Interim financial report
Third quarter ended
March 31, 2012

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

MANAGEMENT REPORT

Dear Shareholders,

Several key accomplishments were made during this third quarter of fiscal 2012. First, our revenues reached a record-high $10.2 M, the highest level of quarterly revenues in our 12-year history. Not only did this quarter's revenues top the $10 M mark, but they also showed a very significant increase of 44.8% ($3.1 M) compared with revenues recorded in the last quarter and an increase of 43.4% (also $3.1 M) compared with last year's third quarter. Starting the fiscal year with our highest order backlog ever – at $36.6 M –, revenue growth was expected for the second half of the year as we advanced with project execution. Throughout the quarter, we finally saw our order backlog's largest projects move from their initial design and engineering phases to the higher revenue-generating phase. During this third quarter of fiscal 2012, several large municipal and industrial projects entered the production phase and reached invoicing milestones, contributing to higher invoicing converted into revenues during the quarter.

As a second accomplishment, we brought in a healthy $6.0 M in new bookings for water treatment systems and equipment. These new bookings kept our order backlog high at $28.1 M as at March 31, 2012. And thirdly, with higher revenues and an honest gross profit margin of 26.4%, we successfully concluded the quarter with a positive EBITDA of $1.3 M, making a quick and strong return to positive EBITDA after last quarter's negative EBITDA parenthesis. Net loss for the quarter was ($7.7 M). Excluding the goodwill impairment charge of ($8.2 M), the ($0.4 M) impairment of intangible assets, the related deferred tax benefit of $0.2 M and the $0.8 M changes in fair value of contingent considerations resulting from the conclusions of our annual impairment test for goodwill, net loss for the quarter would have been inches away from net earnings, at ($52,810). With higher revenues, we took advantage of the scalability of our business model to generate higher EBITDA and close in on net earnings, without needing to proportionally add resources or grow costs.

Revenues from water treatment systems and equipment increased by 79% compared with the third quarter of fiscal 2011. Our second business sector, specialty chemicals and consumables, also experienced growth during the quarter. Compared with the corresponding quarter of fiscal 2011, sales of specialty chemicals and consumables increased by 4%, from $3.3 M to $ 3.5 M.

During the quarter, our Californian business unit Professional Water Technologies launched a new high performance antiscalant SpectraGuard™ 350. This new product has been developed to provide a much higher level of protection and control over inorganic and colloidal species in water reclamation plants and brackish water reverse osmosis plants. Recently certified for use by the National Sanitation Foundation (NSF) to ANSI/NSF Standard 60, SpectraGuard™ 350 is already in use in a major water reclamation plant in Arizona.

The significant growth in our revenues also came along with an increase in gross profit margin compared with a quarter ago. Our operations during this third quarter produced a 26.4% gross profit margin, compared with 22.2% last quarter, where several factors had combined to negatively affect gross profit margin. While this quarter's margin is not as high as the unusually high level recorded a year ago when systems and equipment revenues reached a low point, it positively progressed to a sound level.

Selling, operating and administrative expenses remained fairly stable during the quarter and are on track with budgeted levels. Increases in selling and administrative expenses were mostly offset by a decrease in operating expenses. With the quarter's higher revenues, selling, operating and administrative expenses as a whole represented 21.4% of revenues, compared with 30.1% in the previous fiscal year, a clear demonstration of the scalability of our business model.

EBITDA for the quarter was recorded at $1.3 M, compared with $369,211 for the same period ended March 31, 2011. The fair value of contingent considerations was reduced based on actual and forecasted sales of certain wastewater equipment and this reduction had a positive effect of $0.8 M to the quarter's EBITDA. Excluding change in fair value of contingent considerations, EBITDA stood at $434,551. At the beginning of the year, our objectives were to continue the company's growth and bring it to a level of positive EBITDA. While we are yet to know the results of the fourth quarter, this quarter's positive EBITDA and the progress recorded during this year's first nine months are encouraging and demonstrate that we are moving in the right direction.

The higher level of activities registered during the quarter also impacted our balance sheet. Accounts receivable increased by $1.3 M compared with their level as at June 30, 2011, an increase due to the higher level of activities. The use of our revolving bank loan increased during the quarter as a result of important progress made in project execution and higher level of manufacturing and procurement activities.

Goodwill impairment charge and impairment of intangible assets

In the third quarter of fiscal 2012, we performed our annual impairment test for goodwill. Two factors have required that we re-evaluate the book value of our goodwill mainly related to the acquisition of Itasca Systems, Inc. in July 2008 and that of Wastewater Technology Inc. in April 2008. First, the prolonged decrease of our sales in the ethanol production sector, and second, lower sales of our patented Bio-Wheel™ and Bio-Brane™ systems in the U.S. municipal sector through manufacturer's representatives.

After the end of the quarter, we realigned our sales strategy for Bio-Wheel™ and Bio-Brane™ systems. We are now mainly targeting sales of containerized systems for small municipal streams and industrial applications (such as support to man camps and remote locations), two segments where our unique technology is highly differentiated and can attain stature as the preferred solution. And although systems and equipment sales to ethanol producers are scarce, we remain engaged and quite active in ethanol production sector serving an important customer base with specialty chemicals and consumables.

As at March 31, 2012, we reviewed the carrying amounts of our intangible assets and determined that some intangible assets related to the cash-generating unit "United States" were no longer used and were not generating material cash flows. Therefore, the recoverable amount of the intangible assets was estimated to nil. The impairment loss of the intangible assets is due to the prolonged decrease of our operations in the industrial sector – mainly the ethanol production subsector.

The result of these re-evaluations was respectively a $8.2 M and $0.4 M decrease in the book value of our goodwill and intangible assets, which increased the net loss for the quarter.

The net loss for the quarter totalled ($7.7 M), including a non-monetary loss of ($7.6 M) related to the goodwill impairment charge, impairment of intangible assets, deferred income tax benefit and changes in fair value of contingent considerations. Excluding the previous, net loss for the quarter would have amounted to ($52,810), inches away from net earnings. As a direct result of the impairment of intangible assets, our quarterly amortization charges of intangible assets will be reduced by approximately $8,000 starting next quarter.

After a fast start in bookings and revenues during its first year of operations, our Indian joint venture H_2O Innovation India concluded its second year of activities experiencing some of the hiccups that many fast-paced start-ups experience as they develop. The recent commissioning of its first large site-built system has brought mainly challenges to our young Indian partnership, some that have negatively affected its results, and others that have accelerated its collective learning and development. We are confident that the completion – albeit at a very low margin – of this flagship project will be an invaluable investment in the future growth of our Indian partnership. This unique reference in India will serve a key role in demonstrating our Indian joint venture's engineering and technical capabilities and enabling it to successfully secure a growing number of new bookings. We continue to support H_2O Innovation India very closely with visits from all level of management and constant coaching.

As we look ahead, we are expecting to be able to maintain a higher level of activity than what was recorded in the last fiscal year and the first six months of this year, closer to the level of activities recorded this quarter. With a production calendar full of the projects and new bookings that we are adding every quarter, and steadily growing sales of specialty chemicals and consumables, this quarter's results are no doubt a great progression. A progression we intend to build on for more quarters to come.

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 March 31, 2012, in comparison with the corresponding period ended March 31, 2011. They should be read in conjunction with the consolidated financial statements and accompanying notes. Comparison of Balance sheets as at March 31, 2012 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 words such as "anticipate", "if", "believe", "plan", "estimate", "expect", "intend", "may", "could", "should", "will", and other similar expressions, as well as those usually used in the future and the conditional, notably regarding certain assumptions as to the success of a venture. Those forward-looking statements 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

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 20, 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 20 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 May 14, 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 20 presents IFRS information for the year ended June 30, 2011 that is material to an understanding of these unaudited condensed interim consolidated financial statements.

NON-IFRS FINANCIAL MEASUREMENTS

In addition to the IFRS earnings measurements provided, the Company has included certain non-IFRS earnings measurements. These measurements are presented for information purposes only. They do not have a standardized meaning prescribed by IFRS and therefore may not be comparable to similar measurements presented by other public companies.

EARNINGS BEFORE FINANCE COSTS – NET, INCOME TAXES, DEPRECIATION, AMORTIZATION AND IMPAIRMENT (EBITDA)

EBITDA is a measurement of earnings that excludes finance costs – net, income taxes, depreciation, amortization and impairment. Management believes that EBITDA is a measurement commonly used by readers of financial statements to evaluate a company's operational cash-generating capacity and ability to discharge its financial expenses.

	Three months ended March 31,		**Nine months ended March 31,**	
	2012	2011	**2012**	2011
	$	$	**$**	$
Net loss	**(7,651,400)**	(125,006)	**(8,954,127)**	(1,278,309)
Finance costs – net	**221,023**	177,950	**609,891**	586,039
Income taxes	**(152,088)**	7,712	**(329,276)**	7,712
Depreciation	**75,233**	75,050	**221,569**	224,959
Amortization	**191,134**	233,505	**667,418**	717,323
Impairment of goodwill	**8,221,423**	-	**8,221,423**	-
Impairment of intangible assets	**378,728**	-	**378,728**	-
EBITDA	**1,284,053**	369,211	**815,626**	257,724

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 12 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 110 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 March 31 2012	Three-month periods ended March 31 2011	Nine-month periods ended March 31 2012	Nine-month periods ended March 31 2011
	$	$	**$**	$
Revenues	**10,222,312**	7,126,952	**24,348,575**	19,806,120
Gross profit	**2,700,507**	2,379,123	**6,038,065**	6,257,747
Gross profit	**26.4%**	33.4%	**24.8%**	31.6%
Operating expenses	**177,749**	302,263	**464,393**	917,890
Selling expenses	**993,043**	885,194	**2,811,716**	2,676,510
Administrative expenses	**1,022,044**	959,289	**2,796,783**	2,505,168
Net loss	**(7,651,400)**	(125,006)	**(8,954,127)**	(1,278,309)
Basic and diluted loss per share	**(0.127)**	(0.002)	**(0.149)**	(0.021)
EBITDA[1]	**1,284,053**	369,211	**815,626**	257,724

Revenues and gross profit

Revenues for the quarter reached a record-high $10.2 M, the highest level of quarterly revenue in our 12-year history. Revenues increased significantly by 44.8% ($3.1 M) compared with revenues recorded in the previous quarter ended December 31, 2011, and increased by 43.4% (also $3.1 M) compared the third quarter of the previous fiscal year. As we started the fiscal year with our highest order backlog ever – at $36.6 M –, revenue growth was expected for the second half of the year as project execution advanced. Throughout the quarter, we finally saw our order backlog's largest projects move from their initial design and engineering phases to the higher revenue-generating phase. During this third quarter of fiscal 2012, several large municipal and industrial projects entered production phase and reached invoicing milestones, contributing to higher invoicing converted into revenues during the quarter.

Both business sectors of the Company recorded increased revenues compared with the third quarter of fiscal 2011. Revenues from water treatment systems stood at $6.7 M compared with $3.8 M in 2011, while revenues from specialty chemicals and consumables reached $3.5 M in this quarter compared with $3.3 M in 2011.

The following table summarizes the evolution of the Company's revenues and new orders, together with the variations in its backlog over the last seven quarters. This analysis shows how the Company has evolved in a volatile economy, how its business model combining water treatment revenues and revenues 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**	**(Q4 FY2011 & Q1, Q2 & Q3 FY2012)**	(Q4 FY2010 & Q1, Q2 & Q3 FY2011)
Order backlog	$14.3 M	$15.1 M	$21.6 M	$35.3 M	$31.6 M	$30.0 M	$28.1 M	**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	$6.0 M	**$29.0 M**	$25.6 M
Revenues from water treatment systems	$3.5 M	$3.6 M	$3.8 M	$4.5 M	$4.3 M	$4.1 M	$6.7 M	**$19.6 M**	$14.6 M
Bookings / Revenues Ratio	***1.1***	***2.1***	***1.6***	***3.9***	***0.2***	***1.1***	**0.9**	***1.48***	***1.74***
Revenues 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	$3.5 M	**$12.6 M**	$11.8 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] See section on "Non-IFRS Financial Measurements"

Revenues from water treatment systems and equipment increased by 79% compared with the third quarter of fiscal 2011. Our second business sector, specialty chemicals and consumables, also experienced growth during the quarter. Compared with the corresponding quarter of fiscal 2011, sales of specialty chemicals and consumables increased by 4%, from $3.3 M to $ 3.5 M.

The significant growth in our revenues also came along with an increase in gross profit margin compared with a quarter ago. The Company's operations during this third quarter produced a 26.4% gross profit margin, compared with 22.2% last quarter, where several factors had combined to negatively affect gross profit margin. While this quarter's margin is not as high as the unusually high level (33.4%) recorded a year ago when systems and equipment revenues reached a low point, it positively progressed to a level management finds sound.

The Company also brought in a healthy $6.0 M in new bookings for water treatment systems and equipment over the quarter. These new bookings kept the order backlog high at $28.1 M as at March 31, 2012. The Company's bookings over revenue ratio for systems and equipment was close to 1 at 0.9 for the quarter and well above 1 at 1.48 for the last twelve months, showing sound replenishment of the order backlog while it is being transformed into revenues. With the record revenues of this third quarter and an order backlog remaining high nine months into the fiscal year, management continues to expect reaching record-high revenues for the year ending June 30, 2012.

Operating expenses

Operating expenses decreased from $0.3 M to $0.2 M for the quarter ended March 31, 2012 compared with the corresponding quarter of fiscal 2011.This decrease is due to resources that were reallocated during the first quarter of fiscal 2012. This reallocation will have a permanent impact through increased costs of goods sold and reduced operating expenses. The reallocation of resources is the result of sound management analysis in regards of its project execution.

Selling expenses

Selling expenses show an increase of approximately $108,000 or 12.2% for this quarter compared with the corresponding quarter of the previous fiscal year, while revenues increased by 43.4%. Selling expenses are linked to bookings and revenues, but do not fluctuate proportionally.

Administrative expenses

Administrative expenses increased by approximately $63,000 or 6.5% in this third quarter of fiscal 2012 compared with the third quarter of fiscal 2011. Administrative expenses in the third quarter of fiscal 2012 increased due to higher professional fees related to audit-related services and the successful defense of a patent litigation related to an exclusive maple syrup production product and, to a lesser extent, to the increase in compensation of administrative personnel and management.

With the quarter's higher revenues, selling, operating and administrative expenses ("SG&A") as a whole represented 21.4% of revenues, compared with 30.1% in the previous fiscal year, a demonstration of the scalability of the Company's business model. Overall, the Company's SG&A expenses remain under its fiscal year 2012 budget.

Goodwill impairment charge and impairment of intangible assets

In the third quarter of fiscal 2012, we performed our annual impairment test for goodwill. Two factors have required that we re-evaluate the book value of our goodwill mainly related to the acquisition of Itasca Systems, Inc. in July 2008 and that of Wastewater Technology Inc. in April 2008. First, the prolonged decrease of our sales in the ethanol production sector, and second, lower sales of our patented Bio-Wheel™ and Bio-Brane™ systems in the U.S. municipal sector through manufacturer's representatives.

After the end of the quarter, we realigned our sales strategy for Bio-Wheel™ and Bio-Brane™ systems. We are now mainly targeting sales of containerized systems for small municipal streams and industrial applications (such as support to man camps and remote locations), two segments where our unique technology is highly differentiated and can attain stature as the preferred solution. And although systems and equipment sales to ethanol producers are scarce, we remain engaged and quite active in ethanol production sector serving an important customer base with specialty chemicals and consumables.

As at March 31, 2012, we reviewed the carrying amounts of our intangible assets and determined that some intangible assets related to the cash-generating unit "United States" were no longer used and were not generating material cash flows. Therefore, the recoverable amount of the intangible assets was estimated to nil. The impairment loss of the intangible assets is due to the prolonged decrease of our operations in the industrial sector – mainly the ethanol production subsector.

The result of these re-evaluations was respectively a $8.2 M and $0.4 M decrease in the book value of our goodwill and intangible assets, which increased the net loss for the quarter.

The net loss for the quarter totalled ($7.7 M), including a non-monetary loss of ($7.6 M) related to the goodwill impairment charge, impairment of intangible assets, deferred income tax benefit and changes in fair value of contingent considerations. Excluding the previous, net loss for the quarter would have amounted to ($52,810), inches away from net earnings. As a direct result of the impairment of intangible assets, our quarterly amortization charges of intangible assets will be reduced by approximately $8,000 starting next quarter.

EBITDA

EBITDA for the quarter was recorded at $1.3 M, compared with $369,211 for the same period ended March 31, 2011. The fair value of contingent considerations was reduced based on actual and forecasted sales of certain wastewater equipment and this reduction had a positive effect of $0.8 M to the quarter's EBITDA. Excluding this effect, EBITDA for the quarter would have amounted to $434,551. The higher revenues recorded during the quarter compared with the corresponding quarter of the previous fiscal year and the somewhat stable SG&A expenses also contributed to generating positive EBITDA. The Company quickly and strongly returned to positive EBITDA this quarter after one quarter of negative EBITDA for the quarter ended December 31, 2011.

Other gains (losses) – net

Other gains (losses) – net amounting to ($26,680) for the period ended March 31, 2012 compared with $47,123 for the quarter ended March 31, 2011 are mostly composed of a foreign exchange loss, which is entirely due to exchange rate fluctuations related to working capital items.

Finance costs – net

Finance costs – net totalled $221,023 for the period ended March 31, 2012 compared with $177,950 for the comparable period in the previous fiscal year. These expenses relate mostly to the long-term debt. Of this amount, $30,899 represent the theoretical and non-monetary part of interest on long-term debt and $7,595 represent the unwinding of the discount on contingent considerations.

Share of loss in a joint venture

Share of loss in a joint venture totalled ($100,000) for the period ended March 31, 2012 compared with a share of earnings of $183,956 for the quarter ended March 31, 2011. This loss was largely attributable to the completion of the Company's joint venture's first large-scale project, which was completed and handed over to the client in April 2012.

Net loss

The net loss was ($7,651,400) or ($0.127 per share) for the third quarter of fiscal 2012 compared with ($125,006) or ($0.002 per share) for the third quarter of fiscal 2011. Excluding the non-monetary loss of ($8.2 M) related to the goodwill impairment charge, ($0.4 M) impairment of intangible assets, $0.8 M changes in fair value of contingent considerations and related deferred tax benefit of $0.2 M, net loss for the quarter would have amounted to ($52,810), inches away from net earnings.

Commitments

The Company has entered into long-term lease agreements expiring in 2012, 2013, 2017 and 2022, which call for lease payments of $3,427,084 for the rental of space. The minimum annual lease payments over the next five years are $524,878 in 2012, $425,645 in 2013, $406,082 in 2014, $414,925 in 2015 and $423,993 in 2016.

Information on share capital

As at March 31, 2012, 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 $5.0 M as at March 31, 2012, the Company's current ratio slightly declined from 1.76 to 1.45. This reflects important progress made in project execution and higher level of manufacturing activity, as well as a related increase in the usage of the Company's revolving credit facilities.

The net debt excluding contingent considerations, which stood at $6.7 M as at March 31, 2012, increased by nearly $2.0 M compared with $4.7 M as at June 30, 2011. This increase is mainly due to the general decline in working capital, itself caused by the higher level of manufacturing and procurement activities.

Equity stood at $13.1 M as at March 31, 2012, compared with $21.5 M as at June 30, 2011. As at March 31, 2012 the net debt equity ratio was 0.54 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 March 31, 2012**	**Period ended June 30, 2011**
Working capital	$5,011,284	$6,192,049
Current ratio	1.45	1.76
Net debt[1]	$6,735,730	$4,749,073
Equity	$13,097,199	$21,534,615
Net debt to equity ratio	0.51	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 March 31, 2012 accounts receivable stood at $9.2 M compared with $7.8 M as at June 30, 2011. The increase of $1.3 M is attributable to higher invoicing completed during the quarter, as invoicing milestones were reached on a higher number of active projects. Part of the Company's trade account receivables is guaranteed by Export Development Canada.

Inventories increased by $0.3 M to $2.6 M as at March 31, 2012 compared with $2.2 M as at June 30, 2011. This is mainly explained by the increase of raw material ordered and received for ongoing projects that have just entered the manufacturing and assembly phases. When comparing with the previous quarter ended December 31, 2011, inventories decreased by $0.3 M this quarter, mostly because of the sale of finished goods manufactured during the previous summer in preparation for the maple syrup production season that started at mid-point during the quarter.

Costs incurred in excess of billings increased by $0.5 M to $2.8 M as at March 31, 2012, from $2.3 M as at June 30, 2011, primarily due to a higher number of active projects and to differences between project advancement and project invoicing schedules. Billings in excess of costs incurred increased by $0.6 M to $1.9 M as at March 31, 2012, from $1.3 M as at June 30, 2011. This increase is also attributable to differences between project advancement and project invoicing schedules.

Accounts payable and accrued liabilities increased by $0.4 M to $4.6 M as at March 31, 2012, from $4.2 M as at June 30, 2011. This is mostly due to an increased number of active projects entering the production phase for which important components are being purchased in this second-half of fiscal year 2012.

Contingent considerations totalled $0.9 M as at March 31, 2012 compared with $2.2 M as at June 30, 2011. The decrease is due to the reduction of the fair value of contingent consideration based on actual and forecasted sales of certain wastewater equipment, 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 $0.9 M total contingent considerations, an amount of $0.25 M is expected to be paid over the next 12 months, the balance of $0.7 M over a period stretching up to 2018.

FINANCIAL SITUATION

Before the change in operating working capital, operating activities generated $566,586 in cash for the period ended March 31, 2012, compared with $346,024 of cash generated during the corresponding period ended March 31, 2011, a progression mainly caused by the higher revenues. Under IFRS, management elected to disclose interest paid under financing activities as opposed to operating activities under previous GAAP.

For the third quarter of fiscal 2012, investing activities generated net cash of $218,825, mainly attributable to the disposal of guaranteed deposit certificates required under international bids that came to an end.

Financing activities generated cash of $439,682 in the third quarter of fiscal 2012 compared with $205,380 of cash generated during the corresponding period ended March 31, 2011. 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 $652,318. 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**
	March 31, 2012	**December 31, 2011**	**September 30, 2011**	**June 30, 2011**	
Revenues	10,222,312	7,056,495	7,069,768	7,826,146	32,174,721
EBITDA	1,284,053	(707,814)	239,387	(107,679)	707,947
Net loss	(7,651,400)	(1,214,510)	(88,216)	(72,989)	(9,027,115)
EPS basic and diluted	(0.127)	(0.020)	(0.001)	(0.001)	(0.150)

	Three-month periods ended				**Previous twelve months**
	March 31, 2011	**December 31, 2010**	**September 30, 2010**	**June 30, 2010 (1)**	
Revenues	7,126,952	6,354,087	6,325,081	5,921,355	25,727,475
EBITDA	369,211	(23,624)	(87,863)	(785,178)	(527,094)
Net loss	(125,006)	(523,693)	(629,610)	(6,220,440)	(7,498,749)
EPS basic and diluted	(0.002)	(0.009)	(0.010)	(0.113)	(0.136)

(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 20 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 20 of the financial statements for the quarter ended March 31, 2012 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 March 31, 2012.

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 March 31, 2012, 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 March 31, 2012, 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, a deposit certificate secures $1.1 M. 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.

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)

March 31, 2012

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)

	March 31, 2012	June 30, 2011
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	**315,444**	440,356
Guaranteed deposits certificates	**1,147,425**	1,412,963
Accounts receivable (note 4)	**9,158,705**	7,828,476
Inventories (note 5)	**2,555,088**	2,230,656
Costs incurred in excess of billings	**2,788,391**	2,264,941
Prepaid expenses	**138,800**	198,504
	16,103,853	14,375,896
Non-current assets		
Property, plant and equipment	**2,042,422**	2,065,814
Intangible assets (note 6)	**5,294,897**	6,124,548
Investment in a joint venture	**-**	88,041
Other assets	**42,669**	41,942
Goodwill (note 7)	**2,338,038**	10,179,427
Deferred income tax assets	**2,010,622**	1,627,665
	27,832,501	34,503,333
LIABILITIES		
Current liabilities		
Bank overdraft	**144,700**	291,520
Bank loan	**3,261,795**	1,353,625
Accounts payable and accrued liabilities (note 8)	**4,643,593**	4,181,901
Provisions (note 9)	**29,943**	32,300
Billings in excess of costs incurred	**1,910,823**	1,310,866
Income taxes payable	**-**	7,649
Current portion of long-term debt (note 11)	**849,220**	319,108
Contingent considerations (note 10)	**252,495**	686,878
	11,092,569	8,183,847
Non-current liabilities		
Long-term debt (note 11)	**2,795,459**	3,225,176
Contingent considerations (note 10)	**679,886**	1,521,794
Net investment in a joint venture	**119,351**	-
Deferred rent	**48,037**	37,901
	14,735,302	12,968,718
SHAREHOLDERS' EQUITY		
Share capital	**45,852,436**	45,852,436
Reserve - Stock options (note 13)	**1,852,919**	1,734,952
Reserve - Warrants	**10,142,512**	10,143,677
Deficit	**(43,227,899)**	(34,273,772)
Accumulated other comprehensive loss	**(1,522,769)**	(1,922,678)
	13,097,199	21,534,615
	27,832,501	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 nine-month periods ended March 31, 2012 and 2011
(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 13)	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	-	-	-	206,541	-	-	-	206,541
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	-	-	-	-	-	(1,278,309)	-	(1,278,309)
Other comprehensive loss	-	-	-	-	-	-	(1,852,598)	(1,852,598)
Balance as at March 31, 2011	**60,145,832**	**45,852,436**	**301,023**	**1,653,126**	**(10,001,890)**	**(34,518,596)**	**(1,852,598)**	**21,437,281**
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	-	-	-	117,967	-	-	-	117,967
Warrant issue expenses related to financing	-	-	-	-	(1,165)	-	-	(1,165)
Net loss for the period	-	-	-	-	-	(8,954,127)	-	(8,954,127)
Other comprehensive income	-	-	-	-	-	-	399,909	399,909
Balance as at March 31, 2012	**60,145,832**	**45,852,436**	**-**	**1, 852,919**	**10,142,512**	**(43,227,899)**	**(1,522,769)**	**13,097,199**

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

CONDENSED INTERIM CONSOLIDATED STATEMENT OF LOSS
For the three-month and nine-month periods ended March 31, 2012 and 2011
(in Canadian dollars, except the number of shares)
(Unaudited)

	Three months ended March 31,		Nine months ended March 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Revenues (note 17)	**10,222,312**	7,126,952	**24,348,575**	19,806,120
Cost of goods sold (note 14 a))	**7,521,805**	4,747,829	**18,310,510**	13,548,373
Gross profit	**2,700,507**	2,379,123	**6,038,065**	6,257,747
Operating expenses (note 14 a))	**177,749**	302,263	**464,393**	917,890
Selling expenses (note 14 a))	**993,043**	885,194	**2,811,716**	2,676,510
Administrative expenses (note 14 a))	**1,022,044**	959,289	**2,796,783**	2,505,168
Depreciation of property, plant and equipment (note 14 b))	**75,233**	75,050	**221,569**	224,959
Amortization of intangible assets (note 14 b))	**191,134**	233,505	**667,418**	717,323
Changes in fair value of contingent considerations (note10)	**(849,502)**	-	**(849,502)**	-
Impairment of intangible assets (note 6)	**378,728**	-	**378,728**	-
Impairment of goodwill (note 7)	**8,221,423**	-	**8,221,423**	-
Other (gains) losses – net (note 14c))	**(26,880)**	47,123	**(396,120)**	23,777
	10,182,972	2,502,424	**14,316,408**	7,065,627
Operating loss	**(7,482,465)**	(123,301)	**(8,278,343)**	(807,880)
Finance income	**(5,567)**	(20,641)	**(16,945)**	(29,883)
Finance costs	**226,590**	198,591	**626,836**	615,922
Finance costs – net	**221,023**	177,950	**609,891**	586,039
Share of (earnings) loss in a joint venture	**100,000**	(183,956)	**395,169**	(123,322)
	321,023	(6,006)	**1,005,060**	462,717
Loss before income taxes	**(7,803,488)**	(117,294)	**(9,283,403)**	(1,270,597)
Current income tax benefit	**(29)**	7,712	**(29)**	7,712
Deferred tax benefit	**(152,059)**	-	**(329,247)**	-
Net loss for the period	**(7,651,400)**	(125,006)	**(8,954,127)**	(1,278,309)
Net loss per share attributable to the equity holders of the Company during the period				
Basic net loss per share	**(0.127)**	(0.002)	**(0.149)**	(0.021)
Diluted net loss per share	**(0.127)**	(0.002)	**(0.149)**	(0.021)
Weighted average number of shares outstanding (note 15)	**60,145,832**	60,145,832	**60,145,832**	60,141,087

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 nine-month periods ended March 31, 2012 and 2011
(in Canadian dollars)
(Unaudited)

	Three months ended March 31,		Nine months ended March 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Net loss for the period	**(7,651,400)**	(125,006)	**(8,954,127)**	(1,278,309)
Other comprehensive income (loss)				
Currency translation adjustments	**(337,214)**	(443,125)	**399,909**	(1,852,598)
Comprehensive income (loss) for the period	**(7,988,614)**	(568,131)	**(8,554,218)**	(3,130,907)

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 nine-month periods ended March 31, 2012 and 2011
(in Canadian dollars)
(Unaudited)

	Three months ended March 31,		Nine months ended March 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Cash flows from operating activities				
Net loss for the period	**(7,651,400)**	(125,006)	**(8,954,127)**	(1,278,309)
Non-cash items				
Finance costs – net	**221,023**	177,950	**609,891**	586,039
Depreciation of property, plant and equipment	**75,233**	75,050	**221,569**	224,959
Amortization of intangible assets	**191,134**	233,505	**667,418**	717,323
Changes in fair value of contingent considerations	**(849,502)**	-	**(849,502)**	-
Impairment of intangible assets	**378,728**	-	**378,728**	-
Impairment of goodwill	**8,221,423**	-	**8,221,423**	-
Deferred rent	**2,954**	(3,265)	**8,867**	(9,793)
Stock-based compensation	**29,052**	95,870	**117,967**	206,542
Share of (earnings) loss of joint venture	**100,000**	(108,081)	**407,414**	(39,447)
Deferred tax benefit	**(152,059)**	-	**(329,247)**	-
	566,586	346,024	**500,401**	407,314
Change in working capital items (note 16 a))	**(991,400)**	50,930	**(1,256,087)**	(2,441,426)
Cash generated by (used in) operations	**(424,814)**	396,954	**(755,686)**	(2,034,112)
Interests received	**5,567**	20,641	**16,945**	29,883
Income taxes paid	**-**	-	**(5,976)**	-
Net cash generated by (used in) operating activities	**(419,247)**	417,595	**(744,717)**	(2,004,229)
Cash flows from investing activities				
Disposal of guaranteed deposits certificates	**361,286**	-	**476,688**	39,298
Acquisition of guaranteed deposits certificates	**(111,150)**	(80,652)	**(211,150)**	(227,762)
Acquisition of property, plant and equipment	**(27,886)**	(6,821)	**(182,407)**	(185,619)
Investment in a joint venture	**-**	-	**(200,022)**	-
Acquisition of intangible assets	**(3,425)**	5,418	**(10,660)**	(4,328)
Contingent considerations paid	**-**	(250,350)	**(515,745)**	(1,088,591)
Net cash generated by (used in) investing activities	**218,825**	(332,405)	**(643,296)**	(1,467,002)
Cash flows from financing activities				
Variation of bank loan	**652,318**	465,915	**1,908,171**	2,141,666
Long-term debt reimbursement	**(6,558)**	(162,516)	**(13,504)**	(503,597)
Long-term debt contracted	**-**	-	**-**	124,692
Interest paid	**(206,078)**	(98,019)	**(508,817)**	(412,194)
Issuance of shares	**-**	-	**-**	8,000
Warrants issue expenses	**-**	-	**(1,165)**	-
Share issue expenses	**-**	-	**-**	(5,420)
Net cash (used in) generated by financing activities	**439,682**	205,380	**1,384,685**	1,353,147
Net change in cash and cash equivalents	**239,260**	290,570	**(3,328)**	(2,118,084)
Effect of exchange rate changes on the balance of cash held in foreign currencies	**(19,309)**	(48,782)	**25,236**	(70,642)
Increase (Decrease) in cash and cash equivalents	**219,951**	241,788	**21,908**	(2,188,726)
Cash and cash equivalents - Beginning of period (note 16 b))	**(49,207)**	155,533	**148,836**	2,586,047
Cash and cash equivalents - End of period (note 16 b))	**170,744**	397,321	**170,744**	397,321

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 May 14th, 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 20, 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 20 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 May 14th, 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 20 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.

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

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).

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 flow to the entity; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

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

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

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

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.

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 March 31, 2012, 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 March 31, 2012	As at June 30, 2011
	$	$
Accounts receivable	**7,938,555**	6,791,625
Retentions from customers under manufacturing contracts	**808,305**	566,938
Allowance for doubtful accounts	**(3,720)**	(3,720)
	8,743,140	7,354,843
Tax credits receivable	**161,653**	157,990
Other receivables	**253,912**	315,643
	9,158,705	7,828,476

5. Inventories

	As at March 31, 2012	As at June 30, 2011
	$	$
Raw materials	**1,707,987**	1,455,388
Finished goods	**847,101**	775,268
	2,555,088	2,230,656

6. Intangible Assets

Cost	**Software**	**Patents**	**Rights on technologies**	**Technologies**	**Trademarks**	**Customer relations**	**Distribution network**	**Intellectual property**	**Total**
	$	**$**	**$**	**$**	**$**	**$**	**$**	**$**	**$**
Balance as at July 1, 2010	383,201	3,544,321	377,592	1,149,768	508,204	3,761,100	2,101,980	2,416,642	14,242,808
Additions	4,328	-	-	-	-	-	-	-	4,328
Write-off of fully amortized intangible assets	-	-	-	-	-	-	(755,866)	-	(755,866)
Effect of foreign currency exchange differences	(813)	(311,777)	-	(102,600)	(40,883)	(332,500)	(120,121)	(215,650)	(1,124,344)
Balance as at March 31, 2011	**386,716**	**3,232,544**	**377,592**	**1,047,168**	**467,321**	**3,428,600**	**1,225,993**	**2,200,992**	**12,366,926**
Accumulated amortization									
Balance as at July 1, 2010	(181,517)	(833,146)	(284,884)	(897,720)	(144,313)	(2,695,090)	(1,344,622)	(166,480)	(6,547,772)
Amortization expense	(30,649)	(180,064)	(40,456)	(19,258)	(52,873)	(101,342)	(177,766)	(114,915)	(717,323)
Write-off of fully amortized intangible assets	-	-	-	-	-	-	755,866	-	755,866
Effect of foreign currency exchange differences	2,132	81,969	-	80,591	14,252	243,450	60,064	19,722	502,180
Balance as at March 31, 2011	**(210,034)**	**(931,241)**	**(325,340)**	**(836,387)**	**(182,934)**	**(2,552,982)**	**(706,458)**	**(261,673)**	**(6,007,049)**
Net amount as at March 31, 2011	**176,682**	**2,301,303**	**52,252**	**210,781**	**284,387**	**875,618**	**519,535**	**1,939,319**	**6,359,877**

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

Cost	Software	Patents	Rights on technologies	Technologies	Trademarks	Customer relations	Distribution network	Intellectual property	Total
	$	$	$	$	$	$	$	$	$
Balance as at July 1, 2011	415,319	3,214,512	377,592	1,041,444	464,926	3,410,050	1,219,291	2,188,961	12,332,095
Additions	10,660	-	-	-	-	-	-	-	10,660
Effect of foreign currency exchange differences	536	110,672	-	35,856	15,000	116,200	41,980	75,365	395,609
Balance as at March 31, 2012	**426,515**	**3,325,184**	**377,592**	**1,077,300**	**479,926**	**3,526,250**	**1,261,271**	**2,264,326**	**12,738,364**
Accumulated amortization									
Balance as at July 1, 2011	(221,280)	(983,317)	(338,826)	(837,928)	(198,854)	(2,571,381)	(759,033)	(296,726)	(6,207,345)
Amortization expense	(34,636)	(178,203)	(38,766)	(12,701)	(52,410)	(98,964)	(138,054)	(113,684)	(667,418)
Impairment losses recognized in profit or loss	-	-	-	(198,589)	-	(180,139)	-	-	(378,728)
Effect of foreign currency exchange differences	(103)	(33,127)	-	(28,082)	(6,517)	(86,833)	(25,566)	(9,748)	(189,976)
Balance as at March 31, 2012	**(256,019)**	**(1,194,647)**	**(377,592)**	**(1,077,300)**	**(257,781)**	**(2,937,317)**	**(922,653)**	**(420,158)**	**(7,443,467)**
Net amount as at March 31, 2012	**170,496**	**2,130,537**	**-**	**-**	**222,145**	**588,933**	**338,618**	**1,844,168**	**5,294,897**

As at March 31, 2012, the Company reviewed the carrying amounts of its intangible assets and determined that some intangible assets related to the cash-generating unit “United States” were no longer used and were not generating material cash flows. Therefore, the recoverable amount of the intangible assets was estimated to nil. The impairment loss of the intangible assets is due to the prolonged decrease of the Company’s operations in the industrial sector – mainly the ethanol production subsector.

7. 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
Impairment of goodwill	**(8,221,423)**
Effect of foreign exchange differences	**380,034**
Balance as at March 31, 2012	**2,338,038**

In the third quarter of fiscal year 2012, the Company assessed the recoverable amount of the cash-generating unit “United States” and recognized a goodwill impairment loss of $8,221,423 ($US 8,212,389). The fair value less costs to sell was used to determine the recoverable amount of this cash-generating unit by applying new discounted projections of future cash flows based on a five-year financial forecast approved by management. The cash-generating unit impairment loss is due to market conditions resulting from the ongoing economic slowdown in the United States, the prolonged decrease of the Company’s operations in the industrial sector – mainly the ethanol production subsector and the lower expected sales of the Company’s patented Bio-Wheel™ and Bio-Brane™ systems in the United States.

(in Canadian dollars)

	United States
Growth rate [(1)]	9.98%
Discount rate	14.80%

(1) Average growth rate used for extrapolating the budget estimates over the next five years. The terminal growth is 3.0%.

8. Accounts Payable and Accrued Liabilities

	As at March 31, 2012	As at June 30, 2011
	$	$
Trade accounts payable	**3,100,902**	2,010,603
Other accrued liabilities and accounts payable	**1,542,691**	2,171,298
	4,643,593	4,181,901

9. 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	**30,037**
Less: Payments	**(32,760)**
Effect of foreign exchange differences	**366**
Balance as at March 31, 2012	**29,943**

10. 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	**22,827**
Less: Reduction of contingent consideration through statement of income (loss)	**(849,502)**
Less: Payments	**(515,745)**
Effect of foreign exchange differences	**66,129**
	932,381
Less: short-term contingent considerations	**252,495**
Balance as at March 31, 2012	**679,886**

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

Under the acquisition agreement of Wastewater Technology Inc., the Company has a contingent consideration of up to $1,718,403 ($US 1,722,710) based on sales volume of certain wastewater equipments over a ten-year period ending on April 6, 2018. The Company records the contingent consideration at fair value at each reporting period based on actual and forecasted sales over the period of the contingent consideration. Changes in the fair value of the contingent consideration are recorded in the consolidated statement of loss.

As at March 31, 2012, the fair value of the contingent consideration was reduced based on actual and forecasted sales of certain wastewater equipments over the period of the contingent consideration; the resulting change in the fair value, in the amount of $849,502 ($US 848,569), has been recorded in the consolidated statement of loss for the three months and nine months periods ended March 31, 2012.

11. Long-Term Debt

	As at March 31, 2012	As at June 30, 2011
	$	$
Unsecured – at amortised cost		
Bank loans, denominated in Canadian dollars	**1,386,945**	1,338,945
Loans from other entities, denominated in Canadian dollars	**1,847,776**	1,810,230
Loans from shareholders, denominated in US dollars	**312,025**	290,930
Loans from other entities, denominated in US dollars	**97,933**	104,179
	3,644,679	3,544,284
Less : Current portion	**(849,220)**	(319,108)
Long-term debt	**2,795,459**	3,225,176

As at March 31, 2012, the Company respects all its bank covenants.

12. 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”.

13. Capital Stock

Stock options

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

	Nine-month period ended March 31, 2012		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	**(467,000)**	**1.27**	-	-
Forfeited	**(628,500)**	**1.02**	(15,000)	0.50
Outstanding - End of period	**2,849,500**	**0.68**	3,945,000	0.80

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

14. Additional information about the nature of costs components

a) Expenses by nature

	Three-month period ended March 31,		Nine-month period ended March 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Material	**4,783,907**	3,646,846	**11,789,538**	10,094,635
Changes in inventories of raw material, finished goods and costs incurred in excess of billings	**(70,889)**	(355,509)	**(724,223)**	(790,968)
Salaries and fringe benefits	**2,296,112**	2,023,715	**6,410,610**	5,736,466
Subcontractors and professional fees	**1,777,153**	707,937	**4,515,612**	2,087,696
Rent, electricity , insurance and office expenses	**322,167**	284,539	**657,678**	741,394
Telecommunications and travel expenses	**289,560**	256,615	**875,308**	869,431
Other expenses	**316,633**	321,270	**929,680**	909,319
Total cost of goods sold, operating, selling and administrative expenses	**9,714,642**	6,894,613	**24,383,404**	19,647,974

b) Depreciation and amortization

The Company has elected to present depreciation and amortization as a separate line item in its condensed interim consolidated statement of loss, as opposed to reflecting the fraction of such amount that pertains to each of the cost of goods sold, operating expenses, selling expenses and administrative expenses, within those cost categories. The following tables provide: i) a breakdown of the depreciation and amortization expense by cost category as noted above, for the three-month and nine-month periods ended March 31, 2012 and 2011 and ii) the amounts of cost of goods sold, operating expenses, selling expenses and administrative expenses, if depreciation and amortization were allocated within those cost categories for the periods as noted above.

Depreciation by function	Three-month period ended March 31,		Nine-month period ended March31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Cost of goods sold	**40,322**	41,985	**119,374**	124,115
Operating expenses	**1,338**	1,098	**3,820**	3,302
Selling expenses	**13,887**	16,316	**39,024**	50,708
Administrative expenses	**19,686**	15,651	**59,351**	46,834
	75,233	75,050	**221,569**	224,959

Amortization by function	Three-month period ended March 31,		Nine-month period ended March31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Cost of goods sold	**109,017**	115,440	**343,305**	354,694
Selling expenses	**70,349**	107,811	**289,476**	331,981
Administrative expenses	**11,768**	10,254	**34,637**	30,648
	191,134	233,505	**667,418**	717,323

(in Canadian dollars)

Impairment of intangible assets by function	Three-month period ended March 31, 2012	2011	Nine-month period ended March31, 2012	2011
	$	$	**$**	$
Cost of goods sold	**198,589**	-	**198,589**	-
Selling expenses	**180,139**	-	**180,139**	-
	378,728	-	**378,728**	-

Cost per function including depreciation, amortization and impairment of intangible assets	Three-month period ended March 31, 2012	2011	Nine-month period ended March31, 2012	2011
	$	$	**$**	$
Cost of goods sold	**7,869,733**	4,905,254	**18,971,778**	14,027,182
Operating expenses	**179,087**	303,361	**468,213**	921,192
Selling expenses	**1,257,418**	1,009,321	**3,320,355**	3,059,199
Administrative expenses	**1,053,498**	985,194	**2,890,771**	2,582,650

c) Other (gains) losses – net

	Three-month period ended March 31, 2012	2011	Nine-month period ended March31, 2012	2011
	$	$	**$**	$
Exchange (gain) loss	**4,191**	62,880	**(319,915)**	34,162
Other revenues	**(37,707)**	(15,765)	**(90,091)**	(20,513)
Acquisition and integration expenses	**-**	-	**-**	10,128
(Gain) Loss on disposal of assets	**6,636**	-	**7,886**	-
	(26,880)	47,123	**(396,120)**	23,777

15. 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 March 31, 2012	2011	Nine-month period ended March31, 2012	2011
	$	$	**$**	$
Net loss	**(7,651,400)**	(125,006)	**(8,954,127)**	(1,253,809)
Basic and diluted weighted average number of share outstanding	**60,145,832**	60,145,832	**60,145,832**	60,141,087
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	**1,703,250**	1,827,500	**1,703,250**	1,827,500
Warrants (number of equivalent shares)	**2,249,998**	9,179,877	**2,249,998**	9,179,877
Convertible debenture	**-**	1,435,406	**-**	1,435,406

(in Canadian dollars)

For the three-month periods and the nine-month periods ended March 31, 2012 and 2011, 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.

16. Cash Flows

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

	Three-month period ended March 31,		**Nine-month period ended March 31,**	
	2012	2011	**2012**	2011
	$	$	**$**	$
Accounts receivable	**(3,090,875)**	690,942	**(1,198,504)**	(2,681,587)
Inventories	**327,199**	(248,447)	**(303,585)**	(941,433)
Costs incurred in excess of billings	**(397,844)**	(372,544)	**(482,245)**	323,435
Prepaid expenses	**(19,318)**	(263,531)	**61,409**	(185,014)
Accounts payable and accrued liabilities	**1,192,368**	361,769	**68,170**	(181,516)
Provisions	**10,008**	-	**30,037**	28,773
Billings in excess of work in progress	**981,084**	(124,971)	**570,600**	1,188,204
Income taxes payable	**5,978**	7,712	**(1,969)**	7,712
	(991,400)	50,930	**(1,256,087)**	(2,441,426)

b) Cash and cash equivalents consist of the following:

	Three-month period ended March 31,		**Nine-month period ended March 31,**	
	2012	2011	**2012**	2011
	$	**$**	**$**	$
Beginning of period				
Cash and cash equivalents	**238,149**	155,533	**440,356**	2,586,047
Bank overdraft	**(287,356)**	-	**(291,520)**	-
	(49,207)	155,533	**148,836**	2,586,047

	Three-month period ended March 31,		**Nine-month period ended March 31,**	
	2012	2011	**2012**	2011
	$	$	**$**	$
End of period				
Cash and cash equivalents	**315,444**	397,321	**315,444**	397,321
Bank overdraft	**(144,700)**	-	**(144,700)**	-
	170,744	397,321	**170,744**	397,321

17. Financial Instruments

Exchange risk

The Company is exposed to exchange risk as a result of its U.S. dollar purchases and sales and also as a result of its foreign subsidiary net assets. To limit the impact of fluctuations of the Canadian dollar over the U.S. dollar, the Company matches, in general and when possible, the cash receipts in a foreign currency with the cash disbursements in the same foreign currency. The Company does not use derivative financial instruments to cover the variability of cash flows in foreign currencies.

As at March 31, 2012, if the Canadian dollar had increased or decreased by five percent (5%) compared to the U.S. dollar, assuming that all other variables remained constant, net loss for the nine-month period ended March 31, 2012 would have been lesser or greater by approximately \$366,360 (\$80,928 as at March 31, 2011).

The financial assets and liabilities denominated in U.S. dollars are as follows:

	As at March 31, 2012	As at June 30, 2011
	US$	US$
FINANCIAL ASSETS		
Cash	700	700
Guaranteed deposits certificates	15,466	15,452
Accounts receivable	1,280,498	932,469
	1,296,664	948,621
FINANCIAL LIABILITIES		
Bank overdraft	38,695	117,727
Bank loan	1,786,250	283,754
Accounts payable	780,821	929,656
Long-term debt	313,435	301,700
	2,919,201	1,632,837

Interest rate risk

In the normal course of business, the Company is exposed to interest rate fluctuation risk as a result of the floating-rate loans and debts receivable and loans payable. The Company manages its interest rate fluctuation exposure by allocating its financial debt between fixed and floating-rate instruments.

The guaranteed deposit certificates, unsecured loans and the convertible debenture bear interest at fixed rates and the Company is, therefore, exposed to the risk of changes in fair value resulting from interest rate fluctuations.

The bank loans bear interest at floating rates and the Company is, therefore, exposed to the cash flow risks resulting from interest rate fluctuations.

As at March 31, 2012 and 2011, a 25-basis-point increase or decrease in interest rates, assuming that all other variables remain constant, would not have had a significant impact on the Company's net loss. These changes were retained because they are considered reasonably possible according to observations and the economic situation.

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

18. 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 revenues for the period for the continuing operations.

	Three-month period ended March 31,		Nine-month period ended March 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Revenues from sales of consumables	**3,498,350**	3,372,972	**10,813,060**	8,860,028
Manufacturing contracts revenues	**6,723,962**	3,753,980	**13,535,515**	10,946,092
	10,222,312	7,126,952	**24,348,575**	19,806,120

Geographical information

Revenues from external customers	Three-month period ended March 31, **2012**	2011	Nine-month period ended March 31, **2012**	2011
	$	$	**$**	$
Revenues according to geographic location				
Canada	**3,668,626**	2,425,097	**7,512,126**	6,117,368
United States	**5,240,111**	4,204,409	**12,870,373**	11,916,302
Tunisia	**761,247**	-	**2,499,284**	-
China	**251,538**	321,870	**570,195**	576,403
Egypt	**174,270**	-	**336,266**	451,726
Other	**126,520**	175,576	**560,331**	744,321
	10,222,312	7,126,952	**24,348,575**	19,806,120

Revenues are attributed to the various countries according to the customer's country of residence.

	As at March 31, 2012	As at June 30, 2011
	$	$
Noncurrent assets other than financial instruments and deferred tax assets according to geographic location		
Canada	**1,755,803**	1,864,466
United States	**7,919,554**	16,505,322
	9,675,357	18,369,788

(in Canadian dollars)

19. 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 March 31,		Nine-month period ended March31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Short-term benefits	**189,220**	180,803	**562,955**	567,951
Post-employment benefits	**2,959**	2,016	**8,803**	6,788
Share-based payments	**16,420**	31,575	**61,889**	68,413
	208,599	214,394	**633,647**	643,152

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

20. 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 2 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.

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

Currency translation differences

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

Fair value of property, plant and equipment and intangible assets as deemed cost

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

Share-based payment transactions

IFRS 1 provides alternatives that permit first-time adopters to apply IFRS 2 – Share-based payments in a prospective manner. The Company has elected to use the exemption that allows first-time adopters not to apply IFRS 2 for equity-settled share-based payments granted on or before November 7, 2002 and the exemption that allows first-time adopters not to apply IFRS 2 to share-based payments granted after November 7, 2002 that vested before the Transition Date.

Mandatory IFRS exceptions

Accounting estimates

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

Reconciliation of Canadian GAAP to IFRS

IFRS 1 requires a first-time adopter of IFRS to reconcile shareholders' equity, comprehensive loss and cash flows for prior periods beginning on the date of transition to IFRS. Reconciliations of shareholders' equity as at March 31, 2011 and June 30, 2011 and comprehensive loss for the year-to-date periods ended March 31, 2011 and June 30, 2011 are provided below.

	As at June 30, 2011	As at March 31, 2011
Reconciliation of shareholders' equity	**$**	**$**
Shareholders' equity under Canadian GAAP	25,112,244	25,232,412
IFRS adjustments attributable to:		
Impairment of intangible assets	(1,412,746)	(1,420,511)
Land and building carried at fair value	(250,404)	(250,404)
Contingent considerations	(2,032,678)	(2,214,647)
Amortization of intangible assets	110,529	86,101
Depreciation of property, plant and equipment	7,670	4,330
Shareholders' equity under IFRS	21,534,615	21,437,281

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

	Three-month period ended March 31, 2011	Nine-month period ended March 31, 2011
Reconciliation of comprehensive loss	**$**	**$**
Comprehensive loss under Canadian GAAP	(687,284)	(3,252,235)
IFRS adjustments attributable to:		
Impairment of intangible assets	36,626	139,180
Contingent considerations	55,432	215,439
Interest on contingent considerations	(8,283)	(26,019)
Amortization of intangible assets	32,636	86,101
Depreciation of property, plant and equipment	2,742	4,330
Foreign currency translation adjustments to shareholders'deficiency	-	(295,703)
Comprehensive loss under IFRS	(568,131)	(3,130,907)

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.

	As at June 30, 2011	As at March 31, 2011
	$	**$**
Cash and cash equivalent	25,071	15,000
Accounts receivable	584,039	607,202
Inventories	50,663	75,755
Work in process	67,404	-
Future income taxes	664	-
Property, plant and equipment	24,177	9,754
Bank loan	(225,861)	(126,327)
Accounts payable and accrued liabilities	(427,788)	(458,000)
Income taxes payable	(10,328)	-
Investment in a joint venture	88,041	123,384

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:

(in Canadian dollars)

	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.

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.

As at June 30, 2011 the Company had recorded contingent consideration in the amount of $510,885 and the counterpart was captured in goodwill since the conditions were met.

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.

As at July 1, 2010, the Company recorded additional contingent considerations for conditions not yet met but estimated in the amount of $1,521,794. These contingent considerations as well as the $510,885 recorded as goodwill under Canadian GAAP as at June 30, 2011 totalled $2,032,678 as shown in the Reconciliation of shareholder's equity.

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.

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.

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

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 nine-month periods ended March 31, 2011, stock-based compensation, government assistance and acquisition and integration expenses have been classified within administrative expenses. Operating, selling, administrative and general expenses have been separated by function such as operating expenses, selling expenses and administrative expenses. Bank charges and other financial expenses have been classified with finance costs. Other income and exchange (loss) have been reclassified as other income and finance income.

j) Restatement of cash flow statements from Canadian GAAP to IFRS

The restatement from Canadian GAAP to IFRS had an impact caused by the new accounting method for the Company's joint venture as described in section a) above. Also, the Company decided to disclose the interest received and paid in the financing activities. As a result, for the three-month and nine-month periods ended March 31, 2011 there is a reclassification of $98,019 and $412,194 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 March 31, 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)	412,320	(15,000)	-	397,320	Cash and cash equivalents
Held-for-trading investments		1,493,674	-	-	1,493,674	Guaranteed deposits certificates
Accounts receivable	(a)	7,801,096	(607,202)	-	7,193,894	Accounts receivable
Inventories	(a)	2,861,792	(75,755)	-	2,786,037	Inventories
Work in process		1,736,898	-	-	1,736,898	Costs incurred in excess of billings
Prepaid expenses		482,905	-	-	482,905	Prepaid expenses
		14,788,685	(697,957)	-	14,090,728	
						Non-current assets
Fixed assets	(a) (b)	2,375,859	(255,647)	-	2,120,212	Property, plant and equipment
Intangible assets	(c)	8,647,229	(2,287,351)	-	6,359,878	Intangible assets
	(a)	-	123,203	-	123,203	Investment in a joint venture
Other assets		42,058	-	-	42,058	Other assets
Goodwill		10,235,376	-	-	10,235,376	Goodwill
Future income tax assets	(c)	6,597	952,941	-	959,538	Deferred income tax assets
		36,095,804	(2,164,811)	-	33,930,993	
LIABILITIES						**LIABILITIES**
Current liabilities						**Current liabilities**
Bank loan		2,267,993	(126,327)	-	2,141,666	Bank loan
Accounts payable and accrued liabilities	(a)(g)	3,862,769	(458,000)	(517,501)	2,887,268	Accounts payable and accrued liabilities
	(g)	-	-	28,900	28,900	Provisions
Billings in excess of work in process		1,347,801	-	-	1,347,801	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		750,000	-	-	750,000	Current portion of convertible debenture
	(d)(g)	-	794,447	488,601	1,283,048	Contingent considerations
		8,857,548	210,120	-	9,067,668	
						Non-current liabilities
Long-term debt		1,261,058	-	-	1,261,058	Long-term debt
Convertible debenture (Note 6)		702,184	-	-	702,184	Convertible debenture
	(d)	-	1,420,200		1,420,200	Contingent considerations
Deferred rent		42,602	-	-	42,602	Deferred rent
		10,863,392	1,630,320	-	12,493,712	
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)	11,655,016	-	(11,655,016)	-	
	(f)	-	-	301,023	301,023	Reserve – Option premium on convertible debenture
	(f)	-	-	1,653,126	1,653,126	Reserve - Stock options
	(f)	-	-	10,001,890	10,001,890	Reserve - Warrants
Deficit	(b) (c) (d) (e)(f)(h)	(30,682,015)	(3,850,370)	13,789	(34,518,596)	Deficit
Accumulated other comprehensive loss	(a) (c) (d)	(1,907,837)	55,239	-	(1,852,598)	Accumulated other comprehensive loss
		25,232,412	(3,795,131)	-	21,437,281	
		36,095,804	(2,164,811)	-	33,930,993	

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

Reconciliation of Consolidated Statement of Comprehensive Loss for the three-month period ended March 31, 2011

(in Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balances	IFRS adjustments	IFRS reclassifications	IFRS balances	IFRS accounts
		$	$	$	$	
						Continuing operations
Sales	(a)	7,950,587	(823,635)	-	7,126,952	Revenue
Cost of goods sold	(a)	5,324,654	(576,825)	-	4,747,829	Cost of goods sold
Gross margin		2,625,933	(246,810)	-	2,379,123	**Gross profit**
Expenses						
Operating, selling, administrative and general expenses	(a)(i)	2,122,272	(61,805)	(2,060,467)	-	
	(i)	-	-	302,263	302,263	Operating expenses
	(i)	-	-	885,194	885,194	Selling expenses
	(i)	-	-	959,289	959,289	Administrative expenses
Depreciation of fixed assets	(b)(i)	79,006	(3,956)	-	75,050	Depreciation of property, plant and equipment
Amortization of intangible assets	(c)(i)	268,038	(34,533)	-	233,505	Amortization of intangible assets
Bank charges and other financial expenses	(i)	40,969	-	(40,969)	-	
Government assistance	(i)	(2,068)	-	2,068	-	
Stock-based compensation	(i)	95,869	-	(95,869)	-	
	(i)	-	-	47,123	47,123	Other (gains) losses – net
		2,604,086	(100,294)	(1,368)	2,502,424	
Operating earnings (loss) before the following items		21,847	(145,516)	1,368	(123,301)	**Operating earnings (loss)**
Other income	(i)	(36,407)	-	36,407	-	
Exchange (gain) loss	(i)	38,487	-	(38,487)	-	
	(i)	-	-	(20,641)	(20,641)	Finance income
	(d)(i)	-	8,872	189,719	198,591	Finance costs
		-	8,872	169,078	177,950	Finance costs – net
Interest on long-term debt	(i)	148,751	-	(148,751)	-	
Acquisition and integration expenses	(i)	16,879	-	(16,879)	-	
	(a)(i)	-	(183,956)	-	(183,956)	Share of in earnings in a joint venture
		167,710	(175,084)	1,368	(6,006)	
Loss before income taxes		(145,863)	28,569	-	(117,294)	**Loss before income taxes**
Income tax recovery						**Income tax recovery**
Current income taxes		7,712	-	-	7,712	Current income taxes
Future income taxes		-	-	-	-	Deferred income taxes
Net loss for the period		(153,575)	28,569	-	(125,006)	**Loss for the period**
Other comprehensive loss						Other comprehensive loss
Translation adjustment	(a)(c)(d)	(545,550)	102,425	-	(443,125)	Translation adjustment
Comprehensive loss for the period		(699,125)	130,994	-	(568,131)	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		(0.003)	(0.001)	-	(0.002)	**Basic and diluted loss per share**
Weighted average number of shares outstanding		60,145,832	-	-	60,145,832	Weighted average number of shares outstanding

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
Reconciliation of Consolidated Statement of Comprehensive Loss for the nine-month period ended March 31, 2011
(in Canadian dollars)

Canadian GAAP accounts	Notes	Canadian GAAP balances	IFRS adjustments	IFRS reclassifications	IFRS balances	IFRS accounts
		$	$	$	$	
						Continuing operations
Sales	(a)	20,711,959	(905,839)	-	19,806,120	Revenue
Cost of goods sold	(a)	14,175,352	(626,979)	-	13,548,373	Cost of goods sold
Gross margin		6,536,607	(278,860)	-	6,257,747	**Gross profit**
Expenses						
Operating, selling, administrative and general expenses	(a)(i)	6,080,590	(153,610)	(5,926,980)	-	
	(i)	-	-	917,890	917,890	Operating expenses
	(i)	-	-	2,676,510	2,676,510	Selling expenses
	(i)	-	-	2,505,168	2,505,168	Administrative expenses
Depreciation of fixed assets	(b)(i)	231,466	(6,507)	-	224,959	Depreciation of property, plant and equipment
Amortization of intangible assets	(c)(i)	806,998	(89,675)	-	717,323	Amortization of intangible assets
Bank charges and other financial expenses	(i)	106,310	-	(106,310)	-	
Government assistance	(i)	(50,831)	-	50,831	-	
Stock-based compensation	(i)	206,541	-	(206,541)	-	
	(i)	-	-	23,777	23,777	Other (gains) losses – net
		7,381,074	(249,792)	(65,654)	7,065,627	
Operating loss before the following items		(844,467)	(29,068)		(807,880)	**Operating loss**
Other income	(i)	(50,396)	-	50,396	-	
Exchange (gain) loss	(i)	34,162	-	(34,162)	-	
	(i)	-	-	(29,883)	(29,883)	Finance income
	(d)(i)	-	27,166	588,756	615,922	Finance costs
		-	27,166	558,873	586,039	Finance costs – net
Interest on long-term debt	(i)	482,446	-	(482,446)	-	
Acquisition and integration expenses	(i)	27,007	-	(27,007)	-	
	(a)(i)	-	(123,322)	-	(123,322)	Share of loss in a joint venture
		493,219	(96,156)	65,654	462,717	
Loss before income taxes		(1,337,686)	67,089	-	(1,270,598)	**Loss before income taxes**
Income tax recovery						**Income tax recovery**
Current income taxes		7,712	-	-	7,712	Current income taxes
Future income taxes		-	-	-	-	Deferred income taxes
Net loss for the period		(1,345,398)	67,089	-	(1,278,309)	**Loss for the period**
Other comprehensive loss						Other comprehensive loss
Translation adjustment	(a)(c)(d)	(1,907,837)	55,239	-	(1,852,598)	Translation adjustment
Comprehensive loss for the period		(3,252,235)	122,328	-	(3,130,907)	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		(0.022)	(0.001)	-	(0.021)	**Basic and diluted loss per share**
Weighted average number of shares outstanding		60,141,087	-	-	60,141,087	Weighted average number of shares outstanding

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
Reconciliation of Consolidated Statement of Cash Flows for the three-month period ended March 31, 2011
(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)	(153,575)	28,569	-	(125,006)	Loss before income taxes
Non-cash items						Non cash items
	(j)	-	29,031	156,631	185,662	Finance costs – net
Depreciation of property, plant and equipment	(a)(b)	79,006	(3,955)	-	75,050	Depreciation of property, plant and equipment
Amortization of intangible assets	(c)	268,038	(34,533)	-	233,505	Amortization of intangible assets
Net lease obligations		(3,135)	(130)	-	(3,265)	Net lease obligations
Stock-based compensation		95,870	-	-	95,870	Stock-based compensation
	(a)	-	(108,081)	-	(108,081)	Share of loss of a joint venture
Imputed interest on long-term debt and convertible debenture	(j)	79,253	-	(79,253)	-	
		365,456	(89,099)	77,378	353,735	
Accounts receivable	(a)	129,312	561,630	-	690,942	Accounts receivable
Inventories	(a)	(302,318)	53,871	-	(248,447)	Inventories
Work in process		(379,318)	6,774	-	(372,544)	Costs incurred in excess of billings
Prepaid expenses		(263,611)	80	-	(263,531)	Prepaid expenses
Accounts payable and accrued liabilities	(a)(g)	684,910	(323,140)	-	361,770	Accounts payable and accrued liabilities
	(g)	-		-	-	Provisions
Billings in excess of work in process		(141,017)	16,046	-	(124,971)	Billings in excess of costs incurred
		93,065	226,511	77,378	396,954	Cash generated by (used in) operations
	(j)	-	-	20,641	20,641	Interest received
		-	-	-	-	Income taxes paid
		93,065	226,511	98,019	417,595	Net cash used by operating activities
Cash flows from investing activities						**Cash flows from investing activities**
Acquisition of held-for-trading investments		(81,158)	506	-	(80,652)	Acquisition of guaranteed deposits certificates
Acquisition of property, plant and equipment	(a)	(10,132)	3,311	-	(6,821)	Acquisition of property, plant and equipment
Acquisition of intangible assets	(a)	(2,774)	8,192	-	5,418	Acquisition of intangible assets
Business acquisition		(250,350)	-	-	(250,350)	Contingent considerations paid
		(344,414)	12,009	-	(332,405)	Net cash used in investing activities
Cash flows from financing activities						**Cash flows from financing activities**
Variation of bank loan		596,210	(130,295)		465,915	Variation of bank loan
Long-term debt reimbursement		(162,516)	-		(162,516)	Long-term debt reimbursement
Issuance of shares		-	-		-	Issuance of shares
	(j)	-	-	(98,019)	(98,019)	Interest paid
		433,694	(130,295)	(98,019)	205,380	Net cash generated in financing activities
Net change in cash and cash equivalents		182,345	108,225	-	290,570	Net change in cash and cash equivalents
Effect of exchange rate changes on the balance of cash held in foreign currencies	(a)	(14,694)	(34,088)	-	(48,782)	**Effect of exchange rate changes on the balance of cash held in foreign currencies**
Net change in cash and cash equivalents		167,651	74,137	-	241,788	**Increase (Decrease) in cash and cash equivalents**
Cash and cash equivalents – Beginning of period	(a)(c)(d)	244,670	(89,137)	-	155,533	**Cash and cash equivalents – Beginning of period**
Cash and cash equivalents – End of period		412,321	(15,000)	-	397,321	**Cash and cash equivalents – End of period**

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (CONTINUED)
Reconciliation of Consolidated Statement of Cash Flows for the nine-month period ended March 31, 2011
(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)	(1,345,398)	67,089	-	(1,278,309)	Net loss
Non-cash items						Non cash items
	(j)	-	29,031	564,720	593,751	Finance costs – net
Depreciation of property, plant and equipment	(a)(b)	231,466	(6,506)	-	224,959	Depreciation of property, plant and equipment
Amortization of intangible assets	(c)	806,998	(89,675)	-	717,323	Amortization of intangible assets
Net lease obligations		(9,663)	(130)		(9,793)	Net lease obligations
Stock-based compensation		206,542	-		206,542	Stock-based compensation
	(a)	-	(39,447)	-	(39,447)	Share of loss of a joint venture
Imputed interest on long-term debt and convertible debenture	(j)	182,409	-	(182,409)	-	
		72,353	(39,638)	382,311	415,026	
Accounts receivable	(a)	4,289,358	611,157	-	(2,681,587)	Accounts receivable
Inventories	(a)	(103,887)	76,898	-	(941,433)	Inventories
Work in process		(1,613,463)	6,774	-	323,435	Costs incurred in excess of billings
Prepaid expenses		(308,296)	80	-	(185,014)	Prepaid expenses
Accounts payable and accrued liabilities	(a)(g)	(1,721,864)	(459,249)	(28,733)	(181,516)	Accounts payable and accrued liabilities
	(g)	-	-	28,733	28,733	Provisions
Billings in excess of work in process		(904,113)	16,046	-	1,188,204	Billings in excess of costs incurred
		(2,628,840)	212,417	382,311	(2,034,112)	Cash used in operations
	(j)	-	-	29,883	29,883	Interest received
		-	-	-	-	Income taxes paid
		(2,628,840)	212,417	412,194	(1,804,229)	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		(228,268)	506	-	(227,762)	Acquisition of guaranteed deposits certificates
Acquisition of property, plant and equipment	(a)	(192,653)	7,034	-	(185,619)	Acquisition of property, plant and equipment
Acquisition of intangible assets	(a)	(12,517)	8,189	-	(4,328)	Acquisition of intangible assets
Business acquisition		(1,088,591)	-	-	(1,088,591)	Contingent considerations paid
		(1,482,731)	15,729	-	(1,467,002)	Net cash used in investing activities
Cash flows from financing activities						**Cash flows from financing activities**
Variation of bank loan		2,271,961	(130,295)	-	2,141,666	Variation of bank loan
Long-term debt reimbursement		(503,597)	-	-	(503,597)	Long-term debt reimbursement
Long-term debt contracted		124,692	-	-	124,692	Long-term debt contracted
	(j)	-	-	(412,194)	(412,194)	Interest paid
Issuance of shares		8,000	-	-	8,000	Issuance of shares
Share issue expenses		(5,420)	-	-	(5,420)	Share issue expenses
		1,895,636	(130,295)	(412,194)	1,353,147	Net cash generated in financing activities
Net change in cash and cash equivalents		(2,215,935)	97,851	-	(2,118,084)	Net change in cash and cash equivalents
Effect of exchange rate changes on the balance of cash held in foreign currencies	(a)	(44,119)	(26,523)	-	(70,642)	**Effect of exchange rate changes on the balance of cash held in foreign currencies**
Net change in cash and cash equivalents		(2,260,054)	71,328	-	(2,188,726)	**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		412,321	(15,000)	-	397,321	**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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