



Interim Financial Statements

**INTERNATIONAL WATER-GUARD
INDUSTRIES INC.**

Three months ended December 31, 2006 and 2005

Interim Financial Statements of

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notice of no auditor review of interim financial statements to December 31, 2006

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.
BALANCE SHEETS

	December 31 <u>2006</u>	September 30 <u>2006</u>
ASSETS		
Current assets:		
Cash	\$ 338,754	\$ 133,529
Accounts receivable	743,113	755,321
Inventory	363,016	388,844
Prepaid expenses	<u>40,564</u>	<u>21,664</u>
	1,485,447	1,299,358
Furniture and equipment	<u>200,321</u>	<u>205,946</u>
	<u>\$ 1,685,768</u>	<u>\$ 1,505,304</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 396,883	\$ 354,383
Current portion of capital lease obligations and loans	<u>36,494</u>	<u>35,479</u>
	433,377	389,862
Capital lease obligations and loan payable	<u>57,784</u>	<u>70,567</u>
Shareholders' equity:		
Share capital	7,538,289	7,533,289
Contributed surplus	99,774	90,319
Deficit	<u>(6,443,456)</u>	<u>(6,578,733)</u>
	1,194,607	1,044,875
	<u>\$ 1,685,768</u>	<u>\$ 1,505,304</u>

These financial statements have been prepared by management and are unaudited.
See accompanying notes to financial statements.

On behalf of the Board:

"J. D. Lawson" Director

"D. C. Fox" Director

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

STATEMENTS OF OPERATIONS AND DEFICIT

Three months ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Sales	\$ 1,013,684	\$ 793,579
Cost of goods sold	<u>436,028</u>	<u>297,173</u>
Gross profit	<u>577,656</u>	<u>496,406</u>
Expenses		
Selling expenses	81,730	98,220
Research & development	112,601	116,057
General & administration	223,984	179,036
Stock-based compensation	9,455	7,472
Amortization	11,909	1,848
Interest & bank charges	<u>2,700</u>	<u>21,651</u>
	<u>442,379</u>	<u>424,284</u>
Net earnings for the period	135,277	72,122
Deficit, beginning of period	<u>6,578,733</u>	<u>6,983,278</u>
Deficit, end of period	<u>\$ 6,443,456</u>	<u>\$ 6,911,156</u>
Earnings per share, basic and fully diluted	<u>0.4¢</u>	<u>0.2¢</u>
Weighted average shares outstanding		*
Basic	33,593,583	33,302,194
Fully diluted	<u>33,664,337</u>	<u>33,302,194</u>

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See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.
STATEMENTS OF CASH FLOWS
Three months ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from (used by):		
Operations:		
Net earnings for the period	\$ 135,277	\$ 72,122
Items not involving cash -		
Stock-based compensation	9,455	7,472
Amortization	11,909	1,848
	<u>156,641</u>	<u>81,442</u>
Changes in non-cash operating working capital:		
Accounts receivable	12,208	43,726
Inventory	25,828	3,172
Prepaid expenses	(18,900)	5,897
Accounts payable and accrued liabilities	42,500	(6,592)
	<u>218,277</u>	<u>127,645</u>
Investing activities:		
Purchase of capital assets	<u>(6,284)</u>	<u>(4,684)</u>
Financing activities:		
Repayment of factoring loan	-	(70,400)
Repayment of capital leases and note payable	(11,768)	(4,146)
Issuance of common shares	5,000	-
	<u>(6,768)</u>	<u>(74,546)</u>
Increase in cash	205,225	48,415
Cash, beginning of period	<u>133,529</u>	<u>354,804</u>
Cash, end of period	<u>\$ 338,754</u>	<u>\$ 403,219</u>
Supplementary information		
Interest paid	\$ 2,700	\$ 21,651
Income taxes paid	\$ -	\$ -

These financial statements have been prepared by management and are unaudited.
See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.
STATEMENTS OF COST OF GOODS SOLD
Three months ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Opening inventory	\$ 388,844	\$ 282,922
Manufacturing costs:		
Materials	204,746	152,531
Labour, freight and other	90,230	52,956
Manufacturing overhead	<u>115,224</u>	<u>88,514</u>
Cost of goods available for sale	799,044	576,923
Closing inventory	<u>363,016</u>	<u>279,750</u>
Cost of goods sold	<u>\$ 436,028</u>	<u>\$ 297,173</u>

These financial statements have been prepared by management and are unaudited.
See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Interim Financial Statements December 31, 2006

1. Significant accounting policies:

These interim statements are prepared in a manner consistent with the accounting policies and methods applicable to the Company's audited annual financial statements. However, these interim financial statements do not include all disclosure in notes normally provided in annual financial statements, consequently this report should be read in conjunction with the Company's audited financial statements for the year ended September 30, 2006.

Certain comparative figures have been reclassified to conform to the presentation of amounts in the current fiscal period.

In management's opinion, the unaudited financial information includes all normal adjustments necessarily to present fairly such information. Interim results are not necessarily indicative of the results expected for the fiscal year.

2. Equipment and furniture:

Manufacturing equipment	\$ 54,178
Furniture and office equipment	265,233
Leasehold improvements	<u>87,682</u>
	407,093
Accumulated amortization	<u>(206,772)</u>
Net book value	<u>\$200,321</u>

3. Obligations under capital leases and other loans, long term portion:

Obligation under capital leases	\$73,449
Loan payable	<u>20,729</u>
	94,278
Current portion	<u>36,494</u>
Long term portion	<u>\$57,784</u>

The company entered into several capital lease agreements during 2006 to acquire equipment for its new facility and expansion. These lease obligations have terms from 27 to 53 months, each with purchase options approximating 10% of the equipment cost at the completion of the lease period. The present value of the lease obligation is recorded as a liability. The current portion is included in current liabilities.

4. Share capital:

a) Authorized capital of the Company as at December 31, 2006 includes an unlimited number of both common shares and preferred shares, of which 33,599,694 common shares and no preferred shares were issued and outstanding.

b) Under the Company's stock option plan, there were 2,897,500 options outstanding as of December 31, 2006 held by directors, officers, and employees, exercisable at various dates to December 13, 2009, as follows:

Exercise Price Per Share	Number Outstanding	Average Remaining Life in Years	Number Exercisable at December 31st
\$0.18	580,000	0.4	580,000
\$0.115	460,000	1.4	460,000
\$0.10	1,237,500	0.5	840,000
\$0.075 - \$0.09	<u>620,000</u>	<u>2.3</u>	<u>272,000</u>
Total	2,897,500	1.3	2,152,000

5. Commitments and contingencies:

Contractual obligations of the Company are substantially unchanged from those described within the notes to the fiscal 2006 audited financial statements.



INTERNATIONAL WATER-GUARD INDUSTRIES INC.

**MANAGEMENT'S DISCUSSION
AND ANALYSIS**

Fiscal 2007

First Quarter Ended December 31, 2006

dated: February 21, 2007

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS First Quarter to December 31, 2006

Overview

Comments in this analysis should be read in conjunction with the comparative interim financial statements for the three months ended December 31, 2006 and the audited financial statements for the fiscal year ended on September 30, 2006. The following discussion, and the information elsewhere in this report, is intended to provide the reader with a further understanding of the Company's business and factors underlying its financial results.

International Water-Guard Industries Inc. ("IWG") designs, manufactures, sells and services potable water treatment equipment and systems for international aviation customers. The principal technology embodied in IWG's products is irradiation by ultraviolet ("UV") light, with filtration, ancillary systems and controls designed by the Company.

Operating results

The Company reported sales during the first quarter of fiscal 2007 of \$1,013,684, an increase of 28% above the same quarter of the previous year. First quarter earnings were \$135,277 compared to earnings of \$72,122 in the prior year's first quarter.

These results for the quarter provide net earnings of 0.4¢ per share in the current, compared to net earnings of 0.2¢ per share in the first quarter of the prior year on both a basic and fully diluted basis.

Sales

Sales of aviation water treatment equipment continue to increase. The first quarter shows a volume growth of 23% from the previous year augmented by increased parts and service revenue.

Direct sales margins

Gross profit has increased by about 16% in dollar terms year to year. This improvement is primarily attributable to the growth in product sales, partially offset by planned increases to manufacturing overhead costs.

Operating expenses

Selling expenses of \$81,730 for this quarter decreased 17% from the comparable period of the prior year. This decrease was related to reduced trade-show costs during the quarter and special marketing support costs incurred in the prior year's first quarter.

Engineering and product development expenses of \$112,601 in the first quarter was marginally less than the prior year.

General, administration and information technology expenses totaled \$223,984, a 25% increase above the same quarter in the prior year. These increases are primarily attributed to higher

professional fee expenditures with smaller increases in compensation and other office expense over the prior year.

The increase in amortization is related to capital expenditures early in calendar year 2006, while interest expense reduction is attributed to eliminating the Company's factoring loan that existed in the prior year.

Quarterly information

The following summary information is taken from the Company's quarterly and annual financial reports covering the last eight reporting quarters.

Quarterly Results Reported for: (\$000's except per share amounts)

	Fiscal year 2007	Fiscal year 2006				Fiscal year 2005		
	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Sales	\$1,013	\$929	\$1,014	\$926	\$794	\$816	\$723	\$825
Earnings from operations, before under noted	135	67	152	114	72	50	41	41
Gains on asset sales and debt settlements, less write down of deferred and other assets							11	740
Net income	\$135	\$67	\$152	\$114	\$72	\$50	\$52	\$781
Earnings per share, basic and fully diluted	0.4¢	0.2¢	0.5¢	0.3¢	0.2¢	0.2¢	0.2¢	3.1¢

There are no factors which may be used to predict future performance in either sales or in net income or loss on a quarter to quarter basis.

Liquidity and capital resources

The Company's liquidity and capital resource position has further improved during the first quarter of fiscal 2007 with cash provided from operations, positioning the Company to pursue new growth opportunities and product development.

Cash position:

Cash increased during the quarter by \$205,225 to \$338,754 due to earnings and operating cash flow.

Cash flow from operations:

Cash provided from operating activities, before non-cash operating working capital, was \$156,641 in the current quarter compared to \$81,442 cash provided in the same quarter of the prior year. Working capital required to finance receivables and inventory was limited, resulting in a further \$61,636 cash provided for operations during the quarter.

Capital expenditures:

Capital expenditures of \$6,284 were incurred during the first quarter to purchase equipment.

Working capital position:

The Company completed its first quarter ended December 31, 2006 with working capital of \$1,052,070, an improvement of \$142,574 from its fiscal year end position. This improvement was primarily attributed to cash flow during the period.

Contractual obligations

The Company's contractual obligations have not changed materially from that stated in its audited financial statements and MD&A for the fiscal year ended September 30, 2006.

Share capital

The Company has 33,599,694 common shares outstanding as at the date of this report. In addition, there are 2,897,500 options outstanding under the Company's stock option plan. Details of these options are included in the notes to the financial statements.

Related party transactions

There are no reportable related party transactions that occurred in the quarter being reported.

Risks and Uncertainties

Aircraft markets

The Company's primary customers are business use aircraft manufacturers, owners and operators. Such markets are cyclical over time although often differing from the cycles for commercial aircraft. Sales are made on a standard or optional basis and are dependent upon the production rates and customization of new aircraft or the requirement for upgrading existing aircraft by owners.

Competition

Aviation - Potable Water Treatment

At this time, there are no other companies of significance supplying flight certified potable water disinfection equipment to the aircraft industry, and IWG leads the market. It is expected that competition will come, although IWG intends to remain a leading player in this field because of its significant head start, and by developing new products, pricing new and existing products as

though competition exists, and continuing to seek customer input. From time to time very small players attempt to penetrate the market, but none have been successful. A variety of water filters are used by some airlines and operators, but these do not actively treat and disinfect the water.

Aviation - Potable Water Systems

Currently, IWG is aware of several major full water systems providers in addition to itself. Their focus tends to be on the airliner/ regional jet markets, whereas the Company currently places most of its attention on the corporate/ VIP jet market. At least one of the companies competes directly in the corporate/ VIP market. A variety of companies provide components to aircraft manufacturers for inclusion in their potable water system designs, but only IWG and these firms are offering aircraft manufacturers a full system solution as a kit

Intellectual Property

The Company has several patents on its aviation products and water treatment systems. In order to properly protect its intellectual property, the Company from time to time must assert its intellectual property against those who appear to be infringing it. In this respect, the Company on June 26th, 2006, filed a Statement of Claim against Bombardier Inc. claiming that a Canadian patent owned by the Company has been infringed by Bombardier. This action is currently in its early stages.

Foreign Exchange

Generally, fluctuations in the Canadian to United States dollar exchange rate are recorded as transactions occur and at the end of the period financial results are reported. The details of the Company's foreign exchange policy are included in the notes to the annual audited financial statements.

The Company's sales are invoiced in U.S. dollars, which are offset to some extent by the portion of its product costs that are also in U.S. dollars. Consequently, fluctuations in the Canadian to U.S. dollar foreign exchange rates will impact sales revenue, gross margins and net earnings reported by IWG. With the shift in US/ Canada exchange rates in recent periods, this is an area of risk that has been mitigated to some degree by carefully considered price increases.

The Company has not previously employed any financial instruments to hedge its foreign exchange position, because its past sales contracts generally have been short term. However, as the Company succeeds in securing longer-term production supply contracts, hedging of future foreign exchange requirements may be implemented.

Financial Resources

Continuing from the results of the prior two fiscal years, the Company's positive cash flow has continued during the current quarter. Sufficient cash is available to fund its current capital expenditures and level of operations, providing a base on which the company can continue its growth in the aviation market. Continuing growth from new projects may require additional capital beyond that generated from operations.

This is not an exhaustive list of the various risk factors that may be faced by the Company, but is a specific reference to the major risk factors addressed by the Company.

Business outlook

Development activity pursued by IWG in recent years has assured that its UV based water treatment products and systems are at the leading edge of aviation market requirements. The business outlook on the aviation sector is strong, and potable water quality is being perceived as an increasingly important issue, as evidenced by recent EPA and Health Canada reports.

International Water-Guard Industries goal is to significantly grow its business as a provider of water systems and disinfection units to the aviation industry.

Other information

Additional information relating to the Company is available under the Company's name on SEDAR at www.sedar.com.