

Clear Progress...



INTERNATIONAL
WATER-GUARD
INDUSTRIES INC.
THE WATER KNOWLEDGE COMPANY

Annual Report 2001

PRESIDENT'S MESSAGE



To Our Shareholders,

It is with great pleasure that I am able to report to you that IWG has passed a major milestone in its corporate history, and now faces the exciting challenge of seizing the opportunities we have all worked so hard to create. Particularly in aviation sales, but also in aquaculture, we have progressed to the point where we have the right products, the right people, and the right market focus to reach the targets we have set for ourselves and our shareholders.

While the Company reported a \$573,002 loss on sales of \$2,385,684 during the 2000 fiscal year, over \$600,000 was spent on market and product development. This necessary investment, made primarily in the aviation sector, helped position IWG to provide a full range of water treatment solutions to new and existing aircraft. The opportunity before us is large - we estimate the annual market for corporate aircraft water systems is \$Cdn 55 million, and for commercial aircraft, \$Cdn 425 million - but the costs of market entry are also high. Both the business and commercial aircraft industries project continued strong growth, and we anticipate a relatively quick return on this investment once follow-on contracts for our patent pending potable water system (PWS) are signed.

The goal of our corporate marketing strategy has been to position IWG as the dominant supplier of water treatment devices and systems for the world's aviation industry. The specific tactic we have adopted is to expand the market for our aircraft potable water treatment units in a value-added fashion by including them as part of a completely new circulating potable water system (PWS). In addition to providing filtered and disinfected water, the new PWS offers valuable economic and other improvements over the system now installed on all business and commercial aircraft.

The first step in capturing this large aircraft water system market has been made. At this writing, IWG has nearly completed installing the new IWG PWS (patent pending) on a Bombardier Global Express aircraft at The Jet Center in Van Nuys, California. This follows Lufthansa Technik's success with the installation of our system concept on several models of Boeing aircraft. Based on customer feedback, we are fully confident that contracts for other aircraft types will be signed in 2001, along with follow-on orders. Once these initial systems are in operation and firmly establish the value of our PWS concept, our next step is to work with the business aircraft manufacturers themselves to "roll back" our system

into production so that new aircraft will be delivered with the IWG PWS already installed. Initial discussions about a production roll-back have already begun with two of the world's largest manufacturers of corporate aircraft.

The ultimate goal of our strategic plan is the inclusion of our products and systems aboard the thousands of commercial aircraft in the world's airline fleets. Success in the business aviation market will demonstrate how the IWG PWS can save aircraft operators money, as well as protect passengers and crew from waterborne disease. With the successful launch of our PWS in the business aircraft market, that goal is significantly closer to realization.

IWG's other main business area, the provision of water treatment solutions to the world's aquaculture industry, has also surged ahead. A new, IWG-designed, open channel ultraviolet water treatment system (patent pending) has been installed at a fish hatchery on Vancouver Island. This design improves on existing technology and will be the focus of an intense marketing campaign by IWG's Industrial/Commercial staff. We estimate the total North America and European market for all types of ultraviolet disinfection systems to be \$Cdn 100 million, and expect that the benefits offered by our new open channel design will be well received.

We are also taking steps to enter China's massive aquaculture market. China is the single largest aquaculture producer in the world. Officials in Fujian province, where our Chinese partner is located, estimate the annual growth rate of Chinese aquaculture at 13.6% (compared to the world average growth rate of 11%). With funding assistance from the Canadian International Development Agency, we are conducting a feasibility study to carefully examine the concept of a joint venture to establish a manufacturing and sales organization in China. The study will be completed in 2001, and if viable, IWG will quickly and aggressively pursue this potentially huge opportunity.

Water treatment in general remains a strong business sector in light of the ever-increasing worldwide concern over water quality. And while competition is strong in the overall water treatment industry, IWG has chosen a path to success with our aviation products and systems that no other company can currently follow. We won't be alone forever, but at this point our ultimate goal is clearly in sight, and we will keep up the pace toward it. Similarly, by focusing on aquaculture, providing innovative new products, and prudently exploring new markets, we are ensuring that no aspect of the company's business remains static.

Because of this momentum, and the measurable progress the company has made in the past year, these are exciting times for all of us at IWG. These accomplishments have come as the result of a concerted team effort, and I would like to take this opportunity to thank all members of IWG's internal and external team for their contributions, including our shareholders, customers, suppliers, associates, advisors, and members of the Board of Directors.

On Behalf of the Board

"C.W. Coote"

Bill Coote
President and CEO

BUSINESS DESCRIPTION

Overview

International Water-Guard Industries Inc. IWG is poised to be the dominant supplier of on-board water systems and water treatment equipment to the aviation industry. Aircraft water systems and water treatment equipment represent a \$480 million annual market (\$55 million for corporate aircraft and \$425 million for commercial aircraft).

IWG is unique in that it is the only company currently supplying non-pressurized water purification equipment and circulating potable water system (PWS) kits to the aviation industry. Its participation in this market represents a major market opportunity in the next few years. The Company's initial marketing efforts in aviation have been focused on corporate aircraft (i.e. aircraft owned by corporations or individuals). To date, over 500 NPS-A2 and NPS-A3 water disinfection units have been installed on corporate aircraft worldwide, including installations on aircraft manufactured by Boeing, Bombardier, Gulfstream, Cessna and Dassault. Collectively, these companies build and sell more than 90% of all corporate jet aircraft.

IWG's new circulating PWS was installed on a Bombardier Global Express corporate jet at the aircraft completion facilities of The Jet Center in Van Nuys, California, in January 2001. A circulating potable water system based on the IWG design and using IWG pumps and disinfection equipment has been operating flawlessly since September of 1999 on a Boeing Business Jet (BBJ) completed by Lufthansa Technik (a major international aircraft completion company). IWG recently signed a long-term contract with Lufthansa Technik to continue supplying these components for installation on a number of BBJ aircraft. This contract has a value of over \$2.5 million.

Ongoing discussions are underway with the major manufacturers of corporate aircraft to have the Company's equipment or circulating PWS incorporated as standard equipment. The Company believes this is achievable in the next 2 years, enabling it to capture a significant share of the annual \$55 million business aircraft market for on board aircraft water systems. Once the Company's circulating PWS is established as a standard issue water system on business aircraft, the Company anticipates that it will be in a position to move its products into the larger commercial airline market (approximately \$425 million per annum).

The Company's expertise in potable water equipment and systems for aircraft originated from developing systems and stand alone water treatment equipment for industrial and commercial customers. These applications include aquaculture and fish farming facilities, small municipal plants, pharmaceutical plants, film processing plants, aquariums and food processing plants. The aquaculture and wastewater UV industrial market sectors in which the Company operates, while quite segmented, represents an estimated \$225 million annual market in North America and the Company anticipates expanding its market share in the next few years. Additionally, IWG is assessing a very large opportunity for its aquaculture products in China following initial sales during the past year.

flow with no need of active controls. This pump is an essential part of IWG's circulating aviation potable water system.



The IWG-specified aircraft potable water system pump.

The IWG water pump project, completed in 1999, resulted in a highly reliable, aviation standard water pump with a guarantee of 100,000 hours mean time between failure (MTBF). While essentially designed as a component of IWG's circulating PWS, water system pumps have been sold for use in existing on-board water systems.

NPS-A2 and NPS-A3 Aircraft Water Treatment Units

The NPS-A2 and NPS-A3 provide on-board water disinfection, and are the only known ultraviolet disinfection units in the world qualified to be marketed for corporate and commercial aircraft. These products have U.S. Federal Aviation Administration (FAA) and Transport Canada approval in the form of Supplemental Type Certificates for corporate aircraft. Additionally, Transport Canada has certified IWG as an approved organization for the Manufacturing, Certification, and Maintenance of aeronautical products.

The NPS-A2 and NPS-A3 were designed to address the problem of water quality on aircraft, and can be installed on both existing aircraft as a retrofit by fleet operators or by OEMs as original equipment.

Airline operators are properly reluctant to take on water from many parts of the world due to growing concerns about various aspects of source contamination. The NPS-A2 and NPS-A3 water treatment units provide added insurance of water quality to the operators (and their passengers) of any aircraft loading water from almost any approved municipal source.

IWG believes that the installation of the NPS-A2 and NPS-A3 as potable water tank exit devices will become an increasingly cost effective measure for airlines and other commercial operators based on regulatory trends. The potable water systems of Interstate Commercial Carriers - including those of commercial airlines - may soon be viewed by U.S. regulatory bodies such as the Environmental Protection Agency (EPA) and the Food and Drug Administration (FDA) as public water systems. As

such, the water in these systems would have to be tested monthly and, if required, immediate system cleansing would have to be undertaken at a very significant cost due to the loss in aircraft operational hours. Independent analysis has calculated that the break-even point for installation of NPS-A2's and NPS-A3's on commercial aircraft ranges from 2.60 to 27.75 months depending on the aircraft involved and its particular operating parameters.



IWG's original model NPS-A2 aircraft potable water disinfection unit.



The new NPS-A3 combines disinfection with filtration.

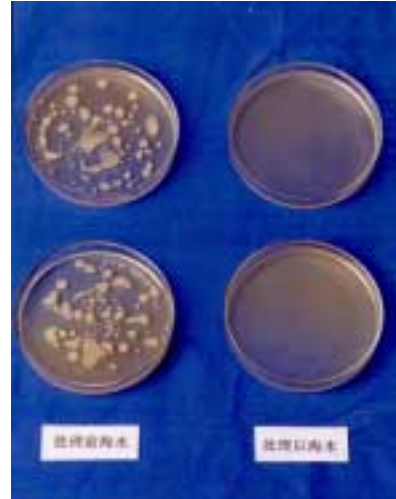
As of January, 2001, over 500 NPS-A2 and NPS-A3 units have been installed on private, corporate and head of state jets around the world.

INDUSTRIAL AND COMMERCIAL MARKET

Industrial/Commercial Ultraviolet Disinfection Units

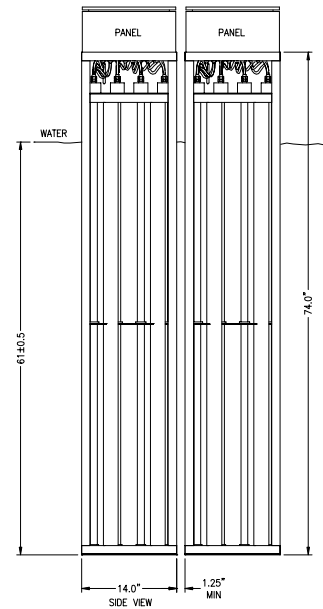
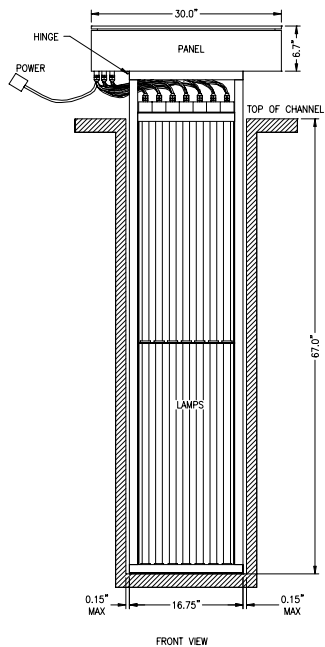
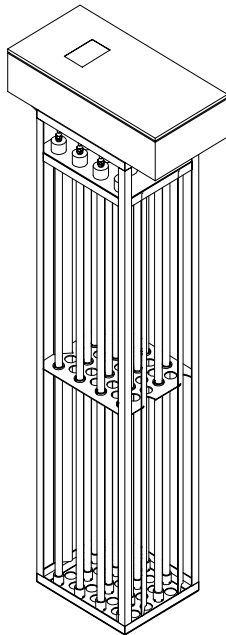
The Company manufactures a series of "closed chamber" UV disinfection units ranging in flow rate from 1 US gallon per minute (USGPM) to 850 USGPM.. These units are designed to exceed the operational and disinfection standards of the National Sanitation Foundation (NSF). The NSF sets standards and grants certification for water treatment equipment in the U.S.

The Company has established sales channels in Canada and the U.S. on which to build a stronger sales base over the next few years. For example, either on a direct sale basis or through agents, IWG equipment has been integrated into numerous coastal hatcheries, seafood processors or aquariums, such as Scotian Halibut in Nova Scotia, Fanny Bay Oysters on Vancouver Island, the San Diego Aquarium and the New Orleans' Aquarium of the Americas. To meet medical biotech water processing requirements, IWG equipment provides a quality solution for the B.C.-based facilities of Response Laboratories, Stem Cell Technology and for Mitro Flow (heart valve) Laboratories.



The photo above (left) shows a new installation of IWG 12-lamp, High Intensity units in an aquaculture facility in Chile. IWG's partner in China took the photo above (right). The petri dishes on the left contain an untreated water sample cultured for 24 hours, while those on the right contain a sample of water taken after IWG disinfection and cultured for the same period of time.

During the year 2000, a major customer commissioned IWG to design and develop a high throughput modular "open channel" ultraviolet water treatment system prototype to treat process or wastewater at flow rates ranging from 200 USGPM to at least 2000 USGPM. The new open channel systems (patent pending) are modular in construction for installation flexibility, and can be employed to disinfect water or for ozone destruction, or 'quenching.'



FINANCIAL REVIEW FOR YEAR 2000

International Water-Guard Industries Inc. (IWG) reports a loss for the fiscal year ended September 30, 2000 of \$573,002 on sales of \$2,385,684. This fiscal year's results compare to a profit in the prior year ended September 30, 1999 of \$373,739 on sales of \$2,347,116. The fiscal year 2000 loss of \$0.06 per share compares to the fiscal 1999 profit of \$0.04 per share.

Sales have increased by 45% between 1998 and 2000, with aviation sales more than doubling during the same period. The anticipated loss results from the company's successful move to capture a portion of the multi-million dollar aircraft water systems market. IWG spent over \$600,000 in the last fiscal year on market and product development. This investment was made primarily in the aviation sector to advance IWG from simply providing potable water disinfection units toward the greater opportunities inherent in providing full aircraft water systems.

The value of these market and product development costs in recent years, required to reach these markets, is already being realized. IWG's sales backlog, including options, has increased to over \$4 million during the past six months. Based on current business activities, the company expects this backlog will further increase.

The Company completed its 2000 fiscal year with \$375,290 in working capital, a slight increase over the prior year. During the year, \$500,000 of financing was raised in the form of a convertible debenture, and the option to convert into common shares was exercised in October 2000. This financing was used to retire a previous loan, finance development costs and add to working capital.

IWG also relocated to new manufacturing, engineering and office facilities during 2000 and will complete additional improvements during year 2001 to accommodate the growth in manufacturing requirements.

In recent years, IWG has operated primarily as a development company with a base level of operations covering only a portion of the product and market development cost and increased working capital. Consequently, the Company is undertaking the next steps necessary to acquire interim and long-term financing, now that major contract agreements are validating the Company's Business Plan.

Financial Statements of

**INTERNATIONAL WATER-GUARD
INDUSTRIES INC.**

Years ended September 30, 2000 and 1999



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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of International Water-Guard Industries Inc. as at September 30, 2000 and 1999 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 Canadian 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, 2000 and 1999 and the results of its operations and its cash flows for the years then ended in accordance with Canadian 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.

Chartered Accountants

Vancouver, Canada

November 20, 2000



KPMG LLP is a Canadian limited liability partnership organized under the laws of Ontario, is a member firm of KPMG International, a Swiss entity.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.



Balance Sheets

September 30, 2000 and 1999

	2000	1999
Assets		
Current assets:		
Cash	\$ 27,597	\$ 135,600
Accounts receivable	400,696	570,645
Government assistance receivable	10,000	121,784
Inventory (note 2)	584,710	236,670
Prepaid expenses	11,830	31,585
	<u>1,034,833</u>	<u>1,096,284</u>
Capital assets (note 3)	173,548	60,341
	<u>\$ 1,208,381</u>	<u>\$ 1,156,625</u>
Liabilities and Shareholders' Equity (Deficiency)		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 515,600	\$ 580,956
Demand loan (note 4)	-	195,761
Current portion of note payable (note 6)	143,943	-
	<u>659,543</u>	<u>776,717</u>
Convertible debenture (note 5)	500,000	-
Note payable (note 6)	241,932	-
	<u>1,401,475</u>	<u>776,717</u>
Shareholders' equity (deficiency):		
Capital stock (note 7)	2,808,236	2,808,236
Deficit	(3,001,330)	(2,428,328)
	<u>(193,094)</u>	<u>379,908</u>
Contingencies and commitments (note 9)		
Subsequent events (notes 5 and 13)		
	<u>\$ 1,208,381</u>	<u>\$ 1,156,625</u>

See accompanying notes to financial statements.

Approved on behalf of the Board:

 Director
 Director

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Statements of Operations and Deficit

Years ended September 30, 2000 and 1999

	2000	1999
Sales	\$ 2,385,684	\$ 2,347,116
Cost of goods sold (note 2)	803,541	558,490
Gross profit	1,582,143	1,788,626
Expenses:		
Remuneration and benefits	586,219	309,958
Research and development	442,694	566,324
Professional and consultants' fees	392,402	265,779
Direct selling	371,134	194,319
Facility costs	150,478	96,594
General and administration	142,170	102,859
Depreciation	30,759	44,640
Interest and bank charges	99,462	44,644
Government assistance	(60,173)	(210,230)
	2,155,145	1,414,887
Net income (loss) for the year	(573,002)	373,739
Deficit, beginning of year	(2,428,328)	(2,802,067)
Deficit, end of year	\$ (3,001,330)	\$ (2,428,328)
Income (loss) per share	\$ (0.06)	\$ 0.04

See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Statements of Cash Flows

Years ended September 30, 2000 and 1999

	2000	1999
Cash flows from (used by):		
Operating activities:		
Net income (loss) for the year	\$ (573,002)	\$ 373,739
Depreciation, an item not involving cash	30,759	44,640
	(542,243)	418,379
Change in non-cash operating working capital:		
Accounts receivable	169,949	(187,929)
Government assistance receivable	111,784	(121,784)
Inventory	(348,040)	(83,698)
Prepaid expenses	19,755	(28,854)
Accounts payable and accrued liabilities	320,519	(68,678)
	(268,276)	(72,564)
Investing activities:		
Purchase of equipment	(143,966)	(11,493)
Financing activities:		
Demand loan	(195,761)	195,761
Issuance of capital stock	-	30,554
Decrease in loan payable	-	(20,716)
Convertible debenture	500,000	-
	304,239	205,599
Increase (decrease) in cash	(108,003)	121,542
Cash, beginning of year	135,600	14,058
Cash, end of year	\$ 27,597	\$ 135,600
Supplementary information:		
Interest paid	\$ 27,960	\$ 16,649
Taxes paid	-	-
Non-cash transactions:		
Settlement of accounts payable through issue of note payable	385,875	-

See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 2000 and 1999

The Company was incorporated on September 22, 1989 under the Company Act (British Columbia). The Company's principal business operations relate to the development, manufacturing and sale of water purification systems.

The Company has a deficit of \$3,001,330 and a shareholders' deficiency of \$193,094 as at September 30, 2000. Due to higher selling and market development costs, the Company has incurred a net loss of \$573,002 during the year ended September 30, 2000. These financial statements were prepared on a going concern basis which assumes the Company will realize its assets and discharge its liabilities in the normal course of business. The ability of the Company to continue as a going concern is dependent on its ability to obtain the financing necessary to continue its research and development activities and operations and ultimately on the attainment of profitable operations.

1. Significant accounting policies:

(a) Basis of presentation and operations:

The Company's financial statements are prepared in accordance with Canadian generally accepted accounting principles. 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. Raw materials inventory includes parts to be used in the manufacturing process. Finished goods inventory includes the cost of raw materials, direct labour, freight and other direct manufacturing costs.

(c) Capital assets:

Capital assets are stated at cost. Depreciation on molds and equipment is provided using the declining-balance method at a rate of 20% per annum. Leasehold improvements are amortized over the term of the lease on a straight-line basis.

(d) Revenue recognition:

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

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements, page 2

Years ended September 30, 2000 and 1999

1. Significant accounting policies (continued):

(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 in respect of operating expenditures are deducted from expenses and payments relating to capital additions are applied to reduce the cost of such additions. Under certain government assistance programs, the Company is required to pay future royalties to the government as a condition of receiving the grant (note 9(b)). Royalty payments are expensed when incurred.

(f) Research and development:

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.

(g) Deferred income taxes:

The Company follows the deferral method of income tax allocation. Deferred income taxes arise from differences in the timing of recognition of income and expenses for accounting and income tax purposes.

(h) Stock-based compensation plans:

The Company has a stock-based compensation plan, which is described in note 7(c). No compensation expense is recognized for this plan when stock options are issued to employees. Any consideration paid by employees on exercise of stock options is credited to share capital.

(i) 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, 2000 has not been provided as the effect of outstanding dilutive securities is anti-dilutive.

2. Inventory:

	2000	1999
Raw materials	\$ 488,670	\$ 229,991
Finished goods	96,040	6,679
	<u>\$ 584,710</u>	<u>\$ 236,670</u>

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements, page 3

Years ended September 30, 2000 and 1999

2. Inventory (continued):

Cost of goods sold is determined as follows:

	2000	1999
Opening inventory	\$ 236,670	\$ 152,972
Manufacturing costs:		
Parts	873,058	409,271
Direct labour, freight and other	278,523	232,917
	1,151,581	642,188
Available for sale	1,388,251	795,160
Closing inventory	584,710	236,670
Cost of goods sold	\$ 803,541	\$ 558,490

3. Capital assets:

	2000	1999
Molds	\$ 60,546	\$ 60,546
Manufacturing and distribution equipment	90,149	89,777
Furniture and office equipment	120,547	77,977
Leasehold improvements	101,023	64,702
	372,265	293,002
Accumulated depreciation	198,717	232,661
	\$ 173,548	\$ 60,341

4. Demand loan:

During the year ended September 30, 1999 the Company had entered into a credit facility to fund current working capital requirements, which facility provided for the Company, maximum advances of an amount equal to the lesser of 75% of current accounts receivable and \$250,000. Outstanding amounts were repayable on demand, bore interest at 2.5% per month and were secured by all assets of the Company.

As at September 30, 2000, the Company has fully repaid the credit facility.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements, page 4

Years ended September 30, 2000 and 1999

5. Convertible debenture:

On October 13, 1999, the Company issued a convertible debenture having a principal amount of \$500,000 and bearing interest at the rate of 10% per annum calculated semi-annually. The convertible debenture matures on October 13, 2001 and is 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 debenture will be deemed to be converted on the first business day after the 20th day of such consecutive trading days. On issuance, the value attributable to the conversion option was not material.

On October 11, 2000, the entire principal amount of the debenture was converted into 833,333 common shares.

6. Note payable:

On September 20, 2000, the Company issued a promissory note, denominated in US dollars, with a principal amount of US\$257,250 (Cdn.\$385,875) in settlement of accounts payable for services rendered prior to September 1, 2000. The note payable bears interest at the rate of 10% per annum calculated monthly, commencing October 1, 2000. Monthly repayment of the principal amount is scheduled to commence on December 1, 2000 with the final payment due on April 1, 2003. The noteholder has the option to convert 50% of the outstanding balance of the note into common shares of the Company at the rate of \$0.85 per share or at terms which are acceptable to the Canadian Venture Exchange. In addition, the Company allotted 277,250 of the issued performance shares described in note 7(b) to the noteholder in connection with this settlement.

7. 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, 1998	9,394,911	\$ 2,777,682
Issued on exercise of stock options	76,350	30,554
Balance, September 30, 1999 and 2000	9,471,261	\$ 2,808,236

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements, page 5

Years ended September 30, 2000 and 1999

7. Capital stock (continued):

(b) Issued common shares:

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 escrowed 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:

The Company, from time to time, grants stock options to employees, directors, officers and certain consultants. The maximum amount of options available for issue is equal to 10% of the issued and outstanding common shares. These stock options are granted at the discretion of the Board of Directors and have terms and conditions as directed by the Board of Directors. Stock options vest immediately upon grant.

A summary of the status of the Company's stock option plan as at September 30, 2000 and 1999 and changes during the years ending on those dates is presented below:

	2000		1999	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding, beginning of year	705,000	\$ 0.80	718,748	\$ 0.88
Granted	-	-	212,500	0.50
Exercised	-	-	(76,350)	(0.40)
Cancelled	(221,250)	(0.74)	(149,898)	(0.89)
Outstanding, end of year	483,750	\$ 0.82	705,000	\$ 0.80
Options exercisable, end of year	483,750	\$ 0.82	705,000	\$ 0.80

Range of exercise prices	Stock options outstanding and exercisable September 30, 2000		
	Number of stock options outstanding	Weighted average exercise price	Weighted average remaining contractual life
\$ 0.41 - \$ 0.50	100,000	\$ 0.50	7.65 months
\$ 0.51 - \$ 0.60	87,500	\$ 0.51	7.90 months
\$ 0.91 - \$ 1.00	71,250	\$ 0.95	7.19 months
\$ 1.01 - \$ 1.10	225,000	\$ 1.05	0.19 months
	483,750	\$ 0.82	4.98 months

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements, page 6

Years ended September 30, 2000 and 1999

7. Capital stock (continued):

(c) Stock options (continued):

Range of exercise prices	Stock options outstanding and exercisable September 30, 1999		
	Number of stock options outstanding	Weighted average exercise price	Weighted average remaining contractual life
\$ 0.41 - \$ 0.50	125,000	\$ 0.50	19.65 months
\$ 0.51 - \$ 0.60	87,500	\$ 0.51	19.90 months
\$ 0.71 - \$ 0.80	176,250	\$ 0.75	3.42 months
\$ 0.91 - \$ 1.00	91,250	\$ 0.95	19.19 months
\$ 1.01 - \$ 1.10	225,000	\$ 1.05	12.19 months
	<u>705,000</u>	<u>\$ 0.80</u>	<u>13.18 months</u>

(d) Share purchase warrants:

In connection with the issue of the convertible debentures (note 5), the Company issued 200,000 share purchase warrants, all of which remain outstanding as at September 30, 2000. The share purchase warrants are exercisable into common shares at \$0.60 until October 13, 2000 and \$0.70 to October 13, 2001, the date of expiry.

8. Related party transactions:

Included in accounts receivable is \$30,268 (1999 - \$6,026) receivable from shareholders of the Company. Included in accounts payable and accrued liabilities is \$10,437 (1999 - \$57,938) payable to shareholders and companies controlled by directors of the Company. During the year, the Company paid \$45,833 (1999 - \$50,004) to a company owned by an officer and shareholder for the provision of services.

9. Contingencies and commitments:

- (a) In 1995, 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. An action was filed in October 2000 with respect to this assertion. Management believes the action is without merit and is responding to the assertions claimed. As the outcome and the amount of any loss to the Company can not yet be determined, no amount has been accrued with respect to this action. The loss, if any, incurred with respect to this action will be recorded when determinable.
- (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. Royalties to September 30, 2000 totaled \$19,982.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

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Years ended September 30, 2000 and 1999

9. Contingencies and commitments (continued):

- (c) The Company entered into a long-term operating lease for premises expiring October 31, 2009. The Company also has several equipment leases expiring at various dates to 2003. The future annual lease payments, exclusive of property taxes and expenses directly payable by the Company:

2001	\$ 81,909
2002	69,690
2003	63,489
2004	63,147
2005	65,905
Thereafter to 2009	297,190

10. Income taxes:

The Company has non-capital loss carry forwards of approximately \$2,800,000 which are available to offset taxable income otherwise calculated through 2007. 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.

11. Financial instruments:

- (a) Fair values:

As at September 30, 2000, the fair values of the convertible debenture and note payable are not materially different from their carrying values based on interest rates for comparable debt instruments. Financial instruments also consist of cash, accounts receivable, accounts payable and accrued liabilities and demand loan, the fair values of which are considered by management to approximate their carrying values due to their ability for prompt liquidation or short-term to maturity.

- (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, 2000, five (1999 - three) customers represented approximately 78% (1999 - 68%) of accounts receivable. The Company mitigates credit risk through regular credit assessment and collection policies.

- (c) Currency risk:

At September 30, 2000, approximately 61% (1999 - 74%) of accounts receivable and 21% (1999 - 43%) of liabilities are denominated in United States dollars. In addition, the note payable (note 6) is repayable in United States dollars. The Company has not entered into foreign exchange contracts to hedge against gains or losses from foreign exchange fluctuations.

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Years ended September 30, 2000 and 1999

12. Segmented information:

The Company's principal business operations relate to the development, manufacturing and sales of water purification systems and accordingly the Company has only one reportable segment. All manufacturing operations and assets are located in Canada. In 2000, approximately 24% (1999 - 17%) of sales revenue was generated by customers in Canada and 76% (1999 - 83%) by customers in other countries, primarily the United States.

13. Subsequent events:

On October 16, 2000, the Company granted 753,750 stock options to employees. Each option is exercisable into one common share of the Company at a price of \$0.85 per share; the options expire on May 28, 2001. The issue of these options is subject to approval by the Canadian Venture Exchange.



**INTERNATIONAL
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