



INTERNATIONAL
Water-Guard

Interim Financial Statements

**INTERNATIONAL WATER-GUARD
INDUSTRIES INC.**

Three months ended December 31, 2005 and 2004

Interim Financial Statements of

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notice of no auditor review of interim financial statements to December 31, 2005

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>2005</u>	September 30 <u>2005</u>
ASSETS		
Current assets:		
Cash	\$ 403,219	\$ 354,804
Accounts receivable	465,050	508,776
Inventory	279,750	282,922
Prepaid expenses	<u>26,031</u>	<u>31,928</u>
	1,174,050	1,178,430
Furniture and equipment	<u>37,328</u>	<u>34,492</u>
	<u>\$ 1,211,378</u>	<u>\$ 1,212,922</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 219,428	\$ 226,020
Factoring loan	297,500	367,900
Current portion of loan payable	<u>4,146</u>	<u>8,292</u>
	<u>521,074</u>	<u>602,212</u>
Loan payable	<u>24,875</u>	<u>24,875</u>
Shareholders' equity:		
Share capital	7,508,539	7,508,539
Contributed surplus	68,046	60,574
Deficit	<u>(6,911,156)</u>	<u>(6,983,278)</u>
	<u>665,429</u>	<u>585,835</u>
	<u>\$ 1,211,378</u>	<u>\$ 1,212,922</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, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Sales	\$ 793,579	\$ 770,948
Cost of goods sold	<u>297,173</u>	<u>346,753</u>
Gross profit	<u>496,406</u>	<u>424,195</u>
Expenses		
Selling expenses	113,220	65,964
Research & development	116,057	81,452
General & administration	164,036	186,790
Stock-based compensation	7,472	10,455
Amortization	1,848	7,025
Interest & bank charges	<u>21,651</u>	<u>52,374</u>
	<u>424,284</u>	<u>404,060</u>
Net earnings for the period	72,122	20,135
Deficit, beginning of period	<u>6,983,278</u>	<u>7,897,389</u>
Deficit, end of period	<u>\$ 6,911,156</u>	<u>\$ 7,877,254</u>
Earnings per share, basic and fully diluted	<u>\$0.00</u>	<u>\$0.00</u>
Weighted average shares outstanding	<u>33,302,194</u>	<u>20,481,194</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, 2005 and 2004

	<u>2004</u>	<u>2003</u>
Cash flows from (used by):		
Operations:		
Net earnings (loss) for the period	\$ 72,122	\$ 20,135
Items not involving cash -		
Stock-based compensation	\$ 7,472	10,455
Amortization	1,848	7,025
Interest accrued		19,514
Unrealized exchange gains	-	(22,000)
	<u>81,442</u>	<u>35,129</u>
Changes in non-cash operating working capital:		
Accounts receivable	43,726	200,225
Inventory	3,172	68,395
Prepaid expenses	5,897	1
Accounts payable and accrued liabilities	(6,592)	(108,807)
	<u>127,645</u>	<u>194,943</u>
Investing activities:		
Purchase of capital assets	<u>(4,684)</u>	<u>(419)</u>
Financing activities:		
Proceeds (repayment) of factoring loan	(70,400)	(160,500)
Repayment of note payable	(4,146)	-
	<u>(74,546)</u>	<u>(160,500)</u>
Increase in cash	48,415	34,024
Cash, beginning of period	<u>354,804</u>	<u>64,836</u>
Cash, end of period	<u>\$ 403,219</u>	<u>\$ 98,860</u>
Supplementary information		
Interest paid	\$ 21,651	\$ 25,124
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, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Opening inventory	\$ 282,922	\$ 423,626
Manufacturing costs:		
Materials	152,531	114,040
Labour, freight and other	52,956	67,235
Manufacturing overhead	<u>88,514</u>	<u>97,083</u>
Cost of goods available for sale	576,923	701,984
Closing inventory	<u>279,750</u>	<u>355,231</u>
Cost of goods sold	<u>\$ 297,173</u>	<u>\$ 346,753</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, 2005

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, 2005.

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. Reclassification of prior year expenses and Retroactive adoption of Stock Based Compensation:

- a) Certain comparative figures have been reclassified to conform to the presentation of manufacturing expenses adopted in the fourth quarter of the prior year, which expenses were previously included in selling, research development, administration and occupancy.
- b) In the fourth quarter of fiscal 2005, the Company adopted, retroactively to fiscal 2004, the amended guidelines for recording the fair value of Stock Options vesting during a reporting period. Accordingly, the stock option compensation benefits recorded for fiscal 2005 has been reflected in the comparative results for stock options vesting in the first quarter of both fiscal 2005 and 2006.

3. Share capital:

- a) Authorized capital of the Company as at December 31, 2005 included 100,000,000 common shares and 5,000,000 preferred shares of which 33,302,194 common shares and no preferred shares were issued and outstanding.
- b) Under the Company's stock option plan, there were 2,330,000 options outstanding as of December 31, 2005 of which 1,790,000 are exercisable and 540,000 have not yet vested. These options, held by directors, officers, and employees, are exercisable at \$0.20 as to 100,000 options until April 6, 2006; at \$0.18 as to 580,000 options until May 3, 2007; at \$0.10 as to 990,000 options until July 30, 2007; at \$0.08 as to 70,000 options until March 17, 2008; at \$0.115 as to 460,000 options until June 10, 2008; at \$0.075 as to 30,000 options until October 4, 2008; and at \$0.08 as to 100,000 options until November 9, 2008.
- c) Warrants to purchase 320,000 common shares were outstanding as at December 31, 2005. These are finder's warrants issued under the private placement of common shares completed on May 5th and exercisable at \$0.10 each, of which 247,500 expire on April 29, 2006 and 72,500 expire on May 4, 2006.

4. Commitments:

- a) The Company has entered into a lease commitment agreement for new operating premises effective for five and one-half years, plus a renewal option, commencing June 1, 2005, coincident with the expiry of its existing premises. Obligations under the lease agreement for rentals, taxes and operating costs aggregate \$ 112,515 during the first year and aggregate \$778,050 during the term of the lease. The Company will also incur during the second quarter approximately \$108,000 to complete leaseholds and furnishings of its new facility.
- b) Other contractual obligations of the Company are unchanged from those described within the notes to the audited financial statements.



INTERNATIONAL
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INTERNATIONAL WATER-GUARD INDUSTRIES INC.

**MANAGEMENT'S DISCUSSION
AND ANALYSIS**

First Quarter Ended

December 31, 2005

dated: February 9, 2006

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS First Quarter to December 31, 2005

Overview

Comments in this analysis should be read in conjunction with the comparative interim financial statements for the three months ended December 31 2005. 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, installs and services potable water treatment/management equipment and systems, primarily 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 2006 of \$793,579, compared to \$770,948 in the prior year. First quarter earnings were \$72,122 compared to earnings of \$20,135 (restated) in the prior year's first quarter.

Prior year 1st quarter sales included sales from the Company's Industrial Division, which division was sold on February 10th during the second quarter.

The results for the quarter provide \$nil earnings per share in the current quarter, unchanged from earnings of \$nil per share in the prior year on both a basic and fully diluted basis.

Sales

Sales of aviation water treatment equipment and parts continue to increase on a comparative basis, showing a 24% growth in this quarter over the same quarter in the prior year. The Company's sales of aviation products and services during the quarter ended December 31, 2005 of \$793,579 compared to similar sales of \$640,040 in 2004. It should be noted that, prior year sales included sales of \$108,908 from the since divested Industrial division and a gain of \$22,000 from foreign exchange gains on US dollar debt recorded in the quarter ended December 31, 2004.

Direct sales margins

Margin rates on equipment and parts sales have increased by about 7% year to year. This improvement is attributable to lower manufacturing overhead expenses (salaries and rentals) and the growth in sales.

Reclassification of prior year expenses and the retroactive adoption of Stock Based Compensation guidelines:

Certain comparative figures have been reclassified to conform to the presentation of manufacturing expenses adopted in the current year, which expenses were previously included in selling, research development, administration and occupancy.

In the fourth quarter of fiscal 2005, the Company adopted, retroactively to fiscal 2004, the amended guidelines for recording the fair value of Stock Options vesting during a reporting period. Accordingly, the stock option compensation benefits recorded for fiscal 2005 has been reflected in the comparative results for stock options vesting in the first quarter of fiscal 2005.

Operating expenses

Selling expenses of \$113,220 for this quarter increased 72% over the comparable period of the prior year. The increase arose from a return to previous sales force levels, increasing emphasis on travel to customers and trade-show costs, and the launch of the Company's new corporate identity and web-site. The Company's participation in the annual NBAA show was the 10th appearance at this major event.

Engineering and product development expenses of \$116,057 in the first quarter increased by 20% for compensation and contracted work. This increase above the prior year was due to increasing emphasis on product improvements and proposal work in recent periods.

General, administration and information technology expenses totaled \$164,036, a 14% decrease from the same quarter in the prior year. This decrease was primarily attributed to decreased consulting fees, legal, IT and other costs incurred in the period.

Capital expenditures

Capital expenditures of \$4,684 were incurred to purchase equipment.

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 2006	Fiscal year 2005				Fiscal year 2004		
	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Sales	\$794	\$816	\$723	\$825	\$771	\$753	\$934	\$791
Earnings (loss) from operations, before write-downs	72	50	42	41	31	(60)	(162)	4
Gains on asset sales and debt settlements			10	755				
Write down of deferred and other assets				(15)	0	(3,834)	0	0
Net income (loss)	\$72	\$50	\$52	\$781	\$ 31	\$(3,894)	\$(162)	4
Earnings (loss) per share, basic and fully diluted	\$0.00	\$0.01	\$0.00	\$0.03	\$0.00	\$(0.21)	\$(0.01)	\$(0.00)

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

Cash flow from operations:

Cash provided from operating activities, before non-cash operating working capital, was \$81,442 in the current quarter compared to \$35,129 cash provided in the same quarter of the prior year. A reduction in operating assets, less a decrease in operating liabilities, provided a further \$46,203 of cash flow during the quarter.

Cash usage for capital investments:

The purchase of equipment for \$4,684 was funded from operating cash.

Cash flow from financing activities:

A \$70,400 additional repayment in the first quarter was made under the Company's credit line, to a factoring company, to utilize a portion of the company's September 30th, 2005 cash reserves. The available credit line may be drawn down as required. Also, a \$4,146 payment was made towards the Company's equipment loan.

Working capital position:

The Company completed its first quarter ended December 31, 2005 with working capital of \$652,976, a further improvement from the position of \$576,218 at its fiscal year end. This improvement of \$76,758 was primarily attributed to improved cash flow during the periods.

Contractual obligations

The new five and 1/2-year premises lease agreement, as amended, has been entered into by the Company effective with the termination of its previous lease on June 1st, 2005, and at financial terms similar to that of the prior lease. During the second quarter, the Company will incur approximately \$108,000 to complete the lease improvements and furnishings of its new facility. The Company's 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, 2005.

Share capital

The Company has 33,302,194 common shares outstanding as at the date of this report. In addition, there are 2,330,000 options outstanding under the Company's stock option plan and 320,000 warrants outstanding related to private placements of common shares in May 2005. Details of these options and warrants 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:

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 dominates the market. It is expected that competition will come, although IWG intends to remain the dominant 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. There is an initiative by a company to enter the market with a system tailored specifically to the Airbus A380 using an alternate water treatment technology. 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

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.

A majority of the Company's sales are invoiced in U.S. dollars, which are offset to some extent by the portion of its product costs, consulting and contractor 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

During fiscal 2005, important milestones were achieved in stabilizing the company's financial situation. Since that time, a positive cash flow has continued and 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 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 reports.

International Water-Guard Industries, historically a developer of UV-based water treatment equipment for several niche markets has become a primary supplier of engineered water treatment units and systems for the aviation market. IWG's 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.