2013 Annual Report

Fiscal year ended
June 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.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE FINANCIAL SITUATION

H_2O Innovation Inc.'s (the "Company" or "H_2O Innovation") President & Chief Executive Officer and Vice President, Finance have signed a statement of management's responsibility regarding financial information included in this Annual Report. The statement – which can be found on page 21– also explains the roles of the Audit Committee and the Board of Directors in respect of financial information included in the Annual Report. This Management's Discussion and Analysis ("MD&A") reviews H_2O Innovation's operating results and financial condition for the years ended June 30, 2013 and 2012. The MD&A should be read in conjunction with the consolidated financial statements for the year ended June 30, 2013 and with the accompanying notes.

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.

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

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 125 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) 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)

Years ended June 30,	**2013**	2012
	$	$
Net earnings (loss) for the year	**312,992**	(8,054,860)
Finance costs – net	**742,734**	908,172
Income taxes	**(167,335)**	(2,507,158)
Depreciation of property, plant and equipment	**279,866**	306,272
Amortization of intangible assets	**720,701**	614,308
Loss on disposal of property, plant and equipment	**23,485**	16,710
Changes in fair value of contingent considerations	**-**	(280,142)
Impairment of goodwill	**-**	8,221,423
Impairment of intangible assets	**-**	378,728
Stock-based compensation costs	**39,619**	86,469
Gain on settlement agreement	**(404,189)**	-
Loss on disposal of investment in a joint venture	**42,521**	-
Share of (earnings) loss in a joint venture	**(6,142)**	322,250
Adjusted EBITDA	**1,584,252**	12,172

RESULTS OF OPERATIONS

Years ended June 30	2013	2012	2011
	$	**$**	$
Revenues	**36,136,901**	35,909,907	27,632,266
Gross profit	**9,251,537**	8,275,358	8,164,191
Gross profit	**25.6%**	23.0%	29.5%
Operating expenses	**696,079**	642,880	1,225,331
Selling expenses	**3,509,081**	3,906,263	3,689,387
Administrative expenses	**3,533,042**	4,206,086	3,467,886
Net earnings (loss)	**312,992**	(8,054,860)	(1,359,380)
Basic and diluted loss per share	**0.005**	(0.134)	(0.023)
Adjusted EBITDA[(a)]	**1,584,252**	12,172	325,292
Total assets	**26,920,524**	28,469,400	34,653,265
Non-current financial liabilities	**64,996**	1,562,315	3,958,024

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

Revenues and gross profit

Revenues increased by $0.2 M in fiscal year 2013 compared to fiscal year 2012, up by less than 1%. The revenues mix has shift while revenues from water treatment projects decreased by $1.3 M, revenues from specialty chemicals and consumables (which includes products for the maple syrup production) increased by $1.5 M. Revenues from water treatment projects have been affected negatively by the termination on June 27, 2013 of 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 equipment was built and ready to be delivered when the agreement was terminated. The Company has instituted legal procedures against the client to seek compensation for the damages it sustained. The Company has also initiated a mediation process through the American Arbitration Association to achieve a settlement. Excluding the impact of that termination, revenues would have reached $37.4 M.

In fiscal year 2013, revenues from water treatment projects stood at $22.9 M compared with $24.2 M in fiscal year 2012, while revenues from specialty chemicals and consumables reached $13.2 M in fiscal year 2013 compared with $11.7 M in fiscal year 2012. This nearly 13% increase of revenues from specialty chemicals and consumables is the result of the strategic decision to build and reinforce long-term relationships with customers bringing a continuous stream of revenues; a direct value creation for our shareholders.

Despite relatively stable revenues from fiscal year 2012 to fiscal year 2013, mostly due to a slower fourth quarter, the Company secured $19.2 M in new bookings for water treatment projects over fiscal year 2013, representing an 18% increase compared to the previous fiscal year. Combined to the termination of a U.S. project, the order backlog declined to $14.1 M as of June 30, 2013. The Company’s bookings over revenue ratio for projects and equipment stood at 0.78 for fiscal year 2013, compared to 0.67 for fiscal year 2012. The current pipeline is rich in opportunities which should allow the Company’s sales backlog to maintain revenue growth. We maintain strong bidding activities and management efforts are aimed at growing the Company’s sales backlog.

These efforts include new 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 this promising territory where there is a growing need for modular plants required on workers camps.

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

	2012 FY				2013 FY				2013 FY	2012 FY
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4[(1)]		
Order backlog	$31.6 M	$30.0 M	$28.1 M	$20.8 M	$20.4 M	$18.7 M	$15.4 M	**$14.1 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	**$4.3 M**	**$17.9 M**	$16.3 M
Revenues from water treatment projects	$4.3 M	$4.1 M	$6.7 M	$9.1 M	$7.1 M	$6.0 M	$5.9 M	**$3.9 M**	**$22.9 M**	$24.2 M
Bookings / Revenues Ratio	***0.2***	***1.1***	**0.9**	**0.5**	**0.9**	**0.7**	**0.4**	**1.1**	**0.78**	***0.67***
Revenues from specialty chemicals and consumables (usually recurrent in nature)	$2.8 M	$3.0 M	$3.5 M	$2.4 M	$2.9 M	$3.4 M	$4.0 M	**$2.9 M**	**$13.2 M**	$11.7 M
Total revenues	$7.1 M	$7.1 M	$10.2 M	$11.5 M	$10.0 M	$9.4 M	$9.9 M	**$6.8 M**	**$36.1 M**	$35.9 M

(1) On June 27, 2013, the Company terminated a project with a customer in the United States for breach in the contract. The contract value was deducted from the order backlog in the fourth quarter. The equipment has been recorded in the statement of financial position of the Company as finished goods.

For fiscal year 2014, we aim at increasing our footprint through the addition of new specialty chemical distributors and helping our actual distributors to increase their market shares. In June 2013, we hired a new sales regional manager for specialty chemicals whose primary responsibilities at Professional Water Technology ("PWT") include identifying new commercial opportunities and providing technical support for PWT's client base in the Southeast USA. In addition, we held our second annual international distributor summit in July 2013. During the summit, our distributors were given technical and commercial training on new chemical products.

Our revenues from specialty chemicals and consumables include sales of products related to maple syrup production. These revenues increased by more than 11% in fiscal year 2013 compared to fiscal year 2012. During the year, we have hired a director of sales in the United States who was able to expand our distribution network in that territory where there is no production quota for maple farmers, which helped to increase our revenues. We intend to pursue our growth by expanding our distribution network on the U.S. territory and other Canadian provinces.

In the system business, management is convinced that developing long-term customer relationships is key to generate recurring revenues. Initiatives such as providing first fill of chemicals, offering preventive maintenance and performance monitoring contracts which will increase the life-span of systems and membranes, reduce the general operational expenditure (OPEX) and produce water of constant quality. By providing our proprietary specialty chemicals along with the delivery of custom-designed membrane systems, we are proposing a "single point of responsibility" for the reliability and performance of the systems. This strategy shows how the system sales and downstream associated recurring revenues are intimately linked.

To strengthen system sales and increase differentiating factors, the Company has announced the introduction of two innovations. The first one is the introduction of its new FiberFlex™ MF/UF membrane module rack design. This skid is physically designed to accommodate several types of microfiltration and ultrafiltration modules. This innovation will allow the Company to enhance its offer and reinforce its leading position in the water treatment industry. Engineers and customers will greatly benefit from this added flexibility in design and operation that provides procurement leverage to the end-user. The Company also launched another innovative platform with a second generation containerized and dual train Membrane Bioreactor dedicated to wastewater effluent. This will be by far the most compact and versatile containerized wastewater treatment package on the market to offer treatment redundancy usually found only in much larger plants.

The resulting impact of the shift in revenue mix in fiscal year 2013 is reflected in gross profit margin increase. The Company's operations in fiscal year 2013 generated a fair 25.6% gross profit, compared with 23.0% in 2012. The 2013 revenue mix shows that revenues from specialty chemicals and consumables represent a higher proportion of total revenues compared to fiscal year 2012 (36.5% in 2013 vs. 32.6% in 2012).

Operating expenses

Operating expenses increased from $0.6 M to $0.7 M for the year ended June 30, 2013 compared with fiscal year 2012.This increase is due to creation of two new positions in the second half of fiscal year 2013:

1) A chemist has been hired to support development and improvement of products for our specialty chemicals. As she will develop new products, the Company will be able to enter new niche markets.

2) A director of supply chain and logistics has also been hired and his responsibilities are to improve our procurement practices, to optimize our terms & conditions with our suppliers, to maximize the use of our inventory and essentially fully integrate the notions of supply chain and logistics in the execution of our projects.

Selling expenses

Selling expenses decreased by approximately $397,000 or 10.2% for the current fiscal year compared with the previous fiscal year, while revenues remained stable. 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 a lesser volume of traveling expenses and to the fact that the second annual international distributor conference was held in July 2013 by Professional Water Technologies ("PWT") and therefore merely no expenses were incurred in fiscal year 2013 as opposed to the previous year when the event took place in April 2012.

Administrative expenses

Administrative expenses decreased by approximately $673,000 or 16.0% in fiscal year 2013 compared with fiscal year 2012. Salaries and fringe benefits have decreased following the elimination of management positions which included termination costs amounting to $175,000 as of June 30, 2012. Professional fees have decreased due to lower other audit-related services following the completion of the IFRS transition. The Company has taken an allowance for doubtful accounts of $151,000 within the consumables operations in regards to receivables from a distributor of maple syrup production products ($254,000 in fiscal year 2012).

The Company's ratio of SG&A as a whole over revenues amounted to 21.4% for fiscal year 2013, down from 24.3% for 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 the first three quarters of fiscal year 2013, while in the fourth quarter we were obligated to terminate a contract which has impacted negatively our revenues by $1.2 M.

Adjusted EBITDA

Adjusted EBITDA for fiscal year 2013 was $1,584,252 compared to $12,172, for fiscal year 2012. The adjusted EBITDA has significantly improved in fiscal year 2013 due to the decrease of SG&A expenses and the increase of revenues derived from specialty chemicals and consumables.

Other losses (gains) – net

Other losses (gains) – net amount to $38,562 for the year ended June 30, 2013 compared with ($368,279) for the year ended June 30, 2012. The decrease is mostly due to a foreign exchange loss, which is entirely due to exchange rate fluctuations related to working capital items, to the loss on disposal of property, plant and equipment following the move of our plant operations in Minneapolis, USA in May 2013 and to other revenues derived from various sources such as rental space activities for equipment not yet delivered.

Finance costs – net

Finance costs – net totalled $742,734 for the year ended June 30, 2013 compared with $908,172 for the previous fiscal year. These expenses relate mostly to the long-term debt. Of this amount, $88,399 represent the theoretical and non-monetary part of interest on long-term debt and $30,492 represent the unwinding of the discount on contingent considerations.

Gain on settlement agreement

On December 1, 2012, the Company entered into a settlement agreement and release with the seller of Wastewater Technology Inc. ("WTI"). Pursuant to this agreement, the Stock Purchase Agreement ("SPA") dated April 10, 2008, relating to the acquisition of WTI, was immediately terminated and the seller and the Company

relinquished all of their rights under the SPA. As consideration for this relinquishment, the seller 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 and loss on disposal of investment in a joint venture

Share of (earnings) loss in a joint venture totalled ($6,142) for the year ended June 30, 2013 compared with a share of (earnings) loss of $322,250 for the year ended June 30, 2012.

The Company decided to terminate its participation in a joint venture as of March 31, 2013 since the sales objectives initially established have not been met. H_2O Innovation India Limited required a lot of attention and resources while the impacts on the revenues and earnings of the Company were insignificant. The Company recorded a loss on disposal of investment in a joint venture of $42,521, following the termination of the agreement as of March 31, 2013.

Net earnings (loss)

The net earnings was $312,992 or $0.005 per share for fiscal year 2013 compared with ($8,054,860) or ($0.134 per share) for fiscal year 2012. This improvement is attributable to three main factors:

1) Management closely monitors the SG&A expenses and is diligent in finding additional savings.
2) The Company kept its level of revenues which generated an improved gross margin due to sound business mix.
3) Finally, the Company did not suffer from goodwill impairment, an impairment of intangible assets and changes in fair value of contingent considerations in fiscal year 2013 compared to fiscal year 2012.

Commitments

The Company has entered into long-term lease agreements expiring in 2014, 2017, 2022 and 2023 which call for lease payments of $4,620,418 for the rental of space. The minimum annual lease payments over the next five years are $567,605 in 2014, $539,113 in 2015, $542,066 in 2016, $554,377 in 2017 and $424,834 in 2018.

Information on share capital

As at September 24, 2013, the Company had 60,145,832 outstanding common shares, 1,862,500 stock options and 1,000,000 common share purchase warrants.

FINANCIAL SITUATION

As working capital decreased from $2.5 M as at June 30, 2012 to $2.1 M as at June 30, 2013, the Company's working capital ratio declined from 1.19 to 1.17 over the same period. This deterioration is caused partly by the reclassification of the long-term portion of a bank loan, a third-party loan and loans from shareholders amounting to $1,809,288 into the current liabilities because the Company did not respect its covenants. However, waivers have been requested and obtained after year-end. The other factors affecting negatively the working capital ratio are the termination of a project with a customer for which the equipment has been recorded as finished goods until we sold it to another customer, as well as a related increase in the usage of the Company's revolving credit facilities. During fiscal year 2013, the Company has converted to cash the high level of accounts receivable it has as of June 30, 2012.

The net debt excluding contingent considerations, which stood at $6.2 M as at June 30, 2013, remained relatively stable, increasing only by $0.1 M, compared with $6.1 M as at June 30, 2012. This increase is mainly due to the general decline in working capital, itself caused largely by the cancellation of a project with a U.S. customer.

Equity stood at $14.4 M as at June 30, 2013, compared with $13.7 M as at June 30, 2012. As at June 30, 2013 the net debt equity ratio was 0.43 whereas it was 0.45 as at June 30, 2012, showing that the Company is not over leveraged.

Year ended June 30, (in Canadian dollars, except for ratio)	**2013**	**2012**
Working capital	$2,144,985	$2,518,829
Working capital ratio	1.18	1.19
Net debt[(1)]	$6,202,865	$6,129,684
Equity	$14,426,788	$13,744,227
Net debt to equity ratio	0.43	0.45

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

As at June 30, 2013 accounts receivable stood at $6.5 M compared with $9.3 M as at June 30, 2012. The decrease of $2.8 M is attributable to lower invoicing completed during the last quarter of fiscal year 2013, as invoicing milestones were reached on a lower number of active projects since the backlog has decline and because of the termination of a project with a U.S. customer.

Inventories jumped at $4.0 M as at June 30, 2013 from $2.2 M as at June 30, 2012. The increase is largely due to the value of a system that has been accounted for as finished goods following the cancellation of a project since the U.S. customer failed to pay for the equipment. The Company still focuses on improving controls on the procurement process and better use of our in-hand or slow moving items with the hiring during the year of a director of supply chain and logistics.

Costs incurred in excess of billings remained stable at $2.2 M as at June 30, 2013 and 2012, even though it is subject to differences between project advancement and project invoicing schedules from one project to the other. Billings in excess of costs incurred increased by $0.2 M to $1.8 M as at June 30, 2013, from $1.6 M as at June 30, 2012. This increase is also attributable to differences between project advancement and project invoicing schedules.

Accounts payable and accrued liabilities decreased by $1.6 M to $4.1 M as at June 30, 2013, from $5.7 M as at June 30, 2012. This is mostly due to a decreased number of active projects entering the production phase for which important components were purchased in the second half of fiscal year 2012.

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).

CASH FLOWS

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

Year ended June 30, (in Canadian dollars)	**2013**	**2012**
	$	$
Cash flows from operating activities	1,053,500	815,699
Cash flows from investing activities	(425,514)	(1,063,618)
Cash flows from financing activities	(1,026,951)	795,701
Effect of exchange rate changes on the balance of cash held in foreign currencies	24,868	(275,285)
Net change	(374,097)	272,497
Cash and cash equivalents – Beginning of year	421,332	148,835
Cash and cash equivalents – End of year	47,235	421,332

Before the change in operating working capital, operating activities generated $1,572,750 in cash for the year ended June 30, 2013, compared with $87,659 of cash generated during the corresponding year ended June 30, 2012. Net cash generated by operating activities amounted to $1,053,500 in fiscal year 2013 compared to $815,699 of net cash generated by operating activities during the previous fiscal year. This improvement is attributable to the significant improvement in net earnings in fiscal year 2013 compared to fiscal year 2012. This significant improvement is also attributable to the following factors:

- Lower volume of activities toward year-end reflected in a decrease of the level of accounts receivable as of June 30, 2013 compared to June 30, 2012;
- This lower volume of activities has also decreased the level of accounts payable and accrued liabilities in fiscal year 2013 compared to fiscal year 2012;
- A tighter follow-up of accounts receivable balances to accelerate payments from customers;
- A timing difference within the projects production phases affecting the invoicing milestones reached and therefore affecting costs incurred in excess of billings and billings in excess of costs incurred; and
- Finally, the termination of a project with a U.S. customer for which the equipment has been recorded as finished goods has increased the inventory level in fiscal year 2013 compared to fiscal year 2012.

For fiscal year 2013, investing activities used net cash of ($425,514), mainly attributable to the acquisition of property, plant and equipment and intangible assets, the acquisition of guaranteed deposit certificate to secure the new lease for the Minneapolis plant, the payment of contingent considerations related to past acquisitions and to a lesser extent to the additional investment into our Indian joint venture before its termination in March 2013.

Financing activities used cash of ($1,026,951) in fiscal year 2013 compared with $795,701 of cash generated during the corresponding fiscal year. The funds used by financing activities were mainly allocated to the reimbursement the long-term debts for the first nine-month of fiscal year 2013 and the related interest expense. In counterpart, the Company used bank loans which resulted in a net increase amounting to $507,449.

Fourth quarter (unaudited)

	Fourth quarter ended June 30	
	2013	**2012**
	$	$
Revenues	**6,768,455**	11,561,332
Cost of goods sold	**4,956,027**	9,324,038
Gross profit	**1,812,428**	2,237,294
Gross profit	**26.8%**	19.4%
Net earnings (loss)	**(532,392)**	880,620
Basic and diluted earnings (loss) per share	**(0.008)**	0.014
Adjusted EBITDA	**(234,355)**	(467,088)

Revenues for the fourth quarter were down by 41.5 % to $6.8 M from $11.5 M for the same quarter of the previous fiscal year. The decrease is explained by the fact that a significant project was delivered at the end of fiscal year 2012 generating record-high revenues for that comparable quarter of the previous fiscal year. The 2013 fourth quarter was negatively impacted by the cancellation of a project with a U.S. customer. Revenues related to that terminated project, amounting to $700,000 were recorded in the first three quarters of fiscal year 2013 which were reversed during the quarter. In addition, no revenues were recognized on the work performed during this fourth quarter.

For the quarter ended June 30, 2013 the gross profit was impacted negatively by the decrease of $5.2 M in the volume of projects executed but this impact was minimized by the increase of $500,000 in revenues from specialty chemicals and consumables for which gross margin is higher than for revenues from water treatment projects.

The fourth quarter SG&A expenses were somewhat stable and similar to the first three quarters of fiscal year 2013. They stand at $1.9 M in this current quarter compared to $2.7 M in the fourth quarter of fiscal year 2012. Last year's fourth quarter was impacted by items that did not occur this year such as termination costs incurred for the termination costs related to the elimination of top management positions along with the re-organisation, by an allowance for doubtful accounts for a distributor of maple syrup production products within the consumables operations and by additional professional fees related to the impairment tests.

The fourth quarter net loss is caused by the lack of volume in revenues of the Company: notably due to the termination of a project in the USA for which the equipment already manufactured has been accounted for as finished goods in the statement of financial position.

Quarterly Summary Financial Information (unaudited)

	Three-month periods ended				Year ended
	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012	June 30, 2013
	$	$	$	$	$
Revenues	6,768,455	9,966,644	9,418,908	9,982,894	36,136,901
Adjusted EBITDA	(234,355)	530,026	561,888	726,693	1,584,252
Net earnings (loss)	(532,392)	86,834	488,854	269,696	312,992
EPS basic and diluted	(0.008)	0.001	0.008	0.004	0.005
Cash flows from operating activities	(107,468)	(1,073,407)	1,024,161	1,210,214	1,053,500

	Three-month periods ended				Year ended
	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011	June 30, 2012
	$	$	$	$	$
Revenues	11,561,332	10,222,312	7,056,495	7,069,768	35,909,907
Adjusted EBITDA	(467,088)	563,603	(407,961)	323,618	12,172
Net earnings (loss)	880,620	(7,651,400)	(1,214,510)	(88,216)	(8,054,860)
EPS basic and diluted	0.014	(0.127)	(0.020)	(0.001)	(0.134)
Cash flows from operating activities	1,560,416	(419,247)	(1,408,003)	1,082,533	815,699

Revenues over the first three quarters of fiscal year 2013 were relatively stable between $9.4 M and $9.9 M. The decrease of revenues to $6.8 M during the fourth quarter is explainable mainly by two factors:

1) The terminated project in the U.S.
2) The move of the manufacturing facility in Minneapolis during which the assembly team had to halt work for three weeks.

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.

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 June 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 June 30, 2013, the Company was not in compliance with the fixed charge coverage ratio which triggered the reclassification of the long-term debt portion to current liabilities. This reclassification caused the working capital ratio not to be met. The Company has requested and obtained waivers after year-end.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of consolidated financial statements in accordance with IFRS often requires management to make estimates about and apply assumptions or subjective judgment to future events or other matters that affect the reported amounts of the Company's assets, liabilities, revenues, expenses and related disclosures. Assumptions, estimates and judgments are based on historical experience, expectations, current trends and other factors that management believes to be relevant at the time at which the Company's consolidated financial statements are prepared. Management reviews, on a regular basis, the Company's accounting policies, assumptions, estimates and judgments in order to ensure that the consolidated financial statements are presented fairly in accordance with IFRS.

Critical accounting estimates and judgments are those that have a significant risk of causing material adjustment and are often applied to matters or outcomes that are inherently uncertain and subject to change.

As such, management cautions that future events often vary from forecasts and expectations and that estimates routinely require adjustment.

Management considers the following areas to be those where critical accounting policies affect the significant judgments and estimates used in the preparation of the Company's consolidated financial statements.

Revenue recognition of manufacturing contracts

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

Impairment of goodwill and other non-current assets

At the end of each reporting period, the Company assesses whether there is any indication that the goodwill and non-current assets have been impaired. If any such indication exists, the recoverable amount of the asset is determined. The recoverable amount is the higher of its fair value less costs to sell and its value in use. In the measurement of the value in use, estimates of future cash flows are discounted. The use of different assumptions could result in different fair values and therefore, in different carrying amounts for goodwill and other non-current assets. If the discount rate had increased or decreased by 1% compared to the assumption taken by the Company, assuming other variables remain constant the recoverable amount would have been greater or lesser by

approximately $1,100,000 and no impairment would have been recorded. If the growth rate had increased or decreased by 1% compared to the assumption taken by the Company, assuming other variables remain constant the recoverable amount would have been greater or lesser by approximately $500,000 and no impairment would have been recorded.

Income taxes and valuation allowances

The estimation of income taxes includes evaluation the recoverability of deferred tax assets based on an assessment of the Company's entities' ability to utilize the underlying future tax deductions against future taxable income prior to expiry of the deductions. Management assesses whether it is probable that some or all of the deferred income tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income. To the extent that management's assessment of any Company's entities ability to utilize future tax deductions changes, the Company would be required to recognize more or fewer deferred tax assets, and future income tax provisions or recoveries could be affected.

Slow moving and obsolete inventory

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

Contingent considerations

The fair value recognized for contingent considerations was estimated by management based on the acquired entities results, budgets and forecasts.

Stock-based compensation and other stock-based payments

As regards to stock option granted, the Company uses the fair value based method of accounting. The fair value of stock options is determined using Black-Scholes pricing model, which required the use of certain assumptions, including future stock price volatility and expected life of instruments. The expected life is estimated using the contractual life of the instrument. The expected volatility is estimated using the historical volatility of the Company's stock over the same period as the contractual life. At the end of each reporting period, the Company revises its estimate of the number of equity instruments expected to vest.

Warrants

The Company uses the fair value method to measure the value of warrants at the grant date. Fair value is determined using the Black-Scholes option pricing model as described above.

CHANGES IN ACCOUNTING POLICIES

The Company has adopted the following revised standards along with any consequential amendments, effective July 1, 2012. These changes were made in accordance with the applicable transitional provisions.

IAS 1, Presentation of Financial Statements: Other Comprehensive Income
IAS 1, Presentation of Financial Statements, was amended to require entities to separate items presented in other comprehensive income in two groups, based on whether or not items may be recycled in the future to net earnings. The Company has adopted the amendments to IAS 1 effective July 1, 2012, which had no significant impacts on the Company's financial statements.)

ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET ADOPTED

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.

(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 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.

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.

OFF-BALANCE SHEET ARRANGEMENTS

As at June 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. From the remaining balance, an amount of $0.2 M is guaranteed by *Export Development Canada*.

FINANCIAL RISK MANAGEMENT AND FINANCIAL RISKS

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

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

Overview

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

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

Currency risk

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

As at June 30, 2013, if the Canadian dollar had increased or decreased by five percent (5%) compared to the U.S. dollar, assuming that all other variables remained constant, net earnings for the year ended June 30, 2013 would have been greater or lesser by approximately $72,722 ($91,393 as at June 30, 2012).

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

	June 30, 2013	June 30, 2012
	$	$
FINANCIAL ASSETS		
Cash	**736**	713
Guaranteed deposit certificates	**16,286**	15,469
Accounts receivable	**900,962**	889,441
	917,984	905,623
FINANCIAL LIABILITIES		
Bank overdraft	**(42,150)**	(137,931)
Bank loans	**(1,895,843)**	(1,628,394)
Accounts payable	**(289,428)**	(644,759)
Long-term debt	**(145,002)**	(322,390)
	(2,372,423)	(2,733,474)

Cash flow and fair value interest rate risk

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

The guaranteed deposit certificates and unsecured bear interest at fixed rates and the Company is, therefore, not exposed to the risk of changes in fair value resulting from interest rate fluctuations.

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

As at June 30, 2013 and 2012, a 25-basis-point increase or decrease in interest rates, assuming that all other variables remain constant, would not have had a significant impact on the Company's net earnings and comprehensive income. These changes were retained because they are considered reasonably possible according to observations and the economic situation.

Credit risk

Credit risk relates to the risk that a party to a financial instrument will not fulfil some or all of its obligations, thereby causing the Company to sustain a financial loss. The main risk relates to accounts receivable. To manage credit risk from accounts receivable, the Company reviews credit limits, monitors aging of accounts receivables and establishes an allowance for doubtful accounts based on specific customer information and general historical trends. Trade receivables consist of a large number of customers, spread across diverse industries and geographical areas. Ongoing credit evaluation is performed on the financial condition of accounts receivable. As at June 30, 2013, the allowance for doubtful accounts was $406,890 ($258,230 as at June 30, 2012).

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

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

	June 30, 2013	June 30, 2012
	$	
Cash and cash equivalents	**303,936**	576,542
Guaranteed deposits certificates	**1,253,786**	1,147,703
Accounts receivable, net of tax credits receivable	**6,404,140**	9,142,340

The Company is also exposed to credit risk due to its cash, its deposit certificate and its investment certificates. The Company has $1,557,722 ($1,724,245 in 2012) in cash and guaranteed deposits certificates with banking institutions that the Company considers at a low risk for loss.

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

	June 30, 2013	June 30, 2012
	$	$
Current	**3,748,719**	4,954,768
Past due 1 to 30 days	**483,113**	1,614,838
Past due 31 to 90 days	**165,551**	358,455
Past due more than 90 days	**1,236,838**	1,200,232
	5,634,221	8,128,293
Less: Allowance for doubtful accounts	**(406,890)**	(258,230)
Trade accounts receivable	**5,227,331**	7,870,063
Provision for back charges	**(3,155)**	-
Retentions from customers under manufacturing contracts	**953,731**	983,900
Tax credits receivable	**84,416**	180,040
Other receivables	**206,233**	288,377
	6,468,556	9,322,380

Liquidity risk

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

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

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

As at June 30, 2013	Carrying amount	0 - 1 year	1 - 2 years	2 - 3 years	4 years and more
	$	$	$	$	$
Bank overdraft	256,701	256,701	-	-	-
Bank loans	3,375,843	3,375,843	-	-	-
Accounts payable	4,080,339	4,080,339	-	-	-
Long-term debt	3,392,707	1,294,641	1,346,519	557,716	193,831
Total	11,105,590	9,007,524	1,346,519	557,716	193,831

As at June 30, 2012	Carrying amount	0 - 1 year	1 - 2 years	2 - 3 years	4 years and more
	$	$	$	$	$
Bank overdraft	155,210	155,210	-	-	-
Bank loans	2,868,394	2,868,394	-	-	-
Accounts payable	5,742,007	5,742,007	-	-	-
Contingent consideration	946,528	24,546	108,111	135,881	677,990
Long-term debt	4,728,920	1,567,070	1,324,653	1,212,153	625,044
Total	14,441,059	10,357,227	1,432,764	1,348,034	1,303,034

Fair value

The fair value hierarchy has the following levels:

Level 1 – Quoted prices in active markets for identical assets or liabilities.
Level 2 – Inputs other than quoted prices included in Level 1, that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
Level 3 – Unobservable inputs such as inputs for the asset or liability that are not based on observable market data.

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

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

Financial instruments whose fair value approximates carrying value

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

Long-term debt

The fair value of the long-term debt has been established by discounting the future cash flows at an interest rate to which the Company would currently be able to obtain for loans with similar maturity dates and terms. The fair value of the long-term debt is $2,873,257 ($3,682,622 as at June 30, 2012).

Contingent consideration

The fair value recognized for contingent considerations has been estimated by management based on the Wastewater Technology Inc. results, budgets and forecasts. The fair value of the contingent considerations is nil ($460,555 as at June 30, 2012).

RISK FACTORS AND UNCERTAINTIES

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

Competitive environment

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

Operating risks

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

Fixed Price Contracts

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

Capacity to secure performance guarantees

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

Management and employees

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

Capital investment

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

Liquidity Risk

Liquidity risk is the risk that the Company will be unable to fulfill its obligations on a timely basis or at reasonable cost. The Company manages its liquidity risk by monitoring its operating requirements and using various funding sources to ensure its financial flexibility. The Company prepares budgets and cash forecast to ensure that it has sufficient funds to fulfill its obligations. For its operating activities, the Company is always trying to negotiate positive cash flow payment terms with its customers in order to minimize its use of credit for its works in progress. The Company has also contracted long-term debts and credit margin which will provide sufficient liquidity. For its investing activities, the Company will evaluate its liquidity needs when applicable and take the necessary action.

Current Global Financial Conditions

The Company offers products and services that are primarily designed for the non-residential construction market. Non-residential construction includes municipal, industrial, commercial and institutional sectors. Activity in the non-residential construction market is closely tied to overall changes in the economy. Economic growth and cycles have a direct impact on the level of construction that takes place on an annual basis. The economic recovery, which follows one of the worst economic and financial crises, still remains fragile. The Company believes that the water industry has a long-term sustained growth curve. During the financial year ended June 30, 2013, investments in water treatment projects have considerably increased; but on a short term basis such growth may be uneven due to the current instability of the global markets.

In addition, the current challenging global financial conditions have been characterized by increased volatility. The difficulties met by financial institutions have contributed to a reduction in liquidity among all financial institutions and

have reduced the availability of credit to those institutions and to the issuers who borrow from them. These factors may impact the ability of the Company to obtain equity or debt financing on terms favorable to the Company. As such, continued increased levels of volatility and market turmoil may impact the Company's operations and adversely affect the price of the common shares of the Company.

Implementation of a strategic plan

The commercial strategy of the Company aims at leveraging its hybrid offering of projects and consumables, focusing on the development of niche sectors and concluding acquisitions or alliances with players in strategic geographical regions, strong complimentary product lines or business models. The strategic plan of the Company should be considered under risks perspective, expenses and difficulties frequently encountered by a developing business. The successful viability of the Company's growth strategy may require capital investments larger than those previously expected and nothing warrants that the Company will achieve the desired growth level.

Product Liability and Other Lawsuits

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

Additional financing and dilution

The Company does not exclude raising additional funds by equity financing. In addition, 1,862,500 stock options and 1,000,000 common share purchase warrants are currently issued and outstanding.

The exercise of warrants and stock options, as well as any new equity financings, represent dilution factors for present and future shareholders.

Market Liquidity

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

Shortage of Raw Materials

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

Development of New Products

From time to time, the Company develops new products of a specialized nature that have inherent risks, namely that either the product does not perform as desired or unacceptable reliability issues render the new product un-merchantable; or supplier risk that required components procured from third party vendors do not perform in an acceptable manner, thereby having an adverse impact on marketability of such new products and on the Company's product liability.

Acquisition and Expansion Risk

The Company may expand its operations, depending on certain conditions, by acquiring additional businesses, products or technologies. There can be no assurance that the Company will be able to identify, acquire or profitably manage additional businesses, or successfully integrate any acquired business, products, or technologies into the business without substantial expenses, delays or other operational or financial difficulties. There can be no assurance that acquired businesses, products or technologies, if any, will achieve anticipated revenues and income.

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

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

Technology and regulatory changes

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

The Company is also subject to risks associated with the introduction of new products and applications, especially the non-acceptance on the markets, a delay in the development or a malfunction of the products.

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 ("VP, 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 VP, 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 VP, Finance, of the effectiveness of our disclosure controls and procedures. Based on this evaluation, the CEO and the VP, Finance concluded that the disclosure controls and procedures are effective.

Internal controls over financial reporting

The CEO and the VP, 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.

An evaluation was carried out, under the supervision of the CEO and the VP, Finance, of the design and effectiveness of our internal controls over financial reporting. Based on this evaluation, the CEO and the VP, Finance concluded that the internal controls over financial reporting are effective, using the criteria set forth by the

Committee of Sponsoring Organizations of the Treadway Commission (COSO) on Internal Control – Integrated Framework.

Changes in internal controls over financial reporting

During the year, 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.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

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

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

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

H_2O Innovation's CEO and VP, Finance have also evaluated the effectiveness of H_2O Innovation's disclosure controls and procedures as of the end of fiscal year 2013. Based on this evaluation, the CEO and the VP, Finance concluded that the disclosure controls and procedures were effective as of that date, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) on Internal Control – Integrated Framework. In addition, based on this assessment, they determined that there were no material weaknesses in internal control over financial reporting as of fiscal year 2013. In compliance with NI 52-109, H_2O Innovation's CEO and VP, Finance have provided a certification related to H_2O Innovation's annual disclosure to the Canadian Securities Administrators, including the Consolidated Financial Statements and MD&A.

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

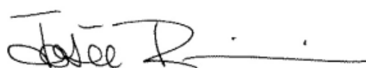
The Audit Committee is appointed by the Board of Directors and is comprised entirely of independent and financially literate directors. The Audit Committee meets periodically with Management, as well as with the internal and external auditors, to review the Consolidated Financial Statements, external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

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

The President and Chief Executive Officer

Frédéric Dugré

The Vice President, Finance



Josée Riverin, CPA, CA

September 24, 2013

CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013 and 2012

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.

Deloitte.

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Independent auditor's report

To the Shareholders of
H_2O Innovation Inc.

We have audited the accompanying consolidated financial statements of H_2O Innovation Inc., which comprise the consolidated statements of financial position as at June 30, 2013 and June 30, 2012, and the consolidated statements of loss, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

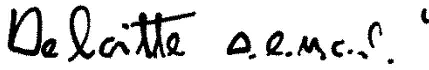
We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of H_2O Innovation Inc. as at June 30, 2013 and June 30, 2012, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Other Matter

The consolidated financial statements of H_2O Innovation Inc. for the year ended June 30, 2012, were audited by another auditor who expressed an unmodified opinion on those consolidated financial statements on September 25, 2012.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[1] CPA auditeur, CA, permis de comptabilité publique n° 107622

September 25, 2013

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(in Canadian dollars)

	June 30, 2013	June 30, 2012
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	**303,936**	576,542
Guaranteed deposits certificates (note 6)	**1,253,786**	1,147,703
Accounts receivable (note 7)	**6,468,556**	9,322,380
Inventories (note 8)	**4,016,558**	2,250,789
Costs incurred in excess of billings (note 9)	**2,203,326**	2,154,311
Prepaid expenses	**225,493**	132,480
	14,471,655	15,584,205
Non-current assets		
Property, plant and equipment (note 10)	**1,878,759**	2,026,695
Intangible assets (note 11)	**4,942,884**	5,459,185
Investment in a joint venture (note 12)	**-**	11,722
Other assets	**37,851**	43,122
Goodwill (note 13)	**2,465,311**	2,386,322
Deferred income tax assets (note 19)	**3,124,064**	2,958,149
	26,920,524	28,469,400
LIABILITIES		
Current liabilities		
Bank overdraft	**256,701**	155,210
Bank loans (note 14)	**3,375,843**	2,868,394
Accounts payable and accrued liabilities (note 15)	**4,080,339**	5,742,007
Provisions (note 16)	**41,637**	40,543
Billings in excess of costs incurred (note 9)	**1,758,432**	1,634,724
Income taxes payable (note 19)	**2,306**	4,378
Deferred rent (note 26)	**3,151**	18,188
Current portion of long-term debt (note 18)	**2,808,261**	2,580,862
Contingent considerations (note 17)	**-**	21,070
	12,326,670	13,065,376
Non-current liabilities		
Long-term debt (note 18)	**64,996**	1,101,760
Contingent considerations (note 17)	**-**	460,555
Deferred rent (note 26)	**102,070**	97,482
	12,493,736	14,725,173
SHAREHOLDERS' EQUITY		
Share Capital (note 20)	**45,852,436**	45,852,436
Reserve - Stock options (note 20)	**1,861,040**	1,821,421
Reserve – Warrants (note 20)	**141,787**	370,076
Deficit	**(32,285,493)**	(32,826,774)
Accumulated other comprehensive loss	**(1,142,982)**	(1,472,932)
	14,426,788	13,744,227
	26,920,524	28,469,400

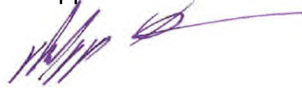
These accompanying notes are an integral part of the consolidated financial statements.

On behalf of the Board,

Frédéric Dugré

President and Chief Executive Officer

Philippe Gervais



Chairman of the Board of Directors

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(in Canadian dollars)

	Common shares Number	Share Capital (note 20)	Reserves		Deficit	Accumulated other comprehensive loss – Translation adjustment	Total
			Stock options (note 20)	Warrants (note 20)			
		$	$	$	$	$	$
Balance as at July 1, 2011	60,145,823	45,852,436	1,734,952	10,143,677	(33,221,162)	(2,036,410)	22,473,493
Stock-based compensation costs	-	-	86,469	-	-	-	86,469
Warrant issue expenses related to financing	-	-	-	(1,165)	-	-	(1,165)
Reversal to deficit of expired warrants, net of current income taxes (note 20)	-	-	-	(9,772,436)	8,449,248	-	(1,323,188)
Net loss for the year	-	-	-	-	(8,054,860)	-	(8,054,860)
Other comprehensive income	-	-	-	-	-	563,478	563,478
Balance as at June 30, 2012	**60,145,823**	**45,852,436**	**1,821,421**	**370,076**	**(32,826,774)**	**(1,472,932)**	**13,744,227**
Balance as at July 1, 2012	60,145,823	45,852,436	1,821,421	370,076	(32,826,774)	(1,472,932)	13,744,227
Stock-based compensation costs	-	-	39,619	-	-	-	39,619
Reversal to deficit of expired warrants, net of current income taxes (note 20)	-	-	-	(228,289)	228,289	-	-
Net earnings for the year	-	-	-	-	312,992	-	312,992
Other comprehensive income	-	-	-	-	-	329,950	329,950
Balance as at June 30, 2013	**60,145,823**	**45,852,436**	**1,861,040**	**141,787**	**(32,285,493)**	**(1,142,982)**	**14,426,788**

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

CONSOLIDATED STATEMENT OF INCOME (LOSS)
(in Canadian dollars)

Years ended June 30,	**2013**	2012
	$	$
Revenues (note 27)	**36,136,901**	35,909,907
Cost of goods sold (note 21a))	**26,885,364**	27,634,549
Gross profit	**9,251,537**	8,275,358
Operating expenses (note 21a))	**696,079**	642,880
Selling expenses (note 21a))	**3,509,081**	3,906,263
Administrative expenses (note 21a))	**3,533,042**	4,206,086
Depreciation of property, plant and equipment (note 21b))	**279,866**	306,272
Amortization of intangible assets (note 21b))	**720,701**	614,308
Changes in fair value of contingent considerations (note 17)	**-**	(280,142)
Impairment of intangible assets (note 11)	**-**	378,728
Impairment of goodwill (note 13)	**-**	8,221,423
Other losses / (gains) – net (note 21c))	**38,562**	(368,279)
	8,777,331	17,627,539
Operating earnings (loss)	**474,206**	(9,352,181)
Finance income	**(16,077)**	(24,049)
Finance costs	**758,811**	932,221
Finance costs – net	**742,734**	908,172
Gain on settlement agreement (note 17)	**(404,189)**	-
Loss on disposal of investment in a joint venture (note 12)	**42,521**	-
Royalties income from a joint venture	**(46,375)**	(20,585)
Share of (earnings) loss in a joint venture (note 12)	**(6,142)**	322,250
	328,549	1,230,144
Earnings (loss) before income taxes	**145,657**	(10,562,018)
Current income tax expense (benefit) (note 19)	**2,306**	4,374
Deferred tax benefit (note 19)	**(169,641)**	(2,511,532)
	(167,335)	(2,507,158)
Net earnings (loss) for the year attributable to shareholders	**312,992**	(8,054,860)
Net earnings (loss) per share attributable to shareholders of the company during the year		
Basic and diluted net earnings (loss) per share	**0.005**	(0.134)
Weighted average number of shares outstanding (note 22)	**60,145,823**	60,145,823

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(in Canadian dollars)

Years ended June 30,	**2013**	2012
	$	$
Net earnings (loss) for the year	**312,992**	(8,054,860)
Other comprehensive income (loss) – Items that may be reclassified subsequently to net earnings		
Currency translation adjustments	**329,950**	563,478
Comprehensive income (loss) for the year attributable to shareholders	**642,942**	(7,491,382)

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

CONSOLIDATED STATEMENT OF CASH FLOWS
(in Canadian dollars)

Years ended June 30,	**2013**	2012
	$	$
Cash flows from operating activities		
Earnings (loss) before income taxes for the year	**145,657**	(10,562,018)
Non-cash items		
Finance costs – net	**742,734**	908,172
Depreciation of property, plant and equipment	**279,866**	306,272
Amortization of intangible assets	**720,701**	614,308
Loss on disposal of property, plant and equipment	**23,485**	16,710
Changes in fair value of contingent considerations	**-**	(280,142)
Gain on settlement agreement	**(404,189)**	-
Impairment of intangible assets	**-**	378,728
Deferred rent	**(11,502)**	75,487
Impairment of goodwill	**-**	8,221,423
Stock-based compensation	**39,619**	86,469
Loss on disposal of investment in a joint venture	**42,521**	-
Share of (earnings) loss of joint venture	**(6,142)**	322,250
	1,572,750	87,659
Change in working capital items (note 23a))	**(530,956)**	716,327
Cash generated by operations	**1,041,794**	803,986
Interests received	**15,986**	24,049
Income taxes paid	**(4,280)**	(12,336)
Net cash generated by operating activities	**1,053,500**	815,699
Cash flows from investing activities		
Disposal of guaranteed deposits certificates	**689**	551,718
Acquisition of guaranteed deposits certificates	**(104,301)**	(286,458)
Proceeds on disposal of property, plant and equipment	**13,255**	-
Acquisition of property, plant and equipment	**(159,355)**	(259,046)
Investment in a joint venture	**(25,453)**	(261,631)
Variation of other assets	**6,316**	-
Acquisition of intangible assets	**(60,654)**	(14,807)
Contingent considerations paid	**(96,011)**	(793,394)
Net cash used in investing activities	**(425,514)**	(1,063,618)
Cash flows from financing activities		
Variation of bank loans	**507,449**	1,514,770
Long-term debt reimbursement	**(910,119)**	(14,086)
Interest paid	**(624,281)**	(703,818)
Warrant issue expenses	**-**	(1,165)
Net cash (used in) generated by financing activities	**(1,026,951)**	795,701
Net change in cash and cash equivalents	**(398,965)**	547,782
Effect of exchange rate changes on the balance of cash held in foreign currencies	**24,868**	(275,285)
Increase (Decrease) in cash and cash equivalents	**(374,097)**	272,497
Cash and cash equivalents - Beginning of year (note 23b))	**421,332**	148,835
Cash and cash equivalents - End of year (note 23b))	**47,235**	421,332

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

1. Governing Statutes and Nature of Operations

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.

On September 24th, 2013, the Board reviewed the consolidated financial statements and authorized its publication.

2. Changes in Accounting Policies

The Company has adopted the following revised standards along with any consequential amendments, effective July 1, 2012. These changes were made in accordance with the applicable transitional provisions.

IAS 1, Presentation of Financial Statements: Other Comprehensive Income
IAS 1, Presentation of Financial Statements, was amended to require entities to separate items presented in other comprehensive income in two groups, based on whether or not items may be recycled in the future to net earnings. The Company has adopted the amendments to IAS 1 effective July 1, 2012, which had no significant impacts on the Company’s financial statements.

3. Basis of Preparation and Summary of Significant Accounting Policies

Statement of Compliance

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

Presentation currency

The Company’s reporting currency is the Canadian dollar. The functional currency of the Canadian corporation is the Canadian dollar. The functional currency of the foreign subsidiaries located in the United States of America is the US dollar. The functional currency of the joint venture was the Indian rupee until the termination of the agreement.

Principles of consolidation

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries H_2O Innovation USA Inc., H_2O Innovation USA Holding Inc. and Professional Water Technologies, LLP.

Interest in a joint venture
A joint venture is a contractual arrangement whereby the Company and other parties undertake an economic activity that is subject to joint control (i.e. when the strategic financial and operating policy decisions relating to the activities of the joint venture require the unanimous consent of the parties sharing control).

Joint venture arrangements that involve the establishment of a separate entity in which each venturer has an interest are referred to as jointly controlled entities. Under the equity method, investments in joint ventures are carried in the consolidated statement of financial position at cost as adjusted for post-acquisition changes in the Company’s share of the net assets of the joint venture, less any impairment in the value of individual investments. Losses of a joint venture in excess of the Company’s interest in that joint venture (which includes any long-term interests that, in substance, form part of the Company’s net investment in the joint venture) are recognised only to the extent that the Company has incurred legal or constructive obligations or made payments on behalf of the joint venture.

When the Company transacts with the joint venture, profits and losses are eliminated to the extent of the Company’s interest in the joint venture.

Subsidiaries
Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are deconsolidated from the date that control ceases.

Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the group.

Business combinations
Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Company, liabilities incurred by the Company to the former owners of the acquiree and the equity interests issued by the Company in exchange for control of the acquiree. Acquisition-related costs are generally recognised in the statement of income (loss) as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognized at their fair value at the acquisition date, except that:

- deferred tax assets or liabilities and liabilities or assets related to employee benefit arrangements are recognized and measured in accordance with *IAS 12 Income Taxes* and *IAS 19 Employee Benefits* respectively;
- assets (or disposal groups) that are classified as held for sale in accordance *with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations* are measured in accordance with that Standard.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognized immediately in the statement of income (loss) as a bargain purchase gain.

Non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at fair value or at the non-controlling interests' proportionate share of the recognized amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis.

When the consideration transferred by the Company in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination.

Changes in the fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the ‘measurement period’ (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date.

The subsequent accounting for changes in the fair value of the contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is remeasured at subsequent reporting dates in accordance with *IAS 39, or IAS 37 Provisions, Contingent Liabilities and Contingent Assets*, as appropriate, with the corresponding gain or loss being recognised in the statement of income (loss).

When a business combination is achieved in stages, the Company's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date (i.e. the date when the Company obtains control) and the resulting gain or loss, if any, is recognized in the statement of income (loss). Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognized in other comprehensive income

are reclassified to the statement of income (loss) where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Company reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see above), or additional assets or liabilities are recognized, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognized at that date.

Foreign currency translation

Monetary assets and liabilities of the Canadian corporation denominated in foreign currencies are translated at the exchange rate in effect at the statement of financial position date, whereas other assets and liabilities are translated at the exchange rate in effect at the transaction date. Revenues and expenses are translated at the average exchange rate in effect during the year, with the exception of revenues and expenses relating to non-monetary assets and liabilities, which are translated at historical rate. Exchange gains and losses are reflected in the statement of income (loss).

The assets and liabilities of the foreign subsidiaries and the joint venture are translated into Canadian dollar using exchange rates prevailing at the end of the reporting period. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during that period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are recognized in other comprehensive loss and accumulated in equity under the heading of currency translation adjustment.

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and are translated at the closing rate.

Financial assets and liabilities

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

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

On initial recognition, all financial assets and liabilities are measured and recognized at their fair value and their subsequent measurement depends on their classification as described below:

Classification

Cash and cash equivalents	Loans and receivables
Guaranteed deposit certificates	Loans and receivables
Accounts receivable	Loans and receivables
Bank overdraft	Other financial liabilities
Bank loans	Other financial liabilities
Accounts payable and accrued liabilities	Other financial liabilities
Long-term debt	Other financial liabilities
Contingent considerations	At fair value

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

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

Cash and cash equivalents

Cash includes cash and demand deposits. Cash equivalents include very liquid investments convertible into a known cash amount and maturing within less than three months from the date of acquisition. The Company considers bank overdraft in its cash and cash equivalents.

Inventories

Inventories are valued at the lower of cost and net realizable value. Cost is determined using the first in first out method for raw materials and finished goods. Also, the Company is using the absorption costing method for finished goods. The absorption costing method used by the Company includes direct materials, labour and manufacturing overhead expenses.

Property, plant and equipment

All property, plant and equipment is shown at cost less depreciation and impairment. Cost includes expenditures that are attributable to the acquisition of the items. Depreciation on assets is calculated using the straight-line method to allocate the cost of each asset less its residual value over its estimated useful economic life. For the buildings, component depreciation accounting is also used for components that have different useful economic life, as follows:

Buildings	25-40 years
Machinery and equipment	10 years
Computer equipment	5 years
Furniture, fixtures and office equipment	10 years
Automotive equipment	5 years
Containerized unit for lease	4 years
Leasehold improvements	Remaining term of the lease between two and ten years

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

The estimated useful lives, residual values and depreciation method are reviewed at each year end, with the effect of any changes in estimate accounted for on a prospective basis.

The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the statement of income (loss).

Intangible assets

Intangible assets acquired are recorded at cost less subsequent amortization and impairment. They are amortized over their estimated useful lives. The amortization expense is included in the statement of income (loss) as “Amortization of intangible assets”.

The Company is using the following amortization methods:

Intangible assets acquired separately
- Software is amortized using the straight-line method over a period of seven (7) years.

Intangible assets acquired in business combinations

- Rights on technologies and technologies are amortized using the straight-line method over periods of seven (7) and fifteen (15) years.
- Patents, trademarks and intellectual property are amortized using the straight-line method over periods of fifteen (15), eighteen (18) and twenty (20) years.
- Customer relations are amortized using the straight-line method over periods of five (5) and fifteen (15) years.
- Distribution network is amortized using the straight-line method over a period of five (5) years.

Goodwill

Goodwill arising in a business combination is recognised as an asset at the date that control is acquired (the acquisition date). Goodwill is measured as the excess of the sum of consideration transferred, the amount of any non-controlling interest in the acquiree, and the fair value of the acquirer's previously held interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

If, the Company's interest in the fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held equity in the acquire (if any), the excess is recognised immediately in the statement of income (loss) as a bargain purchase gain.

Goodwill is not amortised but it is reviewed for impairment at least annually. For the purpose of impairment testing, goodwill is allocated to each of the Company's cash-generating units or a group of cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than its carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

The Company has elected to perform its annual impairment test of goodwill during the third quarter of each year.

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the gain or loss on disposal.

Other assets

Other assets are mainly composed of security deposits and are recorded at cost.

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

At the end of each reporting period, the Company reviews the carrying amounts of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation can be identified.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in the statement of income (loss).

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in the statement of income (loss).

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, rebates and other similar allowances.

Sales of consumables
Revenue from the sale of consumables and consignment inventory is recognised when the following conditions are satisfied:

- The Company has transferred to the buyer the significant risks and rewards of ownership of the goods;
- The Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- The amount of revenue can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to the entity; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

Manufacturing contracts
Manufacturing contracts are within the scope of *IAS 11 – Construction contracts*. Where the outcome of a manufacturing contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the end of the reporting period, measured based on the percentage-of-completion of the contract such as but not limited to approval of drawings, acceptance of piping and instrumentation diagrams, assembly, inspection, start-up and acceptance of the equipment which represent proportion of contract costs incurred for work performed to date relative to the estimated total contract costs. Variations in contract work and claims are included to the extent that the amount can be measured reliably and its receipt is considered probable.

Where outcome of a manufacturing contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred if it is probable that it will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred. When it is probable that the total contract costs will exceed the total contract revenue, the expected loss is recognised as an expense immediately.

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

Share Capital

Common shares are classified as equity. Incremental costs that are directly attributable to the issue of common shares and stock options are recognized as a deduction from equity, net of any tax effects.

Share-Based Payment

The Company offers a stock option plan to directors, executive officers, key employees and consultants providing services to the Company and accounts for these awards in accordance with IFRS 2 – Share-based Payment. Stock options granted to directors, executive officers, key employees and consultants providing services are measured at fair value (excluding the effect of non-market-based vesting conditions) at the date of grant. Details regarding determination the fair value of equity-settled share-based transactions are set out in note 20.

The fair value at the grant date of stock options is determined using the Black-Scholes pricing model and is recognized in the consolidated statement of income (loss) as a compensation expense using a graded vesting schedule over the vesting period, based on the Company's estimate of the number of shares that will eventually

vest. At the end of each reporting period, the Company revises its estimate of the number of equity instruments expected to vest. The impact of the revision of original estimates, if any, is recognized in the statement of income (loss) such that the cumulative compensation expense reflects the revised estimate, with a corresponding adjustment to the Reserve – stock option.

Any consideration received by the Company upon the exercise of stock options is credited to share capital, and the Reserve – stock option component resulting from share-based payment is transferred to share capital upon the issuance of the shares.

Warrants

The Company uses the fair value method to measure the value of warrants at the grant date. Fair value is determined using the Black-Scholes option pricing model and is recorded in the Reserve – Warrants in shareholders' equity. When warrants are exercised, the corresponding Reserve - Warrants and the proceeds received by the Company are credited to share capital.

Research and Development Expenses and Tax Credits for a Company Established under the Carrefour de la Nouvelle Economie ("CNE") relating to Research and Development

Research costs are expensed as incurred. However, development costs are deferred when they meet generally accepted criteria for deferral to the extent that their recovery is reasonably assured.

Tax credits to a company established under the CNE relating to research and development are accounted for during the year in which the costs are incurred, provided that the Company is reasonably certain that the credits will be received. These tax credits are presented against the research and development costs.

These tax credits must be examined by the tax authorities and it is possible that the amounts granted will differ from the amounts recorded.

The Company is entitled to scientific research and experimental development ("SR&ED") tax credits granted by the Canadian federal government ("Federal") and the government of the Province of Quebec ("Provincial"). Federal SR&ED tax credits are earned on qualified Canadian SR&ED expenditures at a rate of 20% and can only be used to offset Federal income taxes otherwise payable. Refundable Provincial SR&ED tax credits are generally earned on qualified salaries, subcontracting and university contract expenses incurred in the Province of Quebec, at a rate of 37.5% of eligible base amounts.

Tax credits and grants are accounted for using the cost reduction method. Accordingly, tax credits and grants are recorded as a reduction of the related expenses or capital expenditures in the period the expenses are incurred, provided that the Company has reasonable assurance the credits or grants will be realized.

Taxation

Income tax expense represents the sum of the current and deferred tax. Tax is recognized in the statement of income (loss), except to the extent it relates to items recognized directly in equity, in which case the related tax is recognized in equity.

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

Deferred tax
Deferred tax is accounted for using a temporary difference approach and is the tax expected to be payable or recoverable on temporary differences between the carrying amount of assets and liabilities in the statement of financial position and the corresponding tax bases on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates and laws enacted or substantively enacted at the statement of financial position date.

Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax liabilities are recognized for taxable temporary differences arising on investments in subsidiaries and joint ventures except where the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future.

Deferred tax assets are recognized to the extent it is probable that taxable profits will be available against which the deductible temporary differences can be utilized. The carrying amount of deferred tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities are not recognized on temporary differences that arise from goodwill which is not deductible for tax purposes. Deferred tax assets and liabilities are not recognized in respect of temporary differences that arise on initial recognition of assets and liabilities acquired other than in a business combination.

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

Segment Reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the chief executive officer who makes strategic decisions.

Segment revenue represents sales by each segment. This is the measure reported to the chief operating decision maker for the purpose of resource allocation and assessment of segment performance

Net earnings (loss) per share

Basic net earnings (loss) per common share are computed by dividing the net earnings available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings per share are calculated giving effect to the potential dilution that could occur if the stock options and warrants to issue common shares were exercised or converted into common shares at the later of the beginning of the year or the issuance date. The treasury stock method is used to determine the dilutive effect of stock options and warrants.

Provisions

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

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Warranties

Provisions for the expected cost of warranty obligations are recognised at the date of the sale of relevant products, at the management's best estimate of the expenditure required to settle the Company's obligation.

The provision for warranty claims represents the present value of the management's best estimate of the future outflow of economic benefits that will be required under the Company's obligations for warranties. The estimate has been made on the basis of historical warranty trends and may vary as a result of new materials, altered manufacturing processes or other events affecting product quality.

The Company offers warranties that are of variable lengths of time depending on each customer agreements.

4. Critical accounting estimates, assumptions and judgements

The preparation of consolidated financial statements in accordance with IFRS often requires management to make estimates about and apply assumptions or subjective judgment to future events or other matters that affect the reported amounts of the Company's assets, liabilities, revenues, expenses and related disclosures. Assumptions, estimates and judgments are based on historical experience, expectations, current trends and other factors that management believes to be relevant at the time at which the Company's consolidated financial statements are prepared. Management reviews, on a regular basis, the Company's accounting policies, assumptions, estimates and judgments in order to ensure that the consolidated financial statements are presented fairly in accordance with IFRS.

Critical accounting estimates and judgments are those that have a significant risk of causing material adjustment and are often applied to matters or outcomes that are inherently uncertain and subject to change.

As such, management cautions that future events often vary from forecasts and expectations and that estimates routinely require adjustment.

Management considers the following areas to be those where critical accounting policies affect the significant judgments and estimates used in the preparation of the Company's consolidated financial statements.

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

Impairment of goodwill and other non-current assets
At the end of each reporting period, the Company assesses whether there is any indication that the goodwill and non-current assets have been impaired. If any such indication exists, the recoverable amount of the asset is determined. The recoverable amount is the higher of its fair value less costs to sell and its value in use. In the measurement of the value in use, estimates of future cash flows are discounted. The use of different assumptions could result in different fair values and therefore, in different carrying amounts for goodwill and other non-current assets. If the discount rate had increased or decreased by 1% compared to the assumption taken by the Company, assuming other variables remain constant the recoverable amount would have been greater or lesser by approximately $1,100,000 and no impairment would have been recorded. If the growth rate had increased or decreased by 1% compared to the assumption taken by the Company, assuming other variables remain constant the recoverable amount would have been greater or lesser by approximately $500,000 and no impairment would have been recorded.

Income taxes and valuation allowances
The estimation of income taxes includes evaluation the recoverability of deferred tax assets based on an assessment of the Company's entities' ability to utilize the underlying future tax deductions against future taxable income prior to expiry of the deductions. Management assesses whether it is probable that some or all of the deferred income tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income. To the extent that management's assessment of any Company's entities ability to utilize future tax deductions changes, the Company would be required to recognize more or fewer deferred tax assets, and future income tax provisions or recoveries could be affected.

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

Contingent considerations
The fair value recognized for contingent considerations was estimated by management based on the acquired entities results, budgets and forecasts.

Stock-based compensations and other stock-based payments
As regards to stock option granted, the Company uses the fair value based method of accounting. The fair value of stock options is determined using Black-Scholes pricing model, which required the use of certain assumptions, including future stock price volatility and expected life of instruments. The expected life is estimated using the contractual life of the instrument. The expected volatility is estimated using the historical volatility of the Company's stock over the same period as the contractual life. At the end of each reporting period, the Company revises its estimate of the number of equity instruments expected to vest.

Warrants
The Company uses the fair value method to measure the value of warrants at the grant date. Fair value is determined using the Black-Scholes option pricing model as described above.

5. Accounting standards and amendments issued but not yet adopted

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.

(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 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.

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.

6. Guaranteed deposit certificates

	June 30, 2013	June 30, 2012
	$	$
Guaranteed deposit certificates in escrow for sales contract execution and performance, bearing interest at 0.90% (at 0.90% as at June 30, 2012) and maturing in September 2013	**30,960**	30,960
Guaranteed deposit certificate , held as collateral for letters of credit bearing interest at 1.15% (at 1.05% as at June 30, 2012) and maturing in July 2013	**1,000,630**	1,000,633
Guaranteed deposit certificate held as collateral for a lease agreement, bearing interest at 0.90% (at 0.90% as at June 30, 2012) and maturing in October 2013	**100,636**	100,641
Guaranteed deposit certificate denominated in US dollars held as collateral for a letter of credit, bearing interest at 0.10% (0.10% as at June 30, 2012) and maturing in September 2013	**16,286**	15,469
Guaranteed deposit certificate held as collateral for a lease agreement, bearing interest at 0.20% and maturing in February 2014	**105,274**	-
	1,253,786	1,147,703

7. Accounts Receivable

	June 30, 2013	June 30, 2012
	$	$
Trade accounts receivable	**5,634,221**	8,128,293
Retentions from customer under manufacturing contracts	**953,731**	983,900
Allowance for doubtful accounts (i)	**(406,890)**	(258,230)
Allowance for back charge	**(3,155)**	-
	6,177,907	8,853,963
Tax credits receivable	**84,416**	180,040
Other receivables	**206,233**	288,377
	6,468,556	9,322,380

As at June 30, 2013, retentions held by customers for contract work amounted to $953,731 ($983,900 as at June 30, 2012).

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

(i) Movement in the allowance for doubtful accounts

	June 30, 2013	June 30, 2012
	$	$
Balance at beginning of the year	**(258,230)**	(3,720)
Impairment losses recognised on receivables	**(151,328)**	(254,510)
Amounts written off during the year as uncollectible	**2,998**	-
Foreign exchange translation gains and losses	**(330)**	-
Balance at end of the year	**(406,890)**	(258,230)

8. Inventories

	June 30, 2013	June 30, 2012
	$	
Raw materials	**1,058,976**	1,112,301
Finished goods	**2,957,582**	1,138,488
	4,016,558	2,250,789

As a result of variations in the ageing of its inventory of raw materials in Canada and in United States, the Company recognized an inventory provision for the year of $62,622 ($50,000 in fiscal year 2012).

9. Work in progress

	June 30, 2013	June 30, 2012
	$	$
Construction costs incurred plus recognised profits less recognised losses to date	**39,531,903**	29,281,800
Less: Progress billings	**(39,087,009)**	(28,762,213)
Net statement of financial position for ongoing contracts	**444,894**	519,587

Recognised and included in the financial statements as amounts due:		
From customers under construction contracts	**2,203,326**	2,154,311
To customers under construction contracts	**(1,758,432)**	(1,634,724)
	444,894	519,587

10. Property, plant and equipment

	June 30, 2013	**June 30, 2012**
	$	
Cost	**4,048,288**	4,400,475
Accumulated depreciation and impairment	**(2,169,529)**	(2,373,780)
	1,878,759	2,026,695
Land	**33,000**	25,000
Buildings	**953,882**	993,641
Machinery and equipment	**370,797**	423,137
Computer equipment	**168,426**	198,226
Furniture, fixtures and office equipment	**97,185**	113,657
Automotive equipment	**83,577**	93,430
Containerized unit for lease	**41,852**	-
Leasehold improvements	**130,040**	179,604
	1,878,759	2,026,695

Cost	Land	Buildings	Machinery and equipment	Computer equipment	Furniture, fixtures and office equipment	Automotive equipment	Leasehold improvements	Total
	$	$	$	$	$	$	$	
Balance as at June 30, 2011	25,000	1,075,000	1,641,843	653,919	292,701	322,627	204,873	**4,215,963**
Additions	-	3,865	16,490	104,436	20,512	58,226	55,517	**259,046**
Disposals	-	-	-	-	-	(99,826)	-	**(99,826)**
Write-off of fully depreciated assets	-	-	-	-	-	-	(23,310)	**(23,310)**
Effect of foreign currency exchange differences	-	-	20,145	2,550	4,182	11,727	9,998	**48,602**
Balance as at June 30, 2012	25,000	1,078,865	1,678,478	760,905	317,395	292,754	247,078	**4,400,475**
Cumulated depreciation								
Balance as at June 30, 2011	-	(42,604)	(1,167,673)	(457,435)	(186,270)	(239,137)	(57,030)	**(2,150,149)**
Depreciation expense	-	(42,620)	(78,400)	(103,676)	(15,585)	(34,429)	(31,562)	**(306,272)**
Disposals	-	-	-	-	-	83,116	-	**83,116**
Write-off of fully depreciated assets	-	-	-	-	-	-	23,310	**23,310**
Effect of foreign currency exchange differences	-	-	(9,268)	(1,568)	(1,883)	(8,874)	(2,192)	**(23,785)**
Balance as at June 30, 2012	-	(85,224)	(1,255,341)	(562,679)	(203,738)	(199,324)	(67,474)	**(2,373,780)**
Net amount as at June 30, 2012	25,000	993,641	423,137	198,226	113,657	93,430	179,604	**2,026,695**

Cost	Land	Buildings	Machinery and equipment	Computer equipment	Furniture, fixtures and office equipment	Automotive equipment	Containerized unit for lease	Leasehold improvements	Total
	$	$	$	$	$	$	$	$	
Balance as at June 30, 2012	25,000	1,078,865	1,678,478	760,905	317,395	292,754	-	247,078	**4,400,475**
Additions	8,000	3,129	9,715	46,334	2,725	34,197	47,830	7,425	**159,355**
Disposals	-	-	-	-	(12,836)	(65,212)	-	(29,034)	**(107,082)**
Write-off of fully depreciated assets	-	-	-	(431,879)	-	-	-	-	**(431,879)**
Effect of foreign currency exchange differences	-	-	12,652	1,397	2,302	5,482	-	5,586	**27,419**
Balance as at June 30, 2013	33,000	1,081,994	1,700,845	376,757	309,586	267,221	47,830	231,055	**4,048,288**
Cumulated depreciation									
Balance as at June 30, 2012	-	(85,224)	(1,255,341)	(562,679)	(203,738)	(199,324)	-	(67,474)	**(2,373,780)**
Depreciation expense	-	(42,888)	(66,979)	(76,036)	(16,693)	(33,167)	(5,978)	(38,125)	**(279,866)**
Disposals	-	-	-	-	9,631	53,107	-	7,604	**70,342**
Write-off of fully depreciated assets	-	-	-	431,879	-	-	-	-	**431,879**
Effect of foreign currency exchange differences	-	-	(7,728)	(1,495)	(1,601)	(4,260)	-	(3,020)	**(18,104)**
Balance as at June 30, 2013	-	(128,112)	(1,330,048)	(208,331)	(212,401)	(183,644)	(5,978)	(101,015)	**(2,169,529)**
Net amount as at June 30, 2013	33,000	953,882	370,797	168,426	97,185	83,577	41,852	130,040	**1,878,759**

11. Intangible Assets

	June 30, 2013	June 30, 2012
	$	$
Cost	**13,452,918**	12,989,077
Accumulated amortization and impairment	**(8,510,034)**	(7,529,892)
	4,942,884	5,459,185
Software	**172,745**	163,243
Patents	**2,052,330**	2,189,932
Rights on technologies	**-**	-
Technologies	**-**	-
Trademarks	**181,817**	234,481
Customer relations	**582,280**	632,435
Distribution network	**208,121**	395,361
Intellectual property	**1,745,591**	1,843,733
	4,942,884	5,459,185

Cost	Software	Patents	Rights on technologies	Technologies	Trademarks	Customer relations	Distribution network	Intellectual property	Total
	$	$	$	$	$	$	$	$	$
Balance as at June 30, 2011	415,615	3,214,513	377,592	1,041,444	464,926	3,410,050	1,219,291	2,188,961	12,332,392
Additions	14,706	-	-	-	-	-	-	-	14,706
Effect of foreign currency exchange differences	2,002	179,114	-	58,104	24,307	188,300	68,026	122,126	641,979
Balance as at June 30, 2012	432,323	3,393,627	377,592	1,099,548	489,233	3,598,350	1,287,317	2,311,087	12,989,077
Accumulated amortization									
Balance as at June 30, 2011	(221,495)	(983,903)	(338,826)	(837,928)	(198,807)	(2,571,065)	(759,094)	(296,726)	(6,207,844)
Amortization expense	(46,477)	(162,799)	(38,766)	(12,729)	(44,776)	(68,251)	(88,590)	(151,920)	(614,308)
Impairment of intangible assets	-	-	-	(198,589)	-	(180,139)	-	-	(378,728)
Effect of foreign currency exchange differences	(1,108)	(56,993)	-	(50,302)	(11,169)	(146,460)	(44,272)	(18,708)	(329,012)
Balance as at June 30, 2012	(269,080)	(1,203,695)	(377,592)	(1,099,548)	(254,752)	(2,965,915)	(891,956)	(467,354)	(7,529,892)
Net amount as at June 30, 2012	163,243	2,189,932	-	-	234,481	632,435	395,361	1,843,733	5,459,185

Cost	Software	Patents	Rights on technologies	Technologies	Trademarks	Customer relations	Distribution network	Intellectual property	Total
	$	$	$	$	$	$	$	$	$
Balance as at June 30, 2012	432,323	3,393,627	377,592	1,099,548	489,233	3,598,350	1,287,317	2,311,087	12,989,077
Additions	60,654	-	-	-	-	-	-	-	60,654
Effect of foreign currency exchange differences	1,936	112,568	-	36,396	15,226	117,950	42,612	76,499	403,187
Balance as at June 30, 2013	494,913	3,506,195	377,592	1,135,944	504,459	3,716,300	1,329,929	2,387,586	13,452,918
Accumulated amortization									
Balance as at June 30, 2012	(269,080)	(1,203,695)	(377,592)	(1,099,548)	(254,752)	(2,965,915)	(891,956)	(467,354)	(7,529,892)
Amortization expense	(51,945)	(200,861)	-	-	(57,470)	(67,257)	(191,290)	(151,878)	(720,701)
Impairment of intangible assets	-	-	-	-	-	-	-	-	-
Effect of foreign currency exchange differences	(1,143)	(49,309)	-	(36,396)	(10,420)	(100,848)	(38,562)	(22,763)	(259,441)
Balance as at June 30, 2013	(322,168)	(1,453,865)	(377,592)	(1,135,944)	(322,642)	(3,134,020)	(1,121,808)	(641,995)	(8,510,034)
Net amount as at June 30, 2013	172,745	2,052,330	-	-	181,817	582,280	208,121	1,745,591	4,942,884

During the third quarter of fiscal year 2012, the Company reviewed the carrying amounts of its intangible assets and determined that some intangible assets related to the cash-generating unit “United States” were no longer used and were not generating material cash flows. Therefore, the recoverable amount of some of the intangible assets was estimated to nil. The impairment loss of the intangible assets is due to the prolonged decrease of the Company’s operations in the industrial sector – mainly the ethanol production subsector.

12. Investment in a joint venture

The Company had the following interest in a joint venture up to its termination as of March 31, 2013:

- A 49% equity shareholding with equivalent voting power in H_2O Innovation India Ltd, a joint venture established in Mumbai, India.

There was no change in the Company’s voting interest in this joint venture since its creation in February 2010 up to its termination. The Company decided to terminate its participation in the joint venture as of March 31, 2013 since the sales objectives initially established have not been met. H_2O Innovation India Limited required a lot of attention and resources and the impact on the revenues and earnings of the Company were insignificant.

The reporting date of H_2O Innovation India Ltd. was March 31. This was the reporting date established when the joint-venture was incorporated because a uniform accounting year ending on March 31 is required for tax purposes. For the purpose of applying the equity method of accounting, H_2O Innovation India Ltd. prepared additional financial statements for H_2O Innovation’s use that correspond to H_2O Innovation’s reporting period which is June 30. The Company had no share of any contingent liabilities or capital commitments up to its termination as of March 31, 2013 or as at June 30, 2012.

Summary financial information not adjusted for the ownership held by the Company is as follows:

As at and for the year ended June 30,	**2013**	2012
	$	$
Current assets	**-**	1,246,821
Long-term assets	**-**	432,821
Current liabilities	**-**	(1,596,873)
Revenues	**-**	1,239,149
Net income (loss)	**-**	(657,653)

The Company has recorded a loss on disposal of investment in a joint venture in the amount of $42,521 in the statement of income (loss), following the termination of the agreement as of March 31, 2013.

13. Goodwill

The change in carrying value is as follows:

	$
Balance as at June 30, 2011	10,179,427
Impairment of goodwill	(8,221,423)
Effect of foreign exchange differences	428,318
Balance as at June 30, 2012	2,386,322
Effect of foreign exchange differences	**78,989**
Balance as at June 30, 2013	**2,465,311**

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

	June 30, 2013	June 30, 2012
	$	$
Canada	**-**	-
United States	**2,465,311**	2,386,322
	2,465,311	2,386,322

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

The recoverable amount of these cash-generating units was determined based on a value-in use calculation which uses cash flow projections based on financial budgets approved by the Board of Directors.

Cash flow projections during the budget period are based on the same expected gross profit throughout the budget period. Management believes that any reasonably possible change in the key assumptions on which recoverable amount is based would not cause the aggregate carrying amount to exceed the aggregate recoverable amount of each of the cash-generating units.

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

As at June 30, 2013	**Growth rate for the terminal period**	**Post-tax discount rate**
Canada	3.0%	14.8%
United States	3.0%	14.8%

As at June 30, 2012	**Growth rate for the terminal period**	**Post-tax discount rate**
Canada	3.0%	14.8%
United States	3.0%	14.8%

In the third quarter of fiscal year 2013, the Company assessed the recoverable amount of the cash-generating unit “United States” at $13,255,000 and did not recognized any goodwill impairment loss ($8,221,423 ($US 8,212,389) in fiscal year 2012). The fair value less costs to sell was used to determine the recoverable amount of this cash-generating unit by applying new discounted projections of future cash flows based on a five-year financial forecast approved by management.

14. Bank loans

The bank loans for an authorized amount of $2,000,000 and US$2,000,000 bearing interest at CDN prime rate plus 1.00% (4.0% as at June 30, 2013) and at US prime rate plus 1.00% (4.75% as at June 30, 2013) are secured by an assignment of book debtors and inventories. These are renegotiable in November 2013 and are secured in part by Export Development Canada (“EDC”).

The Company has a credit facility enabling it to issue letters of credit for a maximum amount of $2,000,000. This credit facility bears interest at prime rate plus 1.0% (4.0% as at June 30, 2013) and is renegotiable on November 30, 2013. The credit facility is secured by a guaranteed deposit certificate ($1,000,630 as at June 30, 2013). As at June 30, 2013, the Company issued $1,338,129 in letters of credit under this credit facility. From these issued letters of credit, an amount of $207,382 is secured by EDC.

Covenants

The Company have undertaken to maintain covenants on a monthly basis in respect of the bank loans described above. The Company was in breach of these covenants as at June 30, 2013 (note 25) but have received a waiver for this breach from the lender. The bank waiver grants a forbearance up to November 30, 2013 at which time the bank facilities are to be renegotiated.

15. Accounts Payable and Accrued Liabilities

	June 30, 2013	June 30, 2012
	$	$
Trade accounts payable	**2,178,120**	3,792,052
Other accrued liabilities and accounts payable	**1,902,219**	1,949,955
	4,080,339	5,742,007

16. 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)
Effects of foreign exchange differences	887
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**

17. 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 the statement of income (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 June 30, 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.

18. Long-Term Debt

	June 30, 2013	June 30, 2012
	$	**$**
Unsecured – at amortised cost		
Bank loan, denominated in Canadian dollars (a) (e)	**1,076,696**	1,401,737
Loan from other entities, denominated in Canadian dollars (b) (e)	**1,568,924**	1,862,820
Loans from shareholders, denominated in US dollars (c) (e)	**145,003**	322,391
Loans from other entities, denominated in US dollars (d)	**82,634**	95,674
	2,873,257	3,682,622
Less : Current portion	**2,808,261**	2,580,862
Long-term debt	**64,996**	1,101,760

(a) Bank loan
The bank loan of $1,076,696 bearing interest at 12.125% (effective rate of 17.6%) since an agreement was concluded on April 23, 2013 giving four options of three-month moratorium starting in April 2013 with an initial increase of 0.50% of the interest rate applicable and an increase of 0.125% of the interest rate applicable upon each used moratorium on the repayment of principal. The bank loan is repayable in monthly instalments, maturing on June 1, 2015.

(b) Loans from other entities
The loan of $1,568,924 bearing interest at 11.625% (effective rate of 16.2%) since an agreement was concluded on April 23, 2013 giving four options of three-month moratorium starting in April 2013 with an initial increase of 0.50% of the interest rate applicable and an increase of 0.125% of the interest rate applicable upon each used moratorium on the repayment of principal. The bank loan is repayable in monthly instalments maturing July 1, 2016. Upon the issue of this loan, the Company issued 1,000,000 warrants, each warrant entitling the holder to the purchase of one share at a price of $0.50 until December 30, 2013.

(c) Loans from shareholders
The loan from shareholders of $145,003 ($US 137,862) bearing interest at 12.125% (effective rate of 17.8%) since an agreement was concluded on April 23, 2013 giving four options of three-month moratorium starting in April 2013 with an initial increase of 0.50% of the interest rate applicable and an

increase of 0.125% of the interest rate applicable upon each used moratorium on the repayment of principal. The bank loan is repayable in monthly instalments, maturing on June 1, 2015. The loan to shareholders is repayable in monthly instalments, maturing on June 1, 2015.

(d) Loans from other entities
A loan of $82,634 ($US 78,565), bearing interest at 8.5% payable in monthly instalments of $1,998 ($US 1,900) and maturing July 1, 2017.

(e) As at June 30, 2013, the Company is in breach of covenants on the bank loan, the loan from other entity and the loans from shareholders to maintain working capital ratio of 1.30:1 and a fixed charge ratio of 1:1 but has requested and obtained a waiver for this breach from the lenders.

(f) The annual principal instalments due on the long-term debt are $998,975 in 2014, $1,179,102 in 2015, $504,165 in 2016, $188,853 in 2017 and $2,162 in 2018.

As at June 30, 2013, the Company was not in compliance with the fixed charge coverage ratio which triggered the reclassification of the long-term debt portion to current liabilities. This reclassification caused the working capital ratio not to be met. The Company has requested and obtained waivers after year-end.

19. Income Taxes

Income tax recoveries are detailed as follows:

	June 30, 2013 $	June 30, 2012 $
Current tax expense:		
Current period	**1,979**	4,374
Adjustment for prior periods	**327**	-
	2,306	4,374
Deferred tax recovery:		
Origination and reversal of temporary differences	**68,812**	(705,967)
Reduction (increase) in tax rate	**(54,770)**	(335,155)
Adjustment for prior periods	**(183,683)**	(1,470,410)
	(169,641)	(2,511,532)
Income taxes	**(167,335)**	(2,507,158)

Reconciliation of the Company's effective income tax recovery:

The standard rate of the Canadian corporate income tax is 26.24% (27.08% for 2012). The following is a reconciliation of income taxes calculated at the Canadian corporate tax rate to the expense for 2013 and 2012.

	June 30, 2013 $	June 30, 2012 $
Earnings (Loss) before income taxes	**145,657**	(10,562,018)
Income taxes at the standard rate of Canadian corporate tax of 26.24% (27.08% in 2012)	**38,320**	(2,860,194)
Tax effect from:		
Changes in statutory rates	**(54,770)**	(335,155)
Non-deductible goodwill impairment	**-**	2,226,361
Utilization of tax benefits previously unrecorded	**(183,683)**	(1,470,410)
Changes in fair value of contingent considerations and unwinding of interest	**8,080**	(53,916)
Gain on settlement agreement	**(106,039)**	-
Non-deductible stock-based payments	**10,394**	23,416
Joint venture results reported net of tax	**(2,623)**	87,265
Tax credits	**(18,306)**	-
Items not affecting earnings	**-**	(315)
Non-deductible items	**21,303**	20,244
Other	**120,089**	(144,828)
Total income tax recovery	**(167,335)**	(2,507,158)

Deferred tax assets and liabilities

	June 30, 2013 $	June 30, 2012 $
Reconciliation to the consolidated statements of financial position:		
Deferred tax assets	**5,042,064**	3,992,149
Deferred tax liabilities	**(1,918,000)**	(1,034,000)
Net deferred tax assets	**3,124,064**	2,958,149

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

	Balance as at July 1, 2012 $	**Recognized in earnings $**	**Recognized in equity $**	**Balance as at June 30, 2013 $**
Non-capital losses	879,442	(474,042)	-	405,400
Property, plant and equipment	(6,000)	34,308	-	28,308
Intangible assets	(287,293)	(137,805)	-	(425,098)
U.S. interests not deducted and deferred	2,308,000	676,022	-	2,984,022
Other assets	64,000	67,432	-	131,432
Foreign exchange difference recognized in equity	-	3,726	(3,726)	-
	2,958,149	169,641	(3,726)	3,124,064

	Balance as at July 1, 2011 $	**Recognized in earnings $**	**Recognized in equity $**	**Balance as at June 30, 2012 $**
Development and exploration expenses	-	695,000	(695,000)	-
Non-capital losses	1,076,303	431,327	(628,188)	879,442
Property, plant and equipment	(20,521)	14,521	-	(6,000)
Intangible assets	(412,185)	124,892	-	(287,293)
U.S. interests not deducted and deferred	994,000	1,314,000	-	2,308,000
Other assets	140,000	(76,000)	-	64,000
Foreign exchange difference recognized in equity	-	7,792	(7,792)	-
	1,777,597	2,511,532	(1,330,980)	2,958,149

At June 30, 2013, the Company had the following tax losses carried forward available to reduce taxable income in the future, and investment tax credits carryovers to reduce income tax payable, and in respect of which the Company has not recognized a deferred tax on those from Canada.

Tax losses carried forward expire as follows:	Date	Canada	USA
		$	$
	2014	13,000	-
	2016	152,000	-
	2027	2,330,000	-
	2028	2,619,000	26,000
	2029	1,000	-
	2030	672,000	1,839,000
	2032	-	605,000
		5,787,000	**2,470,000**

Investment tax credits expire as follows:	Date	Canada
	2020	9,000
	2021	76,000
	2022	141,000
	2023	51,000
	2025	36,000
	2026	22,000
	2027	38,000
	2028	6,000
	2029	21,000
		400,000

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

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

As at June 30, 2013	Canada	United States
	$	$
Tax losses carried forward	2,095,751	591,271
Development and exploration expenses	640,000	-
Capital losses	84,000	-
Research and development expenses	578,000	-
Property, plant and equipment	1,126,000	-
Intangible assets	139,293	-
Financing expenses	8,000	-
Other assets	15,000	-
	4,686,044	591,271

As at June 30, 2012	Canada
	$
Tax losses carried forward	2,188,110
Development and exploration expenses	643,000
Capital losses	63,000
Research and development expenses	563,000
Property, plant and equipment	1,064,000
Intangible assets	139,293
Financing expenses	39,000
Other assets	(23,000)
	4,676,403

20. Capital Stock

Share Capital

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

Stock options

The Company has established a stock option plan whereby the Board of Directors may grant stock options to directors, executive officers, key employees and consultants providing services to the Company. The Board of Directors determines, at its discretion, the vesting terms, if applicable, the expiry date of options and the number of options to be granted. The maximum number of shares that may be issued under the plan amounts to 5,500,000.

For the year ended June 30, 2013, the Company recorded $39,619 ($86,469 in 2012) as stock-based compensation for options granted to its directors, officers and key employees.

The following table summarizes the situation of the Company's stock-based compensation plan as at June 30, 2013 and June 30, 2012 and the change during the years ended on these dates:

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

As at June 30, 2013, the following stock options were granted:

Exercise price	Holders	Number of shares	Weighted average remaining life (years)	Weighted average exercise price
$				$
0.32	Directors	125,000	0.44	0.02
0.50	Directors	290,000	7.37	0.07
0.75	Directors	225,000	6.47	0.08
0.90	Directors	12,000	0.05	0.01
0.50	Employees	1,222,500	7.23	0.29
0.90	Employees	250,000	0.05	0.10
		2,124,500	5.89	0.57

As at June 30, 2013, the following stock options could be exercised:

Exercise price	Number of shares	Weighted average exercise price
$		$
0.32	125,000	0.02
0.50	1,131,250	0.32
0.75	225,000	0.09
0.90	262,000	0.14
	1,743,250	0.57

Warrants

In the course of its financing transactions made during fiscal year 2011 and previous years, the Company issued warrants entitling them the right to acquire shares at a predetermined price. Each warrant issued entitles the holder to acquire one common share of the Company.

The warrants outstanding as at June 30, 2013 and June 30, 2012 and the change during the years ended on those dates are summarized in the following table:

Years ended June 30,		**2013**		2012
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		$		$
Outstanding, beginning of year	**2,250,000**	**0.83**	10,179,877	0.84
Expired	**(1,250,000)**	**1.10**	(7,929,877)	0.85
Outstanding, end of year	**1,000,000**	**0.50**	2,250,000	0.83

The table below shows the assumptions used in determining warrants value under the Black & Scholes pricing model:

As at June 30, 2013, the following warrants were granted:

Maturity date	**Number of warrants**	**Exercise price**
December 2013	1,000,000	$0.50

21. Additional information about the nature of costs components

a) Expenses by nature

Years ended June 30,	**2013**	2012
	$	$
Material	**18,228,038**	16,887,584
Changes in inventories of raw material, finished goods and costs incurred in excess of billings	**64,697**	170,496
Salaries and fringe benefits	**9,078,229**	8,821,883
Subcontractors and professional fees	**3,033,821**	6,706,473
Rent, electricity , insurance and office expenses	**1,357,876**	1,114,643
Telecommunications and travel expenses	**1,130,536**	1,190,314
Bad debt expenses	**190,492**	254,510
Other expenses	**1,539,877**	1,243,875
Total cost of goods sold, operating, selling and administrative expenses	**34,623,566**	36,389,778

b) Depreciation and amortization

The Company has elected to present depreciation and amortization as a separate line item in its 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 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 years ended June 30, 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 years as noted above.

Depreciation by function	**2013**	2012
	$	$
Cost of goods sold	**140,370**	170,183
Operating expenses	**3,802**	5,184
Selling expenses	**44,875**	51,687
Administrative expenses	**90,819**	79,218
	279,866	306,272

Amortization by function	**2013**	2012
	$	$
Cost of goods sold	**352,726**	366,118
Selling expenses	**316,030**	201,646
Administrative expenses	**51,945**	46,544
	720,701	614,308

Impairment of intangible assets by function	**2013**	2012
	$	$
Cost of goods sold	**-**	198,589
Selling expenses	**-**	180,139
	-	378,728

Cost per function including depreciation, amortization and impairment of intangible assets	**2013**	2012
	$	$
Cost of goods sold	**27,378,460**	28,369,439
Operating expenses	**699,881**	648,064
Selling expenses	**3,869,986**	4,339,735
Administrative expenses	**3,675,806**	4,331,848
	35,624,133	37,689,086

c) Other (gains) losses – net

Years ended June 30,	**2013**	2012
	$	$
Exchange (gain) loss	**(15,243)**	(254,614)
Other revenues	**30,320**	(130,375)
(Gain) Loss on disposal of assets	**23,485**	16,710
	38,562	(368,279)

22. 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 earnings (loss) per share:

As at June 30,	2013	2012
Net earnings (loss)	**$312,992**	($8,054,860)
Basic and diluted weighted average number of share outstanding	**60,145,823**	60,145,823
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	**2,124,500**	2,477,000
Warrants (number of equivalent shares)	**1,000,000**	2,250,000

For the years ended June 30, 2013 and 2012, there was no difference in the basic and diluted weighted average number of shares outstanding, since the effect of the stock options and warrants would have been anti-dilutive. Accordingly, the diluted earnings (loss) per share for these years is calculated using the basic weighted average number of shares outstanding.

23. Cash Flows

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

Years ended June 30,	2013	2012
	$	$
Accounts receivable	**2,922,987**	(1,290,126)
Inventories	**(1,665,780)**	14,481
Costs incurred in excess of billings	**(50,840)**	164,058
Prepaid expenses	**(91,665)**	68,143
Accounts payable and accrued liabilities	**(1,724,488)**	1,476,414
Provisions	**(1,418)**	-
Billings in excess of work in process	**80,248**	283,357
	(530,956)	716,327

b) Cash and cash equivalents consist of the following:

As at June 30,	2013	2012
	$	$
Beginning of year		
Cash and cash equivalents	**576,542**	440,355
Bank overdraft	**(155,210)**	(291,520)
	421,332	148,835
End of year		
Cash and cash equivalents	**303,936**	576,542
Bank overdraft	**(256,701)**	(155,210)
	47,235	421,332

24. Financial Risk Management

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

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

Overview

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

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

Currency risk

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

As at June 30, 2013, if the Canadian dollar had increased or decreased by five percent (5%) compared to the U.S. dollar, assuming that all other variables remained constant, net earnings for the year ended June 30, 2013 would have been greater or lesser by approximately $72,722 ($91,393 as at June 30, 2012).

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

	June 30, 2013	June 30, 2012
	$	$
FINANCIAL ASSETS		
Cash	**736**	713
Guaranteed deposits certificates	**16,286**	15,469
Accounts receivable	**900,962**	889,441
	917,984	905,623
FINANCIAL LIABILITIES		
Bank overdraft	**(42,150)**	(137,931)
Bank loans	**(1,895,843)**	(1,628,394)
Accounts payable	**(289,428)**	(644,759)
Long-term debt	**(145,002)**	(322,390)
	(2,372,423)	(2,733,474)

Cash flow and fair value interest rate risk

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

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

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

As at June 30, 2013 and 2012, a 25-basis-point increase or decrease in interest rates, assuming that all other variables remain constant, would not have had a significant impact on the Company's net earnings and comprehensive income. These changes were retained because they are considered reasonably possible according to observations and the economic situation.

Credit risk

Credit risk relates to the risk that a party to a financial instrument will not fulfil some or all of its obligations, thereby causing the Company to sustain a financial loss. The main risk relates to accounts receivable. To manage credit risk from accounts receivable, the Company reviews credit limits, monitors aging of accounts receivables and establishes an allowance for doubtful accounts based on specific customer information and general historical trends. Trade receivables consist of a large number of customers, spread across diverse industries and geographical areas. Ongoing credit evaluation is performed on the financial condition of accounts receivable. As at June 30, 2013, the allowance for doubtful accounts was $406,890 ($258,230 as at June 30, 2012).

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

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

	June 30, 2013	June 30, 2012
	$	$
Cash and cash equivalents	**303,936**	576,542
Guaranteed deposits certificates	**1,253,786**	1,147,703
Accounts receivable, net of tax credits receivable	**6,384,140**	9,142,340

The Company is also exposed to credit risk due to its cash, its deposit certificate and its investment certificates. The Company has $1,557,722 ($1,724,245 in 2012) in cash and guaranteed deposits certificates with banking institutions that the Company considers at a low risk for loss.

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

	June 30, 2013	June 30, 2012
	$	$
Current	**3,748,719**	4,954,768
Past due 1 to 30 days	**483,113**	1,614,838
Past due 31 to 90 days	**165,551**	358,455
Past due more than 90 days	**1,236,838**	1,200,232
	5,634,221	8,128,293
Less: Allowance for doubtful accounts	**(406,890)**	(258,230)
Trade accounts receivable	**5,227,331**	7,870,063
Provision for back charges	**(3,155)**	-
Retentions from customers under manufacturing contracts	**953,731**	983,900
Tax credits receivable	**84,416**	180,040
Other receivables	**206,233**	288,377
	6,468,556	9,322,380

Liquidity risk

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

For its investing activities, the Company will evaluate its liquidity needs when applicable and take the necessary action.
The following table presents the financial liability instalments payable when contractually due including accrued interest as at:

As at June 30, 2013	**Carrying amount**	**0 - 1 year**	**1 - 2 years**	**2 - 3 years**	**4 years and more**
	$	$	$	$	$
Bank overdraft	256,701	256,701	-	-	-
Bank loans	3,375,843	3,375,843	-	-	-
Accounts payable	4,080,339	4,080,339	-	-	-
Long-term debt	3,392,707	1,294,641	1,346,519	557,716	193,831
Total	11,105,590	9,007,524	1,346,519	557,716	193,831

As at June 30, 2012	Carrying amount	0 - 1 year	1 - 2 years	2 - 3 years	4 years and more
	$	$	$	$	$
Bank overdraft	155,210	155,210	-	-	-
Bank loans	2,868,394	2,868,394	-	-	-
Accounts payable	5,742,007	5,742,007	-	-	-
Contingent consideration	946,528	24,546	108,111	135,881	677,990
Long-term debt	4,728,920	1,567,070	1,324,653	1,212,153	625,044
Total	14,441,059	10,357,227	1,432,764	1,348,034	1,303,034

Fair value

The fair value hierarchy has the following levels:

Level 1 – Quoted prices in active markets for identical assets or liabilities.
Level 2 – Inputs other than quoted prices included in Level 1, that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
Level 3 – Unobservable inputs such as inputs for the asset or liability that are not based on observable market data.

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

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

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

Long-term debt
The fair value of the long-term debt has been established by discounting the future cash flows at an interest rate to which the Company would currently be able to obtain for loans with similar maturity dates and terms. The fair value of the long-term debt is $2,873,257 ($3,682,622 as at June 30, 2012).

Contingent consideration
The fair value recognized for contingent considerations has been estimated by management based on the Wastewater Technology Inc. results, budgets and forecasts. The fair value of the contingent considerations is nil ($460,555 as at June 30, 2012).

25. 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 June 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 June 30, 2013, the Company was not in compliance with the fixed charge coverage ratio which triggered the reclassification of the long-term debt portion to current liabilities. This reclassification caused the working capital ratio not to be met.

26. Leases

Leasing arrangements

Operating leases relate to leases of premises with lease terms of between 1 and 10 years. The Company has an option to renew the lease for one premise for an additional term of 5 years. The Company does not have an option to purchase the leased premises at the expiry of the lease periods.

Payments recognised as an expense

Years ended June 30,	**2013**	2012
	$	$
Minimum lease payments	**567,605**	422,847
	567,605	560,225

Non-cancellable operating lease commitments

	June 30, 2013	**June 30, 2012**
	$	$
Not later than 1 year	**567,605**	560,225
Later than 1 year and not later than 5 years	**2,060,390**	1,657,470
Later than 5 years	**1,992,423**	1,294,386
	4,620,418	3,512,081

Liabilities recognised in respect of non-cancellable operating leases

	June 30, 2013	**June 30, 2012**
	$	$
Deferred rents		
Current	**3,151**	18,188
Non-current	**102,070**	97,482
	105,221	115,670

27. 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 year for the continuing operations.

Years ended June 30,	2013	2012
	$	$
Revenues from sales of consumables	**13,191,645**	11,692,712
Manufacturing contracts revenues	**22,945,256**	24,217,195
	36,136,901	35,909,907

Geographical information

The Company is domiciled in Canada. The result of its revenue from external customers in Canada is $16,543,641 ($13,336,990 in 2012), and the total revenue from external customers from other countries is $19,593,260 ($22,572,917 in 2012). Detailed information for the Company's markets is as follows:

Years ended June 30,	2013	2012
	$	$
Revenues from external customers		
Revenue according to geographic location		
Canada	**16,543,641**	13,336,990
United States	**16,290,613**	17,333,794
Tunisia	**844,658**	3,267,369
China	**1,403,057**	844,192
Egypt	**94,286**	349,590
Other	**960,646**	777,972
	36,136,901	35,909,907

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

Years ended June 30,	2013	2012
	$	$
Non-current assets other than financial instruments and deferred tax assets according to geographic location		
Canada	**1,693,898**	1,732,291
United States	**7,593,056**	8,139,911
	9,286,954	9,872,202

Information about major customers

The Company derived more than ten percent (10%) of its revenues from a single external customer in 2013 and it did not in 2012.

28. Related parties disclosure

Compensation of key management personnel

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

Years ended June 30,	2013	2012
	$	$
Short-term benefits	858,513	1,001,569
Termination benefits	-	117,494
Post-employment benefits	10,405	13,420
Share-based payments	33,213	63,560
	902,131	1,196,043

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

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

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.

Auditors
Deloitte S.E.N.C.R.L.

Transfer Agent
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