Amended Interim Financial Report
Second quarter ended
December 31, 2010

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Trading symbols:
TSX Venture: HEO
Alternext: MNEMO: ALHEO

MANAGEMENT REPORT

Dear Shareholders,

While H_2O Innovation's total sales for the second quarter of fiscal 2011 are comparable to those of the previous quarter, our results show a welcomed progression, with positive adjusted EBITDA[1] and cash flows generated from operating activities. During the quarter, our Company steadily stayed on course reinforcing its business model, streamlining its operations and growing its equipment sales backlog. This quarter's results also show several key improvements when compared to the corresponding quarter of the previous fiscal year.

During the quarter, improved project execution and supply chain optimisation, amongst major factors, enabled our operations to generate a gross margin of 31.4%, an increase compared to the same period ended December 31, 2009, when it was recorded at 22.1%. This higher gross margin was recorded on a lower level of sales – demonstrating the impacts of the productivity gains from the cost reduction and spending control program initiated two quarters ago as well as the contribution of the sales of services and consumable products. A higher proportion of industrial systems sales compared to municipal projects in this quarter's revenue mix also positively contributed to this quarter's margin.

For the quarter ended December 31, 2010, H_2O Innovation secured more new bookings for sales of equipment and systems than it recorded revenues of the same nature, for a fourth consecutive quarter. Bookings of equipment and systems sales for the quarter amounted to $7.4 M, compared to only $4.2 M in the second quarter of the previous fiscal year. The continuation of this trend is a positive sign that leads us to expect higher revenues from systems and equipment in the coming quarters.

The new bookings recorded during the quarter brought the Company's sales backlog to $15.1 M as at December 31, 2010, slightly up compared to three months ago and $5.3 M higher than a year ago when it totalled only $9.8 M[2]. The sales backlog is entirely composed of systems and equipment sales and does not include sales of services or consumables, nor does it include the backlog of H_2O Innovation India.

Our sales of services and consumables increased by nearly 17% at $2.8 M during the quarter, compared to $2.4 M for the second quarter of the previous fiscal year. Early in the quarter, we completed the build-out and renovation of our specialty chemicals production facility in Vista, California. New upgrades to the production facilities enable our Professional Water Technologies ("PWT") business unit to be more efficient in polymer synthesis and production

[1] Earnings before interests, taxes, depreciation and amortization (EBITDA) is a performance indicator that is not determined in accordance with Canadian generally accepted accounting principles and is not intended as an alternative measure of net earnings. Because EBITDA may not be calculated identically by all companies, the Company's result may not be directly comparable to similarly titled measures of other companies.
[2] After the cancellation of the previously postponed $9.4 M contract from PCOSI.

operations, generating greater economies of scale and quicker turn-around time for customers, particularly crucial for large orders coming from its network of international distributors.

At $1.96 M, our level of selling, general and administrative ("SG&A") expenses was down approximately $19,000 compared to the previous quarter of the current fiscal year and down over $270,000 compared to the corresponding quarter of the previous year, a decrease of 12.2%. As such, the Company's SG&A expenses were reduced by nearly $317,000 for the first half of fiscal 2011. Management expects the effects of the cost reduction and spending control program to continue to make themselves felt over the course of the next two quarters as more measures start to show results.

EBITDA for the quarter was ($19,376), compared to ($982,738) for the same period ended December 31, 2009. H_2O Innovation's adjusted EBITDA for the quarter reached positive levels at $65,532 (excluding unrealized foreign exchange loss of nil and a ($84,908) stock-based compensation expense), compared to ($760,658) for the corresponding quarter of the previous fiscal year. Management believes positive adjusted EBITDA levels will be maintained for the remainder of the fiscal year, as total sales grow and other variables remain stable.

For the first six months of fiscal 2011, the Company recorded a net loss of ($1.19 M) ($0.020 per share) compared to ($2.22 M) ($0.04 per share) for the comparable six-month period of the previous fiscal year, an improvement of $1.02 M.

Management feels the Company's working capital and overall financial situation at quarter-end is sound, despite the momentary low level of cash and cash equivalents reported on the balance sheet at the end of the quarter. As at December 31, 2010, H_2O Innovation shows an appreciable working capital ratio of 1.8. At period-end, compared to June 30, 2010, the Company records an increase of $3.1 M in accounts receivable due to the completion of several projects close to December 31, 2010. Our balance sheet reflects an increase of $0.66 M in inventories as we prepare for the start of the maple syrup production season and for an important order of membrane antiscalants and cleaners. The Company's balance sheet also shows a decrease of $1.32 M in accounts payable as at December 31, 2010, compared to June 30, 2010. Management is making sound use of the Company's lines of credit to provide short term funding and care for disparities in cash inflows and outflows caused by project evolution.

On the commercial side, sales of our line of high-efficiency wastewater treatment and water reuse systems are continuing to make good progress, with the first sales of Bio-Wheel and Bio-Brane systems recorded in the Canadian provinces of Alberta and Manitoba, for industrial and municipal applications. These first Canadian Bio-Wheel and Bio-Brane systems are promising building grounds for our proprietary wastewater treatment technology in Canada, expanding its U.S. home market where nearly 100 Bio-Wheel and Bio-Brane systems are in operation. The municipal drinking water systems market also generated a number of sound opportunities during the quarter, particularly in the United States. For its part, the market for industrial water treatment systems boomed with opportunities, in both Canada and the United States, and our sales teams focused on the energy, power generation and oil & gas markets, in which our list of references is a definite competitive advantage.

The quarter also saw us execute new procurement agreements with key suppliers that will bring increased procurement efficiencies and higher economies of scale for high volume raw material. Coupled with the update of the Company's ERP system scheduled to take place over the course of the next two quarters and its implementation in our Vista, California specialty chemicals manufacturing plant, upcoming months will see Management continue to focus on operations, supporting our internal and external sales forces by becoming more competitive – and successful.

Frédéric Dugré
President and CEO

MANAGEMENT’S DISCUSSION AND ANALYSIS OF THE FINANCIAL SITUATION

In accordance with National Instrument 51-102 Continuous Disclosure Obligations, the following comments are intended to provide a review and an analysis of H_2O Innovation’s results of operations and financial position for the quarter ended December 31, 2010, in comparison with the corresponding period ended December 31, 2009. They should be read in conjunction with the consolidated financial statements and accompanying notes. Comparison of Balance sheets as at December 31, 2010 to those as at June 30, 2010 is also included. Certain statements set forth in this Management’s Discussion and Analysis regarding the operations and the activities of H_2O Innovation as well as other communications by the Company 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 and the estimate of amounts that cannot yet be yet determined. Forward-looking statements include the use of the words “expect”, “believe”, “estimate” and other similar terms 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 involve a number of risks and uncertainties which may result in actual and future results of the Company to be materially different than those indicated. Information about the risk factors to which the Company is exposed is provided in the Annual Information Form dated September 21, 2010 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 Management’s Discussion and Analysis or in other communications as a result of new information, future events and other changes.

The following financial statements and the corresponding figures have not been reviewed by the Company’s auditors. They have been prepared in accordance with Canadian generally accepted accounting principles. All figures in the present report are expressed in Canadian dollars, unless otherwise indicated.

VISION, MISSION & PROFILE

OUR VISION

Create sustained and growing value for our shareholders by becoming the best in North America, working through consulting engineers, at customizing water treatment solutions based on comprehensive analytical and strong technical capabilities that maximize the efficiency, performance and longevity of our customers’ systems.

OUR MISSION

To provide safe, integrated and customized water treatment solutions in a changing environment.

OUR PROFILE

Building on 10 years of experience, H_2O Innovation designs, manufactures, and integrates state-of-the-art custom-built water treatment systems for the production of drinking water, the reclamation of water, the treatment of wastewater and industrial process water in the municipal, commercial, industrial, oil & gas, mining, and energy markets. Additionally, the Company offers complete operating and maintenance solutions for membrane filtration and reverse osmosis systems. H_2O Innovation has approximately 100 employees and eight offices including three manufacturing and assembly plants in Canada and the United States, and is also a founding partner of H_2O Innovation India, a joint venture with Chembond Chemicals, Mumbai, India.

RESULTS OF OPERATIONS

Selected financial data
(Unaudited)

	Three-month periods ended December 31		Six-month periods ended December 31	
	2010	2009	2010	2009
	$	$	$	$
Sales	6,421,506	7,087,242	12,761,372	15,493,852
Gross margin	2,017,729	1,568,895	3,910,674	4,077,579
Gross margin	31.4 %	22.1%	30.6%	26.3%
Operating, selling, admin. and general expenses	1,969,771	2,243,055	3,958,318	4,275,187
Net loss	(544,417)	(1,576,222)	(1,191,823)	(2,218,910)
Basic and diluted loss per share	(0.009)	(0.029)	(0.020)	(0.040)
EBITDA	(19,376)	(982,738)	(101,367)	(1,055,598)
Adjusted EBITDA	65,532	(760,658)	9,305	(271,458)

Sales and gross margin

Revenues generated during the second quarter of fiscal 2011 are down by 9% compared to the second quarter of fiscal 2010, but slightly up compared to the first quarter of the current fiscal year. This stabilization of sales level over the last six months demonstrates a careful and wise management of the Company. With a solid source of revenues coming from the sales of services and consumables ($2.8 M) and a significant level of new equipment and systems bookings in the second quarter ($7.4 M), we are confident that our revenue level will progressively recover in the coming quarters.

The quarter figures also reflect a higher activity level in the industrial field compared to the corresponding quarter of the previous fiscal year. These new industrial projects result from a major revival of the Company's industrial market, as manufacturers, resource, oil & gas, energy companies and numerous segments of the privately owned economy have restarted investing in capital equipment. Generally speaking, the execution of industrial projects helps improve our gross margin as we offer our clients a wider and more integrated line of products and services. Over the last six months, our sales teams have been working to maximize the connection between the equipment we manufacture and our consumables, among which the chemicals offered by our Professional Water Technologies ("PWT") business unit. This tighter connection within our customer service integration has already had a positive impact on our sales, and has helped us better support our clients in operating their systems as well as secure longer, closer relationships with our clients. By following this strategy, not only can we better face the fluctuations in equipment sales, but we also offer a distinctive customer service.

The following table summarizes the evolution of our sales and new orders, together with the variations in our backlog during the last six quarters. This analysis shows how we have evolved in a volatile economy and how our business model combining sales of equipment and sales of consumables makes us stronger and puts us in a better position to face fluctuations.

	FY 2010				FY 2011	
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Backlog	$13.4 M*	$9.8 M	$14.5 M	$14.7 M	$14.3 M	$15.1 M
Orders for equipment and systems	$2.7 M	$4.2 M	$5.8 M	$6.7 M	$3.7 M	$7.4 M
Sales of equipment and systems	$6.1 M	$4.7 M	$3.6 M	$3.1 M	$3.5 M	$3.6 M
Orders / Sales Ratio	***0.4***	***0.9***	***1.6***	***2.2***	***1.2***	***2.1***
Sales of services and consumables	$2.3 M	$2.4 M	$2.7 M	$2.8 M	$2.8 M	$2.8 M
Total sales	$8.4 M	$7.1 M	$6.3 M	$5.9 M	$6.3 M	$6.4 M

*After cancellation of a $9.4M contract from PCOSI

For the second quarter ended December 31, 2010, total sales amounted to $6.4 M compared to $7.1 M for the corresponding quarter of the previous fiscal year. Despite this modest $0.7 M decrease in total sales in comparison with the corresponding quarter of the previous fiscal year, total sales show a slight increase compared to the last three quarters (FY 2010 Q3 and Q4, and FY 2011 Q1). This turnaround is partially linked to the award of new contracts, but also to the sustained sales of services and consumables. For the six-month period ended December 31, 2010, total sales amount to $12.8 M, compared to $15.5 M for the same six-month period ended December 31, 2009. The difference can mainly be attributed to the economic environment in which the Company has been evolving.

Gross margin for the second quarter of fiscal 2011 increased to 31.4%, compared to 22.1% for the corresponding quarter of the previous fiscal year. This marked increase in gross margin is due to sustained recurring revenues (services and consumables) and to the large proportion of industrial projects in the Company's revenue mix. Similarly, gross margin increased from 26.3% to 30.6% respectively for the six-month periods ended December 31, 2009 and 2010. Revenue composition (equipment versus services and consumables), diversity in applications (drinking water, wastewater treatment, water recycling), balancing of our clients (municipal versus industrial) and their geographical situation are key factors that directly impact the Company's gross margin. The actions we initiated two years ago to diversify our sources of revenue, extend our commercial activities outside Canada and the United States, improve our project execution and optimize our sourcing services today enable the Company to continuously improve its gross margins and competitiveness.

The Company's backlog, consisting solely of sales of systems and equipment and excluding sales recorded by the joint-venture H_2O Innovation India Ltd., increased from $9.8 M to $15.1 M respectively for the quarters ended December 31, 2009 and 2010. This significant increase in backlog over the last twelve months can be linked to the recovery of the North American economy and is likely to translate into increased revenues for the next quarters, provided that sales of services and consumables and other variables remain stable. The award of $7.4 M new contracts during this second quarter, compared to $4.2 M for the corresponding quarter of the previous fiscal year, has maintained this positive trend.

Operating expenses

During this second quarter, operating, selling, administrative and general expenses decreased from $2.24 M to $1.96 M respectively for the quarters ended December 31, 2009 and 2010. This 12.2% decrease over a twelve-month period reflects the positive impacts of the Company's cost reduction and spending control program announced in Spring 2010. Similarly, these operating expenses decreased from $4.27 M to $3.96 M respectively over the six-month periods ended December 31, 2009 and 2010. During the quarters to come, Management intends to maintain this expense level, with the exception of variable costs that are directly linked to sales.

Increase in the depreciation of fixed assets for this quarter compared to the corresponding quarter of the previous fiscal year can be mainly explained by the new upgrades to the production facilities at our PWT plant in California for the production of specialty chemicals. These upgrades, which were substantially completed during the first quarter of fiscal 2011, significantly increase our productivity and efficiency while insuring safer production operations.

Moreover, the decrease in the depreciation of intangible assets for the period ended December 31, 2010 compared to the corresponding quarter of the previous fiscal year is primarily due to the impact of the $1.8 M impairment of intangible assets recorded in the fourth quarter of the fiscal year ended June 30, 2010.

To date, Management is not aware of any factor or sign possibly affecting the value of the intangible assets or the recoverability of goodwill.

EBITDA

EBITDA[3] for the second quarter ended December 31, 2010 was ($19,376) compared to ($982,738) for the same period ended December 31, 2009. On a half-yearly basis, EBITDA was ($101,367) and ($1,055,598) respectively for the six-month periods ended December 31, 2010 and 2009. Excluding unrealized foreign exchange loss and share-based compensation, adjusted EBITDA amounted to $65,532 compared to ($760,658) respectively for the quarters ended December 31, 2010 and 2009.

This turnaround marks a significant change in fiscal 2011 and reflects the positive impacts of the improvement in gross margin combined to our streamlining efforts over the last months. Achieving a positive adjusted EBITDA with this quarter's sales figure of only $6.4 M suggests EBITDA could grow, if sales increase over the next quarters. On a half-yearly basis, adjusted EBITDA amounts to $9,305 and ($271,458) respectively for the six-month periods ended December 31, 2010 and 2009. Increasing EBITDA over the next quarters remains Management's priority.

Other income and expenses

The reclassification of the Company's foreign operations from integrated to self-sustaining (as explained below in the "Accounting Changes" section) eliminates the unrealized exchange loss of $92,614 and results in a realized exchange loss of $3,340 as at December 31, 2010, compared to a mostly unrealized exchange loss of $757,603 as at December 31, 2009.

The interest expenses on long-term debt decreased from $185,188 to $146,575 respectively for the three-month periods ended December 31, 2009 and 2010. Over the six-month periods ended December 31, 2009 and 2010, these same expenses decreased from $386,562 to $333,695 respectively. The decrease of more than 26% on a quarterly basis and of over 13% on a half-yearly basis can mainly be explained by the repayments of principal on our long-term debt, amounting to $170,818 for the second quarter and $341,081 for the first six months of the current fiscal year.

Net loss

During the second quarter of fiscal 2011, the Company recorded a net loss of ($544,417) or ($0.009 per share), compared to a net loss of ($1,576,222) or ($0.029 per share) for the corresponding period of fiscal 2010. On a half-yearly basis, net loss amounts to ($1,191,823) or ($0.020 per share) for the period ended December 31, 2010, compared to ($2,218,910) or ($0.040 per share) for the corresponding period of the previous fiscal year.

In spite of a result that remains negative and a decrease in the sales figure compared to the corresponding quarter of the previous fiscal year, the decrease in net loss for the three- and six-month periods of the current fiscal year can mainly be explained by an improvement in gross margin, a reduction in operating expenses level, a decrease in the depreciation of intangible assets following the impairment recorded in June 2010 and a decrease in interests paid on long-term debts.

Commitments

The Company has entered into long-term lease agreements expiring in 2012, 2013 and 2017, which call for lease payments of $1,766,500 for the rental of space. The minimum annual lease payments over the next five years are $479,126 in 2011, $387,249 in 2012, $255,385 in 2013, $181,174 in 2014 and $185,541 in 2015.

Information on share capital

As at December 31, 2010, the Company had 60,145,832 outstanding shares. During this second quarter, 25,000 shares were issued upon exercise of stock options at $0.32 per share.

During the first six months of fiscal 2011, the Company granted 2,035,000 stock options to its Board members and key personnel, the whole pursuant to the terms and conditions of the Company's stock option plan. These grants aim at implementing a profit sharing and compensation plan to retain personnel and provide an incentive to participate in the long-term development of the Company and the growth of shareholder value. The stock options entitle their holders to

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acquire one common share of the Company at a price of $0.50 before the end of September or November 2020 and have vesting periods from two to four years.

FINANCIAL SITUATION

After the change in operating working capital, **operating activities** for the second quarter ended December 31, 2010 generated $67,095 in cash, in comparison with $3,651,957 of cash used for the corresponding period ended December 31, 2009. For the six-month periods ended December 31, 2010 and 2009, the Company used $2,721,905 and $3,582,268 $ in cash respectively. The decrease in funds used by operating activities both in the second quarter and during the six-month period is mainly attributable to the increase of our operating activities and the significant decrease in our net loss as at December 31, 2010.

For this second quarter, **investing activities** required net cash of $658,624, mainly attributable to the acquisition of long-term assets linked to our manufacturing operations amounting to $56,772 and to payments relating to contingent considerations as part of previous acquisitions amounting to $452,366.

Financing activities used net cash of $32,388 during the second quarter of fiscal 2011, compared to $218,750 of cash used during the corresponding period ended December 31, 2009.

QUARTERLY SUMMARY FINANCIAL INFORMATION (unaudited)

(in dollars, except per share data)

	Three-month periods ended			
	December 31, 2010	**September 30, 2010**	**June 30, 2010**	**March 31, 2010**
Sales	6,421,506	6,339,866	5,921,355	6,312,349
EBITDA	(19,376)	(81,991)	(785,178)	(980,271)
Net earnings (Net loss)	(544,417)	(647,406)	(6,220,440)	(1,558,567)
EPS basic and diluted	(0.009)	(0.011)	(0.113)	(0.028)

	Three-month periods ended			
	December 31, 2009	**September 30, 2009**	**June 30, 2009**	**March 31, 2009**
Sales	7,087,242	8,406,610	7,322,452	8,797,872
EBITDA	(982,738)	(72,860)	(1,301,902)	1,180,650
Net earnings (Net loss)	(1,576,222)	(642,688)	(1,067,448)	684,423
EPS basic and diluted	(0.029)	(0.012)	(0.022)	0.014

CAPITAL MANAGEMENT

The Company's objective when managing capital is to maintain a flexible capital structure, which optimizes the cost of capital at an acceptable risk level. For capital management purposes, the Company defines its capital as follows: shareholders' equity, long-term debt, convertible debenture less cash and cash equivalents, held-for-trading investments and held-to-maturity investment. The Company monitors capital in light of its monthly needs and obligations linked to its financial liabilities.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's critical accounting policies have been the same since June 30, 2010 except for the reclassification of the Company's foreign operations, as explained in the following section. For a comprehensive description of our critical accounting policies and estimates, please refer to our consolidated financial statements as at and for the year ended June 30, 2010.

ACCOUNTING CHANGES

In its interim financial statements for quarters ended September 30, 2010 and December 31, 2010, management had reflected its foreign operations as integrated. During the third quarter of fiscal 2011 it completed a detailed analysis which identified significant changes in the economic facts and circumstances. The information obtained from the analysis states that the significant changes arose during the first quarter of fiscal 2011. In consequence, this analysis requires that the translation method applied to the foreign operations be changed. These significant facts and circumstances include a cost reduction program, merger of offices and a reorganization of the legal and operational structure, which lead to a significant degree of autonomy of the Companyõs foreign operations. Therefore, the foreign operations have been reclassified from integrated to self-sustaining. The restated interim financial statements for quarters ended September 30, 2010 and December 31, 2010 have been re-filed on May 12, 2011.

The financial statements of foreign subsidiaries and of the joint venture considered as self-sustaining operations are translated using the current rate method. Under this method, assets and liabilities are translated in Canadian dollars at the exchange rate prevailing at the balance sheet date, and earnings items are translated in Canadian dollars at the average exchange rate for the period. Translation adjustments arising from exchange rate fluctuations are shown as ñAccumulated other comprehensive lossò under Shareholdersô equity. The translation of Canadian corporations remains unchanged.

The adjustments resulting from the translation of the Companyõs foreign subsidiaries and joint venture are recorded under the caption ñAccumulated other comprehensive lossò. This modification has been applied prospectively from July 1, 2010. The interim financial statements for the quarters ended September 30, 2010 and December 31, 2010 have been amended accordingly and re-filed and contain additional information on the effects of this accounting change.

The following tables present most significant changes to the financial statements of the quarters ended September 30, 2010 and December 31, 2010:

First quarter ended September 30, 2010 - Impact on Consolidated balance sheet	
ASSETS	
Decrease of long term assets	($381,190)
SHAREHOLDERSôEQUITY	
Decrease of deficit	($182,207)
Increase of accumulated other comprehensive loss	$563,397
Net impact	$381,190

First quarter ended September 30, 2010 - Impact on Consolidated statement of earnings	
EXPENSES	
Decrease of expenses	$52,193
Decrease of unrealized exchange loss	$129,294
Decrease of net loss	$182,207

Second quarter ended December 31, 2010 - Impact on Consolidated balance sheet	
ASSETS	
Decrease of long term assets	($1,046,532)
SHAREHOLDERSôEQUITY	
Decrease of deficit	($289,495)
Increase of accumulated other comprehensive loss	$1,373,128
Net impact	$1,046,532

Second quarter ended December 31, 2010 - Impact on Consolidated statement of earnings (3 month-period)	
EXPENSES	
Decrease of expenses	$14,674
Decrease of unrealized exchange loss	$92,614
Decrease of net loss	$107,288

Second quarter ended December 31, 2010 - Impact on Consolidated statement of earnings (6 month-period)	
EXPENSES	
Decrease of expenses	$67,587
Decrease of unrealized exchange loss	$221,908
Decrease of net loss	$289,495

The accounting change had a neutral effect on the Company's consolidated statements of cash flows for the quarters ended September 30, 2010 and December 31, 2010.

For a complete description of the changes to the financial statements of the quarters ended September 30, 2010 and December 31, 2010, please refer to Note 2 of the corresponding restated consolidated financial statements refiled on May 12, 2011.

NEW ACCOUNTING STANDARDS

Future accounting changes

The CICA published the following sections of the CICA Handbook that apply to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011:

a) Section 1582, "Business Combinations", which replaces the former Section 1581 with the same title, establishes standards for a business combination. It provides the Canadian equivalent to International Financial Reporting Standard IFRS 3, "Business Combinations".

b) Section 1601, "Consolidated Financial Statements", which replaces the former Section 1600 with the same title, establishes standards for the preparation of consolidated financial statements.

c) Section 1602, "Non-Controlling Interests". This new section establishes standards on accounting for non-controlling interests in a subsidiary in consolidated financial statements prepared subsequent to a business combination. It is equivalent to the corresponding provisions of International Accounting Standard IAS 27, "Consolidated and Separate Financial Statements".

The Company is presently evaluating the impact of these new standards on its financial statements.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

In February 2008, the Accounting Standards Board ("AcSB") confirmed that Canadian GAAP for publicly accountable enterprises will be converged with IFRS, effective in calendar year 2011, with early adoption allowed starting in calendar year 2009. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences on recognition, measurement, presentation and disclosures.

An implementation plan for the IFRS adoption strategy has been developed. The activities planned include the identification and documentation of existing differences between IFRS and Canadian GAAP in accounting and disclosure requirements; the selection of IFRS accounting policies, including the consideration of options available under IFRS; the determination of the impact of conversion on internal controls, accounting systems and other business solutions and processes; and the development of a training program to assist appropriate employees in the transition to and the ongoing compliance with IFRS.

IFRS 1 – First-time adoption of international reporting standards

Accounting policy developments
Transition to International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB)

The discussion in this section includes expectations at the reporting date about the transition from Canadian GAAP to IFRS as issued by the IASB, or IFRS-IASB (subsequently referred to as IFRS).

Key dates

- ✓ July 1, 2010 (transition date): An opening statement of financial position according to IFRS will be prepared, as at this date, to facilitate the changeover to IFRS in 2011. H_2O Innovation will continue to report its fiscal 2011 and comparative 2010 results according to the Canadian GAAP.
- ✓ July 1, 2011 (changeover date): The date after which H_2O Innovation will prepare and report interim and annual 2012 financial statements with 2011 comparatives according to IFRS.

Transition date impacts and policy choices

The transition to IFRS requires the Company to apply IFRS 1, or other requirements for preparing IFRS-compliant financial statements in the first reporting period after the changeover date. IFRS 1 applies only at the time of changeover, and includes a requirement for retrospective application of each IFRS, as if they were always in effect. IFRS 1 also mandates certain exceptions to retrospective application and provides a series of optional exemptions from retrospective application to ease the transition to the full set of IFRS. The Company discloses its initial decisions regarding transition date impacts in the table below. In addition, the Company determined a modest number of areas where changes in accounting policies were expected that may impact the consolidated financial statements.

Policy area	Choices and impacts
Past business combinations	**IFRS 1 optional exemption and transition date impact:** The Company currently expects not to restate its past business combinations that occurred before July 1, 2010. **Ongoing impact:** The Company had contingent considerations related to past business combinations which were not recognised under the Canadian GAAP. The Company is currently evaluating the liability in relation to those contingent considerations as of July 1, 2010.
Fair value of property, plant and equipment and intangible assets as deemed cost	**IFRS 1 optional exemption and transition date impact:** The Company currently expects to use the carrying value at the date of transition to the exception of the building for which a valuation expertise is under way. **Ongoing impact**: The Company currently expects to continue to use the cost model for each class of assets to the exception of the building.
Share-based payment transactions	**IFRS 1 optional exemption and transition date impact:** The Company currently expects to use the exemption that allows first-time adopters not to apply IFRS 2 for equity settled share-based payments granted on or before November 2, 2002 and the exemption that allows first-time adopters not to apply IFRS 2 to share-based payments granted after November 7, 2002 that vested before the transition date. **Ongoing impact:** The Company is currently evaluating the impact of a forfeiture rate on stock options that have not vested before the transition date.
Designation of previously recognised financial instruments	**IFRS 1 optional exemption and transition date impact:** The Company currently expects not to reclassify a financial asset, other than an asset that meets the definition of "held for trading" as an "available-for-sale" financial asset as of July 1, 2010. **Ongoing impact:** The Company does not anticipate any further impact.

The Company pursues the evaluation of the monetary impacts of the conversion, and these impacts will be subject to a detailed disclosure when all work has been completed.

OFF-BALANCE SHEET ARRANGEMENTS

As at December 31, 2010, the Company had off-balance sheet arrangements consisting of letters of credit amounting to $1.26 M; these letters of credit expire at various dates through fiscal 2012. In these letters of credit, $1 M is secured by a certificate of deposit. The balance, amounting to $0.26 M, was guaranteed by *Export Development Canada*.

CONTROLS AND PROCEDURES

In compliance with the Canadian Securities Administratorsô National Instrument 52-109 (ñNI 52-109ò), we have filed certificates signed by the Chief Executive Officer (ñCEOò) and the Director of Finance (ñDirector of Financeò) that, among other things, report on the design and effectiveness of disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting. These certificates have been refiled on May 12, 2011, at the same date when the corresponding restated financial statements for quarter ended December 31, 2010 have been refiled.

Disclosure controls and procedures

The CEO and the Director of Finance have designed disclosure controls and procedures, or have caused them to be designed under their supervision, in order to provide reasonable assurance that:

- material information relating to the Corporation has been made known to them; and
- information required to be disclosed in the Corporation's filings is recorded, processed, summarized and reported within the time periods specified in securities legislation.

An evaluation was carried out, under the supervision of the CEO and the Director of Finance, of the effectiveness of our disclosure controls and procedures. Based on this evaluation, the CEO and the Director of Finance concluded that the disclosure controls and procedures are effective.

Internal controls over financial reporting

The CEO and the Director of Finance have also designed internal controls over financial reporting, or have caused them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

An evaluation was carried out, under the supervision of the CEO and the Director of Finance, of the design and effectiveness of our internal controls over financial reporting. Based on this evaluation, the CEO and the Director of Finance concluded that the internal controls over financial reporting are effective, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) on Internal Control – Integrated Framework.

Changes in internal controls over financial reporting

During the quarter, the Company did not make any modifications to the internal controls over financial reporting that had or could reasonably be expected to have a significant impact on the internal controls over financial reporting.

Restated Consolidated Financial Statements

Quarterly Report
December 31, 2010

These interim consolidated financial statements have not been subjected to an audit or to a review engagement by the auditors.

These interim financial statements are being re-filed on May 12, 2011.
The Company initially filed them on February 10, 2011.

For additional information:
Investor Relations
investor@h2oinnovation.com

Trading symbols:
TSX Venture: HEO
Alternext: MNEMO: ALHEO

Annual reports and press releases are accessible on our Website: *www.h2oinnovation.com* and on SEDAR

CONSOLIDATED BALANCE SHEETS
(Unaudited)

	RESTATED As at December 31, 2010	As at June 30, 2010
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	**244,670**	2,672,375
Held-for-trading investments	**1,413,022**	1,266,751
Held-to-maturity investments	**-**	39,908
Accounts receivable	**7,988,916**	4,857,285
Inventories	**2,580,414**	1,915,107
Work in process	**1,385,081**	2,148,946
Prepaid expenses	**223,078**	308,263
	13,835,181	13,208,635
Fixed assets	**2,455,470**	2,451,115
Intangible assets	**9,130,822**	10,313,821
Other assets	**42,606**	44,141
Goodwill	**10,499,284**	10,901,443
Future income tax assets	**6,597**	6,597
	35,969,960	36,925,752
LIABILITIES		
Current liabilities		
Bank loan	**1,675,751**	-
Accounts payable and accrued liabilities	**3,487,543**	4,815,253
Billings in excess of work in process	**1,508,302**	233,537
Current portion of long-term debt	**628,985**	619,768
Current portion of convertible debenture (Note 6)	**250,000**	-
	7,550,581	5,668,558
Long-term debt	**1,400,793**	1,569,200
Convertible debenture (Note 6)	**1,146,894**	1,354,530
Deferred rent	**46,865**	56,938
	10,145,133	8,649,226
SHAREHOLDERSôEQUITY		
Equity component of convertible debenture (Note 6)	**301,023**	301,023
Capital stock (Note 7)	**45,866,225**	45,858,645
Contributed surplus	**11,559,147**	11,453,475
Deficit	**(30,528,440)**	(29,336,617)
Accumulated other comprehensive loss	**(1,373,128)**	-
	25,824,827	28,276,526
	35,969,960	36,925,752

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

On behalf of the Board,

Frédéric Dugré
President and Chief Executive Officer

Philippe Gervais
Chairman of the Board of Directors

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERSôEQUITY

(Unaudited)

	Common shares Number	Share capital $	Equity component of convertible debenture $	Contributed surplus $	Deficit $	Accumulated other comprehen-sive loss $	Total $
Balance as at June 30, 2009	**55,146,843**	**43,778,820**	**301,023**	**11,375,483**	**(19,338,700)**	**-**	**36,116,626**
Stock-based compensation costs	-	-	-	26,537	-	-	26,537
Net loss for the period	-	-	-	-	(2,218,910)	-	(2,218,910)
Balance as at December 31, 2009	**55,146,843**	**43,778,820**	**301,023**	**11,402,020**	**(21,557,610)**	**-**	**33,924,253**

	Common shares Number	Share capital $	Equity component of convertible debenture $	Contributed surplus $	Deficit $	Accumulated other comprehen-sive loss $	Total $
RESTATED							
Balance as at June 30, 2010	**60,127,727**	**45,858,645**	**301,023**	**11,453,475**	**(29,336,617)**	**-**	**28,276,526**
Share issue expenses related to private financing (note 7)	-	(5,420)	-	-	-	-	(5,420)
Fair value of stock options exercised	25,000	13,000	-	(5,000)	-	-	8,000
Other comprehensive loss	-	-	-	-	-	(1,373,128)	(1,373,128)
Stock-based compensation costs	-	-	-	110,672	-	-	110,672
Net loss for the period	-	-	-	-	(1,191,823)	-	(1,191,823)
Balance as at December 31, 2010	**60,152,727**	**45,866,225**	**301,023**	**11,479,239**	**(30,528,440)**	**(1,373,128)**	**25,824,827**

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Unaudited)

	Three-month periods ended December 31,		Six-month periods ended December 31,	
	RESTATED 2010	2009	**RESTATED 2010**	2009
	$	$	**$**	$
Net loss for the period	**(544,417)**	(1,576,222)	**(1,191,823)**	(2,218,910)
Other comprehensive loss				
Translation adjustment	**(809,731)**	**-**	**(1,373,128)**	**-**
Comprehensive loss for the period	**(1,354,148)**	(1,576,222)	**(2,564,951)**	(2,218,910)

CONSOLIDATED STATEMENTS OF COMPONENTS OF ACCUMULATED OTHER COMPREHENSIVE LOSS
(Unaudited)

As at December 31,	**RESTATED 2010**	2009
	$	$
Translation adjustment	**(1,373,128)**	-
Accumulated other comprehensive loss	**(1,373,128)**	-

The total of Accumulated Other Comprehensive Loss and Deficit as at December 31, 2010 is $31,901,568 ($21,557,610 as at December 31, 2009).

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

CONSOLIDATED STATEMENT OF EARNINGS

(Unaudited)

	Three-month periods ended December 31,		Six-month periods ended December 31,	
	RESTATED 2010	2009	**RESTATED 2010**	2009
	$	$	**$**	$
Sales	**6,421,506**	7,087,242	**12,761,372**	15,493,852
Cost of goods sold	**4,403,777**	5,518,347	**8,850,698**	11,416,273
Gross margin	**2,017,729**	1,568,895	**3,910,674**	4,077,579
Expenses				
Operating, selling, administrative and general expenses	**1,969,771**	2,243,055	**3,958,318**	4,275,187
Depreciation of fixed assets	**79,228**	72,679	**152,460**	142,176
Amortization of intangible assets	**266,513**	359,875	**538,960**	715,970
Bank charges and other financial expenses	**32,725**	49,183	**65,341**	65,486
Government assistance	**(24,400)**	(51,750)	**(48,763)**	(74,500)
Stock-based compensation	**84,908**	17,450	**110,672**	26,537
	2,408,745	2,690,492	**4,776,988**	5,150,856
Operating loss before the following items	**(391,016)**	(1,121,597)	**(866,314)**	(1,073,277)
Other income	**(6,642)**	(11,924)	**(13,991)**	(17,322)
Exchange loss (gain)	**3,340**	204,630	**(4,323)**	757,603
Interest on long-term debt	**146,575**	185,188	**333,695**	386,562
Loss on disposal of fixed assets	**-**	122,679	**-**	122,679
Loss on disposal of intangible assets	**-**	15,955	**-**	15,955
Acquisition and integration expenses	**10,128**	11,538	**10,128**	27,038
	153,401	528,066	**325,509**	1,292,515
Loss before income taxes	**(544,417)**	(1,649,663)	**(1,191,823)**	(2,365,792)
Income tax recovery				
Future income taxes	**-**	73,441	**-**	146,882
Net loss for the period	**(544,417)**	(1,576,222)	**(1,191,823)**	(2,218,910)
Basic and diluted net loss per share	**(0.009)**	(0.029)	**(0.020)**	(0.040)
Weighted average number of shares outstanding (Note 8)	**60,132,245**	55,139,948	**60,126,539**	55,139,948

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

H_2O INNOVATION INC.

CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

	Three-month periods ended December 31,		Six-month periods ended December 31,	
	RESTATED 2010	2009	**RESTATED 2010**	2009
	$	$	**$**	$
Cash flows from operating activities				
Net loss for the period	**(544,417)**	(1,576,222)	**(1,191,823)**	(2,218,910)
Non-cash items				
Change in fair value of held-for-trading investments	**-**	207	**-**	1,441
Interest capitalized on held-to-maturity investment	**-**	(1,327)	**-**	(883)
Exchange loss on held-to-maturity investment	**-**	1,870	**-**	4,405
Depreciation of fixed assets	**80,229**	72,679	**152,460**	142,176
Amortization of intangible assets	**266,518**	359,875	**538,960**	715,970
Loss on disposal of fixed assets	**-**	122,679	**-**	122,679
Loss on disposal of intangible assets	**-**	15,955	**-**	15,955
Stock-based compensation	**84,908**	17,450	**110,672**	26,537
Deferred rent	**(3,222)**	-	**(6,528)**	-
Future income taxes	**-**	(73,441)	**-**	(146,882)
Unrealized exchange gain on long-term debt	**-**	(9,950)	**-**	(44,291)
Imputed interest on long-term debt and convertible debenture	**48,281**	56,402	**103,156**	123,192
	(67,703)	(1,013,823)	**(293,103)**	(1,258,611)
Net change in non cash working capital items (Note 8)	**134,798**	(2,638,134)	**(2,428,802)**	(2,323,657)
	67,095	(3,651,957)	**(2,721,905)**	(3,582,268)
Cash flows from investing activities				
Disposal of held-for-trading investments	**-**	-	**39,298**	-
Acquisition of held-for-trading investments	**(147,110)**	-	**(147,110)**	-
Acquisition of fixed assets	**(56,772)**	(233,459)	**(182,521)**	(285,021)
Acquisition of intangible assets	**(2,376)**	(28,457)	**(9,743)**	(64,753)
Proceeds from disposal of fixed assets	**-**	127,545	**-**	127,545
Proceeds from disposal of intangible assets	**-**	45,000	**-**	45,000
Business acquisitions (Note 3)	**(452,366)**	-	**(838,241)**	-
Other assets	**-**	685	**-**	3,100
	(658,624)	(88,686)	**(1,138,317)**	(174,129)
Cash flows from financing activities				
Variation of bank loan	**130,430**	-	**1,675,751**	-
Long-term debt reimbursement	**(170,818)**	(218,750)	**(341,081)**	(437,500)
Long-term debt contracted	**-**	-	**124,692**	-
Issuance of shares	**8,000**	-	**8,000**	-
Share issue expenses	**-**	-	**(5,420)**	-
	(32,388)	(218,750)	**1,461,942**	(437,500)
Net change in cash	**(623,917)**	(3,959,393)	**(2,398,280)**	(4,193,897)
Effect of exchange rate changes on cash and cash equivalents	**(8,812)**	-	**(29,425)**	-
Decrease in cash and cash equivalents	**(632,729)**	(3,959,393)	**(2,427,705)**	(4,193,897)
Cash and cash equivalents - Beginning of period	**877,399**	5,359,902	**2,672,375**	5,594,406
Cash and cash equivalents - End of period	**244,670**	1,400,509	**244,670**	1,400,509

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) ï RESTATED

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim consolidated financial statements of the Company for the six-month periods ended December 31, 2010 and 2009 have been prepared in accordance with Canadian generally accepted accounting principles (ñGAAPò) and should be read in conjunction with the 2010 audited annual consolidated financial statements. The accounting policies are the same as those used for the 2010 audited annual consolidated financial statements except for the translation of our foreign operations as further explained in note 2.

2. ACCOUNTING CHANGES

In its interim financial statements for quarters ended September 30, 2010 and December 31, 2010, management had reflected its foreign operations as integrated. During the third quarter of fiscal 2011 it completed a detailed analysis which identified significant changes in the economic facts and circumstances. The information obtained from the analysis states that the significant changes arose during the first quarter of fiscal 2011. In consequence, this analysis requires that the translation method applied to the foreign operations be changed. These significant facts and circumstances include a cost reduction program, merger of offices and a reorganization of the legal and operational structure, which lead to a significant degree of autonomy of the Companyøs foreign operations. Therefore, the foreign operations have been reclassified from integrated to self-sustaining. The restated interim financial statements for quarters ended September 30, 2010 and December 31, 2010 have been re-filed on May 12, 2011.

The financial statements of foreign subsidiaries and of the joint venture considered as self-sustaining operations are translated using the current rate method. Under this method, assets and liabilities are translated in Canadian dollars at the exchange rate prevailing at the balance sheet date, and earnings items are translated in Canadian dollars at the average exchange rate for the period. Translation adjustments arising from exchange rate fluctuations are shown as ñAccumulated other comprehensive lossò under Shareholdersô equity. The translation of Canadian corporations remains unchanged.

The adjustments resulting from the translation of the Companyøs foreign subsidiaries and joint venture are recorded under the caption ñAccumulated other comprehensive lossò. This modification has been applied prospectively from July 1, 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – RESTATED

2. ACCOUNTING CHANGES (CONTINUED)

The following table illustrates the effect of the adjustments by financial statement line item in the Company's consolidated balance sheet as of December 31, 2010:

December 31, 2010	As previously reported	Restatement adjustment	As restated
	$	$	$
ASSETS			
Current assets			
Cash and cash equivalents	**244,670**	-	**244,670**
Held-for-trading investments	**1,413,022**	-	**1,413,022**
Accounts receivable	**7,988,916**	-	**7,988,916**
Inventories	**2,580,414**	-	**2,580,414**
Work in process	**1,385,081**	-	**1,385,081**
Prepaid expenses	**223,077**	-	**223,077**
	13,835,180	-	**13,835,180**
Fixed assets	**2,472,242**	(16,771)	**2,455,471**
Intangible assets	**9,758,424**	(627,602)	**9,130,822**
Other assets	**42,606**	-	**42,606**
Goodwill	**10,901,443**	(402,159)	**10,499,284**
Future income tax assets	**6,597**	-	**6,597**
	37,016,492	(1,046,532)	**35,969,960**
LIABILITIES			
Current liabilities			
Bank loan	**1,675,751**	-	**1,675,751**
Accounts payable and accrued liabilities	**3,450,442**	(37,101)	**3,487,543**
Billings in excess of work in process	**1,508,302**	-	**1,508,302**
Current portion of long-term debt	**628,985**	-	**628,985**
Current portion of convertible debenture	**250,000**	-	**250,000**
	7,513,480	(37,101)	**7,550,581**
Long-term debt	**1,400,793**	-	**1,400,793**
Convertible debenture	**1,146,894**	-	**1,146,894**
Deferred rent	**46,865**	-	**46,865**
	10,108,032	(37,101)	**10,145,133**
SHAREHOLDERS' EQUITY			
Equity component of convertible debenture	**301,023**	-	**301,023**
Capital stock	**45,866,225**	-	**45,866,225**
Contributed surplus	**11,559,147**	-	**11,559,147**
Deficit	**(30,817,935)**	(289,495)	**(30,528,440)**
Accumulated other comprehensive loss	**-**	1,373,128	**(1,373,128)**
	26,908,460	1,083,633	**25,824,827**
	37,016,492	(1,046,532)	**35,969,960**

2. ACCOUNTING CHANGES (CONTINUED)

The following table illustrates the effect of the adjustments by financial statement line item in the Company's consolidated statement of earnings as of December 31, 2010:

Six-month period ended December 31, 2010	**As previously reported**	**Restatement adjustment**	**As restated**
	$	$	$
Sales	**12,761,372**	**-**	**12,761,372**
Cost of goods sold	**8,850,698**	**-**	**8,850,698**
Gross margin	**3,910,674**	**-**	**3,910,674**
Expenses			
Operating, selling, administrative and general expenses	**4,003,518**	(45,200)	**3,958,318**
Depreciation of fixed assets	**153,401**	(941)	**152,460**
Amortization of intangible assets	**560,406**	(21,446)	**538,960**
Bank charges and other financial expenses	**65,341**	**-**	**65,341**
Government assistance	**(48,763)**	**-**	**(48,763)**
Stock-based compensation	**110,672**	**-**	**110,672**
	4,844,575	(67,587)	**4,776,988**
Operating earnings (loss) before the following items	**(933,901)**	67,587	**(866,314)**
Other income	**(13,991)**	-	**(13,991)**
Exchange (gain) loss	**217,585**	(221,908)	**(4,323)**
Interest on long-term debt	**333,695**	-	**333,695**
Acquisition and integration expenses	**10,128**	**-**	**10,128**
	547,417	(221,908)	**325,509**
Net loss for the period	**(1,481,318)**	289,495	**(1,191,823)**
Basic and diluted net loss per share	**(0.025)**	0.005	**(0.020)**
Weighted average number of shares outstanding (Note 8)	**60,126,539**	**-**	**60,126,539**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) ï RESTATED

2. ACCOUNTING CHANGES (CONTINUED)

The following table illustrated the effect of the adjustments by financial statement line item in the Companyôs consolidated statement of cash flows as of December 31, 2010:

Six-month period ended December 31, 2010	As previously reported	Restatement adjustment	As restated
	$	$	$
Cash flows from operating activities			
Net loss	**(1,481,318)**	289,495	**(1,191,823)**
Non-cash items			
Change in fair value of held-for-trading investments	**729**	(729)	**-**
Depreciation of fixed assets	**153,401**	(941)	**152,460**
Amortization of intangible assets	**560,406**	(21,446)	**538,960**
Stock-based compensation	**110,672**	-	**110,672**
Deferred rent	**-**	(6,528)	**(6,528)**
Unrealized exchange gain on long-term debt	**(29,759)**	29,759	**-**
Imputed interest on long-term debt and convertible debenture	**103,156**	-	**103,156**
	(582,713)	289,610	**(293,103)**
Net change in working capital items (Note 9)	**(2,198,122)**	(230,680)	**(2,428,802)**
	(2,780,835)	58,930	**(2,721,905)**
Cash flows from investing activities			
Disposal of held-for-trading investments	**39,908**	(610)	**39,298**
Acquisition of held-for-trading investments	**(147,000)**	(110)	**(147,110)**
Acquisition of fixed assets	**(186,171)**	3,650	**(182,521)**
Acquisition of intangible assets	**(5,009)**	(4,734)	**(9,743)**
Business acquisition (Notes 4 and 9)	**(838,241)**	-	**(838,241)**
Other assets	**1,535**	(1,535)	**-**
	(1,134,978)	(3,339)	**(1,138,317)**
			-
Cash flows from financing activities			
Variation of bank loan	**1,675,751**	-	**1,675,751**
Long-term debt reimbursement	**(313,703)**	(27,378)	**(341,081)**
Long-term debt contracted	**123,480**	1,212	**124,692**
Issuance of shares	**8,000**	-	**8,000**
Share issue expenses	**(5,420)**	-	**(5,420)**
	1,488,108	(26,166)	**1,461,942**
Net change in cash and cash equivalents	**(2,427,705)**	29,425	**(2,398,280)**
Effect of exchange rate changes on cash and cash equivalents	**-**	(29,425)	**(29,425)**
Decrease in cash and cash equivalents	**(2,427,705)**	-	**(2,427,705)**
Cash and cash equivalents - Beginning of period	**2,672,375**	-	**2,672,375**
Cash and cash equivalents - End of period	**244,670**	-	**244,670**

2. ACCOUNTING CHANGES (CONTINUED)

The following table illustrates the effect of the adjustments by financial statement line item in the Company's consolidated statement of earnings for the three-month period December 31, 2010:

Three-month period ended December 31, 2010	As previously reported	Restatement adjustment	As restated
	$	$	$
Sales	**6,421,506**	**-**	**6,421,506**
Cost of goods sold	**4,403,777**	-	**4,403,777**
Gross margin	**2,017,729**	-	**2,017,729**
Expenses			
Operating, selling, administrative and general expenses	**1,969,771**	**-**	**1,969,771**
Depreciation of fixed assets	**80,056**	(828)	**79,228**
Amortization of intangible assets	**280,359**	(13,846)	**266,513**
Bank charges and other financial expenses	**32,725**	**-**	**32,725**
Government assistance	**(24,400)**	-	**(24,400)**
Stock-based compensation	**84,908**	-	**84,908**
	2,423,419	(14,674)	**2,408,745**
Operating earnings (loss) before the following items	**(405,690)**	14,674	**(391,016)**
Other income	**(6,642)**	-	**(6,642)**
Exchange (gain) loss	**95,954**	(92,614)	**3,340**
Interest on long-term debt	**146,575**	-	**146,575**
Acquisition and integration expenses	**10,128**	-	10,128
	246,015	(92,614)	153,401
Net loss for the period	**(651,705)**	107,288	**(544,417)**
Basic and diluted net loss per share	**(0.011)**	0.002	**(0.009)**
Weighted average number of shares outstanding	**60,132,245**	**-**	**60,132,245**

2. ACCOUNTING CHANGES (CONTINUED)

The following table illustrated the effect of the adjustments by financial statement line item in the Company's consolidated statement of cash flows for the three-month period ended December 31, 2010:

Three-month period ended December 31, 2010	**As previously reported**	**Restatement adjustment**	**As restated**
	$	**$**	**$**
Cash flows from operating activities			
Net loss	**(651,705)**	107,288	**(544,417)**
Non-cash items			
Change in fair value of held-for-trading investments	**383**	(383)	**-**
Depreciation of fixed assets	**80,056**	173	**80,229**
Amortization of intangible assets	**280,359**	(13,841)	**266,518**
Stock-based compensation	**84,908**	-	**84,908**
Deferred rent	**-**	(3,222)	**(3,222)**
Unrealized exchange gain on long-term debt	**(16,251)**	16,251	**-**
Imputed interest on long-term debt and convertible debenture	**48,281**	-	**48,281**
	(173,969)	106,266	**(67,703)**
Net change in working capital items (Note 9)	**206,393**	(71,595)	**134,798**
	32,424	34,671	**67,095**
Cash flows from investing activities			
Acquisition of held-for-trading investments	**(147,000)**	(110)	**(147,110)**
Acquisition of fixed assets	**(47,392)**	(9,380)	**(56,772)**
Acquisition of intangible assets	**(609)**	(1,767)	**(2,376)**
Business acquisition (Notes 4 and 9)	**(452,366)**	-	**(452,366)**
Other assets	**755**	(755)	**-**
	(646,612)	(12,012)	**(658,624)**
Cash flows from financing activities			
Variation of bank loan	**130,430**	-	**130,430**
Long-term debt reimbursement	**(156,971)**	(13,847)	**(170,818)**
Issuance of shares	**8,000**	-	**8,000**
	(18,541)	(13,847)	**(32,388)**
Net change in cash and cash equivalents	**(632,729)**	8,812	**(623,917)**
Effect of exchange rate changes on cash and cash equivalents	**-**	(8,812)	**(8,812)**
Decrease in cash and cash equivalents	**(632,729)**	-	**(632,729)**
Cash and cash equivalents - Beginning of period	**877,399**	-	**877,399**
Cash and cash equivalents - End of period	**244,670**	-	**244,670**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – RESTATED

3. FUTURE ACCOUNTING CHANGES

On February 13, 2008, the Accounting Standards Board confirmed the date of changeover from Canadian GAAP to International Financial Reporting Standards (IFRS). Canadian publicly accountable enterprises must adopt IFRS for their interim and annual financial statements relating to fiscal periods beginning on or after January 1, 2011. The Company has developed an IFRS transition plan for the conversion of its consolidated financial statements to IFRS. An analysis of the differences between IFRS and the Company's accounting standards is underway. This analysis is being conducted by taking into account the potential impacts, among others, on accounting policies, financial reporting and information technologies. To date, the Company is unable to show the consequences of the conversion from Canadian GAAP to IFRS on its financial statements.

The CICA published the following sections of the CICA Handbook that apply to interim and annual financial statements relating to fiscal periods beginning on or after January 1, 2011:

a) Section 1582, "Business Combinations", which replaces the former Section 1581 of the same name, establishes accounting standards for a business combination. It provides the Canadian equivalent to International Financial Reporting Standard IFRS 3, "Business Combinations".

b) Section 1601, "Consolidated Financial Statements", which replaces the former Section 1600 of the same name, establishes standards for the preparation of consolidated financial statements.

c) Section 1602, "Non-Controlling Interests". This new section establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements prepared subsequent to a business combination. It is equivalent to the corresponding provisions of International Accounting Standard IAS 27, "Consolidated and Separate Financial Statements".

The Company is currently evaluating the impact of these new standards on its financial statements.

4. BUSINESS ACQUISITIONS

a) During the previous year, the Company recorded a provision of $564,049 (US$529,822) as earn-out payment related to the acquisition of Professional Water Technologies which was captured as goodwill and the counterpart was included in accounts payable and accrued liabilities. During the six-month period, an amount of $531,791 (US$529,822) was paid in relation with this acquisition (during the quarter, an amount of $145,916 (US$154,822) was paid in relation with this acquisition).

b) During the previous year, the Company recorded a provision of $779,830 (US$732,510) as earn-out payment related to the acquisition of Membrane Systems Inc. which was captured as goodwill and the counterpart was included in accounts payable and accrued liabilities. During the quarter, an amount of $306,450 (US$300,000) was paid in relation with this acquisition and the remaining balance is included in accounts payable and accrued liabilities.

c) During the previous year, the Company recorded a provision of $151,432 (US$142,243) as earn-out payment related to the acquisition of Wastewater Technology Inc. This amount is included in accounts payable and accrued liabilities and the counterpart is recorded as goodwill.

5. INTEREST IN A JOINT VENTURE

In February 2010, the Company got involved in a joint venture with Chembond Chemicals Limited of Mumbai, a leading manufacturer and supplier of speciality performance chemicals.

The accounts resulting from that investment have been consolidated with those of the Company using the proportionate consolidation method. The Company holds an interest of 49%. The joint venture began its operations in March 2010.

The following items correspond to the share in assets, liabilities, revenues, expenses and cash flows of the joint venture, which is included in these consolidated financial statements:

	RESTATED Six-month period ended December 31, 2010	Four-month period ended June 30, 2010
	$	$
Earnings		
Revenues	**74,204**	14,711
Expenses	**144,341**	37,762
Net loss	**(70,137)**	(23,051)

	RESTATED As at December 31, 2010	As at June 30, 2010
	$	$
Cash flows		
Change in working capital items	**75,681**	4,637
Acquisition of fixed assets	**(6,498)**	(3,764)
Balance sheet		
Current assets	**165,252**	90,830
Long-term assets	**6,498**	3,764
Current liabilities	**156,433**	9,139

6. CONVERTIBLE DEBENTURE

	As at December 31, 2010	As at June 30,2010
	$	$
Convertible debenture (i)	**1,500,000**	1,500,000
Equity component	**(301,023)**	(301,023)
Financing expenses	**(53,663)**	(53,663)
Accretion of the debt component	**213,515**	177,562
Amortization of financing expenses	**38,064**	31,654
	1,396,893	1,354,530
Less: Current portion of convertible debenture	**(250,000)**	-
Convertible debenture	**1,146,893**	1,354,530

(i) Debenture issued in July 2009 with a par value of $1,500,000, unsecured, bearing interest at the rate of 10% (effective rate of 22.1%), maturing on July 9, 2011. The Company paid $53,663 in financing expenses, which were recorded as a reduction of the debt component. The debenture is convertible at any time, in whole or in part, into common shares of the Company. The conversion price is $0.95 if conversion occurs before July 10, 2010 and $1.045 if conversion occurs between July 10, 2010 and the maturity date.

In July 2010, the convertible debenture repayment terms, which initially stipulated one $1,500,000 installment payable on July 9, 2011, were modified as follows: six $250,000 installment payable every three months from July 9, 2011 to October 9, 2012. The applicable annual interest rate of 10% was increased by 1% to reach 11% (effective rate of 19.1%) as from July 9, 2010. The other debenture terms remain unchanged.

7. CAPITAL STOCK

Authorized
Unlimited number of common shares, without par value

As at December 31, 2010	**Number of shares**	**Amount**
		$
Issued and paid at the beginning of period	**60,120,832**	**45,844,856**
Share issue expenses related to private financing (i)	**-**	**(5,420)**
Shares issued on exercise of options	**25,000**	**13,000**
	60,145,832	**45,852,436**
Shares to be issued		
In settlement of business acquisition	**6,895**	**13,789**
Balance - End of period	**60,152,727**	**45,866,225**

As at June 30, 2010	Number of shares	Amount
		$
Issued and paid at the beginning of period	55,139,948	43,765,031
Shares issued in connection with private financing (ii)	4,955,884	2,066,825
Shares issued on exercise of options	25,000	13,000
	60,120,832	45,844,856
Shares to be issued		
In settlement of business acquisition	6,895	13,789
Balance - End of period	60,127,727	45,858,645

(i) During the period, share issue expenses related to private financing in the previous year amounted to $5,420 have been reflected in capital stock.

(ii) During the previous year, the Company completed a share financing with various investors and issued 4,955,884 shares at $0.425 each.

Stock-Based Compensation Plan

The Company has established a stock option plan whereby the Board of Directors may grant stock options to directors, executive officers, key employees and consultants providing services to the Company. The Board of Directors determines, at its discretion, the vesting terms, if applicable, the expiry date of options and the number of options to be granted. The maximum number of shares that may be issued under the plan is 5,500,000.

The following table shows the assumptions used in determining stock-based compensation costs under the Black & Scholes option pricing model:

Six-month period ended December 31	**2010**
Number of stock options	2,035,000
Expected dividend yield	0%
Expected volatility	70%
Risk-free interest rate	From 2.87% to 3.21%
Weighted average expected life (years)	10
Weighted average fair value at the grant date	$0.25

For the period ended December 31, 2010, the Company recorded $110,672 ($26,537 in 2009) as stock-based compensation for options granted to its directors, officers and key employees.

7. CAPITAL STOCK (CONTINUED)

Stock-Based Compensation Plan (Continued)

The following table summarizes the situation of the Company's stock-based compensation plan as at December 31, 2010 and June 30, 2010 and the change during the periods ended on these dates:

	Six-month period ended December 30, 2010		Twelve-month period ended June 30, 2010	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		$		$
Outstanding - Beginning of period	**1,950,000**	**1.11**	1,815,000	1.15
Granted	**2,035,000**	**0.50**	205,000	0.75
Exercised	**(25,000)**	**0.32**	(25,000)	0.32
Forfeited	**-**	**-**	(45,000)	1.48
Outstanding - End of period	**3,960,000**	**0.80**	1,950,000	1.11
Exercisable - End of period	**1,822,500**	**1.14**	1,691,639	1.14

As at December 31, 2010, the following stock options were granted:

Exercise price	Holders	Number of shares	Weighted average remaining life (years)	Weighted average exercise price
$				$
0.32	Directors	125,000	2.94	0.32
0.50	Directors	290,000	9.87	0.50
0.75	Directors	225,000	9.00	0.75
0.90	Directors	262,000	2.49	0.90
1.20	Directors	260,000	1.02	1.20
1.50	Directors	324,500	1.64	1.50
0.50	Employees	1,725,000	9.73	0.50
0.90	Employees	270,000	2.49	0.90
1.20	Employees	125,000	1.02	1.20
1.50	Employees	333,500	1.64	1.50
1.85	Employees	20,000	1.41	1.85
		3,960,000	6.28	0.80

As at December 31, 2010, the following stock options could be exercised:

Exercise price	Number of shares	Weighted average exercise price
$		$
0.32	125,000	0.32
0.75	102,500	0.75
0.90	532,000	0.90
1.20	385,000	1.20
1.50	658,000	1.50
1.85	20,000	1.85
	1,822,500	1.14

7. CAPITAL STOCK (CONTINUED)

Warrants

In the course of its financing transactions, the Company issued warrants to investors giving them the right to acquire shares at a predetermined price. Each warrant issued entitles the holder to acquire one common share of the Company.

The warrants outstanding as at December 31, 2010 and June 30, 2010 and the change during the periods ended on those dates are summarized in the following table:

	Six-month period ended December 31, 2010		Twelve-month period ended June 30, 2010	
	Number	**Weighted average exercise price**	Number	**Weighted average exercise price**
		$		$
Outstanding - Beginning and end of period	**9,179,877**	**0.88**	9,179,877	0.88

As at December 31, 2010, the following warrants were granted:

Maturity date	Number of warrants	Exercise price
December 2011	**7,929,877**	$0.85
June 2013	**1,250,000**	$0.90 on or before June 30, 2011 $1.00 on or before June 30, 2012 $1.10 on or before June 30, 2013
	9,179,877	

8. EARNINGS PER SHARE

The following table sets out the weighted average basic and diluted number of outstanding shares used to compute the basic and diluted loss per share:

	Three months ended December 31,		**Six months ended December 31,**	
	2010	2009	**2010**	2009
Basic and diluted weighted average number of shares outstanding	**60,132,245**	55,139,948	**60,126,539**	55,139,948

For the periods ended December 31, 2010 and 2009, there was no difference in the basic and diluted weighted average number of shares outstanding, since the effect of the stock options, warrants and convertible debenture would have been anti-dilutive. Accordingly, the diluted loss per share for these periods is calculated using the weighted average basic number of shares outstanding.

However, should the Company's basic earnings per share have been positive, some options would have been dilutive and would have resulted in the addition of nil shares for the period ended December 31, 2010 (175,000 shares for the period ended December 31, 2009), to the weighted average number of shares outstanding used in the diluted earnings per share calculation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) ï RESTATED

9. CASH FLOWS

a) The change in non-cash working capital is as follows:

	RESTATED Three months ended December 31,		Six months ended December 31,	
	2010	2009	**2010**	2009
	$	$	**$**	$
Accounts receivable	**(1,261,857)**	(2,141,473)	**(3,422,056)**	1,721,108
Inventories	**(406,157)**	(117,678)	**(716,013)**	(98,298)
Work in process	**157,975**	680,969	**695,979**	(1,376,982)
Prepaid expenses	**37,328**	45,886	**78,517**	46,549
Accounts payable and accrued liabilities	**858,852**	(964,537)	**(378,404)**	(1,648,525)
Excess of billing over work in process	**748,657**	(136,357)	**1,313,175**	(953,175)
Deferred rent	**-**	(4,944)	**-**	(14,334)
	134,798	(2,638,134)	**(2,428,802)**	(2,323,657)

b) Items not affecting cash related to operating and investing activities:

	As at December 31, 2010	As at June 30, 2010
	$	$
Acquisition of fixed assets included in accounts payable and accrued liabilities	**-**	11,643
Business acquisitions included in accounts payable and accrued liabilities	**362,988**	1,201,229

c) Additional information

	Three months ended December 31,		Six months ended December 31,	
	2010	2009	**2010**	2009
	$	$	**$**	$
Interest paid	**105,918**	83,488	**252,588**	232,189
Income taxes paid	**-**	-	**14,820**	-

10. COMPARATIVE FIGURES

Certain comparative figures of previous year have been reclassified to conform with the presentation adopted in the current year.

GENERAL INFORMATION

Directors

Philippe Gervais, Chairman of the Board (1)
Frédéric Dugré, President, Chief Executive Officer and Director
John G. Booth, Director (2)
Élaine C. Phénix, Director (1) (2)
André Duquenne, Director
Richard Hoel, Director (1)
Lisa Henthorne, Director (2)
Laurence E. Gamst, Director (1)

(1) Audit Committee
(2) Governance and Compensation Committee

Legal Counsel
McCarthy Tétrault S.E.N.C.R.L.

Auditors
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