



International Water-Guard Industries Inc.



INTERNATIONAL
WATER-GUARD
INDUSTRIES INC.
THE WATER KNOWLEDGE COMPANY

Annual Report - Fiscal 2002



PRESIDENT'S MESSAGE

To Our Shareholders,

Fiscal 2002 was a year of milestones passed for IWG. In the midst of a downturn in the worldwide economy generally, and in aviation specifically, IWG managed to move forward on a broad front to achieve a number of key business and technical goals. The progress the Company made in Fiscal 2002 has truly helped to build a strong platform for future success.

IWG sales have again moved forward, albeit not to the degree we had anticipated prior to the events of September 11, 2001, a tragedy that occurred just prior to the beginning of the fiscal year.

Sales for Fiscal 2002 amounted to \$4,048,939, an increase of 4.5% over the previous year's sales of \$3,874,604. A loss of \$395,717 was incurred, compared to a profit of \$205,423 in the previous year. The fiscal 2002 loss of \$0.03 per share compares to fiscal 2001 earnings of \$0.03 per share, on both a basic and fully diluted basis.

Taken in the context of the slowdown in our major market of aviation, the sales increase over Fiscal 2001 is very gratifying. The market will recover, and it is IWG's strategy to build toward the coming opportunities by continually improving the Company's competitive position. A range of major developments during the fiscal year have added significant force to IWG's forward momentum.

Early in the fiscal period, IWG successfully negotiated a contract for a Circulating Potable Water System (C-PWS™) installation on a second type of business jet aircraft: the Gulfstream G-IV. The G-IV is Gulfstream's most popular model, and the installation took place under IWG's direction at Gulfstream's Completion Center in Savannah, Georgia. The C-PWS™ installation was done on an aircraft owned by the Detroit Pistons, a long-time IWG customer. This successful installation and the coming U.S. and Canadian certification will make it much easier to approach the hundreds of other G-IV owners in the marketplace.

We also made significant investments in C-PWS™ design work, principally with D3 Technologies of the U.S., a key member of our 'Virtual Team' for water system development. Working closely with IWG Engineers, D3 completed the major portion of a C-PWS™ design for the Boeing 737/BBJ aircraft. The BBJ is a popular business jet variant of the Boeing 737, which is itself Boeing's most numerous airliner. The C-PWS™ provides a host of benefits for these aircraft; a primary example of which is weight. An IWG C-PWS™ for the Boeing 737/BBJ aircraft reduces overall water system weight by 133 pounds compared to the factory installed water system. This is just one example of the many benefits our C-PWS™ offers to business jet operators and the airlines.

During Fiscal 2002, IWG also negotiated its first long-term contract for water treatment unit installations on British military aircraft. IWG's NPS-A3 aircraft potable water treatment units are being installed by Britain's AIM Aviation on the Royal Air

Force's fleet of Nimrod Long Range Patrol aircraft operated by the Royal Air Force. The RAF's Nimrod fleet is being remanufactured to the Nimrod MRA4 specification, which includes our units. BAE SYSTEMS is the prime contractor for the aircraft remanufacturing program, and has sub-contracted the interior finishing to AIM Aviation. The supply contract for 16 units runs into 2005. We are using this success as a springboard into other military aircraft programs.

Another extremely important development also involves our NPS-A3 aircraft potable water treatment unit. During the fiscal year, IWG was granted a U.S. Patent for the NPS-A3 design, as well as for the new NPS-A6 unit that was designed and developed during the fiscal year. The intellectual property protection of this patent represents a major asset for the company, and provides yet another barrier to entry for any would-be competitors in the aviation market. The NPS-A3 and NPS-A6, although different in materials and flow rates, share a common design concept, and are therefore covered by the same patent (No. US 6,454,952 B1).

IWG also attracted new team members with a great deal of aviation experience. We have been joined by Luigi Esposito, who had taken responsibility for managing IWG's production facility. Luigi has worked in the aerospace industry since 1995, beginning as an Aircraft Assembler with Bombardier de Havilland in Toronto. He then worked as an Aircraft Mechanic for Avcorp Industries, where he rose to the position of Final Assembly Supervisor. He has Diplomas in Commerce and Aircraft Maintenance Engineering.

We were also privileged to welcome John Lawson to our Board of Directors during the fiscal year. John began his aviation career with 18-years in the Canadian Armed Forces, where he was a Flight Instructor, Fighter Pilot, and Test Pilot. He is a graduate of the Royal Military College and the University of Toronto, where he received an Honours BSc in electrical engineering. He left the Air Force in 1975 with the rank of Lieutenant Colonel to pursue a career in business. He retired in 2001 as President of Bombardier Business Aircraft Sales with responsibility for the worldwide marketing and sales of all Learjet and Bombardier corporate jets. John's wealth of aviation experience is an extremely valuable addition to the Board.

IWG's industrial and commercial products team also made progress during fiscal 2002. Relations with our Chinese Joint Venture partner were solidified, and we are pleased with their progress toward becoming an independent manufacturing facility coupled with market development capabilities. IWG's new Open Channel ultraviolet disinfection system design has been improved in time to play a major role in our efforts to gain entry into the Korean market.

In a general sense, Fiscal 2002 also witnessed a rise in public awareness of water and water treatment issues. Of particular interest was a Business and Commercial Aviation Advisory Circular (No. 0208) issued by Transport Canada in May of 2002. The circular pointed out the responsibility that corporate jet and airline operators have under the Department of Health Act to maintain the potable water systems on their aircraft. The circular called for not only compliance, but pro-active steps to meet the air operators' potable water due diligence responsibilities. Statements like this from regulators make IWG's products all the more interesting to the aviation market.

In closing, I would once again like to recognize and thank IWG's staff and virtual team members, as well as our shareholders, customers, suppliers, and members of the Board of Directors.

On Behalf of the Board

"C.W.Coote"

Bill Coote
President and CEO

BUSINESS DESCRIPTION

COMPANY 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 \$1 billion annual market (\$220 million for corporate aircraft and \$780 million for commercial aircraft).

IWG is unique in that it is the only company in the world supplying ultraviolet potable water disinfection equipment and circulating potable water system 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 700 NPS-A2 and NPS-A3 water disinfection units have been installed on corporate aircraft worldwide, including installations on aircraft manufactured by Boeing, Bombardier, Gulfstream, and Dassault Falcon Jet. Collectively, these companies build more than 80% of all corporate 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 (flight-certified in July, 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 has signed a long-term contract with Lufthansa Technik to supply these components for installation on a number of BBJ aircraft. IWG has also installed the C-PWS™ on a Gulfstream G-IV aircraft at Gulfstream's Savannah, GA, completiions facility. The company has also completed the design of a C-PWS™ installation for Boeing BBJ/737 NG aircraft.

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 annual market of several hundred millions in North America and the Company anticipates expanding its market share in the next few years. In this respect, IWG is assessing an emerging opportunity for its aquaculture products in China following initial sales during the past year.

The Company's key asset is its people and their knowledge of reliable, cost effective systems solutions to a wide variety of water treatment and water management problems, which the company calls "water knowledge". The Company's core technical competencies include developing and utilizing ultraviolet disinfection equipment, and applying a broad range of filtration equipment to solve water treatment/management problems in diverse industries. IWG's capabilities include developing systems solutions and new products, systems and equipment repair/service, and consulting on water knowledge issues.

The Company was incorporated on September 22, 1989 under the Company Act of the Province of British Columbia. The head office, manufacturing and engineering facilities are located at 3133 Sumner Avenue, Burnaby, British Columbia V5G 3E3.

PRODUCTS

Aircraft Water Treatment Units

The NPS-A2, NPS-A3, NPS-A4 and NPS-A6 provide on-board potable water disinfection, and are the only known ultraviolet disinfection units in the world qualified for use on corporate and commercial aircraft. The NPS-A2 and NPS-A3 products have U.S. Federal Aviation Administration (FAA) and Transport Canada approval in the form of Supplemental Type Certificates for corporate aircraft. Certification of the NPS-A4 and NPS-A6 is pending. Additionally, Transport Canada has certified IWG as an approved organization for the Manufacturing, Certification, and Maintenance of aeronautical products. An issued U.S. Patent (No. US 6,454,952 B1) covers both the NPS-A3 and NPS-A6.

IWG's aircraft water treatment units were specifically 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 manufacturers 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 assurance of water quality to the operators (and their passengers) of any aircraft loading water from almost any approved municipal source.

There are currently no regulations requiring disinfection of potable water on commercial airliners. However, IWG believes that the installation of ultraviolet disinfection units as potable water tank exit devices will become an increasingly cost

effective measure for airlines and other commercial operators based on regulatory trends. For example, in May of 2002 Transport Canada issued an advisory circular (No. 0208) informing aircraft operators that they should pay closer attention to the condition of aircraft water systems and the quality of water in them. The potable water systems of Interstate Commercial Carriers - including those of commercial airlines - may soon be viewed by

NPS-A2



NPS-A3



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.

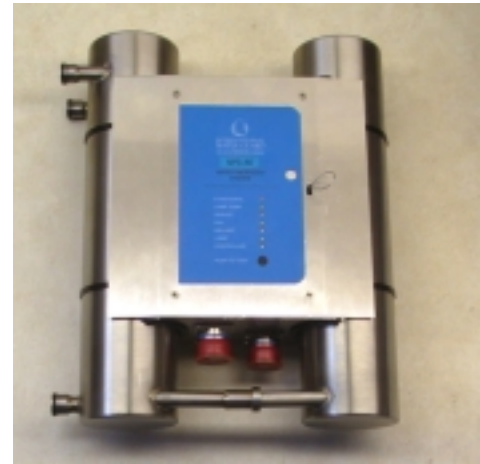
Over 700 aircraft water treatment units (mostly NPS-A2 and NPS-A3) units have been installed on private, corporate and head of state jets since product inception. The NPS-A2 was designed in collaboration with Boeing in the late 1970's by a predecessor company later acquired by IWG in 1989, prior to the airline market depression of the early 1990s.

The NPS-A3 received its Transport Canada certification in 2000. It is designed for smaller spaces and includes both filtration and disinfection features. Other improvements include improved electronics, as well as reduced size and weight. Other "A series" product variants for special aircraft model requirements are also under development.

An example is the “NPS-A4” which was developed at the request of a major corporate jet manufacturer. This new product is essentially an NPS-A3 with the filter feature removed in order to meet specific needs. Other new products are also being designed, including the NPS-A5 which will be similar to the NPS-A6, but will have two ultraviolet disinfection chambers with a larger flow rate aimed at both the large corporate aircraft and airline markets.



NPS-A4

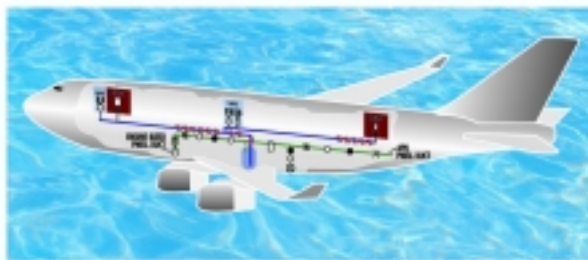


NPS-A6

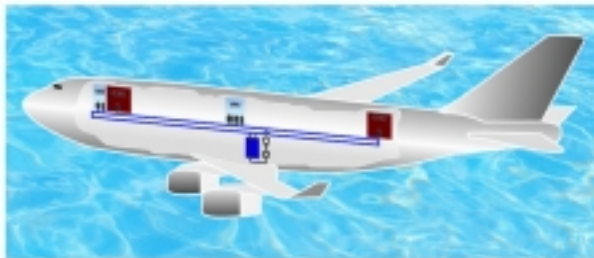
Aircraft Circulating Potable Water System Kits

IWG’s circulating potable water system (C-PWS™) was designed to address the major problems associated with the water systems currently in use on aircraft – water quality and freezing. It was also designed to weigh less and take up less space on aircraft than existing water systems. IWG’s circulating PWS occupies up to 60% less space and weighs from 80 to 200 pounds less than existing systems, depending on which aircraft model is considered. This saving provides more space and weight allocation for paying cargo, including passengers. It is estimated that a pound saved on an aircraft can represent an increased value to the customer of approximately \$1000 (US) or a total saving of up to \$200,000 (US) per aircraft. On the basis of fleet installation, the total value of weight saved would be much higher.

Typical Air-Pressurized PWS



The Patented IWG Circulating PWS



The C-PWS™ is comprised of aviation potable water treatment equipment to disinfect on-board potable water, pumps to circulate the water in the aircraft, tanks that conform to the shape of the aircraft (thereby saving space), piping and related distribution equipment and associated sensors and controls.

The essence of the new system design for aircraft is to constantly circulate potable water within the system, continually upgrading the quality of the water and essentially maintaining all parts of the system itself at a constant temperature. The Company believes this new potable water system has the potential to become a global aviation industry standard, and is in a unique position to become the dominant supplier of full systems, system equipment or licenses to the aviation industry.

In 1998, the Company filed a patent application in the U.S.A. (with corresponding foreign filings) outlining this

totally new approach to potable water treatment and water management on aircraft.

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. disinfection unit.

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.

During the year 2000, IWG designed and developed for a customer a higher throughput modular “open channel” ultraviolet water treatment system prototype to treat drinking water, aquaculture/industrial process water or wastewater at flow rates ranging from 200 USGPM to at least 2000 USGPM. The new open channel systems are modular in construction for installation flexibility, and can be employed to disinfect water or for ozone destruction, or ‘quenching’.



IWG Technician assembling a closed chamber UV unit.

The Company’s disinfection units also have important application in the increasingly important wastewater market. IWG designs, fabricates/assembles, tests, installs and services specialized small scale systems for customers with a wide variety of potable and wastewater treatment and water management applications. An example of a recent wastewater treatment installation is the Riverport Industrial Park in Richmond, BC.

Replacement Parts and Service

The Company sells replacement parts (including spares) and services to customers with their own installed base of IWG systems and products. UV lamps, and the quartz sheaths that enclose them, are subject to gradual degradation over time. The Company is in regular contact with its customers, both to ensure that operational efficiency of its equipment is not compromised due to degraded parts and also to determine what new water treatment/management needs they may have. The Company also has annual service agreements with a number of its larger customers.

In the aviation market, replacement parts and service represent a further potential market of approximately 3% of equipment sales per annum, while in the aquaculture and wastewater markets the potential sales should amount to 10% of equipment sales per annum.

MANAGEMENT DISCUSSION AND ANALYSIS

FISCAL YEAR 2002

Overview

Comments in this analysis should be read in conjunction with the comparative audited financial statements included in this annual report for the fiscal year ended September 30, 2002. Such comments also apply to the financial information summarized in the Company's Annual Information Form. The following discussion, and the information elsewhere in this report, is intended to provide the reader with an understanding of the Company's business and factors underlying its financial results.

International Water-Guard Industries Inc. ("IWG") designs, manufactures, sells, installs and services potable and process water treatment/management equipment and systems, for niche markets to aviation, industrial and commercial customers in a number of areas of the world. The principal technology embodied in IWG's products is irradiation by ultraviolet ("UV") light, with filtration, ancillary systems and controls designed by the Company.

The Company is emerging from several years of operating as a development company, with a base operation and revenues covering a portion of its product and market development costs, and new equity providing the remainder of the Company's capital commitments and working capital requirements. Sales trends are subject to both industry cycles and customer adoption of the Company's technology. Operations, business opportunities and capital requirements are increasing at a planned but significant rate, which will require additional equity and working capital financing, and the best skills of its expanded management team to steer several new projects to successful implementation.

Operating Results

The Company reported sales of \$4,048,939, an increase of 4.5% over the previous year's sales of \$3,874,604. A loss of \$395,717 was incurred for the year, compared to a profit of \$205,423 in the previous year. The fiscal year 2002 loss of \$0.03 per share compares to fiscal 2001 earnings of \$0.03 per share, on both a basic and fully diluted basis.

The \$601,140 adverse change in operating results from the prior year was primarily due to an increase in expenses to support anticipated sales increase that has not yet materialized. The economic impact on the Company's major market in aviation products following the September 11th crisis occurred as the Company was gearing up capacity for increasing sales trends of the prior year and a promising outlook for capturing several C-PWS™ kit sales during fiscal 2002 that have not materialized.

However, included in fiscal 2002 results is the delivery of the Company's second aircraft circulating potable water system, installed on a Gulfstream G-IV aircraft that has been flight certified by the U.S. Federal Aviation Administration.

Sales

Sales increases experienced in the prior fiscal year 2001 continued into the first quarter of fiscal 2002. However, a delay or reduction in sales in subsequent quarters, primarily in its aviation market, held the sales increase to 4.5% in fiscal 2002 over 2001.

Sales of aviation products (representing 77% of total fiscal 2002 sales) increased by 2% over fiscal 2001. Despite a general reduction in global airline and business jet markets, IWG did maintain its sales level vs. the prior year. Fiscal 2002 included the installation of IWG's new complete aircraft circulating potable water system for a Gulfstream customer, which system has been approved for flight by the US Federal Aviation Administration authorities on that aircraft.

The softening aviation sales trend, which became most evident in the third quarter of fiscal 2002, will carry into fiscal 2003. However, the introduction of IWG's next aviation product, the higher throughput volume NPS-A6, a version of the successful NPS-A3, will assist to overcome slower aviation sales. The Company also views the sale of additional C-PWS™ kits important to its longer-term sales growth.

Industrial sales to the aquaculture and other water process applications, representing 23% of fiscal 2002 sales, increased by 7% over the prior year. This increase resulted from sales of higher valued UV based water treatment units and increased spare parts to both existing and new markets, either directly to the customer, through value-added distributors or water treatment facility engineering firms, primarily in Canada and the United States. Introduction of IWG's new Open Channel modular UV water treatment equipment in fiscal 2001, for use in both aquaculture and wastewater applications, formed part of the Company's sales increase in the year.

Sales to customers in Canada represented 46% of the Company's sales (vs. 33% in 2001) with 54% of sales exported, primarily to United States (vs. 67% in 2001).

Direct Sales Margins

Aggregate direct sales margins decreased slightly as a change in sales mix favored products with lower margins. Sales margins vary from product to product so sales mix will determine the overall margin result from period to period. In fiscal 2002, direct gross margin of 61% was slightly less than the 65% experienced in fiscal 2001. This year's results were affected by lower margins on industrial product sales, which increased more than aviation sales that have higher margins, together with selected cost increases while product pricing remained the same.

Operating Expenses

Selling expenses of \$658,184 were 13% more than the \$581,536 in fiscal 2001. The increase was due principally to attendance by the Company at two additional Aerospace Trade Shows in the third quarter of fiscal 2002, combined with additional travel costs to promote the Company's aviation products and water systems.

Engineering and development expenses charged to earnings of \$649,543 was a 45% increase over the \$447,214 in the prior year. Supported by a sales trend in the prior year and anticipated growth in fiscal 2002, as well as the goal of delivering several C-PWS™ kits during the year, IWG added several engineering staff to support its investment in the aviation systems design activities. While the sale of C-PWS™ kits has not yet reached anticipated quantities, these costs are also directed to product technology enhancements and new product variants. Such continuing efforts are in response to customer feedback and stated requirements, and to address known future market requirements as opportunities emerge.

General, administration, information technology and occupancy expenses totaled \$1,435,621, a 30% increase over the \$1,106,148 incurred in fiscal 2001. This increase is attributed to costs of new staff; compensation increases and initial costs for information technology improvements required to position the Company for anticipated growth in sales activity; increased legal fees related to a higher level of intellectual property matters; and facility costs increased due to additional space added in the prior year.

Capital Expenditures

Fiscal 2002 provided a substantial advance by the Company to design and certify specific aircraft model circulating potable water systems (C-PWS™) for sale to business aircraft manufacturers, completion centers and owners. The enhancement

of the Global Express design was adapted for the C-PWS™ kit installation certified for a Gulfstream G-IV aircraft in the fourth quarter of fiscal 2002. In addition, substantial progress was made towards final completion of design of the water system for a Boeing Business Jet. In the fall of 2000, the Company had commenced the design and supply of a circulating potable water system, under a contract, for installation on a Global Express customer's aircraft to be certified for use on future Global Express business aircraft. The installation was completed during the third quarter of fiscal 2001, and following flight test, the system was certified in the fourth quarter of that year by the U.S. Federal Aviation Administration and Transport Canada.

To September 30, 2002, the Company has expended a net accumulated cost of \$2,383,220 (\$1,334,138 September 30, 2001) on such designs, including the certification of its first design for the Global Express and then the G-IV aircraft and substantial completion of a Boeing Business Jet aircraft C-PWS™ design. These initial designs will provide IWG with the certification (STC) necessary to permit it to provide C-PWS™ to aircraft of the same type on a recurring basis in the future. These costs include preliminary and detail design-engineering costs, stress analysis, certification efforts by designated airworthiness engineers, component testing and project management. Although the costs of such initial design and supply contracts are significant, they are necessary in order to enable the Company to achieve its goal of becoming the leading supplier of water systems to business aircraft and, subsequently, commercial aircraft manufacturers. The costs associated with each aircraft model design will be recovered over several years from the ongoing supply of C-PWS™ kits under contracts expected to be completed with IWG's customers.

In prior years, IWG made significant expenditures on initial market and product research and development to establish the marketability of the Company's design concept. It is clear from this assessment that IWG's C-PWS™ will meet or exceed the business aircraft owners' and manufacturers' requirements for significant improvements to on-board water systems. Consequently, IWG has committed to develop a complete C-PWS™ kit for a full range of business aircraft to meet these market opportunities.

System design costs have been deferred and capitalized and will be amortized over future aircraft water system kit deliveries as explained in the notes to the financial statements.

Risks and Uncertainties

IWG recognizes that certain risks are inherent in its business plan and has chosen to implement the following strategies to address them:

Competition

The only other known companies supplying circulating potable water distribution systems to the aircraft industry are aircraft completion centers or a manufacturer that incorporate IWG's equipment and design concepts into their system design. There are indications that some other parties are looking at alternatives to traditional aircraft water systems, including the suppliers of such system designs. Goodrich Corp. and MAN Technologies AG are supplying variations on the 50-year-old pressurized designs. These are much larger and better-financed companies that will be an advantage to such companies. However, such companies are also customers for IWG's products.

To secure a leading position in the aviation water system market, the Company will attempt to protect its competitive position by maintaining its lead in product technology development, securing intellectual property protection (where possible) for its equipment and systems. Further, the Company will secure and maintain all certifications necessary for the manufacture and use of its equipment in the aviation market, pricing its products competitively with current products, and entering into long term agreements with aircraft manufacturers and others. Such agreements are intended to assure that third parties are only able to utilize the Company's Intellectual Property under proper commercial contracts. IWG also

intends to enter into alliances with major aircraft design firms and aviation suppliers to participate in systems designed for each aircraft model, thereby adding personal depth and skills to the Company's development capacity.

The industrial and commercial market is very large and dominated by companies much larger, better financed and with better distribution channels than IWG. Typically, these companies are focused on large projects such as municipal drinking water or wastewater treatment. The Company has chosen to target only niche markets for which it has a competitive position, special knowledge or technology, and ally itself with specific project providers in niche markets. Competitors include Trojan, Zenon, Aquafine, Atlantic Ultraviolet and Ultra Dynamics.

Foreign Exchange

Generally, fluctuations in the Canadian to United States dollar exchange rate are recorded as transactions occur and at the end of the period financial results are reported. The details of the Company's foreign exchange policy are included in the notes to the financial statements. A majority of the Company's sales are invoiced in U.S. dollars, which are offset to some extent by the portion of its product costs, consulting and contractor costs that are also in U.S. dollars. Consequently, fluctuations in the Canadian to U.S. dollar foreign exchange rates will have some impact on sales revenue, gross margins and net earnings reported by IWG. The Company has not previously employed any financial instruments to hedge its foreign exchange position, because its past sales contracts generally have been short term. However, as the Company succeeds in securing longer-term production supply contracts, hedging of future foreign exchange requirements may be implemented.

Financial Resources

The continued growth and viability of IWG may be affected by its ability to achieve profitable operations and the support of its debt holders, or to attract additional capital. In the near term the Company is negotiating the renewal of long term debt agreements and for extended terms with suppliers as it seeks new and longer term contracts for aviation product sales and water systems contracts. The subject is also addressed under the separate section on Liquidity and Capital Resources.

This is not an exhaustive list of the various risk factors that may be faced by the Company, but is a specific reference to the major risk factors addressed by the Company.

Outlook

The market and product development activity pursued by IWG in recent years has assured that its UV based water treatment products and systems are at the leading edge of market requirements. Significant requirements for such products and systems have been identified in both the Company's aviation and industrial/commercial markets and are being pursued to obtaining near term and long term contracts, consistent with the Company's business plan. While significant aircraft water system design costs for contracts and infrastructure expenditures allied with sales growth targets will require additional financing, the required working capital and equity financing is being pursued as noted elsewhere.

International Water-Guard Industries, historically a developer of UV-based water treatment equipment for several niche markets (supported by equity financing and a base level of revenues) has become a niche market supplier and manufacturer of engineered ultraviolet based water treatment products and systems. With its certified and proven business aircraft circulating potable water system, IWG's goal is to become the leading provider of water systems or disinfection units to most of the well known mid to larger business aircraft available.

Liquidity and Capital Resources

The Company completed its 2002 fiscal year with \$146,924 in negative working capital, a \$774,640 decrease from the prior year. During the year, the Company's working capital requirements were partially met by operating cash flow and a credit line from a factoring finance company. In addition, IWG raised \$1,127,767 from the private placement of new common share equity and the exercise of options and financing of \$489,891 from Technology Partnerships Canada, applied principally to new aircraft water system designs.

In recent years, IWG has operated as a development company with its base revenues from operations covering only a portion of its product and market development costs and increased working capital requirements. The additional equity issued in fiscal 2002 and credit line of \$300,000, since amended to US\$280,000, have enabled the Company to maintain its operations and to complete its aircraft circulating water system design and certification. In the prior year, the Company had raised \$1,153,555 in new financing. In addition, negotiations are also underway with two of the Company's associates and larger creditors for long term repayment agreements covering approximately \$750,000 of its unsecured debt.

At the present time, the Company is indebted under its promissory note to one of its contractors for the remaining principal amount of U.S.\$233,329 bearing interest at 10% per annum. With the permission of the creditor, original payment terms have not been maintained, and the Company is currently in negotiation with the note-holder to extend the payment.

Financial commitments by IWG during fiscal 2003 for aircraft water system design expenditures will be substantially less than in 2002 as the Company will concentrate primarily on delivery contracts for existing aircraft model C-PWS™ designs.

The Company's ability to maintain its current level of operations and research and development activities will be governed by a return to the required sales level that provides a positive cash flow, and the eventual issue of long term debt or equity capital.

Summary

The significant efforts undertaken by the Company in recent years to secure a leading position in the design and installation of aircraft water systems has, and will continue to have, a material impact on the Company's sales and earnings in fiscal 2003 and beyond.

Expenditures on market development, product development and certification prior to any significant sales of such new aviation products were largely responsible for reported losses and debt levels prior to fiscal 2001 and in fiscal 2002. Investment in aircraft model specific circulating potable water system design and certification costs have been significant, but are anticipated to be significantly less in the near term. As illustrated from increased revenues starting in fiscal 2001, it is anticipated that greater revenue increases resulting from these development efforts should have a material positive impact upon the Company's earnings in fiscal 2003 and beyond. However, due to their significant impact on IWG's business activity, the timing of the signing and implementation of multiple C-PWS™ kit contracts, will determine the timing of these revenue increases.

Financial Statements of

**INTERNATIONAL WATER-GUARD
INDUSTRIES INC.**

Years ended September 30, 2002 and 2001



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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, 2002 and 2001 and the statements of operations and deficit and cash flow 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, 2002 and 2001 and the results of its operations and its cash flow 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.

KPMG LLP (signed)

Chartered Accountants

Vancouver, Canada

December 6, 2002



INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Balance Sheets

September 30, 2002 and 2001

	2002	2001
Assets		
Current assets:		
Cash	\$ 55,580	\$ 76,434
Accounts receivable	1,054,850	763,562
Inventory (note 3)	867,921	729,651
Prepaid expenses	5,529	7,419
	<u>1,983,880</u>	<u>1,577,066</u>
Furniture and equipment (note 4)	167,814	156,649
Deferred foreign exchange loss	-	12,250
Deferred development costs, net of accumulated amortization of \$80,000 (2001 - \$55,000)	2,410,211	994,082
	<u>\$ 4,561,905</u>	<u>\$ 2,740,047</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,670,346	\$ 607,837
Demand loan (note 5)	55,975	100,000
Current portion of note payable	404,483	241,513
	<u>2,130,804</u>	<u>949,350</u>
Note payable (note 6)	-	124,813
Loan payable (note 7)	33,167	-
	<u>2,163,971</u>	<u>1,074,163</u>
Shareholders' equity:		
Share capital (note 8)	5,589,558	4,461,791
Deficit	(3,191,624)	(2,795,907)
	<u>2,397,934</u>	<u>1,665,884</u>
	<u>\$ 4,561,905</u>	<u>\$ 2,740,047</u>

Contingencies and commitments (note 10)

See accompanying notes to financial statements.

Approved on behalf of the Board:

"C.W. Coote" Director

"R.Z. Shariff" Director

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Statements of Operations and Deficit

Years ended September 30, 2002 and 2001

	2002	2001
Sales	\$ 4,048,939	\$ 3,874,604
Cost of goods sold (note 3)	1,562,103	1,372,787
Gross profit	2,486,836	2,501,817
Expenses:		
Selling expenses	658,184	581,536
Research and development	649,543	447,214
General, administrative and occupancy	1,435,621	1,106,148
Amortization	57,192	84,674
Interest and bank charges	82,013	76,822
	2,882,553	2,296,394
Net earnings (loss)	(395,717)	205,423
Deficit, beginning of year	(2,795,907)	(3,001,330)
Deficit, end of year	\$ (3,191,624)	\$ (2,795,907)
Earnings (loss) per share amounts (note 8(f)):		
Basic	\$ (0.03)	\$ 0.03
Diluted	(0.03)	0.03

See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Statements of Cash Flow

Years ended September 30, 2002 and 2001

	2002	2001
Cash flows from (used by):		
Operations:		
Net earnings (loss)	\$ (395,717)	\$ 205,423
Items not involving cash:		
Amortization	57,192	84,674
Foreign exchange loss	12,250	-
	(326,275)	290,097
Changes in non-cash operating working capital:		
Accounts receivable	(295,116)	(352,866)
Inventory	(138,270)	(144,941)
Prepaid expenses	1,118	4,411
Accounts payable and accrued liabilities	1,062,509	92,237
	303,966	(111,062)
Investments:		
Purchase of furniture and equipment	(38,757)	(12,775)
Deferred development costs	(1,441,129)	(1,049,082)
	(1,479,886)	(1,061,857)
Financing:		
Proceeds of demand loan	-	100,000
Repayment of demand loan	(44,025)	-
Proceeds of note payable	38,157	-
Repayment of note payable	-	(31,799)
Proceeds of loan payable	33,167	-
Issue of common shares for cash, net of issue costs	1,127,767	1,153,555
	1,155,066	1,221,756
Increase (decrease) in cash	(20,854)	48,837
Cash, beginning of year	76,434	27,597
Cash, end of year	\$ 55,580	\$ 76,434
Supplementary information:		
Interest paid	\$ 43,856	\$ 68,046
Income taxes paid	-	-
Non-cash transactions:		
Conversion of debenture into common shares	-	500,000

See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 2002 and 2001

1. Operations:

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

The Company has an accumulated deficit of \$3,191,624 as at September 30, 2002 as a result of losses incurred in past years. In addition the Company has negative working capital of \$146,924, compared to positive working capital of \$627,716 in 2001, has not made required principal and interest payments on the note payable (note 6) and subsequent to September 30, 2002, the Company's credit facility with a Canadian chartered bank was withdrawn. During the year ended September 30, 2002, the Company has, however, increased sales revenue and generated positive cash flow from operating activities. These financial statements are prepared on a going concern basis that 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 consistent profitable operations. The recoverability of deferred development costs is dependent on the Company continuing as a going concern and achieving sufficient sales volumes with the specific products to generate net cash flow in excess of costs incurred to date. The Company continues to negotiate with its vendors and lenders in order to establish extended payment terms on its liabilities. In addition, on an ongoing basis, the Company identifies and evaluates external financing opportunities including government grants and equity financing. There can be no guarantee that such external financing will be available when needed.

2. 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 and the recoverability of deferred development costs. Actual results could differ from these estimates.

These financial statements include the Company's 50% proportionate interest in the Gold Bill Water Treatment Technology Co. Ltd. joint venture (note 12).

(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. Work-in-process and finished goods inventory includes the cost of raw materials, direct labour, freight and other direct manufacturing costs.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 2002 and 2001

2. Significant accounting policies (continued):

(c) Furniture and equipment:

Furniture and equipment are stated at cost. Amortization 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 persuasive evidence of a contractual arrangement exists, all of the products and services have been delivered to the customer and there are no significant vendor obligations remaining, the price is fixed or determinable, and collectibility is reasonably assured.

(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 amounts are received or receivable. Payments received in respect of operating expenditures are deducted from expenses and in respect of furniture and equipment additions and deferred aviation system design costs 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 10(a)). 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 only costs associated with completing specific product applications where an identifiable market exists are deferred. Routine alterations to existing products are expensed as incurred.

Deferred development costs includes \$2,303,220, representing the cost, net of government funding, of designing, testing and certifying the Company's new potable water system for specified aircraft model types, and are deferred until the system is certified for installation in aircraft by relevant authorities. Deferred system design costs are amortized based on future estimated aviation potable water system sales during a maximum period of six years. Deferred development costs also include \$106,991, representing pre-operating expenses associated with the Company's joint venture which are deferred until commencement of the operations of the joint venture and will be amortized thereafter over a three year period.

(g) Income taxes:

Income taxes are accounted for using the asset and liability method. Future income tax assets and liabilities are determined based on temporary differences between the accounting and tax basis of existing assets and liabilities, and are measured using the tax rates expected to apply when these differences reverse. A valuation allowance is recorded against any future tax asset if it is more likely than not that the asset will not be realized.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 2002 and 2001

2. Significant accounting policies (continued):

(h) Stock-based compensation plans:

The Company has a stock-based compensation plan, which is described in note 8(d). 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 (loss) per share:

Earnings (loss) per share amounts have been calculated based on the weighted average number of shares outstanding. Contingently issuable shares, such as those discussed in note 8(c), are excluded from the calculation of weighted average number of common shares outstanding. Fully diluted per share amounts have been calculated using the treasury stock method of calculating the dilutive effect of outstanding warrants and options. Securities such as stock options and warrants are included in the calculation of diluted per share amounts only if the market price of the underlying common shares exceeds the exercise price.

(j) Foreign exchange translation:

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rates of exchange in effect at the balance sheet date. Non-monetary assets and liabilities are translated at historical rates of exchange. Revenues and expenses are translated into the Canadian dollars at the rates of exchange in effect at the dates of the transactions. Gains or losses arising from foreign exchange translation are included in the results from operations, except for gains or losses on translation of long-term monetary items with fixed and determinable lives, which are deferred and amortized over the term to maturity of the long-term monetary item.

3. Inventory:

	2002	2001
Raw materials and work-in-process	\$ 513,642	\$ 477,955
Finished goods	354,279	251,696
	\$ 867,921	\$ 729,651

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 2002 and 2001

3. Inventory (continued):

Cost of goods sold is determined as follows:

	2002	2001
Opening inventory	\$ 729,651	\$ 584,710
Manufacturing costs:		
Parts	1,250,662	1,186,218
Direct labour, freight and other	449,711	331,510
	1,700,373	1,517,728
Available for sale	2,430,024	2,102,438
Closing inventory	867,921	729,651
Cost of goods sold	\$ 1,562,103	\$ 1,372,787

4. Furniture and equipment:

	2002	2001
Molds	\$ 61,390	\$ 60,546
Manufacturing and distribution equipment	94,264	90,948
Furniture and office equipment	175,709	138,550
Leasehold improvements	97,034	94,996
	428,397	385,040
Accumulated amortization	(260,583)	(228,391)
	\$ 167,814	\$ 156,649

5. Demand loan:

The Company has a credit facility agreement with a private company to fund current working capital requirements, which facility provides for maximum advances of \$300,000. Outstanding amounts are repayable on demand, bear interest at 3% per month and are secured by accounts receivable of the Company. As at September 30, 2002, the Company has \$55,595 (US\$35,653) outstanding under the credit facility (2001 - \$100,000 (US\$63,750)).

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 2002 and 2001

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. The principal amount is repayable in monthly installments 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. In addition, a shareholder of the Company allotted 277,250 of the issued performance shares described in note 8(b) to the noteholder in connection with this settlement. The Company has not made the required quarterly payments during the year and is currently in negotiation with the noteholder to extend the payment terms. In the year ended September 30, 2001, payments totaling US\$50,000 (CDN\$78,500), consisting of principal payments of US\$20,254 (CDN\$31,799) and interest of US\$29,746 (CDN\$46,701) was made. On issuance, the value attributable to the conversion option was not material.

7. Loan payable:

During the year, the Company received funds from Technology Partnership Canada. The loan is non-interest bearing and repayable in eight equal annual installments commencing on December 31, 2004.

8. Share capital:

(a) Authorized:

100,000,000 common shares without par value

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

Shareholders approved an increase in the authorized common shares to 100,000,000 from 20,000,000 at their annual meeting on March 28, 2002.

(b) Issued common shares:

	Number of shares	Amount
Balance, September 30, 2000	9,471,261	\$ 2,808,236
Issued on conversion of convertible debenture	833,333	500,000
Issued for cash in private placements of common shares, net of issue costs	2,491,600	1,145,955
Issued for cash on exercise of stock options	15,000	7,600
Balance, September 30, 2001	12,811,194	4,461,791
Issued for cash in private placements of common shares, net of issue costs	2,000,000	1,072,767
Issued for cash on exercise of stock options	110,000	55,000
Balance, September 30, 2002	14,921,194	\$ 5,589,558

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 2002 and 2001

8. Share capital (continued):

(b) Issued common shares (continued):

On April 10, 2002 the Company completed a private placement of 2,000,000 common share units at a price of \$0.60 per unit for gross proceeds of \$1,200,000. Each unit consisted of one common share and one non-transferable purchase warrant to purchase a second share at \$0.75 per share for a period of twenty-four months, subject to certain provisions, none of which have been met, that would force conversion. In addition, 240,000 agents warrants, exercisable at \$0.60 per share for a period of eighteen months, were issued as well as payment of an 8.5% fee on the gross proceeds of the financing.

(c) Shares in escrow:

The Company previously issued 3,679,884 performance shares which were releasable from escrow based upon the satisfaction of certain pre-determined cumulative cash flow tests. Release from escrow was subject to regulatory approval. Any escrowed shares not released by October, 2004 would 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.

In response to an application by the Company, on February 26, 2002, the TSX Venture Exchange approved a revised escrow agreement wherein 10% of the escrowed shares were released from escrow on February 26, 2002, and a further 15% will be released on each six month anniversary of such date, until all of the escrowed shares have been released from escrow. As at September 30, 2002, 2,759,914 common shares remain held under the revised escrow agreement.

(d) Stock options:

The Company, from time to time, grants stock options to employees, directors, officers and certain consultants under the Company's stock option plan. The maximum amount of options available for issue is 2,562,000 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 generally vest over a period of three years following the date of grant.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 2002 and 2001

8. Share capital (continued):

(d) Stock options (continued):

A summary of the status of the Company's stock option plan as at September 30, 2002 and 2001 and changes during the years ending on those dates is presented below:

	2002		2001	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding, beginning of year	1,915,000	\$ 0.50	483,750	\$ 0.82
Granted	75,000	0.64	2,668,750	0.60
Exercised	(110,000)	(0.50)	(15,000)	(0.50)
Cancelled or expired	(10,000)	(0.64)	(1,222,500)	(0.84)
Outstanding, end of year	1,870,000	\$ 0.50	1,915,000	\$ 0.50
Options exercisable, end of year	1,652,000	\$ 0.50	657,000	\$ 0.50

Stock options outstanding and exercisable at September 30, 2002:

Number of stock options outstanding	Options exercisable	Exercise price	Weighted average remaining contractual life
1,805,000	1,613,000	\$0.50	20.7 months
65,000	39,000	0.64	27.2 months
	1,652,000		20.9 months

(e) Share purchase warrants:

The following share purchase warrants were outstanding as of September 30, 2002:

Expiry date	Number of warrants	Exercise price
April 18, 2004	2,000,000	\$0.75
October 18, 2004	240,000	0.60
December 18, 2002	650,000	0.50
December 12, 2002	45,750	0.85
	2,935,750	

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 2002 and 2001

8. Share capital (continued):

(f) Earnings (loss) per share:

	2002			2001		
	Earnings	Weighted average shares	Per share amounts	Loss	Weighted average shares	Per share amounts
Earnings (loss) available to common shareholders	\$ (395,717)	13,818,563		\$ 205,423	11,089,143	
Contingently issuable shares (note 8(c))	-	(1,492,117)		-	(3,679,884)	
Basic earnings (loss) per share	(395,717)	12,326,446	(0.03)	205,423	7,409,259	0.03
Effect of dilutive securities:						
Convertible debenture	-	-		1,781	29,680	
Note payable	-	-		44,040	215,486	
Diluted earnings (loss) per share	\$ (395,717)	12,326,446	\$(0.03)	\$ 251,244	7,654,425	\$ 0.03

For the years ended September 30, 2002 and 2001, options and warrants were not included in the calculation of diluted loss per share as their effects are anti-dilutive. Of these issued equity securities for 39,000 options (2001 - 1,915,000) and 2,285,750 warrants (2001 - 897,750) the fair market value of the underlying shares was less than the exercise price.

9. Related party transactions:

Included in accounts receivable is \$71,541 (2001 - \$60,577) receivable from shareholders of the Company. Included in accounts payable and accrued liabilities is \$10,437 (2001 - \$10,437) payable to shareholders and companies controlled by directors of the Company. During the year, the Company paid \$50,000 (2001 - \$50,000) to a company owned by an officer and shareholder for the provision of services. The services provided were in the normal course of business and valued at amounts agreed to by the parties.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 2002 and 2001

10. Contingencies and commitments:

- (a) The Company has entered into an agreement with Technology Partnerships Canada ("TPC"), whereby TPC will 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 TPC 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. Accumulated royalties paid or payable to September 30, 2002 totaled \$66,838 (2001 - \$41,829).
- (b) 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:

2003	\$ 86,777
2004	81,544
2005	83,009
2006	77,464
2007	71,917
Thereafter to 2009	156,364
	<hr/>
	\$ 557,075

11. Income taxes:

Income tax expense (recovery) attributable to earnings (losses) differs from the amounts computed by applying the combined Canadian federal and provincial income tax rate of 39.62% (2001 - 44.62%) to earnings (loss) before income taxes as follows:

	2002	2001
Net earnings (loss) before income taxes	\$ (395,717)	\$ 205,423
Expected income tax expense (recovery)	\$ (156,783)	\$ 91,659
Tax effect of:		
Expired losses	287,068	-
Change in valuation allowance	(174,766)	(386,018)
Change in tax rates	37,948	291,213
Other	6,533	3,146
Income tax expense (recovery)	\$ -	\$ -

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 2002 and 2001

11. Income taxes (continued):

The tax effects of temporary differences that give rise to future tax assets are presented below:

	2002	2001
Future income tax assets:		
Non-capital losses carried forward	\$ 1,557,039	\$ 1,290,674
Furniture and equipment, undepreciated tax costs in excess of net book value	80,610	69,144
Total gross future income tax assets	1,637,649	1,359,818
Valuation allowance	(817,242)	(992,008)
Net future income tax assets	820,407	367,810
Future income tax liabilities:		
Deferred aviation system design costs	(820,407)	(367,810)
Net future income tax assets	\$ -	\$ -

In assessing the ability to realize future income tax assets, management considers whether it is more likely than not that some or all of the future tax assets will be realized. The ultimate realization of the future tax assets is dependent on the generation of taxable income during periods in which the temporary differences reverse. As at September 30, 2002, evidence does not exist to support a conclusion that it is more likely than not that the future income tax assets will be realized, a valuation allowance has been recorded against all of the future tax assets.

The Company has non-capital loss carry forwards of approximately \$4,371,000 which are available to offset taxable income otherwise calculated through 2009.

12. Investment in joint venture:

The Company has a 50% interest in Gold Bill Water Treatment Technology Co. Ltd., a joint venture being formed between the Company and Mindong Jinding Ocean & Fisheries Research Institute established under the Joint Venture laws of the People's Republic of China. The purpose of the joint venture is to develop, manufacture, sell and service water treatment products for industrial and commercial use and consumption in China. Summarized financial information of the Company's proportionate share of the assets, liabilities and cash flows of the joint venture are as follows:

	2002	2001
Current assets	\$ 100,448	\$ -
Equipment and other assets	64,402	-
Cash flows	-	-

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Financial Statements

Years ended September 30, 2002 and 2001

13. Financial instruments:

(a) Fair values:

As at September 30, 2002, the fair value of the note payable is not readily determinable as the Company is in arrears on its payments and there is no public markets for such a note payable. Details of the note payable are discussed in note 6. Financial instruments also consist of cash, accounts receivable, accounts payable and accrued liabilities and customer deposits, the carrying values of which are considered by management to approximate their fair 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, 2002, six customers (2001 - six) represented approximately 72% (2001 - 78%) of accounts receivable. The Company mitigates credit risk through regular credit assessment and collection policies.

(c) Currency risk:

At September 30, 2002, approximately 84% (2001 - 85%) of accounts receivable and 71% (2001 - 43%) of liabilities are denominated in United States dollars. In addition, the note payable (note 7) 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.

14. Government assistance:

The Company received government assistance totalling \$545,058 in 2002 (2001 - \$76,654) of which \$55,167 (2001 - \$76,654) was included in results from operations as a reduction of research and development expenses and \$489,891 (2001 - nil) was included as a reduction of deferred aviation system design costs.

15. Segmented information:

The Company's principal business operations relate to the development, manufacturing and sales of water treatment systems and accordingly the Company has only one reportable segment. In 2002, sales from 3 customers (2001 - 4 customers) represent approximately 40% (2001 - 54%) of total revenue. 97% of the Company's furniture and equipment are located in Canada and 3% in China. In 2002, approximately 46% (2001 - 33%) of sales revenue was generated by customers in Canada and 54% (2001 - 67%) by customers in other countries, primarily the United States.

CORPORATE INFORMATION

DIRECTORS AND OFFICERS

C.W. (Bill) Coote
President, CEO, and Director

David M. Hall
Director

John (J.D.) Lawson
Director

Kennith A. Mellquist
Director

Ryaz Z. Shariff
Director

James F. Dobie
Vice President

Gerald P. Eiers
General Manager

C. Edward Butterfield
Chief Financial Officer

ANNUAL GENERAL MEETING

The Company's Annual General Meeting of shareholders will be held at 2 p.m. on Wednesday, March 26, 2003, at the Sutton Place Hotel, 845 Burrard Street, Vancouver, BC.

CAPITAL STRUCTURE

(as at January 1, 2003)

Authorized: 100,000,000 Common Shares
5,000,000 Preference Shares
Issued: 14,921,194 Common Shares

STOCK EXCHANGE

TSX Venture Exchange
Trading Symbol: "IWG"

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INTERNATIONAL
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THE WATER KNOWLEDGE COMPANY



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