

Interim Financial Statements of

**INTERNATIONAL WATER-GUARD
INDUSTRIES INC.**

Nine months ended June 30, 2005 and 2004

Interim Financial Statements of

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

Notice of no auditor review of interim financial statements to June 30, 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

	June 30 <u>2005</u>	September 30 <u>2004</u>
ASSETS		
Current assets:		
Cash	\$ 146,534	\$ 64,836
Accounts receivable	450,739	\$ 592,467
Inventory	259,862	423,626
Prepaid expenses	<u>27,822</u>	<u>5,529</u>
	884,957	1,086,458
 Furniture and equipment	 <u>31,279</u>	 <u>75,586</u>
	 <u>\$ 916,236</u>	 <u>\$ 1,162,044</u>
 LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 241,367	\$ 1,018,965
Factoring loan	124,000	449,500
Shareholder loan	-	256,507
Current portion of notes payable	<u>4,146</u>	<u>731,571</u>
	369,513	2,456,543
 Loan payable	 <u>29,021</u>	 <u>29,021</u>
 Shareholders' equity		
Share capital	7,508,059	6,530,913
Deficit	<u>(6,990,357)</u>	<u>(7,854,433)</u>
	517,702	(1,323,520)
	 <u>\$ 916,236</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
Nine months ended June 30th

	Three months ended June 30		Nine months ended June 30	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Sales	\$ 723,342	\$ 934,029	\$ 2,319,068	\$ 2,889,063
Cost of goods sold	<u>256,750</u>	<u>492,133</u>	<u>827,673</u>	<u>1,255,793</u>
Gross profit	<u>466,592</u>	<u>441,896</u>	<u>1,491,395</u>	<u>1,633,270</u>
Expenses:				
Selling expenses	87,832	77,543	245,192	258,085
Research & development	93,458	71,433	292,768	232,570
General, administrative and occupancy	209,321	334,797	692,963	898,799
Interest & bank charges	32,490	48,300	130,910	134,641
Amortization	<u>1,950</u>	<u>72,114</u>	<u>16,000</u>	<u>176,342</u>
	<u>425,051</u>	<u>604,187</u>	<u>1,377,833</u>	<u>1,700,437</u>
Earnings before special gains or write downs	41,541	(162,291)	113,562	(67,167)
Gains on settlement of Notes and accounts payable	10,777		601,451	
Gain on sale of commercial division			164,063	
Write-down of furniture and equipment	<u>-</u>	<u>-</u>	<u>(15,000)</u>	<u>-</u>
Net earnings (loss) for the period	52,318	(162,291)	864,076	(67,167)
Deficit, beginning of period	<u>7,042,675</u>	<u>3,824,474</u>	<u>7,854,433</u>	<u>3,919,598</u>
Deficit, end of period	<u>\$ 6,990,357</u>	<u>\$ 3,986,765</u>	<u>\$ 6,990,357</u>	<u>\$ 3,986,765</u>
Earnings per share amounts (note 6)				
Basic	\$ -	\$ (0.01)	\$ 0.04	\$ -
Diluted	\$ -	\$ (0.01)	\$ 0.04	\$ -

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See accompanying notes to financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

STATEMENTS OF CASH FLOWS

Nine months ended June 30

	Three months ended June 30		Nine months ended June 30	
	<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	\$ 52,318	\$ (162,291)	\$ 864,076	\$ (67,167)
Items not involving cash -				
Gain on settlement of Notes and other liabilities	(10,777)		(601,451)	
Book value of assets sold	-		135,937	
Unrealized foreign exchange gains	-		(28,036)	
Interest accrued	2,192		37,153	
Amortization and equipment write-down	1,950	72,114	31,000	176,342
	<u>45,683</u>	<u>(90,177)</u>	<u>438,679</u>	<u>109,175</u>
Changes in non-cash operating working capital:				
Accounts receivable	(55,662)	190,850	121,728	(56,527)
Inventory	(27,411)	211,507	68,542	208,803
Prepaid expenses	(22,294)	-	(22,293)	1
Accounts payable and accrued liabilities	(179,090)	293,094	(577,779)	142,148
Customer deposits	-	(196,258)	-	(348,257)
Cash flow from operations	<u>(238,774)</u>	<u>409,016</u>	<u>28,877</u>	<u>55,343</u>
Investing activities:				
Sale (purchase) of equipment and furniture	(6,461)	(285)	(7,408)	(1,207)
Deferred development costs	-	(481,848)	-	(1,051,807)
	<u>(6,461)</u>	<u>(482,133)</u>	<u>(7,408)</u>	<u>(1,053,014)</u>
Financing activities:				
Proceeds (repayment) of factoring loan	(116,000)	(101,100)	(325,500)	94,850
Proceeds (repayment) of note and loan payable	(283,577)	144,928	(316,910)	40,860
Issue of common shares for cash	702,639	133,560	702,639	941,355
	<u>303,062</u>	<u>177,388</u>	<u>60,229</u>	<u>1,077,065</u>
Increase in cash	57,827	104,271	81,698	79,394
Cash (bank indebtedness) beginning of period	<u>88,707</u>	<u>(73,065)</u>	<u>64,836</u>	<u>(48,188)</u>
Cash end of period	<u>\$ 146,534</u>	<u>\$ 31,206</u>	<u>\$ 146,534</u>	<u>\$ 31,206</u>
Supplementary information				
Interest paid	\$ 29,768	\$ 34,875	\$ 92,791	\$ 99,689
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

Nine months ended June 30th

	Three months ended June 30		Nine months ended June 30	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Opening inventory	\$ 355,231	\$ 633,518	\$ 423,626	\$ 630,814
Manufacturing costs:				
Materials	82,954	172,186	405,463	713,754
Direct labour, freight and other	<u>78,427</u>	<u>108,440</u>	<u>258,446</u>	<u>333,236</u>
Cost of goods available for sale	516,612	914,144	1,087,535	1,677,804
Closing inventory	<u>259,862</u>	<u>422,011</u>	<u>259,862</u>	<u>422,011</u>
Cost of goods sold	<u>\$ 256,750</u>	<u>\$ 492,133</u>	<u>\$ 827,673</u>	<u>\$ 1,255,793</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, June 30, 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 and a further \$10,777 in the third quarter. The settlement with one note-holder included the issue in April of 225,000 common shares valued at \$0.08 per share.

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 second quarter 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.

c) The completion of a private placement of common shares on May 5 2005 (see note 3 (b) below), together with the debt settlements and sale of the commercial and industrial division, provided the majority of an improvement in negative working capital from (\$1,370,085) at September 30, 2004, to positive working capital of \$515,444 at June 30th, 2005. Further, it also places the Company in a positive shareholder's equity position.

3. Share capital:

a) Authorized capital of the Company as at June 30, 2005 included 100,000,000 common shares and 5,000,000 preferred shares of which 33,302,194 common shares and no preferred shares were issued and outstanding. All common shares subject to an escrow agreement, approved by the TSX Venture Exchange, were released from escrow as of February 26, 2005

b) Included in the issued common shares noted above are 12,572,000 common shares issued under a private placement on May 5, 2005 at \$0.08 per share, for gross proceeds of \$1,005,760. All shares issued under the private placement have a hold period of four months.

c) Under the Company's stock option plan, there were 2,200,000 options outstanding as of June 30, 2005 of which 1,400,000 are exercisable and 800,000 have not yet vested. These options, held by directors, officers, and employees, are exercisable at \$0.20 as to 100,000 options until April 6, 2006; at \$0.18 as to 580,000 options until May 3, 2007; at \$0.10 as to 990,000 options until July 30, 2007; at \$0.08 as to 70,000 options until March 17, 2008, and at \$0.115 as to 460,000 options until June 10, 2008.

d) Warrants to purchase 1,260,000 common shares were outstanding as at June 30, 2005. This number includes 940,000 warrants exercisable at \$0.25, originally issued in conjunction with the private placement of common share units in March 2004, and 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 Commitments:

a) The Company has entered into a lease commitment agreement for new operating premises effective for five and one-half years, plus a renewal option, commencing June 1, 2005, coincident with the expiry of its existing premises. Obligations under the lease agreement for rentals, taxes and operating costs aggregate \$ 112,515 during the first year and aggregate \$778,050 during the term of the lease.

b) Other contractual obligations of the Company are unchanged from those described within the notes to the audited financial statements.

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

**MANAGEMENT'S DISCUSSION
AND ANALYSIS**

Third Quarter Ended

June 30, 2005

dated: August 12, 2005

INTERNATIONAL WATER-GUARD INDUSTRIES INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Third Quarter to June 30, 2005

Overview

Comments in this analysis should be read in conjunction with the comparative interim financial statements for the three months ended June 30 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.

Operating results

The Company reported sales during the third quarter in fiscal 2005 of \$723,342. Third quarter earnings before special items were \$41,541 compared to a loss of (\$162,291) in the prior year's third quarter.

Nine-month sales to June 30th were \$2,319,068 compared to \$2,889,063 in the prior year. Prior year 3rd quarter sales included the delivery of two aircraft circulating potable water systems, with five such systems delivered in the prior year nine month period. Sales volume for the third quarter decreased of 23% from the previous year due to the impact of aircraft water systems sales, while nine-month earnings before special items were \$113,562 compared to a loss of (\$67,167) a year earlier.

During the third quarter to June 30th, the Company recorded special one-time gains of \$10,777, totaling \$750,514 year-to-date, that increased net earnings for the quarter to \$52,318 and to \$864,076 year to date. These special items for the nine months included gains from settlement agreements related to certain of the Company's Noteholders and major suppliers, aggregating \$601,451; a book gain of \$164,063 on the sale of the Company's commercial business and assets; less a \$15,000 write-down of equipment and furniture in advance of the move to new premises in June 2005.

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

Sales

Aviation Products:

Sales of aviation water treatment equipment and parts continues to increase on a quarter to quarter basis compared to the prior year, showing 40% growth for Q3 and 37% year to date. In the prior year, five aircraft circulating potable water systems were delivered against specific contracts in the first nine months, hence total aviation sales show a decrease of 16%. Sales of

aviation products during the third quarter ended June 30, 2005 were \$723,342 and for the nine month period, \$2,119,266.

Industrial Products:

Industrial sales included in the nine-month results were \$199,802 during the 4 ½ months to the date of the sale of this division on February 10th. This total compares to \$374,200 for the full nine-month period in the prior year.

Direct sales margins

Margin rates on equipment and parts sales have not changed significantly year to year. However, margin rates on total sales increased in the current year for both the current quarter and for the year to date, because prior year sales for these periods included special aviation water system sales with lower margins.

Operating expenses

Selling expenses of \$87,832 for this quarter increased 13% over the comparable period expenses in the prior year, although decreasing by 5% on a year-to-date basis. The current period increase arose from more emphasis on travel to customers and trade-show costs, offset in the earlier part of the year principally to a short-term reduction in travel and sales personnel.

Engineering and product development expenses of \$93,458 in the third quarter increased by 31% above the prior year (increasing 26% year-to-date), due to increased product improvements in the current period and expensing rather than deferring engineering costs.

General, administration, information technology and occupancy expenses totaled \$209,321, a 37% decrease from the same quarter in the prior year, and a 23% reduction year-to-date. These decreases were primarily attributed to decreased consulting fees, legal and other costs 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 year 2005			Fiscal year 2004			Fiscal 2003	
	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30
Sales	\$723	\$825	\$771	\$753	\$934	\$791	\$1,163	\$860
Earnings (loss) from operations, before gains & write-downs	42	41	31	(34)	(162)	4	91	(226)
Gains on debt settlements and asset sales	10	755						
Write down of deferred and other assets		(15)	0	(3,834)	0	0	0	(162)
Net income (loss)	\$52	\$781	\$ 31	\$(3,868)	\$(162)	4	91	(388)
Earnings (loss) per share, basic and fully diluted	\$0.00	\$0.04	\$0.00	\$(0.21)	\$(0.01)	\$(0.00)	\$0.01	\$(0.03)

Any significant fluctuations in sales from quarter to quarter 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 \$45,683 in the current quarter (\$438,679 year to date) compared to \$90,177 cash utilized in the same quarter of the prior year (\$109,175 provided in the prior year to date). 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 combined with increases in operating assets, utilized \$284,457 of cash flow during the quarter (\$409,802 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 \$481,848 (or \$1,051,807 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 \$116,000 in the third quarter, \$325,500 year to date, were made under the Company's credit line, to a factoring company, to utilize a portion of the company's cash reserves at June 30th. The available credit line may be drawn down as required.

Working capital position:

The Company completed its third quarter ended June 30, 2005 with working capital of \$515,444, a significant improvement from the negative position of -\$1,370,085 at its fiscal year end. This improvement of \$1,885,529 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; a private placement of equity financing for \$1,005,760 completed on May 5, 2005; and improved cash flow during the periods.

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 33,302,194 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 2,200,000 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 applied to the private placement of shares. The loan, repayable on demand, with interest at 10% per annum, was to mature on June 10, 2005.

During the third quarter, \$33,705 was paid to a company controlled by a director of the Company for provision of services. The services provided during prior periods, 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 and third quarters, 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.