INTERNATIONAL WATER-GUARD

INDUSTRIES INC.

THE WATER KNOWLEDGE COMPANY

Annual Report - Fiscal 2004

PRESIDENT'S MESSAGE

2004 has been a year of significance for IWG. This is my first message as incoming President, which in itself is an indicator that dramatic changes are underway within the company.

Since my joining the company, we have embarked on a program of streamlining operations, and ensuring that our base level of activity is sustained by IWG's standard aviation products in the corporate aviation market. With this established, it is then possible to expand our reach in an organized way to capitalize on the investments that have been made in circulating potable water systems development, and stake out a position in the rapidly evolving market for aircraft water treatment in the airline industry.

We have also reviewed the status of our Industrial/ Commercial business. In July, the decision was made that IWG needs to fully focus its activities on the area of business where it has a commanding lead and highest value-add. This is the aviation sector, which also makes up the bulk of IWG's sales. Consequently, the decision was made to divest the Industrial/ Commercial business. It is planned that the cash proceeds from the divestiture be used to pay down some of the legacy payables and debt that has accrued to IWG from its aviation and other program investments. I would like to acknowledge the support and patience of the numerous organizations and individuals that have stuck with us during this very trying phase while we have been restructuring and finalizing our obligations. This process is still not complete, but significant progress has been made.

IWG is now fully focused into the aviation sector. Today, it should be characterized as an Aviation Systems Company focused on potable water treatment and systems. With this clear focus we can effectively define our path forward and employ the resources to derive benefit from this market without distraction.

On joining IWG in May, the company was completing a very significant development and certification program for its first Boeing Business Jet client. This program has been successfully completed, opening the door to a major market. However, this has come at a very significant price, which, when added to past R&D initiatives, placed a deferred development cost totaling some $3.9M on the company's balance sheet. As part of our move into a new business climate, the Board decided to write down these investments, giving the company a clean path into the future. It should be emphasized that Management considers that ultimately, the development of IWG's unique aircraft water systems will be a benchmark for the industry for years to come and has the potential to generate significant value.

Over the last four years the company has installed and certified circulating potable water systems on the Boeing Business Jet, Airbus A-310, Gulfstream IV and Bombardier Global Express aircraft. This is a very solid base on which to drive future sales. In addition, sales representative agreements have been put in place with Gulfstream itself for the GIV systems retrofit market, and with Aerospace Concepts of Montreal, who are active in the Bombardier aftermarket. This further extends the reach of our company and we will be pursuing additional similar initiatives in the future.

As well as our activities in the corporate aviation market, there have been some significant events in the commercial aviation world regarding water quality. The US EPA has released the results of two surveys of airline water quality, in September 2004, and January 2005. Both have shown that a significant proportion of the aircraft tested do not meet required health standards – 17% in the January results.

On November 9, 2004, the EPA announced commitments from 12 major U.S. passenger airlines to implement new aircraft water testing and disinfection protocols, to be followed by a review of existing guidance governing potable water aboard passenger aircraft. International Water-Guard is ideally positioned to provide a full long-term solution. With the ever increasing visibility of aircraft water quality in the eyes of the traveling public, we are hopeful that IWG will see progress in this market over the coming years.

I would like to conclude by acknowledging that the renewal of IWG would not be a success without the fullest support of our Shareholders and Board of Directors, and the support and exceptional hard work of our staff. Working together we are moving into 2005 as the “Aviation Water Knowledge” company, with exciting times ahead.

“David C. Fox”

David C. Fox
President and CEO

International Water-Guard Industries Inc. (IWG) is the dominant supplier of on-board water treatment equipment to the corporate jet market, and is poised to be a leading supplier of on-board water systems to the aviation industry as a whole.

IWG is unique in that it is the only company in the world focused on supplying ultraviolet potable water disinfection equipment and circulating potable water system kits to the aviation industry. The Company's principal marketing efforts have been focused on corporate aircraft (i.e. aircraft owned by corporations or individuals). To date, more than 900 water disinfection units have been installed on corporate aircraft worldwide.

The Company's water treatment units are currently offered as standard options by the three largest corporate jet manufacturers: Bombardier Aerospace, Dassault Falcon Jet, and Gulfstream Aerospace Corporation. Many Boeing Business Jets are equipped with IWG products. IWG also maintains its focus on the world's aircraft completion centers, where both new production aircraft and older models are modified for use in corporate aviation.

The IWG circulating potable water system (C-PWS™) design has received U.S. and Canadian aviation regulatory approval, and is being offered to aircraft owners and operators whose aircraft are at a completion center for final interior outfitting. The C-PWS™ is patented in the U.S., and has patents pending in countries with involvement in the aerospace industry.

The first installation of the new C-PWS™ (July 2001) was aboard a Bombardier Global Express aircraft completed by The Jet Center in Van Nuys, California. Since then, IWG has also installed the C-PWS™ on a Gulfstream G-IV aircraft at Gulfstream's Savannah, GA, completions facility; has installed and certified a C-PWS™ "mod kit" on five Airbus A310 VIP/Transport aircraft; and in 2004 on a Boeing Business Jet (BBJ) aircraft, which is a variant of the 737, Boeing's most popular aircraft. This is particularly significant, as it opens up the market not only for the Boeing Business Jet, but also the many military variants of the 737.

There are currently no regulations requiring disinfection of potable water on commercial airliners, however, this may well change. On September 20, 2004, the US EPA (Environmental Protection Agency) published results of a survey reporting that 13% of the aircraft it tested had water that did not meet EPA standards. This was followed by a second report in January

> *"A second round of Environmental Protection Agency (EPA) testing shows that 17.2 percent of 169 randomly selected passenger aircraft carried water contaminated with total coliform bacteria. The latest round of tests were performed on domestic and international passenger aircraft at airports nationwide in November and December of last year. The results confirm the presence of bacteria at levels warranting continued EPA scrutiny."*
> US Environmental Protection Agency news release; January 19, 2005

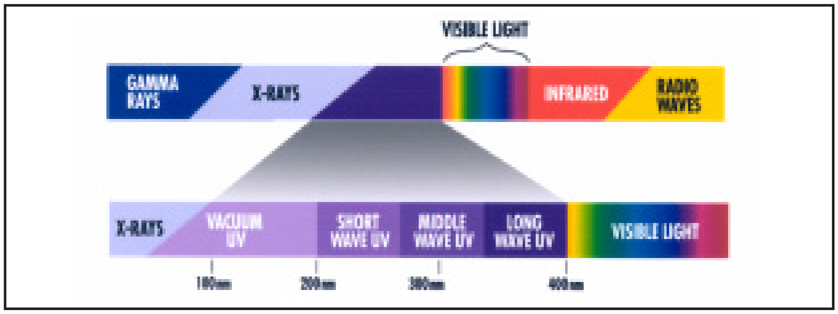
2005, reporting failures of 17%. This has renewed interest by the airline industry in seeking a long term fix to the issue of water quality on board aircraft. IWG is well positioned to take advantage of this interest, and a variety of initiatives are underway.

TECHNOLOGY

Disinfection by Ultraviolet Light

Scientists have known for nearly a century that ultraviolet light of certain wavelengths is an effective germicidal agent. Over the past thirty years, extensive experimental work has been carried out by researchers seeking to establish lethal ultraviolet dosages for a variety of pathogenic micro-organisms. As a result of this research, it is now possible to design ultraviolet irradiation equipment to meet virtually any disinfection requirement.

Ultraviolet radiation is actually high energy light. The wavelengths in the ultraviolet spectrum are too short for the human eye to resolve and ultraviolet light is therefore invisible. The ultraviolet spectrum ranges from 40 to 400 Nanometers (nm), with the most effective spectral region for germicidal purposes being between 250 and 265 nm. At the proper intensity, UV light is fatal to all micro-organisms known to inhabit water.



Mercury arc lamps generate the ultraviolet radiation for water disinfection, with low-pressure lamps being the most common and effective type. Low-pressure mercury arc lamps are efficient producers of ultraviolet rays in the 254 nm range lethal to microbes. This wavelength is very effective in the destruction of all known micro-organisms, including emerging health threats like *E. Coli, Cryptosporidium,* and *Giardia.* IWG also employs high intensity and amalgam ultraviolet lamps in specific applications requiring those types of technological solutions.

Studies show that DNA molecules in the nucleus of the organism absorb ultraviolet light. The organism is inactivated when sufficient dosage has been absorbed to modify the molecular structure in the DNA. It may not be killed instantly, but the scrambling of the genetic code in the nucleus prevents reproduction, rendering it non-viable and harmless to humans.

Filtration alone does not destroy waterborne pathogens; it merely removes unwanted material suspended in the water, such as sediment and chemicals like Chlorine. In fact filters can become a good breeding ground for micro-organisms if not changed regularly.

However, ultraviolet disinfection and filtration work extremely well together, since UV needs clear water to allow the light to penetrate to its maximum effect. The result is clean, safe, good-tasting water that can rival and even exceed the quality of bottled water.

PRODUCTS

Aircraft Water Treatment Units

The Company's NPS-A2, NPS-A3, NPS-A4 and NPS-A6 products provide on-board potable water disinfection, and are fully qualified for use on corporate and commercial aircraft. Transport Canada has certified IWG as an approved organization for the Manufacturing, Certification, and Maintenance of aeronautical products. Additionally, the European Aviation Safety Agency (EASA) has certified IWG as an accepted organization for the maintenance of its units in Europe.

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.

IWG's aviation products must undergo a rigorous, lengthy, and costly certification process in both the United States and Canada. Each new aircraft manufactured, whether it be a Boeing product or another manufacturer's, is flight-certified by Transport Canada or the Federal Aviation Administration on the basis of a "Type Certificate." This essentially means the aircraft is safe, and has been cleared for flight. When any additional equipment is added to such an aircraft, it must be proven that the new addition will not create a flight hazard. This process involves the issuance of a "Supplemental Type Certificate," or "STC." IWG has been issued U.S. and Canadian STC's on its ultraviolet disinfection equipment, and on its new circulating potable water system. The cost and difficulty of the certification process are significant barriers to entry for competitors.

The latest version of the patented NPS-A6 aircraft potable water treatment unit.

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. IWG's four models of 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.

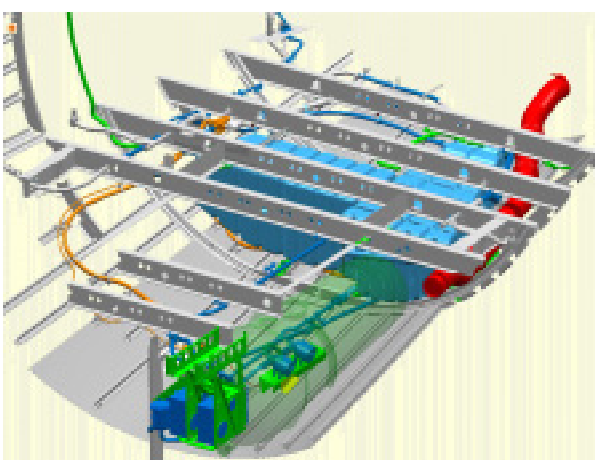
IWG's original product, the NPS-A2 was designed in collaboration with Boeing in the late 1970's by a predecessor company later acquired by IWG in 1989. This robust product continues to be procured to this day.

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.

The NPS-A4 was developed at the request of Dassault Falcon Jet, and is now a standard customer option on its 900 and 2000 series corporate jets. This new product is essentially an NPS-A3 with the filter feature removed in order to meet specific needs. The NPS-A6 is similar in design to the NPS-A3 but is constructed of stainless steel and has a higher flow rate. Both the NPS-A3 and the NPS-A6 are covered by the same U.S. Patent issued in September, 2002.

Aircraft Circulating Potable Water System Kits

IWG's circulating aviation potable water system 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,depending on which aircraft model is considered.



Boeing BBJ C-PWS™ major components

Airbus A310 C-PWS™ major components

IWG has received a Transport Canada Supplemental Type Certificate (STC) for the installation of its patented C-PWS™ on Boeing Business Jet aircraft. Certification by the US Federal Aviation Administration(FAA) is pending. Both US and Canadian STC's are in place for IWG's Airbus A310 C-PWS™ design.

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 C-PWS™ is protected by two US Patents (6,463,956 and 6,766,822) and international filings.

Replacement Parts and Service

In addition to products and systems, the Company sells replacement parts (including spares) and services to customers with their own installed base of IWG systems and products.

MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal Year 2004

Overview

Comments in this analysis should be read in conjunction with the comparative audited financial statements included in the annual report for the fiscal year ended September 30, 2004. The following discussion, and the information elsewhere in this report, is intended to provide the reader with a further 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, primarily for international aviation customers. 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 has been substantially a development company, with base operations and revenues covering a portion of its product, aviation water systems and market development costs. New equity issues have provided the remainder of the Company's capital commitments and working capital requirements. Sales trends are subject to industry cycles and customer adoption of the Company's technology.

During the latter period of fiscal 2004, management reviewed its strategy and progress to develop circulating potable water systems design for several different aircraft types. While re-affirming the goal of continuing to maintain its technological lead in aircraft water treatment equipment and systems, both the cost of development and time to market have become significant. The company has obtained Certification for its C-PWS™ on four aircraft types (The Bombardier Global Express, Gulfstream G-IV, Boeing Business Jet and the Airbus A310). However, the accumulated costs of such development since 2001 has exceeded the original budgets while the sales cycle to delivery of such systems has been longer than expected. While still confident that sales of these systems can be significant, the timing of recovery for expended development costs is difficult to determine.

As a consequence of this review, management decided to expense all development costs incurred through fiscal 2004, such that there are no remaining costs to carry forward to future years. At this time, future aviation system development costs will be expensed unless justified for deferment under current accounting guidelines. Such costs will be negligible in fiscal 2005 as sales efforts for C-PWS™ are directed towards existing certified systems.

SELECTED ANNUAL FINANCIAL INFORMATION

Fiscal year September 30th	**2004**	**2003**	**2002**
Total revenues	$3,641,463	$3,050,097	$4,048,939
Loss from operations before write-downs	(100,523)	(566,134)	Nil
Write down of deferred costs and other assets	(3,834,312)	(161,840)	Nil
Net income (loss)	(3,934,835)	(727,974)	(395,717)
Earnings (loss) per share, basic and fully diluted	$(0.21)	$(0.05)	$(0.03)
Dividends per share	Nil	Nil	Nil
Total assets	$1,162,044	$3,938,970	$4,561,905
Long term debt	$29,021	$478,407	$33,137

An analysis of the annual financial results of the Company from the Company's annual audited financial statements, summarized above, is presented elsewhere in this report.

Operating results

The Company reported sales in fiscal 2004 of $3,641,463, an increase of 19% from the previous year. The operating loss, which is before write-downs, was $100,523 in fiscal 2004 compared to an operating loss of $566,134 in the prior year. A net loss of $3,934,835 was incurred for the year, compared to a net loss of $727,974 in the previous year.

The current year loss includes a $3,786,834 write-down of deferred development costs and a $47,478 write-down of leasehold improvements.

Sales

Sales of aviation products in 2004 of $3,115,020 (representing 86% of total fiscal 2004 sales) increased by 30% over fiscal 2003's aviation sales of $2,393,652. Sales increased in fiscal 2004 over 2003, primarily due to an increase in aviation unit and systems sales, offset by lower industrial sales and the weakening of the US dollar reducing the booked value for the majority of the company's sales. Included in fiscal 2004 results is the delivery of the last four aircraft circulating potable water systems installed on Airbus A310 aircraft and the fourth certified aircraft model system, a Boeing Business Jet aircraft, certified by Transport Canada.

Industrial sales of $488,947 to the aquaculture and other water process applications, representing 14% of fiscal 2004 sales, decreased by 24% from the prior year. This decrease resulted from reduced emphasis and resulting support to this sector while the company focuses on its aviation products and systems. While the company will continue to support its industrial customers with equipment, parts and service, the company is also seeking to sell this division's assets to a suitable buyer.

Sales to customers in Canada represented 45% of the Company's sales (vs. 35% in 2003) with 55% of sales exported, primarily to United States (vs. 65% in 2003). This trend to higher Canadian sales was attributed primarily to the sale of aircraft A310 C-PWS™ kits to Air Canada Technical Services.

Direct sales margins

Overall direct sales margins have been unchanged year to year despite significant fluctuations in the US dollar exchange rate. Overall, the weaker U.S. dollar served to reduce reported sales prices. This decrease was partially offset by U.S. parts procurement, with the balance offset by shifting sales mixes between aviation systems, aviation units and industrial/commercial units.

Operating expenses

Selling expenses of $335,573 were 12% less than in fiscal 2003. The decrease was due principally to reduced travel and fewer sales personnel during the year compared to the prior year.

Engineering and product development expenses (excluding C-PWS™ development) charged to earnings of $334,915 was a 39% decrease from the prior year. There was a significant reduction in consulting staff and development expenditures as projects were completed..

General, administration, information technology and occupancy expenses totaled $1,212,708, a 4% decrease from fiscal 2003. This decrease was primarily attributed to decreased facility operating costs and other general expenses.

Aircraft water system development costs

Aircraft water system development costs of $1,076,642 incurred in fiscal 2004 include costs to complete the Boeing Business Jet and the final A310 designs, through certification.

These programs provide IWG with the certification (STC) necessary 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

The Company has deferred a total of $3,786,834 in aviation system development costs to September 30th, 2004. While the market for these systems represent a significant opportunity for the Company, sales volume has taken longer to grow than anticipated. During the fourth quarter, management reviewed the near term recoverability of such deferred costs from sales margins and determined that acting prudently, previously capitalized costs should be written off as they no longer meet the criteria for deferral under Canadian generally accepted accounting principles. As a result, the Company has written of the deferred costs at September 30, 2004 in the amount of $3,786,834.

In future years, the deferment of development costs under the Company's adopted policy will be determined on a case by case basis related to any new aircraft C-PWS™ designs.

Capital expenditures

Capital expenditures incurred by the company for plant or equipment were not significant in fiscal 2004 or in 2003.

Quarterly information

The following summary information is taken from the Company's quarterly and annual financial reports covering the last two fiscal years.

Fiscal year ended September 30 ($000's except per share amounts)

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Year
Fiscal 2004					
Sales	$1,163	$791	$934	$753	$3,641
Earnings (Loss) from operations before write-downs	91	4	(162)	(34)	(101)
Write down of deferred and other assets				(3,834)	(3,834)
Net income (loss)	91	4	(162)	(3,868)	(3,935)
Earnings (loss) per share, basic and fully diluted	$0.01	$0.00	$(0.01)	$(0.21)	$(0.21)
Fiscal 2003					
Sales	$750	$706	$734	$860	$3,050
Loss from operations before write-downs	(125)	(92)	(123)	(226)	(566)
Write down of joint venture assets				(162)	(162)
Net income (loss)	(125)	(92)	(123)	(388)	(728)
Earnings (loss) per share, basic and fully diluted	$(0.01)	$(0.00)	$(0.01)	$(0.03)	$(0.05)

Fluctuations in sales from quarter to quarter were mainly related to the delivery of the Company's C-PWS™, although there are no factors which may be used to predict future performance in either sales or in net income or loss on a quarter to quarter basis.

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:

Aircraft markets

The Company's primary customers are business use aircraft manufacturers, owners and operators. Such markets are cyclical over time although often differing from the cycles for commercial aircraft. Sales are made on a standard or optional basis and are dependent upon the production rates and customization of new aircraft or the requirement for upgrading existing aircraft by owners. The Company's near term direction is to continue to broaden its customer base by increasing its penetration with existing customer's aircraft and initiate equipment sales to new aircraft models. This will continue to secure and expand the Company's primary sales base for water disinfection equipment, while continuing to seek further customers for the Company's C-PWS™ kits.

Competition

Aviation - Potable Water Treatment

At this time, there are no other companies of significance supplying flight certified potable water disinfection equipment to the aircraft industry, and IWG dominates the market. It is expected that competition will come, although IWG intends to remain the dominant player in this field because of its significant head start, and by developing new products, pricing new and existing products as though competition exists, and continuing to seek customer input. In addition, the Company believes that the very significant product development timelines and costs, its U.S. Patent protection, the extensive regulatory approval process, the multi-year marketing and sales efforts required to penetrate the market and the highly defined niche aspect of the market are all likely to be deterrents to prospective competitors entering the marketplace. From time to time very small players attempt to penetrate the market, but none have been successful. There is an initiative by a company to enter the market with a system tailored specifically to the giant Airbus A380 using an alternate water treatment technology. A variety of water filters are used by some airlines and operators, but these do not actively treat and disinfect the water.

Aviation - Potable Water Systems

Currently, IWG is aware of several major full water systems providers in addition to itself. Their focus tends to be on the airliner/ regional jet markets, whereas the Company currently places most of its attention on the corporate/ VIP jet market with its unique C-PWS product. At least one of the companies competes directly in the corporate/ VIP market. A variety of companies provide components to aircraft manufacturers for inclusion in their potable water system designs, but only IWG and these firms are offering aircraft manufacturers a full system solution as a kit. To secure a leading position in the aviation water system market, the Company will protect its competitive position by maintaining its lead in product technology development and by securing intellectual property protection as appropriate. Further, the Company will secure and maintain necessary certifications for the manufacture and use of its equipment in the aviation market

Industrial/ Commercial

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. However, as the Company has chosen to focus on the aircraft market, the industrial division's business and assets will be eventually sold should a suitable buyer be located to acquire and operate the business. The Company has accepted a conditional offer for sale that is scheduled to close before the end of January 2005. In the meantime, the Company continues to support its current customer base.

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 impact sales revenue, gross margins and net earnings reported by IWG. With the shift in US/ Canada exchange rates over the last year, this is an area of risk.

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 will be affected by its ability to achieve profitable operations, by the continued support of its significant creditors, and by its ability to attract additional capital. The Company has not been able to meet the payment terms for two of its major debt instruments and is in negotiations to restructure such debt. The Company has also negotiated extended terms with some suppliers. However, to improve its working capital position, properly establish its presence in the aviation market, and to achieve sales growth targets, additional financing is being pursued. This 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.

Business outlook

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 aviation market requirements. This market is being very actively pursued. The major aircraft water system design initiatives undertaken to date have been completed although some additional costs may occur in the future.

International Water-Guard Industries, historically a developer of UV-based water treatment equipment for several niche markets has become a primary supplier of engineered ultraviolet based water treatment products and systems for the aviation market. With its certified and proven aircraft circulating potable water system, IWG's goal is to become a leading provider of water systems and disinfection units to the aviation industry

Liquidity and capital resources

Cash flow from operations:

Cash provided from operating activities, before non-cash operating working capital, was $94,007 in 2004. Operating assets and liabilities utilized a further $284,260 during the year related to sales increases and a draw-down of customer deposits received in the prior year.

Cash flow from financing activities:

The Company issued common shares and received proceeds from the exercise of warrants during the year for net proceeds of $941,355. In addition, a Promissory Note was issued to a shareholder, and with accrued interest, total proceeds were $256,507. Additional advances of $298,350 were also made under the Company's credit line with a factoring company.

These financings were sufficient to provide the majority of the Company's cash flow requirements and $1,076,642 in aviation water system development costs during the year, although settlement negotiations with several creditors have yet to be finalized.

Working capital position:

The Company completed its 2004 fiscal year with $1,370,085 in negative working capital, a further increase of $507,570 over the prior year. This increase was primarily attributed to long-term debt maturing within the next year. During the year, the Company's working capital requirements were met primarily by equity financings, a shareholder loan and a credit line from a factoring finance company. With the completion of its aviation system development projects, the Company has begun fiscal 2005 by operating on a cash neutral basis, however it is seeking additional equity financing and debt settlements to meet its future financial requirements.

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.

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 had a material impact on the Company's sales and earnings through fiscal 2004.

Expenditures on market development, product development and certification prior to significant sales of such new aviation products were largely responsible for reported losses and debt levels for the last several years, but these will decrease significantly in fiscal 2005.

With an upturn in the aviation industry now underway, and increased emphasis on water quality on board aircraft, IWG is focused on generating results from its investments in products and systems to date.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The financial statements of International Water-Guard Industries Inc. for the fiscal year ended September 30, 2004 and all other information in the annual report are the responsibility of management and have been approved by the Board of Directors.

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly in all material respects. Management has also prepared the financial information presented elsewhere in the Annual Report and Annual Information Form and has ensured that it is consistent with that in the financial statements.

The Company maintains a system of internal control designed to provide reasonable assurance that financial information is reliable and accurate and that assets are safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting, and is ultimately responsible for reviewing and approving the financial statements. The Board carries out this responsibility, principally through its Audit Committee. The Board appoints the Audit Committee, and the majority of its members are outside directors. The Audit Committee meets periodically with management, as well as the external auditors, to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues, to satisfy itself that each party is properly discharging its responsibilities, and to review the Annual Report, the financial statements and the external auditors' report.

KPMG LLP, the Company's external auditors, have audited the financial statements in accordance with Canadian generally accepted auditing standards on behalf of the shareholders to provide reasonable assurance that the financial statements are presented fairly, in all material respects, in accordance with Canadian generally accepted accounting principles. KPMG LLP have full and unrestricted access to the Audit Committee to discuss their audit and related findings as to the integrity of the Company's financial reporting.

"David C. Fox"	"C. Edward Butterfield"
President, CEO and Director	Chief Financial Officer

Financial Statements of

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Years ended September 30, 2004 and 2003

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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, 2004 and 2003 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, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Vancouver, Canada

December 10, 2004

INTERNATIONAL WATER-GUARD INDUSTRIES INC.
Balance Sheets

September 30, 2004 and 2003

	2004	2003
Assets		
Current assets:		
Cash	$ 64,836	$ -
Accounts receivable	592,467	291,745
Inventory (note 3)	423,626	630,814
Prepaid expenses	5,529	5,529
	1,086,458	928,088
Furniture and equipment (note 4)	75,586	145,691
Deferred development costs, net of accumulated amortization of $264,999 (2003 - $110,000) and write-down (note 5)	-	2,865,191
	$ 1,162,044	$ 3,938,970
Liabilities and Shareholders' Equity (Deficiency)		
Current liabilities:		
Bank indebtedness	$ -	$ 48,188
Accounts payable and accrued liabilities	1,018,965	861,434
Customer deposits	-	348,257
Factoring loan (note 6)	449,500	151,150
Shareholder loan (note 10(a))	256,507	-
Current portion of notes payable (note 7)	727,425	381,574
Current portion of loan payable (note 8)	4,146	-
	2,456,543	1,790,603
Notes payable (note 7)	-	445,240
Loan payable (note 8)	29,021	33,167
	2,485,564	2,269,010
Shareholders' equity (deficiency):		
Share capital (note 9)	6,530,913	5,589,558
Deficit	(7,854,433)	(3,919,598)
	(1,323,520)	1,669,960
	$ 1,162,044	$ 3,938,970

Contingencies and commitments (note 11)
Subsequent event (note 17)

See accompanying notes to financial statements.

Approved on behalf of the Board:

"D. C. Fox" Director **"R.Z. Shariff"** Director

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Statements of Operations and Deficit

Years ended September 30, 2004 and 2003

	2004	2003
Sales	$ 3,641,463	$ 3,050,097
Cost of goods sold (note 3)	1,493,654	1,226,982
Gross profit	2,147,809	1,823,115
Expenses:		
Selling expenses	335,573	379,224
Research and development	334,915	554,668
General, administrative and occupancy	1,212,708	1,269,454
Amortization	178,833	57,203
Interest	186,303	128,700
	2,248,332	2,389,249
Loss from operations, before write downs	(100,523)	(566,134)
Write-down of deferred development costs (note 5)	(3,786,834)	-
Write-down of leasehold improvements (note 7(b))	(47,478)	-
Write-down of joint venture assets (note 13)	-	(161,840)
Loss for the year	(3,934,835)	(727,974)
Deficit, beginning of year	(3,919,598)	(3,191,624)
Deficit, end of year	$ (7,854,433)	$ (3,919,598)
Loss per share amounts:		
Basic	$ (0.21)	$ (0.05)
Diluted	(0.21)	(0.05)
Weighted average shares outstanding	18,644,398	14,921,199

See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Statements of Cash Flows

Years ended September 30, 2004 and 2003

	2004	2003
Cash flows from (used by):		
Operations:		
Loss for the year	$ (3,934,835)	$ (727,974)
Items not involving cash:		
Amortization	178,833	57,203
Accrued interest on notes payable	58,546	34,273
Unrealized foreign exchange gain	(42,849)	(75,851)
Write-down of deferred development costs (note 5)	3,786,834	-
Write-down of leasehold improvements	47,478	-
Write-down of joint venture assets	-	161,840
	94,007	(550,509)
Changes in non-cash operating working capital:		
Accounts receivable	(300,722)	707,982
Inventory	207,188	208,682
Accounts payable and accrued liabilities	157,531	(143,476)
Customer deposits	(348,257)	348,257
	(190,253)	570,936
Investments:		
Purchase of furniture and equipment	(1,207)	(9,681)
Deferred development costs	(1,076,642)	(591,971)
	(1,077,849)	(601,652)
Financing:		
Increase in factoring loan	298,350	95,175
Repayment of notes payable	(115,086)	(168,227)
Proceeds from shareholder loan	256,507	-
Issuance of capital stock	941,355	-
	1,381,126	(73,052)
Increase (decrease) in cash	113,024	(103,768)
Cash, beginning of year	(48,188)	55,580
Cash, end of year	$ 64,836	$ (48,188)

Cash is defined as cash less bank indebtedness.

Supplementary information:		
Interest paid	$ 163,522	$ 141,200
Non-cash transactions:		
Notes payable issued for settlement of accounts payable	-	665,436

See accompanying notes to financial statements.

1. Operations:

The Company is incorporated under the Business Corporations 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 $7,854,433 as at September 30, 2004 as a result of losses incurred in the current and prior years. In addition, the Company has a working capital deficiency of $1,370,085 as at September 30, 2004, which is an increase from a working capital deficiency of $862,515 at September 30, 2003, and has not made certain required payments related to notes payable (note 7). 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 generate positive cash flow from operations on a continuing basis. The Company is renegotiating the payment terms on the notes payable to its largest creditors and continues to negotiate with its other suppliers and lenders in order to establish extended payment terms on its remaining 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 sufficient sales volumes will be achieved to reschedule its outstanding liabilities or that 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 and in Canadian dollars. 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 revenue 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 realizability of future income tax assets. 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. Work-in-process and finished goods inventory includes the cost of raw materials, direct labour, freight and other direct manufacturing costs.

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) Impairment of long-lived assets:

Effective October 1, 2003, the corporation adopted the Canadian Institute of Chartered Accountants Handbook Section 3063, "*Impairment of Long-Lived Assets*" ("HB 3063"). HB 3063 requires the Company to test for impairment of long-lived assets, such as furniture and equipment and deferred development costs when events or circumstances indicate that an impairment exists. Long-lived assets are impaired if the undiscounted cash flows expected to be earned from their use is less than their carrying amount, at which time, long-lived assets are written down to their fair value. The recommendations of HB 3063 were adopted prospectively and had no impact on carrying values at the date of adoption.

(e) Revenue recognition:

Revenue is recognized when persuasive evidence of a contractual arrangement exists, 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. Amounts received from customers in advance of an arrangement satisfying all revenue recognition criteria are classified as "customer deposits" on the balance sheet.

(f) 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 capital expenditures 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 11(a)). Royalty payments are recognized and expensed when incurred.

(g) 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 technological feasible product applications having a continuing identifiable market with best estimates of net cash flows in excess of the carrying value of the costs incurred are deferred. Routine alterations to existing products are expensed as incurred.

2. Significant accounting policies (continued):

(g) Research and development (continued):

Deferred development costs represent the cost, net of government funding and accumulated amortization, of designing, testing and certifying the Company's potable water system for specified aircraft model types when the criteria under generally accepted accounting principles for deferral are met. These costs are deferred until the system is certified for installation in aircraft by relevant authorities. Deferred system design costs are then amortized based on future estimated aviation potable water system sales during a maximum period of six years. If previously capitalized costs are no longer considered to meet all of the criteria for deferral, they are written off.

(h) 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 bases 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.

(i) Stock-based compensation plans:

The Company has a stock-based compensation plan, which is described in note 9(d).

All stock-based payments to non-employees, and employee awards that are direct awards of stock, call for settlement in cash or other assets, or are stock appreciation rights that call for settlement by issuance of equity instruments granted on or after October 1, 2002 are accounted for using the fair value method. As permitted by the Canadian Institute of Chartered Accountants' Handbook Section 3870, the "*Stock-Based Compensation and Other Stock-Based Payments*", no compensation cost on the grant of stock options to employees are recognized unless the exercise price of the granted option is less than the market price at the date of grant. The Company discloses the pro forma effect of accounting for share awards to employees under the fair value method in note 9(d).

(j) Earnings (loss) per share:

Earnings (loss) per share amounts have been calculated based on the weighted average number of shares outstanding. Contingently issuable shares are excluded from the calculation of weighted average number of common shares outstanding until the conditions for their release from escrow are satisfied. Fully diluted per share amounts have been calculated using the treasury stock method, which takes into account 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.

2. Significant accounting policies (continued):

(k) 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. Revenue and expenses are translated into 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 of operations. For the year ended September 30, 2004, foreign exchange gains totaled $57,190 (2003 - $48,861).

(l) Comparative figures:

Certain comparative figures have been reclassified to conform with the presentation adopted in the current year.

3. Inventory:

	2004	2003
Raw materials and work-in-process	$ 290,825	$ 420,385
Finished goods	132,801	210,429
	$ 423,626	$ 630,814

Cost of goods sold is determined as follows:

	2004	2003
Opening inventory	$ 630,814	$ 867,921
Manufacturing costs:		
Parts	867,752	549,242
Direct labour, freight and other	418,714	440,633
	1,286,466	989,875
Available for sale	1,917,280	1,857,796
Closing inventory	423,626	630,814
Cost of goods sold	$ 1,493,654	$ 1,226,982

4. Furniture and equipment:

	2004	2003
Molds	$ 61,390	$ 61,390
Manufacturing and distribution equipment	104,821	104,058
Furniture and office equipment	171,154	170,995
Leasehold improvements	97,319	97,034
	434,684	433,477
Accumulated amortization	(359,098)	(287,786)
	$ 75,586	$ 145,691

5. Deferred development costs:

In prior years, the Company deferred certain costs associated with the designing, testing and certifying the Company's potable water systems for specified aircraft models. Management believes that the market for these systems continue to represent a significant opportunity for the Company but sales volume has taken longer to materialize than anticipated. Accordingly, the Company has determined that previously capitalized costs should be written off as they no longer meet the criteria for deferral under Canadian generally accepted accounting principles. As a result, the Company has written off deferred costs in the amount of $3,786,834 as of September 30, 2004.

6. Factoring 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 US$350,000 (CDN$445,000). The facility allows the Company to sell accounts receivable on a with-recourse basis. The loan is reduced by the related accounts receivable when collected by the purchaser of the accounts receivable. The purchaser has the option to return accounts receivable purchased to the Company if amounts are not collected in a reasonable time period. As the Company retains significant risks relating to the accounts receivable sold, the accounts receivable remain in the Company's financial statements and the amounts advanced by the purchaser are recognized as a factoring loan. Outstanding amounts are repayable on demand, bear interest at 2.75% per month and are secured by accounts receivable and other assets of the Company. As at September 30, 2004, the Company has US$350,000 (CDN$449,500) outstanding under the credit facility (2003 - US$111,963 (CDN$151,150)).

7. Notes payable:

Effective January 1, 2003, the Company entered into an agreement with a contractor to whom it owed US$320,000 for services rendered. Under the agreement, the Company issued a promissory note, denominated in US dollars, with a term to June 15, 2004 as settlement for the amount owed. The promissory note bears interest at 5% per annum calculated monthly, increasing to 8% on any principal still unpaid after June 30, 2004, and provides for monthly payments as prescribed in the agreement commencing February 15, 2003. A late payment fee of 1.5% of the payment is charged if payments are not received as prescribed. For the year ended September 30, 2004, the Company only made US$70,000 (CDN$96,186) of the required payments of US$295,000 (CDN$336,650). The remaining balance of US$184,887 (CDN$239,958) plus accrued interest is the subject of re-negotiation with the Note holder. The promissory note is secured by a 10% interest in any sales revenue earned from certain of the Company's products.

On May 10, 2003, the Company issued an unsecured promissory note, denominated in US dollars, with a principal amount of US$380,000 (CDN$553,726) to reschedule the maturity date of a separate previous promissory note to a contractor and in settlement of other amounts payable for services rendered prior to April 1, 2003. The promissory note bears interest at 7% per annum calculated monthly, with principal repayment at US $3,500 per month until April 24, 2004 and then at US $5,000 thereafter, with the final payment due on September 30, 2005. The Company is required to pay additional monthly principal payments of 10% of revenue earned from certain of the Company's products. The noteholder has the option to convert 50% of the outstanding balance of the note into common shares of the Company subject to terms to be approved by the Company's Board of Directors and regulators. For the year ended September 30, 2004, the Company only made US$14,000 (CDN$18,900) of the required payments of US$42,000 (CDN$56,700). The remaining balance of US$387,888 (CDN$509,833) is the subject of re-negotiation with the Note holder. On issuance, no value was attributable to the conversion option, which was not material.

8. Loan payable:

During 2002, 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.

9. Share capital:

(a) Authorized:

100,000,000 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, 2002	14,921,194	$ 5,589,558
Issued during the year	-	-
Balance, September 30, 2003	14,921,194	5,589,558
Issued for cash in private placements of common shares, net of issue costs	3,000,000	501,355
Issued for cash on exercise of warrants	2,560,000	440,000
Balance, September 30, 2004	20,481,194	$ 6,530,913

On March 15, 2004, the Company completed a private placement of 3,000,000 common share units at a price of $0.18 per unit for gross proceeds of $540,000. Each unit consisted of one common share and one-half of a non-transferable purchase warrant. Each whole share purchase warrant entitles the holder to purchase a second share at $0.25 per share for a period of eighteen months.

(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, 2004, 551,982 common shares remain held under the revised escrow agreement.

9. Share capital (continued):

(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.

A summary of the status of the Company's stock option plan as at September 30, 2004 and 2003 and changes during the years ending on those dates is presented below:

	2004		2003	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding, beginning of year	1,820,000	$ 0.48	1,870,000	$ 0.50
Granted	1,820,000	0.13	110,000	0.20
Exercised	-	-	-	-
Cancelled or expired	(1,710,000)	(0.49)	(160,000)	(0.50)
Outstanding, end of year	1,930,000	$ 0.14	1,820,000	$ 0.48
Options exercisable, end of year	522,000	$ 0.18	1,710,000	$ 0.51

Stock options outstanding and exercisable at September 30, 2004:

Number of stock options outstanding	Options exercisable	Exercise price	Weighted average remaining contractual life
40,000	40,000	$0.64	3.5 months
100,000	80,000	0.20	18.0 months
580,000	160,000	0.18	31.0 months
1,210,000	242,000	0.10	34.0 months
1,930,000	522,000		28.3 months

Had compensation expense for stock options granted to employees in the year ended September 30, 2004 been determined using their fair values at the date of grant recognized straight-line over their vesting period, the Company's net loss and loss per share would have been $3,961,291 (2003 - $744,474) and $0.21 (2003 - $0.05), respectively.

The compensation expense was calculated using the Black-Scholes option pricing model assuming a weighted average risk-free interest rate of 3.55% (2003 - 3.40%), a dividend yield of 0.0%, a weighted average expected volatility of 99.8% (2003 - 104.9%) and expected life of stock options of three years. The weighted average grant date fair value of options granted during the year ended September 30, 2004 was $0.125 (2003 - $0.15).

9. Share capital (continued):

(e) Share purchase warrants:

On October 16, 2003, the exercise price of 2,000,000 warrants outstanding from the company's private placement of common share units in April 2004, was reduced from $0.75 to $0.15. These amendments were approved by the securities regulators. Subsequently, the 2,000,000 warrants were exercised at the amended price of $0.15 for proceeds of $300,000.

As at September 30, 2004, the Company had 940,000 share purchase warrants outstanding with an exercise price of $0.25 and expiring on September 16, 2005. These warrants were originally issued in conjunction with the private placement discussed in note 9(b). In May 2004, 560,000 of warrants issued with the private placement were exercised at $0.25 for proceeds of $140,000.

10. Related party transactions:

(a) Loan payable:

The shareholder loan consists of $250,000 of principal and accrued interest of $6,507. The loan is repayable on demand, bears interest at 10% per annum, is unsecured and matures on June 10, 2005.

(b) Other:

Included in accounts receivable is nil (2003 - $71,251) receivable from shareholders of the Company. Included in accounts payable and accrued liabilities is $37,450 (2003 - $10,438) payable to shareholders and companies controlled by directors of the Company. During the year, the Company paid $99,510 (2003 - $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.

11. 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, 2007, 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, 2004 totaled $120,886 (2003 - $92,928).

11. Contingencies and commitments (continued):

(a) Continued:

An agreement has also been entered into with the National Research Council Canada ("NRC/IRAP"), whereby NRC/IRAP assisted in the funding to further develop the Company's potable water systems for certain aircraft (C-PWSTM) in the amount of $495,000. As a condition of this agreement, the Company has agreed to pay NRC/IRAP a royalty of 2% of the Company's gross revenues earned each quarter from April 1, 2005 and until December 31, 2008, or if the royalty payments to that date do not equal the maximum of $742,500 payable, then until total payments of $742,500 or the date of April 1, 2014 is reached.

(b) The Company entered into a long-term operating lease for premises expiring October 31, 2009. However, the Company has given written notice under the lease agreement, to terminate the lease as of May 31, 2005. The Company has accrued a $15,000 lease termination fee and has written down the carrying value of leasehold improvements by $47,478. The Company also has several equipment leases expiring at various dates to 2008. The future annual lease payments, exclusive of property taxes and expenses directly payable by the Company:

2005	$ 84,489
2006	17,834
2007	9,699
2008	5,397
2009	-
	$ 117,419

12. Income taxes:

Income tax recovery attributable to losses differs from the amounts computed by applying the combined Canadian federal and provincial income tax rate of 35.62% (2003 - 37.62%) to loss before income taxes as follows:

	2004	2003
Net loss before income taxes	$ (3,934,835)	$ (727,974)
Expected income tax recovery	$ (1,401,588)	$ (273,864)
Tax effect of:		
Expired losses	222,813	181,039
Change in valuation allowance	1,191,122	78,824
Change in tax rates and other	(12,347)	14,001
Income tax recovery	$ -	$ -

12. Income taxes (continued):

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

	2004	2003
Future income tax assets:		
Non-capital losses carried forward	$ 1,815,197	$ 1,715,288
Furniture and equipment, undepreciated tax costs in excess of net book value	115,702	92,110
Research and development and investment tax credits	150,946	109,249
Accrued liabilities	5,343	-
Total gross future income tax assets	2,087,188	1,916,647
Valuation allowance	(2,087,188)	(896,066)
Net future income tax assets	-	1,020,581
Future income tax liabilities:		
Deferred development costs	-	(1,020,581)
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, 2004, 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 $5,096,000 which will expire at various dates through 2011. The Company also has Scientific Research and Development expenditures of approximately $424,000 which are available to offset taxable income indefinitely.

13. Investment in joint venture:

The Company had 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 was to develop, manufacture, sell and service water treatment products for industrial and commercial use and consumption in China. No activities occurred in fiscal 2004 and none are contemplated in the future. During fiscal 2003, the Company and its joint venture partner suspended active pursuit of its business plan for China. Accordingly, the Company recorded a provision of $161,840 to write down the Company's proportionate share of the joint venture assets and deferred costs to zero.

14. Financial instruments:

(a) Fair values:

As at September 30, 2004, the fair value of the notes and loan payable is not considered by management to be materially different from their carrying value, apart from the potential of settlement of such notes at a discount should current negotiations to settle repayment of the notes succeed. The fair value of the shareholder loans is not determinable with sufficient reliability due to the related party nature of the amount and the lack of an available market for such instruments. Financial instruments also include 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, 2004, six customers (2003 - six) represented approximately 87% (2003 - 72%) of accounts receivable. The Company mitigates credit risk through regular credit assessment and collection policies.

(c) Currency risk:

At September 30, 2004, approximately 88% (2003 - 77%) of accounts receivable and 41% (2003 - 30%) of liabilities are denominated in United States dollars. In addition, the notes payable (note 6) are repayable in United States dollars. The Company has not entered into foreign exchange contracts to hedge against gains or losses from foreign exchange fluctuations.

15. Government assistance:

In fiscal 2004, the Company received government assistance totalling $1,473 (2003 - $40,409) of which $1,473 (2003 - $35,300) was included in results from operations as a reduction of research and development expenses and nil (2003 - $5,109) was included as a reduction of deferred aviation system design costs.

16. 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 2004, sales to six customers (2003 - six customers) represent approximately 75% (2003 - 72%) of total revenue. 100% of the Company's furniture and equipment are located in Canada. In 2004, approximately 45% (2003 - 35%) of sales revenue was generated by customers in Canada and 55% (2003 - 65%) by customers in other countries, primarily the United States.

17. Subsequent event:

On November 5, 2004, the Company accepted a proposal for the sale of the Company's assets related to its Industrial and Commercial products and services. The offer is subject to satisfactory completion of due diligence by the offeror. Revenue associated with this portion of the Company's business for the year ended September 30, 2004 is approximately $488,000 (2003 - $639,000). The carrying value of assets to be sold, consisting primarily of inventory, is approximately $152,000 as at September 30, 2004.

CORPORATE INFORMATION

DIRECTORS AND OFFICERS

John (J.D.) Lawson
Chairman and Director

David C. Fox
President, CEO, and Director

C.W. (Bill) Coote
Director

Bruce W. Gowan
Director

Kennith A. Mellquist
Director

Ryaz Z. Shariff
Director

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 Thursday, March 17, 2005, at the Sutton Place Hotel, 845 Burrard Street, Vancouver, BC.

CAPITAL STRUCTURE
(as at February 1, 2005)

Authorized:	100,000,000 Common Shares
	5,000,000 Preference Shares
Issued:	20,481,194 Common Shares

STOCK EXCHANGE

TSX Venture Exchange
Trading Symbol: "IWG"

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