



INTERNATIONAL  
**Water-Guard**

Interim Financial Statements of

**INTERNATIONAL WATER-GUARD  
INDUSTRIES INC.**

Nine months ended June 30, 2006

**Interim Financial Statements of**

**INTERNATIONAL WATER-GUARD INDUSTRIES INC.**

**Notice of no auditor review of interim financial statements to June 30, 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. In this respect:

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**

	June 30 <u>2006</u>	September 30 <u>2005</u>
<b>ASSETS</b>		
Current assets:		
Cash	\$ 16,439	\$ 354,804
Accounts receivable	879,367	508,776
Inventory	353,970	282,922
Prepaid expenses	<u>21,115</u>	<u>31,928</u>
	1,270,891	1,178,430
 Equipment and furniture	 <u>210,475</u>	 <u>34,492</u>
	 <u>\$ 1,481,366</u>	 <u>\$ 1,212,922</u>
 <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 331,615	\$ 226,020
Demand loan	65,000	367,900
Current portion of capital lease obligations and loan	<u>24,374</u>	<u>8,292</u>
	<u>420,989</u>	<u>602,212</u>
 Obligations under capital leases and other loan	 <u>90,470</u>	 <u>24,875</u>
 Shareholders' equity:		
Share capital	7,533,289	7,508,539
Contributed surplus	82,012	60,574
Deficit	<u>(6,645,394)</u>	<u>(6,983,278)</u>
	<u>969,907</u>	<u>585,835</u>
	 <u>\$ 1,481,366</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

Nine months ended June 30th

	Three months ended June 30		Nine months ended June 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Sales	\$ 1,014,045	\$ 723,342	\$ 2,733,362	\$ 2,319,068
Cost of goods sold	<u>371,988</u>	<u>323,426</u>	<u>1,051,843</u>	<u>1,050,028</u>
Gross profit	<u>642,057</u>	<u>399,916</u>	<u>1,681,519</u>	<u>1,269,040</u>
Expenses:				
Selling expenses	131,232	75,765	332,286	215,877
Research & development	110,280	82,812	317,698	261,122
General and administration	214,026	165,328	595,268	531,569
Stock option compensation	8,263	-	21,438	18,098
Interest & bank charges	13,446	32,520	50,811	130,910
Amortization	<u>12,690</u>	<u>1,950</u>	<u>26,134</u>	<u>16,000</u>
	<u>489,937</u>	<u>358,375</u>	<u>1,343,635</u>	<u>1,173,576</u>
Earnings from operations, before undernoted	152,120	41,541	337,884	95,464
Gains on settlement of notes and accounts payable		10,777		601,451
Gain on sale of commercial division assets				164,063
Write-down of furniture and equipment	<u>-</u>	<u>-</u>	<u>-</u>	<u>(15,000)</u>
Net earnings for the period	152,120	52,318	337,884	845,978
Deficit, beginning of period	<u>6,797,514</u>	<u>7,060,773</u>	<u>6,983,278</u>	<u>7,854,433</u>
Deficit, end of period	<u>\$ 6,645,394</u>	<u>\$ 7,008,455</u>	<u>\$ 6,645,394</u>	<u>\$ 7,008,455</u>
Earnings per share amounts:				
Basic	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 0.01</u>	<u>\$ 0.04</u>
Fully diluted	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 0.01</u>	<u>\$ 0.04</u>
Weighted average shares outstanding	33,476,535	28,835,538	33,357,192	23,265,975

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See accompanying notes to financial statements.

# INTERNATIONAL WATER-GUARD INDUSTRIES INC.

## STATEMENTS OF CASH FLOWS

Nine months ended June 30

	Three months ended June 30		Nine months ended June 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Cash flows from (used by):				
Operating activities:				
Net earnings for the period	\$ 152,120	\$ 52,318	\$ 337,884	\$ 845,978
Items not involving cash -				
Gain on settlement of Notes and other liabilities	-	(10,777)	-	(601,451)
Book value of assets sold	-	-	-	135,937
Unrealized foreign exchange gains	-	-	-	(28,036)
Compensation related to stock option plan	8,263	-	21,438	18,098
Interest accrued	-	2,192	-	37,153
Amortization and equipment write-down	12,690	1,950	26,134	31,000
	<u>173,073</u>	<u>45,683</u>	<u>385,456</u>	<u>438,679</u>
Changes in non-cash operating working capital:				
Accounts receivable	(287,804)	(55,662)	(370,591)	121,728
Inventory	(98,566)	(27,411)	(71,048)	68,542
Prepaid expenses	2,424	(22,294)	10,813	(22,293)
Accounts payable and accrued liabilities	63,628	(179,090)	105,595	(577,779)
Cash flow from (used in) operations	<u>(147,245)</u>	<u>(238,774)</u>	<u>60,225</u>	<u>28,877</u>
Investing activities:				
Purchase of equipment and leaseholds	<u>(18,544)</u>	<u>(6,461)</u>	<u>(202,117)</u>	<u>(7,408)</u>
Financing activities:				
Proceeds (repayment) of demand loans	(85,500)	(116,000)	(302,900)	(325,500)
Proceeds (repayment) of note and loan payable	5,821	(283,577)	81,677	(316,910)
Issue of common shares for cash	24,750	702,639	24,750	702,639
	<u>(54,929)</u>	<u>303,062</u>	<u>(196,473)</u>	<u>60,229</u>
Increase (decrease) in cash	(220,718)	57,827	(338,365)	81,698
Cash beginning of period	<u>237,157</u>	<u>88,707</u>	<u>354,804</u>	<u>64,836</u>
Cash end of period	<u>\$ 16,439</u>	<u>\$ 146,534</u>	<u>\$ 16,439</u>	<u>\$ 146,534</u>
Supplementary information				
Interest paid	\$ 13,446	\$ 29,768	\$ 50,811	\$ 92,791
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

Nine months ended June 30th

	Three months ended June 30		Nine months ended June 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Opening inventory	\$ 255,404	\$ 355,231	\$ 282,922	\$ 423,626
Manufacturing costs:				
Materials	301,702	82,954	647,828	405,463
Labour, freight and other	65,396	78,427	177,140	258,446
Manufacturing overhead	<u>103,456</u>	<u>66,676</u>	<u>297,923</u>	<u>222,355</u>
Cost of goods available for sale	725,958	583,288	1,405,813	1,309,890
Closing inventory	<u>353,970</u>	<u>259,862</u>	<u>353,970</u>	<u>259,862</u>
Cost of goods sold	<u>\$ 371,988</u>	<u>\$ 323,426</u>	<u>\$ 1,051,843</u>	<u>\$ 1,050,028</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 June 30, 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, 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 periods reported for both fiscal 2005 and 2006.

### 3. Equipment and furniture:

Equipment under capital leases	\$101,122
Leasehold improvements	87,177
Other equipment	<u>204,095</u>
	392,394
Accumulated amortization	<u>(181,919)</u>
Net book value	<u>\$210,475</u>

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

Obligation under capital leases	\$65,595
Loan payable	<u>24,875</u>
	<u>\$90,470</u>

The company entered into several capital lease agreements 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.

### 5. Share capital:

- a) Authorized capital of the Company as at June 30, 2006 includes an unlimited number of common shares and of preferred shares of which 33,549,694 common shares and no preferred shares were issued and outstanding.

- b) Under the Company's stock option plan, there were 2,350,000 options outstanding as of June 30, 2006 held by directors, officers, and employees, exercisable at various dates to April 7, 2009, as follows:

Exercise Price Per Share	Number Outstanding	Average Remaining Life in Years	Number Exercisable at June 30th
\$0.18	580,000	0.9	580,000
\$0.115	460,000	1.9	276,000
\$0.10	890,000	1.1	890,000
\$0.075 - \$0.09	420,000	2.4	118,000
Total	2,350,000	1.2	1,864,000

- c) Warrants to purchase 247,500 common shares at \$0.10 each were exercised on April 28<sup>th</sup> while 72,500 warrants expired on May 4<sup>th</sup> without being exercised.
6. Commitments and contingencies:
- 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. 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.
- b) Apart from the capital lease agreements described in note 4, other contractual obligations of the Company are unchanged from those described within the notes to the audited financial statements.
- c) 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 26<sup>th</sup>, 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.