

Interim Financial Statements of

**INTERNATIONAL WATER-GUARD
INDUSTRIES INC.**

Six months ended March 31, 2005 and 2004

Interim Financial Statements of

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notice of no auditor review of interim financial statements to March 31, 2005

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor. In this respect:

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.
BALANCE SHEETS

	March 31 <u>2005</u>	September 30 <u>2004</u>
ASSETS		
Current assets:		
Cash	\$ 88,707	\$ 64,836
Accounts receivable	395,077	\$ 592,467
Inventory	232,451	423,626
Prepaid expenses	<u>5,528</u>	<u>5,529</u>
	721,763	1,086,458
 Furniture and equipment	 <u>26,770</u>	 <u>75,586</u>
	 <u>\$ 748,533</u>	 <u>\$ 1,162,044</u>
 LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 431,236	\$ 1,018,965
Factoring loan	240,000	449,500
Shareholder loan	268,537	256,507
Current portion of notes payable	<u>291,501</u>	<u>731,571</u>
	1,231,274	2,456,543
 Loan payable	 <u>29,021</u>	 <u>29,021</u>
 Shareholders' equity		
Share capital	6,530,913	6,530,913
Deficit	<u>(7,042,675)</u>	<u>(7,854,433)</u>
	<u>(511,762)</u>	<u>(1,323,520)</u>
	 <u>\$ 748,533</u>	 <u>\$ 1,162,044</u>

These financial statements have been prepared by management and are unaudited.
See accompanying notes to financial statements.

On behalf of the Board:

"J. D. Lawson" Director

"D. C. Fox" Director

INTERNATIONAL WATER-GUARD INDUSTRIES INC.
STATEMENTS OF OPERATIONS AND DEFICIT
Six months ended March 31

	Three months ended March 31		Six months ended March 31	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Sales	\$ 824,778	\$ 791,588	\$ 1,595,727	\$ 1,955,035
Cost of goods sold	<u>301,252</u>	<u>271,210</u>	<u>570,923</u>	<u>763,661</u>
Gross profit	<u>523,526</u>	<u>520,378</u>	<u>1,024,804</u>	<u>1,191,374</u>
Expenses:				
Selling expenses	84,031	86,126	157,360	180,543
Research & development	107,358	72,569	199,310	161,137
General, administrative and occupancy	237,634	296,075	483,643	564,002
Interest & bank charges	46,047	54,216	98,421	86,340
Amortization	<u>7,025</u>	<u>7,114</u>	<u>14,049</u>	<u>104,228</u>
	<u>482,095</u>	<u>516,100</u>	<u>952,783</u>	<u>1,096,250</u>
Earnings before special gains or write downs	41,431	4,278	72,021	95,124
Gains on settlement of Notes and accounts payable	590,674		590,674	
Gain on sale of commercial division's assets over book value	164,063		164,063	
Write-down of furniture and equipment	<u>(15,000)</u>	<u>-</u>	<u>(15,000)</u>	<u>-</u>
Net earnings for the period	781,168	4,278	811,758	95,124
Deficit, beginning of period	<u>7,823,843</u>	<u>3,828,752</u>	<u>7,854,433</u>	<u>3,919,598</u>
Deficit, end of period	<u>\$ 7,042,675</u>	<u>\$ 3,824,474</u>	<u>\$ 7,042,675</u>	<u>\$ 3,824,474</u>
Earnings per share amounts (note 6)				
Basic	<u>\$ 0.04</u>	<u>\$ -</u>	<u>\$ 0.04</u>	<u>\$ 0.01</u>
Diluted	<u>\$ 0.04</u>	<u>\$ -</u>	<u>\$ 0.04</u>	<u>\$ 0.01</u>

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See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

STATEMENTS OF CASH FLOWS

Six months ended March 31

	Three months ended March 31		Six months ended March 31	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Cash flows from (used by):				
Operating activities:				
Net earnings (loss) for the period	\$ 781,168	\$ 4,278	\$ 811,758	\$ 95,124
Items not involving cash -				
Gain on settlement of Notes and other liabilities	(590,674)		(590,674)	
Book value of assets sold	135,937		135,937	
Unrealized foreign exchange gains	(6,036)		(28,036)	
Interest accrued	15,447		34,961	
Amortization and equipment write-down	<u>22,025</u>	<u>7,114</u>	<u>29,049</u>	<u>104,228</u>
	357,867	11,392	392,995	199,352
Changes in non-cash operating working capital:				
Accounts receivable	(22,835)	(116,194)	177,390	(247,377)
Inventory	27,558	(54,370)	95,953	(2,704)
Prepaid expenses	-	-	1	1
Accounts payable and accrued liabilities	(289,880)	(164,681)	(398,687)	(150,946)
Customer deposits	<u>-</u>	<u>(6,792)</u>	<u>-</u>	<u>(151,999)</u>
Cash flow from operations	<u>72,710</u>	<u>(330,645)</u>	<u>267,652</u>	<u>(353,673)</u>
Investing activities:				
Sale (purchase) of equipment and furniture	(530)	(764)	(948)	(922)
Deferred development costs	<u>-</u>	<u>(396,397)</u>	<u>-</u>	<u>(569,959)</u>
	(530)	(397,161)	(948)	(570,881)
Financing activities:				
Proceeds (repayment) of demand loan	(49,000)	134,600	(209,500)	195,950
Proceeds (repayment) of note and loan payable	(33,333)	(26,996)	(33,333)	(104,068)
Issue of common shares for cash	<u>-</u>	<u>507,795</u>	<u>-</u>	<u>807,795</u>
	<u>(82,333)</u>	<u>615,399</u>	<u>(242,833)</u>	<u>899,677</u>
Increase (decrease) in cash	(10,153)	(112,407)	23,871	(24,877)
Cash (bank indebtedness) beginning of period	<u>98,860</u>	<u>39,342</u>	<u>64,836</u>	<u>(48,188)</u>
Cash (bank indebtedness) end of period	<u>\$ 88,707</u>	<u>\$ (73,065)</u>	<u>\$ 88,707</u>	<u>\$ (73,065)</u>
Supplementary information				
Interest paid	\$ 8,607	\$ 40,861	\$ 8,607	\$ 60,213
Taxes paid	\$ -	\$ -	\$ -	\$ -

These financial statements have been prepared by management and are unaudited.
See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

STATEMENTS OF COST OF GOODS SOLD

Six months ended March 31

	Three months ended March 31		Six months ended March 31	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Opening inventory	\$ 355,231	\$ 579,148	\$ 423,626	\$ 630,814
Manufacturing costs:				
Materials	84,170	211,630	199,731	541,995
Direct labour, freight and other	<u>94,302</u>	<u>113,950</u>	<u>180,017</u>	<u>224,370</u>
Cost of goods available for sale	533,703	904,728	803,374	1,397,179
Closing inventory	<u>232,451</u>	<u>633,518</u>	<u>232,451</u>	<u>633,518</u>
Cost of goods sold	<u>\$ 301,252</u>	<u>\$ 271,210</u>	<u>\$ 570,923</u>	<u>\$ 763,661</u>

These financial statements have been prepared by management and are unaudited.
See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notes to Interim Financial Statements, March 31, 2005

1. Significant accounting policies:

These interim statements are prepared in a manner consistent with the accounting policies and methods applicable to the Company's audited annual financial statements. However, these interim financial statements do not include all disclosure in notes normally provided in annual financial statements, consequently this report should be read in conjunction with the Company's audited financial statements for the year ended September 30, 2004.

In management's opinion, the unaudited financial information includes all normal adjustments necessarily to present fairly such information. Interim results are not necessarily indicative of the results expected for the fiscal year.

2. Unusual items:

a) Negotiation of settlement terms for notes payable to the Company's largest creditors and significant other suppliers resulted in net gains of \$590,674 in the second quarter, representing a major portion of an improvement in negative working capital from -\$1,370,085 at September 30, 2004, to -\$509,511. The settlement with one note-holder included the issue of 225,000 common shares valued at \$0.08 per share. The completion of a private placement on May 5 2005 (see subsequent events below) places the Company in both a positive working capital and shareholders equity position.

b) In addition, on February 10th, 2005, the Company completed the closing of the sale for cash of its commercial and industrial business and assets to Violetta Industries Ltd. The Company has recorded a gain over the book value of the assets sold of \$164,063 in the quarterly results. During 2004, the Company had indicated that it was seeking a suitable buyer for its commercial and industrial business so as to concentrate solely on the Company's aviation business. Sales of this division in fiscal 2004 were \$488,000 representing 14% of the Company's sales.

3. Share capital:

a) Authorized capital of the Company as at March 31, 2005 included 100,000,000 common shares and 5,000,000 preferred shares of which 20,481,194 common shares and no preferred shares were issued and outstanding. All common shares subject to an escrow agreement, approved by the TSX Venture Exchange, have now been released from escrow as of February 26, 2005. The private placement noted below increased the outstanding common shares to 33,278,194. This private placement also included 320,000 finder's warrants exercisable at \$0.10 each for one year after closing. All shares issued under the private placement have a hold period of four months.

b) Under the Company's stock option plan, there were 1,790,000 options outstanding as of March 31, 2005 of which 1,360,000 are exercisable and 430,000 have not yet vested. These options, held by directors, officers, and employees, are exercisable at \$0.20 as to 100,000 options until April 8, 2006; at \$0.18 as to 580,000 options until May 3, 2007; at \$0.10 as to 1,040,000 options until July 30, 2007; and at \$0.08 as to 70,000 options until March 17, 2008.

c) Warrants to purchase 940,000 common shares at \$0.25 per share were outstanding as at March 31, 2005. These warrants originally issued in conjunction with the private placement of common share units in March 2004 expire on September 16, 2005. In addition, under the private placement completed on May 5th, finder's warrants to purchase 320,000 common shares, exercisable at \$0.10 each, were issued of which 247,500 expire on April 29, 2006 and 72,500 expire on May 4, 2006.

4 Subsequent events:

- a) On April 19th the Company entered into a lease agreement for new operating premises effective for five years, plus a renewal option, commencing June 1, 2005, coincident with the expiry of its existing premises. Obligations under the lease agreement aggregate \$ 93,600 during the first year and aggregate \$503,100 during the term of the lease. Other contractual obligations of the Company are unchanged from those described within the notes to the audited financial statements.

- b) The Company announced on March 23, 2005 that it was proceeding with the private placement of common shares at \$0.08 per share. Subsequent to the end of the second quarter, on May 5, 2005, the Company completed the private placement of 12,572,000 common shares at \$0.08 per share for gross proceeds of \$1,005,760.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

**MANAGEMENT'S DISCUSSION
AND ANALYSIS**

Second Quarter Ended

March 31, 2005

dated: May 6, 2005

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS Second Quarter to March 31, 2005

Overview

Comments in this analysis should be read in conjunction with the comparative interim financial statements for the three months ended March 31 2005. 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.

Operating results

The Company reported sales during the second quarter in fiscal 2005 of \$824,728, an increase of 4% above the previous year. Six-month sales to March 31st were \$1,595,727 compared to \$1,955,035 in the prior year, which included the delivery of three aircraft circulating potable water systems. Second quarter earnings before special items were \$41,431 compared to earnings of \$4,278 in the prior year's second quarter, while six-month earnings before special items were \$72,021 compared to \$95,124 a year earlier..

During this second quarter to March 31st, the Company recorded special one-time gains of \$739,737 that increased net earnings for the quarter to \$781,168 and to \$811,758 year to date. These special items included gains from settlement agreements related to certain of the Company's Noteholders and major suppliers, aggregating \$590,674; a book gain of \$164,063 on the sale of the Company's commercial business and assets; less a \$15,000 write-down of equipments and furniture in preparation of a move to new premises in June 2005.

The results for the quarter report \$0.04 earnings per share in the current quarter (\$0.04 year to date) compared to earnings of nil per share in the prior year (\$0.01 year to date) on both a basic and fully diluted basis.

Sales

Aviation Products:

Sales of aviation water treatment equipment and parts have continues to increase on a quarter to quarter basis compared to the prior year, showing 12% growth for Q1 and 31% year to date. As noted above, total aviation sales decreased by 16% for the six months since included in prior year first quarter sales was the delivery of three aircraft circulating potable water systems, Sales

of aviation products during the first quarter ended March 31, 2005 was \$733,538 and for the six month period, \$1,395,579.

Industrial Products:

Industrial sales of \$91,240 during this quarter, prior to the date of sale of this division on February 10th, represented 11% of current quarter sales, a decrease of 33% from the prior year's second quarter. The company's previously announced intention to seek a buyer for this division's business and assets has been concluded with the closing of a sale agreement on February 10th.

Direct sales margins

The dollar value of overall direct sales margins increased marginally above the same quarter of a year earlier due to higher sales. Margin rates have not changed significantly year to year.

Operating expenses

Selling expenses of \$84,031 for this quarter were 2% less than in for the comparable period in the prior year, and 13% less on a year-to-date basis. These decreases were due principally to a short-term reduction in travel and sales personnel during the periods.

Engineering and product development expenses of \$107,358 in the second quarter increased by 48% above the prior year (increased 24% year-to-date), when some engineering costs were deferred.

General, administration, information technology and occupancy expenses totaled \$237,634, a 20% decrease from the same quarter in the prior year, and a 14% reduction year-to-date. These decreases were primarily attributed to decreased consulting fees incurred in these periods.

Capital expenditures

Capital expenditures incurred by the company for plant or equipment were not significant in the current quarter results.

Quarterly information

The following summary information is taken from the Company's quarterly and annual financial reports covering the last eight reporting quarters.

Quarterly Results Reported for: (\$000's except per share amounts)

	Fiscal 2005		Fiscal year 2004				Fiscal year 2003	
	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30
Sales	\$825	\$771	\$753	\$934	\$791	\$1,163	\$860	\$734
Earnings (loss) from operations, before write-downs	41	31	(34)	(162)	4	91	(226)	(123)
Gains on debt settlements and asset sales, and Write down of deferred and other assets	755 (15)	0	(3,834)	0	0	0	(162)	0
Net income (loss)	\$781	\$ 31	\$(3,868)	\$(162)	4	91	(388)	(123)
Earnings (loss) per share, basic and fully diluted	\$0.04	\$0.00	\$(0.21)	\$(0.01)	\$(0.00)	\$0.01	\$(0.03)	\$(0.01)

Fluctuations in sales from quarter to quarter, where significant, were mainly related to the delivery of the Company's C-PWS™. 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.

Liquidity and capital resources

Cash flow from operations:

Cash provided from operating activities, before non-cash operating working capital, was \$357,867 in the current quarter (\$392,995 year to date) compared to \$11,392 in the same quarter of the prior year (\$199,392 in the prior year to date). Ongoing operations provided a positive cash flow in all periods. The major cash inflow during the second quarter, was \$300,000 in proceeds from the sale of the Company's industrial / commercial business. A reduction in operating liabilities, less a reduction of assets, utilized \$285,157 of cash flow during the quarter (\$125,343 year to date).

Cash usage for capital investments:

During the current year-to-date, the Company did not incur any aircraft water systems (C-PWS™) design and certification costs. This compares to the prior year second quarter when \$396,397 (or \$569,959 year-to-date) was incurred as the Company was completing the design and certification its A310 and BBJ C-PWS™. Investment in equipment has not been material in any period being reported.

Cash flow from financing activities:

A repayment of advances of \$49,000 in the second quarter (\$209,500 year to date) were made under the Company's credit line, to a factoring company.

Working capital position:

The Company completed its second quarter ended March 31, 2005 with \$509,511 in negative working capital, a significant improvement on \$1,370,085 at its fiscal year end. This decrease

was primarily attributed to receipt of proceeds from the sale of the Company's Industrial & Commercial business and assets; the discount on settlement of supplier Notes and other debts; and improved cash flow during the period. On March 23rd, the Company announced a private placement of equity financing, which financing was completed for \$1,005,760 on May 5, 2005. This financing has overcome its negative working capital position.

Contractual obligations

A new five year premises lease agreement has been entered into by the Company effective with the termination of its previous lease on June 1st, 2005, and at financial terms similar to that of the prior lease. The Company's other contractual obligations have not changed from that stated in its audited financial statements and MD&A for the fiscal year ended September 30, 2004.

Share capital

The Company has 33,278,194 common shares outstanding as at the date of this report. This number includes the 12,572,000 shares issued in the private placement of shares completed on May 5, 2005. In addition, there were 1,760,000 options outstanding under the Company's stock option plan and 1,260,000 warrants outstanding related to private placements of common shares in March 2004 and in May 2005. Details of these options and warrants are included in the notes to the financial statements.

Related party transactions

A shareholder loan and accrued interest, in total \$270,728, was repaid from the proceeds of the private placement of shares. The loan, repayable on demand, with interest at 10% per annum, was to mature on June 10, 2005.

Included in accounts payable are \$33,705 owed to a company controlled by a director of the Company for provision of services. During the period, \$7,490 was paid to such company. The services provided were in the normal course of business and valued at amounts agreed to the parties.

Risks and Uncertainties

IWG recognizes that certain risks are inherent in its business plan:

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.

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. 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 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. 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

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 annual audited 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 in recent periods, 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

During the second quarter important milestones were achieved in stabilizing the company's financial situation. This provides a base on which the company can continue its growth in the aviation market. Continuing growth may require additional capital beyond that generated from operations.

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 has emerged from its post 9/11 turndown, and potable water quality is being perceived as an increasingly important issue, as evidenced by recent EPA reports.

International Water-Guard Industries, historically a developer of UV-based water treatment equipment for several niche markets has become a primary supplier of engineered water treatment units and systems for the aviation market. IWG's goal is to significantly grow its business as a provider of water systems and disinfection units to the aviation industry.

Other information

Additional information relating to the Company is available under the Company's name on SEDAR at www.sedar.com.