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H_2O Innovation reports fiscal year 2017 second quarter results: an indicator of H_2O Innovation's business model evolution

Key highlights

- Continuous revenue growth of 51.6% to reach $19.9 M, compared to $13.2 M for the same period of the previous fiscal year;
- 82.7% of the revenues recorded in this second quarter are coming from O&M and SP&S activities, which are recurring in nature;
- Backlog for water treatment projects increased from $43.1 M for the second quarter of fiscal year 2016, to reach $54.3 M for the corresponding period of this fiscal year, while O&M backlog stands at $54.9 M, for a consolidated backlog of $109.2 M as at December 31, 2016;
- Adjusted EBITDA[1] at $809,625, compared to $1,030,502 for the same quarter last year;
- Net (loss) earnings amounted to ($1,093,270), compared to $174,221 for the same period of the previous fiscal year;
- Cash generated by operating activities reached $1,083,117 compared to $128,382 for the same quarter of the previous fiscal year.

All amounts in Canadian dollars unless otherwise stated.

Quebec City, February 14, 2017 – (TSXV: HEO) – H_2O Innovation Inc. ("H_2O Innovation" or the "Corporation") announces its results for the second quarter of fiscal year 2017 ended December 31, 2016. During this quarter, the Corporation's revenues increased by 51.6% to $19.9 M, up from $13.2 M for the same quarter of fiscal year 2016. This increase is largely attributable to the acquisition of Utility Partners, effective July 1, 2016, which added significant revenues coming from Operation & Maintenance ("O&M") activities.

For this second quarter, 44.0% of the revenues came from O&M activities, 38.7% of the revenues came from the Specialty Products & Services ("SP&S") and 17.3% came from water treatment projects. "Our business model has fundamentally evolved where 82.7% of the revenues recorded on this second quarter are coming from the O&M and SP&S business pillars, considered recurring in nature. This revenue distribution between the pillars is allowing us to gain predictability in our business model and secure long-term relationship with customers", **stated Frédéric Dugré, President and Chief Executive Officer of H_2O Innovation.** The Corporation's adjusted EBITDA stands at $809,625, compared to $1,030,502 for the same quarter last year. The consolidated backlog as of December 31, 2016 stood at $109.2 M, with $54.3 M coming from our projects business pillar and $54.9 M from the O&M activities.

Revenues from water treatment projects have declined momentarily to $3.4 M compared to $5.9 M in the corresponding period of the previous fiscal year, representing a 41.8% decrease. This is not unusual since revenues from projects vary from quarter to quarter and depends on the different milestones reached for revenue recognition. The decrease for the first part of the Corporation's fiscal year is explained by the fact that the nature of projects has changed. The actual water treatment projects backlog consists of projects that have a more extensive engineering phase. During the second half of this current fiscal year, the projects will enter into the manufacturing phase which will allow the recognition of significantly more revenues as fabrication moves forward. Also, project

[1] The definition of adjusted earnings before interest, tax depreciation and amortization (adjusted EBITDA) does not take into account the Corporation's finance costs – net, stock-based compensation costs, gain on purchase price adjustment, unrealized exchange (gains) / losses and acquisition and integration costs. See reconciliation of this non-IFRS measure below. The definition of adjusted EBITDA used by the Corporation may differ from those used by other companies.

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execution can sometime be postponed due to situations outside of the control of the Corporation, and therefore impacts revenue recognition. Even though revenues are slower and lumpy, the water treatment projects are still a growth vehicle of the Corporation. The water treatment projects order backlog stands at $54.3 M as at December 31, 2016, compared to $43.1 M a year ago, representing a 25.8% increase over the last 12 months.

Revenues from SP&S reached $7.7 M compared to $7.2 M in the comparable quarter of the previous fiscal year, which represents an increase of 6.6%. Over the last twelve months, revenues reached $28.9 M, which represents an increase of 21.9% compare to the previous twelve months where revenues were at $23.7 M. This strong increase in SP&S revenues is the direct result of investments made during the last few years in our operating and selling functions to support the growth of this business line. Just over the last six quarters the Corporation has developed, launched and acquired new proprietary technologies such as the High Brix™, Smartrek™, Clearlogx® and SPMC™, which boosted revenues up.

Revenues coming from O&M amounted to $8.8 M. These revenues are recurring sales and came mainly from Utility Partners. The backlog related to these O&M contracts stood at $54.9 M as at December 31, 2016 and consists of long-term contracts, mainly with municipalities, which contain multi-year renewal options. "Since the acquisition, the integration plan is moving very well as expected by management. The change of leadership is transitioning very smoothly. We have successfully renewed all the contracts that were in renewal phase and have also secured some cross selling sales", **added Mr. Dugré.**

In this second quarter of fiscal year 2017, the Corporation generated a 24.2% gross profit before depreciation and amortization, a lower level than the 31.3% gross profit before depreciation and amortization generated in the second quarter of fiscal year 2016. The revenue mix has been modified with the acquisition of Utility Partners which operates in a different model than our previous core activities. Indeed, O&M activities generally generates lower gross margin. Therefore the integration of Utility Partners into H_2O Innovation, which in this quarter represents 44.0% of the total revenues, puts pressure on the overall gross margin of the Corporation, although increasing the predictability and stability of the financial results.

CONSOLIDATED RESULTS **Selected financial data**	**Three-month period ended on December 31, (Unaudited)**		**Six-month period ended on December 31, (Unaudited**	
	2016 **$**	2015 $	**2016** **$**	2015 $
Revenues	**19,957,831**	13,165,590	**39,826,693**	25,424,918
Gross profit before depreciation and amortization	**4,834,439**	4,126,602	**9,297,976**	7,331,088
Gross profit before depreciation and amortization	**24.2%**	31.3%	**23.3%**	28.8%
Operating expenses	**486,003**	318,886	**924,407**	652,866
Selling expenses	**1,615,633**	1,611,384	**3,211,524**	2,969,117
Administrative expenses	**2,132,083**	1,188,169	**3,992,813**	2,231,720
Research and development expenses – net	**33,872**	35,610	**115,244**	120,174
Net (loss) earnings	**(1,093,270)**	174,221	**(2,175,356)**	226,550
Basic and diluted (loss) earnings per share	**(0.027)**	0.008	**(0.074)**	0.011
Adjusted EBITDA	**809,625**	1,030,502	**1,438,640**	1,472,276

The Corporation's ratio of selling, operating and administrative expenses ("SG&A") as a whole over revenues amounted to 21.2% for this quarter, down from 23.7% for the corresponding quarter of the previous fiscal year. This decrease is mostly attributable to the acquisition of Utility Partners in July 2016 which has lower selling and operating expenses.

Adjusted EBITDA for the quarter was recorded at $809,625, compared with $1,030,502 for the same period ended December 31, 2015. The adjusted EBITDA over revenues represents 4.1%, compared to 7.8% for the same quarter in fiscal year 2016. The decrease in the adjusted EBITDA over revenues ratio is due, in part, to a lower volume coming from revenues of water treatment projects. Moreover, the shift in product mix and the addition of Utility Partners results impacted negatively the overall gross margin, decreasing the adjusted EBITDA. Once the volume of revenues will increase, the Corporation expects this percentage to increase accordingly since all the fixed charges are already covered.

The net (loss) earnings amounted to ($1,093,270) or ($0.027) per share for the second quarter of fiscal year 2017 compared with $174,221 or $0.008 per share for the second quarter of fiscal year 2016. The increase in net loss is largely due to the acquisition of Utility Partners and the related acquisition and integration costs and to a higher level of SG&A expenses, aimed to support the constant growth of the Corporation.

Operating activities generated $1,083,117 in cash for the three-month period ended December 31, 2016, compared with $128,382 of cash generated during the corresponding period ended December 31, 2015. The increase is due to the changes in working capital items, to the addition of Utility Partners, and the increase in non-cash items, subdued by the loss before income taxes in the second quarter of fiscal year 2017.

Reconciliation of adjusted EBITDA to net (loss) earnings

Even though adjusted EBITDA is a non-IFRS measure, it is used by management to make operational and strategic decisions. Providing this information to the stakeholders, in addition to the GAAP measures, allows them to see the Corporation's results through the eyes of management, and to better understand the financial performance, notwithstanding the impact of GAAP measures.

	Three-month periods ended December 31,		**Six-month periods ended December 31,**	
	2016	2015	**2016**	2015
	$	$	**$**	$
Net (loss) earnings for the period	**(1,093,270)**	174,221	**(2,175,356)**	226,550
Finance costs – net	**321,870**	216,217	**656,295**	364,254
Income taxes	**(88,127)**	8,000	**(391,593)**	212,853
Depreciation of property, plant and equipment	**181,436**	144,643	**356,464**	271,986
Amortization of intangible assets	**837,666**	236,426	**1,501,522**	468,105
Gain on purchase price adjustment	**-**	-	**-**	(375,977)
Unrealized exchange loss	**135,467**	203,681	**177,868**	257,087
Acquisition and integration costs	**347,124**	47,314	**1,020,829**	47,418
Stock-based compensation costs	**167,459**	-	**292,611**	-
Adjusted EBITDA	**809,625**	1,030,502	**1,438,640**	1,472,276

H_2O Innovation Conference Call

Frédéric Dugré, President and Chief Executive Officer and Marc Blanchet, Chief Financial Officer, will hold an investor conference call to discuss the financial results for 2017 second quarter in further details at 10:00 a.m. Eastern Time on Tuesday, February 14, 2017.

To access the call, please call (877) 223-4471 or (647) 788-4922, five to ten minutes prior to the start time. Presentation slides for the conference call will be made available on the Corporate Presentations page of the Investors section of the Corporation's website.

The second quarter financial report is available on www.h2oinnovation.com and on NYSE Euronext Alternext's site. Additional information on the Corporation is also available on SEDAR (www.sedar.com).

Prospective disclosures

Certain statements set forth in this press release regarding the operations and the activities of H_2O Innovation as well as other communications by the Corporation to the public that describe more generally management objectives, projections, estimates, expectations or forecasts may constitute forward-looking statements within the meaning of securities legislation. Forward-looking statements concern analysis and other information based on forecast future results, performance and achievements and the estimate of amounts that cannot yet be determined. Forward-looking statements include the use of words such as “anticipate”, “if”, “believe”, “continue”, “could”, “estimate”, “expect”, “intend”, “may”, “plan”, “potential”, “predict”, “project”, “should” or “will”, and other similar expressions, as well as those usually used in the future and the conditional, notably regarding certain assumptions as to the success of a venture. Those forward-looking statements, based on the current expectations of management, involve a number of risks and uncertainties, known and unknown, which may result in actual and future results, performance and achievements of the Corporation to be materially different than those indicated. Information about the risk factors to which the Corporation is exposed is provided in the Annual Information Form dated September 26, 2016 available on SEDAR (www.sedar.com). Unless required to do so pursuant to applicable securities legislation, H_2O Innovation assumes no obligation to update or revise forward-looking statements contained in this press release or in other communications as a result of new information, future events and other changes.

About H_2O Innovation

H_2O Innovation designs and provides state-of-the-art, custom-built and integrated water treatment solutions based on membrane filtration technology for municipal, industrial, energy and natural resources end-users. The Corporation’s activities rely on three pillars which are i) water and wastewater projects; ii) specialty products and services, including a complete line of specialty chemicals, consumables, specialized products for the water treatment industry as well as control and monitoring systems; and iii) operation and maintenance services for water and wastewater treatment systems For more information, visit www.h2oinnovation.com.

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– 30 –

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