Interim financial report
Second quarter ended
December 31, 2011

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

MANAGEMENT REPORT

Dear Shareholders,

Our results for the second quarter of fiscal 2012 show both progress and challenges. While total revenues are up 11% compared to the second quarter of fiscal 2011, they have unfortunately remained at the same level they were in this year's first quarter. With our order backlog remaining high and above the $30 M mark throughout the first six months of the year, recording quarterly revenues of $7.1 M is a performance that is under our projections. During the quarter, we successfully added $4.7 M in new bookings for water treatment systems. These new bookings, coupled with the average level of revenues realized from systems projects during the quarter, kept our order backlog high at $30.0 M at quarter's end. With our order backlog remaining this high six months into the fiscal year, we continue to expect reaching record-high revenues at year-end.

Both our business sectors have recorded increased revenues compared to the second quarter of fiscal 2011. Revenues from water treatment systems stood at $4.1 M compared to $3.6 M in 2011, while revenues from specialty chemicals and consumables reached $3.0 M in this quarter compared to $2.8 M in 2011. However, these modest increases have not brought enough momentum to enable us to record a corresponding increase in gross margin. A combination of external and internal factors has put significant pressure on the quarter's gross margin, bringing it at 22.6 % compared to the historical and unusually high level of 31.4 % recorded during the second quarter of fiscal 2011.

Three factors affected gross margin over the quarter, the first one being external and beyond the Company's control:

- First, some of our water treatment systems clients have delayed the delivery or the commissioning of their systems, a situation we cannot control. This has postponed to the second half of the fiscal year the revenue recognition of these projects.
- We also struggled to maintain our margins on two U.S. projects that had been obtained with unusually low margins in the heart of the recession. These were two of the last significant low-margin projects that remained in our backlog.
- And at last, the reallocation of resources and associated charges we completed during the first quarter will have a permanent impact on our gross margin level throughout fiscal 2012, reducing gross margins by approximately 2.0% compared to the margins recorded in fiscal 2011.

In the next two quarters, scheduled project delivery dates will require us to increase production levels and is expected to have a corresponding positive impact on revenue recognition. Already, several large projects have seen their initial design and engineering phase completed and have now entered the higher-revenue generating phases of manufacturing and assembly. The additional resources we added to our equipment and consumables sales forces at the beginning of the year are also expected to start making their impact felt, as should the four new international distributors of Professional Water Technologies products we added during the first quarter. Our equipment sales force is in full action, with intense bidding activity coming from opportunities both in North America and abroad. Demand from the energy sector should remain high throughout the remaining two quarters and beyond, while demand from other industrial sectors in Canada and the United States is also expected to remain sustained and offer interesting opportunities. While demand for large water treatment systems from the U.S. municipal sector remains challenging, demand from the Canadian municipal sector should stay at healthy levels for the coming months.

During the quarter and for the first-half of fiscal 2012, our selling, operating and administrative expenses were kept well under control and are on track with budgeted levels, even though we have added resources to our sales teams.

EBITDA for the quarter was recorded at ($707,814), compared to ($23,624) for the same period ended December 31, 2010. Adjusted EBITDA (excluding stock-based compensation) was for its part recorded at ($671,487), compared to $7,951 in last year's second quarter.

Cash flows for the quarter were affected by project execution and delivery delays, as several large projects were initiated. The renewal and extension of our revolving credit facilities concluded shortly after the end of the quarter will provide us with enhanced flexibility and increases our capabilities to cover the working capital requirements we will have as we gain speed in the execution of our backlog. Our revolving credit line has been extended by $1M to $4M and can be used both in Canadian and U.S. currencies. This renewal under favourable commercial terms and with a reduction in financing and related costs is also a demonstration of confidence and support from the Company's long-time financing partners.

H_2O Innovation India, our Indian joint venture, has continued its fast-paced development and reached an important milestone during the quarter by commissioning its first large-scale site-built water treatment system. Less than 24 months after we founded H_2O Innovation India, it has completed the assembly and started the commissioning of its first major water treatment system, for client Larsen & Toubro Heavy Engineering, a highly respected Indian multinational manufacturer. Unique in India, this 7,000 m^3/day system combining ultrafiltration pre-treatment and reverse osmosis treatment is a technological showcase for H_2O Innovation India. Delivering this project while assembling our own team, recruiting and training the right people, building our assembly plant and implementing procedures and controls is unsurprisingly challenging. But with the close, constant, on-site support from our engineering and management teams, we are giving H_2O Innovation India all the tools and knowledge it needs to overcome the initial challenges inherent to any start-up. Our Indian team is quickly gaining maturity and, although the completion of its first large-scale project was completed with a low margin, we have full confidence in their ability to record higher margins as they execute the industrial systems projects that compose their order backlog.

In closing, as we engage ourselves in the second half of fiscal 2012, our management and operations teams are fully mobilized to do all that can be done to accelerate production and delivery, while maintaining our margins. The common objective of our operations teams and of all our people is to get systems out of our manufacturing facilities and into our client's locations, on time and on budget.

In fiscal 2011, our challenge was to grow our order backlog and we succeeded. With a high order backlog, steady success securing new bookings and gradually increasing sales of specialty chemicals and consumables, we have the foundations required to successfully generate higher revenues during the last six months of fiscal 2012 and finish the year with record-high revenues, positive EBITDA and ensuring the sound growth of our Company for all stakeholders.

Frédéric Dugré
President and CEO

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE FINANCIAL SITUATION

In accordance with National Instrument 51-102 Continuous Disclosure Obligations, the following comments are intended to provide a review and an analysis of H_2O Innovation's results of operations and financial position for the quarter ended December 31, 2011, in comparison with the corresponding period ended December 31, 2010. They should be read in conjunction with the consolidated financial statements and accompanying notes. Comparison of Balance sheets as at December 31, 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 its 2012 interim consolidated financial statements. In these 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 February 13, 2012, 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 condensed 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 December 31 2011	2010	Six-month periods ended December 31 2011	2010
	$	$	$	$
Revenue	7,056,495	6,354,087	14,126,263	12,679,168
Gross profit	1,592,624	1,993,756	3,337,558	3,878,624
Gross profit	22.6%	31.4%	23.6%	30.6%
Operating expenses	181,538	315,340	286,644	615,627
Selling expenses	954,006	866,130	1,818,673	1,791,316
Administrative expenses	919,647	822,033	1,774,739	1,545,879
Net loss	(1,214,510)	(523,693)	(1,302,726)	(1,153,303)
Basic and diluted loss per share	(0.020)	(0.009)	(0.022)	(0.019)
EBITDA[1]	(707,814)	(23,624)	(468,427)	(111,487)

Revenue and gross profit

While total revenues are up 11% compared to the second quarter of fiscal 2011, they have unfortunately remained at the same level they were in this year's first quarter. With the Company's order backlog remaining high and above the $30 M mark throughout the first six months of the year, recording quarterly revenues of $7.1 M is a performance that falls below management's projections.

Both business sectors of the Company have nonetheless recorded increased revenues compared to the second quarter of fiscal 2011. Revenues from water treatment systems stood at $4.1 M compared to $3.6 M in 2011, while revenues from specialty chemicals and consumables reached $3.0 M in this quarter compared to $2.8 M in 2011.

The following table summarizes the evolution of the Company's revenue and new orders, together with the variations in its backlog over the last five quarters. This analysis shows how the Company has evolved in a volatile economy, how its business model combining water treatment revenue and revenue from specialty chemicals and consumables makes it stronger and puts it 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	(Q3 & 4 FY2011 & Q1 & 2 FY2012)	(Q3 & 4 FY2010 & Q1 & 2 FY2011)
Order backlog	$14.3 M	$15.1 M	$21.6 M	$35.3 M	$31.6 M	$30.0M	**N/A**	N/A
Bookings for water treatment systems	$3.7 M	$7.4 M	$6.1 M	$17.4 M	$0.9 M	$4.7 M	**$29.1 M**	$23.6 M
Revenue from water treatment systems	$3.5 M	$3.6M	$3.9M	$4.5 M	$4.3 M	$4.1 M	**$16.8 M**	$13.9 M
Bookings / Revenue Ratio	***1.1***	***2.1***	***1.6***	***3.9***	***0.2***	***1.1***	***1.73***	***1.70***
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	$3.0 M	**$12.4 M**	$11.1 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.

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.

Consequently, revenue during this second quarter amounted to $7.1 M, compared to $6.4 M for the corresponding quarter last year. This increase represents a growth of 11%, mainly in the revenue from water treatment systems and to a smaller scale in the revenue from specialty chemicals and consumables when compared to the corresponding quarter of fiscal year 2011. The average exchange rate for the Company's U.S.-dollar denominated operations in the second quarter of fiscal 2012 over the second quarter of fiscal 2011 was fairly similar and had no impact on the Company's revenue growth.

Recurring revenues lightly increased by $0.2 M for this quarter compared to the corresponding quarter of the previous year. Revenues and profit from large orders of specialty chemicals from the Company's international distributors can easily shift from one quarter to the other depending on the time when they are placed.

These modest increases have unfortunately not brought enough momentum to enable the Company to record a corresponding increase in gross margin. A combination of external and internal factors has put significant pressure on the quarter's gross margin, bringing it at 22.6 % compared to the historical high level of 31.4 % recorded during the second quarter of fiscal 2011.

Three factors affected gross margin over the quarter, the first two of them being external and beyond the Company's control:

- First, some of the Company's water treatment systems clients have delayed the delivery or the commissioning of their systems, a situation the Company cannot control. This has postponed to the second half of the fiscal year the revenue recognition of these projects, while significant costs on these projects have been incurred and are reflected in the Company's balance sheet.
- The Company's also struggled to maintain its margins on two U.S. projects that had been obtained with unusually low margins in the heart of the recession. These were two of the last significant low-margin large projects that remained in its order backlog..
- And at last, the reallocation of resources and associated costs the Company completed during the first quarter will have a permanent impact, reducing by approximately 2.0 percentage points the gross profit margin through increased costs of goods sold and reduced operating expenses. This new allocation of resources is the result of sound management analysis in regards of its project execution.

During the quarter, the Company successfully added $4.7 M in new bookings for water treatment systems. These new bookings, coupled with the average level of revenues realized from systems projects during the quarter, kept the Company's order backlog high at $30.0 M at quarter's end. With its order backlog remaining this high six months into the fiscal year, management continues to expect reaching record-high revenue at year-end.

In the next two quarters, scheduled project delivery dates will require the Company to increase production levels and is expected to have a corresponding impact on revenue recognition. Already, several large projects have seen their initial design and engineering phase completed and have now entered the higher-revenue generating phases of manufacturing and assembly. The additional resources added to the Company's equipment and consumables sales forces at the beginning of the year are also expected to start making their impact felt, as should the four new international distributors of Professional Water Technologies products the Company added during the first quarter. The Company's equipment sales force is in full action, with intense bidding activity coming from opportunities both in North America and abroad. Demand from the energy sector should remain high throughout the remaining two quarters and beyond, while demand from other industrial sectors in Canada and the United States is also expected to remain sustained and offer interesting opportunities. While demand for large water treatment systems from the U.S. municipal sector remains challenging, demand from the Canadian municipal sector should stay at healthy levels for the coming months.

Operating expenses

Operating expenses decreased from $0.3 M to $0.2 M for the quarter ended December 31, 2011 compared with the corresponding quarter of fiscal 2011.This is due to resources that are reallocated to ongoing systems and equipment projects completed during the first quarter of fiscal 2012. This reallocation will have a permanent impact, reducing by approximately 2.0 percentage points the gross profit margin through increased costs of goods sold and reduced operating expenses. This new allocation of resources is the result of sound management analysis in regards of its project execution.

Selling expenses

Showing an increase of approximately $90,000, 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 additional resources added to the Company's equipment and consumables sales forces at the beginning of the current fiscal year.

Administrative expenses

Administrative expenses increased from $0.8 M in the second quarter of fiscal 2011 to $0.9 M in the second quarter of fiscal 2012. The increase in compensation of administrative personnel and management had an impact on the amount of administrative expenses in the second quarter of fiscal 2012.

Overall, our SG&A expenses remain under our fiscal year 2012 budget.

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 ($707,814), compared to ($23,624) for the same period ended December 31, 2010. Adjusted EBITDA (excluding a ($36,327) stock-based compensation expense) for the quarter was ($671,487). These negative EBITDA and negative adjusted EBITDA for the second quarter of fiscal 2012 are partly the result of external factors beyond the Company's control and internal factors. Management and operations teams are fully mobilized to do all that can be done to accelerate production and delivery, while maintaining the Company's margins to better manage internal factors.

Other gains (losses) – net

Other gains (losses) – net amounting to $18,032 for the period ended December 31, 2011 compared to $14,207 for the quarter ended December 31, 2010 are mostly composed of a foreign exchange gain, which is entirely due to exchange rate fluctuations related to working capital items.

Finance costs – net

Finance costs – net totalled $194,704 for the period ended December 31, 2011 compared to $184,970 for the comparable period in the previous fiscal year. These expenses relate mostly to the long-term debt. Of this amount, $65,770 represent the theoretical and non-monetary part of interest on long-term debt and $9,299 represent the unwinding of the discount on contingent considerations.

Share of loss in a joint venture

Share of loss in a joint venture totalled $213,526 for the period ended December 31, 2011 compared to $28,084 for the quarter ended December 31, 2010. This loss was largely attributable to the completion of the Company's joint-venture H_2O Innovation India's first large-scale project that was completed with low margin during the quarter.

Net loss

The net loss grew from ($523,693) or ($0.009 per share) for the second quarter of fiscal 2011 to ($1,214,510) or ($0.020 per share) for the second quarter of fiscal 2012.

Commitments

The Company has entered into long-term lease agreements expiring in 2011, 2012, 2013, 2017 and 2022, which call for lease payments of $3,619,209 for the rental of space. The minimum annual lease payments over the next five years are $489,799 in 2012, $480,913 in 2013, $409,592 in 2014, $418,519 in 2015 and $427,674 in 2016.

Information on share capital

As at December 31, 2011, the Company had 60,145,832 outstanding shares. No share was issued during this quarter.

BALANCE SHEETS

As working capital decreased from $6.2 M as at June 30, 2011 to $4.8 M as at December 31, 2011, the Company's current ratio slightly declined from 1.76 to 1.58. This reflects project execution and delivery delays, as several large projects have been initiated and their costs incurred but not yet billed to clients. The renewal and extension of the Company's revolving credit facilities concluded shortly after the end of the quarter will provide it with enhanced flexibility and increased capabilities to cover the working capital requirements it will have as it gains speed in the execution of its backlog. The Company's revolving credit line has been extended by $1 M to $4 M and can be used both in Canadian and U.S. currencies. This renewal under favourable commercial terms and with a reduction in financing and related costs is also a demonstration of confidence and support from the Company's long-time financing partners.

The net debt excluding contingent considerations, which stood at $6.3 M as at December 31, 2011, increased by nearly $1.55 M compared to $4.75 M as at June 30, 2011. This increase is mainly due to the general decline in working capital, to the investment in guaranteed deposit certificates to secure the new head office lease agreement and the additional investment in the Company's Indian joint venture.

Equity stood at $21.1 M as at December 31, 2011, compared to $21.5 M as at June 30, 2011. As at December 31, 2011 the net debt equity ratio was 0.30 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 December 31, 2011**	**Period ended June 30, 2011**
Working capital	$4,843,429	$6,192,049
Current ratio	1.58	1.76
Net debt[1]	$6,284,031	$4,749,073
Equity	$21,056,762	$21,534,615
Net debt to equity ratio	0.30	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 December 31, 2011 accounts receivable stood at $6.1 M compared with $7.8 M as at June 30, 2011. The $1.7 M decrease is attributable to the lower level of revenue recognized during the second quarter of fiscal 2012 combined to better management of past due receivables on which follow-ups are performed earlier, improving payment delay. Part of the Company's trade account receivables are guaranteed by Export Development Canada.

Inventories increased by $0.7 M to $2.9 M as at December 31, 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 and manufactured chemicals in preparation of a significant foreign order for shipment early January.

Costs incurred in excess of billings increased by $0.1 M to $2.4 M as at December 31, 2011, from $2.3 M as at June 30, 2011. Billings in excess of costs incurred decreased by $0.4 M to $0.9 M as at December 31, 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 higher-revenue generating phases of manufacturing and assembly.

Accounts payable and accrued liabilities decreased by $0.7 M to $3.5 M as at December 31, 2011, from $4.2 M as at June 30, 2011. This is mostly due to the early stage of completion of the Company's projects for which important components will be purchased in the second-half of fiscal year 2012.

Contingent considerations totalled $1.8 M as at December 31, 2011 compared to $2.2 M as at June 30, 2011. The decrease is due to payments amounting to $0.5 M made during the first half of fiscal year 2012 and to the unwinding of the discount rate. Of the $1.8 M total contingent considerations, an amount of $0.4 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 used $400,315 in cash for the period ended December 31, 2011, compared to $66,185 of cash used during the corresponding period ended December 31, 2010, a significant change caused mostly by the lower gross margin. Under IFRS, management elected to disclose interest paid under financing activities as opposed to operating activities under previous GAAP.

For the second quarter of fiscal 2012, investing activities required net cash of $431,222, mainly attributable to the additional investment in the form of a loan note in the Company's Indian joint venture to help it execute its order backlog and the acquisition of guaranteed deposits certificates to secure the new head office lease agreement. Moreover, payments totalling $74,430 relating to contingent considerations as part of previous acquisitions were also made during this quarter.

Financing activities generated cash of $1,312,594 in the second quarter of fiscal 2012 compared to $945,003 of cash generated during the corresponding period ended December 31, 2010. The increase in funds generated by financing activities is mainly caused by the use of bank loan, which resulted in a net increase amounting to $1,489,477. In addition, the use of a moratorium of six months over capital repayments of long-term debts had a positive impact on the financing activities. In December 2011, the Company used a second moratorium of six months over capital repayments of long-term debts to help execute its record-high order backlog. 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**
	December 31, 2011	**September 30, 2011**	**June 30, 2011**	**March 31, 2011**	
Sales	7,056,495	7,069,768	7,826,146	7,126,952	29,079,361
EBITDA	(707,814)	239,387	(107,679)	369,211	(206,895)
Net loss	(1,214,510)	(88,216)	(72,989)	(123,355)	(1,499,070)
EPS basic and diluted	(0.020)	(0.001)	(0.001)	(0.002)	(0.025)

	Three-month periods ended				**Previous twelve months**
	December 31, 2010	**September 30, 2010**	**June 30, 2010 (1)**	**March 31, 2010 (1)**	
Sales	6,354,087	6,325,081	5,921,355	6,312,349	24,912,872
EBITDA	(23,624)	(87,863)	(785,178)	(980,271)	(1,876,936)
Net loss	(523,693)	(629,610)	(6,220,440)	(1,558,567)	(8,932,310)
EPS basic and diluted	(0.009)	(0.010)	(0.113)	(0.028)	(0.160)

(1) 2010 data have not been adjusted to reflect the new IFRS. Only 2011 data have been 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 less cash and cash equivalents, held-for-trading investments and held-to-maturity investment. The Company monitors capital in light of its monthly needs and obligations linked to its financial liabilities.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's condensed 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". 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 Company explains its choices related to IFRS 1, "First-time Adoption of International Financial Reporting Standards", in note 17 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 17 of the financial statements for the quarter ended December 31, 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 (loss) 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 condensed 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 December 31, 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 December 31, 2011, the Company had off-balance sheet arrangements consisting of letters of credit amounting to $1.3 M; these letters of credit expire at various dates through fiscal 2013. In these letters of credit, $1.1 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"), the Company has 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 Company has been made known to them; and
- information required to be disclosed in the Company'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)

December 31, 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
investor@h2oinnovation.com

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

Financial reports, annual reports and press releases are accessible on our website: *www.h2oinnovation.com* and on SEDAR.

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

	December 31, 2011	June 30, 2011
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	**238,149**	440,356
Guaranteed deposits certificates	**1,397,562**	1,412,963
Accounts receivable (note 4)	**6,107,514**	7,828,476
Inventories (note 5)	**2,897,536**	2,230,656
Costs incurred in excess of billings	**2,406,343**	2,264,941
Prepaid expenses	**119,647**	198,504
	13,166,751	14,375,896
Non-current assets		
Property, plant and equipment	**2,082,553**	2,065,814
Intangible assets	**5,969,991**	6,124,548
Investment in a joint venture	**-**	88,041
Other assets	**43,097**	41,942
Goodwill (note 6)	**10,735,744**	10,179,427
Deferred income tax assets	**1,893,117**	1,627,665
	33,891,253	34,503,333
LIABILITIES		
Current liabilities		
Bank overdraft	**287,356**	291,520
Bank loan	**2,609,477**	1,353,625
Accounts payable and accrued liabilities (note 7)	**3,477,308**	4,181,901
Provisions (note 8)	**20,255**	32,300
Billings in excess of costs incurred	**943,536**	1,310,866
Income taxes payable	**-**	7,649
Current portion of long-term debt (note 10)	**572,235**	319,108
Contingent considerations (note 9)	**413,155**	686,878
	8,323,322	8,183,847
Non-current liabilities		
Long-term debt (note 10)	**3,053,112**	3,225,176
Contingent considerations (note 9)	**1,392,732**	1,521,794
Net investment in a joint venture	**19,351**	-
Deferred rent	**45,974**	37,901
	12,834,491	12,968,718
SHAREHOLDERS' EQUITY		
Share capital	**45,852,436**	45,852,436
Reserve - Stock options (note 12)	**1,823,867**	1,734,952
Reserve - Warrants	**10,142,512**	10,143,677
Deficit	**(35,576,498)**	(34,273,772)
Accumulated other comprehensive loss	**(1,185,555)**	(1,922,678)
	21,056,762	21,534,615
	33,891,253	34,503,333

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

CONDENSED INTERIM CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
For the six-month periods ended December 31, 2011 and 2010
(in Canadian dollars, except the number of shares)
(Unaudited)

ATTRIBUTABLE TO THE SHAREHOLDERS OF H_2O INNOVATION INC.

			Reserves					
	Common shares Number	**Share capital**	**Equity component of convertible debenture**	**Stock option** (note 12)	**Warrants**	**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	-	-	-	110,672	-	-	-	110,672
Fair value of stock options exercised	25,000	13,000		(5,000)				8,000
Share issue expenses related to private financing	-	(5,420)	-	-	-	-	-	(5,420)
Net loss for the period	-	-	-	-	-	(1,153,303)	-	(1,153,303)
Other comprehensive loss	-	-	-	-	-	-	(1,409,473)	(1,409,473)
Balance as at December 31, 2010	60,145,832	45,852,436	301,023	1,557,257	10,001,890	(34,393,590)	(1,409,473)	21,909,543
Balance as at July 1, 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	-	-	-	88,915	-	-	-	88,915
Warrant issue expenses related to financing	-	-	-	-	(1,165)	-	-	(1,165)
Net loss for the period	-	-	-	-	-	(1,302,726)	-	(1,302,726)
Other comprehensive income	-	-	-	-	-	-	737,123	737,123
Balance as at December 31, 2011	60,145,832	45,852,436	-	1,823,867	10,142,512	(35,576,498)	(1,185,555)	21,056,762

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 and six-month periods ended December 31, 2011 and 2010
(in Canadian dollars, except the number of shares)
(Unaudited)

	Three months ended December 31,		**Six months ended December 31,**	
	2011	2010	**2011**	2010
	$	$	**$**	$
Revenue (note 15)	**7,056,495**	6,354,087	**14,126,263**	12,679,168
Cost of goods sold	**5,463,624**	4,360,331	**10,788,705**	8,800,544
Gross profit	**1,592,871**	1,993,756	**3,337,558**	3,878,624
Operating expenses	**181,538**	315,340	**286,644**	615,627
Selling expenses	**954,006**	866,130	**1,818,673**	1,791,316
Administrative expenses	**919,647**	822,033	**1,774,739**	1,545,879
Depreciation of property, plant and equipment	**69,333**	77,678	**146,336**	149,909
Amortization of intangible assets	**242,659**	237,421	**476,283**	483,818
Other (gains) losses – net	**(18,032)**	(14,207)	**(369,240)**	(23,346)
	2,349,151	2,304,395	**4,133,435**	4,563,204
Operating loss	**(756,280)**	(310,639)	**(795,877)**	(684,580)
Finance income	**(6,807)**	(3,370)	**(11,378)**	(9,242)
Finance costs	**201,511**	188,340	**400,246**	417,331
Finance costs – net	**194,704**	184,970	**388,868**	408,089
Share of loss in a joint venture	**263,526**	28,084	**295,169**	60,634
	458,230	213,054	**684,037**	468,723
Loss before income taxes	**(1,214,510)**	(523,693)	**(1,479,914)**	(1,153,303)
Deferred tax benefit	**-**	-	**(177,188)**	-
Net loss for the period	**(1,214,510)**	(523,693)	**(1,302,726)**	(1,153,303)
Net loss per share attributable to the equity holders of the Company during the period				
Basic net loss per share	**(0.020)**	(0.009)	**(0.022)**	(0.019)
Diluted net loss per share	**(0.020)**	(0.009)	**(0.022)**	(0.019)
Weighted average number of shares outstanding (note 13)	**60,145,832**	60,132,245	**60,145,832**	60,126,539

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

CONDENSED INTERIM CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)
For the three-month and six-month periods ended December 31, 2011 and 2010
(in Canadian dollars)
(Unaudited)

	Three months ended December 31,		Six months ended December 31,	
	2011	2010	**2011**	2010
	$	$	**$**	$
Net loss for the period	**(1,214,510)**	(523,693)	**(1,302,726)**	(1,153,303)
Other comprehensive income (loss)				
Currency translation adjustments	**(446,825)**	(682,695)	**737,123**	(1,409,473)
Comprehensive income (loss) for the period	**(1,661,335)**	(1,206,388)	**(565,603)**	(2,562,776)

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 and six-month periods ended December 31, 2011 and 2010
(in Canadian dollars)
(Unaudited)

	Three months ended December 31,		Six months ended December 31,	
	2011	2010	**2011**	2010
	$	$	**$**	$
Cash flows from operating activities				
Net loss for the period	**(1,214,510)**	(523,693)	**(1,302,726)**	(1,153,303)
Non-cash items				
Finance costs – net	**194,704**	184,970	**388,868**	408,089
Depreciation of property, plant and equipment	**69,333**	77,678	**146,336**	149,909
Amortization of intangible assets	**242,659**	237,421	**476,283**	483,818
Deferred rent	**4,591**	(3,222)	**5,913**	(6,528)
Stock-based compensation	**36,327**	84,908	**88,915**	110,672
Share of loss of joint venture	**266,581**	30,584	**307,414**	68,634
Deferred tax benefit	**-**	-	**(177,188)**	-
	(400,315)	88,646	**(66,185)**	61,291
Change in working capital items (note 14 a))	**(1,014,495)**	40,006	**(264,687)**	(2,492,357)
Cash generated by (used in) operations	**(1,414,810)**	128,652	**(330,872)**	(2,431,066)
Interests received	**6,807**	3,370	**11,378**	9,242
Income taxes paid	**-**	-	**(5,976)**	-
Net cash generated by (used in) operating activities	**(1,408,003)**	132,022	**(325,470)**	(2,421,824)
Cash flows from investing activities				
Disposal of guaranteed deposits certificates	**38**	-	**115,402**	39,298
Acquisition of guaranteed deposits certificates	**(100,000)**	(147,110)	**(100,000)**	(147,110)
Acquisition of property, plant and equipment	**(56,391)**	(53,067)	**(154,521)**	(178,798)
Investment in a joint venture	**(200,022)**	-	**(200,022)**	-
Acquisition of intangible assets	**(417)**	(2,374)	**(7,235)**	(9,746)
Contingent considerations paid	**(74,430)**	(452,366)	**(515,745)**	(838,241)
Net cash used in investing activities	**(431,222)**	(654,917)	**(862,121)**	(1,134,597)
Cash flows from financing activities				
Variation of bank loan	**1,489,477**	130,430	**1,255,853**	1,675,751
Long-term debt reimbursement	**(3,591)**	(170,818)	**(6,946)**	(341,081)
Long-term debt contracted	**-**	-	**-**	124,692
Interest paid	**(173,292)**	(149,314)	**(302,739)**	(314,175)
Issuance of shares	**-**	8,000	**-**	8,000
Warrants issue expenses	**-**	-	**(1,165)**	-
Share issue expenses	**-**	-	**-**	(5,420)
Net cash (used in) generated by financing activities	**1,312,594**	(181,702)	**945,003**	1,147,767
Net change in cash and cash equivalents	**(526,631)**	(704,597)	**(242,588)**	(2,408,654)
Effect of exchange rate changes on the balance of cash held in foreign currencies	**28,395**	1,269	**44,545**	(21,860)
Decrease in cash and cash equivalents	**(498,236)**	(703,328)	**(198,043)**	(2,430,514)
Cash and cash equivalents - Beginning of period (note 14 b))	**449,029**	858,862	**148,836**	2,586,047
Cash and cash equivalents - End of period (note 14 b))	**(49,207)**	155,533	**(49,207)**	155,533

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 was located at 420, Charest Boulevard East, suite 240, Quebec City (Quebec), Canada. On December 15, 2011, the Company's head office moved to 330 Saint-Vallier Street East, suite 340, Quebec City (Quebec), Canada.

On February 13th, 2012 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 its 2012 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 February 13th, 2012, 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 financial 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 group.

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 is 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 and 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).

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

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 Group'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.

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

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 floe 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 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 Reserve – stock option.

Any consideration received by the Company upon the exercise of stock options is credited to share capital, and the Reserve – stock option 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 Reserve - Warrants. When warrants are exercised, the corresponding Reserve - Warrants 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 judgements

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.

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

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 December 31, 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 Black-Scholes pricing model, which required the use of certain assumptions, including future stock price volatility and expected life of 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.

(in Canadian dollars)

4. Accounts Receivable

	As at December 31, 2011	As at June 30, 2011
	$	$
Accounts receivable	**4,633,678**	6,791,625
Retentions from customers under manufacturing contracts	**742,164**	566,938
Allowance for doubtful accounts	**(3,720)**	(3,720)
	5,372,122	7,354,843
Tax credits receivable	**141,192**	157,990
Other receivables	**594,199**	315,643
	6,107,514	7,828,476

5. Inventories

	As at December 31, 2011	As at June 30, 2011
	$	$
Raw materials	**1,876,672**	1,455,388
Finished goods	**1,020,864**	775,268
	2,897,536	2,230,656

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	**556,317**
Balance as at December 31, 2011	**10,735,744**

7. Accounts Payable and Accrued Liabilities

	As at December 31, 2011	As at June 30, 2011
	$	$
Trade accounts payable	**1,306,298**	2,010,603
Other accrued liabilities and accounts payable	**2,171,009**	2,171,298
	3,477,307	4,181,901

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	**20,029**
Less: Payments	**(32,760)**
Effect of foreign exchange differences	**686**
Balance as at December 31, 2011	**20,255**

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	**15,232**
Less: Payments	**(515,745)**
Effect of foreign exchange differences	**97,728**
	1,805,887
Less: short-term contingent considerations	**(413,155)**
Balance as at December 31, 2011	**1,392,732**

10. Long-Term Debt

	As at December 31, 2011	As at June 30, 2011
	$	$
Unsecured – at amortised cost		
Bank loans, denominated in Canadian dollars	**1,373,348**	1,338,945
Loans from other entities, denominated in Canadian dollars	**1,833,447**	1,810,230
Loans from shareholders, denominated in US dollars	**315,730**	290,930
Loans from other entities, denominated in US dollars	**102,822**	104,179
	3,625,347	3,544,284
Less : Current portion	**(572,235)**	(319,108)
Long-term debt	**3,053,112**	3,225,176

As at December 31, 2011, the Company respects all its bank covenants.

(in Canadian dollars)

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 of convertible debenture".

12. Capital Stock

Stock options

The following table summarizes the activity under the Company's stock-based compensation plan.

	Six-month period ended December 31, 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	**(107,000)**	**1.50**	-	-
Forfeited	**(618,500)**	**1.02**	(15,000)	0.50
Outstanding - End of period	**3,209,500**	**0.74**	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 December 31,		**Six-month period ended December 31,**	
	2011	2010	**2011**	2010
	$	$	**$**	$
Net loss	**(1,302,726)**	(1,153,303)	**(1,214,510)**	(525,326)
Basic and diluted weighted average number of share outstanding	**60,145,832**	60,132,245	**60,145,832**	60,126,139
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			**1,885,750**	1,822,500
Warrants (number of equivalent shares)			**10,179,877**	9,179,877
Convertible debenture			**-**	1,435,406

For the three-month periods and the six-month periods ended December 31, 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.

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

14. Cash Flows

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

	Three-month period ended December 31,		Six-month period ended December 31,	
	2011	2010	**2011**	2010
	$	$	**$**	$
Accounts receivable	**4,073,655**	(1,241,544)	**1,892,371**	(3,372,529)
Inventories	**(372,372)**	(385,023)	**(630,784)**	(692,986)
Costs incurred in excess of billings	**(853,160)**	157,975	**(84,401)**	695,979
Prepaid expenses	**34,209**	37,328	**80,727**	78,517
Accounts payable and accrued liabilities	**(3,825,074)**	693,839	**(1,124,198)**	(543,287)
Provisions	**42,933**	28,773	**20,029**	28,773
Billings in excess of work in progress	**(112,715)**	748,659	**(410,484)**	1,313,175
Income taxes payable	**(1,971)**	-	**(7,947)**	-
	(1,014,495)	40,007	**(264,687)**	(2,492,358)

b) Cash and cash equivalents consist of the following:

	Three-month period ended December 31,		Six-month period ended December 31,	
	2011	**2010**	**2011**	2010
	$	**$**	**$**	$
Beginning of period				
Cash and cash equivalents	**646,851**	858,862	**440,356**	2,586,047
Bank overdraft	**(197,822)**	-	**(291,520)**	-
	449,029	858,862	**148,836**	2,586,047

	Three-month period ended December 31,		Six-month period ended December 31,	
	2011	2010	**2011**	2010
	$	$	**$**	$
End of period				
Cash and cash equivalents	**238,149**	155,533	**238,149**	155,533
Bank overdraft	**(287,356)**	-	**(287,356)**	-
	(49,207)	155,533	**(49,207)**	155,533

(in Canadian dollars)

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 December 31,		Six-month period ended December 31,	
	2011	2010	**2011**	2010
	$	$	**$**	$
Revenue from sales of consumables	**3,010,876**	2,768,080	**7,314,710**	5,507,862
Manufacturing contracts revenue	**4,045,619**	3,586,007	**6,811,553**	7,171,306
	7,056,495	6,354,087	**14,126,263**	12,679,168

Geographical information

	Three-month period ended December 31,		Six-month period ended December 31,	
Revenue from external customers	**2011**	2010	**2011**	2010
	$	$	**$**	$
Revenue according to geographic location				
Canada	**2,130,338**	1,997,713	**3,843,500**	3,692,271
United States	**3,289,229**	3,650,790	**7,630,262**	7,711,893
Tunisia	**1,444,404**	-	**1,738,037**	-
China	**83,546**	-	**318,657**	254,533
Egypt	**-**	383,040	**161,996**	451,726
Other	**108,978**	322,544	**433,811**	568,745
	7,056,495	6,354,087	**14,126,263**	12,679,168

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

	As at December 31, 2011	As at June 30, 2011
	$	$
Noncurrent assets other than financial instruments and deferred tax assets according to geographic location		
Canada	**1,806,747**	1,864,466
United States	**16,981,541**	16,505,322
	18,788,288	18,369,788

(in Canadian dollars)

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 December 31,		Six-month period ended December 31,	
	2011	2010	**2011**	2010
	$	$	**$**	$
Short-term benefits	**156,511**	195,408	**373,735**	387,148
Post-employment benefits	**2,336**	2,439	**5,844**	4,772
Share-based payments	**16,420**	31,575	**45,469**	36,838
	175,267	229,422	**425,048**	428,758

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 condensed 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.

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.

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

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 December 31, 2010 and June 30, 2011 and comprehensive loss for the year-to-date periods ended December 31, 2010 and June 30, 2011 are provided below.

	As at June 30, 2011	As at December 31, 2010
Reconciliation of shareholders' equity	**$**	**$**
Shareholders' equity under Canadian GAAP	25,112,244	25,824,827
IFRS adjustments attributable to:		
Impairment of intangible assets	(1,412,746)	(1,457,137)
Land and building carried at fair value	(250,404)	(250,404)
Contingent considerations	(2,032,678)	(2,262,796)
Amortization of intangible assets	110,529	53,465
Depreciation of property, plant and equipment	7,670	1,588
Shareholders' equity under IFRS	21,534,615	21,909,543

	Three-month period ended December 31, 2010	Six-month period ended December 31, 2010
Reconciliation of comprehensive loss	**$**	**$**
Comprehensive loss under Canadian GAAP	(1,354,148)	(2,564,951)
IFRS adjustments attributable to:		
Impairment of intangible assets	50,398	102,554
Contingent considerations	77,649	158,007
Interest on contingent considerations	(8,567)	(17,736)
Amortization of intangible assets	27,684	53,465
Depreciation of property, plant and equipment	596	1,588
Foreign currency translation adjustments to shareholders'deficiency	-	(295,703)
Comprehensive loss under IFRS	(1,206,388)	(2,562,776)

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 H2O Innovation India Limited joint venture.

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

	As at June 30, 2011	As at December 31, 2010
	$	$
Cash and cash equivalent	25,071	89,137
Accounts receivable	584,039	51,595
Inventories	50,663	24,520
Work in process	67,404	-
Future income taxes	664	-
Property, plant and equipment	24,177	6,498
Bank loan	(225,861)	-
Accounts payable and accrued liabilities	(427,788)	(156,433)
Income taxes payable	(10,328)	-
Investment in a joint venture	88,041	15,317

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 IFRSs 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 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.

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

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 change in measurement methodology, 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.

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 operated 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.

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

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, where it was deemed that the local currency should be the functional currency. The change in historical function currency required retroactive restatement of these subsidiaries and joint venture in to 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.

Has 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 three-month and six-month periods ended December 31, 2010, 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 and six-month periods ended December 31, 2010 there is a reclassification of $131,020 and $295,881 respectively 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 December 31, 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)	244,670	(89,137)	-	155,533	Cash and cash equivalents
Held-for-trading investments		1,413,022	-	-	1,413,022	Guaranteed deposits certificates
Accounts receivable	(a)	7,988,916	(51,595)	-	7,937,321	Accounts receivable
Inventories	(a)	2,580,414	(24,520)	-	2,555,894	Inventories
Work in process		1,385,081	-	-	1,385,084	Costs incurred in excess of billings
Prepaid expenses		223,078	-	-	223,078	Prepaid expenses
		13,835,181	(165,252)	-	13,669,929	
						Non-current assets
Fixed assets	(a) (b)	2,455,470	(255,314)	-	2,200,156	Property, plant and equipment
Intangible assets	(c)	9,130,822	(2,381,184)	-	6,749,638	Intangible assets
	(a)	-	15,317	-	15,317	Investment in a joint venture
Other assets		42,606	-	-	42,606	Other assets
Goodwill		10,499,284	-	-	10,499,284	Goodwill
Future income tax assets	(c)	6,597	977,512	-	984,109	Deferred income tax assets
		35,969,960	(1,808,921)	-	34,161,039	
LIABILITIES						**LIABILITIES**
Current liabilities						**Current liabilities**
Bank loan		1,675,751	-	-	1,675,751	Bank loan
Accounts payable and accrued liabilities	(a)(g)	3,487,543	(156,433)	(529,972)	2,801,138	Accounts payable and accrued liabilities
	(g)	-	-	28,773	28,773	Provisions
Billings in excess of work in process		1,508,302	-	-	1,508,302	Billings in excess of costs incurred
Current portion of long-term debt		628,985	-	-	628,985	Current portion of long-term debt
Current portion of convertible debenture		250,000	-	-	250,000	Current portion of convertible debenture
	(d)(g)	-	832,668	501,199	1,333,867	Contingent considerations
		7,550,581	676,235	-	8,226,816	
						Non-current liabilities
Long-term debt		1,400,793	-		1,400,793	Long-term debt
Convertible debenture (Note 6)		1,146,894	-	-	1,146,894	Convertible debenture
	(d)	-	1,430,128	-	1,430,128	Contingent considerations
Deferred rent		46,865	-	-	46,865	Deferred rent
		10,145,133	2,106,363	-	12,251,496	
SHAREHOLDERS' EQUITY						**SHAREHOLDERS' EQUITY**
Equity component of convertible debenture	(f)	301,023	-	(301,023)	-	
Capital stock	(h)	45,866,225	-	(13,789)	45,852,436	Share capital
Contributed surplus	(f)	11,559,147	-	(11,559,147)	-	
	(f)	-	-	301,023	301,023	Reserve – Option premium on convertible debenture
	(f)	-	-	1,557,257	1,557,257	Reserve - Stock options
	(f)	-	-	10,001,890	10,001,890	Reserve - Warrants
Deficit	(b) (c) (d) (e)(f)(h)	(30,528,440)	(3,878,939)	13,789	(34,393,590)	Deficit
Accumulated other comprehensive loss	(a) (c) (d)	(1,373,128)	(36,345)	-	(1,409,473)	Accumulated other comprehensive loss
		25,824,827	(3,971,926)	-	21,909,543	
		35,969,960	(1,1,808,921)	-	34,161,039	

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
Reconciliation of Consolidated Statement of Comprehensive Loss for the three months ended December 31, 2010
(in Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balances	IFRS adjustments	IFRS reclassifications	IFRS balances	IFRS accounts
		$	$	$	$	
						Continuing operations
Sales	(a)	6,421,506	(67,419)	-	6,354,087	Revenue
Cost of goods sold	(a)	4,403,777	(43,446)	-	4,360,331	Cost of goods sold
Gross margin		2,017,729	(23,973)	-	1,993,756	**Gross profit**
Expenses						
Operating, selling, administrative and general expenses	(a)(i)	1,969,771	(51,178)	(1,918,593)	-	
	(i)	-	-	315,340	315,340	Operating expenses
	(i)	-	-	866,130	866,130	Selling expenses
	(i)	-	-	822,033	822,033	Administrative expenses
Depreciation of fixed assets	(b)(i)	79,228	(1,550)	-	77,678	Depreciation of property, plant and equipment
Amortization of intangible assets	(c)(i)	266,513	(29,092)	-	237,421	Amortization of intangible assets
Bank charges and other financial expenses	(i)	32,725	-	(32,725)	-	
Government assistance	(i)	(24,400)	-	24,400	-	
Stock-based compensation	(i)	84,908	-	(84,908)	-	
	(i)	-	-	(14,207)	(14,207)	Other (gains) losses – net
		2,408,745	(81,820)	(22,530)	2,304,395	
Operating loss before the following items		(391,016)	57,847	22,530	(310,639)	**Operating loss**
Other income	(i)	(6,642)	-	6,642	-	
Exchange (gain) loss	(i)	3,340	-	(3,340)	-	
	(i)	-	-	(3,370)	(3,370)	Finance income
	(d)(i)	-	9,039	179,301	188,340	Finance costs
		-	9,039	179,233	184,970	Finance costs – net
Interest on long-term debt	(i)	146,575	-	(146,575)	-	
Acquisition and integration expenses	(i)	10,128	-	(10,128)	-	
	(a)(i)	-	28,084	-	28,084	Share of loss in a joint venture
		153,401	37,123	22,530	213,054	
Loss before income taxes		(544,417)	20,724	-	(523,693)	**Loss before income taxes**
Income tax recovery						**Income tax recovery**
Future income taxes		-	-	-	-	Deferred income taxes
Net loss for the period		(544,417)	20,724	-	(523,693)	**Loss for the period**
Other comprehensive loss						Other comprehensive loss
Translation adjustment	(a)(c)(d)	(809,731)	127,036	-	(682,695)	Translation adjustment
Comprehensive loss for the period		(1,354,148)	147,760	-	(1,206,388)	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		(0.009)	0.000	-	(0.009)	**Basic and diluted loss per share**
Weighted average number of shares outstanding		60,132,245	-	-	60,132,245	Weighted average number of shares outstanding

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
Reconciliation of Consolidated Statement of Comprehensive Loss for the six months ended December 31, 2010
(in Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balances	IFRS adjustments	IFRS reclassifications	IFRS balances	IFRS accounts
		$	$	$	$	
						Continuing operations
Sales	(a)	12,761,372	(82,204)	-	12,679,168	Revenue
Cost of goods sold	(a)	8,850,698	(50,154)	-	8,800,544	Cost of goods sold
Gross margin		3,910,674	(32,050)	-	3,878,624	**Gross profit**
Expenses						
Operating, selling, administrative and general expenses	(a)(i)	3,958,318	(91,805)	(3,866,513)	-	
	(i)	-	-	615,628	615,628	Operating expenses
	(i)	-	-	1,791,316	1,791,316	Selling expenses
	(i)	-	-	1,545,879	1,545,879	Administrative expenses
Depreciation of fixed assets	(b)(i)	152,460	(2,551)	-	149,909	Depreciation of property, plant and equipment
Amortization of intangible assets	(c)(i)	538,960	(55,142)	-	483,818	Amortization of intangible assets
Bank charges and other financial expenses	(i)	65,341	-	(65,341)	-	
Government assistance	(i)	(48,763)	-	48,763	-	
Stock-based compensation	(i)	110,672	-	(110,672)	-	
	(i)	-	-	(23,346)	(23,346)	Other (gains) losses – net
		4,776,988	(149,498)	(64,286)	4,563,204	
Operating loss before the following items		(866,314)	117,448	(64,286)	(684,580)	**Operating loss**
Other income	(i)	(13,991)	-	13,991	-	
Exchange (gain) loss	(i)	(4,323)	-	4,323	-	
	(i)	-	-	(9,242)	(9,242)	Finance income
	(d)(i)	-	18,294	399,037	417,331	Finance costs
		-	18,294	389,795	408,089	Finance costs – net
Interest on long-term debt	(i)	333,695	-	(333,695)	-	
Acquisition and integration expenses	(i)	10,128	-	(10,128)		
	(a)(i)	-	60,634	-	60,634	Share of loss in a joint venture
		325,509	78,928	64,286	468,723	
Loss before income taxes		(1,191,823)	38,520	-	(1,153,303)	**Loss before income taxes**
Income tax recovery						**Income tax recovery**
Future income taxes		-	-	-	-	Deferred income taxes
Net loss for the period		(1,191,823)	38,520	-	(1,153,303)	**Loss for the period**
Other comprehensive loss						Other comprehensive loss
Translation adjustment	(a)(c)(d)	(1,373,128)	(36,345)	-	(1,409,473)	Translation adjustment
Comprehensive loss for the period		(2,564,951)	2,175	-	(2,562,776)	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		(0.020)	0.001	-	(0.019)	**Basic and diluted loss per share**
Weighted average number of shares outstanding		60,126,539	-	-	60,126,539	Weighted average number of shares outstanding

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
Reconciliation of Consolidated Statement of Cash Flows three-month period ended December 31, 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)	(544,417)	20,724	-	(523,693)	Loss before income taxes
Non-cash items						Non cash items
	(j)	-	(9,255)	194,225	184,970	Finance costs – net
Depreciation of property, plant and equipment	(a)(b)	80,229	(2,551)	-	77,678	Depreciation of property, plant and equipment
Amortization of intangible assets	(c)	266,518	(29,097)	-	237,421	Amortization of intangible assets
Net lease obligations		(3,222)	-	-	(3,222)	Net lease obligations
Stock-based compensation		84,908	-	-	84,908	Stock-based compensation
	(a)	-	30,584	-	30,584	Share of loss of a joint venture
Imputed interest on long-term debt and convertible debenture	(j)	48,281	-	(48,281)	-	
		(67,703)	10,405	145,944	88,646	
Accounts receivable	(a)	(1,261,857)	20,313	-	(1,241,544)	Accounts receivable
Inventories	(a)	(406,157)	21,134	-	(385,023)	Inventories
Work in process		157,975	-	-	157,975	Costs incurred in excess of billings
Prepaid expenses		37,328	-	-	37,328	Prepaid expenses
Accounts payable and accrued liabilities	(a)(g)	858,852	(136,239)	811	723,424	Accounts payable and accrued liabilities
	(g)	-	-	(811)	(811)	Provisions
Billings in excess of work in process		748,657	-	-	748,657	Billings in excess of costs incurred
		67,095	(84,387)	145,944	128,652	Cash generated used in operations
	(j)	-	-	3,370	3,370	Interest received
		-	-	-	-	Income taxes paid
		67,095	(84,387)	149,314	132,022	Net cash used by operating activities
Cash flows from investing activities						**Cash flows from investing activities**
Acquisition of held-for-trading investments		(147,110)	-	-	(147,110)	Acquisition of guaranteed deposits certificates
Acquisition of property, plant and equipment	(a)	(56,772)	3,705	-	(53,067)	Acquisition of property, plant and equipment
Acquisition of intangible assets	(a)	(2,376)	2	-	(2,374)	Acquisition of intangible assets
Business acquisition		(452,366)	-	-	(452,366)	Contingent considerations paid
		(658,624)	3,707	-	(654,917)	Net cash used in investing activities
Cash flows from financing activities						**Cash flows from financing activities**
Variation of bank loan		130,430	-	-	130,430	Variation of bank loan
Long-term debt reimbursement		(170,818)	-	-	(170,818)	Long-term debt reimbursement
Issuance of shares		8,000	-	-	8,000	Issuance of shares
	(j)	-	-	(149,314)	(149,314)	Interest paid
		(32,388)	-	(149,314)	(181,702)	Net cash generated in financing activities
Net change in cash and cash equivalents		(623,917)	(80,680)	-	(704,597)	Net change in cash and cash equivalents
Effect of exchange rate changes on the balance of cash held in foreign currencies	(a)	(8,812)	10,081	-	1,269	**Effect of exchange rate changes on the balance of cash held in foreign currencies**
Net change in cash and cash equivalents		(632,729)	(70,599)	-	(703,328)	**Decrease in cash and cash equivalents**
Cash and cash equivalents – Beginning of period	(a)(c)(d)	877,399	(18,537)	-	858,862	**Cash and cash equivalents – Beginning of period**
Cash and cash equivalents – End of period		244,670	(89,137)	-	155,533	**Cash and cash equivalents – End of period**

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
Reconciliation of Consolidated Statement of Cash Flows six-month period ended December 31, 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)	(1,191,823)	38,520	-	(1,153,303)	Net loss
Non-cash items						Non cash items
	(j)	-	-	408,089	408,089	Finance costs – net
Depreciation of property, plant and equipment	(a)(b)	152,460	(2,551)	-	149,909	Depreciation of property, plant and equipment
Amortization of intangible assets	(c)	538,960	(55,142)	-	483,818	Amortization of intangible assets
Net lease obligations		(6,528)	-	-	(6,528)	Net lease obligations
Stock-based compensation		110,672	-	-	110,672	Stock-based compensation
	(a)	-	68,634	-	68,634	Share of loss of a joint venture
Imputed interest on long-term debt and convertible debenture	(j)	103,156	-	(103,156)	-	
		(293,103)	49,461	304,933	61,291	
Accounts receivable	(a)	(3,422,056)	49,527	-	(3,372,529)	Accounts receivable
Inventories	(a)	(716,013)	23,027	-	(692,986)	Inventories
Work in process		695,979	-	-	695,979	Costs incurred in excess of billings
Prepaid expenses		78,517	-	-	78,517	Prepaid expenses
Accounts payable and accrued liabilities	(a)(g)	(378,404)	(136,109)	(28,773)	(543,286)	Accounts payable and accrued liabilities
	(g)	-	-	28,773	28,773	Provisions
Billings in excess of work in process		1,313,175	-	-	1,313,175	Billings in excess of costs incurred
		(2,721,905)	(14,094)	304,933	(2,431,066)	Cash used in operations
	(j)	-	-	9,242	9,242	Interest received
		-	-	-	-	Income taxes paid
		(2,721,905)	(14,094)	314,175	(2,421,824)	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 held-for-trading investments		(147,110)	-	-	(147,110)	Acquisition of guaranteed deposits certificates
Acquisition of property, plant and equipment	(a)	(182,521)	3,723	-	(178,798)	Acquisition of property, plant and equipment
Acquisition of intangible assets	(a)	(9,743)	(3)	-	(9,746)	Acquisition of intangible assets
Business acquisition		(838,241)	-	-	(838,241)	Contingent considerations paid
		(1,138,317)	3,720	-	(1,134,597)	Net cash used in investing activities
Cash flows from financing activities						**Cash flows from financing activities**
Variation of bank loan		1,675,751	-	-	1,675,751	Variation of bank loan
Long-term debt reimbursement		(341,081)	-	-	(341,081)	Long-term debt reimbursement
Long-term debt contracted		124,692	-	-	124,692	Long-term debt contracted
	(j)	-	-	(314,175)	(314,175)	Interest paid
Issuance of shares		8,000	-	-	8,000	Issuance of shares
Share issue expenses		(5,420)	-	-	(5,420)	Share issue expenses
		1,461,942	-	(314,175)	1,147,767	Net cash generated in financing activities
Net change in cash and cash equivalents		(2,398,280)	(10,374)	-	(2,408,654)	Net change in cash and cash equivalents
Effect of exchange rate changes on the balance of cash held in foreign currencies	(a)	(29,425)	7,565	-	(21,860)	**Effect of exchange rate changes on the balance of cash held in foreign currencies**
Net change in cash and cash equivalents		(2,427,705)	(2,809)	-	(2,430,514)	**Decrease in cash and cash equivalents**
Cash and cash equivalents – Beginning of period	(a)(c)(d)	2,672,375	(86,328)	-	2,586,047	**Cash and cash equivalents – Beginning of period**
Cash and cash equivalents – End of period		244,670	(89,137)	-	155,533	**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	Reserve - Stock options
	(f)	-	-	10,143,677	10,143,677	Reserve - Warrants
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)(j)	307,297	(7,295)	-	300,002	Depreciation of property, plant and equipment
Amortization of intangible assets	(c)(j)	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)	**Operating loss**
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
PricewaterhouseCoopers LLP/S.R.L./S.E.N.C.R.L.

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