred revenue.

Revenues from long-term production-type contracts such as biogas purification equipment and engineering service contracts are determined under the percentage-of-completion method whereby revenues are recognized based on the costs incurred to date in relation to the total expected costs of a contract (costs being mainly composed of materials). Costs and estimated profit on contracts in progress in excess of amounts billed are reflected as work in progress. Cash received in advance of revenues being recognized on contracts is recorded as deferred revenue.

The Company monitors its contracts with customers on a regular basis to determine if a loss is likely to occur. If a loss is anticipated on a contract, the entire estimated loss is recorded as a cost of sales and a reduction in work in progress in the year 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 using the cost reduction method when there is reasonable assurance of their recovery. Investment tax credits are subject to the customary approvals by the pertinent tax authorities. Adjustments, if required, are reflected in the year when such assessments are received.

Warranty provision

During the normal course of its operations, the Company assumes certain maintenance and repair costs under warranties offered on commercial equipment and biogas purification equipment. The warranties cover a period ranging from 12 to 18 months. A liability for the expected cost of the warranty-related claims is established when the product is delivered and completed. In estimating the warranty liability, historical material replacement costs and the associated labour costs are considered. Revisions are made when actual experience differs materially from historical experience.

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.

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 rates 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 transaction dates.

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 rates of exchange prevailing at the balance sheet date and non-monetary assets and liabilities at rates prevailing at the transaction dates. Revenues and expenses (other than amortization, which is translated at the rate applicable on the date of acquisition of the related assets) are translated at average rates for the year. Gains and losses arising on translation are included in 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 earnings over the award’s vesting period. For options granted to non-employees, the fair value is measured when performance is completed, 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.

Financial instruments

The Company classifies its financial instruments as follows:

Cash	Held for trading
Accounts receivable	Loans and receivables
Restricted cash	Held for trading
Loan to a joint venture	Loans and receivables
Bank loan	Other financial liabilities
Accounts payable and accrued liabilities	Other financial liabilities
Derivative financial instruments	Held for trading
Long-term debt	Other financial liabilities
Subordinated loan	Other financial liabilities

Financial assets and financial 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 loss. Loans and receivables 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 as an item of foreign exchange gain or loss in the consolidated statements of loss and comprehensive loss and changes in shareholders’ equity.

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.

4 Future changes to accounting standards

The Company will cease to prepare its consolidated financial statements in accordance with Canadian GAAP as set out in Part V of the Canadian Institute of Chartered Accountants ("CICA") Handbook – Accounting ("Canadian GAAP") for the year beginning on January 1, 2011 when it will start to apply International Financial Reporting Standards as published by the International Accounting Standards Board as set out in Part I of the CICA Handbook – Accounting as its primary basis of accounting. Consequently, future accounting changes to Canadian GAAP effective for periods beginning on or after January 1, 2011 are not discussed in these consolidated financial statements as they will normally never be applied by the Company.

5 Business combination

Pursuant to the arrangement between Xebec and QuestAir on June 12, 2009, the shareholders of Xebec (the "Vendors") sold all of their 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 received enough common shares of QuestAir to affect a reverse takeover of QuestAir. Accordingly, the consolidated 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 amalgamated and have continued as one corporation under the name of Xebec Adsorption Inc.

At the 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 could 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 were achieved by the amalgamated company following completion of the arrangement (in respect of the 2009 and 2010 fiscal years). As those performance targets were not achieved, these shares issued by QuestAir on completion of the arrangement currently held in escrow will be cancelled.

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.

During the year ended December 31, 2010, the Company finalized the purchase price allocation pertaining to this acquisition. The final allocation noted below, completed by management with the assistance of an independent valuator, resulted in increases in accounts receivable of $466,699, in contract asset of $330,886, in customer relations of $1,900,000, in patents of $2,310,000, and in accounts payable and accrued liabilities of $9,238, and decreases in inventories and deferred revenue of $1,724,201 and $1,229,682 respectively. As a result of these changes, goodwill decreased by $4,503,828 and an adjustment of $303,066 was recorded to cost of goods sold. The excess of the purchase price over the net identifiable assets acquired has been allocated to goodwill on the consolidated balance sheet.

The final purchase price allocation for the business combination is as follows:

	$
Assets acquired	
Cash	5,122,028
Accounts receivable – net	1,922,000
Contract asset	330,886
Inventories	487,481
Prepaid expenses	173,354
Restricted cash	62,600
Property, plant and equipment	939,223
Patents	2,310,000
Customer relations	1,900,000
Goodwill	1,438,324
Total assets	14,685,896
Liabilities assumed	
Accounts payable and accrued liabilities	1,416,665
Deferred revenues	225,333
Total liabilities	1,641,998
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.

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

	2010 $	2009 $
Raw materials	1,755,325	1,970,017
Work in progress	942,767	868,663
Finished goods	21,968	29,242
	2,720,060	2,867,922

Cost of goods sold is composed mainly of cost of inventories of $6,966,850 in 2010 (2009 – $8,573,338), and includes an amount of $638,860 (2009 – $355,012) for the writedown of inventories to the lower of cost and net realizable value. Inventories in the amount of $42,319 (2009 – nil) are recorded at their net realizable value.

7 Property, plant and equipment

			2010
	Cost $	Accumulated amortization $	Net $
Land	173,180	-	173,180
Building	981,353	175,504	805,849
Machinery and equipment	784,495	323,430	461,065
Office furniture and equipment	121,060	54,882	66,178
Computers	336,871	273,515	63,356
Moulds	72,584	28,142	44,442
Vehicles	71,968	7,197	64,771
Leasehold improvements	678,358	435,787	242,571
	3,219,869	1,298,457	1,921,412
Machinery and equipment under capital leases	24,967	7,282	17,685
	3,244,836	1,305,739	1,939,097

			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

8 Intangible assets

			2010
	Cost **$**	**Accumulated amortization** **$**	**Net** **$**
Patents*	2,310,000	77,000	2,233,000
Customer relations*	1,900,000	135,714	1,764,286
Software	222,589	198,620	23,969
Engineering drawings	4,700	3,133	1,567
	4,437,289	414,467	4,022,822

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

* During the year ended December 31, 2010, the Company allocated an amount of $4,210,000 (note 5) from goodwill to intangible assets as a result of the finalization of the purchase price allocation.

9 Goodwill

During the year ended December 31, 2010, the Company finalized the purchase price allocation pertaining to the acquisition of QuestAir. As a result of the final allocation, goodwill decreased by $4,503,828 (note 5).

	2010 $	2009 $
Balance – Beginning of year	5,942,152	-
Goodwill resulting from business acquisition (note 5)	-	5,942,152
Finalization of purchase price allocation (note 5)	(4,503,828)	-
Balance – End of year	1,438,324	5,942,152

Goodwill is not deductible for income tax purposes.

10 Restricted cash

Restricted cash consists of amounts which are restricted for specific purposes under certain contractual obligations. Restricted cash will become unrestricted within the next 12 months.

11 Bank loan

As at December 31, 2010, the Company had access to credit facilities in the amount of $1,300,000 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. In addition, the Company had access to credit facilities in the amount of $500,000 which bore interest at the Company's bank's prime rate plus 2.5% per annum and which were limited by certain requirements concerning pre-shipment costs. The bank loan was secured by a first ranking hypothec of $4,000,000 on all movable property of the Company and was renewable annually upon certain conditions. As at December 31, 2010, the unused amount was approximately $1,050,000 for the first credit facility and $500,000 for the second facility. As well, the Company had access to a revolving demand facility by way of letters of credit and letters of guarantee amounting to $750,000. As at December 31, 2010, the unused portion of this demand facility was approximately $596,000.

The credit facilities with Royal Bank of Canada and Export Development Canada matured on October 31, 2010 and have been extended under the same terms and conditions until March 18, 2011 and March 31, 2011 respectively. Management is currently negotiating an amended agreement with Royal Bank of Canada and received confirmation, on March 29, 2011, from Export Development Canada that the agreement related to the pre-shipment costs has been extended under the same terms and conditions until June 15, 2011.

12 Derivative financial instruments

In 2009, the Company entered into a sales contract with a foreign counterparty which contract was denominated in a currency other than the Canadian dollar and the functional currency of the foreign counterparty. As at December 31, 2010, there are no such embedded derivative financial instruments (2009 – liability of $96,645). The change in fair value of $96,645 from the prior year was included in foreign exchange loss (gain) in the consolidated statements of loss and comprehensive loss.

13 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:

	2010 $	**2009** $
Current assets	176,138	173,274
Total assets	195,188	201,144
Current liabilities	152,845	42,039
Total liabilities	174,548	62,916
Revenues	437,904	177,187
Expenses	558,113	378,866
Net loss	(120,209)	(201,679)
Cash flows from:		
Operating activities	(21,828)	(269,114)
Financing activities	-	20,877
Investing activities	-	(34,494)

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

14 Long-term debt

	2010 $	2009 $
Term loan, matures June 2024, 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. An agreement was concluded giving a one-year moratorium on the repayment of principal starting November 2010; thereafter the term loan is repayable in monthly instalments of $8,900 plus interest	1,343,900	1,441,800
Revolving 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 property, repayable in monthly instalments of $8,704 plus interest	26,113	130,566
Term loan, matures June 2014, 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. An agreement was concluded giving a one-year moratorium on the repayment of principal starting November 2010; thereafter the term loan is repayable in monthly instalments of $6,700 plus interest	207,700	281,400
Term loan, matures July 2014, 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. An agreement was concluded giving a one-year moratorium on the repayment of principal starting December 2010; thereafter the term loan is repayable in monthly instalments of $2,500 plus interest	80,000	107,500
Loan from Canada Economic Development for a maximum of $137,500, matures December 2015, bears no interest and is repayable in monthly instalments of $2,578 with the first instalment due 24 months after the project completion date	123,750	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 $12,500 starting July 2011	100,000	68,394
Term finance contracts, mature May 2015 and June 2015, bear annual interest of 5.99% and are secured by a lien on a vehicle. Each is repayable in monthly instalments of $785 including capital and interest	73,558	-
	1,955,021	2,085,149
Less: Current portion	87,151	321,653
	1,867,870	1,763,496

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

		$
Fiscal year ending	2011	87,151
	2012	288,889
	2013	289,859
	2014	231,489
	2015	158,733
	2016 to 2024	898,900
		1,955,021

15 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 revenues during the year.

16 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 14. 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, 2010, the Company is not in compliance with these covenants, so the remaining long-term portion of the loan was classified with the current portion.

17 Share capital

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

b) Share purchase warrants

Information that summarizes the activity related to the Company's share purchase warrants for the year ended December 31, 2010:

	Number of warrants	Weighted average exercise price $
Balance – Beginning of year	17,167,824	1.83
Granted	10,658,136	0.45
Exercised	(9,536)	0.77
Expired	(12,360,000)	2.13
Balance – End of year	15,456,424	0.64

The following table summarizes the share purchase warrants outstanding as at December 31, 2010, all of which are exercisable:

	Warrants outstanding		
Exercise price $	Number of warrants outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price $
1.10	4,292,700	0.11	1.10
0.77	505,588	0.01	0.77
0.45	10,091,886	3.16	0.45
0.40	566,250	0.05	0.40
	15,456,424	2.10	0.64

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, 2010. These shares were to be released to former Xebec shareholders on the achievement of specified financial targets. These targets are measured as at December 31, 2010 and 2009. Consequently, these shares are considered restricted share awards that are issued but not outstanding. As those performance targets have not been achieved, no expense was recorded and these shares will be cancelled.

d) Loss per share is calculated using the weighted average number of common shares outstanding of 30,803,752 for the year ended December 31, 2010 (2009 – 16,147,705). Outstanding share options and warrants to purchase common shares were not included in the computation of diluted loss per share as their impact is anti-dilutive.

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 per share for any 20 consecutive trading days, in which event the Company may give the holder 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.

f) On November 2, 2010, the Company concluded a share offering for 9,491,886 units ("Units") at a price of $0.40 per Unit, for gross proceeds of $3,796,754. Each Unit consists of one common share and one common share purchase warrant ("Warrant"). The net proceeds from the issuance after underwriting fees and offering expenses amounted to $3,631,313. The Warrants entitle the holder to acquire one common share at a price of $0.45 until November 1, 2015, subject to adjustment under the indenture governing the Warrants. The 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 per share for any 20 consecutive trading days, in which event the Company may give the holder written notice that the Warrants will expire at the close of business day on the thirtieth day from the receipt of such notice. The estimated fair value of the Warrants issued is $413,767. The assumptions used are as follows: exercise prices as noted above, risk-free interest rate of 2.04%, expected volatility of 70% and expected life of 5 years. The agents received a commission relating to the offering in the form of an aggregate of 600,000 Units and, as additional consideration, were granted non-transferable warrants to purchase 566,250 common shares at an exercise price of $0.40 per share, subject to adjustment, until May 2, 2012. Using the Black-Scholes option pricing model, the estimated fair value of the warrants issued is $69,649. The assumptions used are as follows: exercise price as noted above, risk-free interest rate of 1.41%, expected volatility of 82% and expected life of 18 months. This amount is included in share issue expenses.

18 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, 2010, the maximum number of common shares available for issuance under all stock-based compensation arrangements is 3,798,967.

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 for the years ended December 31 is presented below:

	2010		2009	
	Number of options	Weighted average exercise price $	Number of options	Weighted average exercise price $
Outstanding – Beginning of year	139,052	5.49	-	-
Assumed upon closing of reverse takeover	-	-	199,347	5.79
Expired	(31,691)	3.78	(60,295)	6.48
Outstanding – End of year	107,361	5.99	139,052	5.49
Exercisable – End of year	88,738	5.20	116,874	4.90

Compensation expenses with respect to these options amounted to $8,114 for the year ended December 31, 2010 (2009 – $24,601).

As at December 31, 2010, options outstanding in the Plan and options exercisable are as follows:

	Options outstanding			Options exercisable	
Exercise price range $	Number of options	Weighted average remaining contractual life (years)	Weighted average exercise price $	Number of options	Weighted average exercise price $
0.44–2.40	63,600	2.24	1.31	60,102	1.36
4.60–6.90	1,381	1.42	6.15	1,294	6.25
9.00–13.90	31,632	4.34	11.58	16,598	11.21
16.20–17.50	10,748	3.59	17.25	10,744	17.25
	107,361	2.98	5.99	88,738	5.20

19 Research and development expenses

	2010 $	2009 $
Research and development expenses	2,668,094	1,499,032
Government grants	(54,984)	(332,790)
Research and development tax credits	(62,472)	(85,604)
	2,550,638	1,080,638

20 Financial expenses

	2010 $	2009 $
Interest and bank charges	58,095	33,612
Interest on bank loan	25,614	29,049
Interest on long-term debt and subordinated loan	111,300	135,911
Interest charges	82,893	35,290
Other financial charges – TPC (note 23(b))	165,140	44,680
	443,042	278,542

21 Income taxes

a) Income tax expense

Income taxes included in the consolidated statements of loss and comprehensive loss are as follows:

	2010 $	2009 $
Current income tax expense	-	(57,206)
Future income tax expense	-	(122,615)
	-	(179,821)

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:

	2010 %	2009 %
Combined statutory rate applied to pre-tax income	29.30	30.86
Difference between Canadian statutory rates and the rate applicable to the foreign subsidiary	-	(0.36)
Non-deductible items	(0.28)	(2.09)
Valuation allowance	(33.93)	(20.77)
Impact of reduction in income tax rates on future income taxes	5.99	(3.71)
Other	(1.08)	(1.33)
Effective income tax rate	-	2.60

c) Future income tax assets and liabilities

	2010 $	2009 $
Future income tax assets		
Property, plant and equipment	387,035	142,559
Net operating losses carried forward	15,848,649	13,233,128
Financing costs	74,862	313,759
Intangible assets	165,291	79,925
Scientific research and development expenses	6,153,407	6,387,391
Tax credits	6,035,647	6,871,600
Other	638,302	212,189
	29,303,193	27,240,551
Future income tax liabilities		
Valuation allowance	(29,303,193)	(27,240,551)
Net future income tax assets (liabilities)	-	-

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 the 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.

d) Other

The Company has non-capital losses carried forward in Canada of approximately $60,200,000 (2009 – $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	10,800,000
2029	7,200,000
2030	10,500,000
	60,200,000

The Company also has non-capital losses carried forward in Singapore of approximately $243,000 which are available to reduce taxable income in future years.

The Company has scientific research and experimental development expenses of approximately $23,392,000 which are available to be carried forward indefinitely and deducted against future taxable income otherwise calculated.

As at December 31, 2010, the Company also has investment tax credits of approximately $7,430,000 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:

	$
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
	7,430,000

22 Supplementary information to consolidated statements of cash flows

Cash flows from operating activities include the following amounts:

	2010 **$**	**2009** **$**
Interest paid	295,681	239,605
Income taxes paid (recovered)	(66,624)	27,351
	229,057	266,956

23 Commitments and contingencies

a) Leases

As at December 31, 2010, 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	2011	584,304
	2012	418,239
	2013	281,874
	2014	168,282
	2015	171,504
		1,624,203

b) Technologies Partnership Canada (“TPC”) Program

Fast Cycle Pressure Swing Adsorption and Gas Management systems

Upon the reverse takeover of QuestAir, the Company assumed the June 6, 2003 agreement with 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”). The agreement had been amended in 2008.

Pursuant to the agreement, total project costs for the period from October 1, 2002 to September 30, 2008 were to be shared, subject to certain contribution limits, such that the Department’s contribution would not exceed the lesser of 30% of eligible project costs and $8,139,937.

The agreement further provides that the Department shall provide the Company 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 Department during the royalty period which ends on September 20, 2022, based on 1.165% (0.471% from October 1, 2009 thereafter) of gross business revenues.

Cumulative repayments of $963,802 have been made to December 31, 2010 (2009 – $797,967). Any amounts ultimately determined to be repayable are accrued as a liability when the project revenues are known and reasonably estimable, and are recorded as royalty expense. As at December 31, 2010, $63,493 (2009 – $165,557) has been accrued as a liability.

Pulsar Pressure Swing Adsorption project

The Company assumed the March 31, 1999 agreement with Industry Canada under the TPC Program to receive financial contributions regarding the development and commercial exploitation of QuestAir's 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 Department's contribution would not exceed the lesser of 35% of eligible project costs and $4,947,330.

QuestAir had 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 $8,750,000. Cumulative repayments of $56,736 have been made to December 31, 2010 (2009 – $56,736). Any amounts ultimately determined to be repayable are accrued as a liability when the project revenues are known and reasonably estimable, and are recorded as royalty expense. As at December 31, 2010, $101,370 (2009 – nil) has been accrued as a liability. The agreement terminates on the later of the date of payment of all amounts due to the Department and 2015.

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, 2010 (2009 – $5,592). Any amounts ultimately determined to be repayable are accrued as a liability when the project revenues are known and reasonably estimable, and are 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 are recorded as royalty expense. To date, no such project revenue has been recorded.

24 Contingent liabilities

The Company is party to various ongoing and pending litigation along with other contingencies arising out of the normal course of business. Management believes that these claims, when resolved, will not have any material adverse effect on the consolidated financial position or results of operations of the Company.

25 Related party transactions

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

	2010 $	2009 $
Marketing and professional services expenses paid to companies controlled by members of the immediate family of a shareholder	85,085	161,020
Sales to joint venture	81,307	-
	166,392	161,020

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

26 Capital management

The Company's objective when managing capital is to use short-term funding sources to manage its working capital requirements and fund capital expenditures required to execute its operating and strategic plans. During the year ended December 31, 2010, the Company changed its strategy regarding the management of its capital structure from that of the previous 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:

	2010 $	2009 $
Cash	(2,262,273)	(5,447,702)
Bank loan	500,000	496,900
Long-term debt	1,955,021	2,085,149
Subordinated loan	156,256	218,752
	349,004	(2,646,901)
Shareholders' equity	2,305,875	12,251,816
	2,654,879	9,604,915

In 2010 and 2009, the Company's capital was significantly affected by the acquisition described in note 5 and the share offerings described in note 17(e) and (f). The Company is not subject to any capital requirements imposed by regulators; however, it must comply with certain financial covenants related to the terms of its subordinated loan. As at December 31, 2010, the Company was in compliance with the required financial covenants, except for the subordinated loan.

27 Segmented information

The Company has only one segment and specializes in the design and manufacture of filtration, purification, separation and dehydration equipment for gases and compressed air. The Company has four product lines and provides related engineering services.

Revenue summarized by country, as determined by location of the customers, is as follows:

	2010 $	2009 $
Revenue		
United States	5,497,131	4,114,862
Canada	1,963,303	3,226,324
South Korea	1,522,076	-
Austria	1,520,141	250,096
China	1,346,693	1,550,101
Middle East	199,075	4,541,472
Argentina	1,546	3,757,598
Other	1,425,246	1,253,335
	13,475,211	18,693,788

Revenue summarized by product line is as follows:

	2010 $	2009 $
Product line		
Natural gas dryers	5,529,018	11,141,555
Compressed gas filtration	3,115,935	3,019,412
Air dryers	358,151	1,246,072
Gas purification	4,366,857	1,831,512
Engineering services	105,250	1,455,237
	13,475,211	18,693,788

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

	2010 $	2009 $
Customers		
Customer A	1,863,821	5,681
Customer B	1,326,037	-
Customer C	1,127,630	-
Customer D	1,101,921	3,757,598
Customer E	4,447	3,106,227
	5,423,856	6,869,506

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

	2010 $	2009 $
Canada	7,170,006	8,357,870
Asia	230,237	468,259
	7,400,243	8,826,129

28 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 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 $341,286 (2009 – $392,042) 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 $8,501 in 2010 (2009 – $222,967). As at December 31, 2010, the Company's three largest trade debtors accounted for 24% (9%, 9% and 6%) of the total accounts receivable balance (2009 – 33% (21%, 7% and 5 %)).

Details of accounts receivable were as follows:

	2010 **$**	**2009** **$**
Current trade receivables	869,264	997,964
Trade receivables past due by:		
1 to 30 days	465,490	315,532
31 to 60 days	92,808	182,429
61 to 90 days	127,748	164,200
Over 90 days	1,175,317	1,233,182
Total trade receivables	2,730,627	2,893,307
Allowances for doubtful accounts	(341,286)	(392,042)
Other receivables	213,920	604,569
Total accounts receivable	2,603,261	3,105,834

The Company's cash is maintained at major financial institutions; therefore, it 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 78% of its sales and 44% of its purchases in foreign currencies. Consequently, certain financial assets and financial liabilities are exposed to foreign exchange fluctuations. As at December 31, 2010, the following amounts are shown in US dollars, euros, renminbis, British pounds sterling and Singapore dollars and converted into Canadian dollars. The Company does not use financial instruments to reduce this risk.

Taking into account the amounts denominated in the currencies indicated above and assuming that all of the other variables remain unchanged, a fluctuation in exchange rates would have an impact on the Company's net loss. Management believes that a 10% change in exchange rates would be reasonably possible and that the impact on net loss of a 10% change in exchange rates would be approximately $87,300.

					2010
	US dollar	**Euro**	**Renminbi**	**British pound sterling**	**Singapore dollar**
Cash	722,636	519	302,958	698	40,322
Accounts receivable	919,988	229,979	4,774,263	2,000	88,313
Restricted cash	-	134,088	-	-	-
Accounts payable and accrued liabilities	(1,715,224)	(199,529)	(9,116,906)	(34,814)	(44,182)
	(72,600)	165,057	(4,039,685)	(32,116)	84,453
Equivalent in Canadian dollars	(72,207)	219,839	(609,588)	(49,822)	65,460

					2009
	US dollar	**Euro**	**Renminbi**	**British pound sterling**	**Singapore dollar**
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 and accrued liabilities	(66,277)	(506,021)	(10,479,976)	(30,073)	(182,307)
	1,096,336	37,213	(1,301,070)	(30,073)	(6,828)
Equivalent in Canadian dollars	1,152,250	55,819	(199,454)	(50,878)	(5,092)

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 loan and long-term debt, for which the interest rates charged fluctuate based on the bank’s prime rate. As at December 31, 2010, the bank loan amounts to $500,000 (2009 – $496,900). Long-term debt that is subject to the variability of interest rate fluctuations amounts to $1,657,713 (2009 – $1,961,266). Annual interest is mainly at the bank’s prime rate plus 2.5%. If the interest rate on the bank debt had been 50 basis points higher (lower) related to the bank loan and long-term debt outstanding as at December 31, 2010, net loss would have been $10,800 (2009 – $12,300) higher (lower).

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:

					2010
	Carrying amount $	**Contractual cash flow $**	**0 to 12 months $**	**13 to 24 months $**	**Thereafter $**
Bank loan	500,000	500,000	500,000	-	-
Accounts payable and accrued liabilities	8,594,752	8,594,752	8,594,752	-	-
Long-term debt and subordinated loan	2,111,277	2,788,631	251,443	441,877	2,095,311
	11,206,029	11,883,383	9,346,195	441,877	2,095,311

					2009
	Carrying amount $	**Contractual cash flow $**	**0 to 12 months $**	**13 to 24 months $**	**Thereafter $**
Bank loan	496,900	496,900	496,900	-	-
Accounts payable and accrued liabilities	5,578,505	5,578,505	5,578,505	-	-
Long-term debt and subordinated loan	2,303,901	2,853,420	484,844	396,700	1,971,876
Derivative financial instruments	96,645	96,645	96,645	-	-
	8,475,951	9,025,470	6,656,894	396,700	1,971,876

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 its operations and 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. The Company also intends to monetize some of its intellectual properties through strategic partnerships and thereby creating additional liquidity (note 1(b)).

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 or 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.

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 maturities. The Company uses the Level 1 input to measure the fair value of its cash.

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 financial instruments effective December 31, 2010 is nil (2009 – $96,645). The Company uses the Level 2 input to measure the fair value of its derivative financial instruments.

Other

The fair values of loan to a joint venture, long-term debt and subordinated loan approximate their carrying values due to their variable interest rates or current market rates in respect of instruments with fixed rates.

29 Subsequent events

On March 17, 2011, the Company signed a licence and engineering service agreement with Nuvera Fuel Cells for a total value of US$3,250,000. Under the terms of the agreement, the Company will receive an upfront payment of US$1,750,000 and the remainder over the course of the development period.

On January 24, 2011, the Company announced it has signed an engineering services contract with ExxonMobil Research and Engineering Company (“EMRE”) valued at US$2,000,000. The engineering services are to be provided under an extension to an existing joint development agreement between the Company and EMRE.

On January 19, 2011, the Company announced that it has signed a contract valued at 6.0 million renminbis to provide a complete upgrading plant with Heilongjiang Loonggas Investment Co., Ltd. in China.