



INTERNATIONAL
Water·Guard

Interim Financial Statements

**INTERNATIONAL WATER-GUARD
INDUSTRIES INC.**

Three months ended December 31, 2007 and 2006

Interim Financial Statements of

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notice of no auditor review of interim financial statements to December 31, 2007

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>2007</u> | September 30 <u>2007</u> |
|--|----------------------------|-----------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 191,522 | \$ 438,932 |
| Accounts receivable | 741,615 | 721,278 |
| Inventory | 618,500 | 642,232 |
| Prepaid expenses | <u>75,254</u> | <u>37,969</u> |
| | 1,626,891 | 1,840,411 |
| | | |
| Furniture and equipment | <u>255,035</u> | <u>219,290</u> |
| | | |
| Future income tax assets | <u>469,000</u> | <u>427,000</u> |
| | <u>\$ 2,350,926</u> | <u>\$ 2,486,701</u> |
| | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$ 343,113 | \$ 425,072 |
| Current portion of capital lease obligations and loans | <u>36,188</u> | <u>28,013</u> |
| | <u>379,301</u> | <u>453,085</u> |
| | | |
| Capital lease obligations and loan payable | <u>57,155</u> | <u>42,685</u> |
| | | |
| Shareholders' equity: | | |
| Share capital | 7,607,553 | 7,607,553 |
| Contributed surplus | 158,194 | 153,964 |
| Deficit | <u>(5,851,277)</u> | <u>(5,770,586)</u> |
| | <u>1,914,470</u> | <u>1,990,931</u> |
| | <u>\$ 2,350,926</u> | <u>\$ 2,486,701</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, 2007 and 2006

| | <u>2007</u> | <u>2006</u> |
|---|---------------------|---------------------|
| Sales | \$ 854,384 | \$ 1,013,684 |
| Cost of goods sold | <u>496,988</u> | <u>436,028</u> |
| Gross profit | <u>357,396</u> | <u>577,656</u> |
| Expenses | | |
| Selling expenses | 42,492 | 81,730 |
| Engineering & product development | 154,695 | 112,601 |
| General & administration | 261,268 | 223,984 |
| Stock-based compensation | 4,230 | 9,455 |
| Amortization | 14,815 | 11,909 |
| Interest & bank charges | <u>2,587</u> | <u>2,700</u> |
| | <u>480,087</u> | <u>442,379</u> |
| Earnings (loss) before income taxes | (122,691) | 135,277 |
| Income tax recovery | 42,000 | - |
| Net earnings (loss) for the period | <u>(80,691)</u> | <u>135,277</u> |
| Deficit, beginning of period | <u>5,770,586</u> | <u>6,578,733</u> |
| Deficit, end of period | <u>\$ 5,851,277</u> | <u>\$ 6,443,456</u> |
| Earnings per share, basic and fully diluted | <u>(0.2)¢</u> | <u>0.4¢</u> |
| Weighted average shares outstanding | | |
| Basic | 34,108,694 | 33,302,194 |
| Fully diluted | <u>34,627,732</u> | <u>33,302,194</u> |

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

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

STATEMENTS OF CASH FLOWS

Three months ended December 31, 2007 and 2006

| | <u>2007</u> | <u>2006</u> |
|---|-------------------|-------------------|
| Cash flows from (used by): | | |
| Operations: | | |
| Net earnings (loss) for the period | \$ (80,691) | \$ 135,277 |
| Items not involving cash - | | |
| Income tax recovery | (42,000) | - |
| Compensation related to stock option plan | 4,230 | 9,455 |
| Amortization | 14,815 | 11,909 |
| | <u>(103,646)</u> | <u>156,641</u> |
| Changes in non-cash operating working capital: | | |
| Accounts receivable | (20,337) | 12,208 |
| Inventory | 23,732 | 25,828 |
| Prepaid expenses | (37,285) | (18,900) |
| Accounts payable and accrued liabilities | (81,959) | 42,500 |
| | <u>(219,495)</u> | <u>218,277</u> |
| Investing activities: | | |
| Purchase of capital assets | <u>(18,552)</u> | <u>(6,284)</u> |
| Financing activities: | | |
| Repayment of capital lease obligations and note payable | (9,363) | (11,768) |
| Issuance of common shares | - | 5,000 |
| | <u>(9,363)</u> | <u>(6,768)</u> |
| Increase (decrease) in cash | (247,410) | 205,225 |
| Cash, beginning of period | <u>438,932</u> | <u>133,529</u> |
| Cash, end of period | <u>\$ 191,522</u> | <u>\$ 338,754</u> |
| Supplementary information | | |
| Interest paid | \$ 2,586 | \$ 2,700 |
| Non- cash transactions: | | |
| Equipment purchased under capital lease | 32,007 | - |

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, 2007 and 2006

| | <u>2007</u> | <u>2006</u> |
|----------------------------------|-------------------|-------------------|
| Opening inventory | \$ 642,232 | \$ 388,844 |
| Manufacturing costs: | | |
| Materials | 249,157 | 204,790 |
| Direct labour, freight and other | 93,845 | 90,231 |
| Manufacturing overhead | <u>130,254</u> | <u>115,224</u> |
| | <u>473,256</u> | <u>410,245</u> |
| Goods available for sale | 1,115,488 | 799,089 |
| Closing inventory | <u>618,500</u> | <u>363,061</u> |
| Cost of goods sold | <u>\$ 496,988</u> | <u>\$ 436,028</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, 2007

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, 2007.

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 | \$ 67,619 |
| Furniture and office equipment | 352,575 |
| Leasehold improvements | <u>96,932</u> |
| | 517,126 |
| Accumulated amortization | <u>(262,091)</u> |
| Net book value | <u>\$ 255,035</u> |

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

| | |
|----------------------------------|-----------------|
| Obligations under capital leases | \$76,756 |
| Loan Payable | <u>16,583</u> |
| | 93,343 |
| Current portion | <u>(32,197)</u> |
| Long term portion | <u>\$61,146</u> |

The Company has entered into several capital lease agreements for equipment. These lease obligations have terms from 5.2 to 53.2 months, with interest rates ranging from 2.3% to 9.75% and averaging 6.4%. Each lease includes a purchase options approximately 10% of the equipment cost exercisable prior to the completion of the lease period. The present value of the lease obligations are recorded as a liability, with the current portion in current liabilities.

4. Share capital:

a) Authorized capital of the Company as at December 31, 2007 includes an unlimited number of both common shares and preferred shares, of which 34,108,694 common shares and no preferred shares were issued and outstanding.

b) Under the Company's stock option plan, as of December 31, 2007 there were 2,062,500 options outstanding held by directors, officers, and employees. These options are exercisable at various dates to July 30, 2012, as follows:

| Exercise Price Per Share | Number Outstanding | Average Remaining Life in Months | Number Exercisable at December 31st |
|-----------------------------|--------------------|-------------------------------------|--|
| \$0.21 | 580,000 | 53.2 | 580,000 |
| \$0.145- 0.15 | 335,000 | 50.4 | 299,000 |
| \$0.115 | 260,000 | 5.2 | 260,000 |
| \$0.10 | 347,500 | 21.4 | 208,500 |
| \$0.075 - \$0.09 | <u>540,000</u> | <u>16.7</u> | <u>460,000</u> |
| Total | 2,062,500 | 31.6 | 1,807,500 |

5. Commitments and contingencies:

Subsequent to December 31st, the Company contracted for a portion of its future short term future U.S. dollar exchange requirements, through to March 31st. No material gain or loss has been incurred to date.

Other contractual obligations of the Company are substantially unchanged from those described within the notes to the fiscal 2007 audited financial statements.



INTERNATIONAL WATER-GUARD INDUSTRIES INC.

**MANAGEMENT'S DISCUSSION
AND ANALYSIS**

First Quarter Ended

December 31, 2007

Dated: February 13, 2008

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS

First Quarter December 31, 2007

Overview

Comments in this analysis should be read in conjunction with the comparative interim financial statements for the three months ended December 31, 2007. The following discussion, and the information elsewhere in this report, is focused primarily on the current quarter's results and is intended to provide the reader with a further understanding of the Company's business and factors underlying such financial results.

International Water-Guard Industries Inc. ("IWG") designs, manufactures, sells and services potable water treatment equipment and water systems for international aviation customers. The principal technology embodied in IWG's water treatment equipment is irradiation by ultraviolet ("UV") light, combined with filtration, ancillary systems and controls designed by the Company. Water systems may include tanks, water lines, pumps, valves and electronic controls in addition to water treatment units.

Operating results

In line with previously announced expectations, there was a decrease in Company revenue for the first quarter resulting in a net loss. This was driven by realignment of customer supply chains and delivery timing, together with the commencement of increased engineering development expenditures. The Company reported sales during the first quarter in fiscal 2008 of \$854,383, a 16% decrease from the same quarter of the previous year. First quarter net loss was \$80,691 compared to net earnings of \$135,277 in the prior year's first quarter.

The US/ Canadian exchange rate continued to have an adverse effect on sales and earnings. Had the US dollar exchange rate for this quarter remained the same as in the prior year's first quarter, sales reported would have been \$136,800 higher, and earnings approximately \$127,000 higher. IWG continues to work to mitigate the impact of exchange rate on financial performance.

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

The Company anticipates that results may fluctuate on a quarter by quarter basis as accelerated engineering development and increased marketing activities continue.

Sales and sales margins

Sales of aviation water treatment equipment have decreased in the first quarter compared to the same quarter in the previous year, for the reasons mentioned above. Equipment and service revenues were at similar levels to those of a year earlier but the decrease in the U.S. dollar reduced the average sales prices in Canadian dollars by 13%.

Overall margin rates in the first quarter were impacted principally by IWG's fixed cost base on lower sales volume, and the US\$ decrease compared to a year earlier. The impact of the weaker US dollar during the quarter resulted in a recorded exchange loss of \$23,651 during the first quarter.

Operating expenses

Selling expenses of \$42,492 for this quarter decreased by 48% from the comparable period of the prior year, due to the NBAA 2007 trade show, a major event for the Company, being held in September of the last fiscal year compared to the 2006 trade show being in October of last year's first quarter.

Engineering and product development expenses of \$154,695 in the first quarter, is an increase of 37% over the prior year due to elevated product development activities, and an increase in staffing levels.

General, administration and information technology expenses totaled \$261,268, a 17% increase above the same quarter in the prior year. This increase was primarily attributed to increased staffing levels and some compensation increases.

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 2008 | Fiscal year 2007 | | | | Fiscal year 2006 | | |
|---|------------------|------------------|---------|---------|---------|------------------|---------|--------|
| | Dec 31 | Sept 30 | Jun 30 | Mar 31 | Dec 31 | Sep 30 | Jun 30 | Mar 31 |
| Sales | \$854 | \$1,279 | \$1,043 | \$1,149 | \$1,013 | \$929 | \$1,014 | \$926 |
| Net income | (\$81) | \$405 | \$91 | \$176 | \$135 | \$67 | \$152 | \$114 |
| Earnings per share, basic and fully diluted | (0.2)¢ | 1.2¢ | 0.3¢ | 0.5¢ | 0.4¢ | 0.2¢ | 0.5¢ | 0.3¢ |

Liquidity and capital resources

The Company's liquidity and capital resource position has decreased during the first quarter of fiscal 2008 with cash used to pursue new growth opportunities and product development.

Cash position:

Cash decreased by \$247,410 to \$191,522 during the three months for operations and capital expenditures as described below.

Cash flow from operations:

Cash used during the first quarter for operating activities, apart from non-cash operating working capital, was \$103,646 compared to a surplus of \$156,641 in the same quarter of the prior year. An increase in working capital items utilized a further \$115,849 during the quarter.

Capital expenditures:

Capital expenditures of \$50,560 were incurred during the first quarter to purchase equipment of which \$32,007 was financed under a capital lease.

Working capital position:

The Company completed its quarter ended December 31, 2007 with working capital of \$1,247,590 a decrease from the position of \$1,387,326 at its fiscal year end. This decrease of \$139,736 was primarily attributed to cash flow used in operations.

Contractual obligations

The Company's lease and other contractual obligations have not changed materially from that stated in its audited financial statements and MD&A for the fiscal year ended September 30, 2007.

Share capital

The Company has 34,108,694 common shares outstanding as at the date of this report. In addition, there are 2,062,500 options outstanding under the Company's stock option plan, details of which 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

IWG recognizes that certain risks are inherent in its business plan, which requires the Company to manage its affairs to minimize the impact of such risks to its operations. The following are the more significant risks managed by the Company.

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. As a consequence, equipment and systems sales can fluctuate from period, although this may be offset by sales from new customers.

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. 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. It is known that one new aircraft program will be employing a

portable water disinfection device in a configuration different from IWG. 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 the Company. 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 suppliers provide components to aircraft manufacturers for inclusion in their potable water system designs, but IWG is one of the few companies 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 progress.

Foreign Exchange

The Company reports its financial results in Canadian dollars. However, the Company's sales are invoiced in U.S. dollars, which are offset to a limited extent by the portion of its product costs that are also in U.S. dollars. Generally, fluctuations in the Canadian to United States dollar exchange rate are recorded as transactions occur and adjusted at the end of the period that financial results are reported. The details of the Company's foreign exchange policy are included in the notes to the financial statements.

The unprecedented shift in the Canadian to U.S. dollar exchange rates during 2007 had a significant effect both on sales and earnings. For the first quarter of fiscal 2008, had the exchange rate remained at a similar level that existed for the first quarter of fiscal 2007, the Company would have seen approximately \$136,800 more in total revenue, to \$991,189, translating to an improvement of \$127,000 in net earnings (0.4¢ per share). This impact is being mitigated to some degree by carefully considered price increases and introducing list pricing in Canadian dollars and Euros.

The Company has not previously employed financial instruments to hedge its foreign exchange position because its past sales contracts generally have been short term. However, during fiscal 2008 the Company anticipates it will initiate the hedging of future foreign exchange requirements.

Financial Resources

The Company's operations continue to provide and ensure cash is available to fund its current product development or capital expenditures and current level of operations, providing a base on which the Company can continue its growth in the aviation market. Continuing growth may require additional capital beyond that generated from operations.

Accounting estimates

The preparation of financial statements requires the Company to estimate the effect of various matters that includes some uncertainty. While most estimates are not deemed material to the

financial position of the Company, the estimate of the anticipated benefit of future income tax loss recoveries requires management to make assumptions and estimates about future financial results. Such estimates are updated on a regular basis.

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.

Forward-looking statements

The Company's financial reports contain forward-looking statements that involve risks and uncertainties. These forward-looking statements are based on current expectations and assumptions of management and actual events may differ materially from current expectations.

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.