Xebec Adsorption Inc.

Consolidated Financial Statements
December 31, 2015 and 2014
(expressed in Canadian dollars)

Deloitte.

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Xebec Adsorption Inc.

We have audited the accompanying consolidated financial statements of Xebec Adsorption Inc., which comprise the consolidated statements of financial position as at December 31, 2015 and December 31, 2014, and the consolidated statements of loss, consolidated statements of comprehensive loss, consolidated statements of changes in equity and consolidated statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

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 International Financial Reporting Standards, 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 audit 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.
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. as at December 31, 2015 and December 31, 2014, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates that the Company is faced with uncertainties that may have an impact on future operating results and liquidity. The Company's ability to continue as a going concern is dependent on achieving and maintaining profitable operations. These conditions, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

Other Matter

The consolidated financial statements of Xebec Adsorption Inc. for the year ended December 31, 2014 were audited by another auditor who expressed an unqualified opinion on those consolidated financial statements on April 29, 2015.

April 28, 2016

Montréal, Canada

Deloitte LLP

(1) CPA auditor, CA, public accountancy permit no. A124341

Xebec Adsorption Inc.

Consolidated Statements of Financial Position

As at December 31, 2015 and 2014

(expressed in Canadian dollars)

	2015 $	2014 $
Assets		
Current assets		
Cash	2,717,965	1,008,421
Restricted cash (note 5)	-	221,930
Trade and other receivables (note 6)	2,437,159	2,681,311
Inventories (note 7)	1,141,840	1,669,350
Investment tax credits receivable	117,676	50,000
Other current assets	158,856	396,241
Total current assets	6,573,496	6,027,253
Non-current assets		
Property, plant and equipment (note 8)	322,395	347,845
Intangible assets (note 9)	240,783	919,297
Goodwill (note 9)	-	142,616
Total non-current assets	563,178	1,409,758
Total assets	7,136,674	7,437,011
Liabilities		
Current liabilities		
Bank loan (note 10)	375,000	136,437
Trade and other payables (note 11)	3,105,172	3,491,897
Accrued liabilities	793,556	723,890
Deferred revenue (note 12)	680,003	815,010
Current portion of long-term debt (note 13a))	-	50,475
Current portion of government royalty program obligation (notes 13c))	243,207	762,825
Current portion of provisions (note 14)	698,561	236,365
Total current liabilities	5,895,499	6,216,899
Non-current liabilities		
Government royalty program obligation (note 13c))	480,834	-
Obligation arising from shares issued by a subsidiary (note 15)	3,583,808	-
Government grants	7,083	12,083
Deferred rent	112,132	85,748
Provisions (note 14)	20,013	192,990
Total non-current liabilities	4,203,870	290,821
Total liabilities	10,099,369	6,507,720
Equity		
Equity attributable to shareholders of the Company		
Share capital (note 16)	19,318,856	19,732,623
Contributed surplus	2,925,379	2,460,146
Accumulated other comprehensive loss	(1,105,821)	(606,685)
Deficit	(24,101,109)	(20,914,588)
	(2,962,695)	671,496
Non-controlling interest	-	257,795
Total equity	(2,962,695)	929,291
Total liabilities and equity	7,136,674	7,437,011

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

Approved by the Board of Directors

(signed) Kurt Sorschak Director

(signed) William Beckett Director

Xebec Adsorption Inc.

Consolidated Statements of Loss
For the years ended December 31, 2015 and 2014
(expressed in Canadian dollars)

	2015 $	2014 $
Revenue	11,350,626	14,368,409
Cost of goods sold	8,545,625	9,490,081
Gross margin	2,805,001	4,878,328
Research and development expenses (note 19)	365,365	224,541
Selling and administrative expenses	5,222,610	5,549,345
Foreign exchange gain	(549,039)	(216,804)
Loss on conversion of shares issued by a subsidiary (note 15)	67,867	-
	5,106,803	5,557,082
Operating loss	(2,301,802)	(678,754)
Other income (charge)		
Finance income	20,006	23,562
Finance expenses (note 20)	(207,974)	(163,985)
Impairment charge of intangible assets and goodwill (note 9)	(696,783)	-
	(884,751)	(140,423)
Net loss for the year	(3,186,553)	(819,177)
Loss attributable to:		
Shareholders of the Company	(3,186,521)	(782,614)
Non-controlling interest	(32)	(36,563)
	(3,186,553)	(819,177)
Loss per share		
Basic (note 16)	(0.08)	(0.02)
Diluted (note 16)	(0.08)	(0.02)

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

Xebec Adsorption Inc.

Consolidated Statements of Comprehensive Loss

For the years ended December 31, 2015 and 2014

(expressed in Canadian dollars)

	2015 $	2014 $
Net loss for the year	(3,186,553)	(819,177)
Other comprehensive loss		
Cumulative translation adjustment	(499,136)	(282,603)
Comprehensive loss for the year	(3,685,689)	(1,101,780)
Attributable to:		
Shareholders of the Company	(3,685,657)	(1,075,813)
Non-controlling interest	(32)	(25,967)
	(3,685,689)	(1,101,780)

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

Xebec Adsorption Inc.

Consolidated Statements of Changes in Equity
For the years ended December 31, 2015 and 2014
(expressed in Canadian dollars)

	Number		Amount						
	Common shares	Warrants	Share capital – Common shares and warrants $	Contributed surplus $	Accumulated other comprehensive loss $	Deficit $	Equity attributable to the shareholders of the Company $	Non-controlling interest $	Total $
Balance – January 1, 2014	39,363,867	10,091,886	19,732,623	2,388,063	(313,486)	(20,131,974)	1,675,226	238,762	1,958,988
Net loss for the year	-	-	-	-	-	(782,614)	(782,614)	(36,563)	(819,177)
Other comprehensive loss	-	-	-	-	(293,199)	-	(293,199)	10,596	(282,603)
Comprehensive loss for the year	-	-	-	-	(293,199)	(782,614)	(1,075,813)	(25,967)	(1,101,780)
Stock-based compensation expense (note 17)	-	-	-	72,083	-	-	72,083	-	72,083
Balance – December 31, 2014	39,363,867	10,091,886	19,732,623	2,460,146	(606,685)	(20,914,588)	671,496	257,795	929,291
Balance – January 1, 2015	39,363,867	10,091,886	19,732,623	2,460,146	(606,685)	(20,914,588)	671,496	257,795	929,291
Net loss for the year	-	-	-	-	-	(3,186,521)	(3,186,521)	(32)	(3,186,553)
Other comprehensive loss	-	-	-	-	(499,136)	-	(499,136)	-	(499,136)
Comprehensive loss for the year	-	-	-	-	(499,136)	(3,186,521)	(3,685,657)	(32)	(3,685,689)
Expired warrants, November 2, 2015 (note 16)	-	(10,091,886)	(413,767)	413,767	-	-	-	-	-
Dissolution of a subsidiary	-	-	-	-	-	-	-	(257,763)	(257,763)
Stock-based compensation expense (note 17)	-	-	-	51,466	-	-	51,466	-	51,466
Balance – December 31, 2015	39,363,867	-	19,318,856	2,925,379	(1,105,821)	(24,101,109)	(2,962,695)	-	(2,962,695)

Accumulated other comprehensive loss relates solely to cumulative translation adjustments.

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, 2015 and 2014
(expressed in Canadian dollars)

	2015 $	2014 $
Cash flows from		
Operating activities		
Net loss for the year	(3,186,553)	(819,177)
Items not affecting cash		
Depreciation of property, plant and equipment (note 8)	107,275	96,231
Amortization of intangible assets (note 9)	152,618	199,295
Reversal of inventory writedown (note 7)	(47,934)	-
Impairment of intangible assets and goodwill	696,783	-
Gain on debt forgiveness	(190,092)	(187,481)
Government grant	(5,000)	(5,000)
Accretion and revaluation of government royalty program obligation	20,676	34,364
Accretion of the obligation arising from shares issued by a subsidiary (note 15)	92,866	-
Stock-based compensation expense	51,466	72,083
Deferred rent	26,384	26,384
	(2,281,511)	(583,301)
Change in non-cash working capital balances related to operations (note 23)	1,016,550	(377,668)
	(1,264,961)	(960,969)
Investing activities		
Decrease (increase) in restricted cash	-	(69,206)
Acquisition of property, plant and equipment	(72,261)	(129,413)
Acquisition of intangible assets	(26,564)	(308,767)
Balance of sale	-	500,000
	(98,825)	(7,386)
Financing activities		
Decrease (increase) in restricted cash	214,592	(145,386)
Increase (decrease) of bank loan	238,563	(233,563)
Obligation arising from shares issued by a subsidiary	3,423,075	-
Repayment of long-term debt	(50,475)	(67,177)
Repayment of government royalty program obligation	(59,460)	(118,000)
	3,766,295	(564,126)
Net increase (decrease) in cash during the year	2,402,509	(1,532,481)
Cash – Beginning of year	1,008,421	2,835,051
Effect of exchange rate changes on cash	(692,965)	(294,149)
Cash – End of year	2,717,965	1,008,421
Additional information		
Interest paid	88,702	129,620

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

1 Nature of business and liquidity risk

a) Nature of business

Xebec Adsorption Inc. ("Xebec" or the "Company") is a global provider which specializes in the design and manufacture of cost-effective and environmentally responsible purification, separation, dehydration and filtration equipment for gases and compressed air. Xebec's main product lines are: biogas plants for the purification of biogas from agricultural digesters, landfill sites and waste water treatment plants, natural gas dryers for natural gas refuelling stations, associated gas purification systems which enable diesel displacement on drilling sites, and hydrogen purification systems for fuel cell and industrial applications. The Company is incorporated and domiciled in Canada and is listed on the TSX Venture (TSXV) Exchange under the symbol XBC-V. The address of its registered office is 730 Industriel Boulevard, Blainville, Quebec, Canada.

b) Liquidity risk

The Company has realized an operating loss of $2,301,802, had cash outflows from operating activities of $1,264,961 for the year ended December 31, 2015 and finished the year with cash amounting to $2,717,965, working capital of $677,997 and had access to credit facilities totalling $500,000 of which $375,000 has been used (see note 10). During the year, management undertook various initiatives and developed a plan to manage its operating and liquidity risks in light of prevailing economic conditions. Management is also currently seeking alternative financings for its operations. The Company has prepared a budget for 2016 for which management believes the assumptions are reasonable. Achieving budgeted results is dependent on improving the volume of revenues in Canada, United States and China, delivering on sales and contract schedules, meeting expected overall operating margin levels and controlling general and administrative costs.

The Company is thus faced with uncertainties that may have an impact on future operating results and liquidity. These uncertainties include 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 including accessing liquidities from China if events or conditions develop that are not consistent with management's expectations, key budget assumptions for 2016 and planned courses of action. Therefore, the Company may require additional external funding, and there is no assurance that it would be successful. Future changes in capital markets conditions could result in such funding not being available when required or at acceptable costs. 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 compliance and basis of preparation

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards (IFRS).

These consolidated financial statements were approved for issue by the Board of Directors of the Company on April 28, 2016.

The consolidated financial statements have been prepared on the historical cost basis except for certain properties and financial instruments that are measured at revalued amounts or fair values at the end of each reporting period, as explained in the accounting policies below.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Group takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis, except for share-based payment transactions that are within the scope of IFRS 2, leasing transactions that are within the scope of IAS 17, and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 or value in use in IAS 36.

These consolidated financial statements are based on the accounting policies as described below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

3 Significant accounting policies

Basis of measurement

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

Basis of consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries. Subsidiaries are entities controlled by the Company. Control is achieved when the Company:

- has power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Company has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Company considers all relevant facts and circumstances in assessing whether or not the Company's voting rights in an investee are sufficient to give it power, including:

- the size of the Company's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Company, other vote holders or other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Company has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

Intercompany transactions, balances and unrealized gains and losses on transactions between different entities within the Company are eliminated. Subsidiaries comprise Xebec Adsorption (Shanghai) Co. Ltd., which is 70% owned, Xebec Adsorption USA Inc. (Houston) which is wholly owned. Subsidiaries are fully consolidated from the date on which control is obtained by the Company and are deconsolidated from the date that control ceases. The Company has the obligation to repurchase the Minority Shareholders' interest owned in Xebec Adsorption (Shanghai) Co. Ltd. under certain circumstances (see note 15). Therefore, the accounts of Xebec Adsorption (Shanghai) Co. Ltd. are consolidated at 100% and the Minority Shareholders' interest is presented as a financial liability in these consolidated financial statements.

Non-controlling interest represented equity interest in a subsidiary owned by an outside party until the dissolution on September 28, 2015. The share of net assets of subsidiaries attributable to non-controlling interest was presented as a component of equity. Its share of net loss and comprehensive loss was recognized directly in equity.

Changes in the Company's ownership interests in subsidiary that do not result in the Company losing control over the subsidiaries are accounted for as equity transactions or liability transactions depending on the conditions that these changes occurred. The carrying amounts of the Company's interests and non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiaries.

Trade receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets. Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment.

Inventories

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

A new assessment is made in each subsequent year when inventories are adjusted to net realizable value. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realizable value because of changed economic circumstances, the amount of the 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 stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the consolidated statement of loss during the year in which they are incurred.

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

Machinery and equipment	3 to 10 years
Office furniture and equipment	2 to 5 years
Computers	3 years
Moulds	5 years
Vehicles	5 years

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

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

Identifiable intangible assets

The Company's intangible assets consist of customer relations and software. It also comprises capitalized development costs when the criteria mentioned in the research and development expenses accounting policy are met. These assets are capitalized and amortized on a straight-line basis in the consolidated statement of loss over the period of their expected useful lives.

Customer relations were amortized over six years. Development costs related to a new line or segment are amortized over a period of five years.

Impairment of non-financial assets

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

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

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Company's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill is tested annually for impairment, or more frequently when there is an indication that the unit may be impaired, and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to each of the Company's cash-generating units (CGUs) for the purpose of impairment testing. The allocation is made to those CGUs that are expected to benefit from the synergies of the business combination in which the goodwill arose, identified according to operating segment.

Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

Provisions

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

During the normal course of its operations, the Company assumes certain maintenance and repair costs under warranties offered on natural gas equipment, biogas, associated gas and hydrogen 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.

Financial instruments

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

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

Cash	Loans and receivables
Trade and other receivables	Loans and receivables
Bank loan	Other financial liabilities
Trade and other payables	Other financial liabilities
Accrued liabilities	Other financial liabilities
Long-term debt	Other financial liabilities
Government royalty program obligation	Other financial liabilities
Obligation arising from shares issued by a subsidiary	Other financial liabilities

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

Interest income is recognised by applying the effective interest rate, except for short-term receivable when the effect of discounting is immaterial.

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

Impairment of financial assets

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

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

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

Government royalty program obligations

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

Share capital

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

Revenue recognition

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

Revenues from long-term production-type contracts such as biogas purification equipment and engineering service contracts are determined under the percentage-of-completion method whereby revenues are recognized based on the costs incurred to date in relation to the total expected costs of a contract (costs being composed mainly of materials and labour). 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. For the year ended December 31, 2015, no long-term production-type contracts bears any outstanding balances (note 12).

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 goods sold in the year in which the loss becomes evident and reasonably estimable.

Revenue is measured based on the price specified in the sales contract, net of discounts and estimated returns at the time of sale. Historical experience is used to estimate and provide for discounts and returns.

Government grants

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

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

Leases

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

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

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

Stock-based compensation plans

The Company accounts for stock options using the fair value method. Each tranche in an award is considered a separate award with its own vesting year and grant date fair value. Fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. The Black-Scholes model was developed to estimate the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, this model usually requires the input of assumptions, including expected stock price volatility. For options granted to directors, officers and employees of the Company, compensation expense is recognized over the tranche's vesting period by increasing contributed surplus based on the number of awards expected to vest. The number of awards expected to vest is reviewed at least annually. For options granted to non-employees, the transaction is measured with reference to the fair value of the goods or services when received. Related expense is recognized over the period during which the goods or services from the non-employees are received. A corresponding increase is recorded in contributed surplus when stock options are expensed. When stock options are exercised, share capital is credited by the sum of the consideration paid and the related amount previously recorded in contributed surplus.

Research and development expenses

Research expenses are charged to expenses as incurred. Development expenses are charged to expenses as incurred unless they meet criteria for deferral and amortization. During the year ended December 31, 2014, development expenses were deferred and accounted for as identified intangible asset.

Income taxes

Income tax comprises current and deferred tax. Income tax is recognized in the consolidated statement of loss except to the extent that it relates to items recognized directly in other comprehensive income or equity, in which case the income tax is also recognized directly as such.

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

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

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

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

Loss per share

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

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

Foreign currency translation

a) Functional and presentation currency

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

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

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

b) Transactions and balances

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

Segment reporting

The Company operates only one segment consisting in the design and manufacturing of filtration, purification, separation and dehydration equipment for gases and compressed air. This segment regroups five product lines and engineering services.

Accounting standards issued but not yet applied that have relevance to the Company

The following standards have been issued but are not yet effective:

In May 2014, the IASB issued IFRS 15, "Revenues from Contracts with Customers", to specify how and when to recognize revenue as well as requiring the provision of more information and relevant disclosure. IFRS 15 supersedes IAS 18, "Revenue", IAS 11, "Construction Contracts", and other revenue-related interpretations. The standard will be mandatory on January 1, 2018 for the Company with earlier adoption permitted. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

In July 2014, the IASB amended IFRS 9, "Financial Instruments", to bring together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39, "Financial Instruments: Recognition and Measurement". The standard supersedes all previous versions of IFRS 9 and will be mandatory on January 1, 2018 for the Company with earlier application permitted. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

In January 2016, IASB issued IFRS 16, "Leases", which specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17. The standard will be mandatory for annual periods beginning on or after January 1, 2019. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

In January 2016, IASB amended IAS 7, "Statement of Cash Flows", The amendments require that the following changes in liabilities arising from financing activities are disclosed (to the extent necessary): (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes. One way to fulfil the new disclosure requirement is to provide a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities. Finally, the amendments state that changes in liabilities arising from financing activities must be disclosed separately from changes in other assets and liabilities. This amendment will be mandatory for reporting periods beginning on or after January 1, 2017. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

4 Significant accounting judgments and estimation uncertainties

Critical accounting estimates and judgments

The Company makes estimates and assumptions concerning the future that will, by definition, seldom equal actual results. The following are the estimates and judgments applied by management that affect the Company's consolidated financial statements.

i. Inventories must be valued at the lower of cost and net realizable value.

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

ii. Impairment of customer relations

The Company performs a test for customer relations impairment when there is any indication that customer relations have suffered any impairment in accordance with the accounting policy stated in the summary of significant accounting policies of these consolidated financial statements. The recoverable amounts of customer relations have been determined based on value-in-use calculations. The value in use calculation is based on a discounted cash flow model. These calculations require the use of estimates and forecasts of future cash flows. Qualitative factors, including strength of customer relationships, degree of variability in cash flows as well as other factors are considered when making assumptions with regard to future cash flows and the appropriate discount rate. A change in any of the significant assumptions or estimates used to evaluate customer relations could result in a material change to the results of operations.

iii. Percentage of completion and revenues from long-term production-type contracts

Revenues recognized on long-term production-type contracts reflect management's best assessment by taking into consideration all information available at the reporting date and the result on each ongoing contract and its estimated costs. The management assesses the profitability of the contract by applying important judgments regarding milestones marked, actual work performed and estimated costs to complete. Actual results could differ because of these unforeseen changes in the ongoing contracts' models.

(expressed in Canadian dollars)

iv. Allowance for doubtful accounts

The Company reviews all amounts periodically for indications of impairment and the amounts impaired have been provided for as an allowance for doubtful accounts.

5 Restricted cash

The guarantee investment certificate equivalent to $152,827 and pledge against a loan to the China subsidiary existing at the end of the fiscal year 2014 was refunded during the first quarter of 2015. The cash equivalent of $69,103 retained by the liquidator of the South East Asia subsidiary at the end of the fiscal year 2014 was distributed to the shareholders during the third quarter of 2015.

6 Trade and other receivables

	2015 $	2014 $
Trade receivables	2,232,813	2,438,197
Other receivables	617,179	460,135
Less: Allowance for doubtful accounts	(412,833)	(217,021)
Trade and other receivables – net	2,437,159	2,681,311

Trade and other receivables are pledged as security for the credit facilities (see note 10, Bank loan).

7 Inventories

	2015 $	2014 $
Raw materials	965,077	1,045,569
Work in progress	176,763	623,781
Inventories	1,141,840	1,669,350

Cost of goods sold includes cost of inventories amounting to $5,113,363 in 2015 (2014 - $6,240,259) including amounts of nil (2014 – nil) for the writedown of inventories to the lower of cost and net realizable value. During the current year, a reversal of a previous inventory writedown amounting to $47,934 was recognized in inventory as the Company deems these parts recoverable for future orders.

Inventories are pledged as security for the credit facilities (see note 10, Bank loan).

(expressed in Canadian dollars)

8 Property, plant and equipment

	Machinery and equipment $	Office furniture and equipment $	Computers $	Moulds $	Vehicles $	Total $
Cost						
Balance at December 31, 2013	477,771	91,152	210,428	90,618	35,984	905,953
Additions	-	47,398	14,979	67,036	-	129,413
Effect of movements in exchange rates	6,983	5,122	7,235	5,777	-	25,117
Balance at December 31, 2014	484,754	143,672	232,642	163,431	35,984	1,060,483
Additions	46,533	333	25,395	-	-	72,261
Effect of movements in exchange rates	17,665	12,532	17,653	13,513	-	61,363
Balance at December 31, 2015	548,952	156,537	275,690	176,944	35,984	1,194,107
Accumulated depreciation						
Balance at December 31, 2013	232,740	85,668	179,425	72,355	25,189	595,377
Depreciation	44,805	11,534	20,230	12,466	7,196	96,231
Effect of movements in exchange rates	4,972	4,680	6,475	4,903	-	21,030
Balance at December 31, 2014	282,517	101,882	206,130	89,724	32,385	712,638
Depreciation	47,434	13,936	23,412	18,894	3,599	107,275
Effect of movements in exchange rates	12,476	11,249	15,986	12,088	-	51,799
Balance at December 31, 2015	342,427	127,067	245,528	120,706	35,984	871,712
Carrying Amount						
At December 31, 2014	202,237	41,790	26,512	73,707	3,599	347,845
At December 31, 2015	206,525	29,470	30,162	56,238	-	322,395

Depreciation of $107,275 (2014 – $96,231) is included in the consolidated statement of loss: $78,671 (2014 – $71,673) in cost of goods sold; and $28,604 (2014 – $24,558) in selling and administrative expenses.

Property, plant and equipment are pledged as security for the credit facilities (see note 10, Bank loan)

(expressed in Canadian dollars)

9 Intangible assets and goodwill

	Other		Internally generated		
	Customer relations $	**Software** $	**Development costs** $	**Total intangible assets** $	**Goodwill** $
Cost					
Balance at December 31, 2013	1,900,000	254,319	-	2,154,319	142,616
Additions	-	10,281	298,485	308,766	-
Effect of movements in exchange rates	-	6,294	-	6,294	-
Balance at December 31, 2014	1,900,000	270,894	298,485	2,469,379	142,616
Additions	-	26,564	-	26,564	-
Impairment	(1,900,000)	-	-	(1,900,000)	(142,616)
Effect of movements in exchange rates	-	16,195	-	16,195	-
Balance at December 31, 2015	-	313,653	298,485	612,138	-
Accumulated amortization					
Balance at December 31, 2013	1,108,333	236,473	-	1,344,806	-
Amortization for the year	158,333	11,922	29,040	199,295	-
Effect of movements in exchange rates	-	5,981	-	5,981	-
Balance at December 31, 2014	1,266,666	254,376	29,040	1,550,082	-
Amortization for the year	79,167	13,754	59,697	152,618	-
Impairment	(1,345,833)	-	-	(1,345,833)	-
Effect of movements in exchange rates	-	14,488	-	14,488	-
Balance at December 31, 2015	-	282,618	88,737	371,355	-
Carrying amount					
At December 31, 2014	633,334	16,518	269,445	919,297	142,616
At December 31, 2015	-	31,035	209,748	240,783	-

Amortization of $152,618 (2014 – $199,295) is included in the consolidated statement of loss: $10,874 (2014 – $3,458) in cost of goods sold; and $141,744 (2014 – $195,827) in selling and administrative expenses.

The Company carried out a review of its customer relations intangible assets relating to one single customer. This review led to the recognition of a full impairment charge of $554,167 due to increased uncertainty regarding future orders from this customer.

For the realization of its impairment test on goodwill, the Company allocates its entire goodwill to one CGU, the Company as a whole, because it is the lowest level at which the goodwill is monitored for internal purposes.

The current operating environment has created considerable uncertainty as to the oil and gas activity that will be undertaken by several of the Company's customers and considerably increases the estimation uncertainty associated with the information used for its goodwill impairment test. Assumptions that are valid at the time of preparing the cash flow models may change significantly when new information becomes available. Considering these factors, management recorded a goodwill impairment charge of $142, 616.

(expressed in Canadian dollars)

10 Bank loan

The Company has access to credit facilities in the amount of $500,000 with Toronto-Dominion Bank of Canada which are guaranteed by Export Development Canada, and bear interest at the Toronto-Dominion's prime rate plus 2.5% per annum and are limited by certain margin requirements concerning trade and other receivables. These credit facilities were used up to $375,000 as at December 31, 2015 (2014 – nil).

The credit facilities are secured by a first ranking hypothec of $1,000,000 on all movable property of the Company and are renewable annually.

11 Trade and other payables

	2015 $	2014 $
Trade payables	3,001,773	3,421,700
Payables to related parties (note 26)	30,595	7,885
Other payables	72,804	62,312
Trade and other payables	3,105,172	3,491,897

12 Deferred revenue

	2015 $	2014 $
Deferred revenue from long-term contracts	-	46,358
Deferred revenue other contracts	680,003	768,652
Deferred revenue	680,003	815,010

Revenue recognized for long-term contracts amounted to $703,367 for the year ended December 31, 2015 (2014 – $1,945,581). No costs were incurred for long-term contracts in progress as at December 31, 2015 (2014 – costs of $205,874, for a profit of $141,293).

(expressed in Canadian dollars)

13 Long-term debt

a) Loans

	2015 $	2014 $
Loan from Canada Economic Development matured in December 2015 (2014 – $33,346), bears no interest and was repayable in monthly instalments of $2,777.	-	33,346
Loan from Canada Economic Development matured in January 2015 (2014 – $12,500), and bears no interest.	-	12,500
Term finance contract, matured in June 2015, bears annual interest of 5.99% was secured by a lien on a vehicle (net book value of $3,599) and was repayable in monthly instalments of $785 including capital and interest.	-	4,629
	-	50,475
Less: Current portion	-	50,475
	-	-

b) Disposal of building and land

On September 30, 2011, the Company sold and leased back its building. The balance of sale of $500,000 has been paid to the Company in 2014.

(expressed in Canadian dollars)

c) Government royalty program obligation

In 2012, the Company signed a settlement agreement with Technology Partnership Canada (TPC) with regard to the Company's Fast Cycle Pressure Swing Adsorption and Gas Management systems and Pulsar Pressure Swing Adsorption project. The Company had to pay $250,000 at the execution of the agreement and $1,000,000 spread over four equal annual non-interest bearing payments, starting on January 31, 2013. Furthermore, the Company was liable to pay up to $750,000 in contingent payments based on proceeds from the sale by the Company of its intellectual property. Upon closing of the transaction, the Company paid $540,000 out of the $750,000 total contingent-based payments. On October 23, 2012, the Company accrued another $150,000 out of the $750,000 total contingent based payments, following additional proceeds received, leaving a potential maximum amount to be paid of $60,000 as at December 31, 2012.

In 2013, the Company realized the last milestone pursuant to the transaction and paid the remaining $60,000. The Company renegotiated its payments terms with TPC, changing from an annual payment of $250,000 to monthly payments of $24,500 but adding an extra year to term.

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

	2015	**2014**
	$	**$**
Balance – Beginning of year	762,825	846,461
Accretion interest	20,676	34,364
Repayment	(59,460)	(118,000)
Balance – End of year	724,041	762,825
Current portion	243,207	762,825
	480,834	-

In 2013, the amendment to the settlement agreement with TPC was accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability, as the terms and conditions are substantially different. The Company recorded a gain on debt settlement of $28,392 in the consolidated statement of loss.

In 2015, a new amendment to this agreement was reached changing the preceding payments terms from monthly payments of $24,500 to monthly payments of:

- $5,000 starting from April 30, 2015 to September 30, 2015
- $10,000 starting from October 31, 2015 to March 31, 2016
- $24,500 starting from April 30, 2016 to December 31, 2016
- And the balance of $504,500 on January 31, 2017.

The carrying amount of the government royalty program obligation has been calculated by discounting the future cash flows at a 5% interest rate.

(expressed in Canadian dollars)

14 Provisions

	Provision for contingencies (a)	**Warranty costs (b)**	**Total provision**
	$	**$**	**$**
At December 31, 2014	207,691	221,664	429,355
Additional provisions	420,000	79,486	499,486
Unused amount reversed	(97,937)	(81,880)	(179,817)
Used during the year	(24,293)	(6,157)	(30,450)
At December 31, 2015	505,461	213,113	718,574
Current portion of provisions	505,461	193,100	698,561
Non-current provisions	-	20,013	20,013

(a) Provision for contingencies

The Company has estimated potential loss and consequently, recognized the expected expense.

(b) Warranty cost

The Company offers warranties 18 months after shipping or 12 months after start-up to the purchasers of its gas purification and natural gas dryers.

(expressed in Canadian dollars)

15 Obligation arising from shares issued by a subsidiary

In September 2015, as a result of a Sino-foreign equity joint venture agreement, Xebec Adsorption (Shanghai) Co. Ltd., a subsidiary of Xebec Adsorption Inc. ("Xebec"), issued 1,714,285 common shares, representing a 30% participation, to Shanghai Chengyi New Energy Venture Capital Co. Ltd. (28.26%), an investment subsidiary of Shanghai based Shenergy Group, Shanghai Zhiyi Enterprise Management Consulting Co. Ltd. (0.1%) and Shanghai Liuhuan Investment Co. Ltd. (1.64%), a company held by a group of employees of Xebec Adsorption (Shanghai) Co. Ltd., (collectively the "Minority Shareholders") for a net cash consideration of $3,423,075 (RMB 16,370,515).

Pursuant to this agreement, Xebec has the obligation to repurchase the Minority Shareholders' interest in Xebec Adsorption (Shanghai) Co. Ltd., for a consideration of no less than the initial investment and annualized return of 10% if a) the achievement of specific financial targets were not achieved in any given year prior to December 31, 2020, or b) should the Minority Shareholders not divest by December 31, 2020 and should the Minority Shareholders exercise their put option with respect to a) or b) as mentioned above.

Xebec recorded the proceeds from this transaction, as a financial liability in these consolidated financial statements. The obligation to repurchase and the related annualized return is presented under "Obligation arising from shares issued by a subsidiary". The conversion of the financial liability denominated in the functional currency of our subsidiary Xebec Adsorption (Shanghai) Co. Ltd. (RMB) will be converted at the exchange rate at the end of each reporting period with gain and losses presented in the statement of income under "Gain/Loss on conversion of shares issued by a subsidiary".

	2015 **$**
Balance – Beginning of year	-
Initial obligation recorded, net of issuance costs	3,423,075
Accretion interest	92,866
Effect of exchange rate change on obligation	67,867
Balance – End of year	3,583,808
Current portion	-
	3,583,808

(expressed in Canadian dollars)

16 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 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, 2015:

	2015		2014	
	Number of warrants	**Weighted average exercise price $**	**Number of warrants**	**Weighted average exercise price $**
Balance – Beginning of year	10,091,886	0.45	10,091,886	0.45
Granted	-	-	-	-
Exercised	-	-	-	-
Expired	(10,091,886)	(0,45)	-	-
Balance – End of year	-	-	10,091,886	0.45

c) Loss per share

i. Basic

Basic loss per share is calculated by dividing net loss attributable to shareholders of the Company by the weighted average number of common shares in issue during the year.

	2015 $	2014 $
Net loss attributable to shareholders of the Company	(3,186,521)	(782,614)
Weighted average number of common shares in issue	39,363,867	39,363,867
Basic loss per share	($0.08)	($0.02)

(expressed in Canadian dollars)

ii. Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding to assume conversion of all dilutive potential common shares. The Company has two categories of dilutive potential common shares: warrants and stock options. For both, a calculation is performed to determine the number of shares that could have been acquired at fair value (determined as the average market share price of the Company's outstanding shares for the period), based on the monetary value of the subscription rights attached to the warrants and stock options. The number of shares calculated below is compared with the number of shares that would have been issued assuming exercise of the warrants and stock options. All such instruments were antidilutive for the year ended December 31, 2015.

	2015 $	**2014** $
Net loss attributable to the shareholders of the Company	(3,186,521)	(782,614)
Weighted average number of common shares in issue	39,363,867	39,363,867
Dilutive effect of stock options	-	-
Diluted weighted average number of shares	39,363,867	39,363,867
Diluted loss per share	($0.08)	($0.02)
Items excluded from the calculation of diluted net loss per share because the exercise price was greater than the average market price of the common shares or due to their anti-dilutive effect		
Stock options	3,707,003	4,438,401
Warrants (number of equivalent shares)	-	10,091,886

17 Stock-based compensation expense

The stock option plan allowed for the issuance of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards and other stock-based awards. Under the Plan, a fixed number of 5,904,580 common shares are available for grant. As at December 31, 2015, the maximum number of common shares available for issuance under all stock-based compensation arrangements is 5,904,580.

Under the terms of the Xebec Adsorption Stock Option 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. The terms and conditions for acquiring and exercising options are set by the Board of Directors. Stock options for employees vest no less than at grant date and no more than quarterly. The vesting right acquisitions are either gradual and equal over four years or at the grant date and are exercisable for three to seven years from the date of grant. Stock options for directors vest at the grant date and are exercisable for seven years from the grant date.

(expressed in Canadian dollars)

Stock option activity for the years ended December 31 is presented below:

	2015		2014	
	Number of options	Weighted average exercise price $	Number of options	Weighted average exercise price $
Outstanding – Beginning of year	5,838,402	0.16	4,316,804	0.18
Granted	-		2,500,000	0.12
Cancelled	(1,448,065)	0.14	(978,402)	0.17
Expired	-	-	-	-
Outstanding – End of year	4,390,337	0.16	5,838,402	0.16
Exercisable – End of year	3,707,003	0.17	4,438,401	0.16

As at December 31, 2015, options outstanding and exercisable are as follows:

					2015
	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 $
0.10 – 0.20	4,118,065	4.51	0.12	3,434,731	0.12
0.22 – 0.27	257,272	2.61	0.22	257,272	0.22
12.00 – 12.25	15,000	0.71	12.00	15,000	12.00
	4,390,337	4.38	0.16	3,707,003	0.17

The fair value of the options granted has been estimated according to the Black-Scholes option pricing model and based on the weighted average of the following assumptions for options granted during the year:

(expressed in Canadian dollars)

	2015		**2014**	
	Non-employees	**Employees**	**Non-employees**	**Employees**
Dividend yield	-	-	0%	0%
Exercise price	-	-	$0.14	$0.12
Risk-free interest rate	-	-	1.06%	1.15%
Estimated life	-	-	2 years	2 years
Expected volatility	-	-	81%	81%
Stock price	-	-	$0.12	$0.14

No options were granted to employees in 2015. In 2014, 2,100,000 options were granted to employees at a weighted average fair value of $0.05.

No options were granted to non-employees in 2015. In 2014, 400,000 options were granted to non-employees at a weighted average fair value of $0.06.

Compensation expense with respect to these options amounted to $51,466 for employees and none for non-employees for the year ended December 31, 2015 (2014 – $47,488 and $24,595).

18 Expenses by nature

	2015 **$**	**2014** **$**
Employee salaries and benefits	5,565,338	5,792,079
Material	5,113,363	6,240,259
Rent and repairs and maintenance	660,728	607,827
Travel expenses	580,180	870,152
Professional fees	552,760	654,405
Depreciation and amortization	259,894	295,526
Subcontracting costs	215,896	277,434
Office expense	214,999	458,431
Stock-based compensation	51,466	72,083
Commission	-	47,052
Other	553,611	(275,822)
	13,768,235	15,039,426

(expressed in Canadian dollars)

19 Research and development expenses

	2015 $	2014 $
Employee salaries and benefits	452,299	23,095
Subcontracting costs	44,229	-
Material	7,968	154,313
Professional fees	3,271	24,390
Travel expenses	799	406
Government grants	(5,000)	(5,000)
Research and development tax credits	(138,201)	27,337
	365,365	224,541

20 Finance expenses

	2015 $	2014 $
Interest and bank charges	33,815	39,910
Interest on long-term debt	92	569
Interest charges	47,250	89,142
Accretion and revaluation of government royalty program obligation (see note 13 (c))	33,951	34,364
Accretion of the obligation arising from shares issued by a subsidiary (see note 15)	92,866	-
	207,974	163,985

21 Compensation of key management

Compensation awarded to key management included:

	2015 $	2014 $
Salaries and short-term employee benefits	1,356,909	980,551
Stock-based compensation	51,466	72,083
Termination benefits	-	93,727
	1,408,375	1,146,361

Key management included the Company's senior management and members of the Board of Directors.

(expressed in Canadian dollars)

22 Income taxes

a) Income tax expense

Income taxes included in the consolidated statements of loss are nil in the current year (2014 – nil).

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:

	2015 %	2014 %
Combined statutory rate applied to pre-tax loss	26.90	26.90
Non-deductible items	(4.19)	(0.85)
Non-taxable portion of tax credits	1.34	(6.77)
Net change in unrecognized deferred income tax assets	(22.24)	37.55
Impact of expiration of non-capital losses available to carry forward	-	(91.42)
Impact of changes in income tax rates on deferred income taxes	(0.13)	41.73
Other	(1.68)	(7.14)
Non-taxable portion of gain on disposal of assets	-	-
Effective income tax rate	-	-

The applicable statutory tax rate is 26.9% in 2015 and 26.9% in 2014. The Company's applicable tax rate is the Canadian federal and provincial combined rate applicable in the jurisdictions in which the Company operates.

(expressed in Canadian dollars)

c) Deferred income tax assets and liabilities

	2015 $	2014 $
Deferred income tax assets		
Property, plant and equipment	234,824	213,891
Net operating losses carried forward	15,195,713	14,710,183
Scientific research and development expenses	6,740,813	6,479,129
Investment tax credits	4,151,007	3,922,377
Other	257,746	122,150
	26,580,103	25,447,730
Deferred income tax liabilities		
Intangible assets	(398)	(244,798)
Other	(12,387)	-
	26,567,318	25,202,932
Unrecognized deferred income tax assets	(26,567,318)	(25,202,932)
Net deferred income tax assets (liabilities)	-	-

In assessing the realisability of deferred income tax assets, management considers whether it is probable that some portion or all of the deferred income tax assets will be realised. The ultimate realisation of deferred income tax assets is dependent on 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 realisation of deferred income tax assets, these deferred income tax assets have not been recognized.

Most of these unrecognized deferred income tax assets relate to QuestAir's deferred income tax asset balance at the acquisition date. When a deferred income tax asset acquired in a business combination is not recognized at the date of acquisition, any subsequent recognition of the tax benefit will reduce income tax expense, resulting in an increase in net earnings.

(expressed in Canadian dollars)

d) Other

The Company has consolidated non-capital losses carried forward of approximately $55,610,000 (2014 – $54,800,000) 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:

	Canadian entity	**USA subsidiary**	**Chinese subsidiary**	**Consolidated**
				$
2016	-	-	160,000	160,000
2017	-	-	385,000	385,000
2018	-	-	605,000	605,000
2025	6,900,000	-	-	6,900,000
2026	7,230,000	-	-	7,230,000
2027	6,795,000	-	-	6,795,000
2028	10,825,000	-	-	10,825,000
2029	7,285,000	-	-	7,285,000
2030	12,360,000	-	-	12,360,000
2031	445,000	-	-	445,000
2032	545,000	-	-	545,000
2034	325,000		-	325,000
2035	1,200,000	560,000	-	1,750,000
	53,900,000	560,000	1,150,000	55,610,000

The Company has scientific research and experimental development expenses of approximately $24,600,000 (2014 – $24,110,000) which are available to be carried forward indefinitely and deducted against future taxable income otherwise calculated. The potential benefit has not been recorded in the accounts.

(expressed in Canadian dollars)

As at December 31, 2015, the Company also has investment tax credits of approximately $5,678,500 (2014 – $5,366,000) available to offset future Canadian federal income taxes payable. The potential benefit of the investment tax credits has not been recognized in the accounts and expires as follows:

	$
2016	11,700
2017	24,100
2018	95,600
2019	466,500
2020	914,300
2021	243,100
2022	915,800
2023	480,500
2024	741,600
2025	649,500
2026	414,600
2027	239,700
2029	32,400
2031	52,200
2032	125,000
2033	109,300
2034	104,200
2035	58,400
	5,378,500

23 Supplemental Cash flow information

Net change in non-cash working capital balances related to operations consists of the following:

	2015 **$**	**2014** **$**
Decrease (increase) in assets:		
Trade and other receivables	244,152	234,389
Inventories	575,444	(130,361)
Investment tax credits receivable	(67,676)	87,760
Other current assets	237,385	162,760
Increase (decrease) in liabilities:		
Trade and other payables	(196,633)	249,958
Accrued liabilities	69,666	(81,673)
Deferred revenues	(135,007)	(527,784)
Other operating liabilities	289,219	(372,717)
	1,016,550	(377,668)

(expressed in Canadian dollars)

24 Commitments

Following is a summary of Xebec's contractual obligations and commitments:

As at December 31, 2015	**Payment Due by Period**			
	1 year	2 - 5 years	Beyond 5 years	Total
	$	$	$	$
Operating leases	480,027	1,336,980	1,922,651	3,739,658

Operating leases include one building in Blainville, Quebec, and various equipment leases.

25 Contingent liabilities

The Company is party to various ongoing and pending litigation along with other contingencies arising out of the normal course of business. As a result, management has provisioned for estimated damages of $603,398 included in current portion of provision (note 14).

26 Related party transactions

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

	2015	**2014**
	$	**$**
Marketing and professional service expenses paid to companies controlled by members of the immediate family of an officer	139,824	108,165
Sales to an entity controlled by a subsidiary manager	882,900	3,260,776

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

(expressed in Canadian dollars)

27 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.

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

	2015 $	2014 $
Cash	(2,717,965)	(1,008,421)
Bank loan	375,000	136,437
Long-term debt	-	50,475
Government royalty program obligation (note 13 (c))	724,041	762,825
Obligation arising from shares issued by a subsidiary (note 15)	3,583,808	-
	1,964,884	(58,684)
Equity	(2,962,695)	929,291
	(997,811)	870,607

The Company is not subject to any capital requirements imposed by regulators.

(expressed in Canadian dollars)

28 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 five product lines and provides related engineering services.

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

	2015 $	2014 $
Revenue		
United States	3,066,409	4,509,675
Singapore	2,942,691	3,260,776
Canada	2,681,035	2,137,609
Republic of China	1,640,521	2,809,819
Other	1,019,971	1,650,530
	11,350,626	14,368,409

Revenue summarized by product line is as follows:

	2015 $	2014 $
Product line		
Natural gas dryers	5,906,344	6,652,931
Compressed gas filtration	3,831,755	3,853,568
Biogas purification	1,090,843	2,494,462
Associated gas	68,850	974,367
Engineering services	8,934	264,223
Air dryers	443,900	128,858
	11,350,626	14,368,409

Included in revenues arising from direct sales of natural gas dryers and biogas purification equipment (2015: $6,671,361 and 2014: $9,147,393) are revenues of approximately $3,017,030 (2014: $3,256,051) which arose from sales to the Group's largest customer. No other single customers contributed more than 10% to the Group's revenue for both 2015 and 2014.

(expressed in Canadian dollars)

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

	2015 $	2014 $
Non-current assets		
Canada	431,173	1,337,833
Asia	127,353	66,826
United States	4,652	5,099
	563,178	1,409,758

29 Financial instruments

(a) Measurement categories and fair values, including valuation methods and assumptions

The following tables show the carrying values and fair values of assets and liabilities by category as at December 31:

December 31, 2015	**Loans and receivables**		**Other financial liabilities**	
	Carrying amount **$**	**Fair value** **$**	**Carrying amount** **$**	**Fair value** **$**
Cash	2,717,965	2,717,965	-	-
Trade and other receivables	2,437,159	2,437,159	-	-
Bank loan	-	-	375,000	375,000
Trade and other payables	-	-	3,105,172	3,105,172
Accrued liabilities	-	-	793,556	793,556
Government royalty program obligation	-	-	724,041	724,041
Obligation arising from shares issued by a subsidiary	-	-	3,583,808	3,583,808

(expressed in Canadian dollars)

December 31, 2014	**Loans and receivables**		**Other financial liabilities**	
	Carrying amount $	**Fair value $**	**Carrying amount $**	**Fair value $**
Cash	1,008,421	1.008.421	-	-
Trade and other receivables	2,681,311	2,681,311	-	-
Bank loan	-	-	136,437	136,437
Trade and other payables	-	-	3,491,897	3,491,897
Accrued liabilities	-	-	723,890	723,890
Long-term debt	-	-	50,475	49,581
Government royalty program obligation	-	-	762,825	762,825

The carrying values of cash, trade and other receivables, trade and other payables, accrued liabilities and bank loan approximate their fair value due to their short-term maturities. The methods and assumptions used in estimating the fair values of other financial assets and financial liabilities are as follows:

- Long-term debt: The Company's long-term debt carries fixed interest rates. The fair value of the Company's debt obligations has been calculated by discounting the future cash flows of the long-term debt at the interest rate of similar debt instruments.

- Government royalty program obligation: Fair value of the government royalty program obligation has been calculated by discounting the future cash flows at the interest rate for a similar loan in the market.

- Obligation arising from shares issued by a subsidiary: Fair value of the obligation arising from shares issued by a subsidiary has been calculated by computing an annualized return of 10% on the initial consideration

- The Company's financial instruments that are measured subsequent to initial recognition at fair value are grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

  Level 1 — Fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
  Level 2 — Fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
  Level 3 — Fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

(expressed in Canadian dollars)

(b) 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 and other receivables. The carrying amount of its outstanding trade and other receivables 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 $412,833 (2014 – $217,021) was established based on prior experience and an assessment of current financial conditions of customers as well as the general economic environment. In cases where an allowance for doubtful accounts provision is recorded and a receivable balance is considered uncollectible, it is written off against the allowance for doubtful accounts. Bad debt expense amounted to $164,820 in 2015 (2014 – reversal amounted to $228,139). As at December 31, 2015, the Company's three largest trade debtors accounted for 41% (20%, 12% and 9%) of the total trade and other receivables balance (2014 – 24% (12%, 6% and 6%)).

Details of trade and other receivables were as follows:

	2015 $	2014 $
Current trade receivables	1,092,498	741,720
Trade receivables past due by:		
1–30 days	160,342	416,515
31–60 days	244,750	326,061
61–90 days	159,546	179,215
Over 90 days	575,677	774,686
Total trade receivables	2,232,813	2,438,197
Allowance for doubtful accounts	(412,833)	(217,021)
Other receivables	617,179	460,135
Total trade and other receivable	2,437,159	2,681,311

The following table summarizes the changes in the allowance for doubtful accounts for trade and other receivables:

	$
At December 31, 2014	(217,021)
Provision for impairment	(303,171)
Impaired receivables written off during the year as uncollectible – current year	-
Impaired receivables written off during the year as uncollectible – last year	
Receivable collected previously written off	
Unused amounts reversed	107,359
At December 31, 2015	(412,833)

The Company's cash is maintained at financial institutions with high credit ratings; therefore, the Company considers the risk of non-performance on this instrument to be remote. To date, the Company has not incurred any losses related to its cash.

(c) Market risk

(i) Currency risk

Certain financial assets and financial liabilities are exposed to foreign exchange fluctuations. Taking into account the amounts denominated in the currencies indicated below and assuming that all of the other variables remain unchanged, a fluctuation in exchanges 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 such a change would be approximately $147,555 for 2015 (2014 – $24,671). As at December 31, 2015, the following accounts are shown in their original currencies and converted into Canadian dollars. The Company does not use financial instruments to reduce this risk.

	2015	
	US dollar	**Euro**
Cash	897,796	17,507
Restricted cash	-	-
Trade and other receivables	369,866	39,483
Trade and other payables	(174,732)	(81,653)
	1,092,930	(24,663)
Equivalent in Canadian dollars	1,512,615	(37,066)

			2014
	Renminbi	**US dollar**	**Euro**
Cash	-	93,554	9,458
Restricted cash	817,695	-	-
Trade and other receivables	-	410,875	-
Trade and other payables	-	(329,919)	(86,592)
	817,692	174,510	(77,134)
Equivalent in Canadian dollars	152,827	202,449	(108,562)

(ii) 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, 2015, the short-term bank loan amounted to $375,000 (2014 – $136,437). If the interest rate on the bank debt had been 50 basis points higher (lower), related to the bank loan as at December 31, 2015, net loss would have been $1,338 (2014 – $1,103) lower (higher).

(expressed in Canadian dollars)

(d) 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:

					2015
	Carrying amount $	**Contractual cash flow $**	**0 to 12 months $**	**13 to 24 months $**	**Thereafter $**
Financial liabilities					
Bank loan	375,000	375,000	375,000	-	-
Trade and other payables	3,105,172	3,105,172	3,105,172	-	-
Accrued liabilities	793,556	793,556	793,556	-	-
Government royalty program obligation	724,041	757,540	250,500	507,040	-
Obligation arising from shares issued by a subsidiary	3,583,808	3,583,808	-	-	3,583,808
	8,581,577	8,615,076	4,524,228	507,040	3,583,808

					2014
	Carrying amount $	**Contractual cash flow $**	**0 to 12 months $**	**13 to 24 months $**	**Thereafter $**
Financial liabilities					
Bank loan	136,437	136,437	136,437	-	-
Trade and other payables	3,491,897	3,491,897	3,491,897	-	-
Accrued liabilities	723,890	723,890	723,890	-	-
Long-term debt	50,475	49,581	49,581	-	-
Government royalty program obligation	762,825	815,000	60,000	250,500	504,500
	5,165,524	5,216,805	4,461,805	250,500	504,500

Contractual interest amounts on floating interest rates are established based on the spot rates as at the statement of financial position dates.

The Company’s development is financed through a combination of borrowing under the existing credit facilities and the issuance of debt and equity (note 1).

30 Subsequent events

Subsequent to year-end, the Company increased its revolving credit facilities with Toronto-Dominion Bank by $1,000,000 through an increase of $250,000 in its demand operating facility (February 2016) and $750,000 in a new guarantee facility (April 2016). Both are guaranteed by Export Development Canada and are now secured by a first ranking hypothec of $2,000,000 on all movable property of the Company and are renewable annually.