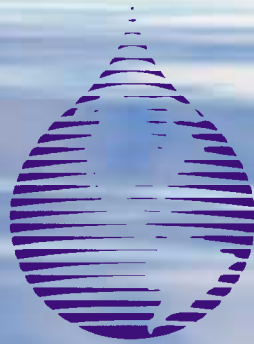


Moving Up...

Moving Ahead.



INTERNATIONAL
WATER-GUARD

INDUSTRIES INC.

THE WATER KNOWLEDGE COMPANY

1999 Annual Report



President's Message

The past year was perhaps the most important one yet in International Water-Guard's history. The company passed a significant financial milestone, as well as making very important progress in several key aviation-related initiatives. To begin with, this discussion will focus on the positive financial aspects of the past twelve months.

In a general sense, the good news is a positive trend in International Water-Guard's financial position. Not only is this good news from a 'here-and-now' perspective for those of us within the company, but also projects a sense of confidence in our future direction to those outside the company. This confidence directly reflects on the company's ability to raise capital and in turn affects the nature and manner of the business we do.

The main points of International Water-Guard's performance in the last fiscal year are summarized as follows:

- The company recorded a profit of almost \$374,000 for fiscal 1999. This compares to a \$298,000 loss for last year. This \$672,000 swing was very significant.
- The company's pre-R&D profit (40% of sales) and level of R&D spending (24% of sales) are both healthy indicators that the company is building a business for the future.
- The company has a sizable income tax loss-carry-forward (\$2,277,000), which if utilized, will not require the payment of income taxes on future profits for a period of time.
- The company has a clean balance sheet devoid of deferred development costs. Future operating results will not be encumbered by the amortization of past development costs.
- The company had no long-term debt (and related debt service requirements) on its September 30, 1999 balance sheet. Subsequent to September 30, 1999, however, the company did issue a \$500,000 Convertible Debenture.
- The company's working capital is positive and has improved from last year.
- There has been a significant increase in sales (42.6%). The biggest part of that increase came in the highly profitable aviation sector.
- There has been a healthy and important increase in gross profit percentage (from 54.6% to 76.2%).
- Overhead expenses were tightly controlled and did not rise at the same rate as gross profit. The affect of this on the company's bottom line was both significant and substantial.

Viewed as a platform from which to continue building the company's growth and development, these results from last year bode well for the future. A number of developments within IWG, from both a physical and business sense also project positively on the coming year's activities.

The largest physical change within the company has been our move to a new location in the Vancouver suburb of Burnaby. We have taken a long-term lease on an expanded manufacturing and office facility at 3133 Sumner Avenue - within two blocks of the British Columbia Institute of Technology, and adjacent to the Discovery Park high technology business center. This new location allows us to take advantage of the technology synergy in our new neighbourhood, and also provides the growth room we need to meet the many opportunities now presenting themselves.

A renovation project for the new facility is underway, with the intent of providing a dynamic and innovative environment for all aspects of International Water-Guard's future operations. The manufacturing area has been expanded and will feature efficient new production infrastructure that can handle both the increased demands of current product sales and those of new products now entering the marketplace. In a similar way, new offices will be built to compliment the production streamlining process. An enhanced information technology (IT) system is the main pillar of this overall integration of manufacturing and office functions in the new facility. The new IT system is being designed so that the company rapidly becomes an e-business with improved internal communications, as well as better inter-activity with outside parties via the internet.

All the factors related to the new facility are planned to fit into our goal of achieving ISO 9001 certification by the end of the year 2000. We are currently meeting many requirements of this industry standard due to our operations within the highly regulated aviation market, but the goal is to not only formalize this in the form of certification, but to apply the same quality standards to all aspects of our operations.

Throughout the past year we have explored several new potential market directions for the profitable application of our Water Knowledge. Our intent is to sustain and build upon our current customer base, but also to focus on specific sectors that provide a clear opportunity for success that parallels our emerging aviation model. At least one such market sector has been identified. Further definition is required, but this market opening gives every indication that such a development effort is justified. In addition, the company continues to explore the value of a potential collaboration with Hankin Atlas Industries Limited, a Calgary-based company with particular technical expertise in both the design and application of ozone equipment and leisure water facilities.

Turning to the aviation market, our progress continues to be based on increased sales of our current NPS-A2 aircraft potable water disinfection unit as well as two new factors: the NPS-A3 aircraft potable water treatment unit, and International Water-Guard's new recirculating aircraft potable water system. In the past year, the NPS-A2 received an upgrade to its electronics package, resulting in significantly improved disinfection performance. While the company is introducing new aviation products, there remains a strong and growing demand for this original equipment with substantial market expansion occurring.

The new generation NPS-A3 has completed its design and testing phases, and is currently entering the certification process. With the assistance of Bombardier Aerospace, the launch customer for the product, all documents required by the Department of Transportation for a Supplemental Type Certificate (STC) specific to the Bombardier Global Express aircraft have been filed. While Bombardier has thus far spoken for all NPS-A3 units produced to date, interest in the new product is strong from other aircraft manufacturers and various completion centers. The manufacturers include Gulfstream, historically International Water-Guard's best customer for NPS-A2 units, and Dassault Falcon Jet, the large French business jet producer. Both Bombardier and Gulfstream have signed Letters of Intent to offer the NPS-A3 as a standard customer option on their respective long-range business jets.

Almost eighteen months ago, International Water Guard applied for patent protection for the intellectual property inherent in our unique recirculating Potable Water System (PWS) design. A Notification of Allowance is expected shortly. Our strong ongoing relationship with Lufthansa Technik (LHT) resulted in a recirculating water system with two of IWG's new potable water pumps being installed on the first Boeing Business Jet (BBJ) completed by LHT. The aircraft has been flying since October of 1999, and feedback from LHT indicates that the customer is extremely pleased with the water system. The supply of this PWS design as a certified kit has been proposed to most major aircraft manufacturers and completion centers to replace the



The New NPS-A3 Aircraft Potable Water Treatment System has integral filtration with advanced ultraviolet intensity monitoring.

current air-pressurized design. The cost and weight savings and other operational advantages of the recirculating design are so compelling that we expect it to become the global aviation industry standard over the next couple of years.

That said, the key to realizing the full potential of the aviation market lies in our ability to open up the large airline sector. IWG continues to conduct direct discussions with airlines that are looking to improve the safety and quality of the water served to passengers and crew. We are also demonstrating to these carriers the inherent economic value in the new potable water system.

Another path to the airline market is through manufacturer acceptance of the PWS concept. The LHT installation mentioned above has provided a great deal of credibility in this area, and proposals are being assessed by a number of the large aircraft manufacturers. So far, our NPS-A2 equipment has been installed in every Boeing Business Jet manufactured to date. This is not going unnoticed by Boeing's commercial aircraft division, and we continue to work for the adoption of this product and our PWS design by that major section of the company. Like all initiatives in aviation, this is a slow, incremental process, but we have made clear progress over this time last year.

A likely regulatory shift in the United States will undoubtedly open the door to the airlines should it be adopted. Deliberations now underway at the U.S. Food and Drug Administration and the U.S. Environmental Protection Agency appear likely to result in the potable water systems of Interstate Commercial Carriers - including those of airlines - being viewed as public water systems. If implemented, this change in regulations will subject airlines to scrutiny and water system maintenance requirements they previously did not face. In this eventuality, IWG's water treatment solutions will attract a great deal of attention.

International Water-Guard currently enjoys the luxury of not having any serious competition in the supply of water treatment equipment to the aviation market, but we are conducting business with the clear understanding that this situation will not last. The regulatory evolution - even revolution - mentioned above will certainly encourage new entrants into the aircraft water treatment field. Our strategy involves being totally focused on our customers and meeting all of their water treatment/management needs with high value-added products.

Aside from the aviation field, opportunity is still before us on all fronts. Only 1% of the water on earth is usable for potable or process purposes; that is, not locked up in ice, or in saltwater form. Clean, safe water is becoming an ever more valuable commodity, and is increasingly being recognized as such by individuals, organizations and governments throughout the world. IWG has a vision of clean, safe water for everyone, everywhere. With our determination to focus our Water Knowledge on a variety of water treatment/management challenges, we and our shareholders are well positioned to profit from this ever changing environment.



Sales of IWG's original NPS-A2 Aircraft Potable Water Disinfection unit continue to grow. Nearly 400 units are flying on corporate and VIP aircraft around the world.



A new IWG-specified potable water pump is the heart of our revolutionary recirculating potable water system for aircraft.

In closing, I most sincerely want to acknowledge and personally thank all of my colleagues for their individual and collective efforts during the past year. It is individuals that create change and get results. The IWG team has performed in an outstanding manner in the past year. At the same time we are deeply indebted to our directors, shareholders, and friends - many of whom have believed in and supported us for years. Thank you all.

On Behalf of The Board,

"C. W. Coote"

President & CEO

Financial Statements of

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Years ended September 30, 1999 and 1998

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of International Water-Guard Industries Inc. as at September 30, 1999 and 1998 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 1999 and 1998 and the results of its operations and its cash flows for the years then ended in accordance with generally accepted accounting principles. As required by the Company Act (British Columbia) we report that, in our opinion, these principles have been applied on a consistent basis.

"signed KPMG LLP"

Chartered Accountants

Vancouver, Canada

October 26, 1999

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Balance Sheets

September 30, 1999 and 1998

	1999	1998
Assets		
Current assets:		
Cash	\$ 135,600	\$ 14,058
Accounts receivable	570,645	382,716
Government assistance receivable (note 7(b))	121,784	–
Inventory (note 2)	236,670	152,972
Prepaid expenses	31,585	2,731
	1,096,284	552,477
Equipment (note 3)	60,341	93,488
	\$ 1,156,625	\$ 645,965
Liabilities and Shareholders' Equity (Deficiency)		
Current liabilities		
Accounts payable and accrued liabilities	\$ 580,956	\$ 649,634
Demand loan (note 4)	195,761	–
Loan payable	–	20,716
	776,717	670,350
Shareholders' equity (deficiency):		
Capital stock (note 5)	2,808,236	2,777,682
Deficit	(2,428,328)	(2,802,067)
	379,908	(24,385)
Contingencies and commitments (notes 7 and 11)		
Subsequent event (note 10)		
	\$ 1,156,625	\$ 645,965

See accompanying notes to financial statements.

Approved on behalf of the Board:

"David Hall" Director

"C.W. Coote" Director

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Statements of Operations and Deficit

Years ended September 30, 1999 and 1998

	1999	1998
Sales	\$ 2,347,116	\$ 1,645,736
Cost of goods sold (note 2)	558,490	747,891
Gross profit	1,788,626	897,845
Expenses:		
Depreciation	44,640	23,372
Direct selling	200,152	108,783
Interest and bank charges	44,644	5,026
Office	67,125	79,220
Professional and consultants' fees	265,779	347,632
Remuneration and benefits	309,958	370,126
Rent	77,795	71,280
Repairs and maintenance	7,553	5,826
Technology investigation costs	566,324	142,514
Telecommunications	32,449	35,746
Utilities	8,698	6,603
Government assistance (note 7(b))	(210,230)	-
	1,414,887	1,196,128
Income (loss) for the year (note 8)	373,739	(298,283)
Deficit, beginning of year	2,802,067	2,503,784
Deficit, end of year	\$ 2,428,328	\$ 2,802,067
Income (loss) per share	\$ 0.04	\$ (0.03)

See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Statements of Cash Flows

Years ended September 30, 1999 and 1998

	1999	1998
Cash flows from (used by):		
Operating activities:		
Income (loss) for the year	\$ 373,739	\$ (298,283)
Depreciation, an item not involving cash	44,640	23,372
	418,379	(274,911)
Change in non-cash operating working capital:		
Accounts receivable	(187,929)	(223,534)
Government assistance receivable	(121,784)	-
Inventory	(83,698)	27,265
Prepaid expenses	(28,854)	8,501
Accounts payable and accrued liabilities	(68,678)	253,302
	(72,564)	(209,377)
Investing activities:		
Purchase of equipment	(11,493)	(434)
Financing activities:		
Demand loan	195,761	-
Issuance of capital stock	30,554	170,901
Decrease in loan payable	(20,716)	(4,454)
	205,599	166,447
Increase (decrease) in cash	121,542	(43,364)
Cash, beginning of year	14,058	57,422
Cash, end of year	\$ 135,600	\$ 14,058
Supplementary information:		
Interest paid	\$ 16,649	\$ 5,026
Taxes paid	-	-

See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 1999 and 1998

The Company was incorporated as Universal Water Systems (1989) Inc. on September 22, 1989 under the Company Act (British Columbia). On May 14, 1990, the Company changed its name to International Water-Guard Industries Inc.

The Company's principal business operations relate to the development, manufacturing and sales of water purification systems. All manufacturing operations and assets are located in Canada. In 1999, approximately 17% (1998 - 35%) of sales revenue was generated by customers in Canada and 83% (1998 - 65%) by customers in other countries, primarily the United States.

1. Significant accounting policies:

(a) Basis of presentation and operations:

The Company's financial statements are prepared in accordance with generally accepted accounting principles in Canada. These principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses during the reporting period. Significant estimates used in the preparation of these financial statements primarily relate to the assessment of the net realizable value of inventory. Actual results could differ from these estimates.

(b) Inventory:

Inventory is valued at the lower of cost, determined on a first-in, first-out basis, and estimated net realizable value.

(c) Equipment:

Equipment is stated at cost. Depreciation is provided using the declining-balance method at a rate of 20% per annum.

(d) Revenue recognition:

Revenue is recognized when products are shipped to the customer and there are no significant vendor obligations remaining.

(e) Government assistance:

The Company receives payments from time to time under various government assistance programs. These payments are recorded in the period during which the associated expenditure is incurred. Payments received for operating expenditures are netted against expenses and payments relating to capital additions are netted against the cost of such additions.

(f) Technology investigation costs:

Research costs are expensed as incurred. Product development costs are expensed as incurred unless certain specified criteria for deferral have been met. The Company applies a stringent interpretation of these criteria, with the result that no development costs have been deferred to date. Costs incurred for routine or periodic alterations to existing products which are not substantial improvements to the products are expensed.

1. Significant accounting policies (continued):

(g) Earnings per share:

Earnings per share has been calculated based on the weighted average number of common shares outstanding. Fully diluted earnings per share for the year ended September 30, 1999 has not been provided as it is not materially different from basic earnings per share, and fully diluted loss per share for the year ended September 30, 1998 has not been provided as it is anti-dilutive.

2. Inventory:

	1999	1998
Raw materials	\$ 229,991	\$ 146,546
Finished goods	6,679	6,426
	\$ 236,670	\$ 152,972

Raw materials include parts to be used in the manufacturing process.

Cost of goods sold is determined as follows:

	1999	1998
Opening inventory	\$ 152,972	\$ 180,237
Manufacturing costs:		
Parts	409,271	388,637
Direct labour, freight and other	232,917	331,989
	642,188	720,626
Available for sale	795,160	900,863
Closing inventory	236,670	152,972
Cost of goods sold	\$ 558,490	\$ 747,891

3. Equipment:

	1999	1998
Molds	\$ 60,546	\$ 60,546
Manufacturing and distribution equipment	89,777	89,777
Furniture and office equipment	77,977	66,484
Leasehold improvements	64,702	64,702
	293,002	281,509
Accumulated depreciation	232,661	188,021
	\$ 60,341	\$ 93,488

4. Demand loan:

The Company has entered into a credit facility to fund current working capital requirements allowing the Company to receive maximum advances of an amount equal to the lesser of 75% of current accounts receivable and \$250,000. Outstanding amounts are repayable on demand, bear interest at 2.5% per month and are secured by all assets of the Company.

5. Capital stock:

(a) Authorized:

20,000,000 common shares without par value

5,000,000 preference shares with a par value of \$1 each

(b) Issued common shares:

	Number of shares	Amount
Balance, September 30, 1997	8,967,759	\$ 2,606,781
Issued on exercise of warrants	427,252	170,901
Balance, September 30, 1998	9,395,011	2,777,682
Issued on exercise of stock options	76,350	30,554
Balance, September 30, 1999	9,471,361	\$ 2,808,236

The Company previously issued 3,679,884 performance shares which are releasable from escrow based upon the satisfaction of certain pre-determined cumulative cash flow tests. Release from escrow is subject to regulatory approval. Any escrow shares not released by October 2004 will be cancelled. Pursuant to the escrow agreement, holders of the performance shares may exercise all voting rights attached thereto, except on a resolution to cancel any of the shares, and have waived their rights to receive dividends or to participate in the assets and property of the Company on a winding-up or dissolution of the Company.

(c) Stock options:

At September 30, 1999, the Company has granted incentive stock options to executive officers, directors, employees and associates to purchase 705,000 common shares subject to certain vesting provisions. The details of these options are as follows:

Number	Exercise price	Expiry date
176,250	\$0.75	January 13, 2000
225,000	\$1.05	October 6, 2000
91,250	\$0.95	May 6, 2001
125,000	\$0.50	May 20, 2001
87,500	\$0.51	May 28, 2001

6. Related party transactions:

Included in accounts payable and accrued liabilities is \$57,938 (1998 - \$129,637) payable to shareholders and companies controlled by directors of the Company. During the year, the Company paid \$50,004 (1998 - \$50,004) to a company owned by an officer and shareholder for the provision of services.

7. Contingencies and commitments:

- (a) In 1994, an unrelated party asserted that the Company's use of the word "WaterGuard" in the United States violated registered trademark rights of that party in the United States. No action has been filed with respect to this assertion. Any costs incurred with respect to this assertion will be recorded when determinable. Management does not believe that the impact of the assertion will be material.
- (b) The Company has entered into an agreement with Technology Partnerships Canada to assist in the funding of the development of its NPS-A3 potable water treatment system to the extent of the lesser of 30% of eligible costs and \$235,845. As a condition of this agreement, the Company has agreed to pay Technology Partnerships Canada a royalty of 2% of the gross revenues from the sale of NPS-A3 systems until September 30, 2005, or if the royalty payments to that date do not exceed \$365,180, then until the limit of \$365,180 is reached.
- (c) The Company entered into a long-term operating lease for premises expiring October 31, 2009. The future annual rents, exclusive of property taxes and expenses directly payable by the Company, are as follows:

2000	\$ 57,885
2001	63,147
2002	63,147
2003	63,147
2004	63,147
Thereafter to 2010	363,095

8. Income taxes:

The Company has non-capital loss carry forwards of approximately \$2,277,000 which are available to offset taxable income otherwise calculated through 2006. The tax benefits of these losses carried forward have not been recorded in the accounts as there is uncertainty as to the extent and timing of their realization. During 1999, loss carry forwards were utilized to offset taxable income earned in the year.

9. Financial instruments:

- (a) Fair values:

Financial instruments consist of cash, accounts receivable, accounts payable and accrued liabilities, demand loan and loan payable, the fair value of which are considered by management to approximate their carrying value due to their ability for prompt liquidation or short-term to maturity.

9. Financial instruments (continued):

- (b) Credit risk:

The Company is exposed to credit risk only with respect to uncertainties as to the timing and collectibility of accounts receivable. At

September 30, 1999, three customers represented approximately 68% (1998 - 65%) of accounts receivables. The Company mitigates credit risk through regular credit assessment and collection policies.

(c) Currency risk:

At September 30, 1999, approximately 74% (1998 - 77%) of accounts receivable and 43% (1998 - 25%) of accounts payable and accrued liabilities are denominated in United States dollars. The Company has not entered into foreign exchange contracts to hedge against gains or losses from foreign exchange fluctuations.

10. Subsequent event:

On October 13, 1999, the Company issued Convertible Debentures having a principal amount of \$500,000 and bearing interest at the rate of 10% per annum calculated semi-annually. The Convertible Debentures mature on October 13, 2001 and are convertible at the option of the holder at \$0.60 per share up to and including October 13, 2000 and thereafter at \$0.70 per share to the maturity date. If the market price of the Company's common shares on each of 20 consecutive trading days is \$1.25 or more, the entire principal amount of the Convertible Debentures will be deemed to be converted on the first business day after the 20th day of such consecutive trading days. As part of the financing, the Company paid a finder's fee of \$37,500 and issued 200,000 share purchase warrants exercisable into common shares at \$0.60 until October 13, 2000 and at \$0.70 to October 13, 2001.

11. Uncertainty due to the Year 2000 Issue:

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, lenders or other third parties, will be fully resolved.



INTERNATIONAL WATER-GUARD

INDUSTRIES INC.

THE WATER KNOWLEDGE COMPANY

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