



INTERNATIONAL
Water·Guard

Interim Financial Statements

**INTERNATIONAL WATER-GUARD
INDUSTRIES INC.**

Three months ended December 31, 2008 and 2007

Interim Financial Statements of

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notice of no auditor review of interim financial statements to December 31, 2008

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>2008</u> | September 30 <u>2008</u> |
|---|----------------------------|-----------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 947,557 | \$ 940,302 |
| Accounts receivable | 752,489 | 710,770 |
| Inventory | 510,662 | 496,335 |
| Prepaid expenses | <u>59,772</u> | <u>65,407</u> |
| | 2,270,480 | 2,212,815 |
| | | |
| Furniture and equipment | <u>250,128</u> | <u>250,606</u> |
| | | |
| Future income tax assets | <u>454,000</u> | <u>478,000</u> |
| | <u>\$ 2,974,608</u> | <u>\$ 2,941,421</u> |
| | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$ 429,997 | \$ 449,247 |
| Current portion of capital lease obligations and loan | <u>39,103</u> | <u>40,593</u> |
| | <u>469,100</u> | <u>489,840</u> |
| | | |
| Capital lease obligations and loan payable | <u>31,151</u> | <u>45,206</u> |
| | | |
| Shareholders' equity: | | |
| Share capital | 8,111,487 | 8,108,202 |
| Contributed surplus | 170,380 | 165,803 |
| Deficit | <u>(5,807,510)</u> | <u>(5,867,630)</u> |
| | <u>2,474,357</u> | <u>2,406,375</u> |
| | <u>\$ 2,974,608</u> | <u>\$ 2,941,421</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, 2008 and 2007

| | <u>2008</u> | <u>2007</u> |
|-----------------------------------|---------------------|---------------------|
| Sales | \$ 1,214,916 | \$ 854,384 |
| Cost of goods sold | <u>463,376</u> | <u>496,988</u> |
| Gross profit | <u>751,540</u> | <u>357,396</u> |
| Expenses | | |
| Selling expenses | 127,294 | 58,092 |
| Engineering & product development | 209,061 | 139,095 |
| General & administration | 313,039 | 265,498 |
| Amortization | 14,159 | 14,815 |
| Interest | <u>3,867</u> | <u>2,587</u> |
| | <u>667,420</u> | <u>480,087</u> |
| Income (loss) before taxes | <u>84,120</u> | <u>(122,691)</u> |
| Income tax (expense) recovery | <u>(24,000)</u> | <u>42,000</u> |
| Net income (loss) for the period | 60,120 | (80,691) |
| Deficit, beginning of period | <u>5,867,630</u> | <u>5,770,586</u> |
| Deficit, end of period | <u>\$ 5,807,510</u> | <u>\$ 5,851,277</u> |
| Earnings (loss) per share amounts | | |
| Basic | 0.2¢ | (0.2)¢ |
| Fully diluted | 0.2¢ | (0.2)¢ |
| Weighted average number of shares | | |
| Basic | 39,293,694 | 34,108,694 |
| Fully diluted | <u>39,293,694</u> | <u>34,627,732</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, 2008 and 2007

| | <u>2008</u> | <u>2007</u> |
|---|-------------------|-------------------|
| Cash flows from (used by): | | |
| Operations: | | |
| Net income (loss) for the period | \$ 60,120 | \$ (80,691) |
| Items not involving cash - | | |
| Income tax expense (recovery) | 24,000 | (42,000) |
| Stock based compensation | 5,612 | 4,230 |
| Change in value of forward exchange contract | 9,000 | - |
| Amortization | <u>14,159</u> | <u>14,815</u> |
| | 112,891 | (103,646) |
| Changes in non-cash operating working capital: | | |
| Accounts receivable | (50,720) | (20,337) |
| Inventory | (14,327) | 23,732 |
| Prepaid expenses | 5,635 | (37,285) |
| Accounts payable and accrued liabilities | <u>(19,250)</u> | <u>(81,959)</u> |
| | <u>34,230</u> | <u>(219,495)</u> |
| Investing activities: | | |
| Purchase of capital assets | <u>(13,681)</u> | <u>(18,552)</u> |
| Financing activities: | | |
| Repayment of capital lease obligations and loan payable | (15,545) | (9,363) |
| Issuance of common shares | <u>2,250</u> | <u>-</u> |
| | <u>(13,295)</u> | <u>(9,363)</u> |
| Increase (decrease) in cash | 7,254 | (247,410) |
| Cash, beginning of period | <u>940,302</u> | <u>438,932</u> |
| Cash, end of period | <u>\$ 947,557</u> | <u>\$ 191,522</u> |
| Supplementary information | | |
| Interest paid | \$ 3,867 | \$ 2,586 |
| 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, 2008, and 2007

| | <u>2008</u> | <u>2007</u> |
|----------------------------------|-------------------|-------------------|
| Opening inventory | \$ 496,335 | \$ 642,232 |
| Manufacturing costs: | | |
| Materials | 242,152 | 249,157 |
| Direct labour, freight and other | 103,010 | 93,845 |
| Manufacturing overhead | <u>132,542</u> | <u>130,254</u> |
| | <u>477,703</u> | <u>473,256</u> |
| Goods available for sale | 974,038 | 1,115,488 |
| Closing inventory | <u>510,662</u> | <u>618,500</u> |
| Cost of goods sold | <u>\$ 463,376</u> | <u>\$ 496,988</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, 2008

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, 2008.

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 | \$ 101,198 |
| Furniture and office equipment | 374,051 |
| Leasehold improvements | <u>101,072</u> |
| | 554,566 |
| Accumulated amortization | <u>(304,438)</u> |
| Net book value | <u>\$ 250,128</u> |

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

| | |
|----------------------------------|-----------------|
| Obligations under capital leases | \$57,816 |
| Loan Payable | <u>12,438</u> |
| | 70,254 |
| Current portion | <u>(39,103)</u> |
| Long term portion | <u>\$31,151</u> |

The company's capital lease agreements have financed equipment acquired for the growth in operations. These lease obligations have terms from 7- 30 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 included in current liabilities.

4. Share capital:

a) Authorized capital of the Company as at December 31, 2008 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, 2008 there were 2,894,500 options outstanding held by directors, officers and employees. These options are exercisable at various dates to Jan 8, 2013, as follows:

| Exercise Price Per Share | Number Outstanding | Average Remaining Life in Months | Number Exercisable at June 30 th |
|--------------------------|--------------------|----------------------------------|---|
| \$0.21 | 580,000 | 40.8 | 580,000 |
| \$0.145 | 215,000 | 38.1 | 215,000 |
| \$0.13 | 390,000 | 49.0 | 156,000 |
| \$0.12 | 280,000 | 31.4 | 70,000 |
| \$0.10 | 1,069,500 | 43.6 | 322,500 |
| \$0.09 | 360,000 | 7.3 | 360,000 |
| Total | 2,894,500 | 37.6 | 1,527,500 |

5. Commitments and contingencies:

Other contractual obligations of the Company are substantially unchanged from those described within the notes to the fiscal 2008 audited financial statements.



INTERNATIONAL
Water·Guard

Management's Discussion and Analysis

**INTERNATIONAL WATER-GUARD
INDUSTRIES INC.**

First quarter ended December 31, 2008

Dated: February 10, 2009

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS

First quarter December 31, 2008

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, 2008. The following discussion, and analysis in this report, is based on information available to management as of February 10, 2009, 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 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

The Company reported sales during the first quarter in fiscal 2009 of \$1,214,916 compared to \$854,384, a 42% increase above the same quarter of the previous year. First quarter net earnings were \$60,120 compared to a net loss of (\$80,691) in the prior year's first quarter.

The Company continued the near term acceleration of its new product development and marketing efforts to meet an emerging need for complementary products in aircraft water treatment and systems. The related expenditures have reduced the Company's net income in this period,

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

Sales and sales margins

Sales of aviation water treatment equipment, parts and service increased in the first quarter reversing a short term drop experienced during the same quarter of the last fiscal year. Service and parts revenue continued to increase with the growing maturity of the Company's equipment install base.

The impact of the higher value of the US dollar during the latest quarter has also added to both the company's reported sales and its margin rates on equipment and part sales.

Operating expenses

Selling expenses of \$127,294 for this quarter increased over the comparable period of the prior year, mainly due to the move of a major tradeshow event, being held in October 2008 rather than in September, which would have placed it in the 2008 financial year.

Engineering and product development expenses of \$209,061 in the quarter, is an increase of 50% over the prior year due to acceleration of new product development during this fiscal year for complementary products in aircraft water treatment and systems.

General, administration and information technology expenses totaled \$313,039, an 18% increase above the same quarter in the prior year. This increase was primarily attributed to increased investor relations costs, and the expense of implementing a director's compensation plan.

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 2009 | Fiscal Year 2008 | | | | Fiscal year 2007 | | |
|---|------------------|------------------|---------|---------|--------|------------------|---------|---------|
| | Dec 31 | Sept 30 | Jun 30 | Mar 31 | Dec 31 | Sept 30 | Jun 30 | Mar 31 |
| Sales | \$1,215 | \$1,153 | \$1,293 | \$856 | \$854 | \$1,279 | \$1,044 | \$1,149 |
| Net income | \$60 | \$41 | \$46 | (\$103) | (\$81) | \$405 | \$92 | \$176 |
| Earnings per share, basic and fully diluted | 0.2¢ | 0.1¢ | 0.1¢ | (0.3)¢ | (0.2)¢ | 1.2¢ | 0.3¢ | 0.5¢ |

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 improved during the first quarter of fiscal 2009 with the improvement in sales orders and earnings.

Cash position:

Cash increased modestly by \$7,254 since the commencement of the fiscal year due to increased sales activities.

Cash flow from operations:

Cash provided from operating activities, including non-cash operating working capital, was \$34,230 in the current quarter compared to \$219,495 cash used in the same quarter of the prior year.

Capital expenditures:

Capital expenditures of \$13,681 were incurred during the first quarter to purchase equipment.

Working capital position:

The Company completed its first quarter ended December 31, 2008 with working capital of \$1,801,380, an increase of \$78,405 from its fiscal year end. These changes generally reflect the trends in sales and earnings.

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, 2008, and there are no future commitments for the purchase of capital equipment

Share capital

The Company has 39,340,694 common shares outstanding as at the date of this report. In addition, there are 2,894,500 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.

Generally, the risks identified in the Company's annual management discussion and analysis for the fiscal year ended September 30, 2008, that relate to the business use aircraft markets, competitive position and intellectual property protection, have not changed from that reported previously.

Financial & Economic Conditions

Current world financial and economic conditions have not affected the company directly as of the date of writing. There are some signs of a weakening corporate jet market, but this has not impacted near term sales. IWG monitors the situation carefully by managing expenses and cash resources with a view to mitigating risk from any potential downturn.

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. In particular, some indicators signal that the present world economic downturn could cause a slowdown for the industry.

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.

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.

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 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 lines of credit have ensured that sufficient 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 and product engineering will require additional capital beyond that generated from operations.

Forward-looking statements

The Company's financial reports contain forward-looking statements regarding the Company, its business, operations, technology and the markets in which it operates. Any projections and forward-looking statements are based on management's current expectations, beliefs, assumptions, estimates and forecasts about market conditions and other factors.

The projections or forward-looking statements included herein are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict as well as factors beyond the Company's control. Actual outcomes and results may differ materially from those expressed in such projections or forward-looking statements

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 recent world wide financial crisis may have an impact on the industry and Company, although there has been no immediate impact on the operations of IWG.

IWG, 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.