# Interim Financial Report
# First quarter ended
# September 30, 2015

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

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE FINANCIAL SITUATION

In accordance with National Instrument 51-102 Continuous Disclosure Obligations, the following comments are intended to provide a review and an analysis of $H_2O$ Innovation's results of operations and financial position for the quarter ended September 30, 2015, in comparison with the corresponding period ended September 30, 2014. They should be read in conjunction with the consolidated financial statements and accompanying notes. Comparison of financial situation as at September 30, 2015 to those as at June 30, 2015 is also included. Certain statements set forth in this Management's Discussion and Analysis (MD&A) regarding the operations and the activities of $H_2O$ Innovation as well as other communications by the Corporation to the public that describe more generally management objectives, projections, estimates, expectations or forecasts may constitute forward-looking statements within the meaning of securities legislation. Forward-looking statements concern analysis and other information based on forecast future results, performance and achievements 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 expressions, as well as those usually used in the future and the conditional, notably regarding certain assumptions as to the success of a venture. Those forward-looking statements, based on the current expectations of management, involve a number of risks and uncertainties, known and unknown, which may result in actual and future results, performance and achievements of the Corporation to be materially different than those indicated. Information about the risk factors to which the Corporation is exposed is provided in the Annual Information Form dated September 22, 2015 available on SEDAR (www.sedar.com). Unless required to do so pursuant to applicable securities legislation, $H_2O$ Innovation assumes no obligation to update or revise forward-looking statements contained in this Management's Discussion and Analysis or in other communications as a result of new information, future events and other changes.

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

### VISION, MISSION & PROFILE

#### OUR VISION

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

#### OUR MISSION

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

#### OUR PROFILE

$H_2O$ Innovation designs and provides state-of-the-art, custom-built, and integrated water treatment solutions based on membrane filtration technology for municipal, energy and natural resources end-users. Also, directly and through its affiliates, $H_2O$ Innovation provides services and products complementary to its membrane filtration and reverse osmosis systems. These products consist of a complete line of specialty chemicals, consumables and couplings. $H_2O$ Innovation employs approximately 168 resources and has six locations in North America.

## IMPORTANT INFORMATION

All shares, options and share purchase warrants as well as per share, option and share purchase warrant information presented in this MD&A have been adjusted, including proportionate adjustments being made to each stock option and share purchase warrant exercise price, to reflect and give effect to a consolidation, on December 1, 2014, of our issued and outstanding common shares on a five-to-one basis (the "Share Consolidation"). The Share Consolidation affected all shareholders, option holders and warrant holders uniformly and thus did not materially affect any security holder's percentage of ownership interest.

## NON-IFRS FINANCIAL MEASUREMENTS

In this MD&A, the Corporation's management uses measurements that are not in accordance with IFRS. The measurements "Adjusted earnings before interest, tax depreciation and amortization (adjusted EBITDA)" and "Net debt" are not defined by IFRS and cannot be formally presented in consolidated financial statements.

The definition of adjusted EBITDA does not take into account the Corporation's finance costs – net, stock-based compensation costs, gain on purchase price adjustment and unrealized exchange loss. The reader can establish the link between adjusted EBITDA and net earnings. The definition of adjusted EBITDA used by the Corporation may differ from those used by other companies.

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

**Reconciliation of adjusted EBITDA to net earnings**

| **Three-month periods ended September 30,** | **2015** | 2014 |
|---|---|---|
| | **$** | $ |
| Net earnings for the period | **52,329** | 282,587 |
| Finance costs – net | **148,037** | 123,841 |
| Income taxes | **204,853** | 118,417 |
| Depreciation of property, plant and equipment | **127,343** | 76,517 |
| Amortization of intangible assets | **231,679** | 206,044 |
| Gain on purchase price adjustment | **(375,977)** | - |
| Unrealized exchange loss | **53,405** | 90,954 |
| Stock-based compensation costs | **-** | 2,421 |
| Adjusted EBITDA | **441,669** | 900,781 |

The definition of net debt consists of bank overdraft, bank loans, long-term debt less cash and cash equivalents. The reader can establish the link between net debt and debt. The definition of net debt used by the Corporation may differ from those used by other companies.

Even though net debt is a non-IFRS measure, it is used by management, analysts, investors and other financial stakeholders to assess the Corporation's capital management.

| | **September 30, 2015** | June 30, 2015 |
|---|---|---|
| | **$** | $ |
| Bank overdraft | **426,657** | 2,052 |
| Bank loans | **4,951,636** | 4,432,077 |
| Current portion of long-term debt | **470,932** | 543,807 |
| Long-term debt | **445,691** | 499,777 |
| Less: Cash and cash equivalents | **(1,964,605)** | (1,335,887) |
| Net debt | **4,330,311** | 4,141,826 |

## RESULTS OF OPERATIONS

### Selected financial data
### (Unaudited)

| | Three-month periods ended September 30, 2015 | 2014 |
|---|---|---|
| | **$** | $ |
| **Revenues** | **12,259,328** | 11,219,131 |
| **Gross profit before depreciation and amortization** | **3,204,486** | 3,032,951 |
| **Gross profit before depreciation and amortization** | **26.1%** | 27.0% |
| **Operating expenses** | **333,980** | 200,486 |
| **Selling expenses** | **1,357,733** | 906,289 |
| **Administrative expenses** | **1,043,551** | 987,796 |
| **Research and development expenses – net** | **84,564** | 39,922 |
| **Net earnings** | **52,329** | 282,587 |
| **Basic and diluted earnings per share** | **0.003** | 0.014 |
| **Adjusted EBITDA** | **441,669** | 900,781 |

### Revenues and gross profit before depreciation and amortization

Revenues for the first quarter of fiscal year 2016 totaled $12.3 M, representing a $1.1 M or 9.3% increase, as compared with revenues of $11.2 M for the same quarter of fiscal year 2015. Revenues from water treatment projects were somewhat stable and reached $7.2 M compared to $7.3 M in the corresponding period of the previous fiscal year, representing a 1% decrease. The revenues level maintained during the quarter is a reflection of the numerous water treatment projects composing our order backlog, which are reaching different milestones, from initial design and engineering phases to higher revenue-generating phases such as manufacturing. Furthermore, revenues from specialty products and services ("SP&S") reached $5.1 M compared to $3.9 M in the comparable quarter of the previous fiscal year, which represents an increase of 29%. This strong increase in SP&S revenues is the direct result of investments made during the last year in our operating and selling functions to support the growth of this business line.

In this first quarter of fiscal year 2016, the Corporation generated a 26.1% gross profit before depreciation and amortization, a lower level than the 27.0% gross profit before depreciation and amortization generated in the first quarter of fiscal year 2015. The revenue mix in this quarter shows that revenues from SP&S still represent a fair proportion of total revenues compared to the corresponding period of the previous fiscal year (41.2% in fiscal year 2016 versus 35.1% in fiscal year 2015). However, even though the volume of SP&S sales increased by additional maple syrup production equipment sales during the first quarter of fiscal year 2016, the Corporation has recorded punctually a lower level of sales of specialty chemicals compared to the corresponding period of the previous fiscal year, creating pressure on the gross margin.

The Corporation secured $9.0 M in new bookings for water treatment projects over the quarter. These new bookings, combined with the realized revenues from water treatment projects during the quarter, have brought up the backlog at $38.3 M as at September 30, 2015 compared to $36.1 M as at September 30, 2014. This level of order backlog gives the Corporation a fairly good perspective over the coming quarters in terms of volume of revenues. Our team has demonstrated that we can manage the execution challenge that comes with such large order backlog and we are confident that our team is able to achieve even more.

The Corporation has never been exposed to so many opportunities of water treatment projects sales. In order to face this upcoming array of bidding opportunities, the Corporation has invested in SG&A expenses, which proved to be a winning move, as the order backlog reached $44.3 M as at November 5, 2015. This level of order backlog should fuel the growth of revenues in the upcoming quarters. With a dedicated sales team, we maintain strong bidding activities and business development mainly in Canada and in the United States. We succeeded to expand our salesforce in the United States to better cover more opportunities in this expanding market.

The following table summarizes the evolution of the Corporation's revenues and new orders, together with the variations in its order backlog over the last five quarters. The revenues figures attest of the Corporation's vision and efforts deployed to grow revenues from specialty products and services while increasing our order backlog.

| | 2015 FY | | | | 2016 FY | Last twelve months | Previous twelve months |
|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | (Q2, Q3 & Q4 FY2015 & Q1 FY2016) | (Q2, Q3 & Q4 FY2014 & Q1 FY2015) |
| Order backlog | $36.1 M | $29.6 M | $40.4 M | $36.5 M | **$38.3 M** | **N/A** | N/A |
| | | | | | | | |
| Bookings for water treatment projects (*) | $5.1 M | $2.2M | $16.4 M | $2.9 M | **$9.0 M** | **$30.5 M** | $43.5 M |
| Revenues from water treatment projects | $7.3 M | $8.7 M | $5.6 M | $6.9 M | **$7.2 M** | **$28.4 M** | $19.8 M |
| | | | | | | | |
| ***Bookings / Revenues Ratio*** | | | | | | ***1.1*** | ***2.2*** |
| | | | | | | | |
| Revenues from SP&S (usually recurrent in nature) | $3.9 M | $5.0 M | $6.5 M | $4.8 M | **$5.1 M** | **$21.4 M** | $17.9 M |
| Total revenues | $11.2 M | $13.7 M | $12.1 M | $11.7 M | **$12.3 M** | **$49.8 M** | $37.7 M |

(*) Bookings for water treatment projects include foreign exchange impact.

### Operating expenses

Operating expenses have increased by $133,494 or 66.6%, totaling $0.3 M this quarter compared to $0.2 M for the corresponding quarter of previous fiscal year. This variation is due to the addition of personnel to ensure the support and growth of our SP&S activities, which generate healthy gross profits.

### Selling expenses

Selling expenses have increased by $451,444 or 49.8%, to reach $1.4 M for this quarter compared to $0.9 M for the corresponding quarter of the previous fiscal year. Selling expenses are linked to bookings and revenues, but do not fluctuate proportionally. The increase is due to the addition of salesman to support the growth of revenues, sales commissions on revenue recorded and to the distributor's event during the quarter ended September 30, 2015 compared to the corresponding quarter of the previous fiscal year. This event takes place every two years and was held in August, including Piedmont Pacific Corporation's ("Piedmont") and Professional Water Technologies' ("PWT") distributors, as we launched the Prodose XPRT™ software and presented the new PWT logo.

### Administrative expenses

Administrative expenses increased by $55,755 or 5.6%, totaling $1.0 M for this quarter compared with the corresponding quarter of the previous fiscal year. The slight increase in administrative expenses is due to the increase in salaries and fringe benefits following the addition of personnel to support our overall operations and our expected growth.

The Corporation's ratio of selling, operating and administrative expenses ("SG&A") as a whole over revenues amounted to 22.3% for this quarter, up from 18.7% for the corresponding quarter of the previous fiscal year. This increase is mostly attributable to the distributors' event held in August. Management aims to keep the annual average SG&A ratio around 20% through a tight management of SG&A expenses and an increase in revenues.

### Research and development expenses – net

For the quarter ended September 30, 2015, gross research and development expenses totaled $84,564, or 0.7% of revenues compared to $39,922 or 0.3% for the quarter ended September 30, 2014. For the three-month period ended September 30, 2015, the Corporation has not recorded tax credits from the Canadian and provincial governments for eligible research and development conducted in Canada, but intends to claim such tax credits during fiscal year 2016.

### Adjusted EBITDA

Adjusted EBITDA for the quarter was recorded at $441,669, compared with $900,781 for the same period ended September 30, 2014. The lower net earnings recorded during the quarter compared with the net earnings for the corresponding quarter of the previous fiscal year and the adjustment for the gain on the purchase price adjustment for the Piedmont's transaction caused the decrease in adjusted EBITDA.

### Other losses / (gains) – net

Other losses / (gains) – net amounting to ($379,583) for the period ended September 30, 2015 compared with $91,052 for the quarter ended September 30, 2014 are mostly due to a gain of $375,977 on purchase price adjustment for the Piedmont's acquisition transaction due to a breach of certain of the representations and warranties contained in the Share Purchase Agreement dated December 5, 2013.

Other losses / (gains) – net also include unrealized and realized exchange losses and (gains) of $53,405 and ($55,310) respectively, as at September 30, 2015.

### Finance costs – net

Finance costs – net totalled $148,037 for the period ended September 30, 2015 compared to $123,841 for the comparable period in the previous fiscal year. These expenses relate mostly to the long-term debt. Of this amount, $4,855 represents the theoretical and non-monetary part of interest on long-term debt. In order to mitigate its credit risk, the Corporation started to insure a part of its accounts receivables through the insurance program of Exportation and Development Canada ("EDC") in August 2014. This insurance program allows under certain conditions, an insurance coverage that can reach an amount equivalent to 90% of the receivables. As at September 30, 2015, the EDC insurance coverage represents approximately 51% of the receivables (63% as at June 30, 2015). The Corporation has given direction to pay all insurance proceeds to the bank since the insurance coverage allows the Corporation to increase its bank loans usage capacity.

### Net earnings

The net earnings amounted to $52,329 or $0.003 per share for the first quarter of fiscal 2016 compared with $282,587 or $0.014 per share for the first quarter of fiscal 2015. The decrease in net earnings is partly due to the distributor event, which is held every two years, and to a higher level of SG&A expenses, aimed to support the constant growth of the Corporation.

### Commitments

The Corporation has entered into long-term lease agreements expiring between 2017 and 2024, which call for lease payments of $5,471,596 for the rental of space. The minimum annual lease payments over the next five years are $879,396 in 2016, $863,262 in 2017, $698,153 in 2018, $708,352 in 2019 and $686,277 in 2020.

### Information on share capital

As at September 30, 2015, the Corporation had 20,926,551 outstanding shares and 331,500 stock options.

## FINANCIAL SITUATION

Working capital increased from $8.4 M as at June 30, 2015 (working capital ratio of 1.75) to $8.9 M as at September 30, 2015 (working capital ratio of 1.63). The increase of $0.5 M is attributable to the $0.2 M, $0.6 M and $2.2 M increase in accounts receivables, inventories and costs incurred in excess of billings respectively, and by the increase of $2.0 M and $0.2 M in accounts payable and accrued liabilities as well as billings in excess of costs incurred respectively.

The net debt which stood at $4.3 M as at September 30, 2015 increased by $0.2 M compared with $4.1 M as at June 30, 2015. This increase is mainly attributable to the increase of the bank loans, but subdued by the reimbursement of a portion of the long-term debt.

Equity stood at $27.4 M as at September 30, 2015, compared with $26.0 M as at June 30, 2015. As at September 30, 2015 and June 30, 2015 the net debt to equity ratio was 0.16, showing that the Corporation is not over leveraged.

| (in Canadian dollars, except for ratios) | Period ended September 30, 2015 | Period ended June 30, 2015 |
|---|---|---|
| Working capital | $8,946,588 | $8,423,583 |
| Working capital ratio | 1.63 | 1.75 |
| Net debt[1] | $4,330,311 | $4,141,826 |
| Equity | $27,376,782 | $26,007,486 |
| Net debt to equity ratio | 0.16 | 0.16 |

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

As at September 30, 2015 accounts receivable stood at $10.1 M compared with $9.9 M as at June 30, 2015. The rise of $0.2 M is mostly attributable to the increase of accounts receivable from customers under manufacturing contracts related to water treatment projects executed during the first quarter of fiscal year 2016.

Inventories increased by $0.6 M to $4.6 M as at September 30, 2015 compared with $4.0 M as at June 30, 2015. Inventories have increased due to finished goods manufactured during the summer in preparation for the start of the maple syrup production season. In addition, finished goods have also increased due to the large order of couplings to be delivered in the second quarter of fiscal year 2016.

Costs incurred in excess of billings increased by $2.2 M to $4.3 M as at September 30, 2015, from $2.1 M as at June 30, 2015, primarily due to a different number of active projects for which there are differences between project advancement and project invoicing schedules. Billings in excess of costs incurred increased by $0.2 M to $1.6 M as at September 30, 2015, from $1.4 M as at June 30, 2015. This increase is also attributable to differences between project advancement and project invoicing schedules.

Accounts payable and accrued liabilities increased by $2.0 M to $6.7 M as at September 30, 2015, from $4.7 M as at June 30, 2015. This is mostly due to increased volume of activities for water treatment projects which have reached, for many of them, the manufacturing stage during which equipment is being assembled and for which suppliers are involved.

The decrease in the current portion of the long-term debt is explained by the repayment of $0.1 M during the quarter. For the first quarter ended September 30, 2015, shareholders' equity increased by $1.4 M to $27.4 M ($26.0 M as at June 30, 2015). The following elements had an impact on shareholders' equity in the first quarter of fiscal year 2016: 1) the $52,329 net earnings for the period ended September 30, 2015 and 2) the Canadian dollar's depreciation which generated an unrealized exchange gain of $1.3 M resulting from the translation of foreign operations, mainly those of the U.S. subsidiaries.

## CASH FLOWS

A comparison of the Corporation's cash flows for the periods ended September 30, 2015 and 2014 is presented below:

| (in Canadian dollars) (unaudited) | Three-month period ended September 30, 2015 | Three-month period ended September 30, 2014 |
|---|---|---|
| | **$** | $ |
| Cash flows from operating activities | **(227,303)** | 411,225 |
| Cash flows from investing activities | **108,454** | (104,484) |
| Cash flows from financing activities | **237,334** | (709,774) |
| Effect of exchange rate changes on the balance of cash held in foreign currencies | **85,628** | 31,032 |
| Net change | **204,113** | (372,001) |
| Cash and cash equivalents – Beginning of period | **1,333,835** | 384,369 |
| Cash and cash equivalents – End of period | **1,537,948** | 12,368 |

Operating activities used ($227,303) in cash for the period ended September 30, 2015, compared with $411,225 of cash generated during the corresponding period ended September 30, 2014. The decline is mainly attributable to the

decrease in earnings before income taxes in the first quarter of fiscal year 2016 and to the gain on purchase price adjustment on the Piedmont's transaction.

For the first quarter of fiscal 2016, investing activities generated net cash of $108,454, compared with ($104,484) of cash used during the corresponding period ended September 30, 2014. The positive variation is mainly attributable to the payment received on the Piedmont's purchase price adjustment and subdued by the investment of $138,000 in a new enterprise resources planning (ERP) software.

Financing activities generated net cash of $237,334 in the first quarter of fiscal 2016 compared with ($709,774) of net cash used during the corresponding period ended September 30, 2014. The Corporation reimbursed $135,416 of its long-term debt but increased the bank loans by $519,559. Interest paid during the first quarter of fiscal year 2016 amounted to $146,809.

## QUARTERLY SUMMARY FINANCIAL INFORMATION (unaudited)

(in dollars, except per share data)

| | Three-month periods ended | | | | Last twelve months |
|---|---|---|---|---|---|
| | **September 30, 2015** | **June 30, 2015** | **March 31, 2015** | **December 31, 2014** | |
| Revenues | 12,259,328 | 11,670,028 | 12,121,641 | 13,689,060 | 49,740,057 |
| Adjusted EBITDA | 441,669 | 548,935 | 905,633 | 670,723 | 2,566,960 |
| Net earnings (loss) | 52,329 | (284,063) | 156,377 | 117,524 | 42,167 |
| EPS basic and diluted | 0.003 | (0.014) | 0.007 | 0.006 | 0.002 |
| Cash flows from operating activities | (227,303) | 867,972 | 1,392,269 | (549,922) | 1,483,016 |

| | Three-month periods ended | | | | Previous twelve months |
|---|---|---|---|---|---|
| | **September 30, 2014** | **June 30, 2014** | **March 31, 2014** | **December 31, 2013** | |
| Revenues | 11,219,131 | 7,896,401 | 9,826,466 | 8,797,428 | 37,739,426 |
| Adjusted EBITDA | 900,781 | (249,642) | 368,230 | (60,496) | 958,873 |
| Net earnings (loss) | 282,587 | (269,242) | (216,314) | (500,581) | (703,550) |
| EPS basic and diluted | 0.014 | (0.01) | (0.004) | (0.03) | (0.03) |
| Cash flows from operating activities | 411,225 | 330,455 | (298,938) | (3,012,316) | (2,569,574) |

## SUBSEQUENT EVENT

On October 21, 2015, the Corporation closed the transaction previously announced on September 24, 2015 with Clearlogx, Inc., whereby it acquired all of the assets of Clearlogx pertaining to its unique Clearlogx® control technology and its specialty coagulant. In addition to the Clearlogx® technology, the Corporation purchased Clearlogx's business related to the sale of coagulants for conventional and membrane filtration systems. This acquisition was made for a total consideration of $1.97 million (US$1.5 million), with potential earn-out payments over a period of three (3) years following the effective date of the transaction. This acquisition was entirely financed with a long-term bank loan of $2.63 million (US$2 million) borrowed from BMO Bank and secured at 75% by EDC, allowing the Corporation to reduce its interest rate.

## CAPITAL MANAGEMENT

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

The Corporation's capital is composed of net debt and shareholders' equity. Net debt consists of bank overdraft, bank loans and long-term debt less cash and cash equivalents. The Corporation's primary uses of capital are to finance increases in non-cash working capital and capital expenditures for capacity expansion and integration.

The Corporation monitors its performance through different ratios such as those required under its credit facility and long-term debt arrangements.

Credit facility and long-term debt arrangements require that the Corporation meet certain annual financial ratios at fixed points in time. The financial ratios are, as at September 30, 2015:

- Working capital ratio, defined as current assets divided by current liabilities greater than or equal to 1.25:1.00;
- Debt-to-equity ratio, defined as total debt excluding deferred taxes divided by equity of less than or equal to 2.00:1.00; 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, 2015, the Corporation was in compliance with its annual financial ratios required for its credit facility and long-term debt arrangements.

## ACCOUNTING POLICIES

The reader is invited to refer to the summary of significant accounting policies presented in note 3 to the consolidated financial statements as at June 30, 2015.

## OFF-BALANCE SHEET ARRANGEMENTS

As at September 30, 2015, the Corporation had off-balance sheet arrangements consisting of letters of credit amounting to $1.2 M; which expire at various dates through fiscal year 2017. In these letters of credit, $1.2 M is secured by deposit certificates.

## CONTROLS AND PROCEDURES

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

### Disclosure controls and procedures

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

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

An evaluation was carried out, under the supervision of the CEO and the CFO, of the effectiveness of our disclosure controls and procedures. Based on this evaluation, the CEO and the CFO concluded that the disclosure controls and procedures are effective, using the criteria set forth in National Instrument 52-109.

### Internal controls over financial reporting

The CEO and the CFO have also designed internal controls over financial reporting, or have caused them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. The internal controls over financial reporting are designed using the criteria set forth by the *Committee of Sponsoring Organizations of the Treadway Commission 2013* (COSO 2013) on Internal Control – Integrated Framework. The work performed allows us to conclude that the internal controls over financial reporting are effective for the period ended September 30, 2015.

### Changes in internal controls over financial reporting

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

# CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

September 30, 2015

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

For additional information:
Investor Relations
*investor@h2oinnovation.com*

Trading symbols:

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

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

## CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (Unaudited)

| | September 30, 2015 | June 30, 2015 |
|---|---|---|
| | $ | $ |
| **ASSETS** | | |
| **Current assets** | | |
| Cash and cash equivalents | **1,964,605** | 1,335,887 |
| Guaranteed deposit certificates | **1,576,269** | 1,629,803 |
| Accounts receivable (note 3) | **10,108,595** | 9,876,150 |
| Inventories (note 4) | **4,603,451** | 3,955,411 |
| Costs incurred in excess of billings | **4,303,875** | 2,096,403 |
| Prepaid expenses | **633,312** | 753,766 |
| | **23,190,107** | 19,647,420 |
| **Non-current assets** | | |
| Property, plant and equipment | **3,096,469** | 3,020,789 |
| Intangible assets | **7,995,383** | 7,592,573 |
| Other assets | **63,569** | 60,515 |
| Goodwill | **5,015,504** | 4,694,166 |
| Deferred income tax assets | **2,822,720** | 2,832,159 |
| | **42,183,752** | 37,847,622 |
| **LIABILITIES** | | |
| **Current liabilities** | | |
| Bank overdraft | **426,657** | 2,052 |
| Bank loans (note 5) | **4,951,636** | 4,432,077 |
| Accounts payable and accrued liabilities (note 6) | **6,706,683** | 4,729,427 |
| Provisions (note 7) | **92,512** | 84,272 |
| Billings in excess of costs incurred | **1,579,304** | 1,409,396 |
| Income taxes payable | **7,206** | 14,908 |
| Deferred rent | **8,589** | 7,898 |
| Current portion of long-term debt (note 8) | **470,932** | 543,807 |
| | **14,243,519** | 11,223,837 |
| **Non-current liabilities** | | |
| Long-term debt (note 8) | **445,691** | 499,777 |
| Deferred rent | **117,760** | 116,522 |
| | **14,806,970** | 11,840,136 |
| **SHAREHOLDERS' EQUITY** | | |
| Share capital (note 9) | **55,298,945** | 55,298,945 |
| Reserve - Stock options | **1,876,379** | 1,876,379 |
| Deficit | **(33,275,083)** | (33,327,412) |
| Accumulated other comprehensive income | **3,476,541** | 2,159,574 |
| | **27,376,782** | 26,007,486 |
| | **42,183,752** | 37,847,622 |

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

On behalf of the Board,

Frédéric Dugré



President and Chief Executive Officer

Philippe Gervais



Chairman of the Board of Directors

## CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
**For the three-month periods ended September 30, 2015 and 2014**
**(Unaudited)**

| | ATTRIBUTABLE TO THE SHAREHOLDERS OF $H_2O$ INNOVATION INC. | | | | | |
|---|---|---|---|---|---|---|
| | | | Reserves | | | |
| | **Common shares Number** (note 11) | **Share capital** (note 9) | **Stock option** (note 9) | **Deficit** | **Accumulated other comprehensive income (loss) – Translation adjustment** | **Total** |
| | | **$** | **$** | **$** | **$** | **$** |
| **Balance as at July 1, 2014** | 20,926,551 | 55,298,945 | 1,873,957 | (33,599,837) | (1,012,182) | 22,560,883 |
| Stock-based compensation costs | - | - | 2,422 | - | - | 2,422 |
| Net earnings for the period | - | - | - | 282,587 | - | 282,587 |
| Other comprehensive income – Currency translation adjustments | - | - | - | - | 969,462 | 969,462 |
| **Balance as at September 30, 2014** | **20,926,551** | **55,298,945** | **1,876,379** | **(33,317,250)** | **(42,720)** | **23,815,354** |
| **Balance as at July 1, 2015** | **20,926,551** | **55,298,945** | **1,876,379** | **(33,327,412)** | **2,159,574** | **26,007,486** |
| Net earnings for the period | **-** | **-** | **-** | **52,329** | **-** | **52,329** |
| Other comprehensive income – Currency translation adjustments | **-** | **-** | **-** | **-** | **1,316,967** | **1,316,967** |
| **Balance as at September 30, 2015** | **20,926,551** | **55,298,945** | **1,876,379** | **(33,275,083)** | **3,476,541** | **27,376,782** |

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

## CONDENSED INTERIM CONSOLIDATED STATEMENTS OF EARNINGS
## For the three-month periods ended September 30, 2015 and 2014
## (Unaudited)

| | Three-month periods ended September 30, | |
|---|---|---|
| | **2015** | 2014 |
| | **$** | $ |
| Revenues (note 13) | **12,259,328** | 11,219,131 |
| Cost of goods sold (note 10 a)) | **9,054,842** | 8,186,180 |
| **Gross profit before depreciation and amortization** | **3,204,486** | 3,032,951 |
| Operating expenses (note 10 a)) | **333,980** | 200,486 |
| Selling expenses (note 10 a)) | **1,357,733** | 906,289 |
| Administrative expenses (note 10 a)) | **1,043,551** | 987,796 |
| Research and development expenses – net (notes 10 a) and c)) | **84,564** | 39,922 |
| Depreciation of property, plant and equipment (note 10 b)) | **127,343** | 76,517 |
| Amortization of intangible assets (note 10 b)) | **231,679** | 206,044 |
| Other (gains) / losses – net (note 10 d)) | **(379,583)** | 91,052 |
| **Operating costs total** | **2,799,267** | 2,508,106 |
| **Operating earnings** | **405,219** | 524,845 |
| Finance income | **(3,627)** | (2,673) |
| Finance costs | **151,664** | 126,514 |
| Finance costs – net | **148,037** | 123,841 |
| **Earnings before income taxes** | **257,182** | 401,004 |
| Current income tax expense | **223,230** | 133,707 |
| Deferred tax benefit | **(18,377)** | (15,290) |
| | **204,853** | 118,417 |
| **Net earnings for the period** | **52,329** | 282,587 |
| **Net earnings per share attributable to the equity holders of the Corporation during the period** | | |
| **Basic and diluted net earnings per share** | **0.003** | 0.014 |
| Weighted average number of shares outstanding (note 11) | **20,926,551** | 20,926,551 |

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

## CONDENSED INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
**For the three-month periods ended September 30, 2015 and 2014**
**(Unaudited)**

| | Three-month periods ended September 30, | |
|---|---|---|
| | **2015** | 2014 |
| | **$** | $ |
| Net earnings for the period | **52,329** | 282,587 |
| Other comprehensive income - Items that may be reclassified subsequently to net earnings | | |
| Currency translation adjustments | **1,316,967** | 969,462 |
| Comprehensive income for the period | **1,369,296** | 1,252,049 |

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

## CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
## For the three-month periods ended September 30, 2015 and 2014
## (Unaudited)

| | Three-month periods ended September 30, 2015 | 2014 |
|---|---|---|
| | **$** | $ |
| **Cash flows from operating activities** | | |
| Earnings before income taxes for the period | **257,182** | 401,004 |
| Non-cash items | | |
| Finance costs – net | **148,037** | 123,841 |
| Depreciation of property, plant and equipment | **127,343** | 76,517 |
| Amortization of intangible assets | **231,679** | 206,044 |
| Gain on purchase price adjustment (note 10d)) | **(375,977)** | - |
| Deferred rent | **(2,479)** | 318 |
| Stock-based compensation | **-** | 2,422 |
| | **385,785** | 810,146 |
| Change in working capital items (note 12a)) | **(616,715)** | (384,326) |
| Cash (used in) generated by operations | **(230,930)** | 425,820 |
| Interests received | **3,627** | 2,673 |
| Income taxes paid | **-** | (17,267) |
| Net cash (used in) generated by operating activities | **(227,303)** | 411,226 |
| **Cash flows from investing activities** | | |
| Variation of guaranteed deposits certificates | **60,847** | (1,121) |
| Acquisition of property, plant and equipment | **(170,756)** | (42,389) |
| Payment received on purchase price adjustment (note d)) | **375,977** | - |
| Acquisition of intangible assets | **(157,614)** | (60,974) |
| Net cash generated by (used in) investing activities | **108,454** | (104,484) |
| **Cash flows from financing activities** | | |
| Variation of bank loans | **519,559** | (345,813) |
| Long-term debt reimbursement | **(135,416)** | (254,812) |
| Interest paid | **(146,809)** | (109,149) |
| Net cash generated by (used in) financing activities | **237,334** | (709,774) |
| Net change in cash and cash equivalents | **118,485** | (403,032) |
| **Effect of exchange rate changes on the balance of cash held in foreign currencies** | **85,628** | 31,031 |
| **Increase (Decrease) in cash and cash equivalents** | **204,113** | (372,001) |
| **Cash and cash equivalents - Beginning of period (note 12b))** | **1,333,835** | 384,369 |
| **Cash and cash equivalents - End of period (note 12b))** | **1,537,948** | 12,368 |

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

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

## 1. Description of Business

$H_2O$ Innovation Inc. (the "Corporation") is incorporated under the *Canada Business Corporations Act*. The Corporation designs and provides state-of-the-art, custom-built, and integrated water treatment solutions based on membrane filtration technology for municipal, energy and natural resources end-users. Also, directly and through its affiliates, $H_2O$ Innovation provides services and products complementary to its membrane filtration and reverse osmosis systems. These products consist of a complete line of specialty chemicals, consumables and couplings. At the same time and on a smaller scale, the Corporation continues its manufacturing and equipment distribution operations for the maple industry. The head office of the Corporation is located at 330 Saint-Vallier Street East, suite 340, Quebec City (Quebec), Canada.

## 2. Basis of Preparation

### Basis of preparation

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

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

The IFRS accounting policies that are set out in the Corporation's consolidated financial statements for the year ended June 30, 2015 were consistently applied to all periods presented. Please refer to note 3 in the Corporation's consolidated financial statements for the year ended June 30, 2015 for a complete description of the Corporation's significant accounting policies.

The preparation of financial statements in conformity with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Corporation's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant are disclosed in note 4 in the Corporation's consolidated financial statements for the year ended June 30, 2015 and remained unchanged for the three-month period ended September 30, 2015.

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

These condensed interim consolidated financial statements are intended to provide an update on 2015 annual statements. Accordingly they do not include all the information required for annual financial statements and should be read in conjunction with the Corporation's 2015 annual audited consolidated financial statements.

On November 9, 2015 the Board reviewed the accompanying condensed interim consolidated financial statements and authorized its publication.

### Standards and interpretations issued to be adopted at a later date

The following revised standards are effective for annual periods beginning on or after January 1, 2018 for IFRS 9 and January 1, 2017 for IFRS 15, with earlier application permitted. On July 22, 2015, the IASB has confirmed a one-year deferral of the effective date of IFRS 15 to January 1, 2018. The Corporation has not yet assessed the impact of these standards and amendment on its unaudited consolidated financial statements or determined whether it will early adopt them.

IFRS 9, *Financial Instruments*, was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39, *Financial Instruments: Recognition and Measurement* with a single approach to determine whether a financial asset is measured at amortized cost, fair value through other comprehensive income or 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.

In May 2014, the IASB released IFRS 15, *Revenue from Contracts with Customers*, which establishes principles for reporting the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. It provides a single model in order to depict the transfer of promised goods or services to customers. The core principle of IFRS 15 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods and services. IFRS 15 also requires more comprehensive disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers.

IFRS 15 supersedes IAS 11, *Construction Contracts*, IAS 18, *Revenue*, and a number of revenue-related interpretations (IFRIC 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreements for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers*, and SIC-31, *Revenue, Barter Transactions Involving Advertising Service*). IFRS 15 is effective for annual periods beginning on or after January 1, 2018, with earlier adoption permitted.

## 3. Accounts Receivable

| | **As at September 30, 2015** | As at June 30, 2015 |
|---|---|---|
| | **$** | $ |
| Trade accounts receivable | **8,051,748** | 8,348,130 |
| Retentions from customers under manufacturing contracts | **868,267** | 1,018,469 |
| Allowance for doubtful accounts | **(17,284)** | (1,270) |
| | **8,902,731** | 9,365,329 |
| Tax credits receivable | **99,885** | 99,885 |
| Other receivables | **1,105,979** | 410,936 |
| | **10,108,595** | 9,876,150 |

In order to mitigate its credit risk, the Corporation started to insure a part of its accounts receivable through the insurance program of Exportation and Development Canada ("EDC") in August 2014. This insurance program allows under certain conditions, an insurance coverage that can reach an amount equivalent to 90% of the receivables. As at September 30, 2015, the EDC insurance coverage represents approximately 51% of the receivables (63% as at June 30, 2015).

The Corporation has given direction to pay all insurance proceeds to the bank since the insurance coverage allows the Corporation to increase its bank loans usage capacity.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

### 4. Inventories

| | As at September 30, 2015 | As at June 30, 2015 |
|---|---|---|
| | $ | $ |
| Raw materials | **1,176,563** | 1,040,487 |
| Finished goods | **3,426,888** | 2,914,924 |
| | **4,603,451** | 3,955,411 |

### 5. Bank loans

The bank loans for an authorized amount of $5,000,000 or US$5,000,000 bearing interest at CDN prime rate plus 1.00% (3.70% as at September 30, 2015 and June 30, 2015) and at US prime rate plus 1.00% (4.75% as at September 30, 2015 and June 30, 2014) are secured by an assignment of accounts receivable and inventories and by Export Development Canada ("EDC"). As at September 30, 2015, $4,951,636 was used on this line of credit ($4,432,077 as at June 30, 2015).

The Corporation has an unused credit facility available of $2,000,000 or US$2,000,000 bearing interest at CDN prime rate plus 1.00% (3.70% as at September 30, 2015 and June 30, 2014) and at US prime rate plus 1.00% (4.75% as at September 30, 2015 and June 30, 2015). This credit facility is secured by EDC.

The Corporation has a credit facility enabling it to issue letters of credit for a maximum amount of $1,000,000. This credit facility is secured either by EDC or guaranteed deposit certificate and is unused as at September 30, 2015.

The Corporation has a credit facility enabling it to issue letters of credit for a maximum amount of $1,000,000. The credit facility is secured by $1,003,304 in guaranteed deposit certificate ($1,001,036 as at June 30, 2015). As at September 30, 2015, the Corporation issued $1,000,000 in letters of credit under this credit facility ($1,000,000 as at June 30, 2015).

The Corporation has access to hedging facility of $500,000. This facility is secured by EDC and is unused as at September 30, 2015 (unused as at June 30, 2015).

The Corporation has a credit facility enabling it to use a maximum amount of $400,000 on credit card for Corporation related expenses. This credit facility is secured by $250,955 in guaranteed deposit certificate ($250,388 as at June 30, 2015).

The Corporation has a letter of credit amounting to $66,725 which is secured by a $67,434 guaranteed deposit certificate.

The Corporation still has letters of credit amounting to $135,573 with its previous bank, which are secured by a $133,001 guaranteed deposit certificate ($132,727 as at June 30, 2015).

Covenants

The Corporation has undertaken to maintain covenants on a yearly basis in respect of the bank loans described above.

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

### 6. Accounts Payable and Accrued Liabilities

| | **As at September 30, 2015** | As at June 30, 2015 |
|---|---|---|
| | **$** | $ |
| Trade accounts payable | **2,719,590** | 3,039,313 |
| Other accrued liabilities and accounts payable | **3,987,093** | 1,690,114 |
| | **6,706,683** | 4,729,427 |

### 7. Provisions

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

| | $ |
|---|---|
| Balance as at June 30, 2014 | 77,391 |
| Additional provisions recognised | 12,000 |
| Less: Payments | (16,273) |
| Effect of foreign exchange differences | 11,154 |
| Balance as at June 30, 2015 | 84,272 |
| **Additional provisions recognised** | **3,000** |
| **Effect of foreign exchange differences** | **5,240** |
| **Balance as at September 30, 2015** | **92,512** |

### 8. Long-Term Debt

| | **As at September 30, 2015** | As at June 30, 2015 |
|---|---|---|
| | **$** | $ |
| ***Unsecured – at amortised cost*** | | |
| Bank loan, denominated in Canadian dollars (a) | **455,880** | 460,000 |
| Loan from other entities, denominated in Canadian dollars (b) | **409,053** | 529,199 |
| Loan from other entities, denominated in US dollars (c) | **51,690** | 54,385 |
| | **916,623** | 1,043,584 |
| Less : Current portion | **470,932** | 543,807 |
| Long-term debt | **445,691** | 499,777 |

(a) Bank loan
On September 20, 2014, an agreement was concluded for a loan amounting up to $460,000, secured by a first rank hypothec on the Ham-Nord plant, representing a carrying value of $1,300,000, bearing interest at prime rate plus 1.05% (5.75% as at September 30, 2015), payable in one instalment of $4,120 on September 23, 2015 and 131 monthly instalments of $3,480, principal only, maturing on August 23, 2026.

(b) Loan from other entities
The loan of $409,053 bearing interest at 12% (effective rate of 17.5%) is repayable in monthly instalments maturing July 1, 2016.

On August 28, 2014, an agreement was concluded giving a six-month moratorium option the repayment of principal with an increase of 0.25% of the interest rate applicable. On October 20, 2014, the Corporation has exercised its six-month moratorium option on the repayment of principal starting November 1, 2014.

(c) Loans from other entities
A loan of $51,690 ($US 38,733), bearing interest at 8.5% payable in monthly instalments of $2,536 ($US 1,900) and maturing July 1, 2017.

## 9. Capital Stock

### Share consolidation (reverse stock split)

On December 1st, 2014, the Corporation effected a consolidation of its issued and outstanding common shares on a five-to-one basis (the "Share Consolidation"). The Share Consolidation affected all shareholders, optionholders and warrantholders uniformly and thus did not materially affect any securityholder's percentage of ownership interest. All references in these consolidated financial statements to common shares, options and share purchase warrants have been retroactively adjusted to reflect the Share Consolidation.

The 104,632,977 common shares issued and outstanding immediately prior to the Share Consolidation were consolidated into 20,926,551 common shares. The Corporation's outstanding stock options and share purchase warrants were adjusted on the same basis with proportionate adjustments being made to each stock option and share purchase warrant exercise price.

All share, option and share purchase warrant and per share, option and share purchase warrant data have been retroactively adjusted to reflect and give effect to the Share Consolidation as if it occurred at the beginning of the earliest period presented.

### Stock options

The Corporation has established a stock option plan whereby the Board of Directors may grant stock options to directors, executive officers, key employees and consultants providing services to the Corporation. The Board of Directors determines, at its discretion, the vesting terms, if applicable, the expiry date of options and the number of options to be granted. The maximum number of shares that may be issued under the plan amounts to 1,100,000.

The following table summarizes the activity under the Corporation’s stock-based compensation plan.

| | **Three-month period ended September 30, 2015** | | Year ended June 30, 2015 | |
|---|---|---|---|---|
| | **Number** | **Weighted average exercise price** | Number | Weighted average exercise price |
| | | **$** | | $ |
| Outstanding - Beginning of period | **331,500** | **2.64** | 347,500 | 2.66 |
| Forfeited | **-** | **-** | (16,000) | 3.13 |
| Outstanding - End of period | **331,500** | **2.64** | 331,500 | 2.64 |

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

## 10. Additional information about the nature of costs components

### a) Expenses by nature

| | **Three-month period ended September 30, 2015** | Three-month period ended September 30, 2014 |
|---|---|---|
| | **$** | $ |
| Material | **5,828,120** | 5,257,610 |
| Changes in inventories of raw material, finished goods and costs incurred in excess of billings | **1,021,260** | 563,614 |
| Salaries and fringe benefits | **3,241,411** | 2,741,341 |
| Subcontractors and professional fees | **430,461** | 680,692 |
| Rent, electricity , insurance and office expenses | **476,176** | 384,335 |
| Telecommunications and travel expenses | **457,104** | 319,200 |
| Bad debt expenses | **16,014** | 30,000 |
| Other expenses | **404,124** | 343,881 |
| Total cost of goods sold, operating, selling, administrative and research and development expenses | **11,874,670** | 10,320,673 |

## b) Depreciation and amortization

The Corporation has elected to present depreciation and amortization as a separate line item in its condensed interim consolidated statement of earnings, as opposed to reflecting the fraction of such amount that pertains to each of the cost of goods sold, operating expenses, selling expenses, administrative expenses and research and development expenses – net, within those cost categories. The following tables provide: i) a breakdown of the depreciation and amortization expense by cost category as noted above, for the three-month periods ended September 30, 2015 and 2014; and ii) the amounts of cost of goods sold, operating expenses, selling expenses, administrative expenses and research and development expenses – net, if depreciation and amortization were allocated within those cost categories for the periods as noted above.

| **Depreciation by function** | **Three-month period ended September 30, 2015** | Three-month period ended September 30, 2014 |
|---|---|---|
| | **$** | $ |
| Cost of goods sold | **98,342** | 47,956 |
| Operating expenses | **572** | 779 |
| Selling expenses | **8,920** | 8,388 |
| Administrative expenses | **19,509** | 19,394 |
| | **127,343** | 76,517 |

| **Amortization by function** | **Three-month period ended September 30, 2015** | Three-month period ended September 30, 2014 |
|---|---|---|
| | **$** | $ |
| Cost of goods sold | **117,299** | 97,672 |
| Selling expenses | **100,897** | 95,364 |
| Administrative expenses | **13,483** | 13,008 |
| | **231,679** | 206,044 |

| **Cost per function including depreciation and amortization** | **Three-month period ended September 30, 2015** | Three-month period ended September 30, 2014 |
|---|---|---|
| | **$** | $ |
| Cost of goods sold | **9,270,483** | 8,331,808 |
| Operating expenses | **334,552** | 201,265 |
| Selling expenses | **1,467,550** | 1,010,041 |
| Administrative expenses | **1,076,543** | 1,020,198 |
| Research and development expenses – net | **84,564** | 39,922 |
| | **12,233,692** | 10,603,234 |

## NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

### c) Research and development expenses – net

| | **Three-month period ended September 30, 2015** | Three-month period ended September 30, 2014 |
|---|---|---|
| | **$** | $ |
| Gross research and development expenses | **84,564** | 39,922 |
| Research and development tax credits and grants | **-** | - |
| | **84,564** | 39,922 |

### d) Other (gains) losses – net

| | **Three-month period ended September 30, 2015** | Three-month period ended September 30, 2014 |
|---|---|---|
| | **$** | $ |
| Unrealized exchange loss | **53,405** | 90,954 |
| Realized exchange (gain) loss | **(55,310)** | 2,118 |
| Other revenues (a) | **(377,678)** | (2,020) |
| | **(379,583)** | 91,052 |

(a) Other revenues
An amount of $375,977 has been recorded following the indemnification by Piedmont's sellers due to a breach of certain of their representations and warranties contained in the Share Purchase Agreement dated December 5, 2013.

## 11. Net earnings per share

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

| | **Three-month period ended September 30, 2015** | Three-month period ended September 30, 2014 |
|---|---|---|
| **Net earnings** | **$52,329** | $282,587 |
| **Basic and diluted weighted average number of share outstanding** | **20,926,551** | 20,926,551 |
| **Basic and diluted net earnings per share** | **$0.003** | $0.014 |
| **Items excluded from the calculation of diluted net earnings per share because the exercise price was greater than the average market price of the common shares** | | |
| Stock options | **331,500** | 331,500 |

For the three-month periods ended September 30, 2015 and 2014, the diluted net earnings per share was the same as the basic net earnings per share, since the effect of the assumed exercise of stock options and warrants to purchase common share is anti-dilutive. Accordingly, the diluted net earnings per share for these periods were calculated using the basic weighted average number of shares outstanding.

## 12. Cash Flows

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

| | **Three-month period ended September 30, 2015** | Three-month period ended September 30, 2014 |
|---|---|---|
| | **$** | $ |
| Accounts receivable | **85,629** | (1,601,145) |
| Inventories | **(580,132)** | 534,189 |
| Costs incurred in excess of billings | **(2,079,456)** | (519,328) |
| Prepaid expenses | **127,358** | (46,705) |
| Accounts payable and accrued liabilities | **1,708,330** | 859,855 |
| Provisions | **3,000** | 3,000 |
| Billings in excess of costs incurred | **118,556** | 385,808 |
| | **(616,715)** | (384,326) |

b) Cash and cash equivalents consist of the following:

| | **As at September 30, 2015** | As at September 30, 2014 |
|---|---|---|
| | **$** | $ |
| **Beginning of period** | | |
| Cash and cash equivalents | **1,335,887** | 497,752 |
| Bank overdraft | **(2,052)** | (113,383) |
| | **1,333,835** | 384,369 |

| | **As at September 30, 2015** | As at September 30, 2014 |
|---|---|---|
| | **$** | $ |
| **End of period** | | |
| Cash and cash equivalents | **1,964,605** | 569,910 |
| Bank overdraft | **(426,657)** | (557,542) |
| | **1,537,948** | 12,368 |

## 13. Segment Information

### Products from which reportable segments derive their revenues

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

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

| | **Three-month period ended September 30, 2015** | Three-month period ended September 30, 2014 |
|---|---|---|
| | **$** | $ |
| Revenues from sales of consumables | **5,078,237** | 3,937,128 |
| Manufacturing contracts revenues | **7,181,091** | 7,282,003 |
| | **12,259,328** | 11,219,131 |

### Geographical information

| | **Three-month period ended September 30, 2015** | Three-month period ended September 30, 2014 |
|---|---|---|
| | **$** | $ |
| **Revenues from external customers** | | |
| Revenue according to geographic location | | |
| Canada | **2,472,083** | 3,891,286 |
| United States | **8,247,492** | 5,545,095 |
| China | **388,431** | 810,544 |
| Mexico | **218,675** | 38,506 |
| Egypt | **199,739** | - |
| Saudi Arabia | **137,272** | 1,284 |
| Chile | **85,545** | 12,822 |
| Tunisia | **58,698** | 88,989 |
| Other | **451,393** | 830,605 |
| | **12,259,328** | 11,219,131 |

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

| | **As at September 30, 2015** | As at June 30, 2015 |
|---|---|---|
| | **$** | $ |
| Non-current assets other than financial instruments and deferred tax assets according to geographic location | | |
| Canada | **3,283,761** | 3,097,671 |
| United States | **12,823,595** | 12,209,857 |
| | **16,107,356** | 15,307,528 |

## 14. Related parties disclosure

### Compensation of key management personnel

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

| | **Three-month period ended September 30, 2015** | Three-month period ended September 30, 2014 |
|---|---|---|
| | **$** | $ |
| Short-term benefits | **297,157** | 266,928 |
| Post-employment benefits | **8,697** | 3,698 |
| Share-based payments | **-** | 2,155 |
| | **305,854** | 272,781 |

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

## 15. Subsequent Event

On October 21, 2015, the Corporation closed the transaction previously announced on September 24, 2015 with Clearlogx, Inc., whereby it acquired all of the assets of Clearlogx pertaining to its unique Clearlogx® control technology and its specialty coagulant. In addition to the Clearlogx® technology, the Corporation purchased Clearlogx's business related to the sale of coagulants for conventional and membrane filtration systems. This acquisition was made for a total consideration of $ 1.97 million (US$1.5 million), with potential earn-out payments over a period of three (3) years following the effective date of the transaction. This acquisition was entirely financed with a long-term bank loan of $ 2.63 million (US$2 million) borrowed from BMO Bank and secured at 75% by EDC, allowing the Corporation to reduce its interest rate.

## GENERAL INFORMATION

### Board of Directors

**Philippe Gervais**, Chairman of the Board[1]
**Frédéric Dugré**, President, Chief Executive Officer and Director[3]
**Pierre Côté**, Director[3]
**Élaine C. Phénix**, Director[1] [2]
**Jean-Réal Poirier**, Director[2] [3]
**Richard Hoel**, Director[1]
**Lisa Henthorne**, Director[2] [3]
**Laurence E. Gamst**, Director[1]
**Peter K. Dorrins**, Director

### Key Management

**Frédéric Dugré**, President and Chief Executive Officer
**Marc Blanchet**, Chief Financial Officer and Secretary
**Guillaume Clairet**, Chief Operating Officer[3]
**Josée Riverin**, Vice President, Finance

[1] Audit Committee
[2] Governance, Remuneration and Risks Committee
[3] Technology and Projects Committee

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

### Independent Auditors
Deloitte LLP

### Transfer Agent
CST Trust Company

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