



INTERNATIONAL
Water·Guard

Interim Financial Statements

**INTERNATIONAL WATER-GUARD
INDUSTRIES INC.**

Three months ended December 31, 2009 and 2008

Interim Financial Statements of

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notice of no auditor review of interim financial statements to December 31, 2009

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 2009	September 30 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,190,291	\$ 1,362,363
Accounts receivable	709,730	672,010
Inventory	546,985	577,993
Prepaid expenses	88,359	42,807
Future income tax asset	80,000	86,000
	<u>2,615,365</u>	<u>2,741,173</u>
 Furniture and equipment	 239,953	 229,135
 Future income tax assets	 279,000	 279,000
	<u>\$ 3,134,318</u>	<u>\$ 3,249,308</u>
 LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 309,376	\$ 449,413
Current portion of capital lease obligations and loan	28,256	25,757
	<u>337,632</u>	<u>475,170</u>
 Capital lease obligations and loan payable	 19,866	 18,101
	<u>357,497</u>	<u>493,271</u>
 Shareholders' equity:		
Share capital	8,111,487	8,111,487
Contributed surplus	205,776	200,164
Deficit	(5,540,442)	(5,555,614)
	<u>2,776,821</u>	<u>2,756,037</u>
 Contingencies and commitments	 \$ 3,134,318	 \$ 3,249,308

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

On behalf of the Board:

"David C. Fox" Director

"Bruce W. Gowan" Director

INTERNATIONAL WATER-GUARD INDUSTRIES INC.
STATEMENTS OF OPERATIONS AND DEFICIT
Three months ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Sales	\$ 1,036,208	\$ 1,214,916
Cost of goods sold	<u>439,105</u>	<u>463,376</u>
Gross profit	<u>597,103</u>	<u>751,540</u>
Expenses		
Selling expenses	93,521	127,294
Engineering and product development	143,268	209,061
General, administration and occupancy	320,765	313,039
Amortization	13,479	14,159
Interest	4,898	3,867
	<u>575,931</u>	<u>667,420</u>
Income before taxes	21,172	84,120
Future income tax expense	<u>6,000</u>	<u>24,000</u>
Net income for the period	15,172	60,120
Deficit, beginning of period	<u>5,555,614</u>	<u>5,867,630</u>
Deficit, end of period	<u>\$ 5,540,442</u>	<u>\$ 5,807,510</u>
Income per share amounts		
Basic	0.0¢	0.2¢
Fully diluted	0.0¢	0.2¢
Weighted average shares outstanding		
Basic	39,340,694	39,293,694
Fully diluted	<u>39,340,694</u>	<u>39,293,694</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, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash flows from (used by):		
Operations:		
Net income for the period	\$ 15,172	\$ 60,120
Items not involving cash -		
Income tax expense	6,000	24,000
Stock based compensation	5,612	5,612
Change in value of forward exchange contracts	9,646	9,000
Amortization	13,479	14,159
	<u>49,909</u>	<u>112,891</u>
Changes in non-cash operating working capital:		
Accounts receivable	(47,366)	(50,720)
Inventory	31,008	(14,327)
Prepaid expenses	(45,552)	5,635
Accounts payable and accrued liabilities	(140,037)	(19,250)
	<u>(152,038)</u>	<u>34,230</u>
Investing activities:		
Purchase of capital assets	<u>(8,174)</u>	<u>(13,681)</u>
Financing activities:		
Repayment of capital lease obligations and loan payable	(11,860)	(15,545)
Issuance of common shares	-	2,250
	<u>(11,860)</u>	<u>(13,295)</u>
Increase (decrease) in cash	(172,072)	7,254
Cash, beginning of period	1,362,363	940,302
Cash, end of period	<u>\$ 1,190,291</u>	<u>\$ 947,556</u>
Supplementary information		
Interest paid	\$ 4,898	\$ 3,867
Non- cash transactions:		
Equipment purchased under capital lease	\$ 16,123	\$ -

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, 2009

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, 2009.

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

2. Equipment and furniture:

Manufacturing equipment	\$ 106,748
Furniture and office equipment	416,634
Leasehold improvements	<u>102,473</u>
	625,855
Accumulated amortization	<u>(385,902)</u>
Net book value	\$ <u>239,953</u>

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

Obligations under capital leases	\$39,830
Loan payable	<u>8,292</u>
	48,122
Current portion	<u>(28,256)</u>
Long term portion	\$ <u>19,866</u>

The company's capital lease agreements have financed equipment acquired for the growth in operations. These lease obligations have terms from 1 to 34 months, each with purchase options approximating 10% of the equipment cost at the completion of the lease period. The present value of a lease obligation is recorded as a liability, with the current portion allocated to current liabilities.

4. Share capital:

a) Authorized capital of the Company as at December 31, 2009 includes an unlimited number of both common shares and preferred shares, of which 39,340,694 common shares and no preferred shares were issued and outstanding.

b) Under the Company's stock option plan, as of December 31, 2009 there were 2,620,000 options outstanding held by directors, officers and employees. These options are exercisable at various dates to November 6, 2014, as follows:

Exercise Price Per Share	Number Outstanding	Average Remaining Life in Months	Number Exercisable at December 31st
\$0.21	580,000	28.6	580,000
\$0.15	190,000	25.3	190,000
\$0.13	320,000	36.8	320,000
\$0.12	280,000	19.6	280,000
\$0.10	720,000	46.6	288,000
\$0.09	530,000	59.0	-
Total	2,620,000	27.2	1,469,500

5. Future accounting changes:

International Financial Reporting Standards:

In February 2008, Canada's Accounting Standards Board confirmed that publicly accountable enterprises would be required to adopt International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board for fiscal years beginning on or after January 1, 2011. The Company will be required to report under IFRS effective for interim and annual financial statements relating to its fiscal year beginning on October 1, 2011.

Adoption of IFRS will impact many areas of financial accounting and reporting. The Company is continuing with the process of assessing the detailed impact of the Canadian convergence initiative on its financial reporting, accounting policies and disclosure and is developing a conversion plan.

6. Commitments and contingencies:

Contractual obligations of the Company are substantially unchanged from those described within the notes to the fiscal 2009 audited financial statements.



INTERNATIONAL
Water·Guard

Management's Discussion and Analysis

**INTERNATIONAL WATER-GUARD
INDUSTRIES INC.**

First quarter ending December 31, 2009

Dated: February 3, 2010

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS First quarter December 31, 2009

Overview

International Water-Guard Industries Inc. ("IWG") is engaged in the development, design, manufacture, sale and service of 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.

This analysis should be read in conjunction with the Company's comparative interim financial statements for the three months ended December 31, 2009. The discussion and analysis in this report is based on information available to management as of February 3, 2010, is focused primarily on results for the quarter just ended, and is intended to provide the reader with a further understanding of the Company's business and factors underlying its financial results.

This analysis and the accompanying interim financial statements, while unaudited, have been prepared using generally accepted accounting principles and have been approved by the Company's Audit Committee and Board of Directors.

Operating results, sales and margins

While the Company's equipment sales were similar to the previous year, the lower value of the U.S. dollar impacted Canadian dollar revenue. The decrease in value of the U.S. dollar also impacted margin rates and reported earnings. Planned cost reductions plus finalization of product development projects have served to partially offset the impact of the lower U.S. dollar to maintain profitability.

Company sales were \$1,036,208 during the first quarter ended December 31, 2009, a 15% decrease from \$1,214,916 for the same period a year earlier. First quarter net earnings were \$15,172 compared to \$60,120 in the previous year.

The results for the quarter provide 0.0¢ net earnings per share for the first quarter, on both a basic and fully diluted basis, compared to net earnings of 0.2¢ per share for the first quarter last year

Operating expenses

Selling expenses for this quarter decreased by 26% over the comparable period of the prior year, to \$93,521, mainly due to reduced travel.

Engineering and product development expenses of \$143,268 in the quarter represent a decrease of 31% over the prior year, due largely to a product development project nearing completion in this period.

General, administration and information technology expenses totaled \$320,765, a small increase above the same quarter in the prior year. Increased professional fees were largely offset by the reduction in compensation and investor relations spending over the same period last 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 2010	Fiscal Year 2009				Fiscal year 2008		
	Dec 31	Sept 30	Jun 30	Mar 31	Dec 31	Sept 30	Jun 30	Mar 31
Sales	\$1,036	\$1,212	\$1,146	\$1,325	\$1,215	\$1,153	\$1,293	\$856
Net income	\$15	\$190	\$23	\$39	\$60	\$41	\$46	(\$103)
Earnings per share, basic and fully diluted	0.0¢	0.4¢	0.0¢	0.1¢	0.2¢	0.1¢	0.1¢	(0.3)¢

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 not changed materially during the first quarter of fiscal 2010.

Cash position:

Cash decreased by \$172,072 since the commencement of the fiscal year, applied principally to the reduction in liabilities.

Cash flow from operations:

Cash used in operating activities, including non-cash operating working capital, was \$152,038 in the current quarter, due principally to the reduction in liabilities, compared to a cash flow of \$34,230 in the same quarter of the prior year.

Capital expenditures:

Capital expenditures of \$24,297 were incurred during the quarter to purchase equipment, of which \$16,123 was leased. This amount included manufacturing equipment and leasehold costs of \$5,092, and computer equipment and software purchases of \$19,205.

Working capital position:

The Company completed its first quarter ended December 31, 2009 with working capital of \$2,277,733, an increase of \$11,731 from its fiscal year end. This improvement is primarily attributed to cash flow from operations. The Company completed this quarter with a cash reserve plus a credit facility available to finance its future growth.

Future accounting changes

In February 2008, CICA's Accounting Standards Board (AcSB) confirmed that publicly accountable enterprises would be required to adopt International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board for fiscal years beginning on or after January 1, 2011. The Company will be required to report under IFRS effective for interim and annual financial statements relating to its fiscal year beginning on October 1, 2011. Adoption of IFRS will impact many areas of financial accounting and reporting. The Company is in the process

of assessing the impacts of the Canadian convergence initiative and is developing a conversion plan.

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, 2009, and there are no future commitments for the purchase of capital equipment

Share capital

The Company had 39,340,694 common shares outstanding as at the date of this report. In addition, there are 2,620,000 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 the three months ended December 31, 2009.

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 potential impact of such risks to its operations.

Generally, the risks identified in the Company's annual management discussion and analysis for the fiscal year ended September 30, 2009, have not changed from that reported previously.

Financial & Economic Conditions

Current world financial and economic conditions have not had a significant impact on the Company directly as of the date of writing. IWG monitors the situation carefully with a view to mitigating risk from any more significant downturns. The Canadian/U.S. dollar exchange rate is a key factor that the company reviews frequently to minimize adverse impact on the company's financial health.

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. The well-documented downturn in the corporate jet market has had little impact on IWG, as it operates in the large business jet and VIP airliner markets that have been less affected.

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 that are not subject to a production agreement will fluctuate from period to period, offset in part by increasing sales to new customers.

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 some extent by the portion of its product costs that are also in U.S. dollars. Generally, fluctuations in the Canadian to U.S. 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 annual financial statements.

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 U.S./Canadian dollar exchange rates in recent periods, this is an area of risk that has impacted the financial results of IWG. This impact has been mitigated to some degree by entering into short-term foreign exchange contracts to hedge against the fluctuation in exchange rates for a portion of the Company's near term cash flow.

Financial Resources

The Company's operations and cash reserves have ensured that sufficient cash is available to fund current level of operations, product development, and capital expenditures. Continuing growth in the aviation market may require additional capital beyond that generated from operations.

The notes to the Company's annual financial statements describe in more detail the credit, liquidity, and fair value risks that may impact the Company's financial instruments.

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's management.

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 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 water treatment products and systems are at the leading edge of aviation market requirements. The long term business outlook on the aviation sector is strong, and potable water quality is being perceived as an increasingly important issue, as evidenced by the October, 2009 release of the EPA's Aircraft Drinking Water Regulation.

With its base in the aviation industry firmly established, a solid infrastructure in place and a robust balance sheet, IWG's objective is to significantly grow its business both within current markets, and through exploration of new opportunities that will lever off its industry expertise, corporate structure and financial strength.

Other information

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