

Xebec Adsorption Inc.

Condensed Interim Consolidated Financial Statements
(Unaudited)

For the period ended September 30, 2021

(Expressed in thousands of Canadian dollars)

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Financial Position (Unaudited)

(Expressed in thousands of Canadian dollars)

	September 30, 2021 \$	December 31, 2020 \$
Assets		
Current assets		
Cash	51,967	160,938
Restricted cash (Note 3)	9,883	7,642
Trade and other receivables	43,584	35,123
Inventories	46,057	21,145
Investment tax credits receivable	-	16
Finance leases receivable	252	129
Prepaid expenses	856	1,131
Total current assets	152,599	226,124
Non-current assets		
Finance leases receivable	9,563	3,016
Investment and advance to related companies	1,677	116
Deferred financing costs	431	985
Property, plant and equipment	35,565	36,578
Intangible assets	14,412	15,004
Goodwill	221,588	162,802
Other non-current assets	47	53
Total non-current assets	283,283	218,554
Total assets	435,882	444,678
Liabilities		
Current liabilities		
Credit facility	5,000	975
Trade, other payables and accrued liabilities	37,143	27,571
Contract liabilities	13,549	7,507
Current portion of long-term debt	22,710	14,052
Current portion of government royalty program obligation (Note 4)	190	185
Current portion of provisions	1,963	1,541
Current portion of obligation arising from shares issued by a subsidiary (Note 5)	-	2,972
Income taxes payable	818	109
Total current liabilities	81,373	54,912
Non-current liabilities		
Long-term debt	37,561	42,626
Government royalty program obligation (Note 4)	59	183
Provisions	311	348
Deferred tax liabilities	2,393	2,576
Total non-current liabilities	40,324	45,733
Total liabilities	121,697	100,645
Equity		
Share capital (Note 6)	403,329	396,609
Contributed surplus	7,211	8,145
Accumulated other comprehensive loss	(10,675)	(914)
Deficit	(85,680)	(59,807)
Total equity	314,185	344,033
Total liabilities and equity	435,882	444,678

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

Approved by the Board of Directors

Director

Director

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Loss (Unaudited)

(Expressed in thousands of Canadian dollars, except net loss per share)

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2021	2020	2021	2020
	\$	\$	\$	\$
Revenue (Note 8)				
Revenue from contracts	26,120	18,389	77,883	50,170
Government grants	586	-	2,111	-
	<u>26,706</u>	<u>18,389</u>	<u>79,994</u>	<u>50,170</u>
Cost of goods sold	<u>16,629</u>	<u>14,018</u>	<u>60,742</u>	<u>38,464</u>
Gross margin	<u>10,077</u>	<u>4,371</u>	<u>19,252</u>	<u>11,706</u>
Research and development expenses	463	74	1,868	94
Selling and administrative expenses	10,844	4,868	31,719	13,039
Other (gains) and losses (Note 9)	<u>6,335</u>	<u>1,137</u>	<u>7,024</u>	<u>932</u>
	<u>17,642</u>	<u>6,079</u>	<u>40,611</u>	<u>14,065</u>
Operating loss	<u>(7,565)</u>	<u>(1,708)</u>	<u>(21,359)</u>	<u>(2,359)</u>
Other charge (income)				
Finance income	(482)	(247)	(922)	(343)
Finance expenses (Note 10)	<u>1,762</u>	<u>762</u>	<u>4,662</u>	<u>1,691</u>
	<u>1,280</u>	<u>515</u>	<u>3,740</u>	<u>1,348</u>
Loss before income taxes	<u>(8,845)</u>	<u>(2,223)</u>	<u>(25,099)</u>	<u>(3,707)</u>
Income taxes	<u>324</u>	<u>(37)</u>	<u>774</u>	<u>(14)</u>
Net loss for the period	<u>(9,169)</u>	<u>(2,186)</u>	<u>(25,873)</u>	<u>(3,693)</u>
Net loss per share				
Basic and diluted net loss per share (Note 6)	<u>(0.06)</u>	<u>(0.02)</u>	<u>(0.17)</u>	<u>(0.04)</u>

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

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Comprehensive Loss (Unaudited)

(Expressed in thousands of Canadian dollars)

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2021	2020	2021	2020
	\$	\$	\$	\$
Net loss for the period	(9,169)	(2,186)	(25,873)	(3,693)
Other comprehensive loss				
Cumulative translation adjustment	2,957	(119)	(9,761)	763
Comprehensive loss for the period	<u>(6,212)</u>	<u>(2,305)</u>	<u>(35,634)</u>	<u>(2,930)</u>

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

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Changes in Equity (Unaudited)

(Expressed in thousands of Canadian dollars)

	Common shares	Warrants and Compensation Shares	Share capital – Common shares	Contributed surplus	Accumulated other comprehensive loss	Deficit	Total
	#	#	\$	\$	\$	\$	\$
Balance – January 1, 2020	84,378,678	11,975,544	63,484	4,569	(1,247)	(27,849)	38,957
Net loss for the year	-	-	-	-	-	(3,693)	(3,693)
Other comprehensive income	-	-	-	-	762	-	762
Comprehensive income (loss) for the year	-	-	-	-	762	(3,693)	(2,931)
Issuance of warrants from new financing	-	3,000,000	-	2,954	-	-	2,954
Share issued from the exercise of options (Note 7)	1,503,333	-	682	(319)	-	-	363
Share issued from public offering	7,986,750	-	26,432	-	-	-	26,432
Warrants and compensation shares issued from public offering	-	826,965	(631)	631	-	-	-
Warrants and compensation shares exercised from public offering	11,881,796	(11,881,796)	20,279	(437)	-	-	19,842
Warrants from public offering – Cancelled	-	(14,357)	-	-	-	-	-
Stock-based compensation expense (Note 7)	-	-	-	151	-	-	151
Deferred share unit compensation expense (Note 7)	-	-	-	105	-	-	105
Balance – September 30, 2020	105,750,557	3,906,356	110,246	7,654	(485)	(31,542)	85,873

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

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Changes in Equity (Unaudited)

(Expressed in thousands of Canadian dollars)

	Common shares	Warrants and Compensation Shares	Share capital – Common shares and warrants	Contributed surplus	Accumulated other comprehensive loss	Deficit	Total
	#	#	\$	\$	\$	\$	\$
Balance – January 1, 2021	152,342,986	3,418,267	396,609	8,145	(914)	(59,807)	344,033
Net loss for the year	-	-	-	-	-	(25,873)	(25,873)
Other comprehensive loss	-	-	-	-	(9,761)	-	(9,761)
Comprehensive loss for the year	-	-	-	-	(9,761)	(25,873)	(35,634)
Share issued from the exercise of options	-	-	87	(40)	-	-	47
Share issued from the exercise of RSU	-	-	93	(132)	-	-	(38)
Share issued from the exercise of DSU	83,334	-	35	(35)	-	-	-
Share issued from public offering	-	-	(9)	-	-	-	(9)
Warrants and compensation shares exercised from public offering	418,265	(418,267)	2,057	(551)	-	-	1,506
Shares issued to Nortec (Note 3)	735,838	-	3,186	-	-	-	3,186
Shares issued to California Compression (Note 3)	382,718	-	1,271	-	-	-	1,271
Stock-based compensation expense (Note 7)	-	-	-	(74)	-	-	(74)
Deferred share unit compensation expense (Note 7)	8,883	-	-	68	-	-	68
Restricted share unit compensation expense (Note 7)	8,414	-	-	(170)	-	-	170
Balance – September 30, 2021	153,980,438	3,000,000	403,329	7,211	(10,675)	(85,680)	314,186

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

Xebec Adsorption Inc.

Condensed Interim Consolidated Statements of Cash Flows (Unaudited)

(Expressed in thousands of Canadian dollars)

	For the nine-month period ended September 30,	
	2021	2020
	\$	\$
Cash flows from		
Operating activities		
Net loss for the period	(25,873)	(3,693)
Items not affecting cash		
Depreciation of property, plant and equipment	3,029	770
Amortization of intangible assets	1,205	1,344
Reversal of inventory write-down	(14)	(48)
Accretion finance expenses and gain on revaluation of government royalty program obligation (Note 4)	11	16
Accretion of the obligation arising from shares issued by a subsidiary (Note 5)	120	228
Exchange gain/loss on the obligation arising from shares issued by a subsidiary	(45)	224
Stock-based compensation expense (Note 7)	(176)	256
Accretion of financing costs	554	-
Accretion of long-term debt	1,029	196
Gain on deconsolidation of a subsidiary	(2,154)	-
Impairment of tangible assets	326	-
Future income taxes	(181)	(24)
	<u>(22,169)</u>	<u>(731)</u>
Change in non-cash working capital balances related to operations (Note 11)	<u>(11,728)</u>	<u>(16,901)</u>
	<u>(33,897)</u>	<u>(17,632)</u>
Investing activities		
Business acquisitions, net of cash acquired (Note 3)	(63,981)	(6,701)
Acquisition of property, plant and equipment	(7,759)	(368)
Restricted cash	(2,241)	(909)
Acquisition of intangible assets	(912)	(766)
Net proceeds from disposal of assets	46	-
Investment in related companies	(135)	-
Finance lease receivable payments	301	-
	<u>(74,681)</u>	<u>(8,744)</u>
Financing activities		
Decrease of bank loan	(15)	-
Increase of credit facility	5,000	-
Long-term debt	-	7,088
Payment of debt liabilities	(5,903)	(997)
Earn-out payment	-	(220)
Proceeds from issuance of share capital	1,506	49,590
Repayment of government royalty program obligation (Note 4)	(130)	(88)
	<u>458</u>	<u>55,373</u>
Net increase (decrease) in cash and cash equivalents during the period	(108,120)	28,997
Cash – Beginning of period	160,938	22,358
Effect of exchange rate changes on cash	(851)	287
Cash – End of period	51,967	51,642

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

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

The condensed interim consolidated financial statements were authorized by the Board of Directors on November 10, 2021.

1 Nature of business

Xebec Adsorption Inc. (“Xebec” or the “Company”) is a global provider of clean energy solutions that is specialized 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 upgrading systems 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 and generation systems for fuel cell and industrial applications, on-site oxygen and nitrogen generators for industrial, energy and healthcare applications and provide services for the compressed air and gas businesses. The Company is incorporated and domiciled in Canada and is listed on the TSX Exchange under the symbol XBC since January 7, 2021. It was previously 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.

The continued spread of COVID-19 around the globe and the responses of governmental authorities and corporate entities, including through mandated or voluntary shutdowns, have and may continue to lead to a general slow-down in the economy and to disruptions to our work force and facilities, our customers, our sales and operations and our supply chain.

The full extent and impact of the COVID-19 pandemic is unknown and at this stage the future is very difficult to project.

The Company’s bad debt expense may increase, revenues and cash resources may be negatively affected, and the Company may need to assist potential customers with obtaining financing or government incentives to help them fund their purchases of our products. Any temporary suspension of production in Xebec facilities, or those of any of its suppliers, partners or customers, as a direct result of COVID-19 may have a material adverse effect on the Company.

Basis of compliance and basis of preparation

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) applicable to the preparation of interim financial statements, including IAS 34 Interim Financial Reporting. The condensed interim consolidated financial statements do not include all of the information required for annual statements and should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2020, as they follow the same accounting policies and methods of application, unless otherwise indicated.

Certain figures of the consolidated statements may have been reclassified in order to comply with the basis of presentation adopted in the current period.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

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.

Subsidiaries are fully consolidated from the date on which control is obtained by the Company and are deconsolidated from the date that control ceases.

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 are adjusted to reflect the changes in their relative interests in the subsidiaries.

Segment reporting

The Company operates three business segments:

- 1) Systems (Cleantech) – Includes Renewable Natural Gas, Hydrogen and Renewable Hydrogen for a variety of applications, from fuel cells to fossil fuel replacement applications for low carbon transportation fuels and project development of renewable natural gas production facilities, in the build, own and operate (BOO) model that will generate low-carbon renewable transport fuels and carbon credits.
- 2) Support (Industrial Products and Services) – foundational recurring revenue model.
- 3) Corporate and other – Includes corporate functions.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

For management purposes, the Company uses the same measurement policies as those outlined in its financial statements.

In addition, corporate assets are used by each segment and are therefore not attributable to any segment specifically.

Use of estimates and judgments

When preparing the condensed interim consolidated financial statements, management undertakes a number of judgements, estimates and assumptions about recognition and measurement of assets, liabilities, income and expenses. On an ongoing basis, management reviews these estimates, which are based on its best knowledge of current events and actions the Company may undertake in the future. The actual results may differ from the judgements, estimates and assumptions made by management, and will seldom equal the estimated results.

The judgements, estimates and assumptions applied in the condensed interim consolidated financial statements, including the key sources of estimation uncertainty, were the same as those applied in the Company's last annual financial statements for the year ended December 31, 2020.

2 Change in significant accounting policies since December 31, 2020

Revenues from contracts with customers

Gases generators and installation revenue comprises the sale of assets which are manufactured based on the customer specific needs and requirements. The Company considers these contracts as one performance obligation. The Company manufactures an asset which would have no alternative use in its completed state and the Company is entitled to receive consideration during the manufacturing period. Consideration received is not refundable to customers to the extent that costs have been incurred during the manufacturing process. The Company recognises revenue over the time of the manufacturing process. Revenue is measured using the input method whereby revenue is recognised based on the pro rata cost incurred in relation to the total estimated cost to manufacture. The manufacturing process for an asset is estimated to be less than 12 months based on experience. The Company therefore applies the practical expedient in IFRS 15.63 whereby an entity does not adjust the consideration to be received for the effects of a significant financing component.

Service and maintenance revenue comprises the after-sale maintenance; and servicing of the asset which was transferred to the customer on an annual subscription contract. The service and maintenance revenue are a distinct performance obligation to provide an undefined quantity of services over the duration of the contract period. A portion of the transaction price is therefore allocated to service and maintenance based on the stand-alone selling price of those services. Discounts are not considered as they are only given in rare circumstances and are never material. Revenue is recognised over the duration of the contract.

Revenues from Gas-as-a-Service (GaaS) are addressed in lease section.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

Government grants

Government grants are recognised where there is reasonable assurance that the grants will be received and all attached conditions will be met. The Company's grants are related to an expense item and recognised as income on a systematic basis over the period the related costs, for which it is intended to compensate, are expensed. Government grants are deducted from the respective expense lines unless they relate to R&D projects in which case they are presented as governments grants under total income.

3 Business combinations

Inmatec

On February 22, 2021, Xebec Deutschland GmbH, a wholly owned subsidiary of Xebec Adsorption Inc, acquired 100% of Inmatec Gase Technologie GmbH & Co. KG, Inmatec GmbH and Inmatec Gas Technology FZC RAK (collectively "Inmatec") in the United Arab Emirates for an aggregate consideration of \$36,705 including a balance of acquisition payable of \$2,456. The transaction was financed with the proceeds from the public offering that closed December 30, 2020 and the concurrent private placement with Caisse de dépôt et placement du Québec ("CDPQ").

Founded in 1993, Inmatec is an international market leader in the production of nitrogen generators and oxygen generators. Designed, developed and produced in Germany, over 8,000 Inmatec systems have been deployed and sold around the world. Its German manufacturing and engineering capabilities have resulted in a reputation for high quality and extremely reliable products. Inmatec's products and manufacturing are among the best-in-class and this acquisition gives Xebec an accelerated entry into offering these products in North America.

Goodwill is not expected to be deductible for tax purposes.

Nortec

On April 30, 2021, Xebec Holding USA Inc., a wholly owned subsidiary of Xebec Adsorption Inc., acquired all of the outstanding shares of Tennessee based Nortekbelair Corporation (Nortec) for a purchase price of \$9,293 through a combination of cash on hand, of which \$4,242 was paid in cash on closing, and 735,838 common shares of Xebec issued to the seller at a fair value of \$4.33 per share, the closing price of Xebec's shares on April 30, 2021. The purchase agreement includes an additional contingent consideration of \$1,619 payable based on achievement of sales targets over the next three years.

Nortec was founded in 2008 based on three key pillars of performance: quality, perfection and innovation. Although the company was founded in 2008, Nortec's origins in the compressed air industry go back several decades. Nortec specializes in compressed air drying and industrial systems, and the company's systems are used in a broad spectrum of applications, ranging from small shops to major manufacturing plants. Nortec's principal will remain with the Company after the acquisition and continue his focus on R&D and product development within the Company.

Goodwill is expected to be deductible for tax purposes.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

Tiger

On June 11, 2021, the Company acquired all of the outstanding shares of United Kingdom based Tiger Filtration Limited (Tiger) for a total consideration of \$20,086 subject to certain holdbacks and adjustments. The purchase agreement includes an additional contingent consideration of \$2,112 payable based on achievement of sales targets over the next two years.

Established in 2004, Tiger Filtration is an independently owned British based company specialising in the manufacture of high-quality alternative in-line filter elements, vacuum pump separators, compressor air & oil separators, high-pressure stainless-steel filter housings and bespoke filtration solutions. Tiger's products are supplied from its 14,000 sq. ft. facility in Sunderland, UK and sold globally to customers ranging from small businesses to international organisations who expect quality products and an exceptional level of service. Two of its principals will retire and one will remain with Tiger as Managing Director and continue his leadership in sales and business development.

California Compression, LLC

On August 26, 2021, Xebec Holding USA Inc, a wholly owned subsidiary of Xebec Adsorption Inc., acquired the securities of California Compression, LLC for a total consideration of \$9,220 through a combination of cash on hand, of which \$6,284 was paid in cash on closing, and 382,718 common shares of Xebec issued to the seller at a fair value of \$3.32 per share. The cash portion of the transaction was financed with the proceeds from the public offering that closed December 30, 2020 and the concurrent private placement with Caisse de dépôt et placement du Québec ("CDPQ").

Founded in 1975, California Compression, LLC is one of the largest compressed air distributors in Northern California. California Compression, LLC gives Xebec distribution facilities for customers located in the Northern California of the United States.

Wisconsin Compressed Air

On September 1, 2021, XBC Flow Services – Wisconsin Inc, a wholly owned subsidiary of Xebec Adsorption Inc, acquired the assets of Wisconsin Compressed Air for an aggregate consideration of \$2,681 including a balance of acquisition payable of \$643. The transaction was financed with the proceeds from the public offering that closed December 30, 2020 and the concurrent private placement with Caisse de dépôt et placement du Québec ("CDPQ").

Founded in 1976, Wisconsin Compressed Air has been supplying customers with high-quality compressed air products from the industry's top manufacturers. Wisconsin Compressed Air services gives Xebec maintenance services capacities to customers located in the North Central region of the United States.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

The determination of the fair value of the assets acquired and liabilities assumed arising from the acquisitions are as follow:

	Inmatec	Nortec	Tiger	California Compression	XBC Flow Services - Wisconsin	Prior Year earnout adjustment	Total
Recognized amounts of identifiable net assets							
Trade and other receivables	3,108	1,428	821	2,143	463	-	7,963
Inventories	4,553	610	307	859	565	-	6,894
Other current assets	64	-	-	35	6	-	105
Total current assets	7,725	2,038	1,128	3,037	1,034	-	14,962
Property, plant and equipment	630	29	1	508	275	-	1,443
Intangibles	5	-	-	-	-	-	5
Total non-current assets	635	29	1	508	275	-	1,448
Trade, other payables and accrued liabilities	(2,849)	(228)	(702)	(2,220)	(126)	-	(6,125)
Contract liabilities	(1,242)	-	-	(215)	(42)	-	(1,499)
Total current liabilities	(4,091)	(228)	(702)	(2,435)	(168)	-	(7,624)
Long-term debt	(2,658)	-	-	(92)	-	-	(2,750)
Total non-current liabilities	(2,658)	-	-	(92)	-	-	(2,750)
Identifiable net assets	1,611	1,839	427	1,018	1,141	-	6,036
Goodwill on acquisition	32,385	7,327	19,138	6,947	1,540	-	67,337
Total assets acquired	33,996	9,166	19,565	7,965	2,681	-	73,373
Cash and cash equivalents acquired	2,709	127	521	1,255	-	-	4,612
Total purchase consideration	36,705	9,293	20,086	9,220	2,681	-	77,985
Fair value of shares issued	-	3,186	-	1,271	-	-	4,457
Fair value of contingent consideration	-	1,619	2,112	-	-	-	3,731
Restricted cash and balance of acquisition payable	2,456	27	856	410	643	-	4,392
Earnout adjustment to prior year acquisitions	-	-	-	-	-	(3,188)	(3,188)
Total cash consideration paid at acquisition date	34,249	4,461	17,118	7,539	2,038	3,188	68,593

The fair value of the trade and other receivables acquired as part of the business acquisitions amounted to \$7,963 with the same gross contractual amount. As at the acquisition dates, the Company's best estimate of the contractual cash flows not expected to be collected amounted to \$NIL.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

4) Government royalty program obligation

In 2012, the Company signed a settlement agreement with Technology Partnership Canada (TPC) regarding the Company's Fast Cycle Pressure Swing Adsorption and Gas Management systems and Pulsar Pressure Swing Adsorption project.

The Company had to pay \$250 at the execution of the agreement and \$1,000 spread over four equal annual non-interest-bearing payments, starting on January 31, 2013. Furthermore, the Company was liable to pay up to \$750 in contingent payments based on proceeds from the sale by the Company of its intellectual property. In February 2017, a new amendment to this agreement was reached extending the payment terms to January 1, 2023. The following table summarizes the activity related to the government royalty program obligation during the periods ended:

	September 30, 2021 \$	December 31, 2020 \$
Balance – Beginning of period	368	466
Accretion finance expenses	11	20
Repayment	(130)	(118)
Balance – End of period	249	368
Current portion	(190)	(185)
	59	183

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

5) Obligation arising from shares issued by subsidiary

In September 2015, as a result of a Sino-foreign equity joint venture agreement, Xebec Adsorption (Shanghai) Co. Ltd. ("Xebec Shanghai"), a subsidiary of the Company, 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 Shanghai, (collectively the "Minority Shareholders") for a net cash consideration of \$3,423 (RMB 16,370).

Pursuant to this agreement, the Company has the obligation to repurchase the Minority Shareholders' interest in Xebec Shanghai, 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 Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

On July 24, 2018, the Minority Shareholders of Xebec Shanghai and the Company agreed that the Company will pay the Minority Shareholders \$186 (RMB 1 million) per year including 2018 until the EDC loan expiry or up to December 31, 2020 (whichever is earlier). The annual fees will be considered a deduction to the repurchase price at the time of repurchase.

In 2020 and 2021 no payments of the annual fee were processed. A conditional amount of \$1,731 was paid in December 2020 based of the achievement of some performance targets as agreed by both parties.

On July 25, 2018, the Minority Shareholders of Xebec Shanghai agreed that, for a period beginning on the date hereof up to the date that Export Development Canada has been repaid in full (including capital, interests and fees) under the EDC Financing Arrangement, it shall not exercise any of its divestment, refund, compensation and other equity repurchase rights.

The Company 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 Shanghai (RMB) will be converted at the exchange rate at the end of each reporting period with gains and losses presented in the statement of income (loss) under "Gain/Loss on conversion of shares issued by a subsidiary".

On June 25, 2021, a new partnership with Shanghai based Shenergy Group Company Limited was approved by the Chinese authority. Xebec Shanghai received a direct equity investment of \$3,400 in exchange for the debt and interest owed by the Company for its share buyback obligation. The Company's participation reduced from 70% to 60%, together with other changes, resulted in a change of control and causing Xebec Shanghai to be deconsolidated from the date that control ceased. Following this transaction, the investment in the new partnership is recognised and presented as an equity investment. Furthermore, the profit resulting from the deconsolidation is preliminary, subject to obtaining the evaluation of the investment's fair value.

	September 30, 2021	December 31, 2020
	\$	\$
Balance – Beginning of period	2,972	4,180
Accretion interest	120	306
Effect of exchange rate change on obligation	(45)	217
Effect of deconsolidation	(3,047)	-
Conditional reimbursement	-	(1,731)
Balance – End of period	-	2,972
Current Portion	-	(2,972)
	-	-

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

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6) Earnings per share

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2021	2020	2021	2020
Weighted average number of shares	153,521,659	105,485,980	153,201,728	92,928,420
Dilutive effect on number of shares	-	-	-	-
Weighted average number of shares for diluted earnings per shares	153,521,659	105,485,980	153,201,728	92,928,420

For the three-month and nine-month periods ended September 30, 2021 warrants, compensation options, compensation warrants, outstanding stock options and outstanding DSUs and RSUs would have been anti-dilutive.

For the three-month and nine-month periods ended September 30, 2020 convertible debentures, warrants, compensation options, compensation warrants, and outstanding stock options would have been anti-dilutive.

7) Long term incentive plan

On June 25, 2020, the Shareholders of Xebec approved the adoption by the Company of the long-term incentive plan (LTIP) replacing the prior Stock Option Plan. The LTIP permits the granting of options ("LTIP Options"), Restricted Stock Units ("RSUs") and Deferred Share Units ("DSUs"), (collectively the "Awards") to eligible participants of the Company and is administered with the oversight of the Compensation Committee.

The total number of common shares reserved and available for grant and issuance pursuant to Awards (including the common shares issuable upon exercise of the outstanding options previously granted under the prior Stock Option Plan) shall not exceed a number of common shares equal to 8,393,115.

No awards shall be granted under the prior Stock Option Plan and all existing options granted under the Stock Option Plan will remain outstanding and subject to the terms of the prior Stock Option Plan.

The LTIP provides that the aggregate number of common shares issued and issuable to insiders and associates of such insiders under the LTIP or any other proposed or established share compensation arrangement within any one-year period, shall not in each case exceed 10% of the issued and outstanding common shares.

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The aggregate number of common shares issuable to any one consultant, within any one-year period, under the LTIP, or when combined with all of the Corporation's other security-based compensation arrangements, shall not exceed 2% of the Corporation's total issued and outstanding securities, calculated on the date the Award is granted to the consultant.

The aggregate number of common shares issuable to all participants retained to provide investor relations activities, within any one-year period, under the LTIP, or when combined with all of the Corporation's other security-based compensation arrangements, shall not exceed 2% of the Corporation's total issued and outstanding securities, calculated on the date the Award is granted to the participant, and options granted to such participants retained to provide investor relations activities must vest in stages over a period of not less than one year with no more than $\frac{1}{4}$ of the options vesting in any three month period.

The exercise price under an option shall be determined by the Human Resources Committee and shall not be less than 100% of the fair market value of a common share on the date of grant of such option; provided, however, that the Committee may designate a purchase price below fair market value on the date of grant if the option is granted in substitution for a stock option previously granted by an entity that is acquired by or merged with the Company or an affiliate. The term of each option shall be fixed by the Committee at the date of grant but shall not be longer than 10 years from the date of grant.

a) Stock option (legacy program) activity for the nine-month period ended September 30, is presented below:

	2021		2020	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Outstanding – Beginning of period	2,178,528	0.48	4,081,860	0.35
Exercised	(83,334)	0.57	(1,903,333)	0.26
Forfeited	(245,000)	0.70	-	-
Expired	(1,063,194)	0.49	-	-
			-	
Outstanding – End of period	787,000	0.40	2,178,528	0.48
Exercisable – End of period	687,000	0.38	1,284,859	0.39

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As at September 30, 2021, options outstanding and exercisable are as follows:

Expiry date	Weighted-Average Exercise Price	Number of Options Outstanding	Weighted-Average Remaining life	Number of Options exercisable
December 19, 2022	\$0.55	200,000	1.22	200,000
January 7, 2023	\$0.05	200,000	1.27	200,000
August 29, 2024	\$0.49	350,000	2.91	250,000
December 19, 2024	\$0.55	37,000	3.21	37,000
	\$0.40	787,000	2.08	687,000

As at September 30, 2020, options outstanding and exercisable are as follows:

Expiry date	Weighted-Average Exercise Price	Number of Options Outstanding	Weighted-Average Remaining life	Number of Options exercisable
December 19, 2022	\$0.55	400,000	2.22	266,666
January 7, 2023	\$0.05	200,000	2.27	200,000
March 5, 2024	\$0.18	373,193	3.43	373,193
August 29, 2024	\$0.49	350,000	3.91	150,000
December 19, 2024	\$0.55	86,334	4.21	49,333
May 14, 2025	\$0.60	34,001	4.62	667
November 19, 2025	\$0.70	735,000	5.14	245,000
	\$0.35	2,178,528	3.80	1,284,859

During the nine-month period ended September 30, 2021, the Company expensed (\$74) (\$151 for the same period in 2020) and during the three-month period ended September 30, 2021, the Company expensed \$23 (\$47 for the same period in 2020) which relates to stock options granted in 2014, 2017 and 2018.

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Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

b) Stock option (LTIP Options) activity for the nine-month period ended September 30, is presented below:

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2021	2020	2021	2020
	Number of Options	Number of Options	Number of Options	Number of Options
Outstanding – Beginning of period	-	-	-	-
Granted	-	-	50,000	-
Exercised	-	-	-	-
Outstanding – End of period	-	-	50,000	-

On May 21, 2021, 50,000 stock options were granted under the new Company's LTIP to an officer of the Company. The stock options will vest on stages until May 2025.

The fair value of the 50,000 stock options was \$167, which was estimated using the Black Scholes Option Pricing Model with the following assumptions:

Risk-free interest rate	0.15%
Annualized volatility	73.14%
Share price	\$5.01
Expected life of stock options	7 years

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(Expressed in thousands of Canadian dollars)

c) DSU activity for the three-month and nine-month periods ended September 30, is presented below:

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2021	2020	2021	2020
	Number of DSU	Number of DSU	Number of DSU	Number of DSU
Outstanding – Beginning of period	66,231	-	66,231	-
Granted	28,322	66,231	28,322	66,231
Exercised	(8,883)	-	(8,883)	-
Outstanding – End of period	85,670	66,231	85,670	66,231

On July 8, 2021, 28,322 DSUs were granted under the Company's LTIP to members of the board of the Company for a fair value of \$125. These DSUs vested immediately.

During the nine-month period ended September 30, 2021, the Company expensed \$68 (\$105 for the same period in 2020) for share-based compensation related to the DSUs.

During the three-month period ended September 30, 2021, the Company expensed \$10 (\$105 for the same period in 2020) for share-based compensation related to the DSUs.

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

- d) RSU activity for the three-month and nine-month periods ended September 30, is presented below:

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2021	2020	2021	2020
	Number of RSU	Number of RSU	Number of RSU	Number of RSU
Outstanding – Beginning of period	400,801	-	265,300	-
Granted	-	-	180,501	-
Cancelled	-	-	(28,658)	-
Exercised	-	-	(16,342)	-
Outstanding – End of period	400,801	-	400,801	-

On May 21, 2021, 186,501 RSUs (net of an adjustment of 6,000 RSUs) were granted under the Company's LTIP to employees of the Company for a fair value of \$934. These RSUs will vest in stages until April 2024.

From the 16,342 RSU exercised, only 8,414 units were issued to shares and the rest were used to cover employees' fiscal obligations.

During the nine-month period ended September 30, 2021, the Company expensed (\$170) (NIL for the same period in 2020) for share-based compensation related to the RSUs.

During the three-month period ended September 30, 2021, the Company expensed (\$347) (NIL for the same period in 2020) for share-based compensation related to the RSUs.

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(Expressed in thousands of Canadian dollars)

8) Segmented information

The Company operates three business segments and specializes in Systems (Cleantech), Support (Industrial Air and Gas Products, Parts, Service and Operational Support) and Corporate and Other.

Incomes (losses) summarized by business segment are as follows:

For the three-month period ended September 30, 2021

	Systems	Support	Corporate	Total
	\$	\$	\$	\$
Revenues	13,083	13,623	-	26,706
COGS	8,018	8,611	-	16,629
Gross margin	5,065	5,012	-	10,077
Gross Margin %	39%	37%	-	38%
Research and Development expenses	463	-	-	463
Selling and administrative expenses	2,648	3,279	4,917	10,844
Other (Gains) and Losses	-	-	6,335	6,335
Financial income	-	-	(482)	(482)
Financial expense	-	-	1,762	1,762
Income taxes	-	-	324	324
Total expenses	3,111	3,279	12,856	19,246
Segment income (loss)	1,954	1,733	(12,856)	(9,169)

For the nine-month period ended September 30, 2021

	Systems	Support	Corporate	Total
	\$	\$	\$	\$
Revenues	44,548	35,446	-	79,994
COGS	37,716	23,026	-	60,742
Gross margin	6,832	12,420	-	19,252
Gross Margin %	15%	35%	-	24%
Research and Development expenses	1,868	-	-	1,868
Selling and administrative expenses	7,256	8,361	16,102	31,719
Other (Gains) and Losses	-	-	7,024	7,024
Financial income	-	-	(922)	(922)
Financial expense	-	-	4,662	4,662
Income taxes	-	-	774	774
Total expenses	9,124	8,361	27,640	45,125
Segment income (loss)	(2,292)	4,059	(27,640)	(25,873)

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

For the three-month period ended September 30, 2020

	Systems	Support	Corporate	Total
	\$	\$	\$	\$
Revenues	10,233	8,156	-	18,389
COGS	8,386	5,632	-	14,018
Gross margin	1,847	2,524	-	4,371
Gross Margin %	18%	31%	-	24%
Research and Development expenses	74	-	-	74
Selling and administrative expenses	535	1,291	3,042	4,868
Other (Gains) and Losses	-	-	1,137	1,137
Financial income	-	-	(247)	(247)
Financial expense	-	-	762	762
Income taxes	-	-	(37)	(37)
Total expenses	609	1,291	4,657	6,557
Segment income (loss)	1,238	1,233	(4,657)	(2,186)

For the nine-month period ended September 30, 2020

	Systems	Support	Corporate	Total
	\$	\$	\$	\$
Revenues	32,187	17,983	-	50,170
COGS	26,592	11,872	-	38,464
Gross margin	5,595	6,111	-	11,706
Gross Margin %	17%	34%	-	23%
Research and Development expenses	94	-	-	94
Selling and administrative expenses	1,415	3,179	8,445	13,039
Other (Gains) and Losses	-	-	932	932
Financial income	-	-	(343)	(343)
Financial expense	-	-	1,691	1,691
Income taxes	-	-	(14)	(14)
Total expenses	1,509	3,179	10,711	15,399
Segment income (loss)	4,086	2,932	(10,711)	(3,693)

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

For the three-month and nine-month periods ended September 30, revenue summarized by country, as determined by customer location, is as follows:

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2021	2020	2021	2020
	\$	\$	\$	\$
Revenue				
United States	9,244	11,682	35,280	28,803
Germany	7,966	-	19,874	-
Canada	6,497	4,315	15,438	11,375
China	46	1,687	3,859	6,420
Others	2,953	705	5,543	3,572
	<u>26,706</u>	<u>18,389</u>	<u>79,994</u>	<u>50,170</u>

No single customer contributed more than 10% to the Company's revenue for the three-month and nine-month periods ended September 30, 2021 and September 30, 2020.

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

	September 30, 2021 \$	December 31, 2020 \$
Non-current assets		
Canada	32,930	166,889
Europe	216,049	33,609
United States	34,304	17,827
Asia	-	229
	<u>283,283</u>	<u>218,554</u>

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

9) Other (gains) and losses

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2021	2020	2021	2020
Foreign exchange loss (gain)	(586)	193	(99)	(555)
Loss (gain) on disposal of assets	-	-	31	-
Loss (gain) on conversion of shares issued by a subsidiary (Note 5)	-	83	(45)	224
Gain on deconsolidation of a subsidiary	-	-	(2,154)	-
Integration and acquisition costs	1,338	861	3,708	1,263
Impairment charge of intangible assets and Goodwill	326	-	326	-
One-time payment arising from the prior departure of employees	5,257	-	5,257	-
Other (gains) and losses	6,335	1,137	7,024	932

10) Finance expenses

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2021	2020	2021	2020
	\$	\$	\$	\$
Accretion of the obligation arising from shares issued by a subsidiary (Note 5)	-	76	120	228
Financing fees	184	-	554	-
Interest and bank charges	490	571	769	778
Guarantee letter fees	3	12	7	131
Interest on long term debt	1,082	98	3,201	538
Accretion and revaluation of government royalty program obligation (Note 4)	3	5	11	16
	1,762	762	4,662	1,691

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

(Expressed in thousands of Canadian dollars)

11) Supplemental Cash flow information

For the nine-month period ended September 30, net change in non-cash working capital balances related to operations consists of the following:

	For the nine-month period ended September 30,	
	2021	2020
	\$	\$
Decrease (increase) in assets:		
Trade and other receivables	(7,923)	(14,423)
Inventories	(20,056)	(4,385)
Other current assets	316	247
Other non-current assets	7	-
Investment tax credits receivable	16	-
Increase (decrease) in liabilities:		
Trade payables, other payables and accrued liabilities	9,188	996
Contract liabilities	6,642	810
Provisions	359	161
Income tax payable (recoverable)	(277)	(307)
	<u>(11,728)</u>	<u>(16,901)</u>
Additional information		
Income tax paid	1,173	468
Interest paid	3,930	1,316

Xebec Adsorption Inc.

Notes to Condensed Interim Consolidated Financial Statements (Unaudited)

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12) Related party transactions

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

	For the three-month period ended September 30,		For the nine-month period ended September 30,	
	2021	2020	2021	2020
	\$	\$	\$	\$
Marketing and professional services expenses paid to companies controlled by members of the immediate family of an officer	7	9	19	70
Rent paid to companies controlled by members of the immediate family of an officer	18	6	55	6
Salaries and short-term benefits paid to members of immediate family of an officer	32	39	162	131
Material purchased to companies controlled by members of the immediate family of an officer	17	9	45	23
	<u>74</u>	<u>63</u>	<u>281</u>	<u>230</u>

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

13) Financial instruments

Measurement categories and fair values, including valuation methods and assumptions

The Company's financial instruments that are measured subsequent to initial recognition at fair value and financial instruments measured at amortized cost for which the fair value is disclosed 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).

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(Expressed in thousands of Canadian dollars)

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

September 30, 2021

	Amortized Cost		Amortized Cost	
	Carrying amount \$	Fair value \$	Carrying amount \$	Fair value \$
Cash	51,967	51,967		
Restricted cash	9,883	9,883		
Trade and other receivables	34,977	34,977		
Finance lease receivables	9,815	9,815		
Credit facility			5,000	5,000
Trade, other payables and accrued liabilities			36,284	36,284
Long-term debt			51,297	51,900
Government royalty program obligation			249	249

December 31, 2020

	Amortized Cost		Amortized Cost	
	Carrying amount \$	Fair value \$	Carrying amount \$	Fair value \$
Cash	160,938	160,938		
Restricted cash	7,642	7,642		
Trade and other receivables	17,918	17,918		
Other current assets	16	16		
Finance lease receivables	3,145	3,145		
Bank loan			975	975
Trade, other payables and accrued liabilities			24,576	24,576
Long-term debt			48,888	48,329
Government royalty program obligation			368	368
Obligation arising from shares issued by a subsidiary			2,972	2,972

The carrying values of cash, restricted 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:

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- Long-term debt (classified in level 2 of the fair value hierarchy): The Company's long-term debts carry 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 (classified in level 2 of the fair value hierarchy): 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 (classified in level 2 of the fair value hierarchy): 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.

14) Subsequent event

Acquisition of UECompression

On November 3, 2021, the Company announced the acquisition of Colorado-based UECompression (UEC) for a total consideration of USD\$ 8 million subject to certain holdbacks and adjustments. Founded in 1983, UEC is a premier designer and builder of custom air and gas compressor solutions for power generation, industrial and energy applications. The acquisition of UEC provides the Company with a cost-effective and timely pathway towards expanding production capacity for standardized renewable gas systems.

The Company is currently assessing the fair value of the assets acquired and liabilities assumed and will disclose the preliminary purchase price allocation in its consolidated financial statements for the fourth quarter ending December 31, 2021.

Increase of credit facility with FSTQ

On November 9, 2021, the Company and FSTQ entered into an amended and restated Loan Agreement, increasing the credit facility provided by FSTQ by \$15.0 million and providing for the issuance of 4,500,000 warrants to FSTQ at an exercise price of \$4.44 per warrant for a three-year term. This transaction provides access to additional liquidity to strengthen the Company's strategic initiatives.