

### International Water-Guard Industries Inc. (TSX-V: IWG) – Well positioned for the downturn

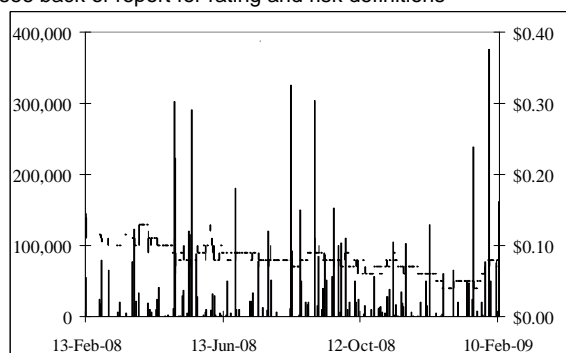
Sector/Industry: Aerospace Products and Services

[www.water.aero](http://www.water.aero)

#### Market Data (as of February 17, 2009)

Current Price	C\$0.08
Fair Value	C\$0.30 (↓)
Rating*	BUY
Risk*	3 (Average)
52 Week Range	C\$0.04 – C\$0.13
Shares O/S	39,340,694
Market Cap	C\$3.15 mm
Current Yield	N/A
P/E (forward)	12.12
P/B	1.27
YoY Return	-30.4%
YoY TSX-V	-64.2%

\*see back of report for rating and risk definitions



#### Q1-2009 Highlights

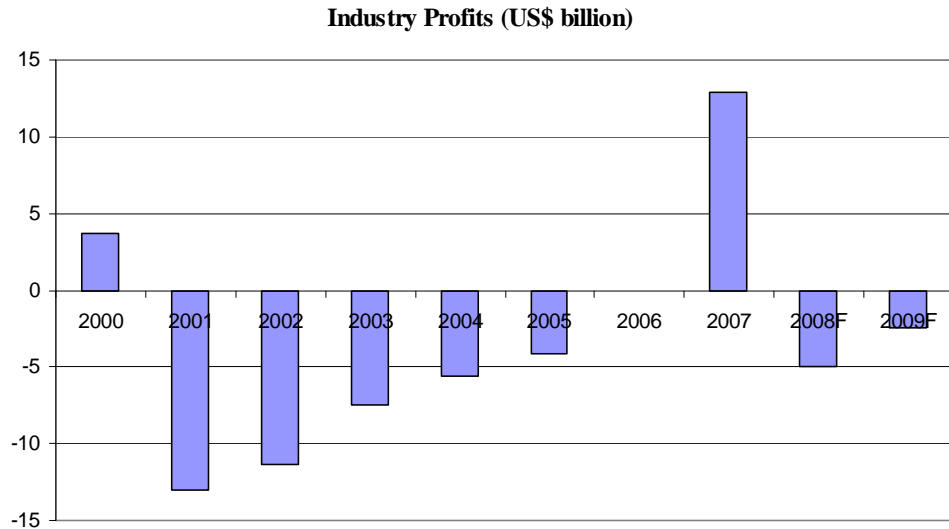
- The global airline industry was poised to post profits through the rest of the decade. However, the global financial crisis and economic slowdown, offset by a steep drop in oil prices, have dramatically changed the near-term outlook of the airline industry, and the business aircraft sector.
- On a positive note, the industry's large order backlog at the end of 2008, we believe, will support near-term momentum, and as a result, 2009 deliveries are expected to remain flat. However, we believe, 2010, and 2011, will be very challenging years for the industry as we expect a significant drop in orders in the near-term.
- We have maintained our positive long-term outlook on the industry primarily because of strong long-term traffic growth, and aircraft delivery forecasts.
- The company reported strong growth in revenues and gross margins in Q1-2009.
- IWG's sound cash position, low debt levels, positive free cash flows, and strong fundamentals, we believe, will see it through the downturn.

(C\$)	2006	2007	2008	2009E	2010E
Revenue	3,662,460	4,484,903	4,156,469	5,263,393	4,673,384
Gross Margin	59.92%	54.91%	53.75%	57.50%	54.75%
Net Income	404,545	808,147	(97,044)	259,754	247,883
EPS (basic)	0.01	0.02	(0.00)	0.01	0.01
Cash	133,529	438,932	940,302	1,009,955	1,405,935
Assets	1,505,304	2,486,701	2,941,421	3,213,607	3,435,004
Debt to Capital	9.21%	3.43%	3.44%	1.63%	0.73%
ROE	49.62%	53.24%	-4.41%	10.13%	8.64%
ROIC	49.05%	61.22%	-6.11%	15.70%	14.63%

*International Water-Guard Industries Inc. ("IWG"), based in Burnaby, BC, Canada, focuses on the design, manufacture, sale, and service of aircraft potable water treatment equipment and systems. IWG has been selling its products to corporate, VIP and military transport manufacturers/operators around the world since 1982. The company is now seeking to break into the largest market of the aircraft industry, the commercial airline sector.*

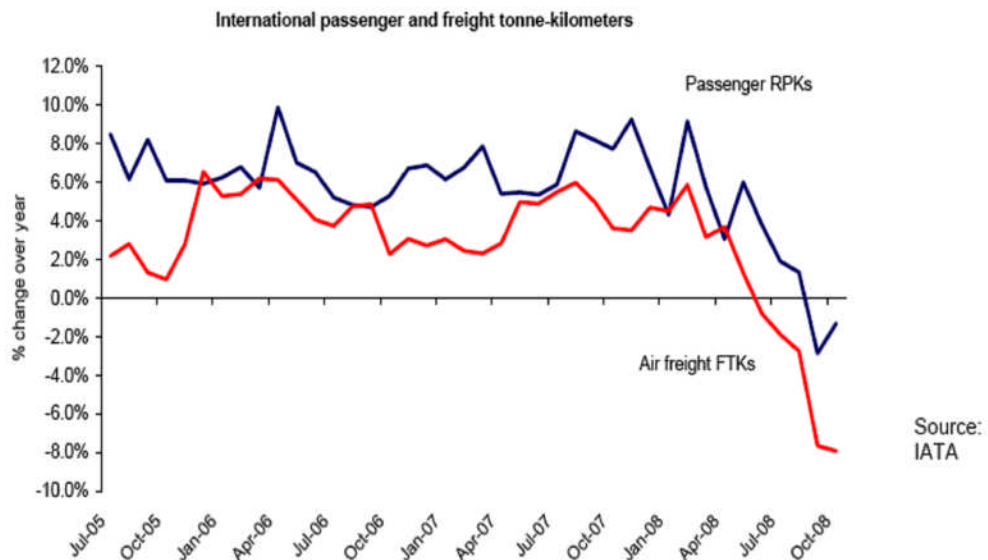
***Dramatic Turnaround in the Industry***

The global airline industry had posted net profits of US\$12.9 billion in 2007, after six consecutive years of net losses following the 9/11 attacks. The industry was poised to post profits through the rest of the decade, however, the global financial crisis and the economic slowdown, offset by a steep drop in oil prices, have dramatically changed the near-term outlook of the industry. The airline industry is now expected to record net losses of US\$5 billion and US\$2.5 billion in 2008, and 2009, respectively (as shown in the following charts).



Source: IATA & ICAO

One of the primary factors currently affecting the profitability of airlines is the significant drop in global air traffic volumes (as shown in the following chart). High oil prices used to be another major concern for the industry until recently. The current oil price of below US\$40/bbl, we believe, should be able to offset some of the potential loss that is expected to arise from dropping passenger traffic volumes.



We believe that the global credit crunch, the recession in developed economies, the slowdown in emerging countries, and declining corporate profits will negatively impact the commercial airline sector. The business aircraft sector is expected to take the biggest hit as customers defer/cancel deliveries due to lack of cash or to preserve cash. Several business jet manufacturers have significantly cut down operations. For example, Bombardier (TSX: BBD) announced that net orders in FY2008 were 262 business jets, compared with 452 in FY2007. They also announced plans to cut more than 1,300 jobs, as they expect a 10% YOY drop in business jet orders this year. The following are a few examples of other manufacturers cutting operations.

- Brazil’s Embraer (NYSE: ERJ) expects to reduce production of its E-Jet line of airliners by 15 – 20% this year
- Cessna Aircraft Company, a unit of Textron Inc. (NYSE: TXT), is planning to reduce 2009 production by 20%. They have cut their workforce by about 30%
- Gulfstream Aerospace (subsidiary of General Dynamics; NYSE: GD) plans to cut production of mid-size aircraft in 2009 by half; although it continues to plan to increase production of large planes

Note that Gulfstream actually plans to increase production of larger aircraft. So far, we have not really seen any major cut back on operations in the large business jets sector; and most of IWG’s customers are in this sector. Although this is encouraging for IWG, considering the soft near-term outlook on the industry, it is possible that the large business jets sector could be negatively impacted going forward.

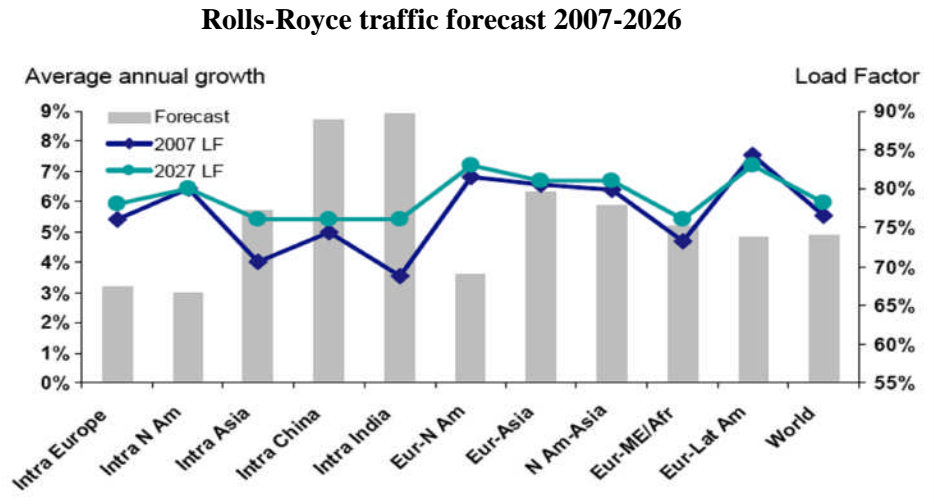
On a positive note, the large order backlog (the chart below shows the high order backlog for Airbus [subsidiary of EADS; Euronext: EAD] and Boeing [NYSE: BA] at the end of 2008) for the industry, we believe, will support near-term momentum, and as a result, 2009 deliveries are expected to remain flat YOY. However, we expect 2010, and 2011, to be very challenging for the industry as we expect a significant drop in orders in 2009 and 2010.



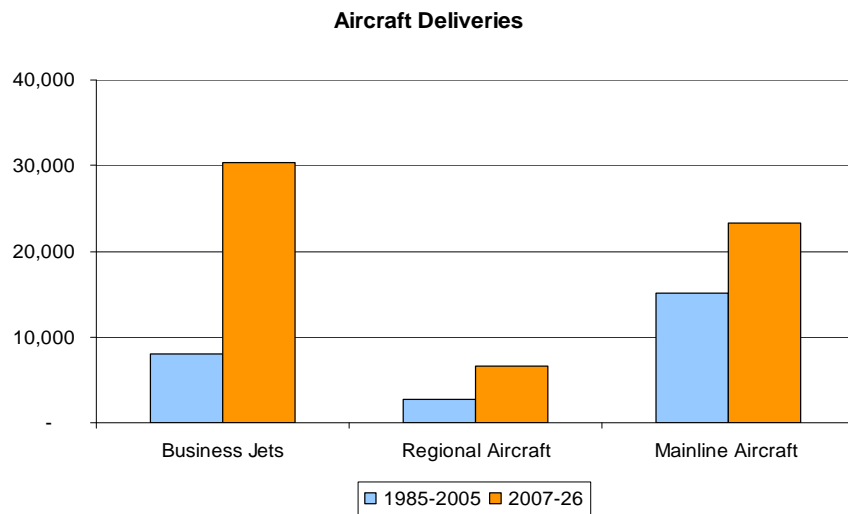
Although we expect the global economic slowdown to negatively impact the industry, we have maintained our positive long-term outlook primarily because of the strong long-term

traffic growth, and aircraft delivery forecasts, as shown in the following section.

According to Rolls Royce, global traffic is expected to grow at about 5% per year during 2007 – 26. China and India are expected to experience growth rates of over 8% per year during the period.



In terms of aircraft deliveries, the following chart shows that mainline aircraft deliveries are expected to increase from 15,179 during 1985-2005, to 23,315 during 2007-26. Similarly, business jets deliveries are expected to increase from 8,081 to 30,388, and regional aircraft deliveries are expected to increase from 2,778 to 6,558.



*Source: Rolls Royce*

The following forecasts also support a strong long-term outlook for the business jet sector.

- Honeywell forecasts delivery of approximately 17,000 new business aircraft from 2008 through 2018
- Embraer, however, has a much more conservative forecast of 11,880 business jets for

2009-2018.

- Bombardier forecasts demand of 13,200 aircraft (during 2008 – 2017) in the light jet to converted airliner segments
- Forecast International projects 15,936 business jets will be produced through 2017

All these forecasts clearly indicate a strong long-term outlook for business jets despite a slowdown in the near-term.

***The EPA  
Proposes  
Aircraft  
Drinking Water  
Regulation***

We had mentioned in our previous reports that one of the key factors that will impact IWG's long-term growth prospects is support from regulators. IWG received such support from regulators in early 2008, as the U.S. Environmental Protection Agency (U.S. EPA) released a draft regulation on commercial aircraft water quality. The EPA's proposed Aircraft Drinking Water Rule (ADWR) is to ensure that safe and reliable drinking water is provided to aircraft passengers and crew. We believe this move by the EPA is very encouraging as it reinforces the value proposition of IWG's products. In addition, the EPA, in its "National Primary Drinking Water Regulations: Drinking Water Regulations for Aircraft Public Water Systems" mentioned that:

*"Interest in using UV light to disinfect drinking water is growing among public water systems due to its ability to inactivate pathogenic microorganisms without forming regulated disinfection byproducts. UV light has also proven effective against some pathogens, such as Cryptosporidium, which are resistant to commonly used disinfectants like chlorine. The EPA is aware that at least one manufacturer provides UV disinfection systems certified by the FAA to be retrofitted onto passenger aircraft."*

The above section shows that the EPA recognizes IWG's products, and supports the efficiency of using UV light for disinfection.

***Other  
Developments***

In addition to the support from regulators, IWG has had several developments in the past few months:

**Reports \$3 million in shipments and backlogs for 2009** – In January 2009, the company announced that it is currently holding more than \$3 million in shipments and backlogs for the year. This is highly encouraging even though we expect 2009 to be stronger than 2010 and 2011.

**Introduces "Smart Water System" at NBAA** - In October 2008, the company announced its "Smart Water System" family of products at the National Business Aviation Association annual convention and tradeshow in Orlando. The "smart water system" comprises a family of controller modules designed to manage power and data to active system components such as pumps, valves, heaters, level sensors and water treatment units. The company believes that this flexible controller technology allows cost effective custom system configurations, as well as fault tolerant and robust solutions for major aircraft programs.

**First C-PWST<sup>TM</sup> on an A319 ACJ** - In September 2008, the company announced that the Airbus Corporate Jet Centre in Toulouse, France, will put its first Circulating Potable Water

System (C-PWS™) on an A319 ACJ this fall. The C-PWS includes IWG's NPS-A6 water treatment unit (the company's latest intelligent aircraft water treatment unit), and continual circulation of water, providing protection from freezing and consistent water pressure and flow.

**Midcoast Aviation buys water system assemblies from IWG** - In September 2008, IWG announced that it is commencing supply of complete water system assemblies to Midcoast Aviation of IL, US, after supplying its water treatment units to Midcoast for several years. Midcoast Aviation, an affiliate of the Jet Aviation Group of Companies, is a full-service AS9100-certified aircraft maintenance, modifications and completions provider. The assemblies are Midcoast's own design. Initial deliveries are expected to begin in early 2009. We believe the extension of the company's relationship with Midcoast to the supply of water system assemblies is a very positive development, as it shows IWG's manufacturing capabilities and credibility in the market today.

**IWG-A4 Water Treatment Unit Now Available for Dassault Falcon Retrofits** – In January 2009, IWG announced that Federal Aviation Administration (FAA) Supplemental Type Certificates (STC) have been released for the IWG-A4 unit for installation on Dassault's Falcon 2000 and Falcon 900 family of aircraft.

IWG's units were previously only available on new Dassault Falcon aircraft. The STC now makes retrofit an option for Falcon 2000 and Falcon 900 Dassault Falcon owner/operators (IWG estimates a retrofit fleet of about 700 aircraft). The STC is available first to only US operators. The equivalent approval in Europe (by the European Aviation Safety Agency) is expected in July/August 2009, which will allow retrofit of IWG's units worldwide.

***Additions to management and board of directors***

Since our previous report, IWG added two new members to its management and board. Brief biographies of the new members, as provided by the company, follow:

**John Rahilly: Director, Business Development – Americas** - A 30-year veteran of the corporate aviation world, Rahilly rose from aircraft mechanic to president of KC Aviation Inc, now part of General Dynamics Aviation Services. He has also held senior management positions with BBA Aviation Inc., the parent company of Signature Flight Support and Dallas Airmotive. More recently, he was vice president, Sales and Marketing for the US service centers of Dassault Falcon Jet. Today he provides business aviation consulting services through his company, Rahilly Aviation Associates, LLC.

Rahilly is a member of the National Business Aviation Association (NBAA), Professional Aircraft Maintenance Association (PAMA) and the National Air Transportation Association (NATA). He graduated from Wentworth Institute in Boston with a degree in Aeronautical Technology. He is also a graduate of Northrop Institute of Technology and is a FAA licensed Airframe & Powerplant technician. He served on active duty in the United States Navy and with the Connecticut Air National Guard and is an instrument rated private pilot.

**Malik Talib: Director** - Mr. Talib is a start-up entrepreneur, devoted to both business and community development. He has been an officer and director of various private and public

companies engaged in communications and technology, mining, import/export, real estate development, health care and publishing. Malik was a Vancouver tax lawyer with Thorsteinssons in Vancouver when he launched eXI Wireless (now VeriChip Inc.) in 2000. He has also served as president and CEO of Corpanada Capital Inc., a venture capital company and merchant bank. Currently he is the CEO of Cuco Resource Limited, a Mining company focused on exploration and mining of Copper and Cobalt. He also served as a member of the B.C. Children's Hospital Foundation and was co-chair of the United Way of the lower Mainland, and is in his second term as President of the Ismaili Council for BC.

In the next section, we review the company's performance in the last two quarters.

### ***Reports strong performance in Q1***

Q1-2009 revenues were in line with expectations as IWG reported 42% YOY growth, from \$0.85 million to \$1.21 million. Q1-2009 revenues, however, are not really comparable to Q1-2008, as revenues in Q1-2008 were unusually low due to short-term delay in orders from a major customer. However, in comparison to revenues in Q1-2007, the company reported a compounded annual growth rate (CAGR) of 10% in the last two years; which is encouraging, and in line with our growth assumptions.

In Q1-2009, the company reported strong improvements in gross margins, which were up from 57%, and 42%, in comparable periods in the past two years, to 62%. Although the company has not indicated the reason for these improvements, we believe it was due to the stronger US\$ (with respect to the C\$) in Q1-2009, versus Q1-2008. The table below shows margin comparisons.

<b>Margins</b>	<b>2007-Q1</b>	<b>2008-Q1</b>	<b>2009-Q1</b>
Gross	56.99%	41.83%	61.86%
EBITDA	14.79%	-12.32%	8.41%
EBIT	13.61%	-14.06%	7.24%
EBT	13.35%	-14.36%	6.92%
Net Margin	13.35%	-9.44%	4.95%

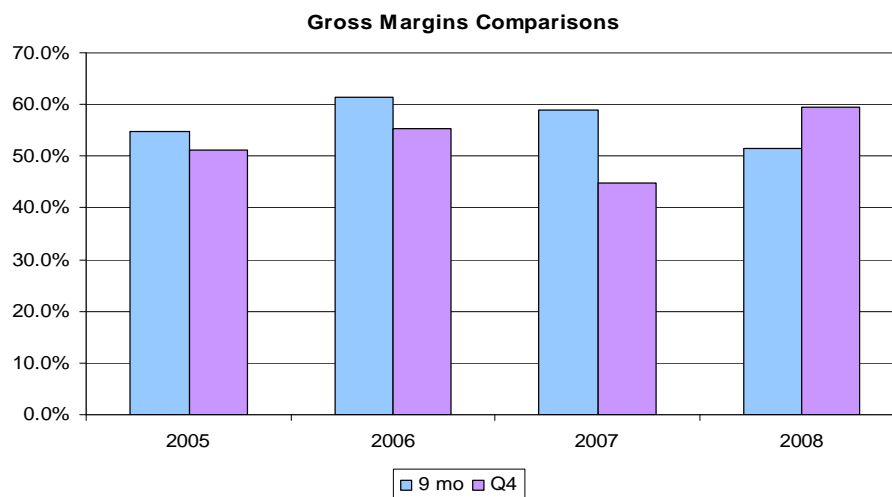
<b>Expenses / Sales</b>	<b>2007-Q1</b>	<b>2008-Q1</b>	<b>2009-Q1</b>
Selling Expenses	8.06%	6.80%	10.48%
R&D	11.11%	16.28%	17.21%
G & A	22.10%	30.58%	25.30%
Stock Option Compensation	0.93%	0.50%	0.46%
<b>Total</b>	<b>42.20%</b>	<b>54.15%</b>	<b>53.45%</b>

**IWG posted net profits of \$0.06 million in Q1-2009, versus a net loss of \$0.08 million in Q1-2008.**

### ***Review of Q4-2008 results***

Although we were pleased with the strong performance in Q1-2009, Q4-2008 revenues were below our expectations as the company reported revenues of \$1.28 million (down 10% YOY) versus our forecast of \$1.41 million. For FY2008, the company reported revenues of \$4.16 million (down 7.3% YOY). Revenues were lower primarily due to a strong C\$ and as the sale of one C-PWS™ in FY2007, was not repeated in FY2008. Although revenues dropped YOY in FY2008, it is important to note that sales of water treatment units, and parts and service revenues, actually increased by 4% YOY and 16% YOY, respectively.

Gross margins in Q4-2008, however, were well above our forecasts. Q4 gross margins in previous years were lower than gross margins in the first nine months, and we were expecting a similar trend in FY2008. However, the company reported strong gross margins of 60% in Q4-2008, versus 45% in Q4-2007, and 52% in the first nine months of FY2008.



Lower revenues and an 18% YOY increase in other costs (which includes selling, product development, and general and administrative costs) resulted in negative EBITDA and net margins in FY2008. The increase in costs, which was primarily due to the increased investment on product development, however, was lower than expected.

Margins	2004	2005	2006	2007	2008
Gross	51.31%	53.84%	59.92%	54.91%	53.8%
EBITDA	6.54%	10.46%	13.68%	9.86%	-1.72%
EBIT	1.63%	9.78%	12.61%	8.70%	-3.28%
EBT	-3.49%	5.22%	11.05%	8.50%	-3.56%
Net Margin	-108.78%	29.16%	11.05%	18.02%	-2.33%

The company posted a net loss in FY2008 after three consecutive years of net profits. Net loss in FY2008 was \$0.10 million (EPS: -\$0.00) versus net profit of \$0.81 million (EPS: \$0.02) in FY2007. Although FY2008 revenues were lower than expected, lower than expected costs resulted in a better EPS; our forecast for FY2008 was a net loss of \$0.18 million (EPS: -\$0.00).

**Revenue and EPS Forecasts** – We have maintained our revenue forecasts, but raised our EPS forecasts for FY2009, as we raised gross margins. Our revised revenue and EPS forecasts for FY2008, are \$5.26 million and net profit of \$0.26 million (EPS: \$0.01). Our previous EPS forecast was \$0.11 million (EPS: \$0.00). We have introduced our estimates for FY2010 in this report. Our forecasts for FY2010 are revenues of \$4.67 million, and net profit of \$0.25 million (EPS: \$0.01).

**Continues to generate positive operating cash flows**

In Q1-2009, IWG generated \$0.03 million in cash from operations versus (\$0.22 million) in Q1-2008, and \$0.22 million in Q1-2007. In FY2008, although the company reported a net loss, the company generated \$0.09 million in cash from operations versus \$0.35 million in FY2007. Capital expenditures in FY2008 were \$0.05 million versus \$0.07 million in FY2007. The chart below shows the company's cash and liquidity ratios at the end of Q1-2009.

Liquidity Analysis	2005	2006	2007	2008	Q1-2009
Working Capital	\$576,218	\$909,496	\$1,387,326	\$1,722,974	\$1,801,380
Current Ratio	1.96	3.33	4.06	4.52	4.84
Debt / Capital	40.6%	9.2%	3.4%	3.4%	2.8%
Interest Coverage Ratio	2.1	8.0	44.1	(11.6)	22.75

IWG continues to be in a sound cash position with very low debt levels (debt to capital was 2.8% at the end of Q1). The company has yet to draw any amount from its \$0.50 million operation loan credit facility with the Toronto - Dominion Bank (interest at bank prime rate plus 1.5%). Our models indicate the company will continue to generate positive free cash flows in FY2009, and FY2010, and therefore, we do not expect any need to raise capital.

**Stock Options and Warrants**

At the end of Q1-2009, the company had 2.89 million stock options outstanding (all of them are currently 'out-of-the-money'), with exercise prices ranging between \$0.09 and \$0.21, and a weighted average time to maturity of 38 months.

**Valuation and Rating**

Our revised valuation dropped from \$0.33 to \$0.28 per share as we lowered our near-term revenue forecasts. A summary of our valuation model is shown below.

DCF Valuation Model								
	2009E	2010E	2011E	2012E	2013E	2014E	2015E	Terminal
FFO	\$379,032	\$363,108	\$847,755	\$1,046,403	\$1,303,982	\$1,638,834	\$1,803,746	\$1,817,466
Investment in WC	(\$211,036)	\$115,942	\$191,381	(\$169,569)	(\$220,439)	(\$286,571)	(\$372,542)	(\$484,305)
CFO	\$167,996	\$479,050	\$1,039,136	\$876,835	\$1,083,543	\$1,352,263	\$1,431,204	\$1,333,161
CAPEX	(\$60,000)	(\$60,000)	(\$60,000)	(\$60,000)	(\$60,000)	(\$60,000)	(\$60,000)	(\$60,000)
FCF	\$107,996	\$419,050	\$979,136	\$816,835	\$1,023,543	\$1,292,263	\$1,371,204	\$1,273,161
PV	\$99,196	\$343,664	\$716,958	\$534,031	\$597,476	\$673,515	\$638,088	\$6,582,928
Discount Rate	12%							
Terminal Growth Rate	3%							
Total PV	\$10,185,856							
Cash - Debt	854,503							
<b>Equity Value</b>	<b>\$11,040,359</b>							
Shares O/S (dil)	39,340,694							
<b>Value per share</b>	<b>\$0.28</b>							

IWG's shares seem to be fairly valued based on our revenues and EPS estimates for 2009 (as shown in the following table).

	Industry	IWG	Fair Value
P/E	12.2	12.1	<b>\$0.08</b>
P/S	0.63	0.60	<b>\$0.08</b>

However, we believe, these valuations do not capture the long-term growth potential of the company.

**Risks**                    **Therefore, we have continued to base our valuation on our DCF model. Based on our revised valuation and review of the company’s progress since our previous report, we reiterate our BUY rating, and lower our fair value from \$0.35 to \$0.30 per share.**

The following risks, though not exhaustive, will cause our estimates to differ from actual results:

- Growth of the company is highly dependent on the overall health of the aerospace industry.
- IWG’s revenues are dependent on aircraft delivery rates and are subject to industry cycles and customer adoption of its products.
- A significant portion of revenues is non-recurring.
- The company has yet to break into the commercial aircraft sector, the largest market in the aerospace industry.
- Foreign exchange fluctuation risks: Most of IWG’s sales are in US dollars.

**We continue to rate the shares Risk 3: Average.**

## Appendix

### STATEMENTS OF OPERATIONS (in C\$)

	2005	2006	2007	2008	2009E	2010E
<b>Sales</b>	<b>3,134,809</b>	<b>3,662,460</b>	<b>4,484,903</b>	<b>4,156,469</b>	<b>5,263,393</b>	<b>4,673,384</b>
COGS	1,447,104	1,467,763	2,022,031	1,922,205	2,236,942	1,986,188
<b>Gross Profit</b>	<b>1,687,705</b>	<b>2,194,697</b>	<b>2,462,872</b>	<b>2,234,264</b>	<b>3,026,451</b>	<b>2,687,196</b>
<b>Expenses</b>						
Selling Expenses	300,604	373,683	369,189	328,773	536,866	476,685
Research&Development	362,948	425,338	500,718	772,194	796,583	567,087
General & Administration	678,122	864,836	1,069,852	1,186,442	1,307,420	1,276,949
Stock Option Compensation	18,098	29,745	80,709	18,408	52,634	46,734
<b>EBITDA</b>	<b>327,933</b>	<b>501,095</b>	<b>442,404</b>	<b>(71,553)</b>	<b>332,948</b>	<b>319,741</b>
Amortization	21,213	39,078	52,414	64,758	66,644	68,491
<b>EBIT</b>	<b>306,720</b>	<b>462,017</b>	<b>389,990</b>	<b>(136,311)</b>	<b>266,304</b>	<b>251,250</b>
Interest & Bank Charges	143,123	57,472	8,843	11,733	6,550	3,367
<b>Earnings from operations, before undernoted</b>	<b>163,597</b>	<b>404,545</b>	<b>381,147</b>	<b>(148,044)</b>	<b>259,754</b>	<b>247,883</b>
Government Assistance						
Gains on settlement of notes and accounts payable	601,451	-	-	-	-	-
Gain on sale of commercial division assets	164,063	-	-	-	-	-
Write-down of assets and costs	(15,000)	-	-	-	-	-
<b>EBT</b>	<b>914,111</b>	<b>404,545</b>	<b>381,147</b>	<b>(148,044)</b>	<b>259,754</b>	<b>247,883</b>
Taxes/(Income Tax Recovery)	-	-	(427,000)	(51,000)	-	-
<b>Net Earnings for the eperiod</b>	<b>914,111</b>	<b>404,545</b>	<b>808,147</b>	<b>(97,044)</b>	<b>259,754</b>	<b>247,883</b>
EPS	0.04	0.01	0.02	(0.00)	0.01	0.01

**BALANCE SHEETS**

<b>(in C\$)</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009E</b>	<b>2010E</b>
<b>Assets</b>						
Cash	354,804	133,529	438,932	940,302	1,009,955	1,405,935
Accounts receivable	508,776	755,321	721,278	710,770	849,004	753,833
Inventory	282,922	388,844	642,232	496,335	591,192	524,921
Prepaid Expenses	31,928	21,664	37,969	65,407	41,494	36,842
<b>Current Assets</b>	<b>1,178,430</b>	<b>1,299,358</b>	<b>1,840,411</b>	<b>2,212,814</b>	<b>2,491,644</b>	<b>2,721,532</b>
Equipment & Furniture	34,492	205,946	219,290	250,607	243,963	235,472
Deferred Dev Costs and foreign exchange loss						
Future income tax assets			427,000	478,000	478,000	478,000
<b>Total Assets</b>	<b>1,212,922</b>	<b>1,505,304</b>	<b>2,486,701</b>	<b>2,941,421</b>	<b>3,213,607</b>	<b>3,435,004</b>
<b>Liabilities &amp; Shareholders' Equity</b>						
Accounts Payables & Accrued Liabilities	226,020	354,383	425,072	449,247	447,388	397,238
Demand / Factoring Loan	367,900	-	-	-	-	-
Customer Deposits, Bank and Shareholder's loan						
Current portion of capital lease obligations and loan	8,292	35,479	28,013	40,593	23,070	10,216
Current portion of notes payable						
<b>Current Liabilities</b>	<b>602,212</b>	<b>389,862</b>	<b>453,085</b>	<b>489,840</b>	<b>470,458</b>	<b>407,454</b>
Convertible Debentures						
Obligations under capital lease and other loan	24,875	70,567	42,685	45,206	22,136	11,920
Notes and Loans payable						
<b>Shareholder's Equity</b>						
Share Capital	7,508,539	7,533,289	7,607,553	8,108,202	8,110,452	8,110,452
Contributed surplus	60,574	90,319	153,964	165,803	218,437	265,171
Deficit	(6,983,278)	(6,578,733)	(5,770,586)	(5,867,630)	(5,607,876)	(5,359,993)
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>1,212,922</b>	<b>1,505,304</b>	<b>2,486,701</b>	<b>2,941,421</b>	<b>3,213,607</b>	<b>3,435,004</b>

**STATEMENTS OF CASH FLOWS**

<b>(in C\$)</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009E</b>	<b>2010E</b>
<b>Operating Activities</b>						
Net earnings for the period	914,111	404,545	808,147	(97,044)	259,754	247,883
<b>Items not involving cash</b>						
Income tax recovery			(427,000)	(51,000)		
Gain on liabilities and sale of commercial division	(765,514)					
Unrealized foreign exchange and other gains				(6,500)		
Compensation related to stock option plan	18,098	29,745	80,709	18,408	52,634	46,734
Write-downs	15,000					
Interest accrued (on NP, on shareholder loan)	20,728					
Amortization and equipment write-down	21,213	39,078	52,414	64,758	66,644	68,491
	<b>223,636</b>	<b>473,368</b>	<b>514,270</b>	<b>(71,378)</b>	<b>379,032</b>	<b>363,108</b>
<b>Changes in non-cash operating working capital</b>						
Accounts receivable	63,691	(246,545)	34,043	17,008	(138,234)	95,171
Inventory	45,482	(105,922)	(253,388)	145,897	(94,857)	66,271
Prepaid expenses	(26,399)	10,264	(16,305)	(27,438)	23,913	4,651
Accounts payable and accrued liabilities	(593,126)	128,363	70,689	24,175	(1,859)	(50,151)
Customer Deposits			-	-	-	-
	<b>(510,352)</b>	<b>(213,840)</b>	<b>(164,961)</b>	<b>159,642</b>	<b>(211,036)</b>	<b>115,942</b>
<b>Cash from from (used in) operations</b>	<b>(286,716)</b>	<b>259,528</b>	<b>349,309</b>	<b>88,264</b>	<b>167,996</b>	<b>479,050</b>
<b>Investing activities</b>						
Purchase of furniture and equipment	(15,834)	(107,791)	(65,758)	(47,173)	(60,000)	(60,000)
Proceeds on sale of commercial division	300,000					
Deferred Development Costs						
<b>Purchase of equipment and leaseholds</b>	<b>284,166</b>	<b>(107,791)</b>	<b>(65,758)</b>	<b>(47,173)</b>	<b>(60,000)</b>	<b>(60,000)</b>
<b>Financing activities</b>						
Proceeds (repayments) of demand loans	(81,600)	(367,900)	(4,146)			
Proceeds (repayments) of payables and leases	(314,300)	(29,862)	(31,202)	(33,801)	(40,593)	(23,070)
Convertible debenture issued						
Issue of common share for cash	688,418	24,750	57,200	494,080	2,250	
	<b>292,518</b>	<b>(373,012)</b>	<b>21,852</b>	<b>460,279</b>	<b>(38,343)</b>	<b>(23,070)</b>
Increase (decrease) in cash	289,968	(221,275)	305,403	501,370	69,653	395,980
Cash beginning of period	64,836	354,804	133,529	438,932	940,302	1,009,955
<b>Cash end of period</b>	<b>354,804</b>	<b>133,529</b>	<b>438,932</b>	<b>940,302</b>	<b>1,009,955</b>	<b>1,405,935</b>

**Buy** – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

**Hold** – Annual expected rate of return is between 5% and 12%

**Sell** – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

**Suspended or Rating N/A**— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

#### **Fundamental Research Corp. Risk Rating Scale:**

**1 (Low Risk)** - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

**2 (Below Average Risk)** - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

**3 (Average Risk)** - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

**4 (Speculative)** - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

**5 (Highly Speculative)** - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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