Interim financial report
Second quarter ended
December 31, 2012

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE FINANCIAL SITUATION

In accordance with National Instrument 51-102 Continuous Disclosure Obligations, the following comments are intended to provide a review and an analysis of H_2O Innovation's results of operations and financial position for the quarter ended December 31, 2012, in comparison with the corresponding period ended December 31, 2011. They should be read in conjunction with the consolidated financial statements and accompanying notes. Comparison of financial situation as at December 31, 2012 to those as at June 30, 2012 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 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 25, 2012 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 have been reviewed by our auditors, except for the corresponding comparative figures that 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.

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

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 approximately 115 employees and eight locations in North America, H_2O Innovation is also a founding partner of H_2O Innovation India, a joint venture based in Mumbai, India.

NON-IFRS FINANCIAL MEASUREMENT

In this MD&A, the Company's management uses a measure that is not in accordance with IFRS. The measurement "Adjusted earnings before interest, tax depreciation and amortization (adjusted EBITDA)" is not defined by IFRS and cannot be formally presented in consolidated financial statements. The definition of adjusted EBITDA does not take into account the Company's changes in fair value of contingent considerations, impairment of intangible assets, impairment of goodwill, stock-based compensation costs, gain on settlement agreement and share of (earnings) loss in a joint venture. The reader can establish the link between adjusted EBITDA and net earnings (loss). The definition of adjusted EBITDA used by the Company may differ from those used by other companies.

Even though adjusted EBITDA is a non-IFRS measure, it is used by management, analysts, investors and other financial stakeholders to assess the Company's performance and management from a financial and operational standpoint.

Reconciliation of adjusted EBITDA to net earnings (loss)

	Three-month period ended December 31,		**Six-month period ended December 31,**	
	2012	2011	**2012**	2011
	$	$	**$**	$
Net earnings (loss) for the period	**488,854**	(1,214,510)	**758,550**	(1,479,914)
Finance costs – net	**208,021**	194,704	**413,140**	388,868
Income taxes	**15,049**	-	**15,049**	(177,188)
Depreciation of property, plant and equipment	**68,823**	69,333	**137,307**	146,336
Amortization of intangible assets	**177,937**	242,659	**355,695**	476,283
Stock-based compensation costs	**9,174**	36,327	**25,348**	88,915
Gain on settlement agreement	**(404,189)**	-	**(404,189)**	-
Share of (earnings) loss in a joint venture	**(1,781)**	266,581	**(12,319)**	307,414
Adjusted EBITDA	**561,888**	(404,906)	**1,288,581**	(72,098)

RESULTS OF OPERATIONS

Selected financial data
(Unaudited)

	Three-month period ended December 31,		Six-month period ended December 31,	
	2012	**2011**	**2012**	**2011**
	$	**$**	$	$
Revenues	**9,418,908**	7,056,495	**19,401,802**	14,126,263
Gross profit	**2,461,061**	1,592,624	**4,923,632**	3,337,558
Gross profit	**26.1%**	22.6%	**25.4%**	23.6%
Operating expenses	**139,369**	181,538	**275,141**	286,644
Selling expenses	**904,630**	954,006	**1,747,784**	1,818,673
Administrative expenses	**853,853**	919,647	**1,717,116**	1,774,739
Net earnings (loss)	**488,854**	(1,214,510)	**758,550**	(1,302,726)
Basic and diluted earnings (loss) per share	**0.008**	(0.020)	**0.013**	(0.022)
Adjusted EBITDA	**561,888**	(404,906)	**1,288,581**	(72,098)

Revenues and gross profit

Revenues for the second quarter of fiscal year 2013 totaled $9.4 M, representing a $2.3 M or 33.5% increase, as compared with revenues of $7.1 M for the same quarter of fiscal year 2012. The increase is largely attributable to revenues from projects which reached $6.0 M compared to $4.0 M in the corresponding period of the previous fiscal year, representing a 47.7% increase. Nearly half of these $6.0 M revenues come from three projects in the oil & gas sector in Western Canada and 25% come from municipal projects in the United States. This is a direct consequence of the materialisation of our order backlog which stood at $18.7 M as at December 31, 2012.

Revenues from sales of specialty chemicals and consumables increased by $0.4 M for this quarter reaching $3.4 M compared with $3.0 M in the comparable quarter in fiscal year 2012, representing a 14.3% increase. These revenues are recurring in nature. Continued efforts are being deployed to increase our footprint through the addition of new specialty chemical distributors. Moreover, we gave particular attention to maintaining service contracts on our installed base while continuing to build relationships with clients of newly commissioned projects through the addition of service field technicians to our team.

In this second quarter of fiscal year 2013, the Company was able to generate a 26.1% gross profit, compared to a 22.6% gross profit during the second quarter of fiscal year 2012. This is a significant improvement from the gross profit generated in the first quarter of fiscal year 2013 and the fourth quarter of fiscal year 2012. This performance is mainly attributable to various factors such as the rise in our business volume and the changes initiated and implemented since June 30, 2012 – which changes are meant to enhance both project execution and manufacturing operations with the primary objective of increasing overall gross profit. Following the restructuration of our operations, and in particular the re-alignment of our engineering resources, the pursuing of operational excellence in project execution, which means delivering on time, on budget, on quality, remains our number one priority. The gross profit has also improved due to the increase of exportation of specialty chemicals that maintained the pace during this second quarter of fiscal year 2013.

During the quarter, the Company added $4.3 M in new bookings for water treatment projects. These new bookings, coupled with the revenues realized from water treatment projects during the quarter, have brought down the backlog at $18.7 M as at December 31, 2012. The Company's bookings over revenues ratio for projects has decreased to 0.7 from 0.9 in the previous quarter despite a lower level of revenues from water treatment projects. Management remains confident to grow its sales backlog again above the $20 M mark as our sales pipeline is rich with multiple opportunities in our targeted markets. In the coming months, the Company will focus on increasing its footprint in North America for water and wastewater treatment projects. Over the last two quarters management has made an important restructuration in its wastewater activities on both technical and commercial sides which will allow the Company to springboard growth momentum in this sector as we are consolidating our sales representatives network.

The following table summarizes the evolution of the Company's revenues and new orders, together with the variations in its backlog over the last six quarters.

	2012 FY				2013 FY		Last twelve months	Previous twelve months
	Q1	Q2	Q3	Q4	Q1	Q2	(Q3 & Q4 FY2012 & Q1 & Q2 FY2013)	(Q3 & Q4 FY2011 & Q1 & Q2 FY2012)
Order backlog	$31.6 M	$30.0 M	$28.1 M	$20.8 M	$20.4 M	**$18.7 M**	**N/A**	N/A
Bookings for water treatment projects	$0.9 M	$4.7 M	$6.0 M	$4.7 M	$6.7 M	**$4.3 M**	**$21.7 M**	$29.1 M
Revenues from water treatment projects	$4.3 M	$4.1 M	$6.7 M	$7.6 M	$7.1 M	**$6.0 M**	**$27.4 M**	$16.8 M
Bookings / Revenues Ratio	***0.2***	***1.1***	***0.9***	***0.6***	***0.9***	***0.7***	***0.8***	***1.7***
Revenues from specialty chemicals and consumables (usually recurrent in nature)	$2.8 M	$3.0 M	$3.5 M	$3.9 M	$2.9 M	**$3.4 M**	**$13.7 M**	$12.4 M

The total revenues for the last twelve months have reached a record high $41.1 M compared to $29.2 M in the previous twelve months, reflecting a strong organic growth. The level of revenues has obviously impacted positively the Company's financial performance, showing the scalability of our business model.

The revenues from specialty chemicals and consumables for the last twelve months have reached $13.7 M, an increase of $1.3 M compared to the previous twelve months. This level of revenues allows the Company to cover an important portion of its selling, operating and administrative expenses ("SG&A"), which contributes to reduce the lumpiness of the water treatment projects activities, solidifying the Company's financial performance.

Operating expenses

Showing a decrease of approximately $40,000, operating expenses remained relatively stable at $0.1 M for this quarter compared to the corresponding quarter of previous fiscal year. This decrease is partly due to the reassignment of a key employee from a technical support role to the position of regional sales manager.

Selling expenses

Selling expenses have decreased by approximately $50,000 and stood at $0.9 M for this quarter compared with the corresponding quarter of the previous fiscal year, despite the 47.7% increase in revenues. Selling expenses are linked to bookings and revenues, but do not fluctuate proportionally. The decrease is partly due to the ending of consulting agreements over the last fiscal year and to a lesser volume of traveling expenses.

Administrative expenses

Administrative expenses decreased by approximately $66,000 or 7.2% in this second quarter of fiscal year 2013 compared with the second quarter of fiscal year 2012. Even though salaries and fringe benefits have decreased following the elimination of management positions in June 2012, the Company encountered higher office expenses during the period ended December 31, 2012 compared with the period ended December 31, 2011.

The Company's ratio of SG&A as a whole over revenues amounted to 20.1% for this quarter, down from 29.1% for the corresponding quarter of the previous fiscal year. This decrease is partially attributable to the increase in volume of business and reflects our efforts to reach profitability and maximize the use of our internal resources, showing the benefit and scalability of our business model. Overall, the Company's SG&A expenses show a decrease of approximately $160,000 compared to the corresponding quarter of fiscal year 2012 and remain in line with our fiscal year 2013 budget.

Adjusted EBITDA

Adjusted EBITDA for the quarter was recorded at $561,888, compared with ($404,906) for the same period ended December 31, 2011. The higher revenues recorded during the quarter compared with the corresponding quarter of the previous fiscal year, combined with the significant gross profit improvement from 22.6% to 26.1 % and the somewhat stable SG&A expenses also contributed to generating positive adjusted EBITDA.

Other losses (gains) – net

Other losses (gains) – net amounting to ($23,735) for the period ended December 31, 2012 compared with $18,032 for the quarter ended December 31, 2011 are mostly composed of a foreign exchange loss (gain), which is entirely due to exchange rate fluctuations related to working capital items.

Finance costs – net

Finance costs – net totalled $208,021 for the period ended December 31, 2012 compared to $194,704 for the comparable period in the previous fiscal year. These expenses relate mostly to the long-term debt. Of this amount, $20,074 represent the theoretical and non-monetary part of interest on long-term debt and $12,167 represent the unwinding of the discount on contingent considerations. The slight increase is due to the higher use of our credit facility during the second quarter of fiscal year 2013. As the Company continues to repay its long-term debt, finance costs are expected to decrease in the coming quarters.

Gain on settlement agreement

On December 1, 2012, the Company entered into a settlement agreement and release with Donald Ricketts (“Mr. Ricketts”). Pursuant to this agreement, the Stock Purchase Agreement (“SPA”) dated April 10, 2008, relating to the acquisition of Wastewater Technology, Inc., was immediately terminated and Mr. Ricketts and the Company relinquished all of their rights under the SPA. As consideration for this relinquishment, Mr. Ricketts received $96,011 and agreed that no amount under the SPA or as an employee or consultant of the Company is due to him or will ever be due to him. Therefore the Company has written off the contingent consideration related to this terminated SPA amounting to $404,189 ($US407,736) and has recorded a gain on settlement agreement of the same amount in the statement of earnings (loss).

Share of earnings (loss) in a joint venture

Share of earnings (loss) in a joint venture totalled $1,781 for the period ended December 31, 2012 compared with a share of earnings (loss) of ($266,581) for the quarter ended December 31 2011. These earnings are largely attributable to the entering of projects into the fabrication phase which is a higher revenue-generating phase.

Net earnings (loss)

The net earnings (loss) was $488,854 or $0.008 per share for the second quarter of fiscal year 2013 compared with ($1,214,510) or ($0.020 per share) for the second quarter of fiscal year 2012. This improvement is attributable to four main factors. First, the Company recorded a high level of revenues. Second, management has applied a tight control on project execution, notably for procurement, and on hours spent on projects. Third, management closely monitors the SG&A and is diligent in finding additional savings. Finally, the Company recorded a gain on settlement agreement related to the Company’s wastewater activities.

Commitments

The Company has entered into long-term lease agreements expiring in 2013, 2014, 2017 and 2022, which call for lease payments of $3,392,145 for the rental of space. The minimum annual lease payments over the next five years are $391,334 in 2013, $406,316 in 2014, $410,368 in 2015, $419,273 in 2016 and $428,402 in 2017.

Information on share capital

As at December 31, 2012, the Company had 60,145,832 outstanding shares. No share was issued during this quarter.

FINANCIAL SITUATION

Working capital increased from $2.5 M as at June 30, 2012 (current ratio of 1.19) to $4.1 M as at December 31, 2012 (current ratio of 1.41). The increase is attributable to the $2.0 M and $0.2 M decrease in accounts receivable and costs incurred in excess of billings respectively, the increase of $0.7 M in inventory, the decrease of $1.0 M in accounts payable and accrued liabilities, the increase of $0.4 M in billings in excess of costs incurred and to the reimbursement of the short-term portion of the long-term debt.

The net debt excluding contingent considerations, which stood at $4.5 M as at December 31, 2012, decreased by nearly $1.7 M compared with $6.1 M as at June 30, 2012. This decrease is mainly attributable to the general improvement in working capital, itself caused by the delivery of important milestones in projects which were billed to clients and cashed during the first six months of fiscal year 2013. The decrease is also caused by the reimbursement of long-term debt after the end of the moratorium exercised during fiscal year 2012.

Equity stood at $14.2 M as at December 31, 2012, compared with $13.7 M as at June 30, 2012. As at December 31, 2012 the net debt equity ratio was 0.31 whereas it was 0.45 as at June 30, 2012, showing that the Company is not over leveraged and has improved its overall financial situation.

(in Canadian dollars, except for ratio)	**Period ended December 31, 2012**	**Period ended June 30, 2012**
Working capital	4,123,833	2,518,829
Current ratio	1.41	1.19
Net debt[1]	4,468,429	6,129,684
Equity	14,232,280	13,744,227
Net debt to equity ratio	0.31	0.45

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

As at December 31, 2012 accounts receivable stood at $7.3 M compared with $9.3 M as at June 30, 2012. The decrease of $2.1 M is attributable to the collection of amounts due by clients derived from high invoicing at the end of the last six-month period. Part of the Company's trade accounts receivable is guaranteed by Export Development Canada.

Inventories increased by $0.7 M to $2.9 M as at December 31, 2012 compared with $2.2 M as at June 30, 2012. This increase is largely attributable to finished goods manufactured during the summer and autumn in preparation for the start of the maple syrup production season. Raw materials have lightly decreased by $0.1 M due to a better use of our in-hand or slow moving items.

Costs incurred in excess of billings decreased by $0.2 M to $1.9 M as at December 31, 2012, from $2.1 M as at June 30, 2012, primarily due to a similar number of active projects for which there are differences between project advancement and project invoicing schedules. Billings in excess of costs incurred increased by $0.5 M to $2.1 M as at December 31, 2012, from $1.6 M as at June 30, 2012. This increase is also attributable to differences between project advancement and project invoicing schedules.

Accounts payable and accrued liabilities decreased by $1.0 M to $4.7 M as at December 31, 2012, from $5.7 M as at June 30, 2012. This decrease is explained by the fact that several large systems projects have completed their manufacturing and assembly phases and are now entering their commissioning phase while new systems projects are entering into their initial design and engineering phases.

The decrease in the current portion of the long-term debt, the balance of which fell from $2.6 M as at June 30, 2012 to $0.98 M as at December 31, 2012, is explained by the repayment of $0.6 M for the long-term debt and the reclassification to the non-current liabilities of the long-term portion of a loan from another entity according to the repayment terms since a waiver has been obtained.

Following the settlement agreement, the Company paid $96,011 to terminate the share purchase agreement ("SPA") and wrote off the remaining contingent consideration related to this terminated SPA amounting to $404,189 ($US407,736).

For the second quarter ended December 31, 2012, shareholders' equity increased by $0.5 M to $14.2 M ($13.7 M as at June 30, 2012). The following elements had an impact on shareholders' equity in the first six months of fiscal year 2013: 1) the $758,550 net earnings for the six-month period ended December 31, 2012; 2) the Canadian dollar's appreciation generated an unrealized exchange loss of $0.3 M resulting from the translation of foreign operations, mainly those of the U.S. subsidiaries; and 3) the stock-based compensation costs of $25,348.

CASH FLOWS

A comparison of the Company's cash flows for the periods ended December 31, 2012 and 2011 is presented below:

(in Canadian dollars) (unaudited)	**Three-month period ended December 31, 2012**	Three-month period ended December 31, 2011	**Six-month period ended December 31, 2012**	Six-month period ended December 31, 2011
	$	$	**$**	$
Cash flows from operating activities	**1,024,161**	(1,408,003)	**2,234,375**	(325,470)
Cash flows from investing activities	**(143,743)**	(431,222)	**(187,866)**	(862,121)
Cash flows from financing activities	**(908,777)**	1,312,594	**(1,766,490)**	945,003
Effect of exchange rate changes on the balance of cash held in foreign currencies	**3,057**	28,395	**(18,628)**	44,545
Net change	**(25,302)**	(498,236)	**261,391**	(198,043)
Cash and cash equivalents – Beginning of period	**708,025**	449,029	**421,332**	148,836
Cash and cash equivalents – End of period	**682,723**	(49,207)	**682,723**	(49,207)

Operating activities generated $1,024,161 in cash for the period ended December 31, 2012, compared with ($1,408,003) of cash used during the corresponding period ended December 31, 2011. The rise is mainly attributable to the significant improvement in net earnings in the second quarter of fiscal year 2013 as compared with the corresponding period ended December 31, 2011 and to the positive change in working capital items.

For the second quarter of fiscal year 2013, investing activities used net cash of ($143,743), mainly attributable to the final payment of a contingent consideration of $96,011, to the acquisition of property, plant and equipment, namely computer and various items for $42,035 and to the acquisition of intangible assets, namely software for our design team in the amount of $6,386.

Financing activities used net cash of ($908,777) in the second quarter of fiscal year 2013 compared with $1,312,594 of net cash generated during the corresponding period ended December 31, 2011. The increase of funds used by financing activities is mainly caused by the reimbursement of bank loans. In addition, the Company started to reimburse its long-term debts after the ending of the two consecutives moratoriums of six months over capital repayments of long-term debts during fiscal year 2012. This had a positive impact on the net debt to equity ratio since management intends to reduce its debt which in turn will reduce our finance costs in the coming quarters.

QUARTERLY SUMMARY FINANCIAL INFORMATION (unaudited)

(in dollars, except per share data)

	Three-month period ended				Last twelve months
	December 31, 2012	**September 30, 2012**	**June 30, 2012**	**March 31, 2012**	
Revenues	9,418,908	9,982,894	11,561,332	10,222,312	41,185,446
Adjusted EBITDA	561,888	726,693	(483,798)	563,603	1,368,386
Net earnings (loss)	488,854	269,696	880,620	(7,651,400)	(6,012,230)
EPS basic and diluted	0.008	0.004	0.014	(0.127)	(0.101)
Cash flows from operating activities	1,024,161	1,210,214	1,560,416	(419,247)	3,375,544

	Three-month period ended				Previous twelve months
	December 31, 2011	**September 30, 2011**	**June 30, 2011**	**March 31, 2011**	
Revenues	7,056,495	7,069,768	7,826,146	7,126,952	29,079,361
Adjusted EBITDA	407,961	323,618	(15,652)	281,125	997,052
Net loss	(1,214,510)	(88,216)	(72,989)	(125,006)	(1,500,721)
EPS basic and diluted	(0.020)	(0.001)	(0.001)	(0.002)	(0.024)
Cash flows from operating activities	(1,408,003)	1,082,533	441,044	417,595	533,169

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.

The Company's financial strategy is designed to meet the objectives stated above and to respond to changes in economic conditions and the risks characteristics of underlying assets. In order to maintain or adjust its capital structure, the Company may issue or repurchase shares, raise or repay debt or undertake any other activities it considers appropriate under the circumstances.

The Company monitors capital on the basis of its total debt-to-equity ratio. Total debt consists of all interest-bearing debt, and equity is defined as total equity.

The total debt-to equity ratio was as follows:

	December 31, 2012	**June 30, 2012**
	$	$
Bank overdraft	156,388	155,210
Bank loans	2,054,608	2,868,394
Current portion of long-term debt [(a)]	981,932	2,580,862
Long-term debt [(a)]	2,114,612	1,101,760
Total debt	5,307,540	6,706,226
Equity	14,232,280	13,744,227
Total debt-to-equity ratio	37.3%	48.8%

(a) The long-term portion of the loan from another entity has been classified as current portion of long-term debt because the waiver from the lender was obtained after the balance sheet date as at June 30, 2012.

The Company's financial objectives and strategy described above have remained unchanged since the last reporting period. These objectives and strategies are reviewed annually or more frequently if the need arises.

The Company renewed its credit facilities in December 2012 and the financial covenants required have been modified and must be met on a monthly basis. The Company is not subject to any externally imposed capital

requirements other than covenants on its bank loans with its lender to maintain the following levels: 1) a debt ratio lesser than or equal to 2.50:1.00, 2) a working capital ratio greater than or equal to 1.30:1.00, and 3) a fixed charge coverage ratio greater than or equal to 1.00:1.00 and a covenant on the loan from other entity to maintain working capital ratio of 1.50:1.00. Business performance is closely monitored and the most cost-effective methods for raising capital are considered to evaluate compliance with covenants. As at December 31, 2012, the Company respected its covenants with the bank but was in breach of the working capital ratio for the loan from other entity; however the Company received a waiver for this breach from the lender.

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, bank loans (including bank overdraft) 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.

ACCOUNTING POLICIES

The reader is invited to refer to the summary of significant accounting policies presented in note 2 to the consolidated financial statements as at June 30, 2012.

OFF-BALANCE SHEET ARRANGEMENTS

As at December 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 year 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 Vice President, Finance ("Vice President, 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 Vice President, 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 Vice President, Finance, of the effectiveness of our disclosure controls and procedures. Based on this evaluation, the CEO and the Vice President, Finance concluded that the disclosure controls and procedures are effective, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) on Internal Control – Integrated Framework.

Internal controls over financial reporting

The CEO and the Vice President, 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)

Second quarter ended
December 31, 2012

The comparative figures of 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:
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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
(Unaudited)

	December 31, 2012	June 30, 2012
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	**839,111**	576,542
Guaranteed deposits certificates	**1,147,128**	1,147,703
Accounts receivable (note 3)	**7,261,875**	9,322,380
Inventories (note 4)	**2,936,716**	2,250,789
Costs incurred in excess of billings	**1,981,748**	2,154,311
Prepaid expenses	**95,331**	132,480
	14,261,909	15,584,205
Non-current assets		
Property, plant and equipment	**1,927,830**	2,026,695
Intangible assets	**5,013,289**	5,459,185
Investment in a joint venture	**48,975**	11,722
Other assets	**18,091**	43,122
Goodwill	**2,331,943**	2,386,322
Deferred income tax assets	**2,977,975**	2,958,149
	26,580,012	28,469,400
LIABILITIES		
Current liabilities		
Bank overdraft	**156,388**	155,210
Bank loans	**2,054,608**	2,868,394
Accounts payable and accrued liabilities (note 5)	**4,709,311**	5,742,007
Provisions (note 6)	**60,768**	40,543
Billings in excess of costs incurred	**2,065,467**	1,634,724
Income taxes payable	**99,410**	4,378
Deferred rent	**10,192**	18,188
Current portion of long-term debt (note 8)	**981,932**	2,580,862
Contingent considerations (note 7)	**-**	21,070
	10,138,076	13,065,376
Non-current liabilities		
Long-term debt (note 8)	**2,114,612**	1,101,760
Contingent considerations (note 7)	**-**	460,555
Deferred rent	**95,044**	97,482
	12,347,732	14,725,173
SHAREHOLDERS' EQUITY		
Share capital	**45,852,436**	45,852,436
Reserve - Stock options (note 9)	**1,846,769**	1,821,421
Reserve - Warrants	**370,076**	370,076
Deficit	**(32,068,224)**	(32,826,774)
Accumulated other comprehensive loss	**(1,768,777)**	(1,472,932)
	14,232,280	13,744,227
	26,580,012	28,469,400

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

On behalf of the Board,

Frédéric Dugré

President and Chief Executive Officer

Philippe Gervais

Chairman of the Board of Directors

H_2O INNOVATION INC.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the six-month periods ended December 31, 2012 and 2011
(Unaudited)

ATTRIBUTABLE TO THE SHAREHOLDERS OF H_2O INNOVATION INC.

			Reserves				
	Common shares Number	Share capital	Stock options (note 9)	Warrants	Deficit	Accumulated other comprehensive loss	Total
		$	$	$	$	$	$
Balance as at July 1, 2011	60,145,832	45,852,436	1,734,952	10,143,677	(34,273,772)	(1,922,678)	21,534,615
Stock-based compensation costs	-	-	88,915	-	-	-	88,915
Share issue expenses related to financing	-	-	-	(1,165)	-	-	(1,165)
Net loss for the period	-	-	-	-	(1,302,726)	-	(1,302,726)
Other comprehensive loss – Currency translation adjustments	-	-	-	-	-	737,123	737,123
Balance as at December 31, 2011	**60,145,832**	**45,852,436**	**1,823,867**	**10,142,512**	**(35,576,498)**	**(1,185,555)**	**21,056,762**
Balance as at July 1, 2012	60,145,832	45,852,436	1,821,421	370,076	(32,826,774)	(1,472,932)	13,744,227
Stock-based compensation costs	-	-	25,348	-	-	-	25,348
Net earnings for the period	-	-	-	-	758,550	-	758,550
Other comprehensive loss – Currency translation adjustments	-	-	-	-	-	(295,845)	(295,845)
Balance as at December 31, 2012	**60,145,832**	**45,852,436**	**1,846,769**	**370,076**	**(32,068,224)**	**(1,768,777)**	**14,232,280**

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

H$_2$O INNOVATION INC.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)
For the three-month and six-month periods ended December 31, 2012 and 2011
(Unaudited)

	Three-month period ended December 31,		**Six-month period ended December 31,**	
	2012	2011	**2012**	2011
	$	$	**$**	$
Revenues (note 13)	**9,418,908**	7,056,495	**19,401,802**	14,126,263
Cost of goods sold (note 10 a))	**6,957,847**	5,463,624	**14,478,170**	10,788,705
Gross profit	**2,461,061**	1,592,871	**4,923,632**	3,337,558
Operating expenses (note 10 a))	**139,369**	181,538	**275,141**	286,644
Selling expenses (note 10 a))	**904,630**	954,006	**1,747,784**	1,818,673
Administrative expenses (note 10 a))	**853,853**	919,647	**1,717,116**	1,774,739
Depreciation of property, plant and equipment (note 10 b))	**68,823**	69,333	**137,307**	146,336
Amortization of intangible assets (note 10 b))	**177,937**	242,659	**355,695**	476,283
Other losses (gains) – net (note 10 c))	**23,735**	(18,032)	**(58,536)**	(369,240)
	2,168,347	2,349,151	**4,174,507**	4,133,435
Operating earnings (loss)	**292,714**	(756,280)	**749,125**	(795,877)
Finance income	**(3,584)**	(6,807)	**(7,987)**	(11,378)
Finance costs	**211,605**	201,511	**421,127**	400,246
Finance costs – net	**208,021**	194,704	**413,140**	388,868
Gain on settlement agreement (note 7)	**(404,189)**	-	**(404,189)**	-
Royalties income from a joint venture	**(13,240)**	(3,055)	**(21,106)**	(12,245)
Share of (earnings) loss in a joint venture	**(1,781)**	266,581	**(12,319)**	307,414
	(211,189)	458,230	**(24,474)**	684,037
Earnings (loss) before income taxes	**503,903**	(1,214,510)	**773,599**	(1,479,914)
Current income tax expense	**15,049**	-	**99,410**	-
Deferred tax benefit	**-**	-	**(84,361)**	(177,188)
	15,049	-	**15,049**	(177,188)
Net earnings (loss) for the period	**488,854**	(1,214,510)	**758,550**	(1,302,726)
Net earnings (loss) per share attributable to the equity holders of the company during the period				
Basic and diluted net earnings (loss) per share	**0.008**	(0.020)	**0.013**	(0.022)
Weighted average number of shares outstanding (note 11)	**60,145,832**	60,145,832	**60,145,832**	60,145,832

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

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the three-month and six-month periods ended December 31, 2012 and 2011
(Unaudited)

	Three-month period ended December 31,		Six-month period ended December 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Net earnings (loss) for the period	**488,854**	(1,214,510)	**758,550**	(1,302,726)
Other comprehensive loss – Items that may be reclassified subsequently to net earnings				
Currency translation adjustments	**147,961**	(446,825)	**(295,845)**	737,123
Comprehensive income for the period	**636,815**	(1,661,335)	**462,705**	(565,603)

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

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three-month and six-month periods ended December 31, 2012 and 2011
(Unaudited)

	Three-month period ended December 31,		Six-month period ended December 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Cash flows from operating activities				
Earnings (loss) before income taxes for the period	**503,903**	(1,214,510)	**773,599**	(1,479,914)
Non-cash items				
Finance costs – net	**208,021**	194,704	**413,140**	388,868
Depreciation of property, plant and equipment	**68,823**	69,333	**137,307**	146,336
Amortization of intangible assets	**177,937**	242,659	**355,695**	476,283
Deferred rent	**(4,644)**	4,591	**(9,240)**	5,913
Stock-based compensation	**9,174**	36,327	**25,348**	88,915
Gain on settlement agreement	**(404,189)**	-	**(404,189)**	-
Share of (earnings) loss of joint venture	**(1,781)**	266,581	**(12,319)**	307,414
	557,244	(400,315)	**1,279,341**	(66,185)
Change in working capital items (note 12 a))	**463,333**	(1,012,524)	**951,327**	(256,740)
Cash generated by (used in) operations	**1,020,577**	(1,412,839)	**2,230,668**	(322,925)
Interests received	**3,584**	6,807	**7,987**	11,378
Income taxes paid	**-**	(1,971)	**(4,280)**	(13,923)
Net cash generated by (used in) operating activities	**1,024,161**	(1,408,003)	**2,234,375**	(325,470)
Cash flows from investing activities				
Disposal of guaranteed deposits certificates	**689**	38	**689**	115,402
Acquisition of guaranteed deposits certificates	**-**	(100,000)	**(115)**	(100,000)
Acquisition of property, plant and equipment	**(42,035)**	(56,391)	**(48,911)**	(154,521)
Investment in a joint venture	**-**	(200,022)	**(25,453)**	(200,022)
Acquisition of intangible assets	**(6,386)**	(417)	**(30,772)**	(7,235)
Disposal of other assets	**-**	-	**12,707**	-
Contingent considerations paid (note 7)	**(96,011)**	(74,430)	**(96,011)**	(515,745)
Net cash used in investing activities	**(143,743)**	(431,222)	**(187,866)**	(862,121)
Cash flows from financing activities				
Variation of bank loans	**(472,752)**	1,489,477	**(813,786)**	1,255,853
Long-term debt reimbursement	**(252,588)**	(3,591)	**(599,096)**	(6,946)
Interest paid	**(183,437)**	(173,292)	**(353,608)**	(302,739)
Warrants issue expenses	**-**	-	**-**	(1,165)
Net cash (used in) generated by financing activities	**(908,777)**	1,312,594	**(1,766,490)**	945,003
Net change in cash and cash equivalents	**(28,359)**	(526,631)	**280,019**	(242,588)
Effect of exchange rate changes on the balance of cash held in foreign currencies	**3,057**	28,395	**(18,628)**	44,545
Increase (decrease) in cash and cash equivalents	**(25,302)**	(498,236)	**261,391**	(198,043)
Cash and cash equivalents - Beginning of period (note 12 b))	**708,025**	449,029	**421,332**	148,836
Cash and cash equivalents - End of period (note 12 b))	**682,723**	(49,207)	**682,723**	(49,207)

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

1. Description of Business

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

2. Basis of Preparation

Basis of preparation

The Company's financial statements are presented in Canadian dollars. All values are rounded at the nearest dollar, except otherwise indicated.

These condensed interim consolidated financial statements have been prepared in accordance with IAS 34, Interim Financial Reporting ("IAS 34").

The IFRS accounting policies that are set out in the Company's consolidated financial statements for the year ended June 30, 2012 were consistently applied to all periods presented. Please refer to note 2 in the Company's consolidated financial statements for the year ended June 30, 2012 for a complete description of the Company's significant accounting policies.

The preparation of financial statements in conformity with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant are disclosed in note 3 in the Company's consolidated financial statements for the year ended June 30, 2012 and remained unchanged for the three-month and six-month periods ended December 31, 2012.

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

These condensed interim consolidated financial statements are intended to provide an update on 2012 annual statements. Accordingly they do not include all the information required for annual financial statements and should be read in conjunction with the Company's 2012 annual audited consolidated financial statements.

On February 12, 2013 the Board reviewed the accompanying condensed interim consolidated financial statements and authorized its publication.

Standards and interpretations adopted during the period

Starting July 1, 2012, the Company has applied the amendment of IAS 1, Presentation of Financial Statements, that require entities to separate items presented in other comprehensive income into two groups, based on whether or not items may be recycled in net earnings in the future.

Standards and interpretations issued to be adopted at a later date

Unless otherwise noted, the following revised standards and amendments are effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. The Company has not yet assessed the impact of these standards and amendments or determined whether it will early adopt them.

(i) IFRS 9, *Financial Instruments*, was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39, *Financial Instruments: Recognition and Measurement*, for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through the statement of earnings (loss). IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through the statement of earnings (loss) or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in the statement of earnings (loss) to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income.

The above revisions are effective for annual periods beginning on or after January 1, 2015 with earlier application permitted.

(ii) IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12, *Consolidation—Special Purpose Entities* and parts of IAS 27, *Consolidated and Separate Financial Statements*.

(iii) IFRS 11, *Joint Arrangements*, requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities—Non-monetary Contributions by Venturers*.

(iv) IFRS 12, *Disclosure of Interests in Other Entities*, establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosure that address the nature of, and risks associated with, an entity's interests in other entities.

(v) IFRS 13, *Fair Value Measurement*, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures.

(vi) There have been amendments to existing standards, including IAS 27, *Separate Financial Statements* ("IAS 27"), and IAS 28, *Investments in Associates and Joint Ventures* ("IAS 28"). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

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

3. Accounts Receivable

	As at December 31, 2012	As at June 30, 2012
	$	$
Accounts receivable	**5,981,933**	8,128,294
Retentions from customers under manufacturing contracts	**1,016,989**	983,900
Allowance for doubtful accounts	**(284,015)**	(258,230)
	6,714,907	8,853,964
Tax credits receivable	**89,106**	180,040
Other receivables	**457,862**	288,376
	7,261,875	9,322,380

4. Inventories

	As at December 31, 2012	As at June 30, 2012
	$	$
Raw materials	**1,027,814**	1,112,301
Finished goods	**1,908,902**	1,138,488
	2,936,716	2,250,789

5. Accounts Payable and Accrued Liabilities

	As at December 31, 2012	As at June 30, 2012
	$	$
Trade accounts payable	**2,811,376**	3,792,052
Other accrued liabilities and accounts payable	**1,897,935**	1,949,955
	4,709,311	5,742,007

6. Provisions

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

	$
Balance as at June 30, 2011	32,300
Additional provisions recognised	40,116
Less: Payments	(32,760)
Effect of foreign exchange differences	887
Balance as at June 30, 2012	40,543
Additional provisions recognised	**42,263**
Less: Payments	**(21,346)**
Effect of foreign exchange differences	**(692)**
Balance as at December 31, 2012	**60,768**

7. Contingent considerations

The change in carrying value is as follows:

	$
Balance as at June 30, 2011	1,419,727
Plus: Unwinding of discount	81,591
Less: Payments	(793,393)
Less: Reduction of contingent consideration through statement of income (loss)	(280,142)
Effect of foreign exchange differences	53,842
Balance as at June 30, 2012	481,625
Plus: Unwinding of discount	**30,492**
Less: Payments	**(96,011)**
Less: Settlement agreement	**(404,189)**
Effect of foreign exchange differences	**(11,917)**
Balance as at December 31, 2012	**-**

On December 1, 2012, the Company entered into a settlement agreement and release with Donald Ricketts (“Mr. Ricketts”). Pursuant to this agreement, the Stock Purchase Agreement (“SPA”) dated April 10, 2008, relating to the acquisition of Wastewater Technology, Inc., was immediately terminated, and Mr. Ricketts and the Company relinquished all of their rights under the SPA. As consideration for this relinquishment, Mr. Ricketts received $96,011 and agreed that no amount under the SPA or as an employee or consultant of the Company is due to him or will ever be due to him. Therefore the Company has written off the contingent consideration related to this terminated SPA amounting to $404,189 ($US407,736) and has recorded a gain on settlement agreement of the same amount in the statement of earnings.

8. Long-Term Debt

	As at December 31, 2012	As at June 30, 2012
	$	$
Unsecured – at amortised cost		
Bank loan, denominated in Canadian dollars	**1,179,886**	1,401,737
Loan from other entities, denominated in Canadian dollars	**1,680,597**	1,862,820
Loans from shareholders, denominated in US dollars	**150,027**	322,391
Loan from other entities, denominated in US dollars	**86,034**	95,674
	3,096,544	3,682,622
Less: Current portion	**(981,932)**	(2,580,862)
Long-term debt	**2,114,612**	1,101,760

As at December 31, 2012, the Company is in breach of covenants on the loan from other entity to maintain a working capital ratio of 1.5:1 and an equity debt ratio of 2.5:1 but received a waiver for this breach from the lender.

9. Capital Stock

Stock options

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

	Six-month period ended December 31, 2012		Year ended June 30, 2012	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		$		$
Outstanding - Beginning of period	**2,477,000**	**0.70**	3,945,000	0.80
Expired	**(352,500)**	**1.50**	(980,000)	1.22
Forfeited	**-**	**-**	(487,500)	0.50
Outstanding - End of period	**2,124,500**	**0.57**	2,477,000	0.70

10. Additional information about the nature of costs components

a) Expenses by nature

	Three-month period ended December 31,		**Six-month period ended December 31,**	
	2012	2011	**2012**	2011
	$	$	**$**	$
Material	**5,392,610**	3,953,143	**11,210,702**	7,164,543
Changes in inventories of raw material, finished goods and costs incurred in excess of billings	**(251,863)**	(1,238,962)	**(547,966)**	(724,223)
Salaries and fringe benefits	**2,209,401**	2,213,957	**4,255,267**	4,114,499
Subcontractors and professional fees	**452,204**	1,688,767	**1,313,985**	2,439,506
Rent, electricity , insurance and office expenses	**335,111**	244,685	**665,222**	475,552
Telecommunications and travel expenses	**283,317**	299,100	**567,260**	585,748
Bad debt expenses	**23,232**	-	**25,773**	-
Other expenses	**411,687**	358,125	**727,968**	613,135
Total cost of goods sold, operating, selling and administrative expenses	**8,855,699**	7,518,815	**18,218,211**	14,668,761

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 earnings (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 six-month periods ended December 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.

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

10. Additional information about the nature of costs components (Continued)

Depreciation by function	Three-month period ended December 31,		Six-month period ended December 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Cost of goods sold	**30,402**	36,771	**60,999**	79,051
Operating expenses	**991**	1,365	**1,942**	2,483
Selling expenses	**11,663**	10,252	**23,352**	25,138
Administrative expenses	**25,767**	20,945	**51,014**	39,664
	68,823	69,333	**137,307**	146,336

Amortization by function	Three-month period ended December 31,		Six-month period ended December 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Cost of goods sold	**87,097**	119,342	**174,545**	234,287
Selling expenses	**78,070**	111,828	**156,444**	219,127
Administrative expenses	**12,770**	11,489	**24,706**	22,869
	177,937	242,659	**355,695**	476,283

Cost per function including depreciation, amortization and impairment of intangible assets	Three-month period ended December 31,		Six-month period ended December 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Cost of goods sold	**7,075,346**	5,619,737	**14,713,714**	11,102,044
Operating expenses	**140,360**	182,903	**277,083**	289,127
Selling expenses	**994,363**	1,076,085	**1,927,580**	2,062,938
Administrative expenses	**892,390**	952,082	**1,792,836**	1,837,272

c) Other (gains) losses – net

	Three-month period ended December 31,		Six-month period ended December 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Exchange (gain) loss	**26,484**	(20,509)	**(51,455)**	(318,106)
Other (revenues) charges	**(2,749)**	2,477	**(7,081)**	(49,153)
Gain on disposal of assets	**-**	-	**-**	(1,981)
	23,735	(18,032)	**(58,536)**	(369,240)

11. Net Earnings (loss) Per Share

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

	Three-month period ended December 31,		Six-month period ended December 31,	
	2012	2011	**2012**	2011
Net earnings (loss)	**$488,854**	($1,214,510)	**$758,550**	($1,302,726)
Basic and diluted weighted average number of share outstanding	**60,145,832**	60,145,832	**60,145,832**	60,145,832
Basic and diluted net earnings (loss) per share	**$0.008**	**($0.020)**	**$0.013**	($0.022)
Items excluded from the calculation of diluted net earnings (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			**1,743,250**	1,885,750
Warrants (number of equivalent shares)			**2,250,000**	10,179,877

For the three-month and six-month periods ended December 31, 2012 and 2011, the diluted net earnings (loss) per share was the same as the basic net earnings (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 earnings (loss) per share for these periods was calculated using the basic weighted average number of shares outstanding.

12. Cash Flows

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

	Three-month period ended December 31,		Six-month period ended December 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Accounts receivable	**820,006**	4,073,655	**1,978,433**	1,892,371
Inventories	**(198,516)**	(372,372)	**(700,854)**	(630,784)
Costs incurred in excess of billings	**(53,417)**	(853,160)	**159,959**	(84,401)
Prepaid expenses	**307**	34,209	**36,758**	80,727
Accounts payable and accrued liabilities	**(825,939)**	(3,825,074)	**(981,675)**	(1,124,198)
Provisions	**4,970**	42,933	**20,906**	20,029
Billings in excess of work in progress	**715,742**	(112,715)	**437,800**	(410,484)
	463,333	(1,012,524)	**951,327**	(256,740)

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

12. Cash Flows (Continued)

b) Cash and cash equivalents consist of the following:

	Three-month period ended December 31,		Six-month period ended December 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Beginning of period				
Cash and cash equivalents	**924,744**	646,851	**576,542**	440,356
Bank overdraft	**(216,719)**	(197,822)	**(155,210)**	(291,520)
	708,025	449,029	**421,332**	148,836

	Three-month period ended December 31,		Six-month period ended December 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
End of period				
Cash and cash equivalents	**839,111**	238,149	**839,111**	238,149
Bank overdraft	**(156,388)**	(287,356)	**(156,388)**	(287,356)
	682,723	(49,207)	**682,723**	(49,207)

13. 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 December 31,		Six-month period ended December 31,	
	2012	2011	**2012**	2011
	$	$	**$**	$
Revenues from sales of consumables	**3,442,474**	3,010,876	**6,385,109**	5,776,810
Manufacturing contracts revenues	**5,976,434**	4,045,619	**13,016,693**	8,349,453
	9,418,908	7,056,495	**19,401,802**	14,126,263

Geographical information

	Three-month period ended December 31,		Six-month period ended December 31,	
Revenue from external customers	**2012**	2011	**2012**	2011
	$	$	**$**	$
Revenue according to geographic location				
Canada	**4,331,372**	2,130,338	**9,572,915**	3,843,500
United States	**3,978,733**	3,289,229	**8,082,351**	7,630,262
Tunisia	**339,795**	1,444,404	**339,795**	1,738,037
China	**593,009**	83,546	**992,267**	318,657
Egypt	**26,807**	-	**94,648**	161,996
Other	**149,192**	108,978	**319,826**	433,811
	9,418,908	7,056,495	**19,401,802**	14,126,263

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13. Segment Information (continued)

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

	As at December 31, 2012	As at June 30, 2012
	$	$
Non-current assets other than financial instruments, investment in a joint venture and deferred tax assets according to geographic location		
Canada	**1,692,311**	1,732,291
United States	**7,580,751**	8,139,911
	9,273,062	9,872,202

14. Related parties disclosure

Compensation of key management personnel

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

	Three-month period ended December 31,		**Six-month period ended December 31,**	
	2012	2011	**2012**	2011
	$	$	**$**	$
Short-term benefits	**219,921**	156,511	**454,471**	373,735
Post-employment benefits	**2,400**	2,336	**5,008**	5,844
Share-based payments	**7,924**	16,420	**21,442**	45,469
	230,245	175,267	**480,921**	425,048

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

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, Remuneration and Risks Committee

Key Management

Frédéric Dugré, President & CEO
Josée Riverin, VP Finance
Marc Blanchet, VP Corporate and Legal Affairs & Secretary of the Board
Guillaume Clairet, Executive VP

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

Auditors
Deloitte L.L.P.

Transfer Agent
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