# ANNUAL REPORT

Fiscal year ended on June 30, 2017

**For additional information:**
Investor Relations
*investor@h2oinnovation.com*

**Trading symbols:**
TSX Venture: HEO
Alternext: MNEMO: ALHEO
OTCQX: HEOFF

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

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# MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2017

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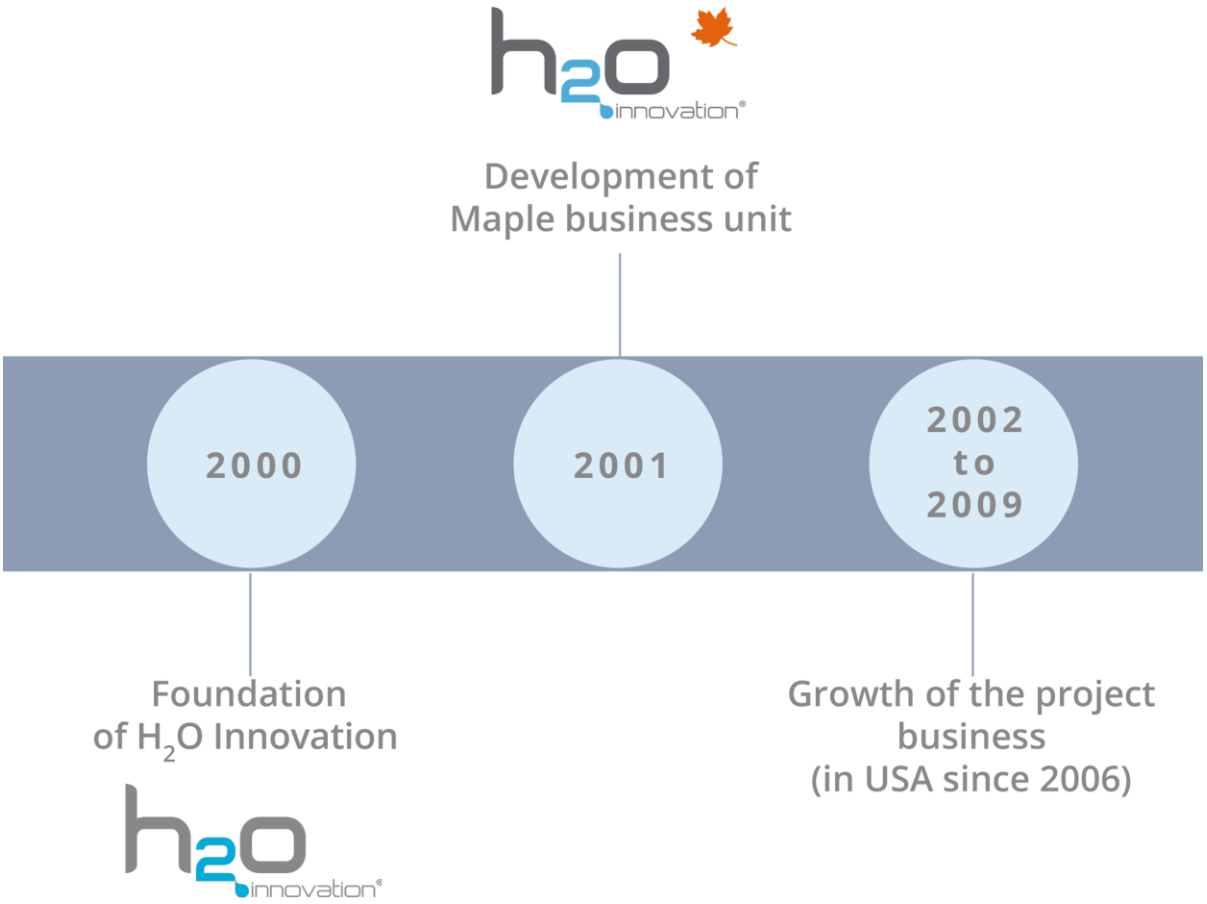
## OUR HISTORY




### 2006

First activity in California with the acquisition of **Membrane Systems Corporation**, specialized in the manufacture of membrane filtration systems.

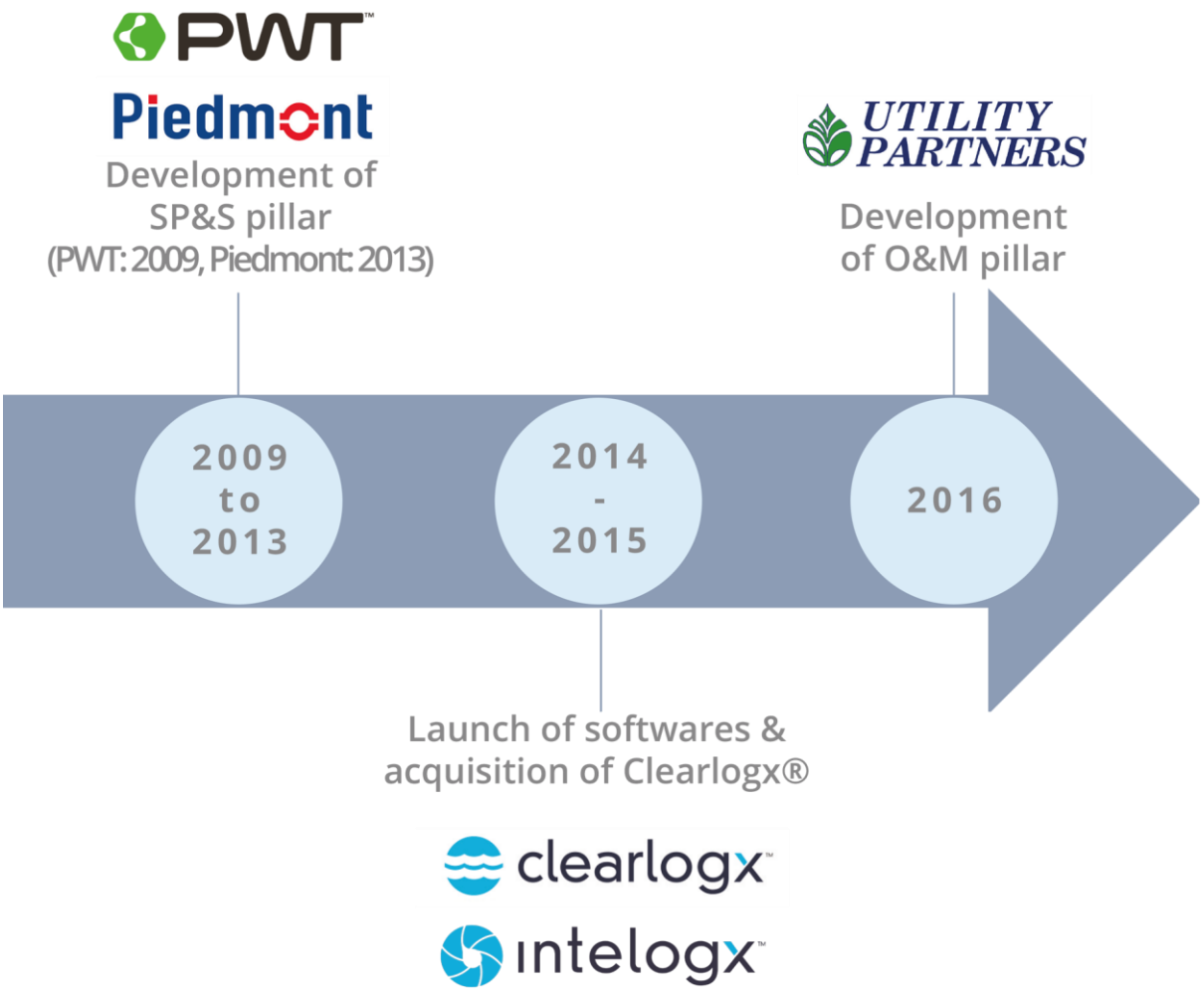
### 2007

Acquisition of **Sigma Environmental Solutions Inc.** and opening of an office in Calgary, Alberta. Expands the Corporation's presence in Western Canada and further develops its offer to the oil & gas and mining industries.

### 2008

Acquisition of **Itasca Systems Inc.** of Minneapolis, Minnesota. Reinforces the Corporation's expertise in industrial process water treatment and adds a 37,000 sq. ft. manufacturing and assembly plant in the Midwest of the USA.

Acquisition of **Wastewater Technology Inc.** of Monterey, Virginia. Brings a deeper expertise in wastewater treatment and water reuse.




## 2009

Acquisition of **Professional Water Technologies (PWT)**, specialized in the manufacturing and distribution of specialty chemicals dedicated to the membrane filtration industry.

## 2013

Acquisition of **Piedmont Pacific Corporation**, California. Piedmont is specialized in Duplex and Super Duplex stainless steel and composite couplings for pressure vessel and membrane system connections.

## 2015

Acquisition of **Clearlogx®,** a patented technology that monitors and controls the feed of specialty chemicals coagulants of water treatment systems

## 2016

Acquisition of **Utility Partners, LLC**, which provides state government, industrial and municipal clients with innovative and cost-effective solutions for operation and maintenance of water and wastewater treatment systems.

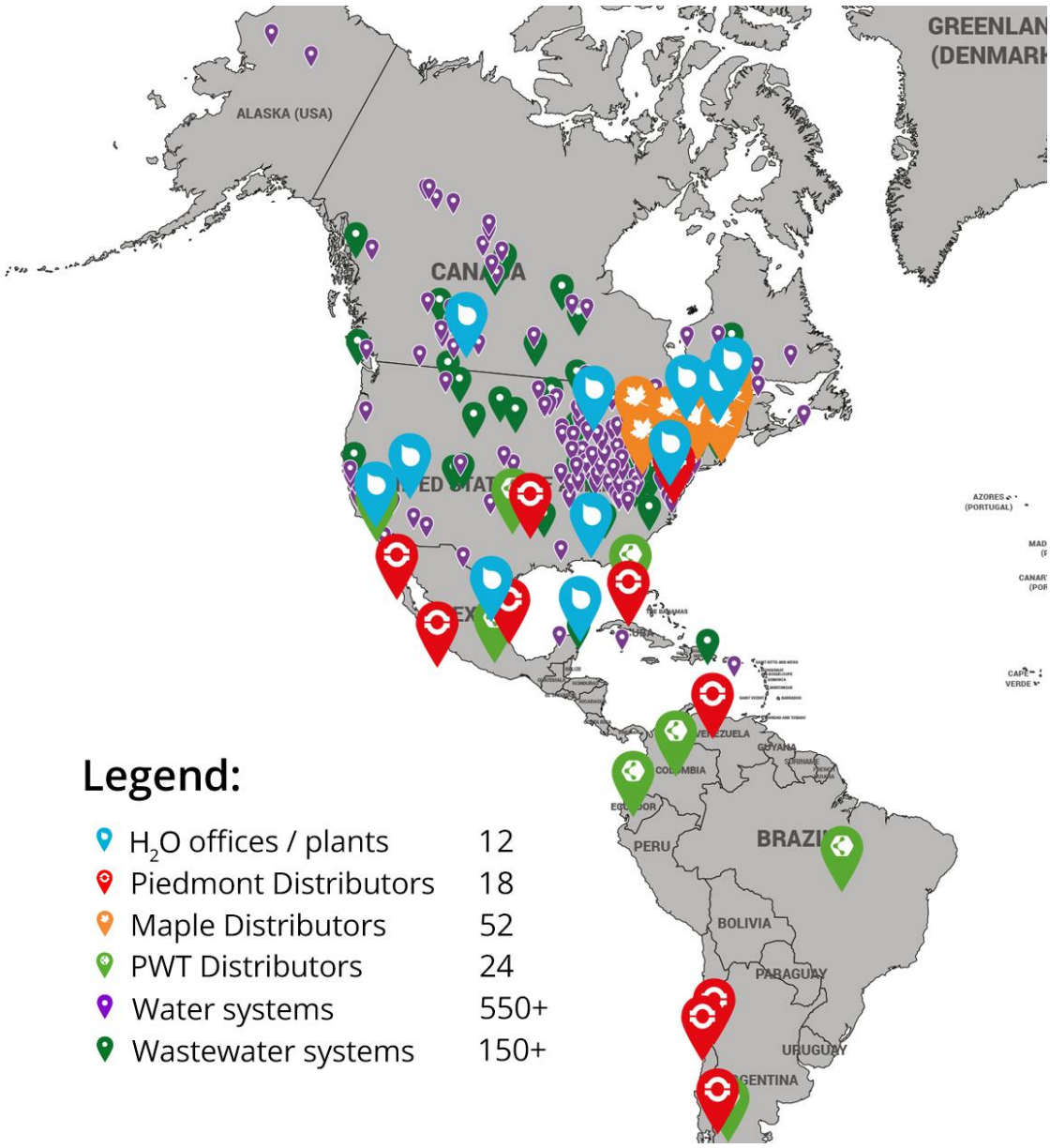
# OUR FOOTPRINT

## Vision

Be the best at providing safe and reliable water treatment solutions and technologies.

## Mission

To provide safe and integrated water treatment solutions and outstanding customer care in order to secure long-term relationships.



## Offices and plants

**Headquarters**
Quebec City, Quebec

**Manufacturing Plants**
Ham-Nord, Quebec
Minneapolis, MN
Vista, CA

**Engineering & Sales Offices**
Burlington, Ontario
Calgary, Alberta
Bilbao, Spain
Gulfport, MS

**Partner in Mexico**
$H_2O$ Innovacion de Mexico, S.A. de C.V.

## IN NUMBERS…

- A total of **555** employees throughout North America and Europe
- More than **700** installed water treatment systems
- Exports its specialty products (chemicals, couplings and filter housings) in more than **40** countries
- Operates **44** water and/or wastewater treatment plants in **7** states
- Acquired and integrated **10** companies since its inception
- Reached **17th** position in the top 20 of EPC (Engineering, Procurement, and Construction) worldwide – IDA.
- More than **50%** of very large desalination plants worldwide are using Piedmont's couplings
- Worked on the **World's largest** water reuse treatment system ever installed, Orange County, CA, **70** MGD (264,978 $m^3$/day), serving **2,400,000**-habitant
- Completed our **largest** UF system using our open-platform FiberFlex™ – Clifton Water District, CO, **12** MGD (45,400 $m^3$/day), serving a **40,000**-habitant
- Launch of the **first** open-platform flexMBR™ for wastewater in 2016
- Awarded the **Water Technology Company of the Year** in 2016 by Global Water Intelligence (GWI)

# VALUE CREATION FOR CUSTOMERS

## Our Three Business Pillars

### Water and Wastewater Treatment Projects ("Projects")

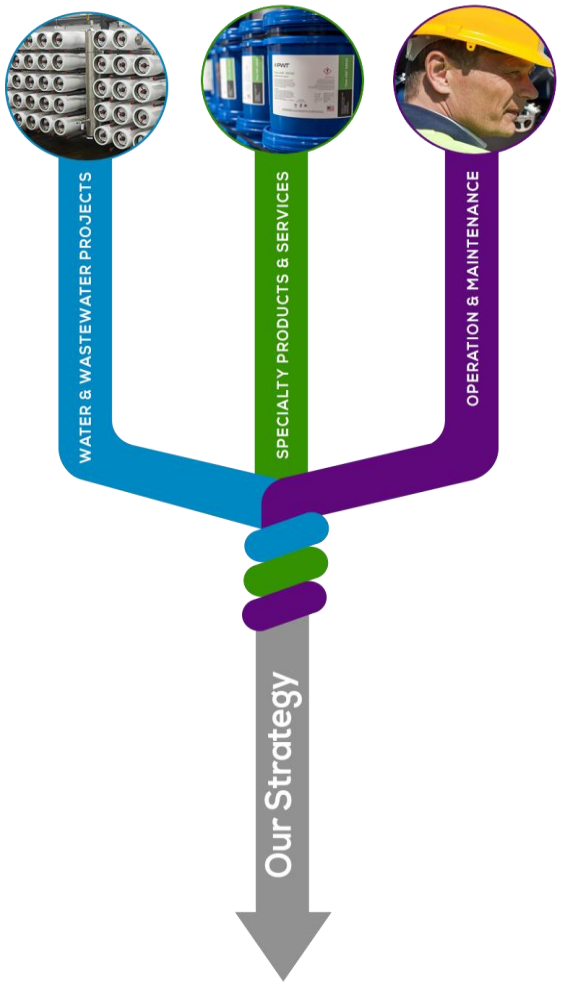
$H_2O$ Innovation designs and provides custom-built and integrated water treatment solutions based on membrane filtration technology for municipal, industrial, energy and natural resources end-users.

### Specialty Products and Services ("SP&S")

$H_2O$ Innovation offers a complete line of maple equipment and products, specialty chemicals, consumables, specialized products (couplings and cartridge filters) for the water treatment industry as well as digital solutions to monitor and optimize a water treatment plants.

### Operation and Maintenance Services ("O&M")

$H_2O$ Innovation operates, maintains, and repairs water and wastewater treatment systems, distribution equipment and associated assets for all of its clients and ensures that water quality meets regulatory requirements.




### Our Synergies

Use our in depth expertise in designing and manufacturing water treatment plants to develop optimal specialty products and assist customers in the operation and maintenance of their water and/or wastewater assets as well as other public infrastructure.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE FINANCIAL SITUATION

$H_2O$ Innovation Inc.'s (the "Corporation" or "$H_2O$ Innovation") President and Chief Executive Officer and Chief Financial Officer have signed a statement of management's responsibility regarding financial information included in this Annual Report. The statement also explains the roles of the Audit Committee and the Board of Directors in respect of financial information included in the Annual Report. This Management's Discussion and Analysis ("MD&A") reviews $H_2O$ Innovation's operating results and financial condition for the years ended June 30, 2017 and 2016. The MD&A should be read in conjunction with the consolidated financial statements for the year ended June 30, 2017 and with the accompanying notes.

Certain statements set forth in this MD&A regarding the operations and the activities of $H_2O$ Innovation as well as other communications by the Corporation 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 the words such as "anticipate", "if", "believe", "continue", "could", "estimate", "expect", "intend", "may", "plan", "potential", "predict", "project", "should" or "will" and other similar terms as well as those usually used in the future and the conditional, notably regarding certain assumptions as to the success of a venture. Those forward-looking statements involve a number of risks and uncertainties, which may result in actual and future results of the Corporation to be materially different than those indicated. Information about the risk factors to which the Corporation is exposed is provided in the Annual Information Form dated September 26, 2017 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 MD&A or in other communications as a result of new information, future events and other changes.

Unless otherwise indicated, all figures in the present report are expressed in Canadian dollars and come from the financial statements prepared in accordance with International Financial Reporting Standards ("IFRS").

## NON-IFRS FINANCIAL MEASUREMENT

In this MD&A, the Corporation's management uses measurements that are not in accordance with IFRS. The measurements "Adjusted earnings before interest, tax depreciation and amortization (adjusted EBITDA)" and "Net debt" are not defined by IFRS and cannot be formally presented in consolidated financial statements. These non-IFRS measures are presented as additional information and should be used in conjunction with the IFRS financial measurements presented in this report.

The definition of adjusted EBITDA does not take into account the Corporation's gain on purchase price adjustment and acquisition and integration costs. These items are non-recurring in nature and management believes that it allows a better comparison of the Corporation's historical data as well as comparison with the information presented by competitors. The adjusted EBITDA also excludes other expenses otherwise considered in net earnings according to Generally Accepted Accounting Principles ("GAAP"), namely the unrealized exchange (gain) loss and the stock-based compensation. These items are non-cash items and do not have an impact on the operating and financial performance of the Corporation. The reader can establish the link between adjusted EBITDA and net (loss) earnings based on the reconciliation presented on the next page. The definition of adjusted EBITDA used by the Corporation may differ from those used by other companies.

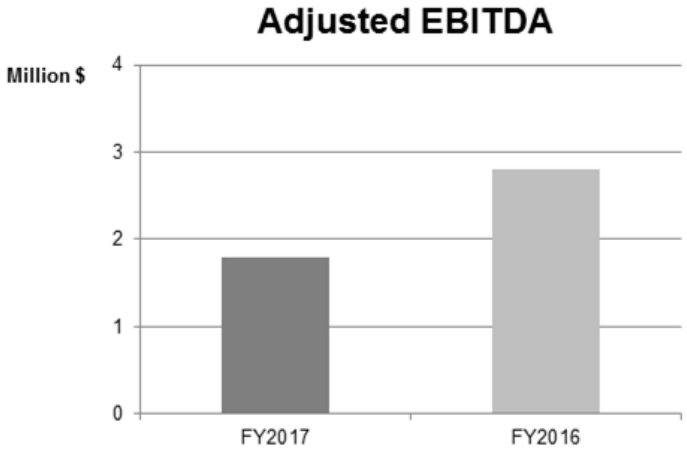
Even though adjusted EBITDA is a non-IFRS measure, it is used by management to make operational and strategic decisions. Providing this information to the stakeholders, in addition to the GAAP measures, allows them to see the Corporation's results through the eyes of management, and to better understand the financial performance, notwithstanding the impact of GAAP measures.

## RECONCILIATION OF AJDUSTED EBITDA TO NET EARNINGS

for the years ended June 30, 2017 and 2016

### Adjusted EBITDA

| Years ended June 30, | 2017 | 2016 (adjusted) |
|---|---|---|
| | $ | $ |
| Net (loss) earnings for the year | **(5,130,986)** | 158,969 |
| Finance costs – net | **1,296,511** | 753,983 |
| Income taxes | **(654,351)** | 678,062 |
| Depreciation of property, plant and equipment | **1,336,729** | 621,057 |
| Amortization of intangible assets | **3,208,599** | 1,059,044 |
| Gain on purchase price adjustment | **-** | (375,977) |
| Gain on settlement for fixed asset damaged | **(265,000)** | - |
| Unrealized exchange (gains) / losses | **14,183** | (78,315) |
| Acquisition costs | **1,066,696** | 58,106 |
| Stock-based compensation costs | **627,526** | - |
| Severances | **329,984** | - |
| **Adjusted EBITDA** | **1,829,891** | 2,874,929 |




- Adjusted EBITDA decreased, from $2.9 M to $1.8 M during fiscal year 2017;
- The ratio of adjusted EBITDA over revenues is at 2.2%, down from 5.7% for fiscal year 2016;

# FINANCIAL HIGHLIGHTS

for the year ended June 30, 2017

**$82.8 M**
↑ 63.3 % from 2016
**Revenues**

- Utility Partners' acquisition, establishing the 3rd business pillar;
- Delays in water treatment project execution;
- Continuous organic growth of the SP&S business pillar through product innovation and sales expansion.

**$62.7 M**
from $27.7 M in 2016
**Recurring revenue**

- From SP&S and O&M business pillars.

**$109.0 M**
from $38.8 M in FY2016
**Consolidated backlog**

- Coming from Projects and O&M business pillars, providing visibility on next fiscal year:
  - $53.9 M in Projects backlog;
  - $55.1 M in O&M backlog.

**$19.2 M**
from $15.5 M in FY2016
**Gross Profit Margin**

- Shift in business and product mix impacting the gross margin.

**$1.8 M**
↓ 35.2 % from 2016
**Adjusted EBITDA**

- Lower volume of executed projects;
- Lower margin in Projects, compared to previous fiscal year;
- Equivalent fixed costs (SG&A) from previous fiscal year.

**($5.1 M)**
from $158,969 in FY2016
**Net loss**

- Acquisition and integration fees for Utility Partners;
- Delays in project execution (lower volume than anticipated);
- Interest on long-term debt and amortization due to Utility Partners' acquisition.

**$1.8 M**
↓ 31.2 % from 2016
**Cash flows from operating activities**

- Positive impact of Utility Partners' working capital items;
- Higher volume of activities toward year-end;
- Negative impact from the net loss.

## ACQUISITION OF UTILITY PARTNERS, LLC

On July 26, 2016, the Corporation entered into a share purchase agreement providing for the acquisition of all of the memberships interests of Utility Partners, LLC ("Utility Partners"), a US-based company specializing in the operation and maintenance of water and wastewater treatment plants (the "acquisition").

Utility Partners provides US government, industrial and municipal clients with innovative and cost-effective solutions for water and wastewater treatment plants and systems. At the closing date of the acquisition, it operated thirty-four plants in six US states, mainly on the US Gulf coast, Southeast, Northeast (New England) and the West Coast (California and Nevada).

$H_2O$ Innovation acquired Utility Partners for an initial purchase price of $22,421,300 (US$17.0 M). The purchase price was subject to customary working capital adjustments as of the closing date. The working capital adjustments were established and agreed upon by both parties at $1,070,018 (US$0.8 M) on December 9, 2016 and were entirely paid as at June 30, 2017. The total purchase price consideration amounted to $23,491,318 (US$17.8 M).

The Corporation financed the acquisition with an equity financing, by way of a bought deal private placement and a concurrent additional non-brokered private placement of Corporation's Common shares at a price of $1.20 per common share for total gross proceeds of $23,061,196.

In addition, $H_2O$ Innovation contracted $10.0 M in credit facilities, which was used, in part, to fund ancillary costs, working capital post acquisition purpose and to support research and innovation initiatives.

This acquisition complements the venture that was started during fiscal year 2015 in leasing and operating and maintenance of water treatment systems. Utility Partners had entered into long-term contracts, mainly with municipalities, that contain multi-year renewal options. It solidifies the Corporation's business model by adding recurring sales coming from O&M activities, which are very predictable, and therefore counterbalance the lumpiness of revenues coming from sales of Projects business pillar.

## RESULTS OF OPERATIONS

For the years ended June 30, 2017 and 2016

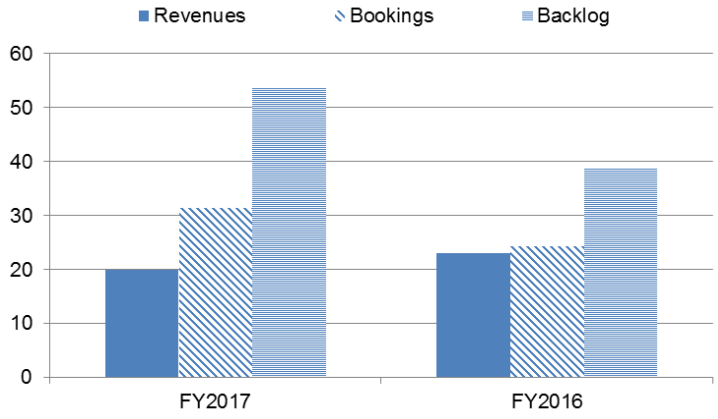
The following paragraphs highlight certain information regarding our operations for the fiscal years ended June 30, 2017 and June 30, 2016. During fiscal year 2017, the Corporation has completed the evaluation of the fair value of the assets acquired for the acquisition of Clearlogx. As a result, the consolidated statement of financial position as at June 30, 2016 and consolidated statements of (loss) earnings for the year ended June 30, 2016 were adjusted to reflect the related impacts on financial results previously reported.

Revenues for fiscal year 2017 totaled $82.8 M, representing a $32.1 M or 63.3% increase, as compared with revenues of $50.7 M for fiscal year 2016. This year's growth is mainly fueled by the acquisition of Utility Partners on July 26, 2016, which impacted the revenues by adding $33.2 M in recurring revenues, for a period of 11 months, and the organic growth of the Corporation's SP&S business pillar. The significant increase of revenues due to Utility Partners' acquisition was subdued by uncontrollable delays in Projects schedule.

| **Years ended June 30** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Revenues | **82,764,508** | 50,667,691 |
| Gross profit before depreciation and amortization | **19,157,380** | 15,542,431 |
| Gross profit before depreciation and amortization | **23.1%** | 30.7% |
| Operating expenses | **1,916,001** | 1,435,187 |
| Selling expenses | **7,165,499** | 6,341,175 |
| Administrative expenses | **9,167,360** | 4,813,709 |
| Research and development expenses – net | **152,949** | 198,004 |
| Net (loss) earnings | **(5,130,986)** | 158,969 |
| Basic and diluted (loss) earnings per share | **(0.133)** | 0.008 |
| Adjusted EBITDA[(a)] | **1,829,891** | 2,874,929 |
| Adjusted EBITDA over revenues (%) | **2.2%** | 5.7% |

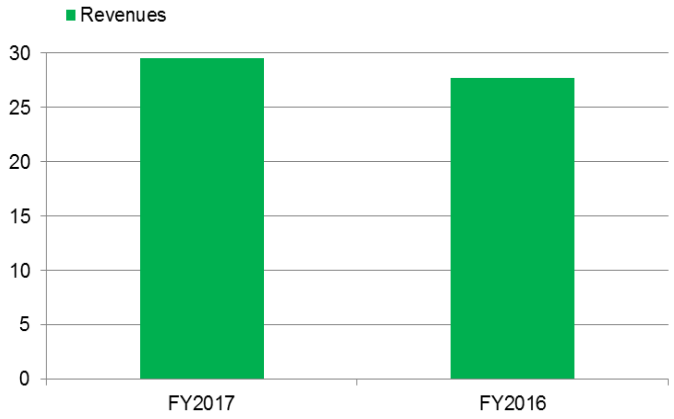
[(a)] See section on "Non-IFRS Financial Measurement".

### Projects Business Pillar



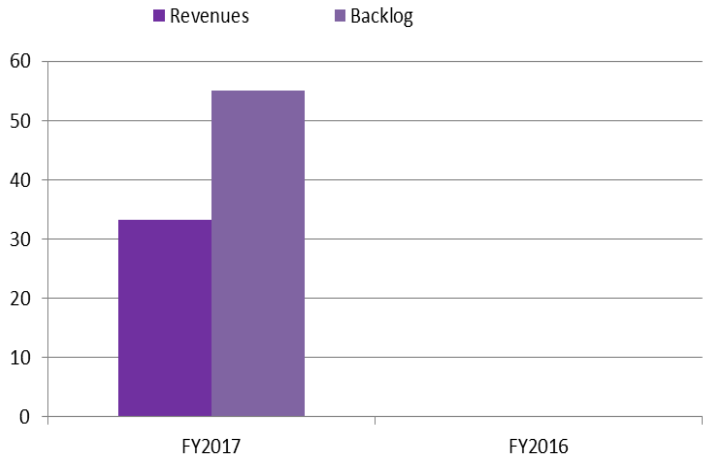

- Projects revenues stood at $20.0 M compared with $23.0 M in fiscal year 2016, representing a 12.7% decrease;
- Projects' schedule postponed due to situations out of the control of the Corporation, resulting in delays of revenue recognition;
- Current pipeline of Projects remains very rich in opportunities, supported by a $53.9 M projects backlog, as of June 30, 2017;
- Launch of the flexMBR™ during the first quarter of fiscal year 2017 which allowed to significantly increase our presence in the wastewater market with bookings of $13.0 M, up from $0.7 M in fiscal year 2016;
- Shift in the nature of our water treatment projects: more municipal projects characterized by a more extensive engineering phase, spreading the revenue recognition over a longer period.

## SP&S Business Pillar




- 6.4% increase, from $27.7 M to $29.5 M;
- Sales record year of our business line dedicated to maple products;
- Investments made in the operating and selling functions to support and fuel the growth of this business line;
- Developed, launched, improved and/or acquired new proprietary technologies such as: High Brix™, Smartrek™, Clearlogx® and Intelogx™, which boosted revenues up.
- Commercialisation of the new fiberglass reinforced polyester ("FRP") cartridge filter housing product line.

## O&M Business Pillar



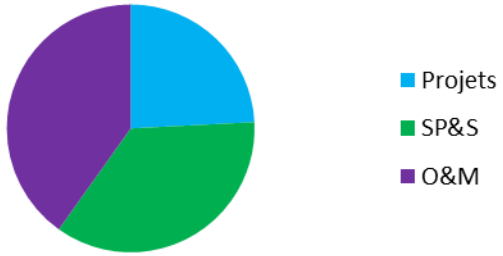

- Acquisition and successful integration of Utility Partners during fiscal year 2017;
- Recurring revenues of $33.2 M for the 11-month period during FY 2017;
- Successful renewal of all contracts expiring during the fiscal year 2017, for an additional backlog value of $16.4 M;
- Signature of $3.4 M in new O&M and public works contracts;
- Cross selling opportunities of $1.2 M were secured within the first 11-month following the acquisition of Utility Partners;
- Backlog for O&M business line stands at $55.1 M as at June 30, 2017, and consists of long-term contracts, mainly with municipalities, which contain multi-year renewal options.

### Bookings and Revenues on a Quarterly Basis

| | FY2017 | | | | | FY2016 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Q1** | **Q2** | **Q3** | **Q4** | **Total** | **Q1** | **Q2** | **Q3** | **Q4** | **Total** |
| Revenues from Projects business pillar[1] | **$5.4 M** | **$3.4 M** | **$4.0 M** | **$7.2 M** | $20.0 M | $7.2 M | $5.9 M | $4.8 M | $5.1 M | $23.0 M |
| Revenues from SP&S business pillar | **$5.9 M** | **$7.7 M** | **$8.6 M** | **$7.3 M** | $29.5 M | $5.1 M | $7.3M | $9.4 M | $5.9 M | $27.7 M |
| Revenues from O&M business pillar | **$6.2 M** | **$8.8 M** | **$8.7 M** | **$9.6 M** | $33.2 M[2] | --- | --- | --- | --- | --- |
| **Total revenues** | **$17.5 M** | **$19.9 M** | **$21.3 M** | **$24.1 M** | $82.8 M | $12.3 M | $13.2 M | $14.2 M | $11.0 M | $50.7 M |

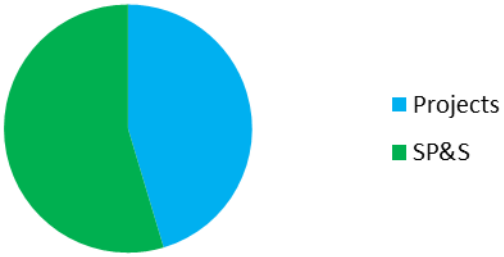
(1) Revenues from Projects vary from quarter to quarter and depend on the different milestones reached for revenues recognition.
(2) During the year-end audit, the acquisition of Utility Partners has been considered effective as of July 26, 2016 (instead of July 1, 2016). Therefore, the revenues of the first quarter of FY2017 have been adjusted accordingly and only 11 months of Utility Partners' operations are recorded in revenues. Would the effective date of the transaction has been July 1, 2016, the total revenue of the Corporation for fiscal year 2017 would have been $85.1 M.

**FY2017 - Revenues**




**$82.8 M**

**FY2016 - Revenues**




**$50.7 M**

The business model is shaping up, and the Corporation is able to identify the benefits of it through its three (3) business pillars. Within the first 11-month following the acquisition of UP, $H_2O$ Innovation has captured multiple cross-selling opportunities between O&M and SP&S business pillars, generated by Utility Partners' existing contracts. The Corporation, through Utility Partners, has secured new O&M projects, using the support of the Projects and SP&S resources. Utility Partners can now be considered fully integrated within $H_2O$ Innovation. With three strong business pillars, the Corporation is very well balanced and not dependant on a single source of revenues. As revenues coming from the SP&S and O&M business pillars are recurring in nature, the strategy to grow these two business pillars is proven to be efficient since it minimizes the impact of revenue volatility associated with the Projects business pillar and thus increase predictability in the Corporation's business model. The SP&S and O&M activities also reinforce long-term relationships with Projects customers. The Corporation has a platform to capture cross-selling opportunities, where one pillar will feed the others. All together, these three business pillars provide a unique and accountable business model to better serve the Design-Build-Operate ("DBO") opportunities, a fast growing segment in the water industry.

## EXPENSES

For the years ended June 30, 2017 and 2016

| | FY2017[3] | FY2016[3] | Variance | Significant contributions to variance |
|---|---|---|---|---|
| **Gross Profit Margin** | **$19.2 M**<br>23.1% | **$15.5 M**<br>30.7% | **+ $3.8 M** | The 7.4% decrease in gross profit margin over revenues is explained by the revenue mix, which has been modified with the acquisition of Utility Partners. Utility Partners operates in a different model than the other Corporation's core activities. Indeed, O&M activities generally generates lower gross margin. Therefore, the integration of Utility Partners into $H_2O$ Innovation, which, in fiscal year 2017, represents 40.1% of the total revenues, puts pressure on the overall gross margin of the Corporation, although increasing the predictability and stability of the financial results. |
| **Operating Expenses** | **$1.9 M**<br>2.3% | **$1.4 M**<br>2.8% | **+ $0.5 M** | This increase of 33.5% is due to hirings for the development of new products and investments to improve our logistics and supply chain activities related to SP&S business line. |
| **Selling Expenses** | **$7.2 M**<br>8.4% | **$6.3 M**<br>12.5% | **+ $0.3 M** | Selling expenses are linked to bookings and revenues, but do not fluctuate proportionally. The 13.0% increase of the selling expenses is mostly due to the participation to tradeshows and to the sales commissions recorded in regards to sales target reached in the SP&S business line. The Corporation has continued to invest in the commercialisation of the new FRP cartridge filter housing product line, which explains part of the increase of the selling expenses. |
| **Administrative Expenses** | **$9.2 M**<br>11.1% | **$4.8 M**<br>9.5% | **+ $4.5 M** | The significant increase of 90.4% in administrative expenses is due to the acquisition of Utility Partners and the integration of employees, the increase in salaries and fringe benefits, the stock based compensation expense and the addition of personnel to support our overall operations. |
| **SG&A[1]** | **$18.2 M**<br>22.0% | **$12.6 M**<br>24.8% | **+ $5.8 M** | This decrease in percentage of SG&A over revenues is mostly attributable to the acquisition of Utility Partners on July 26, 2016 which increased the overall revenues without impacting proportionally the selling and operating expenses. |
| **R&D[2]** | **$152,949**<br>0.2% | **$198,004**<br>0.4% | **- $45,055** | For the year ended June 30, 2017, the Corporation has not recorded tax credits from the Canadian and provincial governments for eligible research and development initiatives conducted in Canada. |

(1) Selling, General & Administrative Expenses (SG&A) represent the total of the operating, selling and administrative expenses described in the table above.
(2) Research and Development.
(3) Percentage (%) of expenses over revenues.

### Other gains – net

Other gains – net amounted to $367,627 for the year ended June 30, 2017 compared with $516,759 for the year ended June 30, 2016. This is mostly due to a gain of $265,000 during the year ended June 30, 2017, on an agreement reached with one of our client, following damages done to an asset used by that same client.

Other gains – net also include unrealized exchange loss of $14,183 for the year ended June 30, 2017 compared to a gain of $78,315 for the year ended June 30, 2016. Realized exchange gains amounted to $57,809 for the year ended June 30, 2017 compared to a gain of $33,282 for the year ended June 30, 2016.

### Finance costs – net

Finance costs – net totalled $1.3 M for the year ended June 30, 2017 compared with $0.8 M for the previous fiscal year. Of this amount, $42,621 represents the theoretical and non-monetary part of interest on long-term debt. The significant increase is attributable to the increase of the Corporation's long-term debt. Also, in order to mitigate its credit risk and mainly increase its bank loans usage capacity, the Corporation insures a part of its accounts receivable through the insurance coverage of Exportation and Development Canada ("EDC"). The Corporation has given direction to pay all insurance proceeds to the bank. The insurance premiums are recorded in finance costs.

### Net (loss) earnings

The net (loss) earnings amounted to ($5.1 M) or ($0.133) per share for fiscal year 2017 compared with earnings of $0.2 M or $0.008 per share for fiscal year 2016. The net loss is mostly caused by delays in project revenue recognition and by the acquisition and integration costs related to the acquisition of Utility Partners, and to a higher level of SG&A expenses, aimed to support the constant growth of the Corporation.

### Commitments

The Corporation has entered into long-term lease agreements expiring between 2018 and 2024 which call for lease payments of $7,765,576 for the rental of space and supply agreements. The minimum annual payments over the next five years are $1,823,365 in 2018, $1,825,455 in 2019, $1,267,393 in 2020, $1,156,855 in 2021 and $1,103,170 in 2022.

### Information on share capital

As at September 28, 2017, the Corporation had 40,144,214 outstanding common shares and 2,565,334 stock options.

## FINANCIAL SITUATION

Working capital increased from $8.4 M as at June 30, 2016 (current ratio of 1.55) to $9.0 M as at June 30, 2017 (current ratio of 1.42). The increase is attributable to the $0.8 M, $3.0 M, $0.5 M, $2.0 M, $0.5 M, $5.7 M, $0.3 M and $1.3 M increase in cash and cash equivalents, accounts receivable, inventories, costs incurred in excess of billings, prepaid expenses, accounts payable and accrued liabilities, billing in excess of costs incurred and current portion of long-term debt respectively, and the decrease of $0.3 M and $0.9 M in bank overdraft and bank loans.

Over the year, the net debt[(1)] increased substantially to $12.6 M as at June 30, 2017, from $6.3 M as at June 30, 2016. This increase is mainly attributable to the increase of the bank loans to finance the acquisition of Utility Partners, but subdued by the reimbursement of the long-term debt and the cash left to support the Corporation's working capital activities.

Equity stood at $43.3 M as at June 30, 2017, compared with $26.6 M as at June 30, 2016. As at June 30, 2017, the net debt equity ratio was 0.29 whereas it was 0.24 as at June 30, 2016, showing that the Corporation is not over leveraged and has maintained its overall financial situation.

| **Years ended June 30,**<br>(in Canadian dollars, except for ratio) | **2017** | **2016** |
|---|---|---|
| | **$** | $ |
| Working capital | **9,047,214** | 8,364,151 |
| Working capital ratio | **1.42** | 1.55 |
| Net debt[(1)] | **12,591,229** | 6,278,343 |
| Equity | **43,302,883** | 26,594,178 |
| Net debt to equity ratio | **0.29** | 0.24 |

[(1)] Net debt comprises bank overdraft, bank loans and long-term debt, net of cash and cash equivalents.

As at June 30, 2017 accounts receivable stood at $13.2 M compared with $10.2 M as at June 30, 2016. The increase of $3.0 M is partly attributable to the acquisition of Utility Partners, as well as the increase of revenues from SP&S, the maple division presenting its record year.

Inventories increased by $0.5 M to $4.9 M as at June 30, 2017 from $4.4 M as at June 30, 2016, to meet the increasing demand of maple activities, for which we need to maintain a higher level of inventories to meet the sales record. In addition, finished goods have also increased due to the manufacturing of specialty chemicals to build a higher level of inventories to better respond to demand from customers and expedite deliveries.

Costs incurred in excess of billings increased by $2.0 M to $5.6 M as at June 30, 2017 from $3.5 M as at June 30, 2016, even though they are subject to differences between project advancement and project invoicing schedules from one project to the other. Billings in excess of costs incurred increased by $0.3 M to $1.2 M as at June 30, 2017, from $0.9 M as at June 30, 2016. This decrease is also attributable to differences between project advancement and project invoicing schedules.

Accounts payable and accrued liabilities increased by $5.7 M to $12.7 M as at June 30, 2017, from $7.0 M as at June 30, 2016. The increase of accounts payable and accrued liabilities is partly due to the acquisition of Utility Partners and to an increased volume of activities for Projects which have reached, for many of them, the manufacturing stage during which equipment is being assembled and for which suppliers are involved.

The increase in the long-term debt is explained by the long-term debt of $10.0 M contracted to finance the acquisition of Utility Partners, subdued by repayments amounting to $1.8 M during fiscal year 2017.

For the year ended June 30, 2017, shareholders' equity increased by $16.7 M to $43.3 M ($26.6 M as at June 30, 2016). The elements impacting the shareholders' equity in the fiscal year 2017 are: 1) the $21.6 M increase in share capital due to the issuance of shares; 2) the $5.1 M net loss for the year ended June 30, 2017 and; 3) the Canadian dollar's depreciation generating an unrealized exchange loss of $0.4 M resulting from the translation of foreign operations, mainly those of the U.S. subsidiaries.

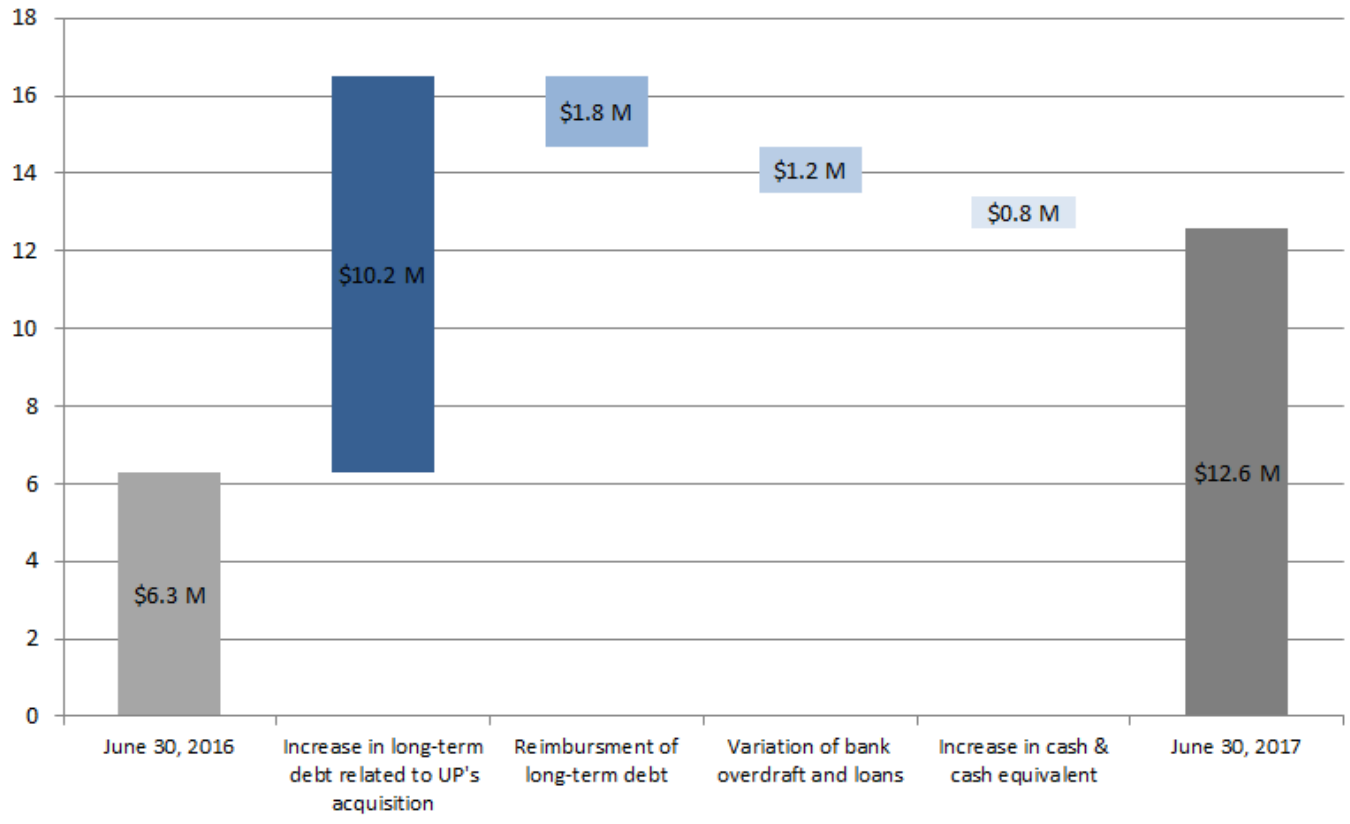
### Net Debt

The definition of net debt consists of bank overdraft, bank loans and long-term debt less cash and cash equivalents. The reader can establish the link between net debt and debt. The definition of net debt used by the Corporation may differ from those used by other companies.

Even though net debt is a non-IFRS measure, it is used by management, analysts, investors and other financial stakeholders to assess the Corporation's capital management.

| **Years ended June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Bank overdraft | **184,120** | 520,208 |
| Bank loans | **5,092,607** | 5,962,750 |
| Current portion of long-term debt | **2,036,151** | 721,973 |
| Long-term debt | **9,148,953** | 2,125,282 |
| Less: Cash and cash equivalents | **(3,870,603)** | (3,051,870) |
| **Net debt** | **12,591,228** | 6,278,343 |

### Movement in Net Debt




## OFF-BALANCE SHEET ARRANGEMENTS

As at June 30, 2017, the Corporation had off-balance sheet arrangements consisting of letters of credit amounting to $1.3 M which expire at various dates through fiscal year 2022. In these letters of credit, $1.1 M is secured by deposit certificates.

## CAPITAL MANAGEMENT

The Corporation's objective in managing capital is to ensure sufficient liquidity to pursue its growth while at the same time taking a prudent approach towards financial leverage and risks.

The Corporation's capital is composed of net debt and shareholders' equity. Net debt consists of interest-bearing debt less cash. The Corporation's primary uses of capital are to finance increases in non-cash working capital and capital expenditures for capacity expansion and integration.

The Corporation monitors its performance through different ratios such as those required under its credit facility and long-term debt arrangements.

Credit facility and long-term debt arrangements require that the Corporation meet certain financial ratios at fixed points in time. The financial ratios are, as at June 30, 2017:

- Working capital ratio, defined as current assets divided by current liabilities, greater than or equal to 1.25:1.00;
- Debt-to-equity ratio, defined as total debt excluding deferred taxes divided by equity, less than or equal to 2.75:1.00; and
- Fixed charge coverage ratio, including all capital and interest payments on borrowings due and capital expenditures, as defined, greater than or equal to 1.00:1.00.

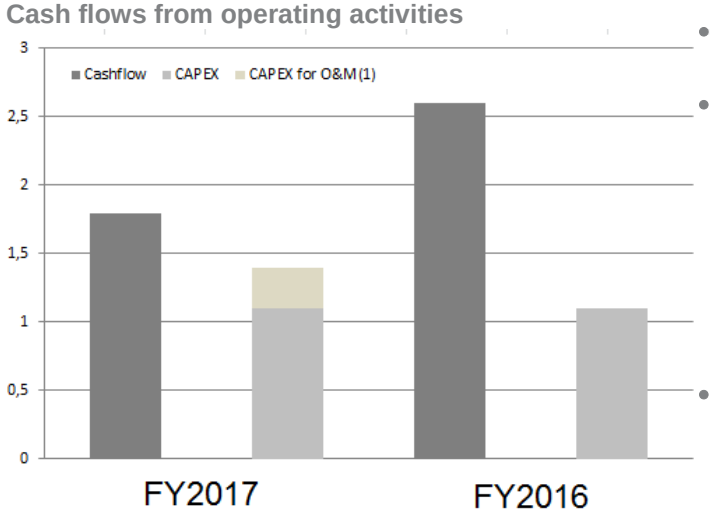
As at June 30, 2017 and June 30, 2016, the Corporation was in compliance with the ratios required under its credit facility and long-term debt arrangements, except for the fixed charge coverage for which it received a waiver from the lender.

## CASH FLOWS AND CAPITAL EXPENDITURE

A comparison of the Corporation's cash flows for the years ended June 30, 2017 and June 30, 2016 is presented below:

| Years ended June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Cash flows from operating activities | **1,807,278** | 2,628,441 |
| Cash flows from investing activities | **(28,096,853)** | (3,916,882) |
| Cash flows from financing activities | **27,725,343** | 2,604,085 |
| Effect of exchange rate changes on the balance of cash held in foreign currencies | **(280,947)** | (117,817) |
| Net change | **1,154,821** | 1,197,827 |
| Cash and cash equivalents – Beginning of year | **2,531,662** | 1,333,835 |
| Cash and cash equivalents – End of year | **3,686,483** | 2,531,662 |

### Cash flows from operating activities




- Impact of the net loss of $5.1 M compared to net earnings of $0.2 M for the previous fiscal year;
- Impact of net loss subdued by the increase of depreciation and amortization due to the acquisition of Utility Partners compared to fiscal year 2016 but also to a positive change in working capital items, such as:
  - Higher volume of activities toward year-end;
  - A timing difference within the projects production phases affecting the invoicing milestones reached;
  - Positive impact of Utility Partners' working capital items.
- Total investment of $1.4 M in property, plant and equipment, of which $0.2 M was made for direct support of O&M specific plants.

(1) Capital expenditure affected to O&M specific plants.

### Cash flows from investing activities

For fiscal year 2017, investing activities used net cash of ($28.1 M), mainly attributable to payments related to the acquisition of Utility Partners and the contingent consideration for the acquisition of Clearlogx, for an aggregate amount of $24,102,288, and to a lesser extent to investments in property, plant and equipment of $1.4 M and intangible assets of $1.0 M.

### Cash flows from financing activities

Financing activities generated net cash of $27.7 M in fiscal year 2017 compared with $2.6 M of net cash generated during the corresponding fiscal year. The increase is mostly due to the issuance of common shares related to the bought deal private placement, and non-brokered private placement for the acquisition of Utility Partners, for an aggregate amount of $23.1 M. The Corporation also contracted $10.0 M of long-term debt for the acquisition of Utility Partners, reimbursed $1.8 M of long-term debt and decreased its bank loans by $0.8 M. Interest paid during fiscal year 2017 amounted to $1.2 M.

## QUARTERLY RESULTS (UNAUDITED)

| Fourth quarters ended June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Revenues | **24,037,884** | 11,042,913 |
| Gross profit before depreciation and amortization | **4,971,074** | 3,688,703 |
| Gross profit before depreciation and amortization | **20.7%** | 33.4% |
| Net loss | **(1,742,862)** | (714,003) |
| Basic and diluted loss per share | **(0.045)** | (0.034) |
| Adjusted EBITDA | **(20,486)** | 157,330 |

Revenues for the fourth quarter were up by 117.7% to $24.0 M from $11.0 M for the same quarter of the previous fiscal year. The increase is explained by the addition of Utility Partners' revenues, following the acquisition on July 26, 2016.

For the quarter ended June 30, 2017, the gross profit before depreciation and amortization decreased to 20.7%, from 33.4% for the same quarter of the previous fiscal year. This is mostly due to a shift in the business mix during fiscal year 2017, where SP&S and O&M revenues exceeded 65% of the total revenues, adding downwards pressure on the gross margin, although increasing the predictability and stability of the financial results.

The fourth quarter SG&A expenses were higher than during the first three quarters of fiscal year 2017. They stand at $5.5 M in this current quarter compared to $3.4 M in the fourth quarter of fiscal year 2016. The significant increase in SG&A expenses is due to the acquisition of Utility Partners and the integration of their employees, the increase in salaries and fringe benefits, to the stock-based compensation expense and to the addition of personnel to support our overall operations. The fourth quarter SG&A expenses were also impacted by a one-time expense of approximately $0.3 M for the payment of severances following notably the right-sizing of the Projects business pillar.

The fourth quarter's net loss is caused by the increase of the SG&A expenses explained in the previous paragraph.

### Quarterly Summary Financial Information (unaudited)

| | Three-month periods ended | | | | Year ended |
|---|---|---|---|---|---|
| | June 30, 2017 | March 31, 2017 | December 31, 2016 | September 30, 2016 | June 30, 2017 |
| | $ | $ | $ | $ | $ |
| Revenues | 24,037,884 | 21,284,643 | 19,957,831 | 17,484,150 | **82,764,508** |
| Adjusted EBITDA | (20,486) | 411,737 | 809,625 | 629,015 | **1,829,891** |
| Adjusted EBITDA over revenues | (0.08%) | 1.9% | 4.1% | 3.6% | **2.2%** |
| Net (loss) | (1,742,862) | (1,345,695) | (1,093,270) | (949,159) | **(5,130,986)** |
| EPS basic and diluted | (0.045) | (0.034) | (0.027) | (0.027) | **(0.133)** |
| Cash flows from operating activities | 3,521,086 | (1,135,127) | 1,083,117 | (1,661,798) | **1,807,278** |

| | Three-month periods ended | | | | Year ended |
|---|---|---|---|---|---|
| | June 30, 2016 | March 31, 2016 | December 31, 2015 | September 30, 2015 | June 30, 2016 |
| | $ | $ | $ | $ | $ |
| Revenues | 11,042,913 | 14,199,860 | 13,165,590 | 12,259,328 | **50,667,691** |
| Adjusted EBITDA | 157,330 | 1,245,324 | 1,030,502 | 441,773 | **2,874,929** |
| Adjusted EBITDA over revenues | 1.4% | 8.8% | 7.8% | 3.6% | **5.7%** |
| Net earnings (loss) | (714,003) | 646,422 | 174,221 | 52,329 | **158,969** |
| EPS basic and diluted | (0.034) | 0.031 | 0.008 | 0.003 | **0.008** |
| Cash flows from operating activities | 3,045,440 | (318,078) | 128,382 | (227,303) | **2,628,441** |

## ACCOUNTING POLICIES

### 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 Corporation'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 Corporation's consolidated financial statements are prepared. Management reviews, on a regular basis, the Corporation'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 Corporation's consolidated financial statements.

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

*Impairment of goodwill and other non-current assets*
Goodwill is tested for impairment at least annually, and whenever there is an indication that the asset may be impaired. 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. If the discount rate had increased by 0.5% compared to the assumption taken by the Corporation, assuming other variables remain constant, the recoverable amount would have been lesser by approximately $2,600,000 (lesser by approximately $1,200,000 as at June 30, 2016) and impairment of $2,500,000 (nil as at June 30, 2016) would have been recorded. If the growth rate had decreased by 0.5% compared to the assumption taken by the Corporation, assuming other variables remain constant the recoverable amount would have been lesser by approximately $1,200,000 (lesser by approximately $600,000 as at June 30, 2016) and impairment of $1,100,000 (nil as at June 30, 2016) would have been recorded.

Other non-current depreciable assets are tested for impairment should events or circumstances indicate that their book value may not be recoverable, as measured by comparing their net book value to their recoverable amount, which correspond to the higher of fair value less costs to sell and its value in use. Should the carrying amount of other non-current assets exceed their recoverable amount, an impairment loss in the amount of the excess would be recognized.

*Income taxes measurement*
The estimation of income taxes includes evaluating the recoverability of deferred tax assets based on an assessment of the Corporation'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 Corporation's entities ability to utilize future tax deductions changes, the Corporation would be required to recognize more or fewer deferred tax assets, and future income tax provisions or recoveries could be affected.

*Slow moving and obsolete inventory*
The value of slow moving and obsolete inventory is based on the Corporation's assessment of historical usage, estimated future demand and in some cases, the specific risks of loss on specifically identified inventory. The write-down may be reversed if the circumstances which caused it no longer exist.

*Development Costs*
Development costs include expenditures to develop new products when the costs are attributable to a clearly defined product, technical feasibility has been established, a market has been identified, the Corporation intends to market the product, and the Corporation has adequate resources expected to be available to complete the project. Management is required to make judgements on when criteria for recognition as an asset is met. During the year ended June 30, 2017, $411,377 ($287,403 in fiscal year 2016) of development costs were recognized as intangible assets on the consolidated statements of financial position.

*Stock-based compensations and other stock-based payments*
As regards to stock option granted, the Corporation 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 Corporation's stock over the same period as the contractual life. At the end of each reporting period, the Corporation revises its estimate of the number of equity instruments expected to vest.

*Fair value of assets acquired in a business combination*
Under the acquisition method, on the date that control is obtained, the identifiable assets, liabilities and contingent liabilities of the acquired business are measured at their fair values. Depending on the complexity of determining the valuation for assets acquired, the Corporation uses appropriate valuation techniques in arriving at the estimated fair value at the acquisition date. These valuations are generally based on a forecast of the total expected future net discounted cash flows and relate closely to the assumptions made by management regarding the future performance of the related assets and the discount rate applied as it would be assumed by a market participant. Determination of the fair value of the acquired assets and liabilities requires judgment and the use of assumptions that, if changed, may affect the consolidated statements of earnings and consolidated statement of financial position.

*Definition of cash-generating units*
The Corporation assesses whether there are any indicators of impairment for all non-financial assets at the end of each financial reporting period. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). When it is not possible to estimate the recoverable amount of an individual asset, the Corporation estimates the recoverable amount of the cash-generating unit to which the asset belongs. Determination of cash-generating units is based on management's best estimate of what constitutes the lowest level at which an asset or group of assets is able to generate cash inflows. The Corporation must also determine whether goodwill can be attributed to one or more cash-generating units.

*Determination of the reportable segment*
Operating segments are determined according to the Corporation's management structure and internal information system. Operating results of each reportable segment are reviewed regularly by the Corporation's Chief Operating decision maker regarding the resources to be allocated to the segments and the assessment of their performance based on available financial information.

Management has identified one operating segment. The information structure indicates how management manages the Corporation and how it classifies its activities for planning and evaluating its performance. As a result, management manages its business line in one strategic business unit.

## Changes in accounting policies

There were no changes in accounting policies during the year ended June 30, 2017.

### Accounting standards and amendments issued but not yet adopted

The following revised standards are effective for annual periods beginning on or after January 1, 2018, for IFRS 9 and for IFRS 15, and January 1, 2019, for IFRS 16. The Corporation has not yet assessed the impact of these standard and amendment.

*Classification and Measurement of Financial Assets and Financial Liabilities*

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* with a single approach to determine whether a financial asset is measured at amortized cost, fair value through other comprehensive income or fair value through the statement of income (loss). IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through the statement of income (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 income (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.

*Revenue from Contracts with Customers*

In May 2014, the IASB released IFRS 15, *Revenue from Contracts with Customers*, which establishes principles for reporting the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. It provides a single model in order to depict the transfer of promised goods or services to customers. The core principle of IFRS 15 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods and services. IFRS 15 also requires more comprehensive disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers.

IFRS 15 supersedes IAS 11, *Construction Contracts*, IAS 18, *Revenue*, and a number of revenue-related interpretations (IFRIC 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreements for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers*, and SIC-31, *Revenue, Barter Transactions Involving Advertising Service*).

*Leases*

On January 13, 2016, the IASB issued IFRS 16, *Leases*, which provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. It supersedes IAS 17, *Leases* and its associated interpretive guidance. Significant changes were made to lessee accounting with the distinction between operating and finance leases removed and assets and liabilities recognized in respect of all leases (subject to limited exceptions for short-term leases and leases of low value assets). In contrast, IFRS 16 does not include significant changes to the requirements for lessors. IFRS 16 will be effective as of January 1st, 2019, with earlier application permitted for companies that have also adopted IFRS 15, *Revenues from Contracts with Customers.*

*Statement of Cash Flows*

In January 2016, the IASB issued amendments to IAS 7, *Statement of Cash Flows*. The amendments are intended to improve information provided to users of financial statements about an entity's financing activities. They are effective for annual periods beginning on or after January 1, 2017, with earlier adoption permitted. The Corporation is currently assessing the impact of these amendments on its consolidated financial statements.

*Income Taxes*

In January 2016, the IASB issued amendments to IAS 12, *Income taxes*, to clarify the requirements for recognizing deferred tax assets on unrealized losses. The amendments clarify the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. They also clarify certain other aspects of accounting for deferred tax assets. The amendments are effective for the year beginning on or after January 1, 2017, with earlier adoption permitted. The Corporation has not yet examined the impacts of these amendments on its consolidated financial statements.

*Share-based payment*

In June 2016, the IASB issued an amendment to IFRS 2, *Share-based payment*, clarifying the accounting for certain types of share-based payment transactions. The amendments provide requirements on accounting for the effects of vesting and non-vesting conditions of cash-settled share-based payments, withholding tax obligations for share-based payments with a net settlement feature, and when a modification to the terms of a share-based payment changes the classification of the transaction from cash-settled to equity-settled. The amendments are effective for the year beginning on or after January 1, 2018. The Corporation is currently assessing the impact of this amendment on its consolidated financial statements.

## FINANCIAL RISK MANAGEMENT AND FINANCIAL RISKS

The Corporation's activities expose it to a variety of financial risks: market risks (including currency risk, cash flow interest risk and fair value interest risk), credit risk and liquidity risk. The Corporation's overall financial risk management program focuses on mitigating unpredictable financial market risks and their potential adverse effects on the Corporation's financial performance.

The Corporation's financial risk management is generally carried out by the corporate team, based on policies approved by the Board of Directors. The identification and evaluation of the financial risks are the responsibility of the corporate team.

### Overview

The Corporation's financial instruments and the nature of risks which they may be subject to are set out in the following table:

| | Risks | | | |
|---|---|---|---|---|
| | Market risks | | | |
| **Financial instrument** | **Currency** | **Interest rate** | **Credit** | **Liquidity** |
| Cash and cash equivalents | X | X | X | |
| Guaranteed deposit certificates | | X | X | |
| Accounts receivable | X | | X | |
| Related party loans receivable | | X | X | |
| Other assets | | | X | |
| Bank overdraft | X | X | | X |
| Bank loans | X | X | | X |
| Accounts payable and other accrued liabilities | X | | | X |
| Long-term debt | X | X | | X |
| Contingent consideration | X | | | X |

### Currency risk

The Corporation 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 Corporation matches, in general and when possible, the cash receipts in a foreign currency with the cash disbursements in the same foreign currency. The Corporation does not use derivative financial instruments to cover the variability of cash flows in foreign currencies.

As at June 30, 2017, 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 year ended June 30, 2017 would have been greater or lesser by approximately $365,802 ($308,579 for the year ended June 30, 2016).

The financial assets and liabilities denominated in U.S. dollars included in the Canadian corporation are as follows:

| As at June 30, | 2017 | 2016 (adjusted) |
|---|---|---|
| | $ | $ |
| **FINANCIAL ASSETS** | | |
| Cash and cash equivalents | **484,530** | 377,128 |
| Accounts receivable | **621,266** | 801,278 |
| | **1,105,796** | 1,178,406 |
| **FINANCIAL LIABILITIES** | | |
| Bank overdraft | **(15,582)** | (97,941) |
| Bank loans | **(4,103,377)** | (4,603,019) |
| Accounts payable and accrued liabilities | **(2,572,604)** | (410,076) |
| Long-term debt | **(1,730,266)** | (2,238,946) |
| Contingent consideration | **-** | (874,596) |
| | **(8,421,829)** | (8,224,578) |

### Cash flow and fair value interest rate risk

In the normal course of business, the Corporation is exposed to interest rate fluctuation risk as a result of the cash and cash equivalents, related party loans receivable, bank overdraft, bank loans and long-term debt. The Corporation doesn't use derivatives to cover this risk.

The guaranteed deposit certificates and unsecured loans bear interest at fixed rates and are accounted for at amortized cost. The Corporation is, therefore, not exposed to the risk of cash flows, however is exposed to changes in fair value resulting from interest rate fluctuations.

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

As at June 30, 2017 and 2016, a 25-basis-point increase or decrease in interest rates, assuming that all other variables remained constant, would not have had a significant impact on the Corporation's net loss and comprehensive income. These changes were retained because they are considered reasonably possible according to observations and the economic situation.

### Credit risk

Credit risk relates to the risk that a party to a financial instrument will not fulfil some or all of its obligations, thereby causing the Corporation to sustain a financial loss. The main risk relates to accounts receivable. To manage credit risk from accounts receivable, the Corporation reviews credit limits, monitors aging of accounts receivable and establishes an allowance for doubtful accounts based on specific customer information and general historical trends. Trade receivables consist of a large number of customers, spread across diverse industries and geographical areas. Ongoing credit evaluation is performed on the financial condition of accounts receivable. As at June 30, 2017, the allowance for doubtful accounts was nil (nil as at June 30, 2016).

The carrying amount on the consolidated statement of financial position of the Corporation's financial assets exposed to credit risk represents the maximum amount exposed to credit risk.

The following table summarizes the Corporation's exposure to credit risk:

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Cash and cash equivalents | **3,870,603** | 3,051,870 |
| Guaranteed deposit certificates | **1,371,591** | 1,461,462 |
| Accounts receivable, net of tax credits receivable | **13,164,948** | 10,109,288 |
| Other Assets | **563,564** | 70,366 |
| Related party loans receivable | **1,250,000** | - |

The Corporation is also exposed to credit risk due to its cash and cash equivalents, its guaranteed deposit certificates and its related party loans receivable. The Corporation has $5,242,194 ($4,513,332 in 2016) in cash and cash equivalent and guaranteed deposits certificates with banking institutions and loans of $1,250,000 with related party, which are secured by a pledge of the acquired common shares that the Corporation considers at a low risk for loss.

The table below summarizes the ageing of trade accounts receivable as at:

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Current | **4,706,358** | 6,565,121 |
| Past due 1 to 30 days | **1,399,913** | 870,582 |
| Past due 31 to 90 days | **2,344,076** | 57,221 |
| Past due more than 90 days | **1,573,639** | 623,073 |
| | **10,023,986** | 8,115,997 |
| Less: Allowance for doubtful accounts | **-** | - |
| Trade accounts receivable | **10,023,986** | 8,115,997 |
| Retentions from customers under project contracts | **1,980,423** | 1,012,846 |
| Tax credits receivable | **45,527** | 83,395 |
| Other receivables | **1,135,896** | 980,445 |
| | **13,210,475** | 10,192,683 |

### Liquidity risk

Liquidity risk is the risk that the Corporation will be unable to fulfil its obligations on a timely basis or at reasonable cost. The Corporation manages its liquidity risk by monitoring its operating requirements and using various funding sources to ensure its financial flexibility. The Corporation prepares budgets and cash forecast to ensure that it has sufficient funds to fulfil its obligations.

For its investing activities, the Corporation will evaluate its liquidity needs when applicable and take the necessary action.

The following table presents the financial liability instalments payable when contractually due including accrued interest as at:

| As at June 30, 2017 | Carrying amount | 0 - 1 year | 1-2 years | 2-3 years | 4 years and more |
|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ |
| Bank overdraft | 184,120 | 184,120 | - | - | - |
| Bank loans | 5,092,607 | 5,092,607 | - | - | - |
| Accounts payable and accrued liabilities | 12,683,815 | 12,683,815 | - | - | - |
| Long-term debt | 13,052,941 | 2,617,460 | 2,469,857 | 2,369,485 | 5,596,139 |
| Contingent consideration | 232,683 | - | 232,683 | - | - |
| **Total** | **31,246,166** | **20,578,002** | **2,702,540** | **2,369,485** | **5,596,139** |

| As at June 30, 2016 | Carrying amount | 0 - 1 year | 1 - 2 years | 2 - 3 years | 4 years and more |
|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ |
| Bank overdraft | 520,208 | 520,208 | - | - | - |
| Bank loans | 5,962,750 | 5,962,750 | - | - | - |
| Accounts payable and accrued liabilities | 6,999,829 | 6,999,829 | - | - | - |
| Long-term debt | 3,158,977 | 825,309 | 652,232 | 612,796 | 1,068,640 |
| Contingent consideration | 874,596 | 641,421 | 233,175 | - | - |
| **Total** | **17,516,360** | **14,949,517** | **885,407** | **612,796** | **1,068,640** |

### Fair value

The fair value of financial instruments is based on quoted market prices when an active market exists. Otherwise, it is estimated using techniques and valuation models, such as analysis of discounted cash flows for the long-term debt, for which the significant unobservable inputs used are the discount rates which reflects the Corporation's credit risk.

There was no transfer between the levels of fair value hierarchy during the year.

The carrying amount and estimated fair value of financial instruments are as follows:

*Financial instruments whose fair value approximates carrying value*

Cash and cash equivalents, guaranteed deposit certificates, accounts receivable, other assets, bank overdraft, bank loans, accounts payable and accrued liabilities and contingent consideration are financial instruments whose fair value approximates their carrying value due to their short-term maturity.

*Long-term debt*

The fair value of the long-term debt has been established by discounting the future cash flows at an interest rate to which the Corporation would currently be able to obtain for loans with similar maturity dates and terms. The fair value of the long-term debt is $11,185,104 ($2,847,255 as at June 30, 2016) and was determined to be a level 2 financial instrument.

## RISK FACTORS AND UNCERTAINTIES

The following risks and uncertainties relating to the Corporation are not comprehensive; the Corporation operates in a constantly evolving sector, which can cause new risks and uncertainties to arise. The Corporation is not in position to neither predict these risks and uncertainties, nor evaluate their impact, as the case may be, on its activities, nor to evaluate to what extent may a factor, or a combination of factors, cause actual results to differ from those presented in the forward-looking statements. Therefore, the Corporation's shareholders should not unduly rely on these forward-looking statements.

*Competitive environment*

In the markets targeted by the Corporation, competition is based on a number of factors, especially price, technology, application know-how, financing viability, corporate image, product warranty, reliability, distribution network, and after-sales services. Some competitors of the Corporation have the benefit of relying on larger resources, notably financial, than those of the Corporation. In the past, the Corporation noticed that challenging global financial conditions contributed to reduce the number of water treatment projects and increase the competition as well as the number of companies bidding on each project. If such competitive environment persists, profit margins on projects may be lowered and it may adversely affect the Corporation's business, financial situation and results of operations.

During the year ended June 30, 2017, many announcements of investments in water treatment equipment over the next years were carried out at municipal level in Canada and the United States. However on a short-term basis such growth may be uneven due to the current instability of the global markets.

*Operating risks*

Design and fabrication of water treatment projects involve a high degree of operating risks. Human error in design and fabrication can cause material damage or delays in delivery. The occurrence of any of these events could result in loss of revenues, increased costs and liability to third parties. The Corporation uses software that has improved the design, drafting, estimation and fabrication of its products to minimize human error. The Corporation also controls production quality in its plants and is protected by a general insurance coverage.

Different types of events could induce an interruption of operation and/or a loss of production, as loss of a key supplier, natural disaster or failure of a program that runs a production line. All those events could cause significant delays in operation. The Corporation has located a part of its inventory in nearby warehouse and an emergency plan has been implemented and is regularly reviewed. The Corporation has also subscribed to business interruption and contingent business interruption insurance coverages.

As part of operating risks, risk to lose customers or distributors is considered and would have a noticeable gap in sales. The likelihood of occurrence is possible, while low, considering the significant amount of competition in the markets targeted by the Corporation. The Corporation develops broad distribution network and regularly add more distributors in its distribution network to dilute customers' concentration of each distributor.

*Management and employees*

The Corporation depends on the skills and experience of its management team and other key employees. The Corporation relies heavily on its ability to attract and retain highly-skilled personnel in a competitive environment. The Corporation may be unable to recruit, retain, and motivate highly-skilled employees in order to assist the Corporation's business, especially sales activities that are essential to the success of the Corporation. Failure to recruit and retain highly-skilled employees may adversely affect the Corporation's business, financial condition and results of operations.

Considering the type of industry and the line of work of the Corporation, the Corporation is facing situations that may result in accidents causing injuries to employees, customers or sub-contractors. The Corporation has implemented a health and safety program within its organization. Its employees are properly trained to face such kind of situations and are aware of potential hazardous work situations. Health and Safety Committees have been created by the Corporation in each facility and such committees meet on a regular basis to, among others, plan training sessions for the Corporation's employees.

*Acquisition and expansion risk*

The Corporation may expand its operations by acquiring additional businesses, products or technologies. There can be no assurance that (i) the Corporation will be able to identify, acquire or profitably manage additional businesses, or successfully integrate any acquired business, products, or technologies into the business without

substantial expenses, delays or other operational or financial difficulties, or (ii) that acquired businesses, products or technologies, if any, will achieve anticipated revenues and income.

In connection with acquisitions completed by the Corporation, liabilities and contingencies that the Corporation failed to discover or was unable to quantify during the due diligence process conducted prior to the acquisition may exist. The Corporation may not be indemnified for some or all of these liabilities and contingencies. The existence of any material liabilities or contingencies could have a material adverse effect on the Corporation's business, financial condition and results of operations. Furthermore, acquisitions may involve a certain number of particular risks including diversion of management's attention, failure to retain key personnel and unanticipated events or circumstances, some or all of which could have a material adverse effect on the Corporation's performance.

The failure of the Corporation to successfully manage its acquisition or expansion strategy could have a material adverse effect on the Corporation's results of operations and financial condition.

*Fixed price contracts and renewal*

The Corporation typically enters into fixed price manufacturing contracts based upon estimates of technical risks and total production costs. Such estimates, if materially inaccurate, can result in potential losses related to fulfilling the contractual obligations of the Corporation.

Through its subsidiary Utility Partners, the Corporation enters into operation and maintenance contracts that are effective for a period of time that may vary from 3 to 5 years, with multi-year renewal options. In the event an operation and maintenance contract is not renewed at its end, this can result in potential loss and adversely affect the Corporation's results and financial position.

*Development of new products*

Development of new products of a specialized nature by the Corporation entails inherent risks, namely that either the product does not perform as desired or unacceptable reliability issues making such new product unmerchantable; or the risk that required components procured from third party suppliers do not perform in an acceptable manner, thereby having an adverse impact on marketability of such new products and on the Corporation's product liability. The Corporation is also subject to risks associated with the introduction of new products and applications, especially the non-acceptance on the markets, a delay in the development or a malfunction of the products.

*IP infringement*

$H_2O$ Innovation protects its intellectual property related to investments in research and development by relying on trade secret laws and confidentiality agreements with third parties who have access to information about the Corporation's research and development activities. It also relies on a combination of laws effective in Canada, the United States or foreign countries with respect to trademarks, patents, trade secrets and other intellectual properties.

Despite its efforts, the Corporation may not be able to determine the extent of unauthorized use and infringement of its intellectual property rights related to its trademarks, patents and other intellectual property. In any case, such efforts are difficult, expensive, and time-consuming. Failure to protect $H_2O$ Innovation's existing and future intellectual property rights could seriously harm its business and may result in the loss of its ability to exclude others from practicing the Corporation's technology.

The Corporation's patent position is subject to complex factual and legal issues that may give rise to uncertainty as to the validity, scope and enforceability of a particular patent. The question as to property ownership in the Corporation's industry is complicated and, in some cases, it is difficult to define with precision where one property begins and another ends. Therefore, there can be no assurance that infringing products or goods could not be manufactured without the Corporation's knowledge and consent

*Product liability*

The Corporation may be subject to a variety of potential product liabilities claims and other claims related with its operations, including liabilities and expenses associated with product defects. The Corporation maintains product liability and other insurance coverage that management believes as generally in accordance with the market practice in its industry, but there can be no assurance that the Corporation will always be adequately insured against all such potential liabilities.

*Litigation*

In the course of our business, the Corporation may become involved in, named as a party to, or be the subject of various legal proceedings and other claims relating to the conduct of our business. These may include claims, suits, government investigations and other proceedings, the outcome of which cannot be predicted with certainty and may be determined adversely to us. As a result, such matters could have a material adverse effect on the reputation, results of operations, liquidity or financial position of the Corporation. Moreover, the cost of defending against lawsuits and diversion of management's attention could be significant.

*Cybersecurity and Cyber Threats*

The Corporation relies on the accuracy, reliability, and proper use of sophisticated and dependable information processing systems and management information technology and provides several services to its customers using such kind of information processing systems. Any interruption in these systems or any interruption associated with the transition of these systems to a new information technology platform could have a material adverse effect on the Corporation's business, financial condition and results of operations.

Network and information systems-related events, such as computer hackings, cyber-attacks, ransomware, computer viruses, worms or other destructive or disruptive software, process breakdowns, denial of service attacks, malicious social engineering or other malicious activities, or any combination of the foregoing, or other similar events, could result in significant expenditures to repair or replace information systems, reacquire access to networks and information systems, or to protect them from similar events in the future. Further, any security breaches, such as misappropriation, misuse, leakage, falsification or accidental release or loss of information maintained in the Corporation's information technology systems could damage its reputation and require capital expenses to remedy any such security breach.

The Corporation has developed and implemented a cybersecurity plan to mitigate the risks associated with cyber threats, breach or loss of data and inadequate users' behaviors. Different controls are currently in place, such as network security, data security, training and awareness. The Corporation also maintain a cyber liability insurance coverage as well as a technology error and omission insurance coverage with respect to all services offered to its customers with respect to electronic or computer based system or network.

*Implementation of a strategic plan*

The commercial strategy of the Corporation aims at leveraging its offering based on three pillars, namely water treatment projects, specialty products and services and operation and maintenance services of water and wastewater treatment systems, by focusing on the development of niche sectors and by concluding acquisitions or alliances with players in strategic geographical regions, complimentary product lines or business models. The strategic plan of the Corporation should be addressed taking into consideration potential risks, expenses and difficulties frequently encountered by a growing company. The successful viability of the Corporation's growth strategy may require capital investments larger than those previously expected and nothing warrants that the Corporation will achieve its desired growth level.

*Capacity to secure performance guarantees*

In the industry in which the Corporation evolves, it is important for the Corporation to be able to provide required performance guarantees such as bonds or insurance coverages in order to bid for and obtain certain contracts. The capacity of the Corporation to secure performance guarantees depends among other factors on its financial situation and on the collateral that the Corporation is able to provide to a bonding company. The financial situation of the Corporation and its capacity to provide collateral can be affected by many different factors and there is no assurance that the Corporation will always be able to provide the required performance guarantees for any project. If required performance guarantees cannot be provided and the Corporation cannot enter into an agreement with a customer, the Corporation may not be able to execute a project for which it had all required technical skills and competitive pricing.

*Market liquidity*

Trading on the Corporation's common shares may be unstable, which could in same period result in a lack of liquidity for those shares. The market price for the common shares of the Corporation could consequently be subject to wide fluctuations. Factors such as the announcement of significant contracts, technological innovations, new commercial products, patents, a change in regulations, quarterly financial results, future sales of common shares by the Corporation or current shareholders, and many other factors could have considerable repercussions on the price of the Corporation's common shares. In addition, the financial markets may experience significant price and value fluctuations that affect the market prices of equity securities of companies that sometimes are

unrelated to the operating performance of these companies. Broad market fluctuations, as well as economic conditions generally may adversely affect the market price of the Corporation's common shares.

*Capital investment*

The business of the Corporation depends in part upon capital investment of its customers. In many cases such capital expenditures are substantial compared to its operating budget. The technologies of the Corporation frequently represent a new solution to a customer's water treatment problems, leading to a need to educate the customer about the solutions of the Corporation. As a result, a significant proportion of the Corporation's business is made up of large orders compared to its total revenues and subject to a sale cycle which may exceed one year as well as to postponement and cancellation of projects.

*Current global financial conditions*

The Corporation offers products and services that are primarily designed for the non-residential construction market. Non-residential construction includes municipal, industrial, commercial and institutional sectors. The non-residential construction market is closely tied to overall changes in the economy. Economic growth and cycles have a direct impact on the level of construction that takes place on an annual basis.

In addition, the current challenging global financial conditions have been characterized by increased volatility. The difficulties met by financial institutions have contributed to a reduction in liquidity among all financial institutions and have reduced the availability of credit to those institutions and to the issuers who borrow from them. These difficulties may impact the ability of the Corporation to obtain equity or debt financing on terms favourable to the Corporation. As such, continued increased levels of volatility and market turmoil may impact the Corporation's operations.

*Additional financing and dilution*

The Corporation does not exclude raising additional funds by equity financing. In addition, as at September 28, 2017, 2,565,334 stock options are currently issued and outstanding. The exercise of stock options, as well as any new equity financings, represents dilution factors for present and future shareholders.

*Shortage of raw materials*

Some of the products manufactured by the Corporation require specialized raw materials. If such raw material is not available or not available under satisfactory terms and the Corporation cannot manufacture and provide its customers with the requested product, sales level and relationships of the Corporation with its customers can be negatively affected.

*Liquidity risk*

Liquidity risk is the risk that the Corporation will be unable to fulfill its obligations on a timely basis or at reasonable cost. The Corporation manages its liquidity risk by monitoring its operating requirements, using various funding sources to ensure its financial flexibility and by preparing budgets and cash forecast to ensure that it has sufficient funds to fulfill its obligations. For its investing activities, the Corporation will evaluate its liquidity needs when applicable and take the necessary action.

*Interest rate risk*

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

The guaranteed deposit certificates and unsecured loans bear interest at fixed rates and the Corporation is, therefore, not exposed to the risk of changes in fair value resulting from interest rate fluctuations. The bank loans bear interest at floating rates and the Corporation is, therefore, exposed to the cash flow risks resulting from interest rate fluctuations.

*Insurance coverage risk*

The Corporation maintains a wide insurance portfolio relating to its operations, including, among other coverage, property, general and product liability, professional liability, workers' compensation as well as directors' and officers' liability policies. However, the Corporation's insurance coverage is subject to large individual claim deductibles for certain policies, individual claim limits, exclusions, and other terms and conditions. Certain damages in litigation, such as punitive damages, are generally not covered by insurance. There is a small risk that the Corporation's current insurance coverage will not be sufficient to cover all losses, that future insurance coverage will not contain additional exclusions or limitations, that the Corporation will not be able to continue to obtain

insurance coverage, or that insurance coverage will not be available at an economically reasonable cost. In the event that the Corporation does not have adequate or any insurance, product liability claims, litigation or other losses could have a material adverse effect on results of operations and financial condition.

*Technological changes*

The water treatment industry is characterized by evolving technologies, competition imposed standards and regulatory requirements which have an impact on the demand and compel the Corporation to improve its products and services. The evolution of legal, regulatory or local requirements may render obsolete some products and some water treatment processes offered by the Corporation. The acceptance of new products may also be negatively impacted by the enforcement of new governmental legislation imposing more stringent standards.

*Reputation and Regulatory Risk*

Given the nature of its international operations, the Corporation is required to comply with a large range of local, national and international laws enforced by governments or other regulatory authorities in all aspects of its operations. Non-compliance with these laws and regulations on the part of employees, agents, subcontractors, suppliers and partners could have an adverse impact on the Corporation's results and reputation. The Corporation develops and maintains client relationships in the normal course of business in accordance with high ethical standards as set out in its policies. The risk of non-performance of a contract under the terms agreed including the possibility of a default or a significant incident could adversely impact its reputation and influence its future capacity to win projects.

*Credit Risk*

Credit risk relates to the risk that a party to a contract will not fulfil some or all of its obligations, thereby causing the Company to sustain a financial loss. The main risk relates to accounts receivable. To manage credit risk from account receivables, the Company reviews credit limits, monitors aging of accounts receivable and establishes an allowance for doubtful accounts based on specific customer information and general historical trends. Also, the Corporation insures a part of its accounts receivable through the insurance coverage of EDC.

*Currency risk*

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

*Transfer pricing*

The Corporation conducts business operations in various jurisdictions and through legal entities in Canada and the United States. The tax laws of these jurisdictions have detailed transfer pricing rules which require that all transactions with non-resident related parties be priced using arm's-length pricing principles and that contemporaneous documentation must exist to support that pricing. The taxation authorities in the jurisdictions where the Corporation carries on business could challenge the Corporation's arm's-length related party transfer pricing policies. International transfer pricing is a subjective area of taxation and generally involves a significant degree of judgment. If any of these taxation authorities were to successfully challenge the Corporation's transfer pricing policies, its income tax expense could be adversely affected and it could also be subject to interest and penalty charges. Any such increase in its income tax expense and related interest and penalties could have a significant impact on the Corporation's future earnings and future cash flows.

## CONTROLS AND PROCEDURES

In compliance with the Canadian Securities Administrators' National Instrument 52-109 ("NI 52-109"), the Corporation has filed certificates signed by the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") 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 CFO have designed disclosure controls and procedures, or have caused them to be designed under their supervision, in order to provide reasonable assurance that:

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

An evaluation was carried out, under the supervision of the CEO and the CFO of the effectiveness of the Corporation's disclosure controls and procedures. Following such evaluation, the management concluded that the disclosure controls and procedures are not effective by using the criteria set forth by NI 52-109, as further explained in the paragraph below.

### Internal controls over financial reporting

The CEO and the CFO 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. The internal controls over financial reporting are designed using the criteria set forth by the *Committee of Sponsoring Organizations of the Treadway Commission 2013* (COSO 2013) on Internal Control – Integrated Framework.

Following their evaluation of the effectiveness of $H_2O$ Innovation's disclosure controls and procedures, management concluded that the disclosure controls and procedures were not effective, in the context of a lack of cybersecurity and social engineering awareness which led to an external fraud on the banking online platform of $H_2O$ Innovation, which occurred after June 30, 2017. As a result, management identified a material weakness, based on material weakness' definition set forth in NI 52-109, in certain of the Corporation's internal control over financial reporting as of June 30, 2017. The Corporation's management considers there had been a lack of segregation of duties between the creation of user's profiles on the banking online platform of $H_2O$ Innovation, the initiation of transactions and the approval of such transactions via this same online platform.

### Changes in internal controls over financial reporting

During the year, the Corporation 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.

However, for the current fiscal year and following the identification of a material weakness, the Corporation intends to take appropriate steps to mitigate cybersecurity and cyber threats risks by increasing cybersecurity and social engineering training and awareness, implementing additional control procedures throughout its organization, reinforcing the application of the Delegation of Authority Policy and by dividing differently responsibilities and duties between the finance department and corporate team.

## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The Consolidated Financial Statements and Management's Discussion and Analysis ("MD&A") of $H_2O$ Innovation Inc. ("$H_2O$ Innovation" or the "Corporation") and all other information in the Annual Report are the responsibility of management and have been reviewed and approved by the Board of Directors.

The Consolidated Financial Statements have been prepared by management in accordance with International Financial Reporting Standards ("IFRS"). The MD&A has been prepared in accordance with the requirements of securities regulators. The Consolidated Financial Statements and MD&A include items that are based on best estimates and judgments of the expected effects of current events and transactions. Management has determined such items on a reasonable basis in order to ensure that the Consolidated Financial Statements and MD&A are presented fairly in all material respects. Financial information presented elsewhere in the Annual Report is consistent with that in the Consolidated Financial Statements.

$H_2O$ Innovation's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have designed disclosure controls and procedures, or have caused them to be designed under their supervision, to provide reasonable assurance that material information relating to $H_2O$ Innovation Inc. has been made known to them; and information required to be disclosed in $H_2O$ Innovation Inc.'s filings is recorded, processed, summarized and reported within the time periods specified in securities legislation.

The Corporation's management evaluated the effectiveness of $H_2O$ Innovation's disclosure controls and procedures and concluded that certain disclosure controls and procedures were not effective, in the context of a lack of cybersecurity and social engineering awareness which led to an external fraud on the banking online platform of $H_2O$ Innovation, which occurred after June 30, 2017. As a result, management identified a material weakness, based on material weakness' definition set forth in Canadian Securities Administrators' National Instrument 52-109 ("NI 52-109"), in certain of the Corporation's internal control over financial reporting as of June 30, 2017. The Corporation's management considers there had been a lack of segregation of duties between the creation of user's profiles on the banking online platform of $H_2O$ Innovation, the initiation of transactions and the approval of such transactions via this same online platform.

This control deficiency cannot be considered to be remediated until the applicable remedial controls operate for a sufficient period of time and management concludes, through testing, that the controls are operating effectively. The Corporation intends to take appropriate steps to mitigate those risks in the future, by increasing cybersecurity and social engineering training and awareness, implementing additional control procedures throughout its organization, reinforcing the application of the Delegation of Authority Policy and by dividing differently responsibilities and duties between the finance department and corporate team.

$H_2O$ Innovation's CEO and CFO have provided a certification related to $H_2O$ Innovation's annual disclosure to the Canadian Securities Administrators, including the Consolidated Financial Statements and MD&A.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the Consolidated Financial Statements and MD&A. The Board of Directors carries out this responsibility principally through its Audit Committee.

The Audit Committee is appointed by the Board of Directors and is comprised entirely of independent and financially literate directors. The Audit Committee meets periodically with management, as well as with the internal and external auditors, to review the Consolidated Financial Statements, external auditors' report, MD&A, auditing matters and financial reporting issues, to discuss internal controls over the financial reporting process, and to satisfy itself that each party is properly discharging its responsibilities. In addition, the Audit Committee has the duty to review the appropriateness of the accounting policies and significant estimates and judgments underlying the Consolidated Financial Statements as presented by management, and to review and make recommendations to the Board of Directors with respect to the fees of the external auditors. The Audit Committee reports its findings to the Board of Directors for its consideration when it approves the Consolidated Financial Statements and MD&A for issuance to shareholders.

The Consolidated Financial Statements have been audited by Deloitte LLP., the external independent auditor, in accordance with IFRS on behalf of the shareholders. The external independent auditor has full and free access to the Audit Committee to discuss their audit and related matters.

| The President and Chief Executive Officer | The Chief Financial Officer |
|---|---|
| Frédéric Dugré | Marc Blanchet |

September 28, 2017

# CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017 and 2016

For additional information:
Investor Relations
*investor@h2oinnovation.com*

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

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

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## Independent auditor's report

To the Shareholders of
$H_2O$ Innovation Inc.

We have audited the accompanying consolidated financial statements of $H_2O$ Innovation Inc., which comprise the consolidated statements of financial position as at June 30, 2017, and June 30, 2016, and the consolidated statements of (loss) earnings, comprehensive (loss) income, changes in shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of $H_2O$ Innovation Inc. as at June 30, 2017 and June 30, 2016, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

/signed/
Deloitte LLP [1]
September 28, 2017

[1] CPA auditor, CA, public accountancy permit No. A129221

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(in Canadian dollars)

| As at June 30, | 2017 | 2016 (adjusted, note 2) |
|---|---|---|
| | $ | $ |
| **ASSETS** | | |
| **Current assets** | | |
| Cash and cash equivalents | **3,870,603** | 3,051,870 |
| Guaranteed deposit certificates (note 6) | **1,371,591** | 1,461,462 |
| Accounts receivable (note 7) | **13,210,475** | 10,192,683 |
| Inventories (note 8) | **4,917,592** | 4,444,810 |
| Costs incurred in excess of billings (note 9) | **5,567,267** | 3,534,972 |
| Prepaid expenses | **1,449,007** | 909,369 |
| | **30,386,535** | 23,595,166 |
| **Non-current assets** | | |
| Property, plant and equipment (note 10) | **4,167,162** | 3,512,648 |
| Intangible assets (note 11) | **20,419,906** | 9,612,911 |
| Other assets | **563,564** | 70,366 |
| Related party loans receivable (note 27a) | **1,250,000** | - |
| Goodwill (notes 5 and 12) | **14,300,722** | 5,893,636 |
| Deferred income tax assets (note 18) | **3,082,941** | 2,267,227 |
| | **74,170,830** | 44,951,954 |
| **LIABILITIES** | | |
| **Current liabilities** | | |
| Bank overdraft | **184,120** | 520,208 |
| Bank loans (note 13) | **5,092,607** | 5,962,750 |
| Accounts payable and accrued liabilities (note 14) | **12,683,815** | 6,999,829 |
| Provisions (note 15) | **151,718** | 114,224 |
| Billings in excess of costs incurred (note 9) | **1,190,909** | 912,032 |
| Income taxes payable (note 18) | **53,930** | 10,775 |
| Deferred rent (note 25) | **668** | 10,661 |
| Current portion of contingent consideration (notes 5 and 17) | **-** | 641,421 |
| Current portion of long-term debt (note 16) | **2,036,151** | 721,973 |
| | **21,393,918** | 15,893,873 |
| **Non-current liabilities** | | |
| Long-term debt (note 16) | **9,148,953** | 2,125,282 |
| Deferred rent (note 25) | **92,392** | 105,446 |
| Contingent consideration (notes 5 and 17) | **232,683** | 233,175 |
| | **30,867,946** | 18,357,776 |
| **SHAREHOLDERS' EQUITY** | | |
| Share Capital (note 19) | **76,918,285** | 55,298,945 |
| Reserve - Stock options (note 19) | **2,503,905** | 1,876,379 |
| Deficit | **(38,299,429)** | (33,168,443) |
| Accumulated other comprehensive income | **2,180,123** | 2,587,297 |
| | **43,302,884** | 26,594,178 |
| | **74,170,830** | 44,951,954 |

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

On behalf of the Board,

Frédéric Dugré — President and Chief Executive Officer

Philippe Gervais — Chairman of the Board of Directors

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(in Canadian dollars)

| | Common shares (Number) (note 19) | Share capital (note 19) | Reserves – Stock option (note 19) | Deficit | Accumulated other comprehensive income – Translation adjustment | Total |
|---|---|---|---|---|---|---|
| | | $ | $ | $ | $ | $ |
| **Balance as at July 1, 2015** | 20,926,551 | 55,298,945 | 1,876,379 | (33,327,412) | 2,159,574 | 26,007,486 |
| Net earnings for the period (adjusted, note 2) | - | - | - | 158,969 | - | 158,969 |
| Other comprehensive income – Currency translation adjustments | - | - | - | - | 427,723 | 427,723 |
| **Balance as at June 30, 2016** | 20,926,551 | 55,298,945 | 1,876,379 | (33,168,443) | 2,587,297 | 26,594,178 |
| **Balance as at July 1, 2016** | **20,926,551** | **55,298,945** | **1,876,379** | **(33,168,443)** | **2,587,297** | **26,594,178** |
| Issuance of common shares under private placement (notes 5 and 19) | **19,217,663** | **23,061,196** | **-** | **-** | **-** | **23,061,196** |
| Share issue expenses (notes 5 and 19) | **-** | **(1,441,856)** | **-** | **-** | **-** | **(1,441,856)** |
| Stock-based compensation costs (note 19) | **-** | **-** | **627,526** | **-** | **-** | **627,526** |
| Net loss for the period | **-** | **-** | **-** | **(5,130,986)** | **-** | **(5,130,986)** |
| Other comprehensive income – Currency translation adjustments | **-** | **-** | **-** | **-** | **(407,174)** | **(407,174)** |
| **Balance as at June 30, 2017** | **40,144,214** | **76,918,285** | **2,503,905** | **(38,299,429)** | **2,180,123** | **43,302,884** |

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

## CONSOLIDATED STATEMENTS OF (LOSS) EARNINGS
(in Canadian dollars)

| Years ended June 30, | 2017 | 2016 (adjusted, note 2) |
|---|---|---|
| | $ | $ |
| Revenues (note 26) | **82,764,508** | 50,667,691 |
| Cost of goods sold (note 20a) | **63,607,128** | 35,125,260 |
| **Gross profit before depreciation and amortization** | **19,157,380** | 15,542,431 |
| Operating expenses (note 20a) | **1,916,001** | 1,435,187 |
| Selling expenses (note 20a) | **7,165,499** | 6,341,175 |
| Administrative expenses (note 20a) | **9,167,360** | 4,813,709 |
| Research and development expenses – net (note 20c) | **152,949** | 198,004 |
| Depreciation of property, plant and equipment (note 20b) | **1,336,729** | 621,057 |
| Amortization of intangible assets (note 20b) | **3,208,599** | 1,059,044 |
| Other gains – net (note 20d) | **(367,627)** | (516,759) |
| **Operating costs total** | **22,579,510** | 13,951,417 |
| **Operating (loss) earnings** | **(3,422,130)** | 1,591,014 |
| Acquisition-related costs and integration costs (note 5) | **1,066,696** | **-** |
| Finance income | **(42,337)** | (14,408) |
| Finance costs | **1,338,848** | 768,391 |
| Finance costs – net | **1,296,511** | 753,983 |
| | **2,363,207** | 753,983 |
| **(Loss) earnings before income taxes** | **(5,785,337)** | 837,031 |
| Current income tax expense (note 18) | **167,359** | 12,113 |
| Deferred tax (recovery) charge (note 18) | **(821,710)** | 665,949 |
| | **(654,351)** | 678,062 |
| **Net (loss) earnings for the year** | **(5,130,986)** | 158,969 |
| **Basic and diluted net (loss) earnings per share** | **(0.133)** | 0.008 |
| Weighted average number of shares outstanding (note 21) | **38,674,011** | 20,926,551 |

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

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(in Canadian dollars)

| Years ended June 30, | 2017 | 2016 (adjusted, note 2) |
|---|---|---|
| | $ | $ |
| Net (loss) earnings for the year | (5,130,986) | 158,969 |
| Other comprehensive income – Items that may be reclassified subsequently to net earnings | | |
| Currency translation adjustments | (407,174) | 427,723 |
| **Comprehensive (loss) income for the year** | **(5,538,160)** | 586,692 |

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS
(in Canadian dollars)

| Years ended June 30, | 2017 | 2016 (adjusted, note 2) |
|---|---|---|
| | $ | $ |
| **Cash flows from operating activities** | | |
| (Loss) earnings before income taxes for the year | **(5,785,337)** | 837,031 |
| Non-cash items | | |
| Finance costs – net | **1,296,511** | 753,983 |
| Depreciation of property, plant and equipment | **1,336,729** | 621,057 |
| Amortization of intangible assets | **3,208,599** | 1,059,044 |
| Unrealized exchange gain (loss) on long-term debt | **22,080** | (42,027) |
| Deferred rent | **(23,638)** | (10,607) |
| Stock-based compensation | **627,526** | - |
| | **682,470** | 3,218,481 |
| Change in working capital items (note 22a) | **1,120,761** | (577,136) |
| Cash generated by operations | **1,803,231** | 2,641,345 |
| Interests received | **42,337** | 14,408 |
| Income taxes paid | **(38,290)** | (27,312) |
| **Net cash generated by operating activities** | **1,807,278** | 2,628,441 |
| **Cash flows from investing activities** | | |
| Variation of guaranteed deposits certificates | **90,170** | 174,349 |
| Variation of other assets | **(502,240)** | (8,325) |
| Acquisition of property, plant and equipment | **(1,363,599)** | (1,096,323) |
| Acquisition of intangible assets | **(989,574)** | (1,010,333) |
| Business combination, net of cash acquired (note 5) | **(24,102,288)** | (1,976,250) |
| Related party loans receivable (note 27a) | **(1,250,000)** | - |
| Proceeds from disposal of property, plant and equipment | **20,678** | - |
| **Net cash used in investing activities** | **(28,096,853)** | (3,916,882) |
| **Cash flows from financing activities** | | |
| Variation of bank loans | **(870,143)** | 1,530,673 |
| Long-term debt reimbursement | **(1,763,066)** | (923,770) |
| Long-term debt contracted (note 16) | **10,200,060** | 2,754,600 |
| Interest paid | **(1,296,227)** | (757,418) |
| Financing costs (note 5) | **(164,621)** | - |
| Issuance of common shares under private placement (note 19) | **23,061,196** | - |
| Share issue expense (note 19) | **(1,441,856)** | - |
| **Net cash generated by financing activities** | **27,725,343** | 2,604,085 |
| Net change in cash and cash equivalents | **1,435,768** | 1,315,644 |
| **Effect of exchange rate changes on the balance of cash held in foreign currencies** | **(280,947)** | (117,817) |
| **Increase in cash and cash equivalents** | **1,154,821** | 1,197,827 |
| **Cash and cash equivalents - Beginning of year (note 22b)** | **2,531,662** | 1,333,835 |
| **Cash and cash equivalents - End of year (note 22b)** | **3,686,483** | 2,531,662 |

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

## 1. Governing Statutes and Nature of Operations

$H_2O$ Innovation Inc. ("$H_2O$ Innovation" or the "Corporation") is incorporated under the *Canada Business Corporations Act*. The Corporation designs and provides state-of-the-art, custom-built, and integrated water treatment solutions based on membrane filtration technology for municipal, energy and natural resources end-users. The Corporation's activities rely on three pillars which are: i) water and wastewater projects; ii) specialty products and services, including a complete line of specialty chemicals, consumables, and specialized products for the water treatment industry as well as control and monitoring systems; and iii) operation and maintenance services for water and wastewater treatment systems. The head office of the Corporation is located at 330 Saint-Vallier Street East, suite 340, Quebec City (Quebec), Canada.

## 2. Basis of Preparation and Summary of Significant Accounting Policies

### Statement of Compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The consolidated financial statements were prepared on a going concern basis, under the historical cost convention.

On September 28, 2017, the Board reviewed these consolidated financial statements and authorized their publication.

### Reporting and functional currency

The Corporation's reporting currency is the Canadian dollar. The functional currency of the Canadian corporations is the Canadian dollar. The functional currency of the foreign subsidiaries located in the United States of America and in Hong Kong is the U.S. dollar.

### Comparative figures

The Corporation has completed the evaluation of the fair value of assets acquired for the acquisition of Clearlogx®. As a result, the intangible assets, the goodwill and the contingent consideration in the consolidated statement of financial position as at June 30, 2016 and the amortization of intangible assets in the statements of (loss) earnings for the year ended June 30, 2016 were adjusted to reflect these changes. Refer to note 5b for more details on the adjustments made to the fair value of assets acquired for this acquisition.

### Principles of consolidation

The consolidated financial statements include the accounts of the Corporation, its wholly-owned subsidiaries $H_2O$ Innovation USA, Inc., $H_2O$ Innovation USA Holding, Inc., Professional Water Technologies, LLC, Piedmont Pacific Corporation, Piedmont Pacific Inc., $H_2O$ Operation & Maintenance Inc., Piedmont Hong Kong Limited and Utility Partners, LLC.

*Subsidiaries*
Subsidiaries are all entities over which the Corporation has control. Control exists when the Corporation has all three of the following elements: the power to direct the relevant activities of the subsidiary, exposure or rights to variable returns from its involvement with the subsidiary; and the ability to use its power over the subsidiary to affect the amount of the Corporation's returns. The Corporation reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of controls listed above. Subsidiaries are fully consolidated from the date on which control is transferred to the Corporation. They are deconsolidated from the date that control ceases.

Intercompany transactions, balances and unrealized gains and losses on transactions between group companies are 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 Corporation, liabilities incurred by the Corporation to the former owners of the acquiree and the equity interests issued by the Corporation in exchange for control of the acquiree. Acquisition-related costs are generally recognized in the consolidated statement of income 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 the consolidated statement of income as a bargain purchase gain.

When the consideration transferred by the Corporation 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 Financial Instruments: recognition and measurement* or *IAS 37 Provisions, Contingent Liabilities and Contingent Assets*, as appropriate, with the corresponding gain or loss being recognized in the consolidated statement of income.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Corporation 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.

### Foreign currency translation

Monetary assets and liabilities of the Canadian corporations denominated in foreign currencies are translated at the exchange rate in effect at the statement of financial position date, whereas other assets and liabilities are translated at the exchange rate, using the Bank of Canada published rates, 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 consolidated statement of income.

The assets and liabilities of the foreign subsidiaries 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 (loss) income and accumulated in equity under the heading of currency translation adjustment.

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 rate prevailing at the end of each reporting period. Exchange differences arising are recognized in other comprehensive (loss) income.

### Fair value measurement

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.

The Corporation has an established control framework with respect to the measurement of fair values. Management has the responsibility for overseeing fair value measurements.

Management regularly reviews significant unobservable inputs and valuation adjustment. If third party information is used to measure fair values, management assesses the evidences obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

When measuring the fair value of an asset or a liability, the Corporation uses market observable data as far as possible. Fair values are categorized into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows.

- Level 1: quoted prices (unadjusted) in active markets for identical assets and liabilities that the Corporation can access at the measurement date.
- Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: inputs for the asset or liability that are not based on observable market data.

The Corporation recognizes transfers between levels of the fair value hierarchy at the end of the reporting period during which that change has occurred.

Further information about the assumptions made in measuring fair values is included in the notes to the consolidated financial statements.

### Financial assets and liabilities

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. The Corporation's financial assets comprise mainly cash and cash equivalents, guaranteed deposit certificates and accounts receivable. The Corporation's financial liabilities comprise mainly bank overdraft, bank loans, accounts payable and accrued liabilities, long-term debt and contingent consideration.

*Recognition*
The Corporation recognizes a financial instrument on its consolidated statement of financial position when it becomes party to the contractual provisions of the financial instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Corporation has transferred substantially all risks and rewards of ownership.

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 | Loans and receivables |
| Bank overdraft | Other financial liabilities |
| Bank loans | Other financial liabilities |
| Accounts payable and accrued liabilities | Other financial liabilities |
| Long-term debt | Other financial liabilities |
| Contingent consideration | Other financial liabilities |

*Measurement*
Loans and receivables and other financial liabilities are initially measured at their fair value plus transaction costs. Subsequently, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest method.

The Corporation has evaluated the fair values of its financial instruments based on the current interest rate environment, related market values and current pricing of financial instruments with comparable terms.

### 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. The Corporation considers bank overdraft in its cash and cash equivalents.

### 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 finished goods. Also, the Corporation is using the absorption costing method for finished goods. The absorption costing method used by the Corporation includes direct materials, labour and manufacturing overhead expenses.

### Property, plant and equipment

All property, plant and equipment are shown at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are attributable to the acquisition of the items. Depreciation on assets is calculated using the straight-line method to allocate the cost of each asset less its residual value over its estimated useful economic life. Moulds are amortized on a unit of production basis over expected total production per mould. Land is not depreciated. 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 | 7-10 years |
| Computer equipment | 3-5 years |
| Furniture, fixtures and office equipment | 10 years |
| Automotive equipment | 5 years |
| Containerized units for lease | 4 years |
| Moulds | 3-5 years |
| Leasehold improvements | Remaining term of the lease between two and ten years |

The depreciation expense is included in the consolidated statement of income as “Depreciation of property, plant and equipment”.

The estimated useful lives, residual values and depreciation method are reviewed at each reporting period 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 recognized in the consolidated statement of income.

### Intangible assets

Intangible assets acquired are recorded at cost less accumulated amortization and accumulated impairment losses. They are amortized over their estimated useful lives. The estimated useful lives, residual values and amortization method are reviewed at each reporting period end, with the effect of any changes in estimate accounted for on a prospective basis. The amortization expense is included in the consolidated statement of income as “Amortization of intangible assets”.

The Corporation is using the following amortization methods:

*Intangible assets acquired separately*

- Software is amortized using the straight-line method over periods of seven (7) years. Software in progress is not amortized until it is completed and ready to be used.

*Intangible assets acquired in business combinations*

- Intellectual property includes the patents, the rights on technologies and technologies and the technical drawings. Intellectual properties and patents are amortized using the straight-line method over a period of ten (10) to fifteen (15) years. Rights on technologies and technologies are amortized using the straight-line method over periods of seven (7) and fifteen (15) years, respectively. Technical drawings are amortized using the straight-line method over a period of ten (10) years.
- Trademarks with a definite useful life are amortized using the straight-line method over a period of seven (7) to ten (10) years.
- Customer relations are amortized using the straight-line method over periods of five (5), ten (10) and fifteen (15) years.
- Contractual agreements are amortized over the related contract length.
- Distribution network is amortized using the straight-line method over a period of five (5) years.
- Non-compete agreements are amortized using the straight-line method over a period of ten (10) years.
- Customer backlog is amortized over its related sales period.

Intangible assets also include development costs for new products which have proven technical feasibility and for which a clearly defined future market exists. Costs of developing the new products are reduced by the related investment tax credits and amortized over a maximum period of four years on a straight-line basis. Expenditures on research activities are expensed as incurred.

### Goodwill

Goodwill arising in a business combination is recognized 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 Corporation’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 recognized immediately in the consolidated statement of income as a bargain purchase gain.

Goodwill arising on an acquisition of a business is carried at cost as established at the date of acquisition of the business less accumulated impairment losses. For the purpose of impairment testing, goodwill is allocated to each of the Corporation’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 recognized for goodwill is not reversed in a subsequent period.

The Corporation 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 gain or loss on disposal.

### Other assets

Other assets are mainly composed of accounts receivable in more than 12 months and of security deposits. The security deposits are recorded at amortized cost.

### Impairment of property, plant and equipment and intangible assets excluding goodwill

At the end of each reporting period, the Corporation reviews the carrying amounts of its property, plant and equipment 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). When it is not possible to estimate the recoverable amount of an individual asset, the Corporation estimates the recoverable amount of the cash-generating unit to which the asset belongs. When 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 of 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 recognized immediately in the consolidated statement of income.

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 recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in the consolidated statement of income.

### 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 specialty products and services*

Revenue from the sale of specialty products and services and consignment inventory is recognized when the following conditions are satisfied:

- The Corporation has transferred to the buyer the significant risks and rewards of ownership of the goods;
- The Corporation 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.

*Project contracts*
Project contracts are within the scope of *IAS 11 – Construction contracts*. Where the outcome of a project contract can be estimated reliably, revenue and costs are recognized by reference to the stage of completion of the contract activity at the end of the reporting period, measured based on the percentage-of-completion of 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 project contract cannot be estimated reliably, contract revenue is recognized to the extent of contract costs incurred if it is probable that it will be recoverable. Contract costs are recognized as expenses in the period in which they are incurred. When it is probable that the total contract costs will exceed the total contract revenue, the expected loss is recognized as an expense immediately.

When contract costs incurred to date plus recognized profits less recognized losses exceed progress billings, the surplus is included in the statement of financial position under “Costs incurred in excess of billings”. For contracts where progress billings exceed contract costs incurred to date plus recognized profits less recognized losses, the surplus is included in the consolidated statement of financial position under “Billings in excess of costs incurred”.

*Operation and maintenance revenue*
Operation and maintenance revenue primarily relates on the rendering of continuous service for water treatment plant operation and public works. The Corporation recognizes revenues over time, when the Corporation has an executed agreement, the amount of the fee to be paid by the customer is fixed and determinable, and the collection of the related receivable is deemed probable from the outset of the arrangement.

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

### Share Capital

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 Corporation offers a stock option plan to directors, executive officers, key employees and consultants providing services to the Corporation 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 18 – *Capital Stock*.

The fair value at the grant date of stock options is determined using the Black-Scholes pricing model and is recognized in the consolidated statement of income as a compensation expense using a graded vesting schedule over the vesting period, based on the Corporation’s estimate of the number of shares that will eventually vest. At the end of each reporting period, the Corporation 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 consolidated statement of income such that the cumulative compensation expense reflects the revised estimate, with a corresponding adjustment to the Reserve – stock option.

Any consideration received by the Corporation 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.

### Research and Development Expenses

Research 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 and they are included in intangible assets.

The Corporation 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 37.5% 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 Corporation 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 consolidated statement of income, 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 assets or current tax liabilities represent the taxation authorities' obligations or claims for prior or current periods which are not received or paid at the statement of financial position date. Current tax is based on taxable profit which differs from accounting profit. Current tax liabilities are measured using tax rates that have been enacted or substantively enacted at the statement of financial position 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 consolidated 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 statement of financial position 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 statement of financial position 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.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

### 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 for the single reportable segment of the Corporation. This is the measure reported to the chief operating decision-maker for the purpose of resource allocation and assessment of segment performance.

### Net earnings (loss) per share

Basic net earnings (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 year. Diluted earnings per share are calculated giving effect to the potential dilution that could occur if the stock options to issue common shares were exercised 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.

### Provisions

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

The amount recognized 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 recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

### Warranties

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 Corporation'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 Corporation offers warranties that are of variable lengths of time depending on each customer agreements.

## 3. Critical accounting estimates, assumptions and judgments

The preparation of consolidated financial statements in accordance with IFRS often requires management to make estimates about and apply assumptions or subjective judgment to future events or other matters that affect the reported amounts of the Corporation'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 Corporation's consolidated financial statements are prepared. Management reviews, on a regular basis, the Corporation'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 Corporation's consolidated financial statements.

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

*Impairment of goodwill and other non-current assets*
Goodwill is tested for impairment at least annually, and whenever there is an indication that the asset may be impaired. 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. If the discount rate had increased by 0.5% compared to the assumption taken by the Corporation, assuming other variables remain constant, the recoverable amount would have been lesser by approximately $2,600,000 (lesser by approximately $1,200,000 as at June 30, 2016) and impairment of $2,500,000 (nil as at June 30, 21016)would have been recorded. If the growth rate had decreased by 0.5% compared to the assumption taken by the Corporation, assuming other variables remain constant the recoverable amount would have been lesser by approximately $1,200,000 (lesser by approximately $600,000 as at June 30, 2016) and impairment of $1,100,000 (nil as at June 30, 2016) would have been recorded.

Other non-current depreciable assets are tested for impairment should events or circumstances indicate that their book value may not be recoverable, as measured by comparing their net book value to their recoverable amount, which correspond to the higher of fair value less costs to sell and its value in use. Should the carrying amount of other non-current assets exceed their recoverable amount, an impairment loss in the amount of the excess would be recognized.

*Income taxes measurement*
The estimation of income taxes includes evaluating the recoverability of deferred tax assets based on an assessment of the Corporation'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 Corporation's entities ability to utilize future tax deductions changes, the Corporation would be required to recognize more or fewer deferred tax assets, and future income tax provisions or recoveries could be affected.

*Slow moving and obsolete inventory*
The value of slow moving and obsolete inventory is based on the Corporation's assessment of historical usage, estimated future demand and in some cases, the specific risks of loss on specifically identified inventory. The write-down may be reversed if the circumstances which caused it no longer exist.

*Development Costs*
Development costs include expenditures to develop new products when the costs are attributable to a clearly defined product, technical feasibility has been established, a market has been identified, the Corporation intends to market the product, and the Corporation has adequate resources expected to be available to complete the project. Management is required to make judgments on when criteria for recognition as an asset is met. During the year ended June 30, 2017, $411,377 ($287,403 in fiscal year 2016) of development costs were recognized as intangible assets on the consolidated statements of financial position.

*Stock-based compensations and other stock-based payments*
As regards to stock option granted, the Corporation 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 Corporation's stock over the same period as the contractual life. At the end of each reporting period, the Corporation revises its estimate of the number of equity instruments expected to vest.

*Fair value of assets acquired in a business combination*
Under the acquisition method, on the date that control is obtained, the identifiable assets, liabilities and contingent liabilities of the acquired business are measured at their fair values. Depending on the complexity of determining the valuation for assets acquired, the Corporation uses appropriate valuation techniques in arriving at the estimated fair value at the acquisition date. These valuations are generally based on a forecast of the total expected future net discounted cash flows and relate closely to the assumptions made by management regarding the future performance of the related assets and the discount rate applied as it would be assumed by a market participant. Determination of the fair value of the acquired assets and liabilities requires judgment and the use of assumptions that, if changed, may affect the consolidated statements of earnings and consolidated statements of financial position.

*Definition of cash-generating units*
The Corporation assesses whether there are any indicators of impairment for all non-financial assets at the end of each financial reporting period. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). When it is not possible to estimate the recoverable amount of an individual asset, the Corporation estimates the recoverable amount of the cash-generating unit to which the asset belongs. Determination of cash-generating units is based on management's best estimate of what constitutes the lowest level at which an asset or group of assets is able to generate cash inflows. The Corporation must also determine whether goodwill can be attributed to one or more cash-generating units.

*Determination of the reportable segment*
Operating segments are determined according to the Corporation's management structure and internal information system. Operating results of each reportable segment are reviewed regularly by the Corporation's Chief Operating decision maker regarding the resources to be allocated to the segments and the assessment of their performance based on available financial information.

Management has identified one operating segment. The information structure indicates how management manages the Corporation and how it classifies its activities for planning and evaluating its performance. As a result, management manages its business line in one strategic business unit.

## 4. Accounting standards and amendments issued but not yet adopted

The following revised standards are effective for annual periods beginning on or after January 1, 2018, for IFRS 9 and for IFRS 15, and January 1, 2019, for IFRS 16. The Corporation has not yet assessed the impact of these standard and amendment.

*Classification and Measurement of Financial Assets and Financial Liabilities*

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* with a single approach to determine whether a financial asset is measured at amortized cost, fair value through other comprehensive income or fair value through the statement of income (loss). IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through the statement of income (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 income (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.

*Revenue from Contracts with Customers*

In May 2014, the IASB released IFRS 15, *Revenue from Contracts with Customers*, which establishes principles for reporting the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. It provides a single model in order to depict the transfer of promised goods or services to customers. The core principle of IFRS 15 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods and services. IFRS 15 also requires more comprehensive disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers.

IFRS 15 supersedes IAS 11, *Construction Contracts*, IAS 18, *Revenue*, and a number of revenue-related interpretations (IFRIC 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreements for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers*, and SIC-31, *Revenue, Barter Transactions Involving Advertising Service*).

*Leases*

On January 13, 2016, the IASB issued IFRS 16, *Leases*, which provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. It supersedes IAS 17, *Leases* and its associated interpretive guidance. Significant changes were made to lessee accounting with the distinction between operating and finance leases removed and assets and liabilities recognized in respect of all leases (subject to limited exceptions for short-term leases and leases of low value assets). In contrast, IFRS 16 does not include significant changes to the requirements for lessors. IFRS 16 will be effective as of January 1st, 2019 with earlier application permitted for companies that have also adopted IFRS 15, *Revenues from Contracts with Customers.*

*Statement of Cash Flows*

In January 2016, the IASB issued amendments to IAS 7, *Statement of Cash Flows*. The amendments are intended to improve information provided to users of financial statements about an entity's financing activities. They are effective for annual periods beginning on or after January 1, 2017, with earlier adoption permitted. The Corporation is currently assessing the impact of these amendments on its consolidated financial statements.

*Income Taxes*

In January 2016, the IASB issued amendments to IAS 12, *Income taxes*, to clarify the requirements for recognizing deferred tax assets on unrealized losses. The amendments clarify the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. They also clarify certain other aspects of accounting for deferred tax assets. The amendments are effective for the year beginning on or after January 1, 2017, with earlier adoption permitted. The Corporation has not yet examined the impacts of these amendments on its consolidated financial statements.

*Share-based payment*

In June 2016, the IASB issued an amendment to IFRS 2, *Share-based payment*, clarifying the accounting for certain types of share-based payment transactions. The amendments provide requirements on accounting for the effects of vesting and non-vesting conditions of cash-settled share-based payments, withholding tax obligations for share-based payments with a net settlement feature, and a modification to the terms of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. The amendment is effective for the year beginning on or after January 1, 2018. The Corporation is currently assessing the impact of this amendment on its consolidated financial statements.

## 5. Business Combination

### A. Acquisition of Utility Partners, LLC

#### Description of the business combination

On July 26, 2016, the Corporation entered into a share purchase agreement providing for the acquisition of all of the memberships interests of Utility Partners, LLC ("Utility Partners"), a US-based company specializing in the operation and maintenance of water and wastewater treatment plants (the "acquisition").

Utility Partners provides US municipal clients with innovative and cost-effective solutions for water and wastewater treatment plants. At the date of the closing of the acquisition, it operated thirty-four (34) plants in six (6) US states, mainly on the US Gulf coast, Southeast, Northeast (New England) and the West Coast (California and Nevada).

$H_2O$ Innovation acquired Utility Partners for an initial purchase price of $22,421,300 (US$17.0 M), on a cash-free, debt-free basis. The total purchase price consideration, including working capital adjustment, amounted to $23,491,318 (US$17.8 M). The Corporation financed the acquisition with an equity financing, by way of a bought deal private placement and a concurrent additional non-brokered private placement of Corporation's Common shares at a price of $1.20 per common share for total gross proceeds of $23,061,196.

In addition, $H_2O$ Innovation contracted $10.0 M in credit facilities, which was used, in part, to fund ancillary costs, working capital post acquisition needs and to support research and innovation initiatives.

#### Fair value recognized on acquisition date

| | July 26, 2016<br>$ |
|---|---|
| **Assets acquired** | |
| Cash and cash equivalents | **31,091** |
| Accounts receivable | **3,033,494** |
| Prepaid expenses | **651,940** |
| Property, plant and equipment | |
| Machinery and equipment | **635,966** |
| Intangible assets | |
| Customer relations | **6,207,502** |
| Contractual agreements | **2,246,647** |
| Non-compete agreements | **3,930,322** |
| Trademark | **766,281** |
| **Liabilities assumed** | |
| Accounts payable and accrued expenses | **(2,546,417)** |
| **Identifiable net assets acquired** | **14,956,826** |
| Goodwill arising on acquisition | **8,534,492** |
| **Purchase price consideration** | **23,491,318** |

The purchase price allocation shown above is final and is a summary of the assets acquired, the liabilities assumed and the consideration transferred at fair value as at the acquisition date. It was completed during the fourth quarter of fiscal year 2017. The original transaction was made in U.S. dollars and converted into Canadian dollars as at the acquisition date.

All of the intangible assets and the goodwill acquired are deductible for tax purposes.

### Sources and uses of funds at the transaction closing date

| | July 26, 2016<br>$ |
|---|---|
| **Sources** | |
| Private placement (note 19) | **21,160,196** |
| Additional private placement (note 19) | **1,901,000** |
| Long-term debt (note 16) | **10,000,000** |
| | **33,061,196** |
| **Uses** | |
| Initial cash consideration transferred | **(22,421,300)** |
| Cash transferred for working capital adjustment | **(1,070,018)** |
| Acquisition and integration costs | **(1,066,696)** |
| Share issuance costs (note 19) | **(1,441,856)** |
| Financing costs (note 16) | **(164,621)** |
| Related party loans receivable (note 27a) | **(1,250,000)** |
| Working capital for the Corporation's current activities | **(5,646,705)** |
| | **-** |

### Costs related to the acquisition

The total acquisition-related and integration costs amounted to $2,673,173 and are included in the financial statements as follows: share issuance costs totalling $1,441,856 are included in the share capital caption in the consolidated statement of changes in shareholders' equity, financing costs totalling $164,621 are included in the long-term debt and $1,066,696 of acquisition and integration costs are included in the consolidated statements of (loss) earnings.

### Determination of fair value

At the acquisition date, the identifiable assets acquired are recognized at the acquisition date fair value.

The Corporation's valuation of intangible assets has identified contractual agreements, customer relations, non-compete agreements and trademark. The assigned useful lives are based on the remaining duration of the contracts for contractual agreements, 10 years for customer relations, 10 years for non-compete agreements and 7 years for trademark. Significant assumptions used in the determination of fair value of intangible assets, as defined by management, are year-over-year sales growth, discount rate and operating income before depreciation and amortization.

### Goodwill arising from the business combination

Based on management's calculations, an amount of $8,534,492 of goodwill has been attributed to the transaction and stems essentially from the synergies with other activities of the Corporation, the economic value of the workforce acquired as well as intangible assets that do not meet the criteria for separate recognition.

### Impact of the business combination on the Corporation's financial performance

The Corporation's loss for the year ended June 30, 2017, includes $33,227,957 in revenues and a $1,236,174 profit, generated from Utility Partners additional business, before depreciation and amortization of $2,113,258.

If the business combination had been completed on July 1, 2016, the Corporation's consolidated revenues for the year ended June 30, 2017 would have totalled $85,149,220 and consolidated net loss for the year ended June 30, 2017, would have been ($5,272,100).

The Corporation considers the pro forma figures to be an approximate measurement of the financial performance of the combined business over a twelve-month period. However, pro forma information does not account for synergies or changes to historical transactions and is not necessarily indicative of the profit of the Corporation if the acquisition actually occurred on July 1, 2016, nor the profit that may be achieved in the future.

To determine the Corporation's pro forma consolidated revenues and profit if Utility Partners had been acquired on July 1, 2016, the Corporation:

- Calculated the revenues based on contractual agreements with customers;
- Calculated depreciation of property, plant and equipment and amortization of other acquired intangible assets based on the fair value arising from initial recognition of the business combination rather than the carrying amounts recognized in the pre-acquisition financial statements;
- Calculated the borrowing costs on the Corporation's net indebtedness after the business combination; and
- Calculated an additional income tax expense to reflect the pro forma adjustments described above.

## B. Acquisition of the assets of Clearlogx®

### Description of the business combination

On October 21, 2015, the Corporation acquired all of the assets of Clearlogx pertaining to its unique Clearlogx® control technology. In addition to the Clearlogx® technology, the Corporation purchased Clearlogx®'s business related to the sale of coagulants for conventional and membrane filtration systems. This acquisition was made for a total consideration of $2,854,281 (US$2,168,591), including an earn-out payment of $641,421 (US$489,287) paid during the fiscal year 2017, and an additional potential earn-out payment of $236,233 (US$179,304) recorded for the remaining period of the three years following the effective date of the transaction. The acquisition of these assets was accounted for using the purchase method. The assets results have been consolidated as of October 21, 2015. This acquisition was entirely financed with a long-term bank loan of $2,634,600 (US$2,000,000).

### Assets acquired at the acquisition date

| | Preliminary allocation | Adjustments | Final allocation |
|---|---|---|---|
| **Assets** | | | **$** |
| **Non-current assets** | | | |
| Property, plant and equipment | | | |
| Machinery and equipment | 9,221 | - | **9,221** |
| Intangible assets | | | |
| Customer backlog | 33,841 | 6 | **33,847** |
| Customer relations | 433,125 | (238,475) | **194,650** |
| Intellectual property | 1,650,935 | (563,723) | **1,087,212** |
| Trademark | 115,000 | 375,362 | **490,362** |
| Identifiable net assets acquired | 2,242,122 | (426,830) | **1,815,292** |
| Goodwill arising on acquisition | - | 1,038,989 | **1,038,989** |
| Purchase price consideration | 2,242,122 | 612,159 | **2,854,281** |

The purchase price allocation shown above is final and is a summary of the assets acquired and the consideration transferred at fair value as at the acquisition date. It was completed during the second quarter of fiscal year 2017. The original transaction was made in U.S. dollars and converted into Canadian dollars as at the acquisition date.

In the intangible assets' tax treatment, 75% of the intellectual property and the trademark acquired will be treated as eligible assets with related tax deductions and 25% as non-deductible. The goodwill, the customer backlog and the client relationship are deductible for tax purposes.

### Sources and uses of funds at the transaction closing date

| | Preliminary allocation | Adjustments | Final allocation |
|---|---|---|---|
| **Sources** | | | **$** |
| Long-term debt (note 16) | 2,634,600 | - | **2,634,600** |
| Working capital | - | 219,304 | **219,304** |
| | 2,634,600 | 219,304 | **2,853,904** |
| **Uses** | | | |
| Initial cash consideration transferred | (1,976,250) | - | **(1,976,250)** |
| Working capital for the Corporation's current activities | (392,478) | 392,478 | **-** |
| Contingent consideration paid | - | (641,421) | **(641,421)** |
| Contingent consideration (unpaid as of June 30, 2017) | (265,872) | 29,639 | **(236,233)** |
| | - | - | **-** |

The unpaid contingent consideration was estimated based on certain forecasted revenues and projected earnings before income taxes, depreciation and amortization (EBITDA) over a three-year period.

### Costs related to the acquisition

The total acquisition-related costs amounted to $58,106 and have been included in administrative expenses in the consolidated statements of (loss) earnings for the year ended June 30, 2016.

### Determination of fair value

At the acquisition date, the identifiable assets acquired are recognized at the acquisition-date fair value.

The Corporation's valuation of intangible assets has identified customer backlog, customer relations, intellectual property and trademark. The assigned useful lives are 3.5 months for customer backlog, 10 years for customer relations, 10 years for intellectual property and 10 years for trademark. Significant assumptions used in the determination of intangible assets, as defined by management, are year-over-year sales growth, discount rate and operating income before depreciation and amortization.

### Goodwill arising from the business combination

Based on management's calculations, goodwill amounting to $1,038,989 has been attributed to the transaction. The goodwill is deductible for tax purposes.

## 6. Guaranteed deposit certificates

| **As at June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Guaranteed deposit certificates, held as collateral for credit cards, bearing interest at 0.80% (0.75% as at June 30, 2016) and maturing in April 2019 | **254,498** | 252,623 |
| Guaranteed deposit certificates, held as collateral for letters of credit, bearing interest at 0.30% (0.40% as at June 30, 2016), and renewed monthly | **33,717** | 133,401 |
| Guaranteed deposit certificates, held as collateral for letters of credit, bearing interest at 0.80% (0.75% as at June 30, 2016) and maturing in May 2019 | **1,017,526** | 1,010,057 |
| Guaranteed deposit certificate held as collateral for letters of credit , bearing interest at 0.28% (0.24% as at June 30, 2016) and maturing in July 2017 | **65,850** | 65,381 |
| | **1,371,591** | 1,461,462 |

## 7. Accounts receivable

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Trade accounts receivable | **10,023,986** | 8,115,997 |
| Retentions from customer under project contracts | **1,980,423** | 1,012,846 |
| Allowance for doubtful accounts (i) | **-** | - |
| | **12,004,409** | 9,128,843 |
| Tax credits receivable | **45,527** | 83,395 |
| Other receivables | **1,160,539** | 980,445 |
| | **13,210,475** | 10,192,683 |

Trade accounts receivable disclosed above include amounts that are past due at the end of the reporting period for which the Corporation has not recognized an allowance for doubtful accounts because there has not been a significant change in credit quality and the amounts are still considered recoverable. In some cases, the Corporation holds the legal right to lien construction projects in the event that certain counterparties do not pay their balance within a specified period of time. The gross amount of accounts receivable for which an allowance for doubtful accounts is recorded is nil (nil as at June 30, 2016).

(i) Movement in the allowance for doubtful accounts

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Balance at beginning of the year | **-** | (1,270) |
| Amounts written off during the year as uncollectible | **-** | 1,270 |
| Balance at end of the year | **-** | - |

There is no impairment or amount past due other than those related to trade accounts receivable.

## 8. Inventories

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Raw materials | **1,157,069** | 1,201,951 |
| Finished goods | **3,760,523** | 3,242,859 |
| | **4,917,592** | 4,444,810 |

As a result of variations in the ageing of its inventory of raw materials in Canada and in the United States, the Corporation recognized an inventory provision for the year of $273,194 ($132,256 in fiscal year 2016).

## 9. Work in progress

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Construction costs related to Projects incurred plus recognized profits less recognized losses to date | **46,185,881** | 62,807,664 |
| Less: Progress billings | **(41,809,523)** | (60,184,724) |
| Net statement of financial position for ongoing Projects contracts | **4,376,358** | 2,622,940 |

| | | |
|---|---|---|
| Recognized and included in the consolidated statement of financial position as amounts due: | | |
| From customers under project contracts (costs incurred in excess of billings) | **5,567,267** | 3,534,972 |
| To customers under project contracts (billings in excess of costs incurred) | **(1,190,909)** | (912,032) |
| | **4,376,358** | 2,622,940 |

## 10. Property, plant and equipment

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Cost | **8,519,299** | 6,696,144 |
| Accumulated depreciation and impairment | **(4,352,137)** | (3,183,496) |
| | **4,167,162** | 3,512,648 |
| | | |
| Land | **73,600** | 60,300 |
| Buildings | **1,207,078** | 1,197,157 |
| Machinery and equipment | **595,758** | 340,484 |
| Computer equipment | **132,861** | 126,377 |
| Furniture, fixtures and office equipment | **217,641** | 200,989 |
| Automotive equipment | **489,391** | 16,173 |
| Containerized unit for lease | **812,200** | 1,143,998 |
| Moulds | **340,308** | 219,004 |
| Leasehold improvements | **298,325** | 208,166 |
| | **4,167,162** | 3,512,648 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in Canadian dollars)

| Cost | Land | Buildings | Machinery and equipment | Computer equipment | Furniture, fixtures and office equipment | Automotive equipment | Containerized unit for lease | Moulds | Leasehold improvements | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ | $ | $ | $ | $ |
| **Balance as at June 30, 2016** | 60,300 | 1,495,966 | 1,975,406 | 331,321 | 492,887 | 103,552 | 1,523,539 | 285,187 | 427,986 | **6,696,144** |
| Additions | 13,300 | 83,605 | 333,980 | 56,019 | 53,473 | 195,259 | 319,371 | 144,382 | 164,210 | **1,363,599** |
| Assets acquired through business combination (note 5) | - | - | 66,998 | 13,242 | - | 555,726 | - | - | - | **635,966** |
| Disposals | - | - | - | - | - | (41,333) | - | - | - | **(41,333)** |
| Write-off of fully depreciated assets | - | - | (24,136) | (54,464) | - | (41,716) | - | - | - | **(120,316)** |
| Effect of foreign currency exchange differences | - | - | (4,972) | 657 | 379 | (9,672) | (2,998) | 721 | 1,124 | **(14,761)** |
| **Balance as at June 30, 2017** | **73,600** | **1,579,571** | **2,347,276** | **346,775** | **546,739** | **761,816** | **1,839,912** | **430,290** | **593,320** | **8,519,299** |
| **Cumulated depreciation** | | | | | | | | | | |
| Balance as at June 30, 2016 | - | (298,809) | (1,634,922) | (204,944) | (291,898) | (87,379) | (379,541) | (66,183) | (219,820) | **(3,183,496)** |
| Depreciation expense | - | (73,684) | (140,409) | (62,612) | (37,079) | (272,302) | (651,464) | (24,086) | (75,093) | **(1,336,729)** |
| Disposals | - | - | - | - | - | 41,333 | - | - | - | **41,333** |
| Write-off of fully depreciated assets | - | - | 24,136 | 54,464 | - | 41,716 | - | - | - | **120,316** |
| Effect of foreign currency exchange differences | - | - | (323) | (822) | (121) | 4,207 | 3,293 | 287 | (82) | **6,439** |
| **Balance as at June 30, 2017** | - | (372,493) | (1,751,518) | (213,914) | (329,098) | (272,425) | (1,027,712) | (89,982) | (294,995) | **(4,352,137)** |
| **Net amount as at June 30, 2017** | **73,600** | **1,207,078** | **595,758** | **132,861** | **217,641** | **489,391** | **812,200** | **340,308** | **298,325** | **4,167,162** |

| Cost | Land | Buildings | Machinery and equipment | Computer equipment | Furniture, fixtures and office equipment | Automotive equipment | Containerized unit for lease | Moulds | Leasehold improvements | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ | $ | $ | $ | $ |
| **Balance as at June 30, 2015** | 33,000 | 1,476,521 | 1,884,360 | 395,622 | 411,429 | 101,823 | 926,852 | 223,121 | 293,926 | **5,746,654** |
| Additions | 27,300 | 19,445 | 66,604 | 77,946 | 78,693 | - | 610,405 | 55,003 | 160,927 | **1,096,323** |
| Business combination (note 5) | - | - | 7,226 | 1,995 | - | - | - | - | - | **9,221** |
| Write-off of fully depreciated assets | - | - | - | (145,391) | - | - | - | - | (34,863) | **(180,254)** |
| Effect of foreign currency exchange differences | - | - | 17,216 | 1,149 | 2,765 | 1,729 | (13,718) | 7,063 | 7,996 | **24,200** |
| **Balance as at June 30, 2016** | **60,300** | **1,495,966** | **1,975,406** | **331,321** | **492,887** | **103,552** | **1,523,539** | **285,187** | **427,986** | **6,696,144** |
| **Cumulated depreciation** | | | | | | | | | | |
| Balance as at June 30, 2015 | - | (227,564) | (1,531,638) | (296,344) | (259,105) | (65,398) | (114,707) | (30,078) | (201,031) | **(2,725,865)** |
| Depreciation expense | - | (71,245) | (92,723) | (52,864) | (31,022) | (21,002) | (267,019) | (36,072) | (49,110) | **(621,057)** |
| Write-off of fully depreciated assets | - | - | - | 145,391 | - | - | - | - | 34,863 | **180,254** |
| Effect of foreign currency exchange differences | - | - | (10,561) | (1,127) | (1,771) | (979) | 2,185 | (33) | (4,542) | **(16,828)** |
| **Balance as at June 30, 2016** | - | (298,809) | (1,634,922) | (204,944) | (291,898) | (87,379) | (379,541) | (66,183) | (219,820) | **(3,183,496)** |
| **Net amount as at June 30, 2016** | **60,300** | **1,197,157** | **340,484** | **126,377** | **200,989** | **16,173** | **1,143,998** | **219,004** | **208,166** | **3,512,648** |

## 11. Intangible Assets

| As at June 30, | 2017 | 2016 (adjusted, note 2) |
|---|---|---|
| | $ | $ |
| Cost | **36,776,647** | 22,815,146 |
| Accumulated amortization and impairment | **(16,356,741)** | (13,202,235) |
| | **20,419,906** | 9,612,911 |
| | | |
| Software | **1,896,077** | 1,269,644 |
| Intellectual property | **3,912,723** | 4,493,744 |
| Trademark | **1,627,841** | 1,035,313 |
| Customer relations | **7,721,027** | 2,526,807 |
| Contractual agreements | **1,346,108** | - |
| Non-compete agreements | **3,504,754** | - |
| Deferred development costs | **411,376** | 287,403 |
| | **20,419,906** | 9,612,911 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in Canadian dollars)

| Cost | Software | Intellectual property | Trademarks | Customer relations | Distribution network | Customer Backlog | Contractual agreements | Non-Compete agreements | Deferred development costs | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ | $ | $ | $ | $ |
| Balance as at June 30, 2016 | 1,657,680 | 10,264,324 | 1,674,376 | 7,264,249 | 1,633,267 | 33,847 | - | - | 287,403 | **22,815,146** |
| Additions | 681,764 | 11,733 | - | 1,390 | - | - | - | - | 294,687 | **989,574** |
| Business combination (note 5a) | - | - | 766,281 | 6,207,502 | - | - | 2,246,647 | 3,930,322 | - | **13,150,752** |
| Write-off of fully depreciated assets | (49,879) | - | - | - | - | - | - | - | - | **(49,879)** |
| Effect of foreign currency exchange differences | 1,698 | 40,466 | (6,966) | (71,417) | 7,587 | (509) | (36,112) | (63,176) | (517) | **(128,946)** |
| **Balance as at June 30, 2017** | **2,291,263** | **10,316,523** | **2,433,691** | **13,401,724** | **1,640,854** | **33,338** | **2,210,535** | **3,867,146** | **581,574** | **36,776,647** |
| **Accumulated amortization** | | | | | | | | | | |
| Balance as at June 30, 2016 | (388,036) | (5,770,580) | (639,063) | (4,737,442) | (1,633,267) | (33,847) | - | - | - | **(13,202,235)** |
| Amortization expense | (56,457) | (618,736) | (166,670) | (357,649) | - | - | - | - | (170,197) | **(1,369,745)** |
| Business combination (note 5) | - | - | - | (584,620) | - | - | (883,744) | (370,490) | - | **(1,838,854)** |
| Write-off of fully depreciated assets | 49,879 | - | - | - | - | - | - | - | - | **49,879** |
| Effect of foreign currency exchange differences | (572) | (14,484) | (117) | (986) | (7,587) | 509 | 19,317 | 8,098 | - | **4,214** |
| **Balance as at June 30, 2017** | (395,186) | (6,403,800) | (805,850) | (5,680,697) | (1,640,854) | (33,338) | (864,427) | (362,392) | (170,197) | **(16,356,741)** |
| **Net amount as at June 30, 2017** | **1,896,077** | **3,912,723** | **1,627,841** | **7,721,027** | **-** | **-** | **1,346,108** | **3,504,754** | **411,376** | **20,419,906** |

| Cost | Software | Intellectual property | Trademarks | Contractual relations | Distribution network | Customer Backlog | Deferred development costs | Total |
|---|---|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ | $ | $ |
| Balance as at June 30, 2015 | 995,058 | 8,824,737 | 1,145,107 | 6,837,054 | 1,579,276 | - | - | **19,381,232** |
| Additions | 656,714 | 65,389 | 827 | - | - | - | 287,403 | **1,010,333** |
| Business combination (adjusted, notes 2 and 5) | - | 1,087,212 | 490,362 | 194,650 | - | 33,847 | - | **1,806,071** |
| Effect of foreign currency exchange differences | 5,908 | 286,986 | 38,080 | 232,545 | 53,991 | - | - | **617,510** |
| **Balance as at June 30, 2016** | **1,657,680** | **10,264,324** | **1,674,376** | **7,264,249** | **1,633,267** | **33,847** | **287,403** | **22,815,146** |
| **Accumulated amortization** | | | | | | | | |
| Balance as at June 30, 2015 | (330,165) | (5,107,059) | (520,509) | (4,251,650) | (1,579,276) | - | - | **(11,788,659)** |
| Amortization expense | (56,723) | (514,359) | (103,614) | (350,501) | - | (33,847) | - | **(1,059,044)** |
| Effect of foreign currency exchange differences | (1,148) | (149,162) | (14,940) | (135,291) | (53,991) | - | - | **(354,532)** |
| **Balance as at June 30, 2016** | (388,036) | (5,770,580) | (639,063) | (4,737,442) | (1,633,267) | (33,847) | - | **(13,202,235)** |
| **Net amount as at June 30, 2016** | **1,269,644** | **4,493,744** | **1,035,313** | **2,526,807** | **-** | **-** | **287,403** | **9,612,911** |

## 12. Goodwill

The change in carrying value is as follows:

| | Total<br>$ |
|---|---|
| Balance as at June 30, 2015 | 4,694,166 |
| Effect of foreign exchange differences | 160,481 |
| Balance as at June 30, 2016 | 4,854,647 |
| **Adjustment to reflect final allocation - Clearlogx (note 5b)** | **1,038,989** |
| **Adjusted balance as at June 30, 2016 (note 2)** | **5,893,636** |
| **Business combination – Utility Partners (note 5a)** | **8,534,492** |
| **Effect of foreign exchange differences** | **(127,406)** |
| **Balance as at June 30, 2017** | **14,300,722** |

Goodwill has been allocated to the Corporation's cash-generating units ("CGU"), United States and Canada, for impairment testing purposes. The carrying amount of goodwill was allocated to cash-generating units as follows:

| **As at June 30,** | **2017** | 2016<br>(adjusted, note 2) |
|---|---|---|
| | **$** | $ |
| Canada | **-** | - |
| United States | | |
| Goodwill | **14,300,722** | 5,893,636 |
| | **14,300,722** | 5,893,636 |

The Corporation carries out its impairment test annually or more frequently if there is an indicator of impairment. The Corporation has aggregated its cash-generating units into countries for the purposes of the goodwill impairment test. The carrying values of the goodwill have been allocated for impairment testing purposes to these CGU groups.

As at March 31, 2017, the recoverable amount of the cash-generating unit was established by calculating its value in use which is performed using discounted cash flow projections that are based on a one-year financial budget approved by the Board of Directors. These cash flow projections consider the historical results of the cash-generating units, the market tendencies and the Corporation operational strategies. At the end of this one-year period, management estimates future cash flow projections for a period of four years. The Corporation measures the terminal value of the cash-generating units at the end of the five-year projections.

Cash flow projections during the five-year budget period are based on the same expected gross profit throughout the budget period. Management estimated that, if a change occurred in the key assumptions on which recoverable amount is based, it could cause the aggregate carrying amount to exceed the aggregate recoverable amount of each of the cash-generating units, resulting in the recognition of an impairment charge.

The key assumptions to which the recoverable amounts of each of the CGU groups are most sensitive include discount rates applied to cash flow projections, growth rates for revenue as well as future gross profits on projects, products and services and operation and maintenance. Cash flows and future gross profit were projected based on past experience and actual operating results using forecasts approved by management. The discount rates were based on the Corporation's weighted average cost of capital using a standard capital structure and reflect specific risks related to the CGU groups under review. The calculation of the recoverable amounts was based on the following key assumptions:

| **As at June 30, 2017** | **Growth rate for the terminal period** | **Post-tax discount rate** |
|---|---|---|
| Canada | 3 % | 14 % |
| United States | 3 % | 14.5 % |

| As at June 30, 2016 | Growth rate for the terminal period | Post-tax discount rate |
|---|---|---|
| Canada | 3.0% | 15.3% |
| United States | 3.0% | 14.9% |

In the third quarter of fiscal year 2017, the Corporation assessed the recoverable amount of the cash-generating unit "United States" at $43,000,000 ($27,852,000 in fiscal year 2016) and did not recognize any goodwill impairment loss. The value-in use calculation 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 estimated by management, based on past experience and consistent with external sources of information.

## 13. Bank loans

The Corporation has an authorized credit facility available of US$5,000,000 ($6,488,500) bearing interest at CDN prime rate plus 1.00% (3.70% as at June 30, 2017 and June 30, 2016) and at US prime rate plus 1.00% (5.75% as at June 30, 2017, and 5.00% as at June 30, 2016) are secured by an assignment of accounts receivable and inventories and by Export Development Canada (EDC). As at June 30, 2017, $3,396,231 was used on this line of credit ($3,832,858 as at June 30, 2016).

The Corporation has an authorized credit facility available of US$2,000,000 ($2,595,400) bearing interest at CDN prime rate plus 1.00% (3.70% as at June 30, 2017 and June 30, 2016) and at US prime rate plus 1.00% (5.75% as at June 30, 2017 and 5.00% as at June 30, 2016). This credit facility is secured by EDC. As at June 30, 2017, $1,696,376 was used on this credit facility ($2,129,892 as at June 30, 2016).

The Corporation has a credit facility enabling it to issue letters of credit for a maximum amount of $1,000,000. This credit facility is secured either by EDC or guaranteed deposit certificate. As at June 30, 2017, $292,585 was used on this credit facility ($487,550 as at June 30, 2016).

The Corporation has a credit facility enabling it to issue letters of credit for a maximum amount of $1,000,000. The credit facility is secured by $1,017,526 in guaranteed deposit certificate ($1,010,057 as at June 30, 2016). As at June 30, 2017, the Corporation issued $1,000,000 in letters of credit under this credit facility ($1,000,000 as at June 30, 2016).

The Corporation has access to hedging facility of $500,000. This facility is secured by EDC and is unused as at June 30, 2017 (unused as at June 30, 2016).

The Corporation has a credit facility enabling it to use a maximum amount of $250,000 on credit cards for Corporation's related expenses. This credit facility is secured by $254,498 in guaranteed deposit certificate ($252,623 as at June 30, 2016). As at June 30, 2017, $55,269 was used on this credit facility ($110,507 as at June 30, 2016).

A letter of credit issued by the Corporation and amounting to $64,580 as at June 30, 2016 has been cancelled during fiscal year ended June 30, 2017, for which the collateral, a guaranteed deposit certificate in the amount of $65,850 ($65,381 as at June 30, 2016), should be released during the first quarter of the next fiscal year.

The Corporation still has letters of credit amounting to $21,173 ($121,074 as at June 30, 2016) with its previous bank, which are secured by a $33,717 guaranteed deposit certificate ($133,401 as at June 30, 2016).

Covenants
The Corporation has undertaken to maintain covenants in respect of the bank loans, as described in note 24-Capital Management.

## 14. Accounts Payable and Accrued Liabilities

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Trade accounts payable | **8,056,117** | 2,275,716 |
| Other accrued liabilities and accounts payable | **4,627,698** | 4,724,113 |
| | **12,683,815** | 6,999,829 |

## 15. Provisions

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

| | $ |
|---|---|
| Balance as at June 30, 2015 | 84,272 |
| Additional provisions recognized | 33,500 |
| Less: Payments | (12,338) |
| Effect of foreign exchange differences | 8,790 |
| Balance as at June 30, 2016 | 114,224 |
| **Additional provisions recognized** | **37,000** |
| **Less: Payments** | **-** |
| **Effect of foreign exchange differences** | **494** |
| **Balance as at June 30, 2017** | **151,718** |

## 16. Long-Term Debt

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| ***Unsecured – at amortized cost*** | | |
| Loan, denominated in Canadian dollars (a)(h) | **4,242,440** | - |
| Loan from other entities, denominated in Canadian dollars (b)(h) | **4,628,474** | - |
| Loan, denominated in US dollars (c)(h) | **1,730,266** | 2,238,946 |
| Loans, denominated in Canadian dollars (d) | **400,360** | 536,200 |
| Loan from other entities, denominated in US dollars (e) | **2,668** | 30,584 |
| Loan from other entities, denominated in Canadian dollars (f) | **32,772** | - |
| Loan from other entities, denominated in Canadian dollars (g) | **148,124** | - |
| Loan from other entities, denominated in Canadian dollars | **-** | 41,525 |
| | **11,185,104** | 2,847,255 |
| Less: Current portion | **2,036,151** | 721,973 |
| Long-term debt | **9,148,953** | 2,125,282 |

(a) Loan
On July 18, 2016, an agreement was concluded for a loan amounting to $5,000,000, to finance the acquisition of Utility Partners. The loan bears interest at prime rate plus 1.5% (4.2% as at June 30, 2017), payable in 72 monthly instalments of $69,444, principal only, maturing on July 18, 2022. The loan is presented net of financing costs of $63,115.

(b) Loan from other entities
On July 18, 2016, an agreement was concluded for a loan amounting to $5,000,000, to finance the acquisition of Utility Partners. The loan bears interest at prime rate plus 2.5% (5.2% as at June 30, 2017), payable in 96 monthly instalments of $52,083, principal only, reimbursement starting the 14th day of six-month following the disbursement, maturing on December 4, 2024. The loan is presented net of financing costs of $59,026.

(c) Loan
On October 20, 2015, an agreement was concluded for a loan amounting to $2,585,400 (US$2,000,000), to finance the acquisition of all the assets of Clearlogx®'s control technology and its specialty coagulant business line. The loan bears interest at prime rate plus 1.0% (5.75% as at June 30, 2017), payable in 60 monthly instalments of $43,256 (US$33,333), principal only, maturing on October 20, 2020.

(d) Loans
On September 20, 2014, an agreement was concluded for a loan amounting up to $460,000, secured by a first rank hypothec on the Ham-Nord plant, representing a carrying value of $1,260,000, bearing interest at floating prime rate plus 1.05% (5.85% as at June 30, 2017), payable in one instalment of $4,120 on September 23, 2015 and 131 monthly instalments of $3,480, principal only, maturing on August 23, 2026.

On April 13, 2016, an agreement was concluded for a loan amounting up to $565,000, bearing interest at floating prime rate plus 1.0% (5,80% as at June 30, 2017), payable in one instalment of $8,360 on June 23, 2016 and 71 monthly instalments of $7,840, principal only, maturing on May 23, 2022.

(e) Loan from other entities
A loan of $2,668 (US$2,056), bearing interest at 8.5% payable in monthly instalments of $2,454 (US$1,900) is maturing on July 1, 2017.

(f) Loan from other entities
On July 12, 2016, an agreement was concluded for a loan of $32,772 bearing interest at 3.4% payable in monthly instalments of $801 and maturing July 12, 2021.

(g) Loan from other entities
The Corporation entered into an agreement for a loan of $148,124 for the renovation of the premises. The loan bears interest at 6.83% and is payable in 87 monthly instalments of $2,921, principal and interest, and is maturing in June 2022.

(h) These long-term debt arrangements require that the Corporation meet the following financial ratios at fixed points in time;
- Working capital ratio, defined as current assets divided by current liabilities greater than or equal to 1.25:1.00;
- Debt-to-equity ratio, defined as total debt excluding deferred taxes divided by equity of less than or equal to 2.75:1.00; and
- Fixed charge coverage ratio, including all capital and interest payments on borrowings due and capital expenditures, as defined, greater than or equal to 1.00:1.00.

The annual principal instalments due on the long-term debt are $2,073,396 in 2018, $2,054,491 in 2019, $2,056,922 in 2020 and $1,712,675 in 2021.

## 17. Contingent consideration

The change in carrying value of the contingent consideration is as follows:

| | $ |
|---|---|
| Balance as at June 30, 2015 | - |
| Contingent consideration – Clearlogx® | 262,437 |
| Balance as at June 30, 2016 | 262,437 |
| Additional contingent consideration recognized (notes 2 and 5) | 641,421 |
| Variation of contingent consideration (notes 2 and 5) | (29,639) |
| Effect of foreign exchange differences | 377 |
| Balance as at June 30, 2016 (adjusted, note 2) | 874,596 |
| **Less: Payments** | **(641,421)** |
| **Effect of foreign exchange differences** | **(492)** |
| **Balance as at June 30, 2017** | **232,683** |

## 18. Income Taxes

**Income tax expenses are detailed as follows:**

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Current tax expense: | | |
| Current period | **88,830** | 3,892 |
| Adjustment for prior periods | **78,529** | 8,221 |
| | **167,359** | 12,113 |
| Deferred tax expense: | | |
| Origination and reversal of temporary differences | **(1,071,337)** | 297,889 |
| Reduction in tax rate | **-** | 166,040 |
| Adjustment for prior periods | **249,627** | 202,020 |
| | **(821,710)** | 665,949 |
| **Income taxes** | **(654,351)** | 678,062 |

**Reconciliation of the Corporation's effective income tax expense:**

The Canadian statutory tax rate is 26.75 % (26.87 % for 2016). The decrease is caused by a change in the Canadian provinces tax rate. The following is a reconciliation of income taxes calculated at the Canadian statutory tax rate to the expense for 2017 and 2016.

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| (Loss) earnings before income taxes | **(5,785,337)** | 837,031 |
| Income taxes at the Canadian statutory tax rate of 26.75% (26.87% in 2016) | **(1,547,578)** | 224,910 |
| **Tax effect from:** | | |
| Effect of differences in tax rates in other jurisdictions | **(260,110)** | 166,040 |
| Tax losses and deductible temporary differences for which no deferred income tax assets is recognized | **612,226** | 21,209 |
| Changes in statutory rates | **22,469** | - |
| Non-deductible stock-based payments | **167,866** | - |
| Adjustments in respect of prior years | **328,156** | 202,020 |
| Tax credits | **-** | 3,819 |
| Items not affecting earnings | **-** | (40,029) |
| Non-deductible items | **62,660** | 49,583 |
| Other | **(40,040)** | 50,510 |
| **Total income tax (recovery) charge** | **(654,351)** | 678,062 |

**Deferred tax assets and liabilities**

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Reconciliation to the consolidated statements of financial position: | | |
| Deferred tax assets | **4,179,078** | 4,720,889 |
| Deferred tax liabilities | **(1,096,137)** | (2,453,662) |
| **Net deferred tax assets** | **3,082,941** | 2,267,227 |

Changes to deferred tax assets (liabilities) related to temporary differences as follows:

| | Balance as at July 1, 2016 $ | Recognized in earnings $ | Recognized in equity $ | Balance as at June 30, 2017 $ |
|---|---|---|---|---|
| Non-capital losses | 1,081,705 | (826,914) | 21,066 | 275,857 |
| Property, plant and equipment | (170,703) | (117,836) | 1,493 | (287,046) |
| Intangible assets | (1,262,473) | 468,330 | (14,950) | (809,093) |
| U.S. interests not deducted and deferred | 2,413,884 | 594,071 | (312) | 3,007,643 |
| Other assets | 204,814 | 704,059 | (13,293) | 895,580 |
| | **2,267,227** | **821,710** | **(5,996)** | **3,082,941** |

| | Balance as at July 1, 2015 $ | Recognized in earnings $ | Recognized in equity $ | Balance as at June 30, 2016 $ |
|---|---|---|---|---|
| Non-capital losses | 940,115 | 109,450 | 32,140 | 1,081,705 |
| Property, plant and equipment | (101,442) | (65,793) | (3,468) | (170,703) |
| Intangible assets | (1,183,226) | (38,796) | (40,451) | (1,262,473) |
| U.S. interests not deducted and deferred | 3,065,882 | (761,002) | 109,004 | 2,413,884 |
| Other assets | 110,830 | 90,192 | 3,792 | 204,814 |
| | **2,832,159** | **(665,949)** | **101,017** | **2,267,227** |

At June 30, 2017, the Corporation had the following tax losses carried forward available to reduce taxable income in the future, and investment tax credits carryovers to reduce income tax payable, and in respect of which the Corporation has not recognized a deferred tax on those from Canada.

| Tax losses carried forward expire as follows: | Date | Canada | USA |
|---|---|---|---|
| | | $ | $ |
| | 2026 | 69,000 | - |
| | 2027 | 1,924,000 | - |
| | 2028 | 2,619,000 | - |
| | 2029 | 1,000 | - |
| | 2030 | 672,000 | - |
| | 2032 | - | - |
| | 2033 | - | 362,000 |
| | 2034 | 2,612,000 | - |
| | 2035 | 205,000 | - |
| | 2036 | 305,000 | 224,000 |
| | 2037 | 2,419,000 | - |
| | | **10,826,000** | **586,000** |

| Investment tax credits expire as follows: | Date | Canada |
|---|---|---|
| | 2021 | 9,000 |
| | 2022 | 76,000 |
| | 2023 | 141,000 |
| | 2024 | 51,000 |
| | 2026 | 36,000 |
| | 2027 | 22,000 |
| | 2028 | 38,000 |
| | 2029 | 6,000 |
| | 2030 | 21,000 |
| | 2031 | 21,000 |
| | 2033 | 29,000 |
| | | **450,000** |

The ability to realize the tax benefits from these losses and investment tax credits is dependent upon a number of factors, including the future profitability of operations in the jurisdictions in which the tax losses and investment tax credits arose. Deferred tax assets are recognized in respect of tax losses and other temporary differences giving rise to deferred tax assets only to the extent that it is probable that sufficient taxable profits will be available to allow the asset to be recovered.

Accordingly, no deferred tax asset has been recognized on the following tax losses carried forward and temporary differences.

| **As at June 30, 2017** | Canada | United States |
|---|---|---|
| | $ | $ |
| Tax losses carried forward | 8,741,641 | - |
| Development and exploration expenses | 1,976,886 | - |
| Capital losses | 249,649 | - |
| Research and development expenses | 2,374,112 | - |
| Property, plant and equipment | 7,439,069 | - |
| Intangible assets | - | - |
| Financing and share issue expenses | 1,327,129 | - |
| | **22,108,486** | **-** |

| **As at June 30, 2016** | Canada | United States |
|---|---|---|
| | $ | $ |
| Tax losses carried forward | 8,398,050 | - |
| Development and exploration expenses | 1,814,421 | - |
| Capital losses | 249,349 | - |
| Research and development expenses | 2,389,282 | - |
| Property, plant and equipment | 5,169,334 | - |
| Intangible assets | - | - |
| Financing and share issue expenses | 275,400 | - |
| | **18,295,836** | **-** |

## 19. Capital Stock

### Private placements

On July 26, 2016, the Corporation issued, by way of a bought deal private placement and concurrent additional non-brokered private placement, 19,217,663 common shares with gross proceeds of $23,061,196, expenses of $1,441,856 for net proceeds of $21,619,340. The Corporation used the proceeds to complete the acquisition of Utility Partners (note 5) and to support its working capital.

### Share Capital

The Corporation has authorized an unlimited number of common shares (being voting and participating shares) with no par value.

As of June 30, 2017, the Corporation has a total of 40,144,214 shares issued (20,926,551 as of June 30, 2016).

### Stock options

The Corporation has established a stock option plan whereby the Board of Directors may grant stock options to directors, executive officers, key employees and consultants providing services to the Corporation. The Board of Directors determines, at its discretion, the vesting terms, if applicable, the expiry date of options and the number of options to be granted. The maximum number of shares that may be issued under the plan amounts to 4,000,000.

On July 26, 2016, the Corporation granted a total of 2,303,334 stock options issued to members of top management with a vesting period of eight years as an incentive to participate in the long-term development of the Corporation and the growth of the shareholder's value. Each stock option entitles its holders to acquire one common share of the Corporation at a price of $1.65 before July 26, 2026. The Black-Scholes value was established at $0.856 per option.

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

| **Year ended June 30,** | **2017** |
|---|---|
| Number of stock options | **2,303,334** |
| Expected dividend yield | **0%** |
| Expected volatility | **48%** |
| Risk-free interest rate | **0.81%** |
| Expected life (years) | **8** |
| Fair value at the grant date | **$0.856** |

For the year ended June 30, 2017, the amount recorded as stock-based compensation for options granted to its directors, officers and key employees is $627,526 (nil in 2016).

The following table summarizes the situation of the Corporation's stock-based compensation plan as at June 30, 2017, and June 30, 2016 and the change during the years ended on these dates:

| **Years ended June 30,** | **2017** | | 2016 | |
|---|---|---|---|---|
| | **Number** | **Weighted average exercise price** | Number | Weighted average exercise price |
| | | **$** | | $ |
| Outstanding - Beginning of year | **262,000** | **2.64** | 331,500 | 2.64 |
| Granted | **2,303,334** | **1.65** | - | - |
| Expired | **-** | **-** | (13,000) | 2.50 |
| Forfeited | **-** | **-** | (56,500) | 2.68 |
| Outstanding - End of year | **2,565,334** | **1.75** | 262,000 | 2.64 |

As at June 30, 2017, the following stock options were granted:

| Exercise price | Holders | Number of shares | Weighted average remaining life (years) | Weighted average exercise price |
|---|---|---|---|---|
| $ | | | | $ |
| 3.75 | Directors | 25,000 | 2.41 | 0.04 |
| 3.75 | Directors | 4,000 | 3.04 | 0.01 |
| 2.50 | Employees | 191,000 | 3.23 | 0.19 |
| 2.50 | Directors | 42,000 | 3.37 | 0.04 |
| 1.65 | Employees | 2,303,334 | 7.08 | 1.48 |
| | | 2,565,334 | 6.68 | 1.75 |

As at June 30, 2017, the following stock options could be exercised:

| Exercise price | Number of shares | Weighted average exercise price |
|---|---|---|
| $ | | $ |
| 3.75 | 29,000 | 0.05 |
| 2.50 | 233,000 | 0.23 |
| | 262,000 | 0.28 |

## 20. Additional information about the nature of costs components

### a) Expenses by nature

| **Years ended June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Material | **30,698,038** | 24,350,640 |
| Changes in inventories of raw material and finished goods | **(2,892,905)** | 1,345,849 |
| Salaries and fringe benefits | **41,096,787** | 14,841,700 |
| Subcontractors and professional fees | **3,662,930** | 1,433,282 |
| Rent, electricity, insurance and office expenses | **2,256,559** | 1,939,708 |
| Telecommunications and travel expenses | **3,615,283** | 2,054,566 |
| Bad debt expenses | **-** | 132,616 |
| Stock-based compensation | **627,526** | - |
| Other expenses | **2,944,719** | 1,814,974 |
| Total cost of goods sold, operating, selling and administrative expenses and research and development expenses - net | **82,008,937** | 47,913,335 |

## b) Depreciation and amortization

The Corporation has elected to present depreciation and amortization as a separate line item in its consolidated statement of income, as opposed to reflecting the fraction of such amount that pertains to each of the cost of goods sold, operating expenses, selling expenses, administrative expenses and research and development expenses – net, 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 years ended June 30, 2017 and 2016 and ii) the amounts of cost of goods sold, operating expenses, selling expenses, administrative expenses and research and development expenses - net, if depreciation and amortization were allocated within those cost categories.

| **Depreciation by function**<br>**Years ended June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Cost of goods sold | **1,167,411** | 483,971 |
| Operating expenses | **2,868** | 2,643 |
| Selling expenses | **39,553** | 39,207 |
| Administrative expenses | **126,897** | 95,236 |
| | **1,336,729** | 621,057 |

| **Amortization by function**<br>**Years ended June 30,** | **2017** | 2016<br>(adjusted, note 2) |
|---|---|---|
| | **$** | $ |
| Cost of goods sold | **584,983** | 475,718 |
| Selling expenses | **2,529,944** | 459,936 |
| Administrative expenses | **93,672** | 123,390 |
| | **3,208,599** | 1,059,044 |

| **Cost per function including depreciation and amortization**<br>**Years ended June 30,** | **2017** | 2016<br>(adjusted, note 2) |
|---|---|---|
| | **$** | $ |
| Cost of goods sold | **65,359,522** | 36,084,949 |
| Operating expenses | **1,918,869** | 1,437,830 |
| Selling expenses | **9,734,996** | 6,840,318 |
| Administrative expenses | **9,387,929** | 5,032,335 |
| Research and development expenses – net | **152,949** | 198,004 |
| | **86,554,265** | 49,593,436 |

## c) Research and development expenses – net

| **Years ended June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Gross research and development expenses | **152,949** | 177,807 |
| Research and development tax credits and grants denied | **-** | 20,197 |
| | **152,949** | 198,004 |

### d) Other gains – net

| Years ended June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Unrealized exchange loss (gain) | **14,182** | (78,315) |
| Realized exchange (gain) | **(57,809)** | (33,282) |
| Other revenues | **(38,322)** | (28,559) |
| (Gain) on purchase price adjustment (a) | **-** | (375,977) |
| (Gain) on settlement for containerized unit | **(265,000)** | - |
| (Gain) on disposal of property, plant and equipment | **(20,678)** | (626) |
| | **(367,627)** | (516,759) |

(a) Other gains
In July 2015, an amount of $375,977 has been recorded following the indemnification by Piedmont's sellers due to a breach of certain of their representations and warranties contained in the Share Purchase Agreement dated December 5, 2013.

## 21. Net (Loss) earnings per share

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

| Years ended June 30, | 2017 | 2016 (adjusted, note 2) |
|---|---|---|
| **Net (loss) earnings** | **($5,130,986)** | $158,969 |
| **Basic and diluted weighted average number of share outstanding** | **38,674,011** | 20,926,551 |
| **Items excluded from the calculation of diluted net earnings per share because the exercise price was greater than the average market price of the common shares** | | |
| Stock options | **2,565,334** | 262,000 |

For the years ended June 30, 2017 and 2016, there was no difference in the basic and diluted weighted average number of shares outstanding, since the effect of the stock options would have been anti-dilutive. Accordingly, the diluted earnings per share for these years is calculated using the basic weighted average number of shares outstanding.

## 22. Cash Flows

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

| **Years ended June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Accounts receivable | **1,163** | (248,801) |
| Inventories | **(466,937)** | (457,948) |
| Costs incurred in excess of billings | **(2,031,496)** | (1,427,466) |
| Prepaid expenses | **96,673** | (153,119) |
| Accounts payable and accrued liabilities | **3,197,071** | 2,216,466 |
| Provisions | **36,999** | 28,063 |
| Billings in excess of work in process | **287,288** | (534,331) |
| | **1,120,761** | (577,136) |

b) Cash and cash equivalents consist of the following:

| **As at June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| **Beginning of year** | | |
| Cash and cash equivalents | **3,051,870** | 1,335,887 |
| Bank overdraft | **(520,208)** | (2,052) |
| | **2,531,662** | 1,333,835 |
| **End of year** | | |
| Cash and cash equivalents | **3,870,603** | 3,051,870 |
| Bank overdraft | **(184,120)** | (520,208) |
| | **3,686,483** | 2,531,662 |

## 23. Financial Risk Management

The Corporation's activities expose it to a variety of financial risks: market risks (including currency risk, cash flow interest rate risk and fair value interest rate risk), credit risk and liquidity risk. The Corporation's overall financial risk management program focuses on mitigating unpredictable financial market risks and their potential adverse effects on the Corporation's financial performance.

The Corporation's financial risk management is generally carried out by the corporate team, based on policies approved by the Board of Directors. The identification and evaluation of the financial risks are the responsibility of the corporate team.

### Overview

The Corporation's financial instruments and the nature of risks which they may be subject to are set out in the following table:

| | Risks | | | |
|---|---|---|---|---|
| | Market risks | | | |
| **Financial instrument** | **Currency** | **Interest rate** | **Credit** | **Liquidity** |
| Cash and cash equivalents | X | X | X | |
| Guaranteed deposit certificates | | X | X | |
| Accounts receivable | X | | X | |
| Related party loans receivable | | X | X | |
| Other assets | | | X | |
| Bank overdraft | X | X | | X |
| Bank loans | X | X | | X |
| Accounts payable and other accrued liabilities | X | | | X |
| Long-term debt | X | X | | X |
| Contingent consideration | X | | | X |

### Currency risk

The Corporation 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 Corporation matches, in general and when possible, the cash receipts in a foreign currency with the cash disbursements in the same foreign currency. The Corporation does not use derivative financial instruments to cover the variability of cash flows in foreign currencies.

As at June 30, 2017, 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 year ended June 30, 2017 would have been greater or lesser by approximately $365,802 ($308,579 for the year ended June 30, 2016).

The financial assets and liabilities denominated in U.S. dollars included in the Canadian corporation are as follows:

| **As at June 30,** | **2017** | 2016 (adjusted, note 2) |
|---|---|---|
| | **$** | $ |
| FINANCIAL ASSETS | | |
| Cash and cash equivalents | **484,530** | 377,128 |
| Accounts receivable | **621,266** | 801,278 |
| | **1,105,796** | 1,178,406 |
| FINANCIAL LIABILITIES | | |
| Bank overdraft | **(15,582)** | (97,941) |
| Bank loans | **(4,103,377)** | (4,603,019) |
| Accounts payable and accrued liabilities | **(2,572,604)** | (410,076) |
| Long-term debt | **(1,730,266)** | (2,238,946) |
| Contingent consideration | **-** | (874,596) |
| | **(8,421,829)** | (8,224,578) |

### Cash flow and fair value interest rate risk

In the normal course of business, the Corporation is exposed to interest rate fluctuation risk as a result of the cash and cash equivalents, related party loans receivable, bank overdraft, bank loans and long-term debt. The Corporation does not use derivatives to cover this risk.
The guaranteed deposit certificates and unsecured loans bear interest at fixed rates and are accounted for at amortized cost. The Corporation is, therefore, not exposed to the risk of cash flows, however is exposed to changes in fair value resulting from interest rate fluctuations.

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

As at June 30, 2017 and 2016, 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 Corporation's net loss and comprehensive income. These changes were retained because they are considered reasonably possible according to observations and the economic situation.

### Credit risk

Credit risk relates to the risk that a party to a financial instrument will not fulfil some or all of its obligations, thereby causing the Corporation to sustain a financial loss. The main risk relates to accounts receivable. To manage credit risk from accounts receivable, the Corporation reviews credit limits, monitors aging of accounts receivable and establishes an allowance for doubtful accounts based on specific customer information and general historical trends. Trade receivables consist of a large number of customers, spread across diverse industries and geographical areas. Ongoing credit evaluation is performed on the financial condition of accounts receivable. As at June 30, 2017, the allowance for doubtful accounts was nil (nil as at June 30, 2016).

The carrying amount on the consolidated statement of financial position of the Corporation's financial assets exposed to credit risk represents the maximum amount exposed to credit risk.

The following table summarizes the Corporation's exposure to credit risk:

| **As at June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Cash and cash equivalents | **3,870,603** | 3,051,870 |
| Guaranteed deposit certificates | **1,371,591** | 1,461,462 |
| Accounts receivable, net of tax credits receivable | **13,164,948** | 10,109,288 |
| Other assets | **563,564** | 70,366 |
| Related party loans receivable | **1,250,000** | - |

The Corporation is also exposed to credit risk due to its cash, its deposit certificate and its related party loans receivable. The Corporation has $5,242,194 ($4,513,332 as at June 30, 2016) in cash and guaranteed deposits certificates with banking institutions and loans of $1,250,000 with related party, which are secured by a pledge of the acquired common shares (see note 26a) that the Corporation considers at a low risk for loss.

The table below summarizes the aging of trade accounts receivable as at:

| As at June 30, | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| Current | **4,706,358** | 6,565,121 |
| Past due 1 to 30 days | **1,399,913** | 870,582 |
| Past due 31 to 90 days | **2,344,076** | 57,221 |
| Past due more than 90 days | **1,573,639** | 623,073 |
| | **10,023,986** | 8,115,997 |
| Less: Allowance for doubtful accounts | **-** | - |
| Trade accounts receivable | **10,023,986** | 8,115,997 |
| Retentions from customers under project contracts | **1,980,423** | 1,012,846 |
| Tax credits receivable | **45,527** | 83,395 |
| Other receivables | **1,160,539** | 980,445 |
| | **13,210,475** | 10,192,683 |

### Liquidity risk

Liquidity risk is the risk that the Corporation will be unable to fulfil its obligations on a timely basis or at reasonable cost. The Corporation manages its liquidity risk by monitoring its operating requirements and using various funding sources to ensure its financial flexibility. The Corporation prepares budgets and cash forecast to ensure that it has sufficient funds to fulfil its obligations.

For its investing activities, the Corporation will evaluate its liquidity needs when applicable and take the necessary action.

The following table presents the financial liability instalments payable when contractually due including accrued interest:

| As at June 30, 2017 | Carrying amount | 0 - 1 year | 1 - 2 years | 2 - 3 years | 4 years and more |
|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ |
| Bank overdraft | 184,120 | 184,120 | - | - | - |
| Bank loans | 5,092,607 | 5,092,607 | - | - | - |
| Accounts payable and accrued liabilities | 12,683,815 | 12,683,815 | - | - | - |
| Long-term debt | 13,052,941 | 2,617,460 | 2,469,857 | 2,369,485 | 5,596,139 |
| Contingent consideration | 232,683 | - | 232,683 | - | - |
| **Total** | **31,246,166** | **20,578,002** | **2,702,540** | **2,369,485** | **5,596,139** |

| As at June 30, 2016 (adjusted, note 2) | Carrying amount | 0 - 1 year | 1 - 2 years | 2 - 3 years | 4 years and more |
|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ |
| Bank overdraft | 520,208 | 520,208 | - | - | - |
| Bank loans | 5,962,750 | 5,962,750 | - | - | - |
| Accounts payable and accrued liabilities | 6,999,829 | 6,999,829 | - | - | - |
| Long-term debt | 3,158,977 | 825,309 | 652,232 | 612,796 | 1,068,640 |
| Contingent consideration | 874,596 | 641,421 | 233,175 | - | - |
| **Total** | **17,516,360** | **14,949,517** | **885,407** | **612,796** | **1,068,640** |

### Fair value

The fair value of financial instruments is based on quoted market prices when an active market exists. Otherwise, it is estimated using techniques and valuation models, such as analysis of discounted cash flows for the long-term debt, for which the significant unobservable inputs used are the discount rates which reflects the Corporation's credit risk.

There was no transfer between the levels of fair value hierarchy during the year.

The carrying amount and estimated fair value of financial instruments are as follows:

*Financial instruments whose fair value approximates carrying value*
Cash and cash equivalents, guaranteed deposit certificates, accounts receivable, other assets, bank overdraft, bank loans, accounts payable and accrued liabilities and contingent consideration are financial instruments whose fair value approximates their carrying value due to their short-term maturity.

*Long-term debt*
The fair value of the long-term debt has been established by discounting the future cash flows at an interest rate to which the Corporation would currently be able to obtain for loans with similar maturity dates and terms. The fair value of the long-term debt is $11,185,104 ($2,847,255 as at June 30, 2016) and was determined to be a level 2 financial instrument.

### Contingencies

Various claims and legal proceedings have been initiated against the Corporation in the normal course of its operating activities. Although the outcome of these proceedings cannot be determined with certainty, management estimates that any payments resulting from their outcome are not likely to have a substantial negative impact on the Corporation's consolidated financial statements. The Corporation limits its exposure to some risks of claims related to its activities by subscribing to insurance policies.

## 24. Capital Management

The Corporation's objective in managing capital is to ensure sufficient liquidity to pursue its growth while at the same time taking a prudent approach towards financial leverage and financial risk.

The Corporation's capital is composed of net debt and shareholders' equity. Net debt consists of interest-bearing debt less cash. The Corporation's primary uses of capital are to finance increases in non-cash working capital and capital expenditures for capacity expansion and integration.

The Corporation monitors its performance through different ratios such as those required under its credit facility and long-term debt arrangements.

Credit facility and long-term debt arrangements require that the Corporation meet certain financial ratios at fixed points in time. The financial ratios are, as at June 30, 2017:

- Working capital ratio, defined as current assets divided by current liabilities greater than or equal to 1.25:1.00;
- Debt-to-equity ratio, defined as total debt excluding deferred taxes divided by equity of less than or equal to 2.75:1.00; and
- Fixed charge coverage ratio, including all capital and interest payments on borrowings due and capital expenditures, as defined, greater than or equal to 1.00:1.00.

As at June 30, 2017 and June 30, 2016, the Corporation was in compliance with the ratios required under its credit facility and long-term debt arrangements, except for the fixed charge coverage for which a waiver was received from the lenders.

## 25. Leases

### Leasing arrangements

Operating leases relate to leases of premises with lease terms of between 1 and 10 years. The Corporation has options to renew the leases for its premises for additional terms varying between 3 to 5 years. The Corporation does not have an option to purchase the leased premises at the expiry of the lease periods.

### Payments recognized as an expense

| **Years ended June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Minimum lease payments | **1,823,365** | 989,743 |
| | **1,823,365** | 989,743 |

### Non-cancellable operating lease commitments

| **As at June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Not later than 1 year | **1,823,365** | 989,743 |
| Later than 1 year and not later than 5 years | **5,352,873** | 3,132,014 |
| Later than 5 years | **589,338** | 1,152,713 |
| | **7,765,576** | 5,274,470 |

### Liabilities recognized in respect of non-cancellable operating leases

| **As at June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Deferred rents | | |
| Current | **668** | 10,661 |
| Non-current | **92,392** | 105,446 |
| | **93,060** | 116,107 |

## 26. Segment Information

### Products from which reportable segments derive their revenues

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

The following is an analysis of the Corporation's revenues for the year for the continuing operations.

| **Years ended June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Revenues from specialty products and services | **29,487,693** | 27,701,625 |
| Project contracts revenues | **20,048,858** | 22,966,066 |
| Operation and maintenance revenues | **33,227,957** | - |
| | **82,764,508** | 50,667,691 |

### Geographical information

The Corporation is domiciled in Canada. The result of its revenue from external customers in Canada is $20,156,723 ($12,608,625 in 2016), and the total revenue from external customers from other countries is $62,607,785 ($38,059,066 in 2016). Detailed information for the Corporation's markets is as follows:

| **Years ended June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| **Revenues from external customers** | | |
| Revenue according to geographic location | | |
| Canada | **20,156,723** | 12,608,625 |
| United States | **55,431,884** | 29,464,622 |
| Spain | **344,119** | 1,261,499 |
| China | **2,385,707** | 2,185,369 |
| United Arab Emirates | **503,299** | 886,088 |
| Mexico | **756,526** | 367,459 |
| France | **424,045** | 247,846 |
| Egypt | **228,092** | 922,674 |
| Other | **2,534,113** | 2,723,509 |
| | **82,764,508** | 50,667,691 |

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

| **As at June 30,** | **2017** | 2016 (adjusted, note 2) |
|---|---|---|
| | **$** | $ |
| Non-current assets other than financial instruments and deferred tax assets according to geographic location | | |
| Canada | **6,090,837** | 6,892,004 |
| United States | **32,796,953** | 12,127,191 |
| | **38,887,790** | 19,019,195 |

### Information about major customers

For the fiscal years ended June 30, 2017 and June 30, 2016, no customer accounted for more than ten percent (10%) of its revenues.

## 27. Related parties disclosure

### a) Related party loans receivable

Following the approval of the disinterested shareholders of the Corporation at the annual meeting of its shareholders held on November 15, 2016, the Corporation extended to executive officers, individual loans in an aggregate amount of $1,250,000 (the "Loans"), effective as of July 26, 2016, in order for them to acquire common shares as part of the non-brokered private placement (notes 5 and 19). These loans are repayable in one single installment on the 8th anniversary of the effective date and they can be reimbursed in full at any time before the end of the term, without penalty. These loans bear interest at a rate of 2.5%, payable monthly. They are secured by a pledge of the acquired common shares. The market value of the underlying common shares pledged to secure these loans was $1,375,000 as at June 30, 2017.

An amount of $29,110 was paid to the Corporation in regards of these loans and recorded as finance income in the consolidated statements of (loss) earnings for the year ended June 30, 2017 (nil for the year ended June 30, 2016).

### b) Compensation of executive officers and Board of Directors

The remuneration of executive officers and members of the Board of Directors during the years was as follows:

| **Years ended June 30,** | **2017** | 2016 |
|---|---|---|
| | **$** | $ |
| Short-term benefits | **1,536,312** | 1, 174,175 |
| Post-employment benefits | **112,384** | 40,642 |
| Share-based payments | **627,526** | - |
| | **2,276,222** | 1, 214,817 |

The remuneration of key executives is determined by the remuneration committee having regard 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
**Pierre Côté**, Director[3]
**Élaine C. Phénix**, Director[1] [2]
**Jean-Réal Poirier**, Director[2] [3]
**Richard Hoel**, Director[1]
**Lisa Henthorne**, Director[2] [3] [4]
**Peter K. Dorrins**, Director[2]
**Stephen A. Davis,** Director

### Management

**Frédéric Dugré**, President and Chief Executive Officer[3] [4]
**Marc Blanchet**, Chief Financial Officer and Secretary
**Guillaume Clairet**, Chief Operating Officer[3] [4]
**Denis Guibert**, Vice President and General Manager, Engineering
**Gregory Madden**, Vice President, Aftermarket and Digital Solutions
**Rock Gaulin**, Vice President, Manufacturing and Operations
**William Douglass**, Vice President, Operation and Maintenance

[1] Audit Committee
[2] Governance, Remuneration and Risks Committee
[3] Technology and Projects Committee
[4] Operation and Maintenance Committee

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