Interim Financial Report
First quarter ended September 30, 2013

www.h2oinnovation.com
investor@h2oinnovation.com

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE FINANCIAL SITUATION

In accordance with National Instrument 51-102 Continuous Disclosure Obligations, the following comments are intended to provide a review and an analysis of H_2O Innovation's results of operations and financial position for the quarter ended September 30, 2013, in comparison with the corresponding period ended September 30, 2012. They should be read in conjunction with the consolidated financial statements and accompanying notes. Comparison of financial situation as at September 30, 2013 to those as at June 30, 2013 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 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 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 24, 2013 available on SEDAR (www.sedar.com). Unless required to do so pursuant to applicable securities legislation, H_2O Innovation assumes no obligation to update or revise forward-looking statements contained in this Management's Discussion and Analysis or in other communications as a result of new information, future events and other changes.

The following financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). All figures in the present report are expressed in Canadian dollars, unless otherwise indicated.

VISION, MISSION & PROFILE

OUR VISION

To become the best in North America at providing membrane-related water treatment solutions and technologies.

OUR MISSION

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

OUR PROFILE

H_2O Innovation provides integrated technological water treatment solutions based on membrane filtration technology to municipal, energy & mining end-users. H_2O Innovation designs state-of-the-art custom-built water treatment projects for the production of drinking water and industrial process water, the reclamation and reuse of water, and the treatment of wastewater, while providing a complete line of specialty chemicals and consumables for membrane filtration and reverse osmosis systems. H_2O Innovation employs approximately 135 resources and has eight locations in North America.

NON-IFRS FINANCIAL MEASUREMENT

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

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

Reconciliation of adjusted EBITDA to net earnings (loss)

Three-month periods ended September 30,	**2013**	2012
	$	$
Net earnings (loss) for the period	**(469,994)**	269,696
Finance costs – net	**185,927**	205,119
Income taxes	**90,292**	-
Depreciation of property, plant and equipment	**72,408**	68,484
Amortization of intangible assets	**186,386**	177,758
Gain on disposal of property, plant and equipment	**(1,000)**	-
Stock-based compensation costs	**5,651**	16,174
Share of earnings in a joint venture	**-**	(10,538)
Adjusted EBITDA	**69,670**	726,693

RESULTS OF OPERATIONS

H_2O Innovation has begun fiscal year 2014 with an operating plan relying on three major pillars: Quality, Innovation and People. This plan is the continuation of the 2013 operating plan which focused on "Operational Excellence". Throughout this fiscal year, management will continue to strengthen the Company's business model established on the combination of water treatment projects sales and recurring sales of speciality products, consumables and services.

Over the past few quarters we have demonstrated that an increase in recurring sales contributes to reduce the volatility of the water treatment projects sales – resulting in a stabilization of the gross margin, a significant coverage of the Company's operating, selling and administrative expenses ("SG&A expenses") and building long-term relationships with customers. During the last twelve months, many improvements have been implemented to ensure that projects would be executed on budget, on quality and on time. Today, we are pursuing on the same path but we are adding more emphasis toward **QUALITY**. This focus around quality should enable the Company to improve its gross margin, respect its projects schedule and ensure a greater customer's satisfaction. To increase its recurring sales, its success rate at winning bids and its customer offering, the Company will focus on **INNOVATION** to drive revenue growth and gross margin improvement. In July 2013, the Company has launched a new technological platform for ultrafiltration (FiberFlex™) and another innovative platform with a second generation of Membrane Bioreactor dedicated to wastewater effluent. Both of these platforms should enable us to differentiate ourselves in the water treatment projects business. Indeed, the wastewater offering has been completely reviewed and up-graded with new marketing tools, new representatives' organization and improved technical support. In parallel, we are increasing our water treatment projects sales outreach by adding new salesman to cover new territories within Canada and United States. These efforts initiated in the second half of fiscal year 2013 provides us today with an extensive sales pipeline of $190 M, representing an increase of 200% compared to last year. With an historical bidding activities success rate that fluctuates from 15% to 20%, H_2O Innovation is very well positioned to generate revenue growth in the coming quarters.

Moreover, the Company is also relying on the development of new specialty chemicals, new products for the maple syrup production activities and a new performance monitoring system to boost our recurring sales at higher margin. These new products will certainly strengthen our product portfolio; increase the differentiators from our competitors, thus, improving the overall profitability and financial performance of the Company.

To improve our project execution, grow water treatment projects sales and develop new products we have assemble a team of **PEOPLE** with strategic expertise, experience and motivation capable to support the Company's objectives. Over the last twelve months, we have been very selective to find key personnel for different positions. People are among our most important assets to ensure the execution of our business plan and reach out the Company's objectives.

Selected financial data
(Unaudited)

	Three-month periods ended September 30, 2013	2012
	$	$
Revenues	**8,311,219**	9,982,894
Gross profit	**2,141,991**	2,462,571
Gross profit	**25.8%**	24.7%
Operating expenses	**182,586**	135,772
Selling expenses	**966,669**	843,154
Administrative expenses	**919,063**	863,263
Research and development expenses – net	**43,407**	-
Net earnings (loss)	**(469,994)**	269,696
Basic and diluted earnings (loss) per share	**(0.008)**	0.004
Adjusted EBITDA	**69,670**	726,693

Revenues and gross profit

Revenues for the first quarter of fiscal year 2014 totaled $8.3 M, representing a $1.7 M or 16.7% decrease, as compared with revenues of $9.9 M for the same quarter of fiscal year 2013. The decline is largely attributable to revenues from projects which reached $5.1 M compared to $7.0 M in the corresponding period of the previous fiscal year, representing a 27.5% decrease. The decline is partly attributable to the fact that some of the Company's water treatment projects clients have delayed the delivery or the commissioning of their systems, a situation the Company cannot control. This situation has postponed to the second half of fiscal year 2014 the revenue recognition of these projects. In addition, more than half of last year's comparable quarter revenues came from three (3) projects in the oil & gas sector in Western Canada, which were of bigger sizes than this quarter's projects. From time to time, the nature of projects realized varies depending on the sales backlog used.

The decrease of revenues has been softened by an increase of revenues from sales of specialty chemicals and consumables which reached $3.2 M in this quarter compared with $2.9 M in the comparable quarter of the previous fiscal year, representing a 9.2% increase. These revenues are recurring in nature. In the first quarter of fiscal year 2014, we have added two new distributors to our sales force who will now represent PWT products and services in Brazil and Tunisia. In addition, our efforts toward the expansion of our distribution network for products related to maple syrup production have significantly contributed to the increase of our revenues from specialty chemicals and consumables during this quarter.

In this first quarter of fiscal year 2014, the Company was able to generate a 25.8% gross profit, a level higher than the 24.7 % gross margin generated in the first quarter of fiscal year 2013. The revenue mix in this quarter shows that revenues from specialty chemicals and consumables represent a higher proportion of total revenues compared to the corresponding period of the previous fiscal year (38.6% in fiscal year 2014 versus 29.4% in fiscal year 2013).

On June 27, 2013, the Company terminated an agreement to provide a custom containerized water treatment system for a U.S. municipality due to a default of payment from the customer. The Company has initiated a mediation process during the first quarter of fiscal year 2014. Parties have participated to this mediation process and reached an agreement in which the customer have agreed to compensate the Company for the cancellation of the agreement. The terms of the agreement are confidential, but management is satisfied with the settlement terms. Parties have also executed a final release. The equipment is still available for sale and is recorded as finished goods in the statement of financial position.

The Company secured $3.4 M in new bookings for water treatment projects over the quarter. These new bookings, combined with the realized revenues from water treatment projects during the quarter, have brought down the backlog at $12.4 M as at September 30, 2013. Based on the actual delivery schedule, our backlog is expected to be mostly recognized through revenues by the end of this current fiscal year. The Company's bookings over revenue ratio for projects have declined to 0.7 from 1.1 in the previous quarter. The current pipeline is still rich in opportunities which should allow the Company's sales backlog to support its revenue growth. We maintain strong bidding activities and management efforts are aimed at growing the Company's sales backlog rapidly.

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

	2013 FY				**2014 FY**	**Last twelve months**	**Previous twelve months**
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**(Q2, Q3 & Q4 FY2013 & Q1 FY2014)**	(Q2, Q3 & Q4 FY2012 & Q1 FY2013)
Order backlog	$20.4 M	$18.7 M	$15.4 M	$14.1 M	**$12.4 M**	**N/A**	N/A
Bookings for water treatment projects	$6.7 M	$4.3 M	$2.6 M	$4.3 M	**$3.4 M**	**$14.6 M**	$22.1 M
Revenues from water treatment projects	$7.1 M	$6.0 M	$5.9 M	$3.9 M	**$5.1 M**	**$20.9 M**	$25.5 M
Bookings / Revenues Ratio	**0.9**	0.7	0.4	1.1	**0.67**	**0.70**	0.87
Revenues from specialty chemicals and consumables (usually recurrent in nature)	$2.9 M	$3.4 M	$4.0 M	$2.9 M	**$3.2 M**	**$13.5 M**	$13.3 M

Operating expenses

Showing an increase of nearly $50,000, operating expenses totaled almost $0.2 M for this quarter compared to $0.1 M for the corresponding quarter of previous fiscal year. This increase is due to creation of two new positions in the second half of fiscal year 2013 to support specialty chemicals development and to optimize overall supply chain and logistics for projects.

Selling expenses

Selling expenses have increased by $123,000 and reached $0.9 M for this quarter compared with the corresponding quarter of the previous fiscal year, despite revenues having decreased by 16.7%. Selling expenses are linked to bookings and revenues, but do not fluctuate proportionally. The increase is mostly due to the hiring of sales managers and a sale director toward the end of fiscal year 2013 who are responsible to develop new territories and identify new commercial opportunities.

Administrative expenses

Administrative expenses increased by approximately $56,000 or 6.5% in this first quarter of fiscal year 2014 compared with the first quarter of fiscal year 2013. Salaries and fringe benefits have increased following the addition of personnel to support operations during the second half of fiscal year 2013 and the use of trainees to cover for the summer vacation period and year-end procedures. As expected last year, professional fees and office expenses have decreased during the three-month period ended September 30, 2013 compared with the period ended September 30, 2012 since some expenses were non-recurring in nature. Finally, telecommunications and travel expenses have lightly increased in this first quarter of fiscal year 2014 compared with the first quarter of fiscal year 2013.

The Company's ratio of selling, operating and administrative expenses ("SG&A") as a whole over revenues amounted to 24.9% for this quarter, up from 18.4% for the corresponding quarter of the previous fiscal year. This increase is largely attributable to the decline in volume of water treatment projects business due to some clients-related delays and due to a higher level of SG&A expenses. Management aims to keep the SG&A ratio to a level similar to last year through a tight management of SG&A expenses and an increase in revenues.

Research and development expenses – net

Management has streamlined the research and development activities into a more structured model to ensure that the objectives included in our 2014 operating plan relying on three pillars: Quality, Innovation and People are met. Therefore, a new function has been identified in the Company's statement of earnings to reflect the decisions made in this plan.

For the quarter ended September 30, 2013, gross research and development expenses totaled $60,951, or 0.7 % of revenues. For the three-month period ended September 30, 2013, the Company has record $17,544 for tax credits from the Canadian provincial government for eligible research and development conducted in Canada.

Adjusted EBITDA

Adjusted EBITDA for the quarter was recorded at $69,670, compared with $726,693 for the same period ended September 30, 2012. The lower revenues recorded during the quarter compared with the corresponding quarter of the previous fiscal year and the higher SG&A expenses also contributed to generating lower adjusted EBITDA. The Company returned to positive adjusted EBITDA this quarter after one quarter of negative adjusted EBITDA for the fourth quarter ended June 30, 2013.

Other gains – net

Other gains – net amounting to $34,753 for the period ended September 30, 2013 compared with $82,271 for the quarter ended September 30, 2012 are mostly composed of a foreign exchange gain, which is entirely due to exchange rate fluctuations related to working capital items.

Finance costs – net

Finance costs – net totalled $185,927 for the period ended September 30, 2013 compared to $205,119 for the comparable period in the previous fiscal year. These expenses relate mostly to the long-term debt. Of this amount, $31,709 represents the theoretical and non-monetary part of interest on long-term debt. On September 30, 2013, the

Company reimbursed $1,157,154 of its long-term debt through a private placement. Management expects finance costs to decrease significantly through the remaining quarters of fiscal year 2014.

Net earnings (loss)

The net earnings (loss) was ($469,994) or ($0.008) per share for the first quarter of fiscal 2013 compared with $269,696 or $0.004 per share for the first quarter of fiscal 2013. This deterioration is primarily due to lower revenues despite maintaining an improved gross profit of 25.8% and to higher SG&A expenses.

Commitments

The Company has entered into long-term lease agreements expiring in 2014, 2017, 2022 and 2023, which call for lease payments of $4,539,480 for the rental of space. The minimum annual lease payments over the next five years are $566,043 in 2014, $540,839 in 2015, $548,565 in 2016, $533,271 in 2017 and $406,048 in 2018.

Information on share capital

As at September 30, 2013, the Company had 69,850,378 outstanding shares. 9,704,546 shares were issued during this quarter.

FINANCIAL SITUATION

Working capital increased from $2.1 M as at June 30, 2013 (working capital ratio of 1.17) to $4.8 M as at September 30, 2013 (working capital ratio of 1.46). The increase of $2.7 M is attributable to the $0.2 M, $0.3 M and $0.5 M increase in accounts receivables, inventories and costs incurred in excess of billings respectively. The improvement in working capital is also attributable to the equity issuance by way of private placement which proceeds were used to reimburse a portion of long-term debts and the balance was affected to support our working capital by reimbursing the bank loans. The working capital was negatively impacted by the increase of $0.9 M and $0.5 M in accounts payable and accrued liabilities and billings in excess of costs incurred respectively.

The net debt which stood at $3.8 M as at September 30, 2013 decreased by more than $2.3 M compared with $6.2 M as at June 30, 2013. This decrease is mainly attributable to the reimbursement of a portion of the long-term debts and the reimbursement of the bank loans.

Equity stood at $15.8 M as at September 30, 2013, compared with $14.4 M as at June 30, 2013. As at September 30, 2013 the net debt equity ratio was 0.25 whereas it was 0.43 as at June 30, 2013, showing that the Company is not over leveraged.

(in Canadian dollars, except for ratio)	Period ended September 30, 2013	Period ended June 30, 2013
Working capital	$4,818,017	$2,144,985
Working capital ratio	1.46	1.17
Net debt[1]	$3,852,226	$6,201,865
Equity	$15,782,971	$14,426,788
Net debt to equity ratio	0.24	0.43

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

As at September 30, 2013 accounts receivable stood at $6.7 M compared with $6.5 M as at June 30, 2013. The minor accretion of $0.2 M is mostly attributable to the increase of retentions from customers under manufacturing contracts related to municipal projects executed during the first quarter of fiscal year 2014.

Inventories increased by $0.3 M to $4.3 M as at September 30, 2013 compared with $4.0 M as at June 30, 2013. This increase is largely attributable to finished goods manufactured during the summer in preparation for the start of the maple syrup production season.

Costs incurred in excess of billings increased by $0.5 M to $2.7 M as at September 30, 2013, from $2.2 M as at June 30, 2013, primarily due to a different number of active projects for which there are differences between project advancement and project invoicing schedules. Billings in excess of costs incurred increased by $0.5 M to $2.3 M as at

September 30, 2013, from $1.8 M as at June 30, 2013. This increase is also attributable to differences between project advancement and project invoicing schedules.

Accounts payable and accrued liabilities increased by $0.9 M to $5.0 M as at September 30, 2013, from $4.1 M as at June 30, 2013. This is mostly due to impact of the cancellation of a contract following the default of payment of a client for which the suppliers used to fulfill the contract were paid.

The decrease in the current portion of the long-term debt, the balance of which fell from $2.8 M as at June 30, 2013 to $0.9 M as at September 30, 2013, is explained by the repayment of $1.1 M for the long-term debt with proceeds from the equity issuance by way of private placement completed on September 30, 2013. The Company has obtained waivers from its lenders in September 2013, which led to the reclassification to non-current liabilities of the long-term debt portion.

For the first quarter ended September 30, 2013, shareholders' equity increased by $1.4 M to $15.8 M ($14.4 M as at June 30, 2013). The following elements had an impact on shareholders' equity in the first quarter of fiscal year 2014: 1) the issuance of 9,704,546 common shares by way of an equity private placement for a net proceeds of $2,083,080; 2) the ($469,994) net loss for the period ended September 30, 2013; 3) the Canadian dollar's depreciation generated an unrealized exchange loss of $0.3 M resulting from the translation of foreign operations, mainly those of the U.S. subsidiaries; and 4) the stock-based compensation costs of $5,651.

CASH FLOWS

A comparison of the Company's cash flows for the periods ended September 30, 2013 and 2012 is presented below:

(in Canadian dollars) (unaudited)	**Three-month period ended September 30, 2013**	**Three-month period ended September 30, 2012**
Cash flows from operating activities	**494,483**	1,210,214
Cash flows from investing activities	**(35,100)**	(44,123)
Cash flows from financing activities	**(526,901)**	(857,713)
Effect of exchange rate changes on the balance of cash held in foreign currencies	**(5,016)**	(21,685)
Net change	**(72,534)**	286,693
Cash and cash equivalents – Beginning of period	**47,235**	421,332
Cash and cash equivalents – End of period	**(25,299)**	1,210,214

Operating activities generated $494,483 in cash for the period ended September 30, 2013, compared with $1,210,214 of cash generated during the corresponding period ended September 30, 2012. The decline is mainly attributable to the degradation in net loss in the first quarter of fiscal year 2014 as compared with the corresponding period ended September 30, 2012 and to the change in working capital items.

For the first quarter of fiscal 2014, investing activities used net cash of ($35,100), mainly attributable to the refection of the parking lot at our Ham-Nord plant and to the acquisition of intangible assets, namely the development of dosage software for our specialty chemicals.

Financing activities used net cash of ($526,901) in the first quarter of fiscal 2014 compared with ($857,713) of net cash used during the corresponding period ended September 30, 2012. Proceeds from the equity issuance by way of private placement generated net cash flows amounting to $1,925,926. These funds were used to reimburse the Company's long-term debts and its bank loans. This had a positive impact on the net debt to equity ratio since management intends to reduce the Company's debt and it will also have a positive impact on the finance costs which will be significantly reduced through the end of fiscal year 2014.

QUARTERLY SUMMARY FINANCIAL INFORMATION (unaudited)

(in dollars, except per share data)

	Three-month periods ended				Last twelve months
	September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012	
Revenues	8,311,219	6,768,455	9,966,644	9,418,908	34,465,226
Adjusted EBITDA	69,670	(234,355)	530,026	561,888	927,229
Net earnings (loss)	(469,994)	(532,392)	86,834	488,854	(426,698)
EPS basic and diluted	(0.008)	(0.008)	0.001	0.008	(0.007)
Cash flows from operating activities	494,483	(107,468)	(1,073,407)	1,024,161	337,769

	Three-month periods ended				Previous twelve months
	September 30, 2012	June 30, 2012	March 31, 2012	December 31, 2011	
Revenues	9,982,894	11,561,332	10,222,312	7,056,495	38,823,033
Adjusted EBITDA	726,693	(483,798)	563,603	407,961	1,214,459
Net earnings (loss)	269,696	880,620	(7,651,400)	(1,214,510)	(7,715,594)
EPS basic and diluted	0.004	0.014	(0.127)	(0.020)	(0.129)
Cash flows from operating activities	1,210,214	1,560,416	(419,247)	(1,408,003)	943,380

CAPITAL MANAGEMENT

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

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

The Company 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 Company meet certain financial ratios at fixed points in time. The financial ratios are, as at September 30, 2013:

- Working capital ratio, defined as current assets divided by current liabilities greater than or equal to 1.30:1.00;
- Debt-to-equity ratio, defined as total debt excluding deferred taxes divided by equity of less than or equal to 2.50:1.00; 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, 2013, the Company was in compliance with its financial ratios required for its credit facility and long-term debt arrangements.

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, 2013.

CHANGES IN ACCOUNTING POLICIES

The Company has adopted standards along with any consequential amendments, effective July 1, 2013.

a) Consolidated financial statements, joint arrangements, disclosure of interests in other entities

In May 2011, the IASB issued IFRS 10, Consolidated Financial Statements, IFRS 11, *Joint Arrangements* and IFRS 12, *Disclosure of Interests in Other Entities*. IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12, *Consolidation—Special Purpose Entities* and parts of IAS 27, *Consolidated and Separate Financial Statements*.

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

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

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

As of July 1, 2012, the interest held in a joint venture by the Company was recognized as a joint venture and accounted for using the equity method until it disposed of it as of March 31, 2013.

The adoption of these new standards and modification did not have a significant impact on the Company's financial position and consolidated results.

b) Fair value measurement

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

The adoption of this new standard did not have an impact on the calculation of the fair values in the Company's unaudited condensed consolidated financial statements. The adoption of this new standard will require additional disclosures in the audited annual consolidated financial statements of the Company.

OFF-BALANCE SHEET ARRANGEMENTS

As at September 30, 2013, the Company had off-balance sheet arrangements consisting of letters of credit amounting to $1.4 M; these letters of credit expire at various dates through fiscal year 2013 and 2014. In these letters of credit, $1.2 M is secured by deposit certificates. The balance, amounting to $0.2 M, is guaranteed by *Export Development Canada*.

CONTROLS AND PROCEDURES

In compliance with the Canadian Securities Administrators' National Instrument 52-109 ("NI 52-109"), the Company has filed certificates signed by the Chief Executive Officer ("CEO") and the Vice President, Finance ("Vice President, Finance") that, among other things, report on the design and effectiveness of disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting.

Disclosure controls and procedures

The CEO and the Vice President, Finance have designed disclosure controls and procedures, or have caused them to be designed under their supervision, in order to provide reasonable assurance that:

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

An evaluation was carried out, under the supervision of the CEO and the Vice President, Finance, of the effectiveness of our disclosure controls and procedures. Based on this evaluation, the CEO and the Vice President, Finance concluded that the disclosure controls and procedures are effective, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) on Internal Control – Integrated Framework.

Internal controls over financial reporting

The CEO and the Vice President, Finance have also designed internal controls over financial reporting, or have caused them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

Changes in internal controls over financial reporting

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

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

September 30, 2013

For additional information:
Investor Relations
investor@h2oinnovation.com

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

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

H$_2$O INNOVATION INC.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Unaudited)

	September 30, 2013	June 30, 2013
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	**137,613**	303,936
Guaranteed deposits certificates	**1,251,404**	1,253,786
Accounts receivable (note 3)	**6,723,594**	6,468,556
Inventories (note 4)	**4,261,331**	4,016,558
Costs incurred in excess of billings	**2,734,338**	2,203,326
Prepaid expenses	**201,930**	225,493
	15,310,210	14,471,655
Non-current assets		
Property, plant and equipment	**1,819,468**	1,878,759
Intangible assets	**4,676,325**	4,942,884
Other assets	**37,243**	37,851
Goodwill	**2,414,917**	2,465,311
Deferred income tax assets	**2,977,621**	3,124,064
	27,235,784	26,920,524
LIABILITIES		
Current liabilities		
Bank overdraft	**162,912**	256,701
Bank loans	**2,083,154**	3,375,843
Accounts payable and accrued liabilities (note 5)	**5,025,338**	4,080,339
Provisions (note 6)	**40,507**	41,637
Billings in excess of costs incurred	**2,286,281**	1,758,432
Income taxes payable	**4,408**	2,306
Deferred rent	**3,151**	3,151
Current portion of long-term debt (note 7)	**886,442**	2,808,261
	10,492,193	12,326,670
Non-current liabilities		
Long-term debt (note 7)	**857,331**	64,996
Deferred rent	**103,289**	102,070
	11,452,813	12,493,736
SHAREHOLDERS' EQUITY		
Share capital (note 8)	**47,935,516**	45,852,436
Reserve - Stock options	**1,866,691**	1,861,040
Reserve - Warrants	**141,787**	141,787
Deficit	**(32,755,487)**	(32,285,493)
Accumulated other comprehensive loss	**(1,405,536)**	(1,142,982)
	15,782,971	14,426,788
	27,235,784	26,920,524

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, 2013 and 2012
(Unaudited)

ATTRIBUTABLE TO THE SHAREHOLDERS OF H_2O INNOVATION INC.

			Reserves				
	Common shares Number	**Share capital**	**Stock option** (note 8)	**Warrants**	**Deficit**	**Accumulated other comprehensive loss**	**Total**
		$	$	$	$	$	$
Balance as at July 1, 2012	60,145,832	45,852,436	1,821,421	370,076	(32,826,774)	(1,472,932)	13,744,227
Stock-based compensation costs	-	-	16,174	-	-	-	16,174
Net earnings for the period	-	-	-	-	269,696	-	269,696
Other comprehensive loss – Currency translation adjustments	-	-	-	-	-	(443,806)	(443,806)
Balance as at September 30, 2012	**60,145,832**	**45,852,436**	**1,837,595**	**370,076**	**(32,557,078)**	**(1,916,738)**	**13,586,291**
Balance as at July 1, 2013	60,145,832	45,852,436	1,861,040	141,787	(32,285,493)	(1,142,982)	14,426,788
Issuance of common shares under private placement (note 8)	9,704,546	2,135,005	-	-	-	-	2,135,005
Share issue expenses (note 8)	-	(51,925)	-	-	-	-	(51,925)
Stock-based compensation costs	-	-	5,651	-	-	-	5,651
Net loss for the period	-	-	-	-	(469,994)	-	(469,994)
Other comprehensive loss – Currency translation adjustments	-	-	-	-	-	(262,554)	(262,554)
Balance as at September 30, 2013	**69,850,378**	**47,935,516**	**1,866,691**	**141,787**	**(32,755,487)**	**(1,405,536)**	**15,782,971**

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

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)
For the three-month periods ended September 30, 2013 and 2012
(Unaudited)

	Three-month ended September 30,	
	2013	2012
	$	$
Revenues (note 12)	**8,311,219**	9,982,894
Cost of goods sold (note 9 a))	**6,169,228**	7,520,323
Gross profit	**2,141,991**	2,462,571
Operating expenses (note 9 a))	**182,586**	135,772
Selling expenses (note 9 a))	**966,669**	843,154
Administrative expenses (note 9 a))	**919,063**	863,263
Research and development expenses – net (notes 9 a) and c))	**43,407**	-
Depreciation of property, plant and equipment (note 9 b))	**72,408**	68,484
Amortization of intangible assets (note 9 b))	**186,386**	177,758
Other losses / (gains) – net (note 9 d))	**(34,753)**	(82,271)
	2,335,766	2,006,160
Operating earnings (loss)	**(193,775)**	456,411
Finance income	**(3,537)**	(4,403)
Finance costs	**189,464**	209,522
Finance costs – net	**185,927**	205,119
Royalties income from a joint venture	**-**	(7,866)
Share of earnings in a joint venture	**-**	(10,538)
	185,927	186,715
Earnings (loss) before income taxes	**(379,702)**	269,696
Current income tax expense	**94,700**	84,361
Deferred tax benefit	**(4,408)**	(84,361)
	90,292	-
Net earnings (loss) for the period	**(469,994)**	269,696
Net earnings (loss) per share attributable to the equity holders of the company during the period		
Basic and diluted net earnings (loss) per share	**(0.008)**	0.004
Weighted average number of shares outstanding (note 10)	**60,251,316**	60,145,832

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

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
For the three-month periods ended September 30, 2013 and 2012
(Unaudited)

	Three month ended September 30,	
	2013	2012
	$	$
Net earnings (loss) for the period	**(469,994)**	269,696
Other comprehensive loss - Items that may be reclassified subsequently to net earnings		
Currency translation adjustments	**(262,554)**	(443,806)
Comprehensive income for the period	**(732,548)**	(174,110)

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, 2013 and 2012
(Unaudited)

	Three-months ended September 30, 2013	2012
	$	$
Cash flows from operating activities		
Earnings (loss) before income taxes for the period	**(379,702)**	269,696
Non-cash items		
Finance costs – net	**185,927**	205,119
Depreciation of property, plant and equipment	**72,408**	68,484
Amortization of intangible assets	**186,386**	177,758
Gain on disposal of property, plant and equipment	**(1,000)**	-
Deferred rent	**2,039**	(4,596)
Stock-based compensation	**5,651**	16,174
Share of earnings of joint venture	**-**	(10,538)
	71,709	722,097
Change in working capital items (note 11a))	**421,419**	487,994
Cash generated operations	**493,128**	1,210,091
Interests received	**3,537**	4,403
Income taxes paid	**(2,182)**	(4,280)
Net cash generated by operating activities	**494,483**	1,210,214
Cash flows from investing activities		
Variation of guaranteed deposits certificates	**231**	(115)
Acquisition of property, plant and equipment	**(20,002)**	(6,876)
Investment in a joint venture	**-**	(25,453)
Acquisition of intangible assets	**(16,329)**	(24,386)
Disposal of property, plant and equipment	**1,000**	-
Disposal of other assets	**-**	12,707
Net cash (used in) investing activities	**(35,100)**	(44,123)
Cash flows from financing activities		
Variation of bank loans	**(1,292,689)**	(341,034)
Long-term debt reimbursement	**(1,005,920)**	(346,508)
Interest paid	**(154,218)**	(170,171)
Issuance of common shares (note 8)	**1,977,851**	-
Payment for share issue expenses (note 8)	**(51,925)**	-
Net cash (used in) financing activities	**(526,901)**	(857,713)
Net change in cash and cash equivalents	**(67,518)**	308,378
Effect of exchange rate changes on the balance of cash held in foreign currencies	**(5,016)**	(21,685)
(Decrease) Increase in cash and cash equivalents	**(72,534)**	286,693
Cash and cash equivalents - Beginning of period (note 11b))	**47,235**	421,332
Cash and cash equivalents - End of period (note 11b))	**(25,299)**	708,025

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

1. Description of Business

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

2. Basis of Preparation

Basis of preparation

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

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

The IFRS accounting policies that are set out in the Company's consolidated financial statements for the year ended June 30, 2013 were consistently applied to all periods presented. Please refer to note 3 in the Company's consolidated financial statements for the year ended June 30, 2013 for a complete description of the Company's significant accounting policies.

The preparation of financial statements in conformity with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant are disclosed in note 3 in the Company's consolidated financial statements for the year ended June 30, 2013 and remained unchanged for the three-month period ended September 30, 2013.

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 2013 annual statements. Accordingly they do not include all the information required for annual financial statements and should be read in conjunction with the Company's 2013 annual audited consolidated financial statements.

On November 11th, 2013 the Board reviewed the accompanying condensed interim consolidated financial statements and authorized its publication.

Standards and interpretations adopted during the period

a) Consolidated financial statements, joint arrangements, disclosure of interests in other entities

In May 2011, the IASB issued IFRS 10, Consolidated Financial Statements, IFRS 11, *Joint Arrangements* and IFRS 12, *Disclosure of Interests in Other Entities*. IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12, *Consolidation—Special Purpose Entities* and parts of IAS 27, *Consolidated and Separate Financial Statements*.

IFRS 11, *Joint Arrangements*, requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation.

IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities—Non-monetary Contributions by Venturers*.

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

There have been amendments to existing standards, including IAS 27, *Separate Financial Statements* ("IAS 27"), and IAS 28, *Investments in Associates and Joint Ventures* ("IAS 28"). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10, IFRS 11 and IFRS 12.

As of July 1, 2013, the Company has adopted IFRS 10, 11 and 12, and the amendments of IAS 27 and 28. As of July 1, 2012, the interest held in a joint venture by the Company was recognized as a joint venture and accounted for using the equity method until it disposed of it as of March 31, 2013.

The adoption of these new standards and modification did not have a significant impact on the Company's financial position and consolidated results. Given the insignificant impact of the adoption of these amendments on the statement of financial position, these interim condensed consolidated financial statements do not include the statement of financial position as at July 1, 2012.

b) Fair value measurement

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

The adoption of this new standard did not have an impact on the calculation of the fair values in the Company's unaudited condensed consolidated financial statements. The adoption of this new standard will require additional disclosures in the audited annual consolidated financial statements of the Company.

Standards and interpretations issued to be adopted at a later date

Unless otherwise noted, the following revised standard and amendment are effective for annual periods beginning on or after January 1, 2015 with earlier application permitted. The Company has not yet assessed the impact of these standard and amendment or determined whether it will early adopt them.

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

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

3. Accounts Receivable

	As at September 30, 2013	As at June 30, 2013
	$	$
Accounts receivable	**5,425,457**	5,634,221
Retentions from customers under manufacturing contracts	**1,263,710**	953,731
Allowance for doubtful accounts	**(400,938)**	(406,890)
Allowance for back charges	**-**	(3,155)
	6,288,229	6,177,907
Tax credits receivable	**111,136**	84,416
Other receivables	**324,229**	206,233
	6,723,594	6,468,556

4. Inventories

	As at September 30, 2013	As at June 30, 2013
	$	$
Raw materials	**1,020,321**	1,058,976
Finished goods	**3,241,010**	2,957,582
	4,261,331	4,016,558

5. Accounts Payable and Accrued Liabilities

	As at September 30, 2013	As at June 30, 2013
	$	$
Trade accounts payable	**2,737,132**	2,178,120
Other accrued liabilities and accounts payable	**2,288,206**	1,902,219
	5,025,338	4,080,339

6. Provisions

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

	$
Balance as at June 30, 2012	40,543
Additional provisions recognised	77,745
Less: Payments	(79,163)
Effect of foreign exchange differences	2,512
Balance as at June 30, 2013	41,637
Additional provisions recognised	**26,369**
Less: Payments	**(26,206)**
Effect of foreign exchange differences	**(1,293)**
Balance as at September 30, 2013	**40,507**

7. Long-Term Debt

	As at September 30, 2013	As at June 30, 2013
	$	$
Unsecured – at amortised cost		
Bank loan, denominated in Canadian dollars	**585,529**	1,076,696
Loan from other entities, denominated in Canadian dollars	**1,081,483**	1,568,924
Loans from shareholders, denominated in US dollars	**-**	145,003
Loan from other entities, denominated in US dollars	**76,761**	82,634
	1,743,773	2,873,257
Less : Current portion	**886,442**	2,808,261
Long-term debt	**857,331**	64,996

On September 30, 2013, the Company used the proceeds from an equity private placement (note 8) to reimbursed $500,000 of its bank loan and $500,000 of its loan from other entities. The Company also issued 714,312 common shares to reimburse the loans from shareholders amounting to $157,154.

8. Capital Stock

Share capital

On September 30, 2013, the Company issued, by way of an equity private placement, 9,704,546 common shares with gross proceeds of $2,135,005, expenses of $51,925 for a net proceeds of $2,083,080. The Company used the proceeds to reimburse partially its long-term debt and to support its working capital. Among the common shares issued in connection with this offering, 714,312 common shares were issued to reimburse the loans from shareholders amounting to $157,154.

Stock options

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

	Three-month period ended September 30, 2013		Year ended June 30, 2013	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		$		$
Outstanding - Beginning of period	**2,124,500**	**0.57**	2,477,000	0.70
Expired	**(262,000)**	**0.90**	(352,500)	1.50
Outstanding - End of period	**1,862,500**	**0.52**	2,124,500	0.57

9. Additional information about the nature of costs components

a) Expenses by nature

	Three-month period ended September 30, 2013	Three-month period ended September 30, 2012
	$	$
Material	**4,426,842**	5,818,092
Changes in inventories of raw material, finished goods and costs incurred in excess of billings	**(71,237)**	(296,103)
Salaries and fringe benefits	**2,461,643**	2,045,866
Subcontractors and professional fees	**487,428**	861,781
Rent, electricity , insurance and office expenses	**365,313**	330,111
Telecommunications and travel expenses	**251,500**	283,943
Bad debt expenses	**3,399**	2,541
Other expenses	**356,065**	316,281
Total cost of goods sold, operating, selling, administrative and research and development expenses	**8,280,953**	9,362,512

b) Depreciation and amortization

The Company has elected to present depreciation and amortization as a separate line item in its condensed interim consolidated statement of loss, as opposed to reflecting the fraction of such amount that pertains to each of the cost of goods sold, operating expenses, selling expenses, 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, 2013 and 2012 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.

Depreciation by function	**Three-month period ended September 30, 2013**	Three-month period ended September 30, 2012
	$	$
Cost of goods sold	**41,610**	30,597
Operating expenses	**909**	951
Selling expenses	**10,832**	11,689
Administrative expenses	**19,057**	25,247
Research and development expenses – net	**-**	-
	72,408	68,484

Amortization by function	**Three-month period ended September 30, 2013**	Three-month period ended September 30, 2012
	$	$
Cost of goods sold	**91,178**	87,448
Selling expenses	**81,153**	78,374
Administrative expenses	**14,055**	11,936
Research and development expenses – net	**-**	-
	186,386	177,758

Cost per function including depreciation and amortization	**Three-month period ended September 30, 2013**	Three-month period ended September 30, 2012
	$	$
Cost of goods sold	**6,302,016**	7,638,368
Operating expenses	**183,495**	136,723
Selling expenses	**1,058,654**	933,217
Administrative expenses	**952,175**	900,446
Research and development expenses – net	**43,407**	-
	8,539,747	9,608,754

c) Research and development expenses – net

	Three-month period ended September 30, 2013	Three-month period ended September 30, 2012
	$	$
Gross research and development expenses	**60,951**	-
Research and development tax credits and grants	**(17,544)**	-
	43,407	-

d) Other (gains) losses – net

	Three-month period ended September 30, 2013	Three-month period ended September 30, 2012
	$	$
Exchange (gain) loss	**(26,143)**	(77,939)
Other revenues	**(7,610)**	(4,332)
(Gain) Loss on disposal of assets	**(1,000)**	-
	(34,753)	(82,271)

10. Net Earnings (loss) Per Share

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

	Three-month period ended September 30, 2013	Three-month period ended September 30, 2012
Net earnings (loss)	**($469,994)**	$269,696
Basic and diluted weighted average number of share outstanding	**60,251,316**	60,145,832
Basic and diluted net earnings (loss) per share	**($0.008)**	$0.004
Items excluded from the calculation of diluted net earnings (loss) per share because the exercise price was greater than the average market price of the common shares		
Stock options	**1,707,500**	1,952,000
Warrants (number of equivalent shares)	**1,000,000**	2,250,000

For the three-month periods ended September 30, 2013 and 2012, the diluted net earnings (loss) per share was the same as the basic net earnings (loss) per share, since the effect of the assumed exercise of stock options and warrants to purchase common share is anti-dilutive. Accordingly, the diluted net earnings (loss) per share for these periods were calculated using the basic weighted average number of shares outstanding.

11. Cash Flows

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

	Three-month period ended September 30, 2013	Three-month period ended September 30, 2012
	$	$
Accounts receivable	**(305,187)**	1,158,247
Inventories	**(292,467)**	(502,338)
Costs incurred in excess of billings	**(539,864)**	213,376
Prepaid expenses	**22,829**	36,451
Accounts payable and accrued liabilities	**989,758**	(155,736)
Provisions	**162**	15,936
Billings in excess of costs incurred	**546,188**	(277,942)
	421,419	487,994

b) Cash and cash equivalents consist of the following:

	As at September 30, 2013	As at September 30, 2012
	$	$
Beginning of period		
Cash and cash equivalents	**303,936**	576,542
Bank overdraft	**(256,701)**	(155,210)
	47,235	421,332

	2013	2012
	$	$
End of period		
Cash and cash equivalents	**137,613**	924,744
Bank overdraft	**(162,912)**	(216,719)
	(25,299)	708,025

12. Segment Information

Products from which reportable segments derive their revenues

The Company 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 Company's revenues for the period for the continuing operations.

	Three-month period ended September 30, 2013	Three-month period ended September 30, 2012
	$	$
Revenues from sales of consumables	**3,212,174**	2,942,635
Manufacturing contracts revenues	**5,099,045**	7,040,259
	8,311,219	9,982,894

Geographical information

	Three-month period ended September 30, 2013	Three-month period ended September 30, 2012
	$	$
Revenues from external customers		
Revenue according to geographic location		
Canada	**3,161,306**	5,241,543
United States	**4,402,434**	4,103,618
China	**406,821**	399,258
Switzerland	**123,073**	-
Tunisia	**49,600**	-
Egypt	**-**	67,841
Other	**167,985**	170,634
	8,311,219	9,982,894

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

	As at September 30, 2013	As at June 30, 2013
	$	$
Non-current assets other than financial instruments and deferred tax assets according to geographic location		
Canada	**1,650,511**	1,693,898
United States	**7,260,199**	7,593,056
	8,910,710	9,286,954

13. Related parties disclosure

Compensation of key management personnel

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

	Three-month period ended September 30, 2013	Three-month period ended September 30, 2012
	$	$
Short-term benefits	**274,789**	234,550
Post-employment benefits	**2,792**	2,608
Share-based payments	**5,651**	13,518
	283,232	250,676

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

GENERAL INFORMATION

Board of Directors

Philippe Gervais, Chairman of the Board (1)
Frédéric Dugré, President, Chief Executive Officer and Director
Élaine C. Phénix, Director (1) (2)
André Duquenne, Director
Richard Hoel, Director (1)
Lisa Henthorne, Director (2)
Laurence E. Gamst, Director (1)

(1) Audit Committee
(2) Governance, Remuneration and Risks Committee

Key Management

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

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

Independent Auditors
Deloitte s.e.n.c.r.l.

Transfer Agent
Computershare Investor Services Inc.

Head Office
330, rue St-Vallier Est, Suite 340
Quebec City, Quebec, G1K 9C5
Phone: 418.688.0170
Fax: 418.688.9259

investor@h2oinnovation.com
www.h2oinnovation.com

Plants (North America)
201, 1st Avenue
Ham-Nord, Quebec G0P 1A0

1048 La Mirada Court
Vista, California 92081

8900, 109th Ave N, Suite 1000
Champlin, Minnesota 55316

Sales and Engineering Offices
1046, 18th Ave SE
Calgary, Alberta T2G 1L6

5100, South Service Road, Unit 17
Burlington, Ontario L7L 6A5