Interim Financial Report
First quarter ended
September 30, 2017

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE FINANCIAL SITUATION

In accordance with National Instrument 51-102 Continuous Disclosure Obligations, the following comments are intended to provide a review and an analysis of H_2O Innovation's operating results and financial position for the quarter ended September 30, 2017, in comparison with the corresponding period ended September 30, 2016. The MD&A should be read in conjunction with the consolidated financial statements and with the accompanying notes for the quarter ended September 30, 2017. 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").

RESULTS OF OPERATIONS

For the three-month periods ended September 30, 2017 and 2016

COMPARATIVE FIGURES

The following paragraphs highlight certain information regarding our operations for the three-month periods ended September 30, 2017 and September 30, 2016. During the year-end audit of fiscal year 2017, the acquisition of Utility Partners has been considered effective as of July 26, 2016 instead of July 1, 2016, as disclosed in the unaudited interim consolidated financial statements for the period ended September 30, 2016. Therefore, the comparative figures for the first quarter ended September 30, 2016 have been adjusted accordingly and only 2 months of Utility Partners' operations are recorded for the first quarter of fiscal year 2017. The impact on the results for the period ended September 30, 2016 are as follow: a decrease in revenues of $2,384,712, a decrease in cost of goods sold of $2,212,400, a decrease in administrative expenses of $172,312 and a decrease of amortization of intangible assets related to the acquisition of Utility Partners of $132,927. The net impact is a decrease of the net loss of $132,927. The basic loss per share decreased from ($0.028) to ($0.024), while the diluted loss per share decreased from ($0.027) to ($0.024). The profitability of the Corporation has not been affected by this adjustment, creating distortion on the results of operations (gross profit margin and adjusted EBITDA over revenues ratio). Refer to the 2016 adjusted versus unadjusted columns presented below.

Although these numbers have been adjusted in the comparable period, management has elected to present both the adjusted and unadjusted numbers as if the transaction had occurred on July 1st, 2016, to give a more accurate picture of the results.

For clarity and fair comparison, the first quarter of fiscal year 2018 numbers should be compared to the unadjusted numbers of the first quarter of fiscal year 2017.

Three-month periods ended September 30,	**2017**	2016 (adjusted) [1]	2016 (unadjusted) [2]
	$	$	$
Revenues	**22,617,998**	17,484,150	19,868,862
Gross profit before depreciation and amortization	**4,454,386**	4,291,226	4,463,537
Gross profit before depreciation and amortization	**19.7%**	24.5%	22.5%
Operating expenses	**877,385**	438,404	438,404
Selling expenses	**1,638,213**	1,595,891	1,595,891
Administrative expenses	**1,477,610**	1,688,419	1,860,730
Research and development expenses – net	**8,515**	81,372	81,372
Net loss	**(1,089,875)**	(949,159)	(1,082,086)
Basic loss per share	**(0.027)**	(0.024)	(0.028)
Diluted loss per share	**(0.027)**	(0.024)	(0.027)
Adjusted EBITDA[a]	**588,063**	629,015	629,015
Adjusted EBITDA over revenues (%)	**2.6%**	3.6%	3.2%

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

(1) The adjusted results disclosed in this MD&A represent the numbers recorded in the financial statements for the fiscal year 2017, with the acquisition of Utility Partners dated July 26, 2016. They include only 2.2 months of Utility Partners' operations.

(2) The unadjusted results represent the initial numbers disclosed by the Corporation for the first quarter of fiscal year 2017, as if the acquisition was effective as of July 1, 2016. Although the financial statements have been adjusted to reflect the acquisition as of July 26, 2016, management still believes that the unadjusted numbers, including a full 3 months of Utility Partners' operations, give a more accurate picture of the results and should be used as a base of comparison for this quarter ended September 30, 2017.

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 net loss from bank fraud 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 based on the reconciliation presented below. 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.

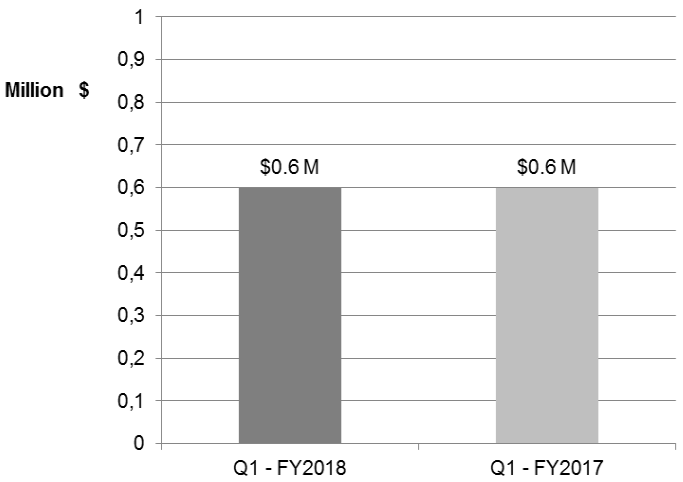
RECONCILIATION OF AJDUSTED EBITDA TO NET LOSS

for the three-month periods ended September 30, 2017 and 2016

Adjusted EBITDA

Three-month periods ended September 30,	**2017**	2016 (adjusted)	2016 (unadjusted)
	$	$	$
Net loss for the period	**(1,089,875)**	(949,159)	(1,082,086)
Finance costs – net	**351,206**	334,425	334,425
Income taxes	**(137,985)**	(303,466)	(303,466)
Depreciation of property, plant and equipment	**307,230**	175,028	175,028
Amortization of intangible assets	**691,117**	530,929	663,856
Unrealized exchange (gains) / losses	**(98,501)**	42,401	42,401
Acquisition and integration costs	**80,875**	673,705	673,705
Stock-based compensation costs	**120,632**	125,152	125,152
Net loss on bank fraud	**363,364**	-	-
Adjusted EBITDA	**588,063**	629,015	629,015

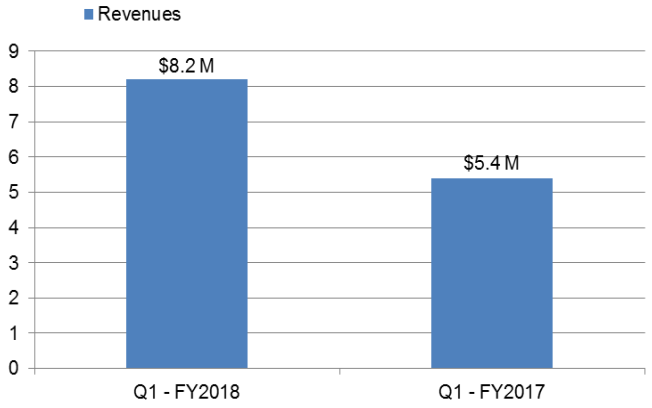
Adjusted EBITDA



- Adjusted EBITDA stable at $0.6 M during the first quarter of fiscal year 2018 and for the comparable quarter of fiscal year 2017;
- If the acquisition was considered effective July 1st, 2016, the adjusted EBITDA would have been stable at $0.6 M, while the adjusted EBITDA over revenues ratio would have been 3.2%. This measure was presented in the financial statements issued for the first quarter of fiscal year 2017. Management believes that this measure gives a more accurate picture of the results for the comparable period ended September 30, 2016.

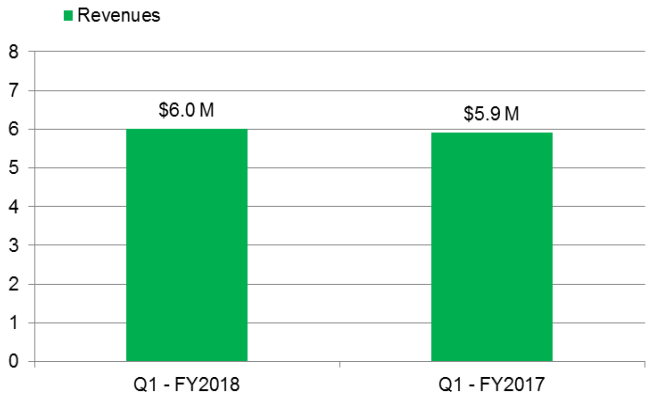
Revenues for the first quarter of fiscal year 2018 increased by $2.7 M or 13.8%, compare to the first quarter of the previous fiscal year, considering a full three months of revenues from Utility Partners' operation. This increase is fueled by the organic growth of the Projects business pillar, with more projects reaching the revenue recognition phase for this quarter compare to the same quarter of fiscal year 2017. The following tables are illustrating the revenues coming from the business pillars.

Projects Business Pillar



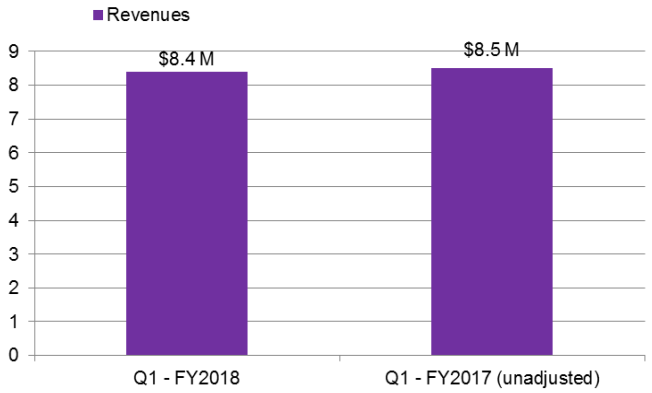
- Projects revenues stood at $8.2 M compared with $5.4 M for the same quarter of fiscal year 2017, representing a 51.9% increase;
- Increase explained by a greater number of projects entering more important revenue recognition phase;
- Current pipeline of Projects remains very rich in opportunities, supported by a $54.7 M projects backlog, as of September 30, 2017.

SP&S Business Pillar



- 1.1% increase in SP&S revenues, reaching $6.0 M for the quarter ended September 30, 2017, from $5.9 M for the comparable quarter of the previous fiscal year;
- Investments have been made in the operating and selling functions to support and fuel the growth of this business line.
- Sales activities for this business line are slower during the first quarter, due to seasonality of the Maple products and the timing of significant orders for the specialty products.

O&M Business Pillar



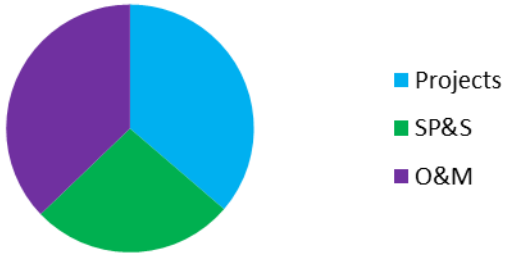
- Recurring revenues of $8.4 M for the first quarter of fiscal year 2018, compare with unadjusted revenues of $8.5 M for the comparable three-month period of fiscal year 2017, representing a 1.1% decrease;
- Negative impact of $0.3 M due to the appreciation of the Canadian dollar over US dollar, showing an organic growth of 2.4% if compared in US dollar;
- Backlog for O&M business line stands at $50.6 M as at September 30, 2017, and consists of long-term contracts, mainly with municipalities, which contain multi-year renewal options;
- All contracts expiring during the year following the acquisition have been renewed successfully.

Revenues on a Quarterly Basis

	FY2018	FY2017				Last twelve months	Previous twelve months
	Q1	Q1 (unadjusted)	Q2	Q3	Q4	**(Q2, Q3 & Q4 FY2017 & Q1 FY2018)**	**(Q2, Q3 & Q4 FY2016 & Q1 FY2017)**
Revenues from Projects business pillar[1]	**$8.2 M**	$5.4 M	$3.4 M	$4.0 M	$7.2 M	**$22.8 M**	$21.2 M
Revenues from SP&S business pillar	**$6.0 M**	$5.9 M	$7.7 M	$8.6 M	$7.3 M	**$29.6 M**	$28.5 M
Revenues from O&M business pillar[2]	**$8.4 M**	$8.5 M (unadjusted)	$8.8 M	$8.7 M	$9.6 M	**$35.5 M**	$8.5 M (unadjusted)
Total revenues	**$22.6 M**	$19.9 M (unadjusted)	$19.9 M	$21.3 M	$24.1 M	**$87.9 M**	$58.2 M (unadjusted)

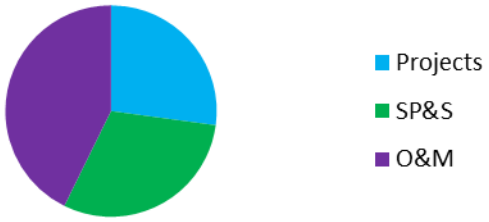
(1) Revenues from Projects vary from quarter to quarter and depend on the different milestones reached for revenues recognition.
(2) During the year-end audit, the acquisition of Utility Partners has been considered effective as of July 26, 2016 (instead of July 1, 2016). Therefore, the revenues of the first quarter of fiscal year 2017 have been adjusted accordingly and only 2 months of Utility Partners' operations are recorded in revenues for Q1 2017. For comparative purposes, unadjusted revenues are presented above. It allows the readers to understand the recurring nature of the revenues for this business pillar over a comparable three-month period. Revenues for the first quarter of the previous fiscal year, representing 2 months of operation of Utility Partners, stood at $6.2 M, for total revenues of $17.5 M.

Q1 FY2018 - Revenues



$22.6 M

Q1 FY2017 - Revenues (unadjusted)



$19.9 M
(unadjusted)

The business model is getting stronger, and the Corporation is able to identify the benefits of it through its three (3) business pillars. After merely a year following the acquisition of Utility Partners, 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. 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 three-month periods ended September 30, 2017 and 2016

	Q1 FY2018[3]	Q1 FY2017[3] (Unadjusted)	Variance	Significant contributions to variance
Gross Profit Margin	**$4.5 M** 19.7%	**$4.5 M** 22.5%	**Nil**	If the transaction had been considered effective as of July 1st, 2016, the gross profit margin would have been 22.5%, representing a slight decrease of 2.8%, explained by the revenue mix, which has been modified with the increase of revenues coming from Projects business pillar. Indeed, Projects and O&M activities generally generates lower gross margin. Therefore, having 73.4% of revenues coming from these two pillars puts pressure on the overall gross margin of the Corporation, although increasing the predictability and stability of the financial results.
Operating Expenses	**$0.9 M** 3.9%	**$0.4 M** 2.1%	**+ $0.4 M**	This increase of 100.1% is due to a reclass of the expenses of Utility Partners, from the administrative expenses to the operating ($0.2 M) and selling expenses ($0.2 M). This classification was not performed during the first quarter of fiscal year 2017, following the acquisition. The remaining balance of the increase is due to the hirings for the development of new products and investments to improve our logistic and supply chain activities, to support the increasing volume of operations.
Selling Expenses	**$1.6 M** 7.2%	**$1.6 M** 8.0%	**Nil**	Selling expenses are linked to bookings and revenues, but do not fluctuate proportionally. The 2.7% increase of the selling expenses is mostly due to a reclass of the expenses of Utility Partners, from the administrative expenses to the operating ($0.2 M) and selling expenses ($0.2 M). This classification was not performed during the first quarter of fiscal year 2017, following the acquisition.
Administrative Expenses	**$1.5 M** 6.5%	**$1.9 M** 9.4%	**- $0.4 M**	Would the acquisition of Utility Partners had been considered effective as at July 1st, 2016, the administrative expenses would have stood at $1.9 M as at September 30, 2016. The decrease of $0.4 M or 20.6% is due to a reclass of the expenses of Utility Partners, from the administrative expenses to the operating ($0.2 M) and selling expenses ($0.2 M). This classification was not performed during the first quarter of fiscal year 2017, following the acquisition.
SG&A[1]	**$4.0 M** 17.7%	**$3.7 M** 19.6%	**+ $0.3 M**	This decrease in percentage of SG&A over revenues is mostly attributable to the increase of the overall revenues without impacting proportionally the selling, operating and administrative expenses. The overall level of SG&A was somewhat stable for the first quarters of fiscal year 2017 and fiscal year 2018.
R&D[2]	**$8,515** 0.0%	**$81,372** 0.4%	**- $72,857**	For the quarter ended September 30, 2017, the Corporation has not claimed 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 losses – net

Other losses – net amounted to $0.3 M for the period ended September 30, 2017 compared with $0.03 M for the quarter ended September 30, 2016. This increase is mostly due to a net loss of $0.4 M due to an external fraud perpetrated through the Corporation's banking online platform during the first quarter of fiscal year 2018.

Other losses – net also include unrealized exchange gain of ($0.1 M) for the period ended September 30, 2017 compared to a loss of $0.04 M for the quarter ended September 30, 2016.

Finance costs – net

Finance costs – net were somewhat stable, totaling $0.3 M for the period ended September 30, 2017 and for the comparable period in the previous fiscal year. Of this amount, $10,022 represents the theoretical and non-monetary part of interest on long-term debt. 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

The net loss amounted to ($1.1 M) or ($0.027) per share for the first quarter of fiscal year 2018 compared with loss of ($0.9 M) or ($0.024) per share for the first quarter of fiscal year 2017. The net loss is mostly caused by the product mix with more revenues coming from the Projects and O&M business pillars, putting pressure on the gross profit margin and to the net impact of the external fraud perpetrated through the Corporation's banking online platform.

Commitments

The Corporation has entered into long-term lease agreements expiring between 2018 and 2024 which call for lease payments of $7.3 M for the rental of space and supply agreements. The minimum annual payments over the next five years are $1.9 M in 2018, $1.4 M in 2019, $1.4 M in 2020, $1.1 M in 2021 and $1.0 M in 2022.

Information on share capital

As at September 30, 2017, the Corporation had 40,144,214 outstanding common shares and 2,565,334 stock options.

FINANCIAL SITUATION

Working capital decreased from $9.0 M as at June 30, 2017 (current ratio of 1.42) to $7.9 M as at September 30, 2017 (current ratio of 1.30). The decrease is attributable to the $3.0 M, $1.2 M, $2.1 M, $2.9 M and $1.5 M increase in accounts receivable, inventories, costs incurred in excess of billings, bank loans and billings in excess of costs incurred respectively and the decrease of $1.0 M and $0.4 M in cash and cash equivalent and prepaid expenses respectively.

The net debt[(1)] increased to reach $16.4 M as at September 30, 2017, from $12.6 M as at June 30, 2017. This increase is mainly attributable to the increase of the bank loans of $2.9 M. The bank loans were used by the Corporation to support the Projects business pillar, with the significant increase of costs incurred in excess of billings, as well as the investment in inventories and in capital expenditure for the period. The liquidity was also affected by the financial loss caused by a fraud perpetrated by an external party.

Periods ended (in Canadian dollars, except for ratio)	**September 30, 2017**	**June 30, 2017**
	$	$
Working capital	**7,871,971**	8,992,616
Working capital ratio	**1.31**	1.42
Net debt[(1)]	**16,413,725**	12,591,229
Equity	**40,677,152**	43,302,884
Net debt to equity ratio	**0.40**	0.29

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

As at September 30, 2017 accounts receivable stood at $16.2 M compared with $13.2 M as at June 30, 2017. The increase of $3.0 M is partly attributable to invoicing milestone reached in Projects before the end of the period and to the gain on settlement agreed between the Corporation, the insurance carrier and the financial institution in regards to the external fraud of the Corporation's bank account.

Inventories increased by $1.2 M to $6.1 M as at September 30, 2017 from $4.9 M as at June 30, 2017. This increase is due to finished goods manufactured during the summer in preparation for the start of the maple syrup production season. 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 $2.1 M to $7.6 M as at September 30, 2017 from $5.6 M as at June 30, 2017, 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 $1.4 M to $2.6 M as at September 30, 2017, from $1.2 M as at June 30, 2017. This increase is also attributable to differences between project advancement and project invoicing schedules.

Accounts payable and accrued liabilities increased by $1.5 M to $14.2 M as at September 30, 2017, from $12.7 M as at June 30, 2017. The increase is mainly due 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.

For the quarter ended September 30, 2017, shareholders' equity decreased by $2.6 M to $40.7 M ($43.3 M as at June 30, 2017). The elements impacting the shareholders' equity in the first quarter of fiscal year 2018 are: 1) the $0.1 M increase in stock option due to the stock-based compensation costs; 2) the $1.1 M net loss for the period ended September 30, 2017 and; 3) the Canadian dollar's appreciation generating an unrealized exchange loss of $1.7 M resulting from the translation of foreign operations, mainly those of the U.S. subsidiaries.

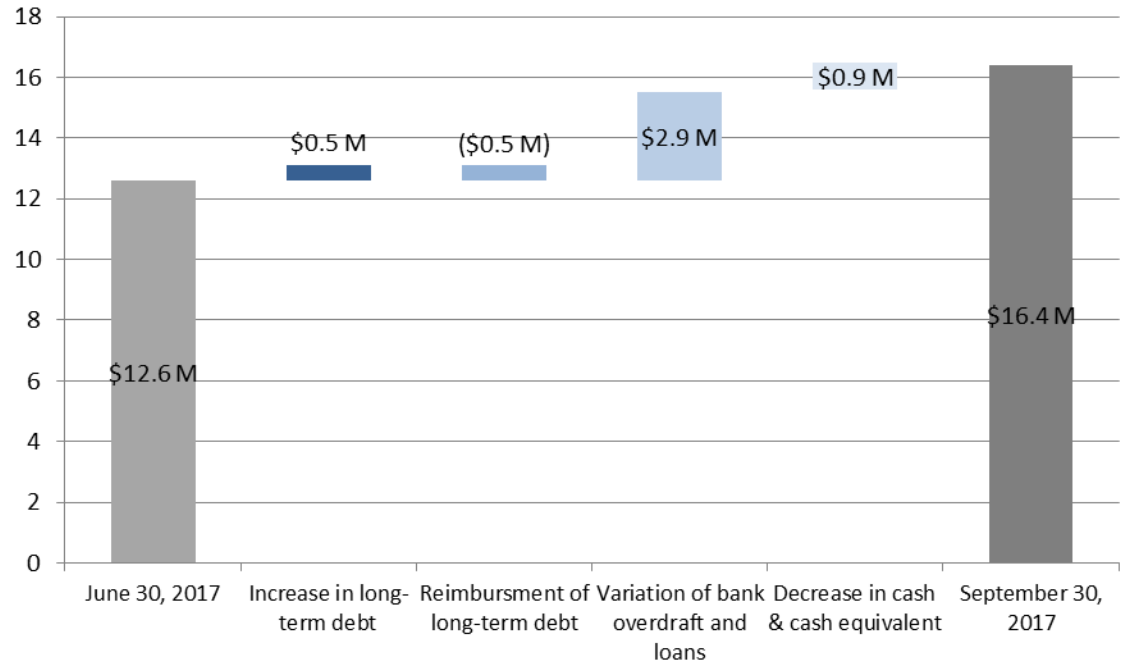
Net Debt

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.

Periods ended	**September 30, 2017**	June 30, 2017
	$	$
Bank overdraft	**284,255**	184,120
Bank loans	**7,948,056**	5,092,607
Current portion of long-term debt	**2,094,040**	2,036,151
Long-term debt	**8,992,159**	9,148,953
Less: Cash and cash equivalents	**(2,904,784)**	(3,870,603)
Net debt	**16,413,725**	12,591,229

Movement in Net Debt



OFF-BALANCE SHEET ARRANGEMENTS

As at September 30, 2017, the Corporation had off-balance sheet arrangements consisting of letters of credit amounting to $1.4 M which expire at various dates through fiscal year 2022. In these letters of credit, $0.3 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 September 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 3.25:1.00; 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.

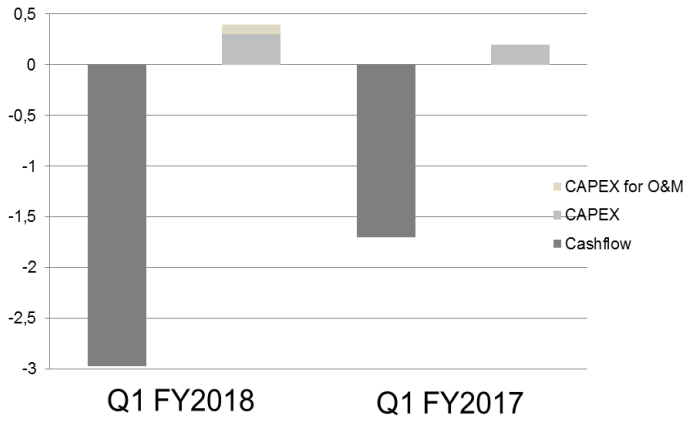
As at September 30, 2017, the Corporation was in compliance with the ratios required under its credit facility and long-term debt arrangements, except for the fixed charge coverage for which it received a waiver from the lender.

CASH FLOWS AND CAPITAL EXPENDITURE

A comparison of the Corporation's cash flows for the three-month periods ended September 30, 2017 and September 30, 2016 is presented below:

Three-month periods ended September 30, (in Canadian dollars) (unaudited)	**2017**	2016
	$	$
Cash flows from operating activities	**(2,974,694)**	(1,661,798)
Cash flows from investing activities	**(429,302)**	(24,154,934)
Cash flows from financing activities	**2,461,553**	30,164,082
Effect of exchange rate changes on the balance of cash held in foreign currencies	**(123,511)**	171,193
Net change	**(1,065,954)**	4,518,543
Cash and cash equivalents – Beginning of year	**3,686,483**	2,531,662
Cash and cash equivalents – End of year	**2,620,529**	7,050,205

Cash flows from operating activities



- Impact of net loss subdued by the increase of depreciation and amortization compared to the first quarter of fiscal year 2017;
- Negative impact of the external fraud perpetrated through the Corporation's banking online platform during the first quarter of fiscal year 2018;
- Significant impact of change in working capital items, such as:
  - Higher volume of activities during this quarter compare to the first quarter of fiscal year 2017 ;
  - Increase of level of finished goods inventory to meet the growing demands;
  - A timing difference within the projects production phases affecting the invoicing milestones reached.
- Total investment of $0.4 M in property, plant and equipment, of which $0.1 M was made for direct support of O&M specific plants.

Cash flows from investing activities

For the first quarter of fiscal year 2018, investing activities used net cash of ($0.4 M), compare to ($24.2 M) used in investing activities for the comparable period of the previous fiscal year. This year investments are mainly attributable to the acquisition of property, plant and equipment of $379,597 and to a lesser extent to investments in intangible assets of $110,686. The significant level of cash used in investing activities for the comparable period is mainly attributable to the business combination of Utility Partners and the related cash in trust, for an aggregate amount of $23.8 M, the remaining balance of investments being stable at $0.4 M.

Cash flows from financing activities

Financing activities generated net cash of $2.5 M in the first quarter of fiscal year 2018 compared with $30.2 M of net cash generated during the corresponding period ended September 30, 2016. During this quarter, the Corporation contracted $0.5 M of long-term debt, reimbursed $0.5 M of long-term debt and increased its bank loans by $2.9 M. The increase of bank loans during the first quarter of fiscal year 2018 are mostly related to the support of operation for Projects business pillar, with the significant increase of costs incurred in excess of billings, as well as the investment in inventories and capital expenditure for the period. The fraud of $0.4 M committed by an external party through the Corporation's online banking platform also put pressure on the liquidity of the Corporation. Interest paid during the first quarter of fiscal year 2018 amounted to $0.4 M.

The significant level of cash generated by financing activities for the comparable period is mainly attributable to the acquisition of Utility Partners on July 26, 2016 and to the related bought deal private placement, and non-brokered private placement for a net amount of $21.6 M. The Corporation's also contracted $10.0 M in long term debt to finance the acquisition.

QUARTERLY SUMMARY FINANCIAL INFORMATION (UNAUDITED)

	Three-month periods ended				Last twelve months
	September 30, 2017	**June 30, 2017**	**March 31, 2017**	**December 31, 2016**	
	$	$	$	$	**$**
Revenues	22,617,998	24,037,884	21,284,643	19,957,831	**87,898,356**
Adjusted EBITDA	588,063	(20,486)	411,737	809,625	**1,788,939**
Adjusted EBITDA over revenues	2.6%	(0.08%)	1.9%	4.1%	**2.0%**
Net loss	(1,089,875)	(1,742,862)	(1,345,695)	(1,093,270)	**(5,271,702)**
EPS basic and diluted	(0.027)	(0.045)	(0.034)	(0.027)	**(0.13)**
Cash flows from operating activities	(2,974,694)	3,521,086	(1,135,127)	1,083,117	**494,382**

	Three-month periods ended				Last twelve months
	September 30, 2016 (unadjusted)	**June 30, 2016**	**March 31, 2016**	**December 31, 2015**	
	$	$	$	$	**$**
Revenues	19,868,862	11,042,913	14,199,860	13,165,590	**58,277,225**
Adjusted EBITDA	629,015	157,330	1,245,324	1,030,502	**3,062,171**
Adjusted EBITDA over revenues	3.2%	1.4%	8.8%	7.8%	**5.3%**
Net earnings (loss)	(1,082,086)	(714,003)	646,422	174,221	**(975,446)**
EPS basic	(0.028)	(0.034)	0.031	0.008	**(0.023)**
EPS diluted	(0.027)	(0.034)	0.031	0.008	**(0.022)**
Cash flows from operating activities	(1,661,798)	3,045,440	(318,078)	128,382	**1,193,946**

ACCOUNTING POLICIES

The reader is invited to refer to the summary of significant accounting policies presented in note 3 to the consolidated financial statements as at June 30, 2017.

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 one of the disclosure controls and procedures was 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 one of the disclosure controls and procedures was 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 the definition set forth in NI 52-109, in one of the Corporation's internal control over financial reporting as of September 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. Since then, this weakness has been corrected.

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.

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

September 30, 2017

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

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CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (Unaudited)

As at	September 30, 2017	June 30, 2017
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	**2,904,784**	3,870,603
Guaranteed deposit certificates	**1,308,337**	1,371,591
Accounts receivable (note 4)	**16,206,936**	13,210,475
Inventories (note 5)	**6,140,510**	4,917,592
Costs incurred in excess of billings	**7,623,076**	5,567,267
Prepaid expenses	**1,000,328**	1,449,007
	35,183,971	30,386,535
Non-current assets		
Property, plant and equipment	**4,175,653**	4,167,162
Intangible assets	**19,196,793**	20,419,906
Other assets	**546,035**	563,564
Related party loans receivable (note 16 a)	**1,250,000**	1,250,000
Goodwill (note 3)	**13,753,026**	14,300,722
Deferred income tax assets	**3,231,408**	3,082,941
	77,336,886	74,170,830
LIABILITIES		
Current liabilities		
Bank overdraft	**284,255**	184,120
Bank loans (note 6)	**7,948,056**	5,092,607
Accounts payable and accrued liabilities (note 7)	**14,203,226**	12,683,815
Provisions (note 8)	**120,232**	151,718
Billings in excess of costs incurred	**2,601,593**	1,190,909
Income taxes payable	**60,599**	53,930
Deferred rent	**-**	668
Current portion of long-term debt (note 9)	**2,094,040**	2,036,151
	27,312,001	21,393,918
Non-current liabilities		
Long-term debt (note 9)	**8,992,159**	9,148,953
Deferred rent	**131,803**	92,392
Contingent consideration (note 10)	**223,771**	232,683
	36,659,734	30,867,946
SHAREHOLDERS' EQUITY		
Share capital (note 11)	**76,918,285**	76,918,285
Reserve - Stock options	**2,624,537**	2,503,905
Deficit	**(39,389,304)**	(38,299,429)
Accumulated other comprehensive income	**523,634**	2,180,123
	40,677,152	43,302,884
	77,336,886	74,170,830

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

On behalf of the Board,

Frédéric Dugré

President and Chief Executive Officer

Philippe Gervais

Chairman of the Board of Directors

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the three-month periods ended September 30, 2017 and 2016
(Unaudited)

	Common Shares (Number) (note 11)	Share capital (note 11)	Share capital under escrow (note 3)	Stock option (note 11)	Deficit	Accumulated other comprehensive income (loss) – Translation adjustment	Total
		$	$	$	$	$	$
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 3 and 11)	19,217,663	21,811,196	1,250,000	-	-	-	23,061,196
Share issue expenses (notes 3 and 11)	-	(1,441,856)	-	-	-	-	(1,441,856)
Stock-based compensation costs (note 11)	-	-	-	125,152	-	-	125,152
Net loss for the period (adjusted, note 3)	-	-	-	-	(949,159)	-	(949,159)
Other comprehensive income – Currency translation adjustments	-	-	-	-	-	560,627	560,627
Balance as at September 30, 2016 (adjusted, note 3)	40,144,214	75,668,285	1,250,000	2,001,531	(34,117,602)	3,147,924	47,950,138
Balance as at July 1, 2017	**40,144,214**	**76,918,285**	**-**	**2,503,905**	**(38,299,429)**	**2,180,123**	**43,302,884**
Net loss for the period	**-**	**-**	**-**	**-**	**(1,089,875)**	**-**	**(1,089,875)**
Stock-based compensation costs (note 11)	**-**	**-**	**-**	**120,632**	**-**	**-**	**120,632**
Other comprehensive loss – Currency translation adjustments	**-**	**-**	**-**	**-**	**-**	**(1,656,489)**	**(1,656,489)**
Balance as at September 30, 2017	**40,144,214**	**76,918,285**	**-**	**2,624,537**	**(39,389,304)**	**523,634**	**40,677,152**

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

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF LOSS
For the three-month periods ended September 30, 2017 and 2016
(Unaudited)

Three-month periods ended September 30,	2017	2016 (Adjusted, note 3)
	$	$
Revenues (note 15)	**22,617,998**	17,484,150
Cost of goods sold (note 12 a)	**18,163,612**	13,192,924
Gross profit before depreciation and amortization	**4,454,386**	4,291,226
Operating expenses (note 12 a)	**877,385**	438,404
Selling expenses (note 12 a)	**1,638,213**	1,595,891
Administrative expenses (note 12 a)	**1,477,610**	1,688,419
Research and development expenses – net (notes 12 a and c)	**8,515**	81,372
Depreciation of property, plant and equipment (note 12 b)	**307,230**	175,028
Amortization of intangible assets (note 12 b)	**691,117**	530,929
Other losses – net (note 12 d)	**250,095**	25,678
Operating costs total	**5,250,165**	4,535,721
Operating loss	**(795,779)**	(244,495)
Acquisition-related costs and integration costs (note 3)	**80,875**	673,705
Finance income	**(9,817)**	(2,459)
Finance costs	**361,023**	336,884
Finance costs – net	**351,206**	334,425
	432,081	1,008,130
Loss before income taxes	**(1,227,860)**	(1,252,625)
Current income tax expense	**124,750**	11,712
Deferred tax benefit	**(262,735)**	(315,178)
	(137,985)	(303,466)
Net loss for the period	**(1,089,875)**	(949,159)
Net loss per share		
Basic loss per share	**(0.027)**	(0.024)
Diluted loss per share	**(0.027)**	(0.024)
Weighted average number of basic shares outstanding (note 13)	**40,144,214**	39,102,547
Weighted average number of diluted shares outstanding (note 13)	**40,144,214**	40,144,214

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

H_2O INNOVATION INC.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
For the three-month periods ended September 30, 2017 and 2016
(Unaudited)

Three-month periods ended September 30,	**2017**	2016 (Adjusted, note 3)
	$	$
Net loss for the period	**(1,089,875)**	(949,159)
Other comprehensive income - Items that may be reclassified subsequently to net earnings		
Currency translation adjustments	**(1,656,489)**	560,627
Comprehensive loss for the period	**(2,746,364)**	(388,532)

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

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three-month periods ended September 30, 2017 and 2016
(Unaudited)

Three-month periods ended September 30,	2017	2016 (Adjusted, note 3)
	$	$
Cash flows from operating activities		
Loss before income taxes for the period	**(1,227,860)**	(1,252,625)
Non-cash items		
Finance costs – net	**351,206**	334,425
Depreciation of property, plant and equipment	**307,230**	175,028
Amortization of intangible assets	**691,117**	530,929
Deferred rent	**40,801**	(5,635)
Unrealized exchange (gain) loss on long-term debt	**(65,940)**	34,220
Stock-based compensation	**120,632**	125,152
	217,186	(58,506)
Change in working capital items (note 14a)	**(3,089,210)**	(1,604,830)
Cash used in operations	**(2,872,024)**	(1,663,336)
Interests received	**9,817**	2,459
Income taxes paid	**(112,487)**	(921)
Net cash used in operating activities	**(2,974,694)**	(1,661,798)
Cash flows from investing activities		
Variation of guaranteed deposits certificates	**60,981**	(2,454)
Variation of cash in trust (note 3)	**-**	(1,250,000)
Variation of other assets	**-**	2,541
Business combination (note 3)	**-**	(22,502,253)
Acquisition of property, plant and equipment	**(379,597)**	(244,957)
Acquisition of intangible assets	**(110,686)**	(157,811)
Net cash used in investing activities	**(429,302)**	(24,154,934)
Cash flows from financing activities		
Variation of bank loans	**2,855,449**	(690,108)
Long-term debt contracted (note 9)	**450,086**	10,041,720
Long-term debt reimbursement	**(492,981)**	(310,413)
Interest paid	**(351,001)**	(331,836)
Financing costs (note 9)	**-**	(164,621)
Issuance of common shares under private placement (note 11)	**-**	23,061,196
Share issue expenses (note 11)	**-**	(1,441,856)
Net cash generated by financing activities	**2,461,553**	30,164,082
Net change in cash and cash equivalents	**(942,443)**	4,347,350
Effect of exchange rate changes on the balance of cash held in foreign currencies	**(123,511)**	171,193
Increase (Decrease) in cash and cash equivalents	**(1,065,954)**	4,518,543
Cash and cash equivalents - Beginning of period (note 14b)	**3,686,483**	2,531,662
Cash and cash equivalents - End of period (note 14b)	**2,620,529**	7,050,205

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

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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

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

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

The IFRS accounting policies that are set out in the Corporation's consolidated financial statements for the year ended June 30, 2017 were consistently applied to all periods presented. Please refer to note 2 in the Corporation's consolidated financial statements for the year ended June 30, 2017 for a complete description of the Corporation's significant accounting policies.

The preparation of financial statements in conformity with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Corporation's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant are disclosed in note 3 in the Corporation's consolidated financial statements for the year ended June 30, 2017 and remained unchanged for the three-month period ended September 30, 2017.

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

These condensed interim consolidated financial statements are intended to provide an update on 2017 annual statements. Accordingly they do not include all the information required for annual financial statements and should be read in conjunction with the Corporation's 2017 annual audited consolidated financial statements.

On November 13, 2017 the Board reviewed and approved the accompanying condensed interim consolidated financial statements and authorized its publication.

3. Business Combination

Acquisition of Utility Partners, LLC

Comparative figures

During the year-end audit of fiscal year 2017, the acquisition of Utility Partners has been considered effective as of July 26, 2016 instead of July 1, 2016, as disclosed in the unaudited interim consolidated financial statements for the three-month period ended September 30, 2016. Therefore, the comparative figures for the first quarter ended September 30, 2016 have been adjusted accordingly and only 2 months of Utility Partners' operations are recorded. The impact on the results for the period ended September 30, 2016 are as follow: a decrease in revenues of $2,384,712, a decrease in cost of goods sold of $2,212,400, a decrease in administrative expenses of $172,312 and a decrease of amortization of intangible assets related to the acquisition of Utility Partners of $132,927. The net impact is a decrease of the net loss and retained earnings of $132,927. The basic loss per share decreased from ($0.028) to ($0.024), while the diluted loss per share decreased from ($0.027) to ($0.024).

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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
	$
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.

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Sources and uses of funds at the transaction closing date

	July 26, 2016
	$
Sources	
Private placement (note 11)	**21,160,196**
Additional private placement (note 11)	**1,901,000**
Long-term debt (note 9)	**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	**(1,147,671)**
Share issuance costs (note 11)	**(1,441,856)**
Financing costs (note 9)	**(164,621)**
Related party loans receivable (note 16 a)	**(1,250,000)**
Working capital for the Corporation's current activities	**(5,565,830)**
	-

Costs related to the acquisition

The total acquisition-related and integration costs amounted to $2,754,148 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 $1,147,671 of acquisition and integration costs are included in the consolidated statements of loss.

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.

Goodwill following the business combinations

The change in carrying value of the goodwill is as follows:

	$
Balance as of June 30, 2016	5,893,636
Business combination – Utility Partners	8,534,492
Effect of foreign exchange differences	(127,406)
Balance as at June 30, 2017	14,300,722
Effect of foreign exchange differences	**(547,696)**
Balance as at September 30, 2017	**13,753,026**

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

4. Accounts Receivable

As at	**September 30, 2017**	June 30, 2017
	$	$
Trade accounts receivable	**11,989,477**	10,023,986
Retentions from customers under manufacturing contracts	**1,216,590**	1,980,423
	13,206,067	12,004,409
Tax credits receivable	**45,527**	45,527
Other receivables	**2,955,342**	1,160,539
	16,206,936	13,210,475

No allowance for doubtful accounts has been recorded as of September 30, 2017 and 2016.

5. Inventories

As at	**September 30, 2017**	June 30, 2017
	$	$
Raw materials	**1,457,615**	1,157,069
Finished goods	**4,682,895**	3,760,523
	6,140,510	4,917,592

6. Bank loans

The Corporation has an authorized credit facility available of US$5,000,000 ($6,240,000) bearing interest at CDN prime rate plus 1.00% (4.20% as at September 30, 2017 and 3.70% as at June 30, 2017) and at US prime rate plus 1.00% (5.75% as at September 30, 2017 and June 30, 2017) are secured by an assignment of accounts receivable and inventories and by Export Development Canada (EDC). As at September 30, 2017, $5,256,332 was used on this line of credit ($3,396,231 as at June 30, 2017).

The Corporation has an authorized credit facility available of US$2,000,000 ($2,496,000) bearing interest at CDN prime rate plus 1.00% (4.20% as at September 30, 2017 and 3.70% as at June 30, 2017) and at US prime rate plus 1.00% (5.75% as at September 30, 2017 and June 30, 2017). As at September 30, 2017, $2,691,724 was used on this credit facility ($1,696,376 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 September 30, 2017, $382,689 was used on this credit facility ($292,585 as at June 30, 2017).

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 EDC ($1,017,526 in guaranteed deposit certificate as at June 30, 2017). As at September 30, 2017, the Corporation issued $1,000,000 in letters of credit under this credit facility ($1,000,000 as at June 30, 2017).

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

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 $255,010 in guaranteed deposit certificate ($254,498 as at June 30, 2017). As at September 30, 2017, $60,911 was used on this credit facility ($55,269 as at June 30, 2017).

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

The Corporation still has letters of credit amounting to $20,362 ($21,173 as at June 30, 2017) with its previous bank, which are secured by a $33,751 guaranteed deposit certificate ($33,717 as at June 30, 2017).

Covenants
As at September 30, 2017, the Corporation was in compliance with the ratios required under its credit facility, as described in note 9 – *Long-term debt*, and long-term debt arrangements, except for the fixed charge coverage for which it received a waiver from the lender.

7. Accounts Payable and Accrued Liabilities

As at	**September 30, 2017**	June 30, 2017
	$	$
Trade accounts payable	**9,408,712**	8,056,117
Other accrued liabilities and accounts payable	**4,794,514**	4,627,698
	14,203,226	12,683,815

8. Provisions

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

	$
Balance as at June 30, 2016	114,224
Additional provisions recognised	37,000
Less: Payments	-
Effect of foreign exchange differences	494
Balance as at June 30, 2017	151,718
Less : write-off of unused provision	**(27,389)**
Effect of foreign exchange differences	**(4,097)**
Balance as at September 30, 2017	**120,232**

9. Long-Term Debt

As at	**September 30, 2017**	June 30, 2017
	$	$
Unsecured – at amortised cost		
Loan, denominated in Canadian dollars (a)(g)	**4,040,258**	4,242,440
Loan from other entities, denominated in Canadian dollars (b)(g)	**4,476,095**	4,628,474
Loan, denominated in US dollars (c)(g)	**1,580,800**	1,730,266
Loan, denominated in Canadian dollars (d)	**811,400**	400,360
Loan from other entities, denominated in US dollars	**-**	2,668
Loan from other entities, denominated in Canadian dollars (e)	**30,706**	32,772
Loan from other entities, denominated in Canadian dollars (f)	**141,854**	148,124
Loan from other entities, denominated in Canadian dollars	**5,086**	-
	11,086,199	11,185,104
Less : Current portion	**2,094,040**	2,036,151
Long-term debt	**8,992,159**	9,148,953

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(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% (4.7% as at September 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 $56,964.

(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% (5.7% as at September 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 $55,155.

(c) Loan
On October 20, 2015, an agreement was concluded for a loan amounting to $2,496,000 (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 September 30, 2017), payable in 60 monthly instalments of $41,600 (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 $1,240,000, bearing interest at floating prime rate plus 1.05% (6.35% as at September 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% (6.30% as at September 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
On July 12, 2016, an agreement was concluded for a loan of $39,655 bearing interest at 3.4% payable in monthly instalments of $801 and maturing July 12, 2021.

(f) 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.

(g) 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 3.25:1.00; 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.

<u>Covenants</u>
As at September 30, 2017, 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.

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

10. Contingent consideration

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

	$
Balance as at June 30, 2016	874,596
Less: Payments	(641,421)
Effect of foreign exchange differences	(492)
Balance as at June 30, 2017	232,683
Effect of foreign exchange differences	**(8,912)**
Balance as at September 30, 2017	**223,771**

11. 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 3) 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 at September 30, 2017, the Corporation has a total of 40,144,214 shares issued (40,144,214 as of June 30, 2017).

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:

	July 26, 2016
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**

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

For the three-month period ended September 30, 2017, the Corporation recorded $120,632 ($125,152 for the three-month period ended September 30, 2016) as stock-based compensation for options granted to executive officers.

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

	Three-month period ended September 30, 2017		Year ended June 30, 2017	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		$		$
Outstanding - Beginning of period	**2,565,334**	**1.75**	262,000	2.64
Granted	**-**	**-**	2,303,334	1.65
Forfeited	**-**	**-**	-	-
Expired	**-**	**-**	-	-
Outstanding - End of period	**2,565,334**	**1.75**	2,565,334	1.75

12. Additional information about the nature of costs components

a) Expenses by nature

Three-month period ended September 30,	**2017**	2016 (Adjusted, Note 3)
	$	$
Material	**6,810,188**	6,763,973
Changes in inventories of raw material and finished goods	**1,193,775**	(812,894)
Salaries and fringe benefits	**10,017,660**	7,719,229
Subcontractors and professional fees	**2,131,324**	830,541
Rent, electricity , insurance and office expenses	**478,077**	504,548
Telecommunications and travel expenses	**890,316**	755,367
Stock options compensation costs	**120,632**	125,152
Other expenses	**523,363**	1,111,094
Total cost of goods sold, operating, selling, administrative and research and development expenses	**22,165,335**	16,997,010

b) Depreciation and amortization

The Corporation has elected to present depreciation and amortization as a separate line item in its condensed interim consolidated statement of earnings, 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 three-month periods ended September 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 for the periods as noted above.

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Depreciation by function

Three-month periods ended September 30,	2017	2016 (Adjusted, note 3)
	$	$
Cost of goods sold	**268,752**	135,140
Operating expenses	**682**	774
Selling expenses	**9,435**	10,375
Administrative expenses	**28,361**	28,739
	307,230	175,028

Amortization by function

Three-month periods ended September 30,	2017	2016 (Adjusted, note 3)
	$	$
Cost of goods sold	**112,450**	117,099
Selling expenses	**547,636**	365,563
Administrative expenses	**31,031**	48,267
	691,117	530,929

Cost per function including depreciation and amortization

Three-month periods ended September 30,	2017	2016 (Adjusted, note 3)
	$	$
Cost of goods sold	**18,544,814**	13,445,163
Operating expenses	**878,067**	439,178
Selling expenses	**2,195,284**	1,971,830
Administrative expenses	**1,537,002**	1,765,424
Research and development expenses – net	**8,515**	81,372
	23,163,682	17,702,967

c) Research and development expenses – net

Three-month periods ended September 30,	2017	2016
	$	$
Gross research and development expenses	**8,515**	81,372
	8,515	81,372

d) Other (gains) losses – net

Three-month periods ended September 30,	2017	2016
	$	$
Unrealized exchange (gain) loss	**(98,501)**	42,401
Realized exchange (gain) loss	**2,794**	(8,098)
Other (gains)/losses (a)	**345,802**	(8,625)
	250,095	25,678

(a) During the first quarter of fiscal year 2018, the Corporation was victim of an external fraud perpetrated through its banking online platform, which led to a net loss of $363,364.

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

13. Loss per share

Basic loss per share is computed by dividing net loss by the weighted average number of shares outstanding during the period. Dilutive computations are based upon: (i) share capital under escrow as if they were released (note 11) and (ii) stock options whereby the number of dilutive shares is calculated as the difference between the number of shares issued and the number of shares that would have been issued at the average market price during the period based upon the assumed initial proceeds. Options are not dilutive if the average price is below the strike price.
The capital shares under escrow were dilutive and therefore included in the calculation of diluted (loss) earnings per share.

The computations of basic and diluted loss per share are shown below:

Three-month period ended September 30,	**2017**	2016 (Adjusted, note 3)
Net loss	**($1,089,875)**	($949,159)
After tax impact of long term stock compensation	**-**	-
Fully diluted net loss	**($1,089,875)**	($949,159)
Weighted average shares outstanding	**40,144,214**	39,102,547
Dilutive impact of shares under escrow	**-**	1,041,667
Weighted average diluted shares outstanding	**40,144,214**	40,144,214
Basic loss per share	**($0.027)**	($0.024)
Diluted loss per share	**($0.027)**	($0.024)

14. Cash Flows

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

Three-month period ended September 30,	**2017**	2016
	$	$
Accounts receivable	**(3,358,980)**	(398,226)
Inventories	**(1,260,782)**	(690,470)
Costs incurred in excess of billings	**(2,173,335)**	(1,202,011)
Prepaid expenses	**423,929**	709,272
Accounts payable and accrued liabilities	**1,852,474**	(142,641)
Provisions	**(27,497)**	3,000
Billings in excess of costs incurred	**1,454,981**	116,246
	(3,089,210)	(1,604,830)

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

b) Cash and cash equivalents consist of the following:

As at September 30,	2017	2016
	$	$
Beginning of period		
Cash and cash equivalents	**3,870,603**	3,051,870
Bank overdraft	**(184,120)**	(520,208)
	3,686,483	2,531,662

As at September 30,	2017	2016
	$	$
End of period		
Cash and cash equivalents	**2,904,784**	7,145,078
Bank overdraft	**(284,255)**	(94,873)
	2,620,529	7,050,205

15. 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 period for the continuing operations.

Three-month periods ended September 30,	2017	2016 (Adjusted, note 3)
	$	$
Revenues from sales of consumables	**6,024,862**	5,962,106
Projects contracts revenues	**8,155,342**	5,368,697
Operation and maintenance revenues	**8,437,794**	6,153,347
	22,617,998	17,484,150

Geographical information

Three-month period ended September 30,	2017	2016 (Adjusted, note 3)
	$	$
Revenues from external customers		
Revenue according to geographic location		
Canada	**5,114,976**	5,071,103
United States	**15,789,946**	11,083,293
Egypt	**1,173,020**	38,424
Other	**540,056**	1,291,330
	22,617,998	17,484,150

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

As at	September 30, 2017	June 30, 2017
		$
Non-current assets other than financial instruments and deferred tax assets according to geographic location		
Canada	**6,093,384**	6,418,968
United States	**31,578,123**	33,882,263
	37,671,507	40,301,231

16. 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 3 and 11). 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 September 30, 2017.

An amount of $7,192 was paid to the Corporation in regards of these loans and recorded as finance income in the consolidated statements of loss for the three-month period ended September 30, 2017 (nil for the three-month period ended September 30, 2016).

b) Compensation of executive officers and Board of Directors

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

Three-month period ended September 30,	2017	2016
	$	$
Short-term benefits	**441,222**	477,096
Post-employment benefits	**15,906**	17,316
Share-based payments	**120,632**	125,152
	577,760	619,564

The remuneration of executive officers and Board of Directors is determined by the corporate governance, remuneration and risks committee having regards to the performance of individuals and market trends.

17. Comparative figures

Certain comparative figures have been reclassified to conform to the current year's presentation.

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

Advisory Members
Operation and Maintenance Committee

Elisa Speranza
Leonard Graziono

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

Transfer Agent
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