Interim financial report First quarter ended September 30, 2011

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

MANAGEMENT REPORT

Dear Shareholders,

We have started this new fiscal year with a stronger position than ever in our eleven-year history. Starting the year with our backlog of orders for water treatment systems standing at the record high level of $36.6 M, a sound revenue mix between systems sales and consumables sales, a streamlined operational structure and a clear focus on the three key markets of energy, mining and municipal, we are confident that fiscal 2012 will be for H_2O Innovation a year of growth and positive EBITDA.

By its very nature, the sale of water treatment systems implies a long sales cycle. This long cycle – compared to the shorter and more predictable sales cycle of specialty chemicals and consumables – causes the Company's bookings to irregularly progress from quarter to quarter, with the awarding of new contracts sometimes shifting from one quarter to the other. This has been the case in the last two quarters, with record-high bookings secured in the fourth quarter of fiscal 2011 while this quarter's bookings are unusually low. This condition is inherent to the sale of water treatment systems that require thorough consideration and important capital investments from our clients. Fortunately, temporary fluctuations of the Company's quarterly bookings mitigate themselves over the course of several quarters while our backlog continues to grow, positioning us for further growth of revenues.

Our total revenues for the quarter increased to $7.1 M, up from $6.3 M in the first quarter of the previous fiscal year, representing a 11.8% increase. When compared to the previous quarter (Q4 fiscal 2011), our total revenues show a slight decrease, mainly due to the somewhat seasonal nature of our sales of specialty chemicals and consumables, which have a tendency to slow down during the summer period when plant operators and procurement personnel take vacations. Sales of our specialized products for the maple syrup production industry are also at a low point during first quarters, as production season has ended and producers have yet to place orders for the next season. During the quarter, we added four new international distributors for our Professional Water Technologies brand of specialized chemicals for membrane systems. As these new distributors start picking up speed in their respective geographies, their contribution to our sales of specialty chemicals and consumables is expected to start to be felt within the year. Throughout fiscal 2012, we will seek to increase the conversion rate of our systems clients into consumables clients – which currently stands at 70% – by implementing a proactive approach earlier in the sales cycle and by offering value-added services to systems operators.

Revenue generated by water treatment systems during the first quarter of this new fiscal year represents a somewhat modest increase compared to the corresponding quarter of the previous fiscal year, especially in regards to the current backlog level. This situation is partly caused both by the completion stage of new projects awarded in

the fourth quarter of fiscal 2011, projects that are still mostly in the design and engineering phases and have yet to enter the high revenue generating phases of manufacturing and assembly. These phases will be reached progressively in the next quarters of the year and we are presently not expecting any delays in project delivery dates.

This quarter's bookings totalled the unusually low level of $0.9 M, compared to $3.5 M for the corresponding quarter last year. This contraction in new bookings obtained in this first quarter of fiscal 2012 is partly due to the fact that our selling team members have been working on finalizing the agreements of the numerous bookings secured in the fourth quarter of fiscal 2011, which reached the record high level of $17.4 M, and ensuring proper kick-offs of these projects. We believe that this temporary situation will reverse in the following quarters of fiscal 2012 as the Company sales efforts in the mining, energy and Canadian municipal markets bear fruits, notwithstanding the fact that demand from the U.S. municipal sector remains challenging due to the state of the U.S. economy. On a trailing twelve-months basis, comparing the October 1st to September 30 periods ended in 2010 and 2011, bookings positively progressed from $20.4 M to $33.5 M, showing a year-long trend of backlog growth that we expect to continue in the next quarters.

The reduction of the gross profit during the quarter compared to the first quarter of the previous fiscal year was caused by a combination of three factors. First, the quarter's revenue mix shows that revenues from specialty chemicals and consumables represent a lower proportion of total revenues compared to fiscal 2011 (39.1% vs. 43.4% in fiscal 2011). Second, most of the systems projects from which revenue was recorded during the quarter were in the planning and engineering phases, when invoicing and revenue recognition are lower than during the manufacturing and assembly phases. The third factor that negatively affected this quarter's gross profit is a reallocation of resources completed during the quarter to ensure proper execution of the projects in our backlog. This reallocation has reduced by 2.7 percentage points the gross profit margin by increasing costs of goods sold and reduction our operating expenses.

EBITDA and adjusted EBITDA for the quarter were both positive for the quarter. EBITDA was recorded at $239,387 for the quarter, compared to ($87,863) for the same period ended September 30, 2010. Adjusted EBITDA (excluding stock-based compensation) was for its part recorded at $291,975, an increase compared to ($62,099) in last year's first quarter. This is the result of Company-wide efforts deployed to better manage project execution and to keep costs under tight control. It is also a quick reversal of the temporary slip into negative territory of our EBITDA in the fourth quarter of fiscal 2011. We believe that we will be able to build strong positive EBITDA throughout fiscal year 2012 as we execute the numerous projects in our backlog.

Our Indian joint venture, H_2O Innovation India, performed well throughout the quarter, both on a sales perspective and an operational perspective. It also benefited from several visits from key Company personal and managers, collaborating with its local management and people to execute manufacturing contracts in its backlog.

As we advance in our twelfth year of operations, we will continue to pay close attention to project execution and cost control, now more than ever as the major projects from our record-high backlog enter the critical phases of production. The new additions to our sales teams completed early in this quarter will help drive sales growth of both our business sectors over the course of the year. Looking further ahead, as new opportunities present themselves, we continue to look for new international partnerships or strategic alliances that could have strategic or tactical fit with our business model and geographical footprint.

In closing, we are proud to welcome our shareholders, directors, executives and other invitees to Quebec City on this Wednesday, December 7, 2011 for our Annual General Meeting of Shareholders. It is always a great pleasure for us to gather with you at this annual event to take a moment to discuss about the Company's development and thank all of you for your enduring trust and confidence.

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 September 30, 2011, in comparison with the corresponding period ended September 30, 2010. They should be read in conjunction with the consolidated financial statements and accompanying notes. Comparison of Balance sheets as at September 30, 2011 to those as at June 30, 2011 is also included. Certain statements set forth in this Management's Discussion and Analysis ("MD&A") 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 28, 2011 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 our auditors. They have been prepared in accordance with International Financial Reporting Standards ("IFRS"). All figures in the present report are expressed in Canadian dollars, unless otherwise indicated.

TRANSITION TO IFRS and NON-IFRS FINANCIAL MEASURES

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards, and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis in these condensed interim consolidated financial statements. In the financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These condensed interim consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 and IFRS 1. Subject to certain transition elections disclosed in note 17, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position as at July 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 17 discloses the impact of the transition to IFRS on the company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the company's consolidated financial statements for the year ended June 30, 2010.

The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as of December 5, 2011, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending June 30, 2011 could result in restatement of these condensed interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

These unaudited condensed interim consolidated financial statements should be read in conjunction with the Company's Canadian GAAP consolidated financial statements as at June 30, 2011 and June 30, 2010 and for the years ended June 30, 2011 and 2010. Note 17 presents IFRS information for the year ended June 30, 2011 that is material to an understanding of these unaudited interim consolidated financial statements.

VISION, MISSION & PROFILE

OUR VISION

To become the best in North America, working through consulting engineers, at customizing water treatment systems based on comprehensive analytical and strong technical capabilities aimed at maximizing the efficiency, performance and longevity of systems and by this, create sustained and growing value for our shareholders.

OUR MISSION

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

OUR PROFILE

Building on 11 years of experience, H_2O Innovation provides integrated technological water treatment solutions based on membrane filtration technology to municipal, energy & mining end-users. H_2O Innovation designs state-of-the-art custom-built water treatment systems for the production of drinking water and industrial process water, the reclamation and reuse of water, and the treatment of wastewater, while providing a complete line of specialty chemicals and consumables for membrane filtration and reverse osmosis systems. With more than 100 employees and seven locations in North America, H_2O Innovation is also a founding partner of H_2O Innovation India, a joint venture based in Mumbai, India.

RESULTS OF OPERATIONS

Selected financial data
(Unaudited)

Three-month periods ended September 30	2011	2010
	$	$
Revenue	7,069,768	6,325,081
Gross profit	1,744,687	1,884,867
Gross profit	24.7%	29.8%
Operating expenses	105,106	300,287
Selling expenses	864,667	925,186
Administrative expenses	855,092	748,208
Net loss	(88,216)	(629,610)
Basic and diluted loss per share	(0.001)	(0.010)
EBITDA[1]	239,387	(87,863)

Revenue and gross profit

Revenue during the first quarter of this new fiscal year represents a modest increase in regards of the backlog to be realized in the next quarters. This situation is partly caused both by the stage of completion of new projects that are mostly in the design and engineering phase, and by a light slowdown during the summer period, usually less active in terms of delivery of water treatment systems and specialty chemicals and consumables.

The following table summarizes the evolution of our revenue and new orders, together with the variations in our backlog over the last five quarters. This analysis shows how we have evolved in a volatile economy and how our business model combining water treatment revenue and revenue from specialty chemicals and consumables makes us stronger and puts us in a better position to face fluctuations.

	2011 FY				2012 FY	Last twelve months	Previous twelve months
	Q1	Q2[(a)]	Q3[(a)]	Q4[(a)]	Q1	**(Q2, 3, & 4 FY2011 & Q1 FY2012)**	(Q1 FY2011 & Q2, 3, & 4 FY2010)
Backlog	$14.3 M	$15.1 M	$21.6 M	$35.3 M	$31.6 M	**-**	-
Bookings for water treatment systems	$3.7 M	$7.4 M	$6.1 M	$17.4 M	$0.9 M	**$33.5 M**	$20.4 M
Revenue from water treatment systems	$3.5 M	$3.5M	$3.9M	$4.5 M	$4.3 M	**$17.1 M**	$14.9 M
Bookings / Revenue Ratio	***1.1***	***2.1***	***1.6***	***3.9***	***0.2***	***1.96***	***1.36***
Revenue from specialty chemicals and consumables (usually recurrent in nature)	$2.8 M	$2.8 M	$3.3 M	$3.3 M	$2.8 M	**$12.2 M**	$10.7 M

(a) The above table has been adjusted to reflect the fact that the Company's joint venture is now accounted for using the equity accounting method which means that backlog and bookings generated in India in fiscal 2011 will not affect the Company's revenue line but only the net results from this joint venture.

Consequently, revenue during this first quarter amounted to $7.1 M, compared to $6.3 M for the corresponding quarter last year. This increase represents a growth of 11.8%, mainly in the revenue from water treatment systems, while the revenue from specialty chemicals and consumables remained stable when compared to the corresponding quarter of the previous fiscal year. Also, a decrease of 5.6% in the average exchange rate for our U.S.-dollar denominated operations in the first quarter of fiscal 2012 over the first quarter of fiscal 2011 negatively impacted revenues by $0.3 M. Without the currency impact in 2012, revenue growth would have reached 16.1%.

[1] Earnings before interests, taxes, depreciation and amortization (EBITDA) is a performance indicator that is not determined in accordance with International Financial Reporting Standards nor 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.

Recurring revenues remained stable for this quarter compared to the corresponding quarter of the previous year. This directly contributed to reducing the gross profit for this first quarter. During this first quarter of fiscal 2012, revenues from sales of consumables reached a level similar to the same quarter of the previous fiscal year at $2.8 M. This was primarily caused by the somewhat seasonal nature of our sales of specialty chemicals and consumables, which have a tendency to slow down during the summer period when plant operators and procurement personnel take vacation.

Revenue composition constitutes a strategic factor that has a direct impact on gross profit, revenue volatility and corporate growth. With revenues from specialty chemicals and consumables representing a lower proportion of the quarter's total revenue compared to the first quarter of fiscal 2011, the quarter's gross profit was directly impacted and declined compared to the corresponding quarter of the previous year. This represents a nominal decrease in gross profit, from $1.9 M in the first quarter of fiscal 2011 to $1.7 M in the first quarter of fiscal 2012.

The backlog, consisting solely of sales of water treatment systems, increased from $14.1 M to $31.6 M respectively for the periods ended September 30, 2010 and 2011. This increase over the last twelve months was supported by an increasing level of new orders, which reflects positive signs of economic revival in most of the key segments of the North American economy targeted by the Company and a likely increase in revenues for the next quarters. New contracts obtained during this first quarter totalled $0.9 M, compared to $3.5 M for the corresponding quarter last year. This contraction in new bookings obtained in this first quarter of fiscal 2012 is partly due to the fact that our selling team members have been working on finalizing the agreements of the numerous bookings secured in the fourth quarter of fiscal 2011, which reached the record high level of $17.4 M, and ensuring proper kick-offs of these projects. Management believes that this temporary situation will reverse in the following quarters of fiscal 2012 as the Company benefits from the healthy economic state of the mining, energy and Canadian municipal markets it targets, notwithstanding the fact that demand from the U.S. municipal sector remains challenging due to the state of the U.S. economy. By nature, the long sales cycle of systems and equipment causes the Company's bookings to irregularly progress from quarter to quarter, as represented by the record-high bookings secured in the fourth quarter of fiscal 2011 and this quarter's unusually low level of bookings.

Operating expenses

Operating expenses decreased from $0.3 M to $0.1 M for the quarter ended September 30, 2011 compared with the corresponding quarter of fiscal 2011.This is due to a better utilization of our resources that are allocated to our ongoing systems and equipment projects, projects that are growing in importance in the Company's revenue streams in this current fiscal year. This reallocation has reduced by 2.7 percentage points the gross profit margin by increasing costs of goods sold and reduction our operating expenses. This new allocation of resources is the result of sound management analysis in regards of its project execution.

Selling expenses

Showing a decrease of approximately $60,000, selling expenses remained relatively stable at $0.9 M for this quarter compared to the corresponding quarter of the previous fiscal year. This is the result of the cost reduction program induced last year and the increased focus it is showing in following sales opportunities.

Administrative expenses

Administrative expenses increased from $0.7 M in the first quarter of fiscal 2011 to $0.8 M in the first quarter of fiscal 2012. This increase is partly due to stock-based compensation costs, which are related to the granting of stock options to executive officers and key employees of the Company at the end of the first quarter of fiscal 2011. The increase in compensation of administrative personnel and management also had an impact on the amount of administrative expenses in the first quarter of fiscal 2012.

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 for the quarter was $239,387, compared to ($87,863) for the same period ended September 30, 2010. Adjusted EBITDA (excluding a ($52,588) stock-based compensation expense) for the quarter was $291,975. These positive EBITDA and positive adjusted EBITDA for the first quarter of fiscal 2012 are the result of Company-wide efforts deployed to better manage project execution and to keep the cost reduction program reflexes in place. Management believes it will be able to build strong positive EBITDA throughout fiscal year 2012.

Other gains (losses) – net

Other gains (losses) – net amounting to ($351,208) for the period ended September 30, 2011 compared to ($33,501) for the quarter ended September 30, 2010 are mostly composed of a foreign exchange gain (foreign exchange loss for the quarter ended September 30, 2010), which is entirely due to exchange rate fluctuations related to working capital items.

Finance costs – net

Finance costs – net totalled $194,164 for the period ended September 30, 2011 compared to $223,119 for the comparable period in the previous fiscal year. These expenses relate mostly to the long-term debt. Of this amount, $54,560 represent the theoretical and non-monetary part of interest on long-term debt and $7,509 represent the unwinding of the discount on contingent considerations. The reduction of finance costs can be explained by the decrease in long-term debt balances and is partly offset by the use of the bank loan for working capital purposes during this quarter.

Net loss

The net loss has been cut by 86% compared to the first quarter of fiscal 2011, from ($629,610) or ($0.010 per share) to ($88,216) or ($0.001 per share) for the first quarter of fiscal 2011

Commitments

The Company has entered into long-term lease agreements expiring in 2011, 2012, 2013, 2017 and 2022, which call for lease payments of $3,944,204 for the rental of space. The minimum annual lease payments over the next five years are $416,326 in 2012, $542,613 in 2013, $413,534 in 2014, $422,555 in 2015 and $431,809 in 2016.

Information on share capital

As at September 30, 2011, the Company had 60,145,832 outstanding shares. No share was issued during this quarter.

BALANCE SHEETS

Although working capital decreased from $6.2 M as at June 30, 2011 to $5.7 M as at September 30, 2011, the Company's current ratio has slightly improved from 1.76 to 1.83, showing sound management of working capital and cash position as the Company grows.

The net debt excluding contingent considerations, which stood at $4.3 M as at September 30, 2011, decreased by nearly $0.5 M compared to $4.75 M as at June 30, 2011. This decrease is mainly due to the accounts receivable collection, which enabled the Company to reduce its usage of bank loan.

Equity stood at $22.7 M as at September 30, 2011, compared to $21.5 M as at June 30, 2011. As at September 30, 2011 the net debt equity ratio was 0.19 whereas it was 0.22 as at June 30, 2011, showing that the Company is not over leveraged.

(in Canadian dollars, except for ratio)	Period ended September 30, 2011	Period ended June 30, 2011
Working capital	$5,689,330	$6,192,049
Current ratio	1.83	1.76
Net debt[1]	$4,274,321	$4,749,073
Equity	$22,681,770	$21,534,615
Net debt to equity ratio	0.19	0.22

[1] Net debt comprises bank overdraft, bank loan and the long-term debt, net of cash and cash equivalents, but excludes the contingent considerations.

As at September 30, 2011 accounts receivable stood at $6.3 M compared with $7.8 M as at June 30, 2011. The $1.5 M decrease is attributable to the seasonality of revenues from specialty chemicals and consumables and to the end of the strike at Canada Post, on June 28, 2011, three days before the beginning of fiscal 2012.

Inventories increased by $0.3 M to $2.5 M as at September 30, 2011 compared with $2.2 M as at June 30, 2011. This is explained by two factors: 1) the increase of raw material ordered and received for ongoing projects that will

enter the manufacturing and assembly phases in the next quarters; and 2) the increase of finished goods manufactured during summer in preparation for the start of the maple season.

Costs incurred in excess of billings decreased by $0.7 M to $1.6 M as at September 30, 2011, from $2.3 M as at June 30, 2011. Billings in excess of costs incurred also decreased by $0.25 M to $1.1 M as at September 30, 2011, from $1.3 M as at June 30, 2011. This decrease is explained by the delivery of a large completed project early in the first quarter of fiscal year 2012 and by the early stage of design and engineering of projects won during the last quarter of the previous fiscal year that have yet to enter the high-revenue generating phases of manufacturing and assembly.

Accounts payable and accrued liabilities decreased by $0.9 M to $3.3 M as at September 30, 2011, from $4.2 M as at June 30, 2011. This is partly due to the ending of the Canada Post strike early in this quarter and by the early stage of completion of our projects for which important components will be purchased later during fiscal year 2012.

Contingent considerations totalled $1.9 M as at September 30, 2011 compared to $2.2 M as at June 30, 2011. The decrease is due to payments amounting to $0.4 M made during the first quarter and to the unwinding of the discount rate. Of the $1.9 M total contingent considerations, an amount of $0.5 M is expected to be paid over the next 12 months, the balance ($1.4 M) over a period stretching up to 2018.

FINANCIAL SITUATION

Before the change in operating working capital, operating activities generated $334,130 in cash for the period ended September 30, 2011, compared to $27,355 of cash used during the corresponding period ended September 30, 2010, a significant reversal and positive progress. Under IFRS, management elected to disclose interest paid under financing activities as opposed to operating activities under previous GAAP.

For the first quarter of fiscal 2012, investing activities required net cash of $430,899, mainly attributable to the acquisition of long-term assets necessary to improve the flow of operations of our Canadian plant in Quebec for the manufacturing of water treatment systems, the reorganization of our engineering department in Minneapolis and the renewal of servers to improve the robustness of our network and systems. Most of these actions were completed during the first quarter of fiscal 2012; productivity and efficiency gains should be felt over the next quarters. Moreover, payments totalling $441,315 relating to contingent considerations as part of previous acquisitions were also made during this quarter.

Financing activities used cash of $367,591 in the first quarter of fiscal 2012 compared to $1,329,059 of cash generated during the corresponding period ended September 30, 2010. The increase in funds used by financing activities is mainly caused by the use of bank loan, which resulted in a net reimbursement amounting to $233,624. The use of a moratorium of six months over capital repayments of long-term debts also had a positive impact on the financing activities. Under IFRS, management elected to disclose interest paid under financing activities as opposed to operating activities under previous GAAP.

QUARTERLY SUMMARY FINANCIAL INFORMATION (unaudited)

(in dollars, except per share data)

	Three-month periods ended				Last twelve months
	September 30, 2011	June 30, 2011	March 31, 2011	December 31, 2010	
Sales	7,069,768	7,826,146	7,126,952	6,354,087	28,376,953
EBITDA	239,387	(107,679)	369,211	(23,623)	477,296
Net loss	(88,216)	(72,989)	(123,355)	(526,326)	(810,886)
EPS basic and diluted	(0.001)	(0.001)	(0.002)	(0.009)	(0.016)

	Three-month periods ended				Previous twelve months
	September 30, 2010	June 30, 2010 (1)	March 31, 2010 (1)	December 31, 2009 (1)	
Sales	6,325,081	5,921,355	6,312,349	7,087,242	25,646,027
EBITDA	(87,863)	(785,178)	(980,271)	(982,738)	(2,836,050)
Net loss	(629,610)	(6,220,440)	(1,558,567)	(1,576,222)	(9,984,839)
EPS basic and diluted	(0.010)	(0.113)	(0.028)	(0.029)	(0.18)

(1) 2010 presented data have not been adjusted to reflect the new standards IFRS. Only 2011 data were adjusted.

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

Our interim consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRS") applicable to the preparation of interim financial statements, IAS 34, "Interim Financial Reporting". These are the Company's first interim consolidated financial statements prepared in accordance with IFRS; in consequence the Company explains its choices related to IFRS 1, "First-time Adoption of International Financial Reporting Standards", in note 16 of the financial statements.

The Company has consistently applied the same accounting policies in its opening IFRS consolidated balance sheet at July 1, 2010 and throughout all periods presented, as if these accounting policies had always been in effect. Note 16 of the financial statements for the quarter ended September 30, 2011 discloses the impact of the transition to IFRS on the Company's reported consolidated balance sheet, consolidated statement of earnings, consolidated statement of comprehensive income and consolidated statement of cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended June 30, 2011. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending June 30, 2012 could result in restatement of these interim consolidated financial statements, including the transition adjustments recognized on changeover to IFRS.

The full description of accounting policies and estimates are presented in the relevant section of the Company's financial statements for the quarter ended September 30, 2011.

Estimates, assumptions and judgments are continually evaluated by the Company and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Company makes estimates, assumptions and judgments concerning the future. The estimates, assumptions and judgments that have a risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below. Actual results could differ from these estimates.

Revenue recognition of manufacturing contracts
The stage of completion of any manufacturing contract is assessed by management by taking into consideration all information available at the reporting date. In this process, management applies significant judgments about milestones, actual work performed and the estimated costs to be incurred to complete work.

Impairment of goodwill and other non-current assets
At the end of each reporting period, the Company assesses whether there is any indication that the goodwill and non-current assets have been impaired. If any such indication exists, the recoverable amount of the asset is determined. The recoverable amount is the higher of its fair value less costs to sell and its value in use. In the measurement of the value in use, estimates of future cash flows are discounted. The use of different assumptions could result in different fair values and therefore, in different carrying amounts for goodwill and other non-current assets.

Income taxes and valuation allowances
The estimation of income taxes includes evaluation of the recoverability of deferred tax assets based on an assessment of the Company's entities' ability to utilize the underlying future tax deductions against future taxable income prior to expiry of the deductions. Management assesses whether it is probable that some or all of the deferred income tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income. To the extent that management's assessment of any Company's entities ability to utilize future tax deductions changes, the Company would be required to recognize more or fewer deferred tax assets, and future income tax provisions or recoveries could be affected.

Useful lives of depreciable assets
Management reviews the useful lives of depreciation assets at each reporting date. As at September 30, 2011, management has assessed that the useful lives represent the expected utility of the assets to the Company. Actual results, however, may vary due to technical obsolescence or changes in the market, particularly for computer equipment, customer relationships, trademarks, patents and software.

Contingent considerations
The fair value recognized for contingent considerations has been estimated by management based on the acquired entities results, budgets and forecasts. However, the actual contingent considerations may vary due to unexpected changes in the acquired entities activities.

OFF-BALANCE SHEET ARRANGEMENTS

As at September 30, 2011, the Company had off-balance sheet arrangements consisting of letters of credit amounting to $1.2 M; these letters of credit expire at various dates through fiscal 2013. In these letters of credit, $1 M is secured by a deposit certificate. The balance, amounting to $0.2 M, was guaranteed by *Export Development Canada*.

CONTROLS AND PROCEDURES

In compliance with the Canadian Securities Administrators' National Instrument 52-109 ("NI 52-109"), we have filed certificates signed by the Chief Executive Officer ("CEO") and the Director of Finance ("Director of Finance") 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.

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 IFRS.

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.

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

September 30, 2011

The condensed interim consolidated financial statements which are included in this report have not been subject to a review by the Company's external auditors.

For additional information:
Investor Relations
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Trading symbols:
TSX Venture: HEO
Alternext: MNEMO: ALHEO

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H_2O INNOVATION INC.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(in Canadian dollars)
(Unaudited)

	September 30, 2011	June 30, 2011	July 1, 2010
	$	$	$
ASSETS			
Current assets			
Cash and cash equivalents	**646,851**	440,356	2,586,047
Guaranteed deposits certificates	**1,297,600**	1,412,963	1,306,658
Accounts receivable (note 4)	**6,314,840**	7,828,476	4,854,584
Inventories (note 5)	**2,542,415**	2,230,656	1,913,306
Costs incurred in excess of billings	**1,551,393**	2,264,941	2,148,946
Prepaid expenses	**154,284**	198,504	308,263
	12,507,383	14,375,896	13,117,804
Non-current assets			
Property, plant and equipment	**2,123,491**	2,065,814	2,204,447
Intangible assets	**6,339,851**	6,124,548	7,695,036
Investment in a joint venture	**47,208**	88,041	85,455
Other assets	**43,578**	41,942	44,141
Goodwill (note 6)	**10,966,926**	10,179,427	11,254,505
Deferred income tax assets	**1,931,310**	1,627,665	1,052,906
	33,959,747	34,503,333	35,454,294
LIABILITIES			
Current liabilities			
Bank overdraft	**197,822**	291,520	-
Bank loan	**1,120,000**	1,353,625	-
Accounts payable and accrued liabilities (note 7)	**3,326,429**	4,181,901	3,407,858
Provisions (note 8)	**10,292**	32,300	30,425
Billings in excess of costs incurred	**1,056,829**	1,310,866	233,537
Income taxes payable	**1,176**	7,649	-
Current portion of long-term debt (note 10)	**601,386**	319,108	619,768
Contingent considerations (note 9)	**504,119**	686,878	2,292,188
	6,818,053	8,183,847	6,583,776
Non-current liabilities			
Long-term debt (note 10)	**3,001,964**	3,225,176	1,569,201
Contingent considerations (note 9)	**1,415,716**	1,521,794	1,530,781
Convertible debenture (note 11)	**-**	-	1,354,531
Deferred rent	**42,244**	37,901	56,938
	11,277,977	12,968,718	11,095,227
SHAREHOLDERS' EQUITY			
Share capital	**45,852,436**	45,852,436	45,844,856
Equity component of convertible debenture reserve	**-**	-	301,023
Stock options reserve (note 12)	**1,787,540**	1,734,952	1,451,585
Warrants reserve	**10,142,512**	10,143,677	10,001,890
Deficit	**(34,361,988)**	(34,273,772)	(33,240,287)
Accumulated other comprehensive loss	**(738,730)**	(1,922,678)	-
	22,681,770	21,534,615	24,359,067
	33,959,747	34,503,333	35,454,294

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

On behalf of the Board,

Frédéric Dugré

President and Chief Executive Officer

Philippe Gervais

Chairman of the Board of Directors

H_2O INNOVATION INC.

CONDENSED INTERIM CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
For the three-month periods ended September 30, 2011 and 2010
(in Canadian dollars, except the number of shares)
(Unaudited)

	ATTRIBUTABLE TO THE SHAREHOLDERS OF H_2O INNOVATION INC.							
	Common shares (Number)	Share capital	Equity component of convertible debenture reserve	Stock options reserve (note 12)	Warrants reserve	Deficit	Accumulated other comprehensive loss	Total
		$	$	$	$	$	$	$
Balance as at July 1, 2010	60,120,832	45,844,856	301,023	1,451,585	10,001,890	(33,240,287)	-	24,359,067
Stock-based compensation costs	-	-	-	25,764	-	-	-	25,764
Share issue expenses related to private financing	-	(5,420)	-	-	-	-	-	(5,420)
Net loss for the period	-	-	-	-	-	(629,610)	-	(629,610)
Other comprehensive loss	-	-	-	-	-	-	(726,778)	(726,778)
Balance as at September 30, 2010	60,120,832	45,839,436	301,023	1,477,349	10,001,890	(33,869,897)	(726,778)	23,023,023
Balance as at June 30, 2011	60,145,832	45,852,436	-	1,734,952	10,143,677	(34,273,772)	(1,922,678)	21,534,615
Stock-based compensation costs	-	-	-	52,588	-	-	-	52,588
Warrant issue expenses related to financing	-	-	-	-	(1,165)	-	-	(1,165)
Net loss for the period	-	-	-	-	-	(88,216)	-	(88,216)
Other comprehensive income	-	-	-	-	-	-	1,183,948	1,183,948
Balance as at September 30, 2011	60,145,832	45,852,436	-	1,787,540	10,142,512	(34,361,988)	(738,730)	22,681,770

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

H_2O INNOVATION INC.

CONDENSED INTERIM CONSOLIDATED STATEMENT OF LOSS
For the three-month periods ended September 30, 2011 and 2010
(in Canadian dollars, except the number of shares)
(Unaudited)

	Three months ended September 30,	
	2011	2010
	$	$
Revenue (note 15)	**7,069,768**	6,325,081
Cost of goods sold	**5,325,081**	4,440,214
Gross profit	**1,744,687**	1,884,867
Operating expenses	**105,106**	300,287
Selling expenses	**864,667**	925,186
Administrative expenses	**855,092**	748,208
Depreciation of property, plant and equipment	**77,003**	72,231
Amortization of intangible assets	**233,624**	246,397
Other gains (losses) – net	**(351,208)**	(33,501)
	1,784,284	2,258,808
	(39,597)	(373,941)
Finance income	**(4,571)**	(5,872)
Finance costs	**198,735**	228,991
Finance costs – net	**194,164**	223,119
Share of loss in a joint venture	**31,643**	32,550
	225,807	255,669
Loss before income taxes	**(265,404)**	(629,610)
Deferred tax benefit	**(177,188)**	-
Net loss for the period	**(88,216)**	(629,610)
Net loss per share attributable to the equity holders of the company during the period		
Basic net loss per share	**(0.001)**	(0.010)
Diluted net loss per share	**(0.001)**	(0.010)
Weighted average number of shares outstanding (note 13)	**60,145,832**	60,120,832

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

H_2O INNOVATION INC.

CONDENSED INTERIM CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)
For the three-month periods ended September 30, 2011 and 2010
(in Canadian dollars)
(Unaudited)

	Three months ended September 30,	
	2011	2010
	$	$
Net loss for the period	**(88,216)**	(629,610)
Other comprehensive income (loss)		
Currency translation adjustments	**1,183,948**	(726,778)
Comprehensive income (loss) for the period	**1,095,732**	(1,356,388)

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

CONDENSED INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS
For the three-month periods ended September 30, 2011 and 2010
(in Canadian dollars)
(Unaudited)

	Three months ended September 30,	
	2011	2010
	$	$
Cash flows from operating activities		
Net loss for the period	**(88,216)**	(629,610)
Non-cash items		
Finance costs – net	**194,164**	223,119
Depreciation of property, plant and equipment	**77,003**	72,231
Amortization of intangible assets	**233,624**	246,397
Deferred rent	**1,322**	(3,306)
Stock-based compensation	**52,588**	25,764
Share of loss of joint venture	**40,833**	38,050
Deferred tax benefit	**(177,188)**	-
	334,130	(27,355)
Change in working capital items (note 14 a))	**749,808**	(2,532,365)
Cash generated by (used in) operations	**1,083,938**	(2,559,720)
Interests received	**4,571**	5,872
Income taxes paid	**(5,976)**	-
Net cash generated by (used in) operating activities	**1,082,533**	(2,553,848)
Cash flows from investing activities		
Disposal of guaranteed deposits certificates	**115,364**	39,298
Acquisition of property, plant and equipment	**(98,130)**	(125,731)
Acquisition of intangible assets	**(6,818)**	(7,372)
Contingent considerations paid	**(441,315)**	(385,875)
Net cash used in investing activities	**(430,899)**	(479,680)
Cash flows from financing activities		
Variation of bank loan	**(233,624)**	1,545,321
Long-term debt reimbursement	**(3,355)**	(170,263)
Long-term debt contracted	**-**	124,692
Interest paid	**(129,447)**	(164,861)
Warrants issue expenses	**(1,165)**	-
Share issue expenses	**-**	(5,420)
Net cash (used in) generated by financing activities	**(367,591)**	1,329,469
Net change in cash and cash equivalents	**284,040**	(1,704,059)
Effect of exchange rate changes on the balance of cash held in foreign currencies	**16,153**	(23,126)
Increase (decrease) in cash and cash equivalents	**300,193**	(1,727,185)
Cash and cash equivalents - Beginning of period (note 14 b))	**148,836**	2,586,047
Cash and cash equivalents - End of period (note 14 b))	**449,029**	858,862

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

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(in Canadian dollars)

1. Governing Statutes & Nature of Operations

H_2O Innovation Inc. (the "Company") is incorporated under the *Canada Business Corporations Act*. The Company's mission is to design, develop and market innovative environmentally-friendly water treatment technology and to produce high performance products in the field of membrane filtration and biological and physical water treatment solutions. At the same time and on a smaller scale, the Company continues its manufacturing and equipment distribution operations for the maple industry. The head office of the Company is located at 420, Charest Boulevard East, suite 240, Quebec City (Quebec), Canada. On December 15, 2011, the Company's head office will move to 330 Saint-Vallier Street East, suite 340, Quebec City (Quebec), Canada.

On December 5th, 2011, the Board reviewed the accompanying condensed interim consolidated financial statements and authorized its publication.

2. Summary of Significant Accounting Policies

Basis of preparation

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards, and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis in these condensed interim consolidated financial statements. In the financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These condensed interim consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 and IFRS 1. Subject to certain transition elections disclosed in note 17, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position as at July 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 17 discloses the impact of the transition to IFRS on the company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the company's consolidated financial statements for the year ended June 30, 2010.

The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as of December 5, 2011, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending June 30, 2011 could result in restatement of these condensed interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

These unaudited condensed interim consolidated financial statements should be read in conjunction with the Company's Canadian GAAP consolidated financial statements as at June 30, 2011 and June 30, 2010 and for the years ended June 30, 2011 and 2010. Note 17 presents IFRS information for the year ended June 30, 2011 that is material to an understanding of these unaudited interim consolidated financial statements.

The accompanying unaudited condensed interim consolidated financial statements were prepared on a going concern basis, under the historical cost convention.

Principles of consolidation

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries H_2O Innovation USA, Inc, H_2O Innovation USA Holding, Inc. and Professional Water Technologies, LLP.

Interest in a joint venture
A joint venture is a contractual arrangement whereby the Company and other parties undertake an economic activity that is subject to joint control (i.e. when the strategic financial and operating policy decisions relating to the activities of the joint venture require the unanimous consent of the parties sharing control).

Joint venture arrangements that involve the establishment of a separate entity in which each venturer has an interest are referred to as jointly controlled entities. Under the equity method, investments in joint ventures are carried in the consolidated statement of financial position at cost as adjusted for post-acquisition changes in the Company's share of the net assets of the joint venture, less any impairment in the value of individual investments. Losses of a joint venture in excess of the Company's interest in that joint venture (which includes any long-term interests that, in substance, form part of the Company's net investment in the joint venture) are recognised only to the extent that the Company has incurred legal or constructive obligations or made payments on behalf of the joint venture.

When the Company transacts with the joint venture, profits and losses are eliminated to the extent of the Company's interest in the joint venture.

Subsidiaries
Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are deconsolidated from the date that control ceases.

Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

Business combinations

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Company, liabilities incurred by the Company to the former owners of the acquiree and the equity interests issued by the Company in exchange for control of the acquiree. Acquisition-related costs are generally recognised in the statement of income (loss) as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognized at their fair value at the acquisition date, except that:

- deferred tax assets or liabilities and liabilities or assets related to employee benefit arrangements are recognized and measured in accordance with *IAS 12 Income Taxes* and *IAS 19 Employee Benefits* respectively;
- assets (or disposal groups) that are classified as held for sale in accordance *with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations* are measured in accordance with that Standard.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed

exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognized immediately in profit or loss as a bargain purchase gain.

Non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at fair value or at the non-controlling interests' proportionate share of the recognized amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis. Other types of non-controlling interests are measured at fair value or, when applicable, on the basis specified in another IFRS.

When the consideration transferred by the Company in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Changes in the fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the 'measurement period' (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date.

The subsequent accounting for changes in the fair value of the contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is remeasured at subsequent reporting dates in accordance with *IAS 39, or IAS 37 Provisions, Contingent Liabilities and Contingent Assets*, as appropriate, with the corresponding gain or loss being recognised in the statement of income (loss).

When a business combination is achieved in stages, the Company's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date (i.e. the date when the Group obtains control) and the resulting gain or loss, if any, is recognized in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognized in other comprehensive income are reclassified to profit or loss where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Company reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see above), or additional assets or liabilities are recognized, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognized at that date.

Presentation currency

The Company's reporting currency is the Canadian dollar. The functional currency of the Canadian corporation is the Canadian dollar. The functional currency of the foreign subsidiary located in the United States of America is the US dollar. The functional currency of the joint venture is the Indian rupee.

Foreign currency translation

Monetary assets and liabilities of the Canadian corporation denominated in foreign currencies are translated at the exchange rate in effect at the balance sheet date, whereas other assets and liabilities are translated at the exchange rate in effect at the transaction date. Revenues and expenses are translated at the average exchange rate in effect during the year, with the exception of revenues and expenses relating to non-monetary assets and liabilities, which are translated at historical rate. Exchange gains and losses are reflected in the statement of income (loss).

The assets and liabilities of the foreign subsidiaries and the joint venture are translated into Canadian dollar using exchange rates prevailing at the end of the reporting period. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during that period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are recognized in other comprehensive income and accumulated in equity under the heading of translation adjustment.

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED) (in Canadian dollars)

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and are translated at the closing rate.

Financial assets and liabilities

On initial recognition, all financial assets and liabilities are measured and recognized at their fair value and their subsequent measurement depends on their classification as described below:

Classification	
Cash and cash equivalents	Loans and receivables
Guaranteed deposit certificates	Loans and receivables
Accounts receivable, excluding tax credits receivable	Loans and receivables
Accounts payable and accrued liabilities	Other financial liabilities
Long-term debt	Other financial liabilities
Convertible debenture	Other financial liabilities

Measurement
Financial instruments are initially measured at their fair value. Subsequently, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest method.

Transaction costs are recognized in deduction of the cost of financial assets and liabilities.

Cash and cash equivalents

Cash includes cash and demand deposits. Cash equivalents include very liquid investments convertible into a known cash amount and maturing within less than three months from the date of acquisition.

Inventories

Inventories are valued at the lower of cost and net realizable value. Cost is determined using the first in first out method for raw materials and using the absorption costing method for finished goods. The absorption costing method used by the Company includes direct materials, labour and manufacturing overhead expenses.

Property, plant and equipment

All property, plant and equipment are shown at cost less subsequent depreciation and impairment. Cost includes expenditure that is attributable to the acquisition of the items. Depreciation on assets is calculated using the straight-line method to allocate the cost of each asset to its residual value over its estimated useful economic life; for the buildings, component depreciation accounting is also used for components that have different useful economic life, as follows:

Buildings	25-40 years
Machinery and equipment	10 years
Computer equipment	5 years
Furniture, fixtures and office equipment	10 years
Automotive equipment	5 years
Leasehold improvements	Remaining term of the lease

The estimated useful lives, residual values and depreciation method are reviewed at each year end, with the effect of any changes in estimate accounted for on a prospective basis.

The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the statement of income (loss).

Intangible assets

Intangible assets acquired are recorded at cost less subsequent depreciation and impairment. They are amortized over their estimated useful lives. The amortization expense is included in the statement of income (loss) as “Amortization of intangible assets”.

The Company is using the following amortization methods:

Intangible assets acquired separately
Software is amortized using the straight-line method over a period of seven (7) years.

Intangible assets acquired in business combinations
Rights on technologies and technologies are amortized using the straight-line method over periods of seven (7) and fifteen (15) years, respectively.

Patents, trademarks and intellectual property are amortized using the straight-line method over periods of fifteen (15), eighteen (18) and twenty (20) years, respectively.

Customer relations are amortized using the straight-line method over periods of five (5) to fifteen (15) years.

Distribution network is amortized using the straight-line method over a period of five (5) years.

Goodwill

Goodwill arising in a business combination is recognised as an asset at the date that control is acquired (the acquisition date). Goodwill is measured as the excess of the sum of consideration transferred, the amount of any non-controlling interest in the acquiree, and the fair value of the acquirer’s previously held interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

If, the Company’s interest in the fair value of the acquiree’s identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer’s previously held equity in the acquire (if any), the excess is recognised immediately in the statement of income (loss) as a bargain purchase gain.

Goodwill is not amortised but it is reviewed for impairment at least annually. For the purpose of impairment testing, goodwill is allocated to each of the Company’s cash-generating units or a group of cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than its carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

The Company has elected to perform its annual impairment test of goodwill during the third quarter of each year.

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Other assets

Other assets are mainly composed of security deposits and are recorded at cost.

Impairment of tangible and intangible assets excluding goodwill

At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group if cash-generating units for which a reasonable and consistent allocation can be identified.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.
If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in the statement of income (loss).

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in the statement of income (loss).

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, rebates and other similar allowances.

Sales of consumables
Revenue from the sale of consumables is recognised when the following conditions are satisfied:

- The Company has transferred to the buyer the significant risks and rewards of ownership of the goods;
- The Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- The amount of revenue can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to the entity; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

Manufacturing contracts
Manufacturing contracts are within the scope of *IAS 11 – Construction contracts.* Where the outcome of a manufacturing contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the end of the reporting period, measured based on the milestones reached into the contract such as but not limited to approval of drawings, acceptance of piping and instrumentation diagrams, assembly, inspection, start-up and acceptance of the equipment which represent proportion of contract costs incurred for work performed to date relative to the estimated total contract costs. Variations in contract work and claims are included to the extent that the amount can be measured reliably and its receipt is considered probable.

Where outcome of a manufacturing contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred if it is probable that it will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

When it is probable that the total contract costs will exceed the total contract revenue, the expected loss is recognised as an expense immediately.

Interest revenue
Interest revenue is recognized when it is probable that the economic benefits will flow to the Company and the amount of revenue can be measured reliably using the effective interest rate applicable.

Share Capital

The Company has authorized an unlimited number of common shares (being voting and participating shares) with no par value, as well as an unlimited number of preferred, first and second ranking shares, issuable in series, with rights and privileges specific to each class.

Common shares are classified as equity. Incremental costs that are directly attributable to the issue of common shares and stock options are recognized as a deduction from equity, net of any tax effects.

Share-Based Payment

The Company offers a stock option plan to directors, executive officers, key employees and consultants providing services to the Company and accounts for these awards in accordance with IFRS 2 – Share-based Payment. Stock options granted to directors, executive officers, key employees and consultants providing services are measured at fair value (excluding the effect of non-market-based vesting conditions) at the date of grant. Details regarding determination the fair value of equity-settled share-based transactions are set out in note 17.

The fair value at the grant date of stock options is determined using the Black-Scholes pricing model and is recognized in the consolidated income statement as a compensation expense using a graded vesting schedule over the vesting period, based on the Company’s estimate of the number of shares that will eventually vest. At the end of each reporting period, the Company revises its estimate of the number of equity instruments expected to vest. The impact of the revision of original estimates, if any, is recognized in the income statement such that the cumulative compensation expense reflects the revised estimate, with a corresponding adjustment to the Stock options reserve.

Any consideration received by the Company upon the exercise of stock options is credited to share capital, and the Stock options reserve component resulting from share-based payment is transferred to share capital upon the issuance of the shares.

Warrants

The Company uses the fair value method to measure the value of warrants at the grant date. Fair value is determined using the Black-Scholes option pricing model and is recorded in the Share Capital or the Long-term Debt depending on the financing source with an offset to the Warrants reserve. When warrants are exercised, the corresponding Warrants reserve and the proceeds received by the Company are credited to share capital.

Research and Development Expenses and Tax Credits for a Company Established under the Carrefour de la Nouvelle Économie (“CNE”) relating to Research and Development

Research and development costs are expensed as incurred. However, development costs are deferred when they meet generally accepted criteria for deferral to the extent that their recovery is reasonably assured.

Tax credits to a company established under the CNE relating to research and development are accounted for during the year in which the costs are incurred, provided that the Company is reasonably certain that the credits will be received. These tax credits are presented against the research and development costs.

These tax credits must be examined by the tax authorities and it is possible that the amounts granted will differ from the amounts recorded.

The Company is entitled to scientific research and experimental development ("SR&ED") tax credits granted by the Canadian federal government ("Federal") and the government of the Province of Quebec ("Provincial"). Federal SR&ED tax credits are earned on qualified Canadian SR&ED expenditures at a rate of 20% and can only be used to offset Federal income taxes otherwise payable. Refundable Provincial SR&ED tax credits are generally earned on qualified salaries, subcontracting and university contract expenses incurred in the Province of Quebec, at a rate of 17.5% of eligible base amounts.

Tax credits and grants are accounted for using the cost reduction method. Accordingly, tax credits and grants are recorded as a reduction of the related expenses or capital expenditures in the period the expenses are incurred, provided that the Company has reasonable assurance the credits or grants will be realized.

Taxation

Income tax expense represents the sum of the current and deferred tax. Tax is recognized in the income statement, except to the extent it relates to items recognized directly in equity, in which case the related tax is recognized in equity.

Current tax
Current tax expense is based on the results for the period as adjusted for items that are not taxable or not deductible. Current tax is calculated using tax rates and laws that were enacted or substantively enacted at the balance sheet date.

Deferred tax
Deferred tax is accounted for using a temporary difference approach and is the tax expected to be payable or recoverable on temporary differences between the carrying amount of assets and liabilities in the statement of financial position and the corresponding tax bases on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates and laws enacted or substantively enacted at the balance sheet date.

Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax liabilities are recognized for taxable temporary differences arising on investments in subsidiaries and joint ventures except where the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future.

Deferred tax assets are recognized to the extent it is probable that taxable profits will be available against which the deductible temporary differences can be utilized. The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities are not recognized on temporary differences that arise from goodwill which is not deductible for tax purposes. Deferred tax assets and liabilities are not recognized in respect of temporary differences that arise on initial recognition of assets and liabilities acquired other than in a business combination.

Segment Reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the chief executive officer who makes strategic decisions.

Segment revenue represents sales by each segment. This is the measure reported to the chief operating decision maker for the purpose of resource allocation and assessment of segment performance.

Net loss per share

Basic net loss per common share are computed by dividing the net earnings available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net loss per share is calculated giving effect to the potential dilution that could occur if the stock options, warrants to issue common shares and convertible debenture were exercised or converted into common shares at the later of the beginning of the year or the issuance date. The treasury stock method is used to determine the dilutive effect of stock options, warrants and the "if-converted" method is used for convertible debentures.

Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Warranties

Provisions for the expected cost of warranty obligations are recognised at the date of the sale of relevant products, at the management's best estimate of the expenditure required to settle the Company's obligation.

The provision for warranty claims represents the present value of the management's best estimate of the future outflow of economic benefits that will be required under the Company's obligations for warranties. The estimate has been made on the basis of historical warranty trends and may vary as a result of new materials, altered manufacturing processes or other events affecting product quality.

The Company offers warranties that are of variable lengths of time depending on each customer agreements.

3. Critical accounting estimates, assumptions and judgments

The preparation of consolidated financial statements in accordance with IFRS often requires management to make estimates about and apply assumptions or subjective judgment to future events or other matters that affect the reported amounts of the Company's assets, liabilities, revenues, expenses and related disclosures. Assumptions, estimates and judgments are based on historical experience, expectations, current trends and other factors that management believes to be relevant at the time at which the Company's consolidated financial statements are prepared. Management reviews, on a regular basis, the Company's accounting policies, assumptions, estimates and judgments in order to ensure that the consolidated financial statements are presented fairly in accordance with IFRS.

Critical accounting estimates and judgments are those that have a significant risk of causing material adjustment and are often applied to matters or outcomes that are inherently uncertain and subject to change.

As such, management cautions that future events often vary from forecasts and expectations and that estimates routinely require adjustment.

Management considers the following areas to be those where critical accounting policies affect the significant judgments and estimates used in the preparation of the Company's consolidated financial statements.

Revenue recognition of manufacturing contracts
The stage of completion of any manufacturing contract is assessed by management by taking into consideration all information available at the reporting date. In this process, management applies significant judgments about milestones, actual work performed and the estimated costs to be incurred to complete work.

Impairment of goodwill and other non-current assets
At the end of each reporting period, the Company assesses whether there is any indication that the goodwill and non-current assets have been impaired. If any such indication exists, the recoverable amount of the asset is determined. The recoverable amount is the higher of its fair value less costs to sell and its value in use. In the measurement of the value in use, estimates of future cash flows are discounted. The use of different assumptions could result in different fair values and therefore, in different carrying amounts for goodwill and other non-current assets.

Income taxes and valuation allowances
The estimation of income taxes includes evaluation the recoverability of deferred tax assets based on an assessment of the Company's entities' ability to utilize the underlying future tax deductions against future taxable income prior to expiry of the deductions. Management assesses whether it is probable that some or all of the deferred income tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income. To the extent that management's assessment of any Company's entities ability to utilize future tax deductions changes, the Company would be required to recognize more or fewer deferred tax assets, and future income tax provisions or recoveries could be affected.

Useful lives of depreciable assets
Management reviews the useful lives of depreciation assets at each reporting date. As at September 30, 2011, management has assessed that the useful lives represent the expected utility of the assets to the Company. Actual results, however, may vary due to technical obsolescence or changes in the market, particularly for computer equipment, customer relationships, trademarks, patents and software.

Contingent considerations
The fair value recognized for contingent considerations has been estimated by management based on the acquired entities results, budgets and forecasts. However, the actual contingent considerations may vary due to unexpected changes in the acquired entities activities.

Stock-based compensation and other stock-based payments
As regards to stock option granted, the Company uses the fair value based method of accounting. The fair value of stock options is determined using the Black-Scholes pricing model, which requires the use of certain assumptions, including future stock price volatility and expected life of the instruments. The expected life is estimated using the contractual life of the instrument. The expected volatility is estimated using the historical volatility of the Company's stock over the same period as the contractual life. At the end of each reporting period, the Company revises its estimate of the number of equity instruments expected to vest.

Warrants
The Company uses the fair value method to measure the value of warrants at the grant date. Fair value is determined using the Black-Scholes option pricing model as described above.

4. Accounts Receivable

	As at September 30, 2011	As at June 30, 2011	As at July 1, 2010
	$	$	$
Accounts receivable	**5,088,316**	6,791,625	3,699,074
Retentions from customers under manufacturing contracts	**626,651**	566,938	742,620
Allowance for doubtful accounts	**(3,720)**	(3,720)	(25,724)
	5,711,247	7,354,843	4,415,970
Tax credits receivable	**114,522**	157,990	97,637
Other receivables	**489,071**	315,643	340,977
	6,314,840	7,828,476	4,854,584

5. Inventories

	As at September 30, 2011	As at June 30, 2011	As at July 1, 2010
	$	$	$
Raw materials	**1,605,334**	1,455,388	970,529
Finished goods	**937,081**	775,268	942,777
	2,542,415	2,230,656	1,913,306

6. Goodwill

The change in carrying value is as follows:

	$
Balance as at July 1, 2010	11,254,505
Effect of foreign exchange differences	(1,075,078)
Balance as at June 30, 2011	10,179,427
Effect of foreign exchange differences	**787,499**
Balance as at September 30, 2011	**10,966,926**

7. Accounts Payable and Accrued Liabilities

	As at September 30, 2011	As at June 30, 2011	As at July 1, 2010
	$	$	$
Trade accounts payable	1,853,017	2,010,603	2,053,959
Other accrued liabilities and accounts payable	1,473,412	2,171,298	1,353,899
	3,326,429	4,181,901	3,407,858

8. Provisions

The change in carrying value of the provision for warranties is as follows:

	$
Balance as at July 1, 2010	30,425
Additional provisions recognised	4,243
Effect of foreign exchange differences	(2,368)
Balance as at June 30, 2011	32,300
Additional provisions recognised	9,855
Less: Payments	(32,760)
Effect of foreign exchange differences	897
Balance as at September 30, 2011	**10,292**

9. Contingent considerations

The change in carrying value is as follows:

	$
Balance as at July 1, 2010	3,822,969
Plus: Unwinding of discount	29,857
Less: Payments	(1,157,423)
Less: Reduction of contingent consideration through statement of income (loss)	(114,129)
Effect of foreign exchange differences	(372,602)
Balance as at June 30, 2011	2,208,672
Plus: Unwinding of discount	**7,509**
Less: Payments	**(441,915)**
Effect of foreign exchange differences	**145,569**
	1,919,835
Less: short-term contingent considerations	**(504,119)**
Balance as at September 30, 2011	**1,415,716**

10. Long-Term Debt

	As at September 30, 2011	As at June 30, 2011	As at July 1, 2010
	$	$	$
Unsecured – at amortised cost			
Bank loans, denominated in Canadian dollars	**1,356,748**	1,338,945	1,765,873
Loans from other entities, denominated in Canadian dollars	**1,819,645**	1,810,230	-
Loans from shareholders, denominated in US dollars	**318,273**	290,930	423,095
Loans from other entities, denominated in US dollars	**108,684**	104,179	-
	3,603,350	3,544,284	2,188,968
Less : Current portion	**(601,386)**	(319,108)	(619,768)
Long-term debt	**3,001,964**	3,225,176	1,569,200

As at September 30, 2011, the Company respects all its bank covenants.

11. Convertible Debenture

On June 30, 2011, the Company repaid the convertible debenture in totality for an amount of $1,400,000 plus the accrued interest. This transaction generated a gain of $116,188 that was allocated as follows: $99,415 was recorded in the statement of earnings and $16,773 was recorded in equity under the caption “Gain on early extinguishment convertible debenture”.

12. Capital Stock

Stock options

The following table summarizes the activity under the Company’s stock-based compensation plan:

	Three-month period ended September 30, 2011		Year ended June 30, 2011	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		$		$
Outstanding - Beginning of period	3,945,000	1.06	1,950,000	1.11
Granted	-	-	2,035,000	0.50
Exercised	(-)	-	(25,000)	0.32
Expired	(-)	-	(-)	-
Forfeited	(618,500)	1.02	(15,000)	0.50
Outstanding - End of period	3,326,500	0.76	3,945,000	0.80

13. Net Loss 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-month period ended September 30, 2011	Three-month period ended September 30, 2010
Net loss	**(88,216)**	(629,610)
Basic weighted average number of share outstanding	**60,145,832**	60,120,832
Dilutive effect of stock options	**125,000**	150,000
Diluted weighted average number of share outstanding	**60,270,832**	60,270,832
Items excluded from the calculation of diluted net loss per share because the exercise price was greater than the average market price of the common shares or due to their anti-dilutive effect		
Stock options	**1,872,750**	1,646,250
Warrants (number of equivalent shares)	**10,179,877**	9,179,877
Convertible debenture	**-**	1,435,406

For the three-month periods ended September 30, 2011 and 2010, the diluted net loss per share was the same as the basic net loss per share, since the effect of the assumed exercise of stock options and warrants to purchase common share is anti-dilutive. Accordingly, the diluted net loss per share for these periods was calculated using the basic weighted average number of shares outstanding.

14. Cash Flows

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

	Three-month period ended September 30, 2011	Three-month period ended September 30, 2010
	$	$
Accounts receivable	**(2,181,284)**	(2,130,985)
Inventories	**(258,412)**	(307,963)
Work in process	**768,759**	538,004
Prepaid expenses	**46,518**	41,189
Accounts payable and accrued liabilities	**2,700,876**	(1,237,126)
Provisions	**(22,904)**	-
Billings in excess of work in progress	**(297,769)**	564,516
Income taxes payable	**(5,976)**	-
	749,808	(2,532,365)

b) Cash and cash equivalents consist of the following:

	Three-month period ended September 30, 2011	Three-month period ended September 30, 2010
	$	$
Beginning of period		
Cash and cash equivalents	**440,356**	2,586,047
Bank overdraft	**(291,520)**	-
	148,836	2,586,047

	Three-month period ended September 30, 2011	Three-month period ended September 30, 2010
	$	$
End of period		
Cash and cash equivalents	**646,851**	858,862
Bank overdraft	**(197,822)**	-
	449,029	858,862

15. Segment Information

Products from which reportable segments derive their revenues

The Company operates under a single reportable consisting of delivering drinking water and process water production and wastewater treatment systems, including related services.

The following is an analysis of the Company's revenue for the period for the continuing operations:

	Three-month period ended September 30, 2011	Three-month period ended September 30, 2010
	$	$
Revenue from sales of consumables	**2,765,934**	2,739,782
Manufacturing contracts revenue	**4,303,834**	3,585,299
	7,069,768	6,325,081

Geographical information

Revenue from external customers	**Three-month period ended September 30, 2011**	Three-month period ended September 30, 2010
	$	$
Revenue according to geographic location		
Canada	**1,713,162**	1,694,558
United States	**4,341,033**	4,061,103
Tunisia	**293,633**	-
China	**235,111**	254,533
Egypt	**161,996**	68,686
Other	**324,833**	246,201
	7,069,768	6,325,081

Revenue is attributed to the various countries according to the customer's country of residence.

	As at September 30, 2011	As at June 30, 2011
	$	$
Noncurrent assets other than financial instruments and deferred tax assets according to geographic location		
Canada	**1,839,489**	1,864,466
United States	**17,590,779**	16,505,322
	19,430,268	18,369,788

16. Related parties disclosure

Compensation of key management personnel

The remuneration of members of key management personnel during the period was as follows:

	Three-month period ended September 30, 2011	Three-month period ended September 30, 2010
Short-term benefits	**217,224**	191,740
Post-employment benefits	**3,508**	2,333
Share-based payments	**18,356**	3,326
	239,088	197,399

The remuneration of key executives is determined by the remuneration committee having regards to the performance of individuals and market trends.

17. Transition to IFRS

The Company's consolidated financial statements as at and for the year ended June 30, 2012 will be the first annual financial statements that comply with IFRS.

The accompanying unaudited interim consolidated financial statements were prepared as described in note 1 and reflect the relevant provisions of IFRS 1. IFRS 1 requires an entity to adopt IFRS in its first annual financial statements prepared under IFRS by making an explicit and unreserved statement of compliance with IFRS. The Company will make this statement when it issues its 2012 annual consolidated financial statements.

IFRS 1 is based on the principle that the adoption of IFRS should be applied retrospectively. Retrospective application necessitates that comparative financial information be provided, and, as a result, the first date at which the Company has applied IFRS was July 1, 2010 (the "Transition Date"). However, IFRS 1 offers certain optional exemptions and mandatory exceptions to the retrospective application of IFRS to first-time preparers of IFRS financial statements. Those exemptions and exceptions, which are relevant to the Company, are discussed in turn below.

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
(in Canadian dollars)

Optional IFRS exemptions

Business combinations
IFRS 1 allows first-time adopters to elect not to restate any business combinations that have occurred prior to the Transition Date in accordance with IFRS 3, *Business Combinations* (as revised in 2008) ("IFRS 3"). Retrospective application would require that all business combinations that occurred prior to an entity's date of transition to IFRS be restated, and any goodwill arising on such business combinations would be adjusted from its carrying value as determined under Canadian GAAP.

The Company has elected to apply this exemption and has not restated any prior business combinations. Consequently, IFRS 3 is applicable only to business combinations occurring after the Transition Date. There have been no business combinations since the Transition Date, and, as a result, the Company will apply the provisions of IFRS 3 to future transactions, if any.

Currency translation differences
Full retrospective application of IFRS would require an entity to determine the cumulative foreign currency translation differences, as per the provisions of IAS 21, *The Effects of Changes in Foreign Exchange Rates,* from the date that a subsidiary or an equity-method investee was acquired. IFRS 1 permits a first-time adopter to reset any cumulative translation differences that existed at the date of transition to IFRS to zero. The Company has elected to reset its cumulative translation adjustment balance to zero on July 1, 2010, with a corresponding adjustment to the Company's Transition Date deficit.

Fair value of property, plant and equipment and intangible assets as deemed cost
IFRS 1 allows first-time preparers to elect to use fair value at the Transition Date as deemed cost for any assets within the scope of this exemption. Subsequent depreciation is based on the deemed cost and starts from the date at which the fair value measurement was established. The Company has elected to use the cost model for each class of assets to the exception of the building and land for which the fair value at Transition Date has been chosen resulting in a decrease of the net book value to reflect fair value with a corresponding adjustment to the Company's Transition Date deficit.

Share-based payment transactions
IFRS 1 provides alternatives that permit first-time adopters to apply *IFRS 2 – Share-based payments* in a prospective manner. The Company has elected 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 7, 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.

Mandatory IFRS exceptions

Accounting estimates
IFRS 1 requires that estimates under IFRS at the date of transition should be consistent with estimates made for the same date under previous GAAP, after applying any adjustments to reflect differences in accounting policies, unless there is objective evidence that those estimates were made in error. As such, a first-time adopter cannot use hindsight in order to create or revise any accounting estimates. Estimates previously made by the Company under Canadian GAAP have not been revised, except where necessary to reflect any differences in accounting policies.

Reconciliation of Canadian GAAP to IFRS
IFRS 1 requires a first-time adopter of IFRS to reconcile shareholders' equity, comprehensive loss and cash flows for prior periods beginning on the date of transition to IFRS. Reconciliations of shareholders' equity as at July 1, 2010, September 30, 2010 and June 30, 2011 and comprehensive loss for the year-to-date periods ended September 30, 2010 and June 30, 2011 are provided below.

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
(in Canadian dollars)

	As at June 30, 2011	As at September 30, 2010	As at July 1, 2010
Reconciliation of shareholders' equity	$	$	$
Shareholders' equity under Canadian GAAP	25,112,244	27,086,067	28,572,229
IFRS adjustments attributable to:			
Impairment of intangible assets	(1,412,746)	(1,507,537)	(1,559,691)
Land and building carried at fair value	(250,404)	(250,404)	(250,404)
Contingent considerations	(2,032,678)	(2,331,877)	(2,403,067)
Amortization of intangible assets	110,529	26,050	-
Depreciation of property, plant and equipment	7,670	724	-
Shareholders' equity under IFRS	21,534,615	23,023,023	24,359,067

	Year ended June 30, 2011	Three-month period ended September 30, 2010
Reconciliation of comprehensive loss	$	$
Comprehensive loss under Canadian GAAP	(3,909,492)	(1,210,803)
IFRS adjustments attributable to:		
Impairment of intangible assets	146,944	52,156
Contingent considerations	400,246	80,358
Interest on contingent considerations	(29,857)	(9,169)
Amortization of intangible assets	119,387	25,781
Depreciation of property, plant and equipment	7,664	992
Foreign currency translation adjustments to shareholders' deficiency	(8,850)	(295,703)
Comprehensive loss under IFRS	(3,273,958)	(1,356,388)

Explanatory notes

In addition to the IFRS 1 exemptions discussed above, the following section discusses the changes in accounting policies that resulted in the adjustments shown in the preceding reconciliations.

a) Investment in a joint venture

Canadian GAAP

Investments in joint ventures were accounted for using the proportionate consolidation method.

IFRS

Investments in joint ventures are accounted for using the equity accounting method.

As at July 1, 2010 and since then, the Company held a 49% interest in the H_2O Innovation India Limited joint venture.

	As at June 30, 2011	As at September 30, 2010	As at July 1, 2010
	$	$	$
Cash and cash equivalent	25,071	18,538	86,328
Accounts receivable	584,039	32,616	2,701
Inventories	50,663	3,745	1,801
Work in process	67,404	-	-
Future income taxes	664	-	-
Property, plant and equipment	24,177	4,819	3,764
Bank loan	(225,861)	-	-
Accounts payable and accrued liabilities	(427,788)	(12,915)	(9,139)
Income taxes payable	(10,328)	-	-
Investment in a joint venture	88,041	46,803	85,455

b) Land and building carried at fair value

IFRS 1 – Fair value as deemed cost

IFRS 1 permits any asset in the designated categories to be measured at the Transition Date to IFRS at its fair value and that fair value to be used as the asset's deemed cost at that date.

An independent valuation of the Company's land and building was performed by a specialized firm to determine the fair value of the land and building in Ham-Nord, Canada. The valuation, which conforms to International Valuation Standards, was determined using the comparative method for recent transactions on the local market for similar assets. The report concludes that the fair value of the land and building is as follows:

	July 1, 2010
	$
Land	25,000
Building	1,075,000
	1,100,000

In consequence, the Company elected to use fair value as deemed cost for its land and building and adjustments in the amount of $250,404 have been recorded in reduction of cost of the land and building and the counterpart has been recorded in Deficit.

c) Impairment of intangible assets

Canadian GAAP

Property, plant and equipment and intangible assets with finite lives were reviewed for impairment whenever events or circumstances indicated that the carrying values of those assets may not be recoverable. Impairments were deemed to exist when the carrying value of the asset or asset group was greater than the undiscounted future cash flows expected to be provided by the asset or asset group. The amount of impairment loss, if any, was equivalent to the excess of the asset's or asset group's carrying value over fair value, which in turn was determined based upon discounted cash flows or appraised values, depending on the nature of assets.

IFRS

Once an indication of impairment is identified, similar to Canadian GAAP, an entity is required to make a formal estimate of recoverable amount. However, unlike Canadian GAAP, the carrying amount of an asset that is subject to impairment testing under IFRS is compared to the higher of fair value less costs to sell or value in use. Where the recoverable amount of an asset subject to impairment testing is compared to the asset's value in use, any future cash flows expected to be provided by the asset are discounted, unlike Canadian GAAP.

An impairment loss is recorded when the recoverable amount is less than the carrying amount. The recoverable amount is defined as the higher of the asset's fair value less costs to sell and its value in use. Under the value-in-use calculation, the expected future cash flows from the asset are discounted to their net present value.

As a result of the adoption of IFRS, the Company recognized impairments of $2,606,000 at the Transition Date. The Company has adjusted related amortization charges in the Company's comparative quarterly and year-to-date consolidated statements of comprehensive loss for the year ended June 30, 2011.

d) Contingent considerations – Initial recognition

Canadian GAAP

Contingent considerations are recognized as part of the cost of the purchase price when the amount of the consideration can be reasonably estimated at the date of the acquisition and the outcome of the contingency can be determined beyond reasonable doubt. Neither a liability nor outstanding equity instruments are recognized until the contingency is resolved and consideration is issued or become issuable.

IFRS
Any contingent consideration related to an acquisition need to be estimated and accounted for as a liability at fair value at the date of acquisition.

The Company had contingent considerations related to past business combinations which were not recognized under the Canadian GAAP. The Company has evaluated the liability in relation to those contingent considerations as at the Transition Date.

In addition, subsequent adjustments related to these estimates will be recorded in the statement of income (loss).

Contingent considerations – Interest payment
Contingent considerations booked under IFRS as of the date of acquisition are usually payable more than one year after such date. Adjustments to their fair value related to the passage of time are considered as interest expense.

e) Foreign currency translation adjustment

Canadian GAAP
During the first quarter of fiscal 2011, the Company completed a detailed analysis which identified significant changes in the economic facts and circumstances. In consequence, this analysis requires that the translation method applied to the foreign subsidiaries 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 Company's foreign subsidiaries. Therefore, the foreign subsidiaries have been reclassified from integrated to self-sustaining.

The financial statements of foreign subsidiaries and of the joint venture considered as self-sustaining entities 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 "Accumulated other comprehensive loss" under "Shareholders' equity". This modification has been applied prospectively from July 1, 2010.

As the impact of this reclassification was significant on the July 1, 2010 statement of financial position, an additional column has been included in the tabular reconciliation to historical Canadian GAAP balances to reflect the change.

IFRS
Under IFRS, the framework used to determine the functional currency is similar to that used to determine the currency of measurement under Canadian GAAP; however, under *IAS 21, The Effects of Changes in Foreign Exchange Rates*, the indicators for determining the functional currency are broken down into primary and secondary indicators when determining the functional currency. Primary indicators are closely linked to the primary economic environment in which the entity operates and are given more weight. Secondary indicators provide supporting evidence to determine an entity's functional currency. Primary indicators receive more weight under IFRS than Canadian GAAP.

On transition, the Company performed an assessment of the historical functional currencies for all group companies based on the requirements of IFRS. Based on that assessment, the Company retained the same functional currency that was used under Canadian GAAP (namely the Canadian dollar) except for foreign operations in United States and India, were it was deemed that the local currency should be the functional currency. The change in historical function currency required the retroactive restatement of these subsidiaries and joint venture into their local currencies using the methodology prescribed under IAS 21, with the cumulative impact of the historical translation of these entities from their local currency into the Canadian dollar presentation currency recorded in the cumulative translation adjustment account.

However, in accordance with IFRS 1, the Company has elected to reset the cumulative translation adjustment account, which would otherwise include the historical gains and losses arising from the translation of these foreign operations. The cumulative translation adjustment balance as of July 1, 2010 of $295,703 was recognized as an adjustment to deficit. The application of the exemption had no impact on net equity.

f) Contributed surplus reclassification
Canadian GAAP
Contributed surplus comprise stock-based compensation costs, fair value of stock options exercised and fair value of warrants.

IFRS
The concept of contributed surplus does not exist under IFRS. The Company shall reclassify items recognized in accordance with Canadian GAAP as asset, liability or component of equity of IFRS.

As a result, the Company reclassified amounts presented in the Canadian GAAP Contributed Surplus account to appropriate IFRS section of equity according to their nature.

g) Contingent considerations reclassification
Canadian GAAP
It is desirable to include a reference to provisions and contingencies on the balance sheet but it is not mandatory to include them as a line item in the balance sheet.

IFRS
As a minimum, the statement of financial position shall include a line item for the provisions.
As a result, the Company reclassified short-term contingent considerations included in the caption Accounts payable and accrued liabilities in a single item.

h) Shares to be issued reclassification
Shares to be issued have been reclassified in Deficit.

i) Statement of income (loss) reclassification
Canadian GAAP
The income statement should present fairly the results of operations for the period and should provide some specific information, however the concept of the classification either by nature or by function is not addressed.

IFRS
An entity shall present an analysis of expenses recognized in the statement of income (loss) using a classification based on either their nature or their function within the entity, which ever provides information that is reliable and more relevant. The Company believes that the classification of its expenses by function is more relevant.

As a result, for the quarter ended September 30, 2011, stock-based compensation, government assistance and acquisition and integration expenses have been classified within administrative expenses. Operating, selling, administrative and general expenses have been separated by function such as operating expenses, selling expenses and administrative expenses. Bank charges and other financial expenses have been classified with finance costs. Other income and exchange (loss) have been reclassified as other income and finance income.

j) Restatement of cash flow statements from Canadian GAAP to IFRS
The restatement from Canadian GAAP to IFRS had an impact caused by the new accounting method for the Company's joint venture as described in section a) above. Also, the Company decided to disclose the interest received and paid in the financing activities. As a result, for the three-month period ended September 30, 2010 there is a reclassification of $164,861 between the operating activities and the financing activities.

Reconciliations of consolidated financial statements

Presented below are reconciliations of the Company's consolidated financial statements previously prepared under Canadian GAAP to the consolidated financial statements prepared in accordance with IFRS.

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)

Reconciliation of Consolidated Equity as at July 1, 2010

(in Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balances	Canadian GAAP reclassification (e)	Adjusted Canadian GAAP balances	IFRS adjustments	IFRS reclassifications	IFRS balances	IFRS accounts
		$			$	$	$	
ASSETS								**ASSETS**
Current assets								**Current assets**
Cash and cash equivalents	(a)	2,672,375		2,672,375	(86,328)	-	2,586,047	Cash and cash equivalents
Held-for-trading investments		1,306,659	(1)	1,306,658	-	-	1,306,658	Guaranteed deposits certificates
Accounts receivable	(a)	4,857,285		4,857,285	(2,701)	-	4,854,584	Accounts receivable
Inventories	(a)	1,915,107		1,915,107	(1,801)	-	1,913,306	Inventories
Work in process		2,148,946		2,148,946	-	-	2,148,946	Costs incurred in excess of billings
Prepaid expenses		308,263		308,263	-	-	308,263	Prepaid expenses
		13,208,635	(1)	13,208,634	(90,830)	-	13,117,804	
								Non-current assets
Fixed assets	(a) (b)	2,451,115	7,500	2,458,615	(254,168)	-	2,204,447	Property, plant and equipment
Intangible assets	(c)	10,313,821	(12,785)	10,301,036	(2,606,000)	-	7,695,036	Intangible assets
	(a)	-		-	85,455	-	85,455	Investment in a joint venture
Other assets		44,141		44,141	-	-	44,141	Other assets
Goodwill		10,901,443	353,062	11,254,505	-	-	11,254,505	Goodwill
Future income tax assets	(c)	6,597		6,597	1,046,309	-	1,052,906	Deferred income tax assets
		36,925,752	347,776	37,273,528	(1,819,234)	-	35,454,294	
LIABILITIES								**LIABILITIES**
Current liabilities								**Current liabilities**
Accounts payable and accrued liabilities	(a)(g)	4,815,253	52,073	4,867,326	(9,139)	(1,450,327)	3,407,860	Accounts payable and accrued liabilities
	(g)	-		-	-	30,425	30,425	Provisions
Billings in excess of work in process		233,537		233,537	-	-	233,537	Billings in excess of costs incurred
Current portion of long-term debt		619,768		619,768	-	-	619,768	Current portion of long-term debt
	(d)(g)	-		-	872,286	1,419,902	2,292,188	Contingent considerations
		5,668,558	52,073	5,720,631	863,147	-	6,583,778	
								Non-current liabilities
Long-term debt		1,569,200		1,569,200	-	-	1,569,200	Long-term debt
Convertible debenture		1,354,530		1,354,530	-	-	1,354,530	Convertible debenture
	(d)				1,530,781	-	1,530,781	Contingent considerations
Deferred rent		56,938		56,938	-	-	56,938	Deferred rent
		8,649,226	52,073	8,701,299	2,393,928	-	11,095,227	
SHAREHOLDERS' EQUITY								**SHAREHOLDERS' EQUITY**
Equity component of convertible debenture	(f)	301,023		301,023	-	(301,023)	-	
Capital stock	(h)	45,858,645		45,858,645	-	(13,789)	45,844,856	Share capital
Contributed surplus	(f)	11,453,475		11,453,475	-	(11,453,475)	-	
	(f)	-		-	-	301,023	301,023	Equity component on convertible debenture reserve
	(f)	-		-	-	1,451,585	1,451,585	Stock options reserve
	(e)	-		-	-	10,001,890	10,001,890	Warrants reserve
Deficit	(b) (c) (d) (e) (h)	(29,336,617)		(29,336,617)	(3,917,459)	13,789	(33,240,287)	Deficit
Accumulated other comprehensive gain (loss)	(e)	-	295,703	295,703	(295,703)	-	-	Accumulated other comprehensive gain (loss)
		28,276,526	297,703	28,572,229	(4,213,162)	-	24,359,067	
		36,925,752	347,776	37,273,528	(1,819,234)	-	35,454,294	

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
Reconciliation of Consolidated Equity as at September 30, 2010
(in Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balances	IFRS adjustments	IFRS reclassifications	IFRS balances	IFRS accounts
		$	$	$	$	
ASSETS						**ASSETS**
Current assets						**Current assets**
Cash and cash equivalents	(a)	877,399	(18,538)	-	858,861	Cash and cash equivalents
Held-for-trading investments		1,266,405	-	-	1,266,405	Guaranteed deposits certificates
Accounts receivable	(a)	6,895,242	(32,616)	-	6,862,626	Accounts receivable
Inventories	(a)	2,198,593	(3,745)	-	2,194,848	Inventories
Work in process		1,570,005	-	-	1,570,005	Costs incurred in excess of billings
Prepaid expenses		263,748	-	-	263,748	Prepaid expenses
		13,071,392	(54,899)	-	13,016,493	
						Non-current assets
Fixed assets	(a) (b)	2,496,049	(254,231)	-	2,241,818	Property, plant and equipment
Intangible assets	(c)	9,704,866	(2,493,076)	-	7,211,790	Intangible assets
	(a)	-	46,803	-	46,803	Investment in a joint venture
Other assets		43,361	-	-	43,361	Other assets
Goodwill		10,862,418	-	-	10,862,418	Goodwill
Future income tax assets	(c)	6,597	1,011,321	-	1,017,918	Deferred income tax assets
		36,184,683	(1,744,082)	-	34,440,601	
LIABILITIES						**LIABILITIES**
Current liabilities						**Current liabilities**
Bank loan		1,545,321	-	-	1,545,321	Bank loan
Accounts payable and accrued liabilities	(a)(g)	3,156,670	(12,915)	(1,093,302)	2,050,453	Accounts payable and accrued liabilities
	(g)			29,584	29,584	Provisions
Billings in excess of work in process		793,252	-	-	793,252	Billings in excess of costs incurred
Current portion of long-term debt		629,442	-	-	629,442	Current portion of long-term debt
Current portion of convertible debenture		250,000	-	-	250,000	Current portion of convertible debenture
	(d)(g)	-	845,494	1,063,718	1,909,212	Contingent considerations
		6,374,85	832,579	-	7,207,264	
						Non-current liabilities
Long-term debt		1,544,112	-	-	1,544,112	Long-term debt
		-	-	-	-	Provisions
Convertible debenture (Note 6)		1,128,059	-	-	1,128,059	Convertible debenture
	(d)	-	1,486,383	-	1,486,383	Contingent considerations
Deferred rent		51,760	-	-	51,760	Deferred rent
		9,098,616	2,318,962	-	11,417,578	
SHAREHOLDERS' EQUITY						**SHAREHOLDERS' EQUITY**
Equity component of convertible debenture	(f)	301,023	-	(301,023)	-	
Capital stock	(h)	45,853,225	-	(13,789)	45,839,436	Share capital
Contributed surplus	(f)	11,479,239	-	(11,479,239)	-	
	(f)	-	-	301,023	301,023	Equity component on convertible debenture reserve
	(f)	-	-	1,477,349	1,477,349	Stock options reserve
	(f)	-	-	10,001,890	10,001,890	Warrants reserve
Deficit	(b) (c) (d) (e)(f)(h)	(29,984,023)	(3,899,663)	13,789	(33,869,897)	Deficit
Accumulated other comprehensive loss	(a) (c) (d) (e)	(563,397)	(163,381)	-	(726,778)	Accumulated other comprehensive loss
		27,086,067	(4,069,288)	-	23,023,023	
		36,184,683	(1,744,082)	-	34,440,601	

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
Reconciliation of Consolidated Statement of Comprehensive Loss for the three months ended September 30, 2010
(in Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balances	IFRS adjustments	IFRS reclassifications	IFRS balances	IFRS accounts
		$	$	$	$	
						Continuing operations
Sales	(a)	6,339,866	(14,785)	-	6,325,081	Revenue
Cost of goods sold	(a)	4,446,921	(6,708)	-	4,440,213	Cost of goods sold
Gross margin		1,892,945	(8,077)	-	1,884,868	**Gross profit**
Expenses						
Operating, selling, administrative and general expenses	(a)(i)	1,988,547	(40,627)	(1,947,920)	-	
	(i)	-	-	300,288	300,288	Operating expenses
	(i)	-	-	925,186	925,186	Selling expenses
	(i)	-	-	723,846	723,846	Administrative expenses
Depreciation of fixed assets	(b)(i)	73,232	(1,001)	-	72,231	Depreciation of property, plant and equipment
Amortization of intangible assets	(c)(i)	272,447	(26,050)	-	246,397	Amortization of intangible assets
Bank charges and other financial expenses	(i)	32,616	-	(32,616)	-	
Government assistance	(i)	(24,363)	-	24,363	-	
Stock-based compensation	(i)	25,764	-	(25,764)	-	
	(i)	-	-	(9,139)	(9,139)	Other gains (losses) – net
		2,368,243	(67,678)	(41,756)	2,258,809	
Operating loss before the following items		(475,298)	59,601	(41,756)	(373,941)	
Other income	(i)	(7,349)	-	7,349	-	
Exchange (gain) loss	(i)	(7,663)	-	7,663	-	
	(i)	-	-	(5,872)	(5,872)	Finance income
	(d)(i)	-	9,255	219,736	228,991	Finance costs
		-	9,255	213,864	223,119	Finance costs – net
Interest on long-term debt	(i)	187,120	-	(187,120)	-	
	(a)(i)	-	32,550	-	32,550	Share of loss in a joint venture
		172,108	41,805	41,756	255,669	
Loss before income taxes		(647,406)	17,796	-	(629,610)	**Loss before income taxes**
Income tax recovery						**Income tax recovery**
Future income taxes		-	-	-	-	Deferred income taxes
Net loss for the period		(647,406)	17,796	-	(629,610)	**Loss for the period**
Other comprehensive loss						Other comprehensive loss
Translation adjustment	(a)(c)(d)	(563,397)	(163,381)	-	(726,778)	Translation adjustment
Comprehensive loss for the period		(1,210,803)	(145,585)	-	(1,356,388)	Comprehensive loss for the period
						Loss per share attributable to the equity holders of the company during the period
Basic and diluted net loss per share		(0.011)	0.001	-	(0.010)	**Basic and diluted loss per share**
Weighted average number of shares outstanding		60,120,832	-	-	60,120,832	Weighted average number of shares outstanding

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
Reconciliation of Consolidated Statement of Cash Flows as at September 30, 2010
(in Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balances	IFRS adjustments	IFRS reclassifications	IFRS balances	IFRS accounts
		$	$	$	$	
Cash flows from operating activities						**Cash flows from operating activities**
Net loss	(a)	(647,406)	17,796	-	(629,610)	Loss before income taxes
Non-cash items						Non cash items
	(j)		9,255	213,864	223,119	Finance costs – net
Depreciation of property, plant and equipment	(a)(b)	73,232	(1,001)	-	72,231	Depreciation of property, plant and equipment
Amortization of intangible assets	(c)	272,442	(26,045)	-	246,397	Amortization of intangible assets
Net lease obligations		(3,306)	-	-	(3,306)	Net lease obligations
Stock-based compensation		25,764		-	25,764	Stock-based compensation
	(a)	-	38,050	-	38,050	Share of loss of a joint venture
Imputed interest on long-term debt and convertible debenture	(j)	54,875	-	(54,875)	-	
		(224,399)	38,045	158,989	(27,355)	
Accounts receivable	(a)	(2,160,199)	29,214	-	(2,130,985)	Accounts receivable
Inventories	(a)	(309,856)	1,893	-	(307,963)	Inventories
Work in process		538,004	-	-	538,004	Costs incurred in excess of billings
Prepaid expenses		41,189	-	-	41,189	Prepaid expenses
Accounts payable and accrued liabilities	(a)(g)	(1,237,256)	130	(29,584)	(1,266,710)	Accounts payable and accrued liabilities
	(g)			29,584	29,584	Provisions
Billings in excess of work in process		564,518	-	-	564,518	Billings in excess of costs incurred
		(2,787,999)	69,282	158,989	(2,559,718)	Cash used in operations
	(j)	-		5,872	5,872	Interest received
		-		-	-	Income taxes paid
		(2,787,999)	69,292	164,861	(2,553,846)	Net cash used by operating activities
Cash flows from investing activities						**Cash flows from investing activities**
Disposal of held-for-trading investments		39,298	-	-	39,298	Disposal of guaranteed deposits certificates
Acquisition of property, plant and equipment	(a)	(126,750)	1,019	-	(125,731)	Acquisition of property, plant and equipment
Acquisition of intangible assets	(a)	(7,367)	(5)	-	(7,372)	Acquisition of intangible assets
Business acquisition		(385,785)	-	-	(385,875)	Contingent considerations paid
		(480,694)	1,014	-	(479,680)	Net cash used in investing activities
Cash flows from financing activities						**Cash flows from financing activities**
Variation of bank loan		1,545,321	-	-	1,545,321	Variation of bank loan
Long-term debt reimbursement		(170,263)	-	-	(170,263)	Long-term debt reimbursement
Long-term debt contracted		124,692	-	-	124,692	Long-term debt contracted
	(j)	-	-	(164,861)	(164,861)	Interest paid
Share issue expenses		(5,420)	-	-	(5,420)	Share issue expenses
		1,494,330	-	(164,861)	1,329,469	Net cash generated by financing activities
Net change in cash and cash equivalents		(1,774,363)	70,306	-	(1,704,057)	Net change in cash and cash equivalents
Effect of exchange rate changes on the balance of cash held in foreign currencies	(a)	(20,613)	(2,516)	-	(23,129)	**Effect of exchange rate changes on the balance of cash held in foreign currencies**
Increase (Decrease) in cash and cash equivalents		(1,794,976)	67,790	-	(1,727,186)	**Increase (Decrease) in cash and cash equivalents**
Cash and cash equivalents – Beginning of period	(a)(c)(d)	2,672,375	(86,327)	-	2,586,048	**Cash and cash equivalents – Beginning of period**
Cash and cash equivalents – End of period		877,399	(18,537)	-	858,862	**Cash and cash equivalents – End of period**

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
Reconciliation of Consolidated Equity as at June 30, 2011
(in Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balances	IFRS adjustments	IFRS reclassifications	IFRS balances	IFRS accounts
		$	$	$	$	
ASSETS						**ASSETS**
Current assets						**Current assets**
Cash and cash equivalents	(a)	465,427	(25,071)	-	440,356	Cash and cash equivalents
Held-for-trading investments		1,412,963	-	-	1,412,963	Guaranteed deposits certificates
Accounts receivable	(a)	8,412,515	(584,039)	-	7,828,476	Accounts receivable
Inventories	(a)	2,281,319	(50,663)	-	2,230,656	Inventories
Work in process	(a)	2,332,345	(67,404)	-	2,264,941	Costs incurred in excess of billings
Prepaid expenses		198,504	-	-	198,504	Prepaid expenses
		15,103,073	(727,177)	-	14,375,896	
						Non-current assets
Fixed assets	(a)(b)	2,333,004	(267,190)	-	2,065,814	Property, plant and equipment
Intangible assets	(c)	8,374,218	(2,249,670)	-	6,124,548	Intangible assets
	(a)	-	88,041	-	88,041	Investment in a joint venture
Other assets		41,942	-	-	41,942	Other assets
Goodwill	(d)	10,690,312	(510,885)	-	10,179,427	Goodwill
Future income tax assets	(c)	680,597	947,068	-	1,627,665	Deferred income tax assets
		37,223,146	(2,719,813)	-	34,503,333	
LIABILITIES						**LIABILITIES**
Current liabilities						**Current liabilities**
Bank overdraft		291,520	-	-	291,520	Bank overdraft
Bank loan	(a)	1,579,486	(225,861)	-	1,353,625	Bank loan
Accounts payable and accrued liabilities	(a)(c)(d)(g)	5,328,868	(427,789)	(719,178)	4,181,901	Accounts payable and accrued liabilities
	(g)	-	-	32,300	32,300	Provisions
Billings in excess of work in process		1,310,866	-	-	1,310,866	Billings in excess of costs incurred
Income taxes payable	(a)	17,977	(10,328)	-	7,649	Income taxes payable
Current portion of long-term debt		319,108	-	-	319,108	Current portion of long-term debt
	(d)(g)	-	-	686,878	686,878	Contingent considerations
		8,847,825	(663,978)	-	8,183,847	
						Non-current liabilities
Long-term debt		3,225,176	-	-	3,225,176	Long-term debt
	(g)		1,521,794	-	1,521,794	Contingent considerations
Deferred rent		37,901	-	-	37,901	Deferred rent
		12,110,902	857,816	-	12,968,718	
SHAREHOLDERS' EQUITY						**SHAREHOLDERS' EQUITY**
Capital stock	(h)	45,866,225	-	(13,789)	45,852,436	Share capital
Contributed surplus	(f)	11,878,629	-	(11,878,629)	-	
	(f)	-	-	1,734,952	1,734,952	Stock options reserve
	(f)	-	-	10,143,677	10,143,677	Warrants reserve
Deficit	(b)(c)(d)(e)(g)(h)	(30,635,638)	(3,651,923)	13,789	(34,273,772)	Deficit
Accumulated other comprehensive loss	(a)(c)(d)	(1,996,972)	74,294	-	(1,922,678)	Accumulated other comprehensive loss
		25,112,244	(3,577,629)	-	21,534,615	
		37,223,146	(2,719,813)	-	34,503,333	

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
Reconciliation of Consolidated Statement of Comprehensive Loss for the year ended June 30, 2011
(in Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balances	IFRS adjustments	IFRS reclassifications	IFRS balances	IFRS accounts
		$	$	$	$	
						Continuing operations
Sales	(a)	28,798,161	(1,165,895)	-	27,632,266	Revenue
Cost of goods sold	(a)	20,231,921	(763,846)	-	19,468,075	Cost of goods sold
Gross margin		8,566,240	(402,049)	-	8,164,191	**Gross profit**
Expenses						
Operating, selling, administrative and general expenses	(a)(i)	8,421,342	(410,679)	(8,010.663)	-	
	(i)	-	-	1,225,331	1,225,331	Operating expenses
	(i)	-	-	3,689,387	3,689,387	Selling expenses
	(i)	-	-	3,392,160	3,392,160	Administrative expenses
Depreciation of fixed assets	(a)(i)	307,297	(7,295)	-	300,002	Depreciation of property, plant and equipment
Amortization of intangible assets	(c)(i)	1,065,826	(117,343)	-	948,483	Amortization of intangible assets
Bank charges and other financial expenses	(a)(i)	170,277	(5,656)	(164,621)	-	
Government assistance	(i)	(60,524)	-	60,524	-	
Stock-based compensation	(i)	288,367	-	(288,367)	-	
	(i)	-	-	(82,802)	(82,802)	Other gains (losses) – net
		10,192,585	(540,973)	(179,051)	9,472,561	
Operating loss before the following items		(1,626,345)	138,924	1,548,975	(1,308,370)	
Other income	(i)	(67,872)	-	67,872	-	
Exchange (gain) loss	(i)	(44,846)	(42)	44,888	-	
	(d)(i)	-		(29,958)	(29,958)	Finance income
	(i)	-	-	834,869	834,869	Finance costs
		-	-	804,911	804,911	Finance costs – net
Interest on long-term debt	(i)	700,217	-	(700,217)	-	
Gain on early extinguishment of convertible debenture		(99,415)	-	-	(99,415)	Gain on early extinguishment of convertible debenture
Acquisition and integration expenses	(i)	38,403	-	(38,403)	-	
	(a)		(116,830)	-	(116,830)	Share of profit in a joint venture
		526,487	(116,872)	179,051	588,666	
Loss before income taxes		(2,152,832)	255,796	-	(1,897,036)	**Loss before income taxes**
Income tax recovery						**Income tax recovery**
Current income taxes	(a)	25,096	(10,410)	-	14,686	Current income taxes
Future income taxes	(a)	(561,111)	669	-	(560,442)	Deferred income taxes
		(536,015)	(9,741)	-	(545,756)	
Net loss for the year		(1,616,817)	265,537	-	(1,351,280)	**Loss for the year**
Other comprehensive loss						Other comprehensive loss
Translation adjustment	(a)(c)(d)	(2,292,675)	595,912	-	(1,922,678)	Translation adjustment
Comprehensive loss for the year		(3,909,492)	825,271	-	(3,273,958)	Comprehensive loss for the year
						Loss per share attributable to the equity holders of the company during the year
Basic and diluted net loss per share		(0.027)	0.005		(0.022)	**Basic and diluted loss per share**
Weighted average number of shares outstanding		60,136,106	-	-	60,136,106	Weighted average number of shares outstanding

GENERAL INFORMATION

Board of 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

Key Management

Frédéric Dugré, President & CEO
Jim Peterson, Chief Operating Officer
Josée Riverin, Director of Finance
Guillaume Ducharme, VP Communications & IR
Marc Blanchet, VP Corporate and Legal Affairs & Secretary of the Board

Harbans Kohli, VP Sales North America
Guillaume Clairet, VP Strategic Business Development
Paul Laverty, VP Engineering
David Russell, VP Specialty Chemicals and Services

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

Auditors
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