Interim financial report
Third quarter ended March 31, 2010

www.h2oinnovation.com
investor@h2oinnovation.com

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

MANAGEMENT REPORT

Dear Shareholders,

During the third quarter of fiscal 2010, our Company continued to feel the enduring impact of the recession. The challenging economic environment and, more directly, its effects on the level of capital investments made by our customers – both in the municipal and industrial sectors – translated into unusually low revenues from system sales. Moreover, H_2O Innovation's results for the quarter were adversely affected by the insufficient level of contracts for water treatment systems secured during the first months of the recession, before economic stimulus plans recharged municipal spending.

The decrease in revenues derived from equipment sales brought down the Company's total sales for the quarter, negating the increase of revenues coming from sales of services and consumables. Contrary to system sales, sales of services and consumables performed well and have shown a constant growth quarter after quarter. Increasing the level of sales of services and consumables has been of critical importance within the Company's strategic plan, particularly now as we feel the recession's impact on system sales. The acquisition of Professional Water Technologies ("PWT"), completed shortly before the beginning of fiscal 2010, and its successful integration positively contributed to our results this quarter as in the two previous ones.

For the period ended March 31, 2010, sales amounted to $6,312,349, compared to $8,797,872 for the three-month period ended March 31, 2009. The Company's gross margin for the quarter was 25.4%, slightly down compared to 26.4% for the same period in fiscal 2009 but significantly higher than during the previous quarter of the current fiscal year (Q2 2010), when our gross margin was recorded at only 22.1%. Management is encouraged by the increase in gross margin noted this quarter compared to the previous quarter of this fiscal year, resulting from a higher proportion of revenue coming from services and consumables but also to higher margins on equipment sales. Management expects the cost reduction and spending control program implemented after the close of the quarter to positively contribute to higher gross margins as well as reduced selling, general and administrative expenses.

Loss from operations for the quarter was ($1,269,539), compared to income from operations of $268,446 for the same period of the previous fiscal year. EBITDA[1] for the quarter was ($980,271), compared to $1,180,650 for the same period ended March 31, 2009. Excluding unrealized foreign exchange loss, EBITDA for the quarter was

1 Earnings before interests, taxes, depreciation and amortization (EBITDA) is a performance indicator that is not determined in accordance with Canadian generally accepted accounting principles and is not intended as an alternative measure of net earnings. Because EBITDA may not be calculated identically by all companies, the Company's result may not be directly comparable to similarly titled measures of other companies.

($824,132). During the quarter, the Company recorded a net loss of ($1,558,567) or ($0.028 per share), compared to net earnings of 684,423 or $0.014 per share for the third quarter of fiscal 2009.

The sales backlog stood at $14.5 M as at March 31, 2010. The sales backlog is entirely composed of systems and equipment sales and does not include sales of services or consumables, which represented 43% of the Company's total sales for the quarter, an unusually high proportion due to the lower level of system sales recorded during the quarter. In the two previous quarters of fiscal 2010, sales of services and consumables represented 27% and 33% of total sales.

While the revenues derived from system sales during the quarter were lower than during the previous quarters, we were successful at securing over $5.8 M in new contracts for water treatment systems. This represents an increase of 38% over the value of new contracts secured during the previous quarter of fiscal 2010 and an increase of more than 115% compared to the first quarter of fiscal 2010. The contracts signed during the quarter will translate into revenues during the next quarter and the following ones. Their signing – and the positive trend in new bookings quarter-over-quarter – can be seen as a sign of momentum picking up for our system sales in the municipal sector. We are confident that this momentum will carry on and, as the North American economy slowly moves out of the recession, extend to the industrial sector. As soon as we felt the industrial system sales sector significantly slowing down at the beginning of the recession, we reallocated part of our industrial sales and engineering teams to serve the municipal sector, enabling us to cover U.S. states and regions where we were previously not present in the municipal sector. This reallocation has been a key factor for the Company to successfully secure contracts to provide two integrated ultrafiltration and reverse osmosis systems for municipal water treatment plants in North Dakota, our first sizeable municipal sales in the U.S. Midwest.

Acting on the decline in systems sales and in order to maintain high margins and return to positive EBITDA, the Company has prepared a cost reduction and spending control program with objective to trim approximately $1,25 M in total annual expenses. This program has started to be implemented shortly following the end of the third quarter. Management expects the effects of the program to be evenly divided in a 40/60 proportion between productivity gains and reductions in selling, general and administrative. The effects of the program are expected to start showing in the fourth quarter of fiscal 2010 and to reach their full effect in fiscal 2011. The program includes hiring freeze, workweek reduction for manufacturing staff, selected layoffs, along with a reduction in trade show and travel expenses. All manufacturing processes are also being analyzed to identify additional operational efficiencies, especially in the lower value-added tasks of the Company's manufacturing processes. Selling, general and administrative functions will also thoroughly be reviewed to improve the Company's business processes. The program has been developed with the objective of preserving the Company's sales and engineering resources, essential to fuel the Company's sales growth, making sure we are not jeopardizing the Company's growth for the years ahead.

Some of the most significant actions taken during the quarter were those seeking to grow our revenues derived from industrial sales and our international revenues. We notably undertook two initiatives bringing substantial growth potential: a sales representation agreement with 3M Purification and the creation of H_2O Innovation India Ltd.

Announced on January 20, our agreement with 3M Purification sees it represent our complete line of customized water treatment solutions (systems and consumables) in the U.S. oil & gas and automotive assembly markets. Only two months later, on March 25, we announced the extension of the initial agreement with 3M Purification to cover the Canadian oil & gas and automotive assembly markets. 3M Purification and H_2O Innovation resources from both sides of the border have been working together from day one developing a sales pipeline from 3M Purification's client base. This agreement brings us a very reputable and numerous sales force with significant market access, along with increased visibility and added credibility in two important segments of the industrial water treatment industry.

On February 1, we announced the creation of H_2O Innovation India, our joint venture with Chembond Chemicals of Mumbai, India. H_2O Innovation India is dedicated to providing water treatment systems and maintenance services to the fast growing Indian industrial, commercial, and institutional markets. Its twelve-employee sales and engineering team is actively pursuing sales opportunities in the local Indian market with the support and knowledge of H_2O Innovation's engineers. H_2O Innovation India's sales objectives are to generate between CAN$5 million and CAN$8 million within its first three years of operation.

Growth-fostering initiatives have continued to be put in place subsequently to the end of the quarter. Our Professional Water Technologies business unit has developed three new membrane cleaners targeting the growing reverse osmosis and ultrafiltration/microfiltration membrane markets.

During the quarter, we doubled our efforts to develop additional sources of growth and penetrate additional markets while pursuing numerous new system sales opportunities in the municipal and industrial North American market. We are confident the initiatives put in place during the quarter will enable our Company to increase its sales and, along with the measures taken to improve our cost of goods sold, improve its results. Our top priority is to bring the Company back to positive EBITDA. We are confident that with the hard work and complete dedication of our team we will reach this goal as quickly as possible.

Frédéric Dugré
President and CEO

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE FINANCIAL SITUATION

In accordance with National Instrument 51-102 Continuous Disclosure Obligations, the following comments are intended to provide a review and an analysis of H_2O Innovation's results of operations and financial position for the quarter ended March 31, 2010, in comparison with the corresponding period ended March 31, 2009. They should be read in conjunction with the consolidated financial statements and accompanying notes. Comparison of Balance sheets as at March 31, 2010 to those as at June 30, 2009 is also included. Certain statements set forth in this Management's Discussion and Analysis regarding the operations and the activities of H_2O Innovation as well as other communications by the Company to the public that describe more generally management objectives, projections, estimates, expectations or forecasts may constitute forward-looking statements within the meaning of securities legislation. Forward-looking statements concern analysis and other information based on forecast future results and the estimate of amounts that cannot yet be yet determined. Forward-looking statements include the use of the words "expect", "believe", "estimate" and other similar terms as well as those usually used in the future and the conditional, notably regarding certain assumptions as to the success of a venture. Those forward-looking statements involve a number of risks and uncertainties which may result in actual and future results of the Company to be materially different than those indicated. Information about the risk factors to which the Company is exposed is provided in the Annual Information Form dated September 28, 2009 available on SEDAR (www.sedar.com). Unless required to do so pursuant to applicable securities legislation, H_2O Innovation assumes no obligation to update or revise forward-looking statements contained in this Management's Discussion and Analysis or in other communications as a result of new information, future events and other changes.

The following financial statements and the corresponding figures have not been reviewed by our auditors. They have been prepared in accordance with Canadian generally accepted accounting principles. All figures in the present report are expressed in Canadian dollars, unless otherwise indicated.

VISION, MISSION & PROFILE

OUR VISION

Create sustained and growing value for our shareholders by becoming the best in North America, working through consulting engineers, at customizing water treatment systems based on comprehensive analytical and strong technical capabilities that maximize the efficiency, performance and longevity of our customers' systems.

OUR MISSION

To provide safe, integrated and customized water treatment solutions in a changing environment.

OUR PROFILE

With 10 years of experience developing water treatment solutions, H_2O Innovation is establishing itself as a key player in sustainable development and clean technologies. H_2O Innovation designs, develops, produces, and integrates state-of-the-art custom-built water treatment systems for the production of drinking water, the reclamation of water, the treatment of wastewater and industrial process water in the municipal, commercial, industrial, oil & gas, mining, and energy markets. Additionally, the Company offers complete operating and maintenance solutions for membrane filtration and reverse osmosis systems. H_2O Innovation is also a founding partner of H_2O Innovation India, a joint venture with Chembond Chemicals, Mumbai, India. H_2O Innovation has approximately 90 employees and eight offices including three manufacturing and assembly plants in Canada and the United States.

RESULTS OF OPERATIONS

Selected financial data
(Unaudited)

Three-month period ended March 31	2010	2009	Change
	$	$	$
Sales	6,312,349	8,797,872	(2,485,523)
Gross margin	1,603,062	2,321,069	(718,007)
Gross margin	25.4%	26.4%	(1.0)%
Operating, selling, administrative and general expenses	2,420,690	1,642,342	778,348
Net loss	(1,558,567)	684,423	(2,242,990)
EBITDA[1]	(980,271)	1,180,650	(2,160,921)

Results of operations

When comparing the results of the current quarter with those of the corresponding quarter of the previous year, the reader should keep in mind the impact of the integration of Professional Water Technologies ("PWT") on the sales and expenses figures. This US-based business was acquired in June 2009.

Sales and gross margin

Sales during this third quarter decreased 28% when compared to the corresponding quarter last year, totalling $6,312,349 as at March 31, 2010, in comparison to $8,797,872 as at March 31, 2009. The results of this quarter were strongly colored by the economic slowdown-the North American economy, which concentrates most of our business. Significant activities such as the representation agreement with 3M Purification and the creation of a joint venture in India were undertaken during the current quarter. These actions aim at rebalancing the level of industry sales and municipal sales and expanding both our sales network and our geographic coverage. The contribution to the sales of these growth initiatives will be felt in the coming quarters.

During this quarter we were successful at securing over $5.8 M in new contracts for water treatment systems. This represents an increase of 38% over the value of new contracts secured during the previous quarter of fiscal 2010 ($4.2 M) and an increase of more than 115% ($2.7 M) compared to the first quarter of fiscal 2010.

The decrease in sales resulted in a decrease of our gross margin, which decreased from $2,321,069 to $1,603,062 for the three months ended March 31, 2009 and 2010. This decrease in gross margin for the quarter compared to the same quarter last year was caused by multiple factors, but primarily by the unusually high proportion of income from municipal projects compared to income from industrial projects and a decrease in total sales. However, sales of consumables, including PWT's specialty chemicals and maintenance solutions for membrane filtration, contributed to somewhat mitigating this effect. At 25.4%, the gross margin for the quarter was higher than the previous quarter, mainly because a higher proportion of revenues from sales of services and consumables was recorded, but also due to higher margins achieved for systems and equipment projects.

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Operating expenses

Operating, selling, administrative and general expenses rose from $1,642,342 (18.7% of sales) for the three-month period ended March 31, 2009 to $2,420,690 (38.3% of sales) for the same period ended March 31, 2010. The nominal increase of these expenses can mainly be attributed to the integration of PWT, whose activities are mostly international.

Shortly following the quarter's end, the Company has implemented a cost reduction and spending control program with objective to trim $1,25 M in total annual expenses. Management expects the effects of the program to be divided in a 40/60 proportion between productivity gains and reductions in selling, general and administrative. The effects of the programs are expected to start showing in the fourth quarter of fiscal 2010 and to reach their full effect in fiscal 2011. The program has been developed while taking care to preserve our assets for the development of sales.

The increase in intangible assets depreciation in fiscal 2010 compared to fiscal 2009 can mainly be attributed to the acquisitions completed in fiscal 2009.

For the quarter ended March 31, 2010, the stock-based compensation decreased to $30,924 from $97,360 for the corresponding quarter of fiscal 2009. This nominal decrease of $66,436 is mainly due to the decrease in stock option grants in fiscal 2010.

EBITDA

EBITDA[1] for the quarter ended March 31, 2010 was ($980,271), compared to $1,180,650 for the quarter ended March 31, 2009. The decrease in EBITDA in 2010 is due to a loss on exchange rate of ($156,139) in 2010 compared to a gain on exchange rate of $531,576 in 2009, with a total gap of $687,715 and to a decrease in sales of 28% mainly caused by the slowdown of the U.S. economy and to a decrease in gross margin of 1.0% resulting from the under-representation of industrial sales revenue during the quarter. By implementing a cost reduction and spending controls program shortly following the end of the third quarter, the Company seeks to achieve positive EBITDA as quickly as possible without compromising its growth opportunities.

Other incomes and expenses

The significant foreign exchange gain variation of $531,576 as at March 31, 2009, compared to a loss on exchange rate of ($156,139) as at March 31, 2010, is mainly attributable to the impact of the weakening of the U.S. dollar against the Canadian dollar on the Company's assets and liabilities in U.S. dollars. Of this loss on exchange rate of ($156,139), there is a loss on exchange rate of ($22,752) and an unrealized loss on exchange rate of ($133,387) related to the conversion of assets and liabilities in U.S. dollars and the results of our U.S. subsidiaries. This change did not have any monetary impact on the Company.

The interest expense on long-term debt, totalling $211,974 as at March 31, 2010, is mainly related to the convertible debenture and the new long-term debts incurred during the previous year. Of this amount, $61,697 represents the theoretical and non-monetary part of interest on the convertible debenture and long-term debts.

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Net loss

During the quarter, H_2O Innovation recorded a net loss of ($1,558,567) ($0.028 per share), compared to net earnings of $684,423 ($0.014 per share) for the third quarter of fiscal 2009. This nominal decrease of $2,242,990 may be explained by various factors, including the exchange loss on financial assets and liabilities in U.S. dollars and the decrease in sales.

For the quarter ended March 31, 2010, the Company recognized $73,440 as future income taxes related to variations in future tax liabilities accounted for in the acquisitions of Itasca Systems Inc. and Wastewater Technologies Inc.

Commitments

The Company has entered into long-term lease agreements expiring in 2010, 2012, 2013 and 2017 which call for a payment of $1,999,426 for the rental of premises. The minimum annual lease payments over the next five years are $120,376 in 2010, $419,905 in 2011, $364,420 in 2012, $336,474 in 2013 and $182,840 in 2014.

Shares outstanding

As at March 31, 2010, the number of outstanding shares is 55,149,207. Following the exercise of stock options, the company issued 16.667 shares.

Stock-based compensation plan

No stock options were issued during the quarter and there were 16,667 stock options exercised at a price of $ 0.32.

FINANCIAL SITUATION

Before the change in operating working capital, **operating activities** used $1,146,876 in cash for the period ended March 31, 2010, compared to $1,173,520 of cash generated during the corresponding period ended March 31, 2009. The increase in funds used by operating activities is attributable to the increase in net loss caused by the loss on exchange rate mostly unrealized at March 31, 2010 and declining sales over the previous quarter, as explained above under "Sales and gross margin”. The implementation of the cost reduction and spending controls program should help to mitigate this impact in the next quarters.

Investing activities required net cash of $50,423.

Financing activities required cash of $213,416 mainly for the repayment of long-term debt.

CAPITAL MANAGEMENT

The bank loan and the loan with a Canadian chartered bank include certain covenants regarding among others, the working capital, the debt coverage ratio and the debt ratio. Management is conducting a thorough follow-up of these ratios and two of these were not respected as at March 31, 2010. The tender has served its tolerance in this regard. Except for covenants relating to the bank loan, the Company is not subject to any other capital requirement imposed by a third party.

ACCOUNTING ESTIMATES AND SIGNIFICANT ACCOUNTING POLICIES

Accounting Estimates

The preparation of financial statements in accordance with Canadian GAAP requires Management to make estimates and assumptions that affect the amounts recorded in the financial statements and notes to financial statements. These estimates are based on management's best knowledge of current events and actions that the Company may undertake in the future. Actual results may differ from these estimates.

The most significant estimates include, but are not limited to, assumptions used for impairment testing of goodwill and long-lived assets, the estimated useful lives of depreciable long-lived assets, the recoverability of tax credits and allowances for doubtful accounts, inventory obsolescence and valuation allowances against future income tax assets.

Changes in accounting policies

On July 1, 2009, the Company adopted Section 3064, “Goodwill and Intangible Assets”, of the Canadian Institute of Chartered Accountants (CICA) Handbook. This section establishes standards for the recognition, measurement and disclosure applicable to intangible assets. It replaces Section 3062, “Goodwill and Other Intangible Assets”, and Section 3450, “Research and Development Costs”. The adoption of this section had no impact on the Company’s financial position or results of operations.

Future accounting changes

On February 13, 2008, the Accounting Standards Board confirmed the date of changeover from Canadian GAAP to International Financial Reporting Standards (IFRS). Canadian publicly accountable enterprises must adopt IFRS for their interim and annual financial statements relating to fiscal periods beginning on or after January 1, 2011. The Company has developed an IFRS transition plan for its consolidated financial statements. An analysis of the differences between IFRS and the Company’s accounting standards is underway. This analysis takes into account the potential impacts, among others, on accounting policies, financial reporting and information technologies. To date, the Company is unable to show the consequences of the conversion from Canadian GAAP to IFRS on its financial statements.

The CICA published the following sections of the CICA Handbook that apply to interim and annual financial statements relating to fiscal periods beginning on or after January 1, 2011:

a) Section 1582, “Business Combinations”, which replaces the former Section 1581 of the same name, establishes accounting standards for a business combination. It provides the Canadian equivalent to International Financial Reporting Standard IFRS 3, “Business Combinations”.

b) Section 1601, “Consolidated Financial Statements”, which replaces the former Section 1600 of the same name, establishes standards for the preparation of consolidated financial statements.

c) Section 1602, “Non-Controlling Interests”. This new section establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of International Accounting Standard IAS 27, “Consolidated and Separate Financial Statements”.

The Company is currently evaluating the impact of these new standards on its financial statements.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

In February 2008, the Accounting Standards Board ("AcSB") confirmed that Canadian GAAP for publicly accountable enterprises will be converged with IFRS, effective in calendar year 2011, with early adoption allowed starting in calendar year 2009. For the Company, the changeover to IFRS will be required for interim and annual financial statements beginning on July 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences on recognition, measurement, presentation and disclosures.

During 2009, the Company proceeded with the assistance of external experts to establish diagnosis for the adoption of IFRS. This diagnosis has identified the main differences between the accounting treatments applied by the Company under Canadian GAAP and the IFRS as well as the practical implications related to the measure. The differences were further classified according to their degree of complexity and by the amount of work to implement with respect to the measure.

An implementation plan for the IFRS adoption strategy is being developed. The activities planned include the identification and documentation of existing differences between IFRS and Canadian GAAP in accounting and disclosure requirements; the selection of IFRS accounting policies, including the consideration of options available under IFRS; the determination of the impact of conversion on internal controls, accounting systems and other business solutions and processes; and the development of a training program to assist appropriate employees in the transition to and the ongoing compliance with IFRS.

The Company has decided to switch to IFRS on July 1, 2011. Some options permitted under IFRS are currently under analysis. The various activities related to the IFRS implementation plan will continue throughout the year 2010.

FINANCIAL RISK MANAGEMENT AND FINANCIAL RISKS

Risks and uncertainties and risk management practices are described in the Management's Discussion and Analysis included in the Annual Report 2009 of the Company and the Annual Information Form dated September 28, 2009 available on SEDAR (www.sedar.com). Risks and uncertainties and risk management practices have not materially changed during the three-month period ended March 31, 2010.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company has designed disclosure controls and procedures to ensure that the information reported in this MD&A, the consolidated financial statements and the related interim documents is properly recorded, processed, summarized and reported to the Company's Audit Committee and Board of Directors. Based on its evaluation, as defined in NI 52-109 of the Canadian Securities Administrators, the Company's management has concluded that, at the end of the interim period ended March 31, 2010, the disclosure controls and procedures and the internal controls over financial reporting are adequately designed and provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

This examination was conducted using the framework and criteria set out in the document entitled "Internal Control-Integrated Framework" released by the Committee of Sponsoring Organizations (COSO).

During the quarter, the Company did not make any modifications to the internal controls over financial reporting that had or could reasonably be expected to have a significant impact on the internal controls over financial reporting.

Interim Consolidated Financial Statements

Third quarter ended
March 31, 20010

These interim consolidated financial statements have not been subjected to an audit or to a review engagement by the auditors.

For additional information:
Investor Relations
investor@h2oinnovation.com

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Annual reports and press releases are accessible on our Website: *www.h2oinnovation.com* and on SEDAR

H_2O INNOVATION INC.

INTERIM CONSOLIDATED BALANCE SHEETS
(Unaudited)

	As at March 31, 2010	As at June 30, 2009
	$	$
ASSETS		
Current assets		
Cash	**1,931,777**	5,594,406
Held-for-trading investments	**2,016,123**	2,021,070
Accounts receivable	**5,934,408**	10,223,766
Inventories	**1,888,825**	1,784,938
Work in process	**2,636,722**	1,023,259
Prepaid expenses	**566,567**	258,271
Future income tax assets	**375,376**	375,376
	15,349,798	21,281,086
Held-to-maturity investment	**39,792**	44,077
Fixed assets	**2,354,084**	2,469,680
Intangible assets	**12,392,232**	13,445,145
Other assets	**47,966**	51,890
Goodwill (Note 2)	**14,616,214**	14,616,214
	44,800,086	51,908,092
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	**3,926,819**	5,648,683
Excess of billing over work in process	**441,925**	1,346,038
Current portion of long-term debt	**1,335,708**	875,000
	5,704,452	7,869,721
Long-term debt	**2,979,530**	4,053,535
Convertible debenture	**1,324,288**	1,238,607
Deferred rent	**57,560**	76,969
Future income taxes	**2,332,312**	2,552,634
	12,398,142	15,791,466
SHAREHOLDERS' EQUITY		
Equity component of convertible debenture	**301,023**	301,023
Capital stock (Note 3)	**43,787,487**	43,778,820
Contributed surplus	**11,429,611**	11,375,483
Deficit	**(23,116,177)**	(19,338,700)
	32,401,944	36,116,626
	44,800,086	51,908,092

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

On behalf of the Board,

Frédéric Dugré
President and Chief Executive Officer

Philippe Gervais
Chairman of the Board of Directors

H_2O INNOVATION INC.

INTERIM CONSOLIDATED EARNINGS AND COMPREHENSIVE INCOME
(Unaudited)

	Three months ended March 31,		Nine months ended March 31,	
	2010	2009	**2010**	2009
	$	$	**$**	$
Sales	**6,312,349**	8,797,872	**21,806,201**	23,893,338
Cost of goods sold	**4,709,287**	6,476,803	**16,125,560**	17,777,675
Gross margin	**1,603,062**	2,321,069	**5,680,641**	6,115,663
Expenses				
Operating, selling, administrative and general expenses	**2,420,690**	1,642,342	**6,695,877**	4,644,093
Amortization of fixed assets	**51,084**	67,130	**193,260**	200,875
Depreciation of intangible assets	**346,717**	283,018	**1,062,687**	847,484
Bank charges and other financial expenses	**41,961**	33,734	**107,447**	68,256
Government assistance	**(18,775)**	(70,961)	**(93,275)**	(118,384)
Stock-based compensation	**30,924**	97,360	**57,461**	291,615
	2,872,601	2,052,623	**8,023,457**	5,933,939
Operating earnings (loss) before the following items	**(1,269,539)**	268,446	**(2,342,816)**	181,724
Investment income	**3,484**	7,654	**6,210**	40,139
Rental and interest income	**484**	12,076	**12,353**	43,987
Other income	**4,081**	1,288	**6,808**	9,507
Exchange gain (loss)	**(156,139)**	531,576	**(913,742)**	1,109,153
Interest on long-term debt	**(211,974)**	(112,345)	**(598,536)**	(298,428)
Loss on disposal of fixed assets	**(2,404)**	-	**(125,083)**	-
Loss on disposal of intangible assets	**-**	-	**(15,955)**	-
Acquisition and integration expenses	**-**	(24,272)	**(27,038)**	(83,782)
	(362,468)	415,977	**(1,654,983)**	820,576
Earnings (loss) before income tax	**(1,632,007)**	684,423	**(3,997,799)**	1,002,300
Future income tax benefit	**73,440**	-	**220,322**	-
Net earnings (net loss) for the period and comprehensive income	**(1,558,567)**	684,423	**(3,777,477)**	1,002,300
Basic and diluted net earnings (net loss) per share	**(0.028)**	0.014	**(0.068)**	0.021
Weighted average number of shares outstanding (Note 4)	**55,149,207**	47,367,221	**55,142,989**	47,291,027

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

H_2O INNOVATION INC.

INTERIM CONSOLIDATED CONTRIBUTED SURPLUS AND DEFICIT
(Unaudited)

Nine months ended March 31	**2010**	2009
	$	$
Contributed surplus		
Opening balance	**11,375,483**	9,619,819
Stock-based compensation	**57,461**	291,615
Exercise of stock options	**(3,333)**	-
Closing balance	**11,429,611**	9,911,434
Deficit		
Opening balance	**(19,338,700)**	(19,273,552)
Net earnings (net loss) for the period	**(3,777,477)**	1,002,300
Closing balance	**(23,116,177)**	(18,271,252)

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

H_2O INNOVATION INC.

INTERIM CONSOLIDATED CASH FLOWS (Unaudited)	Three months ended March 31,		Nine months ended March 31,	
	2010	2009	**2010**	2009
	$	$	**$**	$
Cash flows from operating activities				
Net earnings (net loss) for the period	**(1,558,567)**	684,423	**(3,777,477)**	1,002,300
Items not affecting cash				
Change in fair value of held-for-trading investments	**3,506**	5,789	**4,947**	7,428
Interest capitalized on held-to-maturity investment	**(455)**	(505)	**(1,338)**	(1,785)
Exchange (gain) loss on held-to-maturity investment	**1,218**	(1,326)	**5,623**	(8,502)
Amortization of fixed assets	**51,084**	67,130	**193,260**	200,875
Depreciation of intangible assets	**346,717**	283,018	**1,062,687**	847,484
Loss on disposal of fixed assets	**2,404**	-	**125,083**	-
Loss on disposal of intangible assets	**-**	-	**15,955**	-
Stock-based compensation	**30,924**	97,360	**57,461**	291,615
Future income taxes	**(73,440)**	-	**(220,322)**	-
Change in unrealized foreign exchange gain	**(11,964)**	-	**(56,255)**	-
Imputed interest	**61,697**	37,631	**184,889**	93,294
	(1,146,876)	1,173,520	**(2,405,487)**	2,432,709
Net change in non cash working capital items (Note 5)	**1,941,983**	315,813	**(381,674)**	(3,875,165
	795,107	1,489,333	**(2,787,161)**	(1,442,456)
Cash flows from investing activities				
Disposal of held-for-trading investments	**-**	-	**-**	150,000
Receipt of sales-type lease	**-**	-	**-**	70,709
Purchase of fixed assets	**(45,271)**	(34,424)	**(330,292)**	(281,372)
Acquisition of intangible assets	**(5,976)**	(5,969)	**(70,729)**	(22,260)
Proceeds from disposal of fixed assets	**-**	-	**127,545**	-
Proceeds from disposal of intangible assets	**-**	-	**45,000**	-
Business acquisitions (Note 2)	**-**	-	**-**	(9,808,266)
Other assets	**824**	(594)	**3,924**	(6,046)
	(50,423)	(40,987)	**(224,552)**	(9,897,235)
Cash flows from financing activities				
Repayment of bank loan	**-**	-	**-**	(27,259)
Payments on long-term debt	**(218,750)**	(218,750)	**(656,250)**	(437,500)
Long-term debt contracted	**-**	-	**-**	3,500,000
Convertible debenture contracted	**-**	-	**-**	1,500,000
Issuance of shares	**5,334**	-	**5,334**	-
Share issue expenses	**-**	-	**-**	(32,734)
	(213,416)	(218,750)	**(650,916)**	4,502,507
Net change in cash	**531,268**	1,229,596	**(3,662,629)**	(6,837,184)
Cash and cash equivalents - Beginning of period	**1,400,509**	1,482,918	**5,594,406**	9,549,698
Cash and cash equivalents - End of period	**1,931,777**	2,712,514	**1,931,777**	2,712,514
Additional information				
Interest paid	**203,818**	36,413	**436,007**	94,488

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

H_2O INNOVATION INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim consolidated financial statements of the Company for the three months and nine months ended March 31, 2010 and 2009 have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and should be read in conjunction with the 2009 audited annual consolidated financial statements. The accounting policies are the same as those used for the 2009 audited annual consolidated financial statements, with the exception of the accounting changes listed below.

Changes in accounting policies

On July 1, 2009, the Company adopted Section 3064, "Goodwill and Intangible Assets", of the Canadian Institute of Chartered Accountants (CICA) Handbook. This section establishes standards for the recognition, measurement and disclosure applicable to intangible assets. It replaces Section 3062, "Goodwill and Other Intangible Assets", and Section 3450, "Research and Development Costs". The adoption of this section had no impact on the Company's financial position or results of operations.

Future accounting changes

On February 13, 2008, the Accounting Standards Board confirmed the date of changeover from Canadian GAAP to International Financial Reporting Standards (IFRS). Canadian publicly accountable enterprises must adopt IFRS for their interim and annual financial statements relating to fiscal periods beginning on or after January 1, 2011. The Company has developed an IFRS transition plan for the conversion of its consolidated financial statements to IFRS. An analysis of the differences between IFRS and the Company's accounting standards is underway. This analysis is being conducted by taking into account the potential impacts, among others, on accounting policies, financial reporting and information technologies. To date, the Company is unable to show the consequences of the conversion from Canadian GAAP to IFRS on its financial statements.

The CICA published the following sections of the CICA Handbook that apply to interim and annual financial statements relating to fiscal periods beginning on or after January 1, 2011:

a) Section 1582, "Business Combinations", which replaces the former Section 1581 of the same name, establishes accounting standards for a business combination. It provides the Canadian equivalent to International Financial Reporting Standard IFRS 3, "Business Combinations".

b) Section 1601, "Consolidated Financial Statements", which replaces the former Section 1600 of the same name, establishes standards for the preparation of consolidated financial statements.

c) Section 1602, "Non-Controlling Interests". This new section establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements prepared subsequent to a business combination. It is equivalent to the corresponding provisions of International Accounting Standard IAS 27, "Consolidated and Separate Financial Statements".

The Company is currently evaluating the impact of these new standards on its financial statements.

2. BUSINESS ACQUISITIONS

Professional Water Technologies

On June 17, 2009, H_2O Innovation Inc. completed the acquisition of substantially all of the assets of Professional Water Technologies ("PWT") through Membrane Systems Inc., an indirectly wholly-owned U.S. subsidiary of H_2O Innovation. PWT manufactures state-of-the-art products for maintaining and operating membrane filtration systems.

The total consideration of $4,606,746 includes a payment of $4,207,270 (US$3,700,000) in cash. On top of this purchase price, a price adjustment of $349,065 (US$306,978) is added and will be paid in cash. The purchase price will be increased by a maximum of US$2,000,000 if accrued sales reach US$13,100,000 within the 24-month period following the closing of the transaction. Goodwill will be adjusted by any additional consideration. Acquisition costs totalling $50,411 (US$44,333) are in addition to the purchase price.

The purchase price allocation was evaluated at the acquisition date. The results of operations of the acquired company are included in the consolidated earnings since June 17, 2009, the acquisition date. The estimated fair value of the assets acquired and liabilities assumed on the acquisition date are detailed as follows, at the Canadian dollar equivalent:

Assets	$
Accounts receivable	484,698
Inventories	123,257
Fixed assets	39,799
Other assets	11,435
Intellectual property	2,581,217
Trademarks	511,695
Distribution network	864,196
Goodwill	281,073
Total assets acquired	4,897,370
Current liabilities	
Accounts payable	134,467
Notes payable	156,157
	290,624
Final acquisition price	4,606,746

2. BUSINESS ACQUISITIONS (CONTINUED)

Itasca Systems, Inc.

On July 3, 2008, H_2O Innovation Inc. (“H_2O Innovation” or “the Company”) completed the acquisition of all of the shares of Itasca Systems, Inc. (“Itasca”) through H_2O Innovation USA Inc., a wholly-owned subsidiary of H_2O Innovation. Itasca specializes in treating industrial process water, notably for the energy sector.

The total consideration of $17,027,693 is equal to the payment of $9,644,670 (US$9,450,000) in cash, the issuing of 10,476,718 H_2O Innovation common shares and related fees of $163,596. The value attributed to the common shares issued is $7,192,168 and was calculated according to the market price of the issued shares on the date on which the terms and conditions of the combination were agreed upon and disclosed, taking into consideration the potential price fluctuations resulting from the minimum holding period and number of securities that changed hands.

The purchase price allocation was evaluated at the acquisition date. The results of operations of the acquired company are included in the consolidated earnings since July 3, 2008, the acquisition date. The estimated fair value of the assets acquired and liabilities assumed on the acquisition date are detailed as follows, at the Canadian dollar equivalent:

Assets	$
Accounts receivable	1,516,397
Work in process	665,459
Inventories	405,204
Prepaid expenses	38,571
Fixed assets	121,917
Software	12,220
Other assets	12,120
Technologies	1,102,248
Customer relations	2,602,530
Distribution network	724,626
Backlog	214,326
Goodwill (i)	12,358,313
Future income taxes	430,696
Total assets acquired	20,204,627
Current Liabilities	
Bank loan	27,259
Accounts payable	1,216,090
Deferred rent	76,093
Future income taxes	1,857,492
	3,176,934
Final acquisition price	17,027,693

(i) Goodwill is not deductible for tax purposes

2. BUSINESS ACQUISITIONS (CONTINUED)

Wastewater Technology Inc.

On April 10, 2008, H_2O Innovation completed the acquisition of all shares of Wastewater Technology Inc. (“WTI”) through H_2O Innovation USA Inc., a wholly-owned subsidiary of H_2O Innovation. WTI designs, manufactures and assembles wastewater treatment units and systems using patented bioreactor (Bio-Wheel^{TM}) and MBR (Bio-Brane^{TM}) technologies.

The purchase price of the WTI shares is $2,970,624 (US$2,918,385), paid cash. The purchase price will be increased by a maximum of US$2,000,000 (of which $40,716 (US$40,000) was paid on acquisition) if accrued sales over ten periods of the Bio-Brane^{TM} technology amount to US$32.7 million and if sales of the Bio-Wheel^{TM} or related technologies amount to US$8 million. As at June 30, 2009, an amount of $34,287 (US$33,684) was applied against the goodwill. Goodwill will be adjusted by any additional consideration. Acquisition costs totalling $44,792 (US$44,004) are in addition to the purchase price.

During the period ended at June 30, 2009, the Company’s management discovered a discrepancy in its previously reported consolidated financial statements for the fiscal period ended June 30, 2008 in regard to the purchase price allocation of this subsidiary. Consequently, the Company’s management decided to restate its financial statements to account for a future tax liability of $1,547,208 and for an increase of its goodwill of $1,155,878, patents of $339,839 and distribution network of $51,491. This restatement had no impact on the Company’s consolidated earnings or cash flows.

The results of operations of the acquired company are included in the consolidated earnings since April 10, 2008, the acquisition date. Assets acquired and liabilities assumed on the acquisition date are detailed as follows, at the Canadian dollar equivalent:

Assets	$
Accounts receivable	289,906
Work in process	101,306
Inventories	26,441
Fixed assets	50,939
Patents	3,359,070
Distribution network	508,950
Goodwill	1,155,878
Total assets acquired	5,492,490
Current liabilities	
Bank loan	160,648
Accounts payable	725,088
Notes payable	39,822
Future income taxes	1,547,208
	2,472,766
Cash situation on acquisition	36,408
Final acquisition price	3,056,132

2. BUSINESS ACQUISITION (CONTINUED)

Membrane Systems Inc.

On October 1, 2006, the Company completed the acquisition of the assets of Membrane Systems Corporation ("MSC") through Membrane Systems Inc. ("MSI"), a new subsidiary formed under the laws of Delaware, wholly-owned by the Company, pursuant to the September 6, 2006 Purchase Agreement. MSC specializes in the manufacturing of water treatment systems using membrane technologies such as ultra-filtration, nano-filtration and reverse osmosis.

The purchase price of the MSC assets is US$3,073,400 (this amount comprises the initial acquisition price of US$2,875,000 and an adjustment of US$198,400 computed as per clause ii)). This price may be adjusted as follows: i) if accounts receivable are still not paid 180 days after closing, the purchase price will be reduced by an amount equal to the net book value of such accounts receivable at closing; ii) reduced or increased, if applicable, by an amount equal to the difference between the net book value indicated in the financial statements at closing and US$1,000,000 and iii) increased: a) on June 30, 2007, by an amount equal to 50% of the Earning Before Interests, Taxes, Depreciation and Amortization ("EBITDA") of MSI for the period starting at closing date and ending on June 30, 2007 which exceeds the amount calculated by the following formula: US$1,503.10 multiplied by the number of days between closing and June 30, 2007 b) on June 30, 2008, by an amount equal to 50% of the EBITDA of MSI for the 12-month period ending on such date, which exceeds US$623,692; and c) on June 30, 2009, by an amount equal to 50% of the EBITDA of MSI for the 12-month period ending on such date, which exceeds US$706,836. Any additional consideration will be accounted for as consolidated goodwill when the condition is achieved and that additional consideration is issued or to be issued. During the previous period, a cash consideration of US$215,560 was applied against the goodwill. Acquisition costs of $92,075 were added to this price, $40,072 of which were included in deferred charges as at June 30, 2006.

Groupe OxydH_2O

On July 1, 2002, the Company acquired all issued and outstanding shares of Groupe OxydH_2O. This group includes three companies: Les Systèmes Bioflo Inc., 3765415 Canada Inc. and OxydH_2O Canada Inc.

The final purchase price is $917,268. A balance of $13,789 will be settled with the issue of 6,895 common shares.

3. CAPITAL STOCK

Authorized
Unlimited number of common shares, without par value

As at March 31, 2010	**Number**	**Amount**
		$
Issued and fully paid at the beginning of period	**55,139,948**	**43,765,031**
Issuance of shares pursuant to options	**16,667**	**8,667**
Shares to be issued		
In settlement of business acquisition (Note 2)	**6,895**	**13,789**
Balance - End of period	**55,163,510**	**43,787,487**

As at June 30, 2009	Number	Amount
		$
Issued and fully paid at the beginning of period	36,890,503	33,714,355
Shares issued in settlement of business acquisition (i)	10,476,718	7,159,434
Shares issued in connection with private financing (ii)	7,772,727	2,891,242
	55,139,948	43,765,031
Shares to be issued		
In settlement of business acquisition (Note 2)	6,895	13,789
Balance - End of period	55,146,843	43,778,820

(i) During the previous year, the Company made a business acquisition which was partially financed through a 10,476,718 common share issue for $7,192,168. The share issue expenses are $32,734.

(ii) During the previous year, the Company completed two shares and warrants financing campaigns with various investors. The Company issued 7,772,727 units at $0.55 each. Each unit consists of one common share and one warrant, the latter granting the right to subscribe to a common share for a price of $0.85 for 30 months. The fair value of the warrants, using the proportional allocation method, has been established to $1,098,868 or $0.15 per warrant. The Company issued 157,150 units bearing the same characteristics as fees for this financing for a fair market value of $93,680; no shares were included in this payment.

The fair value of each warrant and each unit granted was estimated at the grant date using the Black-Scholes option pricing model. The valuation was carried out using the following weighted averages: expected volatility of 80.6%, risk-free rate of 1.83%, expected life of 30 months and no expected dividend.

Expenses related to shares issue, including warrants, amount to $191,210. The fair value of the warrants is accounted for as a reduction of issue proceeds and the consideration is accounted for as contributed surplus.

3. CAPITAL STOCK (CONTINUED)

Stock-Based Compensation Plan

The Company 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 Company. 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 increased from 3,400,000 to 5,500,000 during the nine months ended March 31, 2010.

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

	Nine months ended March 31, 2010	Year ended June 30, 2009
Number	**205,000**	207,000
Dividend yield	**0%**	0%
Expected volatility	**81.73%**	80.52%
Risk-free interest rate	**3.25%**	2.36%
Weighted average expected life (years)	**10**	5
Weighted average fair value at the grant date	**$0.47**	$0.41

For the three months ended March 31, 2010, the Company recorded $30,924 ($97,360 in 2009) as stock-based compensation for options granted to its directors, officers and key employees.

For the nine months ended March 31, 2010, the Company recorded $57,461 ($291,615 in 2009) as stock-based compensation for options granted to its directors, officers and key employees.

3. CAPITAL-STOCK (CONTINUED)

Stock-Based Compensation Plan (Continued)

The following table summarizes the situation of the Company's stock-based compensation plan as at March 31, 2010 and June 30, 2009 and the change during the periods ended on these dates:

	Nine months ended March 31, 2010		Year ended June 30, 2009	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		$		$
Outstanding - Beginning of period	**1,815,000**	**1.15**	1,671,000	1.26
Granted	**205,000**	**0.75**	207,000	0.41
Exercised	**(16,667)**	**0.32**	-	-
Expired	**-**	**-**	(25,000)	2.30
Forfeited	**(45,000)**	**1.48**	(38,000)	1.26
Outstanding - End of period	**1,958,333**	**1.11**	1,815,000	1.15
Exercisable - End of period	**1,729,027**	**1.16**	1,691,639	1.21

As at March 31, 2010, the following stock options were granted:

Exercise price	Number	Weighted average remaining life (years)	Weighted average exercise price
$			$
0.32	158,333	3.70	0.32
0.75	205,000	9.67	0.75
0.90	532,000	3.24	0.90
1.20	385,000	1,77	1.20
1.50	658,000	2.39	1.50
1.85	20,000	2.16	1.85
	1,958,333	3.37	1.11

As at March 31, 2010, the following stock options could be exercised:

Exercise price	Number	Weighted average exercise price
$		$
0.32	134,027	0.32
0.75	-	0.75
0.90	532,000	0.90
1.20	385,000	1.20
1.50	658,000	1.50
1.85	20,000	1.85
	1,729,027	1.16

3. CAPITAL-STOCK (CONTINUED)

Warrants

In the course of its financing transactions, the Company issued warrants to investors giving them the right to acquire shares at a predetermined price. Each warrant issued entitles the holder to acquire one common share of the Company.

The warrants outstanding as at March 31, 2010 and June 30, 2009 and the change during the periods ended on those dates are summarized in the following table:

		Nine months ended March 31, 2010		Year ended June 30, 2009
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		$		$
Outstanding - Beginning of period	**9,179,877**	**0.88**	9,344,179	2.30
Granted	**-**	**-**	9,179,877	0.88
Expired	**-**	**-**	(9,344,179)	2.30
Outstanding - End of period	**9,179,877**	**0.88**	9,179,877	0.88

As at March 31, 2010, the following warrants were granted:

Maturity date	Number	Exercise price
December 2011	**7,929,877**	$0.85
June 2013	**1,250,000**	$0.80 on or before June 30, 2010
		$0.90 on or before June 30, 2011
		$1.00 on or before June 30, 2012
		$1.10 on or before June 30, 2013
	9,179,877	

4. 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 per share:

	Three months ended March 31,		**Nine months ended March 31,**	
	2010	2009	**2010**	2009
Basic weighted average number of outstanding common shares	**55,149,207**	47,367,221	**55,142,989**	47,291,027
Diluted effect of stock options	**-**	41,973	**-**	68,857
Diluted weighted average number of shares outstanding	**55,149,207**	47,409,194	**55,142,989**	47,359,884

For the three months and nine months ended March 31, 2010, there was no difference in the basic and diluted weighted average number of shares outstanding, since the effect of the stock options, warrants and units described in Note 3 would have been anti-dilutive. Accordingly, the diluted loss per share for these periods is calculated using the weighted average basic number of shares outstanding.

5. CASH FLOWS

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

	Three months ended March 31,		**Nine months ended March 31,**	
	2010	2009	**2010**	2009
	$	$	**$**	$
Accounts receivable	**2,568,250**	403,312	**4,289,358**	(1,640,805)
Inventories	**(5,589)**	(30,081)	**(103,887)**	(343,296)
Work in process	**(236,481)**	2,717,932	**(1,613,463)**	(157,405)
Prepaid expenses	**(354,845)**	21,827	**(308,296)**	16,969
Accounts payable and accrued liabilities	**(73,339)**	(1,815,299)	**(1,721,864)**	(1,356,757)
Excess of billing over work in process	**49,062**	(982,068)	**(904,113)**	(405,458)
Deferred rent	**(5,075)**	190	**(19,409)**	11,587
	1,941,983	315,813	**(381,674)**	(3,875,165)

6. COMPARATIVE INFORMATION

The bank loan and the loan with a Canadian chartered bank include certain covenants regarding among others the working capital, the debt coverage ratio and the debt ratio. Management is conducting a thorough follow-up of these ratios and two of these were not respected as at March 31, 2010. The tender has served its tolerance in this regard. Except for covenants relating to the bank loan, the Company is not subject to any other capital requirement imposed by a third party.

7. COMPARATIVE INFORMATION

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

GENERAL INFORMATION

Directors and Officers

Philippe Gervais, Chairman of the Board, (1)
Frédéric Dugré, President, Chief Executive Officer and Director
John G. Booth, Director (2)
André Duquenne, Director (1) (2)
Richard Hoel, Director (1)
Élaine C. Phénix, Director (1) (2)
Marc Blanchet, Secretary of the Board

Legend:
(1) Audit Committee
(2) Governance and Compensation Committee

Legal Counsel
McCarthy Tétrault LLP

Auditors
PricewaterhouseCoopers LLP

Transfer Agent
Computershare Investor Services Inc.

Head Office
420 Charest Blvd East, Suite 240
Quebec City, Quebec G1K 8M4
Phone: 418-688-0170
Fax: 418-688-9259

investor@h2oinnovation.com
www.h2oinnovation.com

Plants
201 1st Avenue
Ham-Nord, Quebec G0P 1A0

6840 Shingle Creek Parkway, Suite 20
Brooklyn Center, Minnesota 55430

1048 La Mirada Court
Vista, California 92081

Sales and Engineering offices
12780 Danielson Court Suite A
Poway, California 92064

1046, 18th Ave SE
Calgary, Alberta T2G 1L6

6352 Mill Gap Road
Monterey, Virginia 24465