Interim financial report
Third quarter ended
March 31, 2013

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE FINANCIAL SITUATION

In accordance with National Instrument 51-102 Continuous Disclosure Obligations, the following comments are intended to provide a review and an analysis of H_2O Innovation's results of operations and financial position for the quarter ended March 31, 2013, in comparison with the corresponding period ended March 31, 2012. They should be read in conjunction with the consolidated financial statements and accompanying notes. Comparison of financial situation as at March 31, 2013 to those as at June 30, 2012 is also included. Certain statements set forth in this Management's Discussion and Analysis ("MD&A") regarding the operations and the activities of H_2O Innovation as well as other communications by the Company to the public that describe more generally management objectives, projections, estimates, expectations or forecasts may constitute forward-looking statements within the meaning of securities legislation. Forward-looking statements concern analysis and other information based on forecast future results and the estimate of amounts that cannot yet be determined. Forward-looking statements include the use of words such as "anticipate", "if", "believe", "plan", "estimate", "expect", "intend", "may", "could", "should", "will", and other similar expressions, as well as those usually used in the future and the conditional, notably regarding certain assumptions as to the success of a venture. Those forward-looking statements involve a number of risks and uncertainties, which may result in actual and future results of the Company to be materially different than those indicated. Information about the risk factors to which the Company is exposed is provided in the Annual Information Form dated September 25, 2012 available on SEDAR (www.sedar.com). Unless required to do so pursuant to applicable securities legislation, H_2O Innovation assumes no obligation to update or revise forward-looking statements contained in this Management's Discussion and Analysis or in other communications as a result of new information, future events and other changes.

The following financial statements have been reviewed by our auditors, except for the corresponding comparative figures that have not been reviewed by our auditors. They have been prepared in accordance with International Financial Reporting Standards ("IFRS"). All figures in the present report are expressed in Canadian dollars, unless otherwise indicated.

VISION, MISSION & PROFILE

OUR VISION

To become the best in North America, working through consulting engineers, at customizing water treatment systems based on comprehensive analytical and strong technical capabilities aimed at maximizing the efficiency, performance and longevity of systems and by this, create sustained and growing value for our shareholders.

OUR MISSION

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

OUR PROFILE

H_2O Innovation provides integrated technological water treatment solutions based on membrane filtration technology to municipal, energy & mining end-users. H_2O Innovation designs state-of-the-art custom-built water treatment systems for the production of drinking water and industrial process water, the reclamation and reuse of water, and the treatment of wastewater, while providing a complete line of specialty chemicals and consumables for membrane filtration and reverse osmosis systems. H_2O Innovation employs approximately 121 employees and 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 changes in fair value of contingent considerations, impairment of intangible assets, impairment of goodwill, stock-based compensation costs, gain on settlement agreement and share of (earnings) loss in a joint venture. The reader can establish the link between adjusted EBITDA and net earnings (loss). The definition of adjusted EBITDA used by the Company may differ from those used by other companies.

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

Reconciliation of adjusted EBITDA to net earnings (loss)

	Three-month period ended March 31,		**Nine-month period ended March 31,**	
	2013	2012	**2013**	2012
	$	$	**$**	$
Net earnings (loss) for the period	**86,834**	(7,651,400)	**845,384**	(8,954,127)
Finance costs – net	**177,164**	221,023	**590,304**	609,891
Income taxes	**(658)**	(152,088)	**14,391**	(329,276)
Depreciation of property, plant and equipment	**72,226**	75,233	**209,533**	221,569
Amortization of intangible assets	**181,148**	191,134	**536,843**	667,418
Changes in fair value of contingent consideration	**-**	(849,502)	**-**	(849,502)
Impairment of goodwill	**-**	8,221,423	**-**	8,221,423
Impairment of intangible assets	**-**	378,728	**-**	378,728
Stock-based compensation costs	**7,135**	29,052	**32,483**	117,967
Gain on settlement agreement	**-**	-	**(404,189)**	-
Share of (earnings) loss in a joint venture	**6,177**	100,000	**(6,142)**	407,414
Adjusted EBITDA	**530,026**	563,603	**1,818,607**	491,505

RESULTS OF OPERATIONS

Selected financial data
(Unaudited)

	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	**2012**	**2013**	**2012**
	$	**$**	$	$
Revenues	**9,966,644**	10,222,312	**29,368,446**	24,348,575
Gross profit	**2,515,477**	2,700,507	**7,439,109**	6,038,065
Gross profit	**25.2%**	26.4%	**25.3%**	24.8%
Operating expenses	**218,394**	177,749	**493,535**	464,393
Selling expenses	**853,744**	993,043	**2,601,528**	2,811,716
Administrative expenses	**925,700**	1,022,044	**2,642,816**	2,796,783
Net earnings (loss)	**86,834**	(7,651,400)	**845,384**	(8,954,127)
Basic and diluted earnings (loss) per share	**0.001**	(0.127)	**0.014**	(0.149)
Adjusted EBITDA	**530,026**	563,603	**1,818,607**	491,505
Adjusted EBITDA	**5.3%**	5.5%	**6.2%**	2.0%

Revenues and gross profit

Revenues are above the $9 M mark for a fifth consecutive quarter. Revenues for the third quarter of fiscal year 2013 totaled $9.9 M, representing a $0.3 M or 2.5% decrease, as compared with revenues of $10.2 M for the same quarter of fiscal year 2012. Our revenues come from two business activities. Revenues from projects reached $5.9 M compared to $6.7 M in the corresponding period of the previous fiscal year, representing an 11.8% decrease. Nearly 40% of these $5.9 M revenues come from three projects in the oil & gas sector in Western Canada and nearly 20% come from municipal projects in the United States.

Revenues from sales of specialty chemicals and consumables increased by $0.5 M for this quarter reaching $4.0 M compared with $3.5 M in the comparable quarter in fiscal year 2012, representing a 15.5% increase. These revenues are recurring in nature. Continued efforts are being deployed to increase our footprint through the addition of new specialty chemical distributors. The maple syrup production season has reached its peak during this third quarter, which boosted our sales of consumables by approximately 20%. In addition, during this third quarter, the Company started to provide operation assistance services for a drinking water production unit and a wastewater plant in Northern Alberta. Finally, since June 30, 2012, 13 projects have delivered and commissioned and 11 of these projects have integrated our specialty chemicals and consumables or are using our service program for their system operations. We believe this is clearly the result of a better integrated approach in our business model allowing us to grow, strengthen and retain our customer relationships over years to come.

In this third quarter of fiscal year 2013, the Company was able to generate a 25.2% gross profit, compared to a 26.4% gross profit during the third quarter of fiscal year 2012. The current quarter revenue mix shows that revenues from specialty chemicals and consumables represent a greater proportion of total revenues compared to the previous fiscal year comparable quarter (40% in 2013 versus 34% in 2012). The quarter's gross profit has somewhat stabilized in the last three quarters to a level management found sound.

The Company secured $2.6 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 $15.4 M as at March 31, 2013. The Company's booking over revenues ratio for projects has decreased to a deceiving 0.4 from 0.7 in the previous quarter. Many opportunities in both territories and applications are composing the Company's sales pipeline; we maintain strong bidding activities and management efforts are aimed at growing the Company's sales backlog above the $20 M mark before our year-end. These efforts include the strategic hiring within its North American systems sales force. As Director of Systems Sales USA, David Faber has already taken the lead of the U.S. systems sales, closely working with the Company's existing team of sales experts, notably Harbans Kohli, Vice-President Systems Sales, who will now focus on major projects on the U.S. territory. The Company has also hired a sales manager based in British Columbia to develop a sales network and promote our products and services in Western Canada.

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

	2012 FY				2013 FY			Last twelve months	Previous twelve months
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**(Q4 FY2012 & Q1, Q2 & Q3 FY2013)**	(Q4 FY2011 & Q1, Q2 & Q3 FY2012)
Order backlog	$31.6 M	$30.0 M	$28.1 M	$20.8 M	$20.4 M	$18.7 M	**$15.4 M**	**N/A**	N/A
Bookings for water treatment projects	$0.9 M	$4.7 M	$6.0 M	$4.7 M	$6.7 M	$4.3 M	**$2.6 M**	**$18.3 M**	$29.0 M
Revenues from water treatment projects	$4.3 M	$4.1 M	$6.7 M	$7.6 M	$7.1 M	$6.0 M	**$5.9 M**	**$26.6 M**	$19.6 M
Bookings / Revenues Ratio	***0.2***	***1.1***	***0.9***	***0.6***	***0.9***	***0.7***	***0.4***	***0.7***	***1.48***
Revenues from specialty chemicals and consumables (usually recurrent in nature)	$2.8 M	$3.0 M	$3.5 M	$3.9 M	$2.9 M	$3.4 M	**$4.0 M**	**$14.2 M**	$12.6 M
Total revenues	$7.1 M	$7.1 M	$10.2 M	$11.5 M	$10.0 M	$9.4 M	**$9.9 M**	**$40.8 M**	$32.2 M

The total revenues for the last twelve months have reached $40.8 M compared to $32.2 M in the previous twelve months, reflecting a solid organic growth. The level of revenues has obviously impacted positively the Company's financial performance, showing the scalability of our business model. Our scalability goal is to grow the revenue line while maintaining stable our fixed costs structure and making an optimal use of our manufacturing capacities.

The revenues from specialty chemicals and consumables for the last twelve months have reached $14.2 M, an increase of $1.6 M compared to the previous twelve months. This level of revenues allows the Company to cover an important portion of its selling, operating and administrative expenses ("SG&A"), which contributes to reduce the lumpiness of the water treatment projects activities, solidifying the Company's financial performance.

Operating expenses

Operating expenses have increased by approximately $40,000 and remained relatively stable at $0.2 M for this quarter compared to the corresponding quarter of previous fiscal year. This increase is due to the hiring of a chemist to support development and improvement of products for our specialty chemicals. As she will develop new products, we expect it will impact positively our revenues over the next fiscal year. The increase in operating expenses is also due to the hiring of a director of supply chain and logistics whose responsibilities will be to improve our supply management practices, to optimize our terms & conditions with our suppliers, to maximize the use of our inventory and, essentially, to better integrate the notions of supply chain and logistics in the execution of our projects.

Selling expenses

Selling expenses have decreased by approximately $140,000 or 14.2% and stood at $0.9 M for this quarter compared with the corresponding quarter of the previous fiscal year, despite the 2.5% decrease in revenues. Selling expenses are linked to bookings and revenues, but do not fluctuate proportionally. The decrease is partly due to the ending of consulting agreements over the last fiscal year, to the reallocation of staff to project management and to a lesser volume of traveling expenses.

Administrative expenses

Administrative expenses decreased by approximately $96,000 or 9.4% in this third quarter of fiscal year 2013 compared with the third quarter of fiscal year 2012. Professional fees incurred have significantly decreased due to lower other audit-related services following the completion of IFRS transition. Salaries and fringe benefits have decreased following the elimination of management positions in June 2012.

The Company's ratio of SG&A as a whole over revenues amounted to 20.0% for this quarter, down from 21.4% for the corresponding quarter of the previous fiscal year. The improvement of this ratio is partly the result of the important reorganization initiated since June 30, 2012. We were able to maintain the volume of business during this third quarter of fiscal year 2013 and our efforts show the benefit and scalability of our business model.

Adjusted EBITDA

Adjusted EBITDA for the quarter was recorded at $530,026, compared with $563,603 for the same period ended March 31, 2012. While the level of revenues decreased from $10.2 M to $9.9 M and the gross profit declined from 26.4% to 25.2% during the third quarter of fiscal year 2013 compared with the period ended March 31, 2012, the reduction of SG&A expenses was sufficient to maintain a positive adjusted EBITDA above the $0.5 M mark.

Other losses (gains) – net

Other losses (gains) – net amounting to $20,017 for the period ended March 31, 2013 compared with ($26,880) for the quarter ended March 31, 2012 are mostly composed of a foreign exchange loss (gain), which is entirely due to exchange rate fluctuations related to working capital items.

Finance costs – net

Finance costs – net totalled $177,164 for the period ended March 31, 2013 compared to $221,023 for the comparable period in the previous fiscal year. These expenses relate mostly to the long-term debt. Of this amount, $26,775 represents the theoretical and non-monetary part of interest on long-term debt. The slight decrease is due to the repayment of the Company's long-term debt over the last nine months.

Gain on settlement agreement

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

Share of earnings (loss) in a joint venture

Share of earnings (loss) in a joint venture totalled ($6,177) for the period ended March 31, 2013 compared with a share of earnings (loss) of ($100,000) for the quarter ended March 31, 2012.

Net earnings (loss)

The net earnings (loss) was $86,834 or $0.001 per share for the third quarter of fiscal year 2013 compared with ($7,651,400) or ($0.127 per share) for the third quarter of fiscal year 2012. This improvement is attributable to three main factors. First, the Company maintained a high level of revenues, which generated a satisfying gross profit margin. Second, management closely monitors the SG&A and is diligent in finding additional savings. Finally, the Company did not suffer from a goodwill impairment charge, an impairment of intangible assets and changes in fair value of contingent considerations in the third quarter of fiscal year 2013 compared to the third quarter of fiscal year 2012.

Commitments

The Company has entered into long-term lease agreements expiring in 2013, 2014, 2017 and 2022, which call for lease payments of $4,822,528 for the rental of space. The minimum annual lease payments over the next five years are $463,710 in 2014, $490,567 in 2015, $537,813 in 2016, $550,064 in 2017 and $562,603 in 2018.

Information on share capital

As at March 31, 2013, the Company had 60,145,832 outstanding shares. No share was issued during this quarter.

FINANCIAL SITUATION

As working capital increased from $2.5 M as at June 30, 2012 to $4.1 M as at March 31, 2013, the Company's current ratio improved from 1.19 to 1.36. The improvement is due to the reclassification to the non-current liabilities of the long-term portion of a loan from another entity since a waiver was obtained and to the decrease of $0.3 M in accounts payable and accrued liabilities and the decrease of $0.2 M in billings in excess of costs. The Company used its revolving credit facilities to a higher level as at March 31, 2013 which affected negatively the working capital. In addition, a significant milestone in a project located in Northern Alberta was reached in March 2013, when the final delivery to an oil & gas customer took place. As a result, the invoicing for such project is still included in the accounts receivables as at March 31, 2013. Other balance sheet items included in the working capital remained stable as at March 31, 2013 compared to June 30, 2012.

The net debt excluding contingent considerations, which stood at $5.9 M as at March 31, 2013, decreased by $0.2 M compared with $6.1 M as at June 30, 2012. This decrease is mainly attributable to the reimbursement of long-term debt after the end of the moratorium exercised during fiscal year 2012. The general decline in working capital, itself caused by the higher level of manufacturing and procurement activities have increased the level of net debt due to the use of the Company's revolving credit facilities.

Equity stood at $14.6 M as at March 31, 2013, compared with $13.7 M as at June 30, 2012. As March 31, 2013, the net debt equity ratio was 0.41 whereas it was 0.45 as at June 30, 2012, showing that the Company is not over leveraged and has improved its overall financial situation.

(in Canadian dollars, except for ratio)	**Period ended March 31, 2013**	**Period ended June 30, 2012**
Working capital	4,158,734	2,518,829
Current ratio	1.36	1.19
Net debt[1]	5,929,066	6,129,684
Equity	14,588,793	13,744,227
Net debt to equity ratio	0.41	0.45

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

As at March 31, 2013 accounts receivable stood at $9.5 M compared with $9.3 M as at June 30, 2012. The increase of $0.2 M is attributable to the higher invoicing at the end of the current quarter due in part to the final delivery to an oil & gas customer in March 2013.

Inventories remained stable at $2.2 M as at March 31, 2013 compared with the balance as at June 30, 2012. While finished goods have increased nearly $0.1 M due to the maple syrup production season, raw materials have lightly decreased by $0.1 M due to a better use of our in-hand or slow moving items. An effort will be made toward year-end to reduce the level of inventories to a level that is sound to management to fulfill our customers' needs and to improve our overall working capital.

Costs incurred in excess of billings remained stable at $2.2 M compared to the balance as June 30, 2012, primarily due to a similar number of active projects for which there are differences between project advancement and project invoicing schedules. Billings in excess of costs incurred decreased by $0.2 M to $1.5 M as at March 31, 2013, from $1.6 M as at June 30, 2012. This decrease is also attributable to differences between project advancement and project invoicing schedules.

Accounts payable and accrued liabilities decreased by $0.3 M to $5.5 M as at March 31, 2013, from $5.7 M as at June 30, 2012. This decrease is explained by the fact that several large systems projects have completed their manufacturing and assembly phases and are now entering their commissioning phase while new systems projects are entering into their initial design and engineering phases for some and their manufacturing and assembly phases for others.

The decrease in the current portion of the long-term debt, the balance of which fell from $2.6 M as at June 30, 2012 to $0.99 M as at March 31, 2013, is explained by the repayment of $0.9 M for the long-term debt and the reclassification to the non-current liabilities of the long-term portion of a loan from another entity according to the repayment terms since a waiver has been obtained.

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

For the third quarter ended March 31, 2013, shareholders' equity increased by $0.9 M to $14.6 M ($13.7 M as at June 30, 2012). The following elements had an impact on shareholders' equity in the first six months of fiscal year 2013: 1) the $845,384 net earnings for the nine-month period ended March 31, 2013; 2) the Canadian dollar's appreciation generated an unrealized exchange loss of $0.03 M resulting from the translation of foreign operations, mainly those of the U.S. subsidiaries; and 3) the stock-based compensation costs of $32,483.

CASH FLOWS

A comparison of the Company's cash flows for the periods ended March 31, 2013 and 2012 is presented below:

(in Canadian dollars) (unaudited)	**Three-month period ended March 31, 2013**	Three-month period ended March 31, 2012	**Nine-month period ended March 31, 2013**	Nine-month period ended March 31, 2012
	$	$	**$**	$
Cash flows from operating activities	**(1,073,407)**	(419,247)	**1,160,757**	(744,717)
Cash flows from investing activities	**(204,511)**	218,825	**(392,377)**	(643,296)
Cash flows from financing activities	**732,039**	439,682	**(1,034,451)**	1,384,685
Effect of exchange rate changes on the balance of cash held in foreign currencies	**10,036**	(19,309)	**(8,381)**	25,236
Net change	**(535,843)**	219,951	**(274,452)**	21,908
Cash and cash equivalents – Beginning of period	**682,723**	(49,207)	**421,332**	148,836
Cash and cash equivalents – End of period	**146,880**	170,744	**146,880**	170,744

Operating activities used $(1,073,407) in cash for the period ended March 31, 2013, compared with ($419,247) of cash used during the corresponding period ended March 31, 2012. The decline is mainly attributable to the negative change in working capital items, which effect has been offset by the improvement in net earnings in the third quarter of fiscal year 2013 as compared with the corresponding period ended March 31, 2012. Management anticipates an improvement in the working capital items during the next quarter because of the expected milestones to be reached within invoicing and manufacturing activities.

For the third quarter of fiscal year 2013, investing activities used net cash of ($204,511), mainly attributable to the acquisition of a guaranteed deposit certificate to secure the new lease for the Minneapolis plant and office, to the acquisition of property, plant and equipment, namely computer, a small containerized unit and various items for $73,168 and to the acquisition of intangible assets, namely software for our design team in the amount of $21,721.

Financing activities generated net cash of $732,039 in the third quarter of fiscal year 2013 compared with $439,682 of net cash generated during the corresponding period ended March 31, 2012. The increase of funds generated by financing activities is mainly caused by the use of bank loans to support our manufacturing activities. In addition, the Company continued to reimburse its long-term debts after the ending of the two consecutives moratoriums of six months over capital repayments of long-term debts during fiscal year 2012.

QUARTERLY SUMMARY FINANCIAL INFORMATION (unaudited)

(in dollars, except per share data)

	Three-month periods ended				Last twelve months
	March 31, 2013	**December 31, 2012**	**September 30, 2012**	**June 30, 2012**	
Revenues	9,966,644	9,418,908	9,982,894	11,561,332	40,929,778
Adjusted EBITDA	531,561	561,888	726,693	(483,798)	1,336,344
Net earnings (loss)	86,834	488,854	269,696	880,620	1,726,004
EPS basic and diluted	0.001	0.008	0.004	0.014	0.027
Cash flows from operating activities	(1,073,407)	1,024,161	1,210,214	1,560,416	2,721,384

	Three-month periods ended				Previous twelve months
	March 31, 2012	**December 31, 2011**	**September 30, 2011**	**June 30, 2011**	
Revenues	10,222,312	7,056,495	7,069,768	7,826,146	32,174,721
Adjusted EBITDA	563,603	407,961	323,618	(15,652)	1,279,530
Net loss	(7,651,400)	(1,214,510)	(88,216)	(72,989)	(9,027,115)
EPS basic and diluted	(0.127)	(0.020)	(0.001)	(0.001)	(0.149)
Cash flows from operating activities	(419,247)	(1,408,003)	1,082,533	441,044	(303,673)

CAPITAL MANAGEMENT

The Company's objective when managing capital is to maintain a flexible capital structure, which optimizes the cost of capital at an acceptable risk level.

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

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

The total debt-to equity ratio was as follows:

	March 31, 2013	**June 30, 2012**
	$	$
Bank overdraft	143,151	155,210
Bank loans	3,218,444	2,868,394
Current portion of long-term debt [(a)]	994,880	2,580,862
Long-term debt [(a)]	1,862,622	1,101,760
Total debt	6,219,097	6,706,226
Equity	14,588,793	13,744,227
Total debt-to-equity ratio	42.6%	48.8%

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

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

The Company renewed its credit facilities in December 2012 and the financial covenants required have been modified and must be met on a monthly basis. The Company is not subject to any externally imposed capital requirements other than covenants on its bank loans with its lender to maintain the following levels: 1) a debt ratio lesser than or equal to 2.50:1.00, 2) a working capital ratio greater than or equal to 1.30:1.00, and 3) a fixed charge coverage ratio greater than or equal to 1.00:1.00 and a covenant on the loan from other entity to maintain working capital ratio of 1.50:1.00. Business performance is closely monitored and the most cost-effective methods for raising capital are considered to evaluate compliance with covenants. As at March 31, 2013, the Company respected its covenants with the bank but was in breach of the working capital ratio for the loan from other entity; however the Company received a waiver for this breach from the lender. On April 23, 2013, an agreement was concluded giving a three-month moratorium on the repayment of principal starting in April 2013 with an increase of 0.25% of the interest rate applicable on the unsecured loans.

The Company's objective when managing capital is to maintain a flexible capital structure, which optimizes the cost of capital at an acceptable risk level. For capital management purposes, the Company defines its capital as follows: shareholders' equity, long-term debt, bank loans (including bank overdraft) less cash and cash equivalents, held-for-trading investments and held-to-maturity investment. The Company monitors capital in light of its monthly needs and obligations linked to its financial liabilities.

ACCOUNTING POLICIES

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

OFF-BALANCE SHEET ARRANGEMENTS

As at March 31, 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 years 2013 and 2014. In these letters of credit, deposit certificates secure $1.2 M. The balance, amounting to $0.2 M, was guaranteed by *Export Development Canada*.

CONTROLS AND PROCEDURES

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

Disclosure controls and procedures

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

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

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

Internal controls over financial reporting

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

Changes in internal controls over financial reporting

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

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Third quarter ended
March 31, 2013

The comparative figures of the condensed interim consolidated financial statements which are included in this report have not been subject to a review by the Company's independent auditors.

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.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Unaudited)

	March 31, 2013	June 30, 2012
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	**290,031**	576,542
Guaranteed deposits certificates	**1,249,282**	1,147,703
Accounts receivable (note 3)	**9,470,501**	9,322,380
Inventories (note 4)	**2,216,321**	2,250,789
Costs incurred in excess of billings	**2,190,108**	2,154,311
Prepaid expenses	**157,046**	132,480
	15,573,289	15,584,205
Non-current assets		
Property, plant and equipment	**1,937,098**	2,026,695
Intangible assets	**4,955,148**	5,459,185
Investment in a joint venture	**44,344**	11,722
Other assets	**36,838**	43,122
Goodwill	**2,381,400**	2,386,322
Deferred income tax assets	**3,036,668**	2,958,149
	27,964,785	28,469,400
LIABILITIES		
Current liabilities		
Bank overdraft	**143,151**	155,210
Bank loans	**3,218,444**	2,868,394
Accounts payable and accrued liabilities (note 5)	**5,466,532**	5,742,007
Provisions (note 6)	**28,730**	40,543
Billings in excess of costs incurred	**1,459,661**	1,634,724
Income taxes payable	**98,752**	4,378
Deferred rent	**4,405**	18,188
Current portion of long-term debt (note 8)	**994,880**	2,580,862
Contingent considerations (note 7)	**-**	21,070
	11,414,555	13,065,376
Non-current liabilities		
Long-term debt (note 8)	**1,862,622**	1,101,760
Contingent considerations (note 7)	**-**	460,555
Deferred rent	**98,815**	97,482
	13,375,992	14,725,173
SHAREHOLDERS' EQUITY		
Share capital	**45,852,436**	45,852,436
Reserve - Stock options (note 9)	**1,853,904**	1,821,421
Reserve - Warrants	**370,076**	370,076
Deficit	**(31,981,390)**	(32,826,774)
Accumulated other comprehensive loss	**(1,506,233)**	(1,472,932)
	14,588,793	13,744,227
	27,964,785	28,469,400

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

On behalf of the Board,

Frédéric Dugré

President and Chief Executive Officer

Philippe Gervais

Chairman of the Board of Directors

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the nine-month periods ended March 31, 2013 and 2012
(Unaudited)

ATTRIBUTABLE TO THE SHAREHOLDERS OF H_2O INNOVATION INC.

	Common shares Number	**Share capital**	**Reserves**		**Deficit**	**Accumulated other comprehensive loss**	**Total**
			Stock options (note 9)	**Warrants**			
		$	**$**	**$**	**$**	**$**	**$**
Balance as at July 1, 2011	60,145,832	45,852,436	1,734,952	10,143,677	(34,273,772)	(1,922,678)	21,534,615
Stock-based compensation costs	-	-	117,967	-	-	-	117,967
Share issue expenses related to financing	-	-	-	(1,165)	-	-	(1,165)
Net loss for the period	-	-	-	-	(8,954,127)	-	(8,954,127)
Other comprehensive loss – Currency translation adjustments	-	-	-	-	-	399,909	399,909
Balance as at March 31, 2012	**60,145,832**	**45,852,436**	**1,852,919**	**10,142,512**	**(43,227,899)**	**(1,522,769)**	**13,097,199**
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	-	-	32,483	-	-	-	32,483
Net earnings for the period	-	-	-	-	845,384	-	845,384
Other comprehensive loss – Currency translation adjustments	-	-	-	-	-	(33,301)	(33,301)
Balance as at March 31, 2013	**60,145,832**	**45,852,436**	**1,853,904**	**370,076**	**(31,981,390)**	**(1,506,233)**	**14,588,793**

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 and nine-month periods ended March 31, 2013 and 2012
(Unaudited)

	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2012
	$	$	**$**	$
Revenues (note 13)	**9,966,644**	10,222,312	**29,368,446**	24,348,575
Cost of goods sold (note 10 a))	**7,451,167**	7,521,805	**21,929,337**	18,310,510
Gross profit	**2,515,477**	2,700,507	**7,439,109**	6,038,065
Operating expenses (note 10 a))	**218,394**	177,749	**493,535**	464,393
Selling expenses (note 10 a))	**853,744**	993,043	**2,601,528**	2,811,716
Administrative expenses (note 10 a))	**925,700**	1,022,044	**2,642,816**	2,796,783
Depreciation of property, plant and equipment (note 10 b))	**72,226**	75,233	**209,533**	221,569
Amortization of intangible assets (note 10 b))	**181,148**	191,134	**536,843**	667,418
Changes in fair value of contingent considerations	**-**	(849,502)	**-**	(849,502)
Impairment of intangible assets (note 10 b))	**-**	378,728	**-**	378,728
Impairment of goodwill	**-**	8,221,423	**-**	8,221,423
Other losses (gains) – net (note 10 c))	**20,017**	(26,880)	**(38,519)**	(396,120)
	2,271,229	10,182,972	**6,445,736**	14,316,408
Operating earnings (loss)	**244,248**	(7,482,465)	**993,373**	(8,278,343)
Finance income	**(3,770)**	(5,567)	**(11,757)**	(16,945)
Finance costs	**180,934**	226,590	**602,061**	626,836
Finance costs – net	**177,164**	221,023	**590,304**	609,891
Gain on settlement agreement (note 7)	**-**	-	**(404,189)**	-
Royalties income from a joint venture	**(25,269)**	-	**(46,375)**	(12,245)
Share of (earnings) loss in a joint venture	**6,177**	100,000	**(6,142)**	407,414
	158,072	321,023	**133,598**	1,005,060
Earnings (loss) before income taxes	**86,176**	(7,803,488)	**859,775**	(9,283,403)
Current income tax expense (benefit)	**(658)**	(29)	**98,752**	(29)
Deferred tax benefit	**-**	(152,059)	**(84,361)**	(329,247)
	(658)	(152,088)	**14,391**	(329,276)
Net earnings (loss) for the period attributable to shareholders	**86,834**	(7,651,400)	**845,384**	(8,954,127)
Net earnings (loss) per share attributable to the equity holders of the company during the period				
Basic and diluted net earnings (loss) per share	**0.001**	(0.127)	**0.014**	(0.149)
Weighted average number of shares outstanding (note 11)	**60,145,832**	60,145,832	**60,145,832**	60,145,832

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

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the three-month and nine-month periods ended March 31, 2013 and 2012
(Unaudited)

	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2012
	$	$	**$**	$
Net earnings (loss) for the period	**86,834**	(7,651,400)	**845,384**	(8,954,127)
Other comprehensive income (loss) – Items that may be reclassified subsequently to net earnings				
Currency translation adjustments	**262,524**	(337,214)	**(33,301)**	399,909
Comprehensive income for the period attributable to shareholders	**349,378**	(7,988,614)	**812,083**	(8,554,218)

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

H_2O INNOVATION INC.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three-month and nine-month periods ended March 31, 2013 and 2012
(Unaudited)

	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2012
	$	$	**$**	$
Cash flows from operating activities				
Earnings (loss) before income taxes for the period	**86,176**	(7,803,488)	**859,775**	(9,283,403)
Non-cash items				
Finance costs – net	**177,164**	221,023	**590,304**	609,891
Depreciation of property, plant and equipment	**72,226**	75,233	**209,533**	221,569
Amortization of intangible assets	**181,148**	191,134	**536,843**	667,418
Changes in fair value of contingent considerations	**-**	(849,502)	**-**	(849,502)
Impairment of intangible assets	**-**	378,728	**-**	378,728
Impairment of goodwill	**-**	8,221,423	**-**	8,221,423
Deferred rent	**(2,843)**	2,954	**(12,083)**	8,867
Stock-based compensation	**7,135**	29,052	**32,483**	117,967
Gain on settlement agreement	**-**	-	**(404,189)**	-
Share of (earnings) loss in a joint venture	**6,177**	100,000	**(6,142)**	407,414
	527,394	566,586	**1,806,524**	500,401
Change in working capital items (note 12 a))	**(1,604,571)**	(997,378)	**(653,244)**	(1,254,118)
Cash generated by (used in) operations	**(1,077,177)**	(430,792)	**1,153,280**	(753,746)
Interests received	**3,770**	5,567	**11,757**	16,945
Income taxes paid	**-**	5,978	**(4,280)**	(7,916)
Net cash generated by (used in) operating activities	**(1,073,407)**	(419,247)	**1,160,757**	(744,717)
Cash flows from investing activities				
Disposal of guaranteed deposits certificates	**-**	361,286	**689**	476,688
Acquisition of guaranteed deposits certificates	**(103,265)**	(111,150)	**(103,380)**	(211,150)
Acquisition of property, plant and equipment	**(73,168)**	(27,886)	**(122,079)**	(182,407)
Investment in a joint venture	**-**	-	**(25,453)**	(200,022)
Acquisition of intangible assets	**(21,721)**	(3,425)	**(52,493)**	(10,660)
Variation of other assets	**(6,357)**	-	**6,350**	-
Contingent considerations paid (note 7)	**-**	-	**(96,011)**	(515,745)
Net cash generated by (used in) investing activities	**(204,511)**	218,825	**(392,377)**	(643,296)
Cash flows from financing activities				
Net variation of bank loans	**1,163,836**	652,318	**350,050**	1,908,171
Long-term debt reimbursement	**(253,888)**	(6,558)	**(852,984)**	(13,504)
Interest paid	**(177,909)**	(206,078)	**(531,517)**	(508,817)
Warrants issue expenses	**-**	-	**-**	(1,165)
Net cash generated by (used in) financing activities	**732,039**	439,682	**(1,034,451)**	1,384,685
Net change in cash and cash equivalents	**(545,879)**	239,260	**(266,071)**	(3,328)
Effect of exchange rate changes on the balance of cash held in foreign currencies	**10,036**	(19,309)	**(8,381)**	25,236
Increase (decrease) in cash and cash equivalents	**(535,843)**	219,951	**(274,452)**	21,908
Cash and cash equivalents - Beginning of period (note 12 b))	**682,723**	(49,207)	**421,332**	148,836
Cash and cash equivalents - End of period (note 12 b))	**146,880**	170,744	**146,880**	170,744

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

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Description of Business

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

2. Basis of Preparation

Basis of preparation

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

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

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

The preparation of financial statements in conformity with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant are disclosed in note 3 in the Company's consolidated financial statements for the year ended June 30, 2012 and remained unchanged for the three-month and nine-month periods ended March 31, 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 2012 annual statements. Accordingly they do not include all the information required for annual financial statements and should be read in conjunction with the Company's 2012 annual audited consolidated financial statements.

On May 13, 2013 the Board reviewed the accompanying condensed interim consolidated financial statements and authorized its publication.

Standards and interpretations adopted during the period

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

Standards and interpretations issued to be adopted at a later date

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

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

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

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

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

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

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

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

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

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

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

3. Accounts Receivable

	As at March 31, 2013	As at June 30, 2012
	$	$
Accounts receivable	**7,920,064**	8,128,294
Retentions from customers under manufacturing contracts	**1,010,809**	983,900
Allowance for doubtful accounts	**(310,772)**	(258,230)
Allowance for back charges	**(55,713)**	-
	8,564,388	8,853,964
Suppliers advances	**544,821**	139,322
Tax credits receivable	**111,343**	180,040
Other receivables	**249,949**	149,054
	9,470,501	9,322,380

4. Inventories

	As at March 31, 2013	As at June 30, 2012
	$	$
Raw materials	**997,160**	1,112,301
Finished goods	**1,219,161**	1,138,488
	2,216,321	2,250,789

5. Accounts Payable and Accrued Liabilities

	As at March 31, 2013	As at June 30, 2012
	$	$
Trade accounts payable	**2,398,873**	3,792,052
Other accrued liabilities and accounts payable	**3,067,659**	1,949,955
	5,466,532	5,742,007

6. Provisions

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

	$
Balance as at June 30, 2011	32,300
Additional provisions recognised	40,116
Less: Payments	(32,760)
Effect of foreign exchange differences	887
Balance as at June 30, 2012	40,543
Additional provisions recognised	**60,436**
Less: Payments	**(72,350)**
Effect of foreign exchange differences	**101**
Balance as at March 31, 2013	**28,730**

7. Contingent considerations

The change in carrying value is as follows:

	$
Balance as at June 30, 2011	1,419,727
Plus: Unwinding of discount	81,591
Less: Payments	(793,393)
Less: Reduction of contingent consideration through statement of earnings (loss)	(280,142)
Effect of foreign exchange differences	53,842
Balance as at June 30, 2012	481,625
Plus: Unwinding of discount	**30,492**
Less: Payments	**(96,011)**
Less: Settlement agreement	**(404,189)**
Effect of foreign exchange differences	**(11,917)**
Balance as at March 31, 2013	**-**

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

8. Long-Term Debt

	As at March 31, 2013	As at June 30, 2012
	$	$
Unsecured – at amortised cost		
Bank loan, denominated in Canadian dollars(1)	**1,066,709**	1,401,737
Loan from other entities, denominated in Canadian dollars(1)	**1,569,315**	1,862,820
Loans from shareholders, denominated in US dollars(1)	**137,384**	322,391
Loan from other entities, denominated in US dollars	**84,094**	95,674
	2,857,502	3,682,622
Less: Current portion	**(994,880)**	(2,580,862)
Long-term debt	**1,862,622**	1,101,760

As at March 31, 2013, the Company is in breach of covenants on the loan from other entity to maintain a working capital ratio of 1.5:1 and an equity debt ratio of 2.5:1 but received a waiver for this breach from the lender.

(1) On April 23, 2013, an agreement was concluded giving a three-month moratorium on the repayment of principal starting in April 2013 with an increase of 0.25% of the interest rate applicable on the unsecured loans.

9. Share Capital

Stock options

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

	Nine-month period ended March 31, 2013		Year ended June 30, 2012	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		$		$
Outstanding - Beginning of period	**2,477,000**	**0.70**	3,945,000	0.80
Expired	**(352,500)**	**1.50**	(980,000)	1.22
Forfeited	**-**	**-**	(487,500)	0.50
Outstanding - End of period	**2,124,500**	**0.57**	2,477,000	0.70

10. Additional information about the nature of costs components

a) Expenses by nature

	Three-month periods ended March 31,		**Nine-month periods ended March 31,**	
	2013	2012	**2013**	2012
	$	$	**$**	$
Material	**3,880,162**	4,783,907	**15,090,864**	11,789,538
Changes in inventories of raw material, finished goods and costs incurred in excess of billings	**1,044,806**	(70,889)	**496,840**	(724,223)
Salaries and fringe benefits	**2,380,418**	2,296,112	**6,635,685**	6,410,610
Subcontractors and professional fees	**1,070,615**	1,777,153	**2,384,600**	4,515,612
Rent, electricity , insurance and office expenses	**359,158**	322,167	**1,024,380**	657,612
Telecommunications and travel expenses	**290,391**	289,560	**857,651**	875,308
Bad debt expenses	**29,725**	-	**55,498**	-
Other expenses	**393,731**	316,632	**1,121,699**	929,678
Total cost of goods sold, operating, selling and administrative expenses	**9,449,005**	9,714,641	**27,667,216**	24,383,402

b) Depreciation and amortization

The Company has elected to present depreciation and amortization as a separate line item in its condensed interim consolidated statement of earnings (loss), as opposed to reflecting the fraction of such amount that pertains to each of the cost of goods sold, operating expenses, selling expenses and administrative expenses, within those cost categories. The following tables provide: i) a breakdown of the depreciation and amortization expense by cost category as noted above, for the three-month and nine-month periods ended March 31, 2013 and 2012; and ii) the amounts of cost of goods sold, operating expenses, selling expenses and administrative expenses, if depreciation and amortization were allocated within those cost categories for the periods as noted above.

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

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

Depreciation by function	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2012
	$	$	**$**	$
Cost of goods sold	**39,926**	40,322	**100,925**	119,374
Operating expenses	**933**	1,338	**2,875**	3,820
Selling expenses	**11,376**	13,887	**34,728**	39,024
Administrative expenses	**19,991**	19,686	**71,005**	59,351
	72,226	75,233	**209,533**	221,569

Amortization by function	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2012
	$	$	**$**	$
Cost of goods sold	**88,593**	109,017	**263,138**	343,305
Selling expenses	**79,364**	70,349	**235,808**	289,476
Administrative expenses	**13,191**	11,768	**37,897**	34,637
	181,148	191,134	**536,843**	667,418

Impairment of intangible assets by function	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2012
	$	$	**$**	$
Cost of goods sold	**-**	198,589	**-**	198,589
Selling expenses	**-**	180,139	**-**	180,139
	-	378,728	**-**	378,728

Cost per function including depreciation, amortization and impairment of intangible assets	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2012
	$	$	**$**	$
Cost of goods sold	**7,579,686**	7,869,733	**22,293,400**	18,971,778
Operating expenses	**219,327**	179,087	**496,410**	468,213
Selling expenses	**944,484**	1,257,418	**2,872,064**	3,320,355
Administrative expenses	**958,882**	1,053,498	**2,751,718**	2,890,771

c) Other (gains) losses – net

	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2012
	$	$	**$**	$
Exchange (gain) loss	**20,813**	4,191	**(30,642)**	(313,915)
Other revenues	**(796)**	(37,707)	**(7,877)**	(90,091)
Loss on disposal of assets	**-**	6,636	**-**	7,886
	20,017	(26,880)	**(38,519)**	(396,120)

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

11. Net Earnings (loss) Per Share

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

	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2012
Net earnings (loss)	**$86,834**	($7,651,400)	**$845,384**	($8,954,127)
Basic and diluted weighted average number of share outstanding	**60,145,832**	60,145,832	**60,145,832**	60,145,832
Basic and diluted net earnings (loss) per share	**$0.001**	**($0.127)**	**$0.014**	($0.149)
Items excluded from the calculation of diluted net earnings (loss) per share because the exercise price was greater than the average market price of the common shares or due to their anti-dilutive effect				
Stock options	**1,743,250**	1,703,250	**1,743,250**	1,703,250
Warrants (number of equivalent shares)	**2,250,000**	2,250,000	**2,250,000**	2,250,000

For the three-month and nine-month periods ended March 31, 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 was calculated using the basic weighted average number of shares outstanding.

12. Cash Flows

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

	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2012
	$	$	**$**	$
Accounts receivable	**(2,149,363)**	(3,090,875)	**(170,930)**	(1,198,504)
Inventories	**732,581**	327,199	**31,727**	(303,585)
Costs incurred in excess of billings	**(195,658)**	(397,844)	**(35,699)**	(482,245)
Prepaid expenses	**(61,231)**	(19,318)	**(24,473)**	61,409
Accounts payable and accrued liabilities	**719,854**	1,192,368	**(261,821)**	68,170
Provisions	**(33,034)**	10,008	**(12,128)**	30,037
Billings in excess of work in progress	**(617,720)**	981,084	**(179,920)**	570,600
	(1,604,571)	(997,378)	**(653,244)**	(1,254,118)

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

12. Cash Flows (Continued)

b) Cash and cash equivalents consist of the following:

	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2012
	$	$	**$**	$
Beginning of period				
Cash and cash equivalents	**839,111**	238,149	**576,542**	440,356
Bank overdraft	**(156,388)**	(287,356)	**(155,210)**	(291,520)
	682,723	(49,207)	**421,332**	148,836

	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2011
	$	$	**$**	$
End of period				
Cash and cash equivalents	**290,031**	315,444	**290,031**	315,444
Bank overdraft	**(143,151)**	(144,700)	**(143,151)**	(144,700)
	146,880	170,744	**146,880**	170,744

13. Segment Information

Products from which reportable segments derive their revenues

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

The following is an analysis of the Company's revenues for the period for the continuing operations.

	Three-month periods ended March 31,		Nine-month periods ended March 31,	
	2013	2012	**2013**	2012
	$	$	**$**	$
Revenues from sales of consumables	**4,039,391**	3,498,350	**10,424,500**	10,813,060
Manufacturing contracts revenues	**5,927,253**	6,723,962	**18,943,946**	13,535,515
	9,966,644	10,222,312	**29,368,446**	24,348,575

Geographical information

	Three-month periods ended March 31,		Nine-month periods ended March 31,	
Revenue from external customers	**2013**	2012	**2013**	2012
	$	$	**$**	$
Revenue according to geographic location				
Canada	**5,411,425**	3,668,626	**14,984,340**	7,512,126
United States	**3,877,613**	5,240,111	**11,959,964**	12,870,373
Tunisia	**203,766**	761,247	**543,561**	2,499,284
China	**149,036**	251,538	**1,141,303**	570,195
Egypt	**-**	174,270	**94,648**	336,266
Other	**324,804**	126,520	**644,630**	560,331
	9,966,644	10,222,312	**29,368,446**	24,348,575

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

13. Segment Information (continued)

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

	As at March 31, 2013	As at June 30, 2012
	$	$
Non-current assets other than financial instruments, investment in a joint venture and deferred tax assets according to geographic location		
Canada	**1,722,394**	1,732,291
United States	**7,551,252**	8,139,911
	9,273,646	9,872,202

14. Related parties disclosure

Compensation of key management personnel

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

	Three-month periods ended March 31,		**Nine-month periods ended March 31,**	
	2013	2012	**2013**	2012
	$	$	**$**	$
Short-term benefits	**206,213**	189,220	**660,684**	562,955
Post-employment benefits	**2,800**	2,959	**7,808**	8,803
Share-based payments	**5,885**	16,420	**27,327**	61,889
	214,898	208,599	**695,819**	633,647

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

GENERAL INFORMATION

Board of Directors

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

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

Key Management

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

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

Independent Auditors
Deloitte L.L.P.

Transfer Agent
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