

International Water-Guard Industries Inc. (TSX-V: IWG) – Announces new initiative to develop products for aerospace applications beyond water treatment

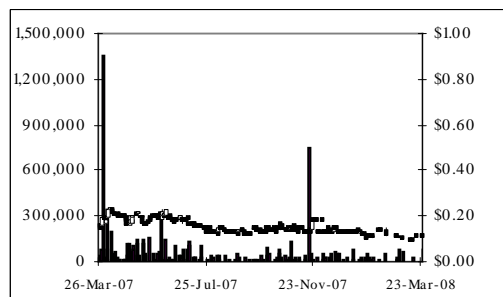
Sector/Industry: Aerospace Products and Services

www.water.aero

Market Data (as of March 28, 2008)

Current Price	C\$0.10
Fair Value	C\$0.35
Rating*	BUY
Risk*	3 (Average)
52 Week Range	C\$0.10 – C\$0.24
Shares O/S	34,210,694
Market Cap	C\$3.42 mm
Current Yield	N/A
P/E (forward)	103.4
P/B	1.79x
YoY Return	-41.2%
YoY TSX-V	-20.6%

*see back of report for rating and risk definitions



Q1-2008 Highlights

- Revenues in Q1-2008 dropped by 15.7% YOY, from \$1.01 million to \$0.85 million. Although it was disappointing, the drop in revenues was no surprise, as management had already warned investors of a soft Q1-2008 in the previous quarter.
- Revenues dropped due to short-term delays in orders from one of their major customers and unfavorable exchange rates. Although both these factors will put pressure on the company's revenues in the short-term, we believe that they do not really change the long-term fundamentals of the company.
- We have lowered our revenue and EPS forecasts for FY2008 and FY2009. Since the company's fundamentals remain intact, and since we continue to maintain a long-term positive outlook on the global business jet market and the airline industry, we have not made any major changes in our forecasts beyond FY2009.
- At their Annual General Meeting, IWG announced that they have started working on developing products for aerospace applications beyond water treatment. Through such initiatives, IWG can not only expand its product offerings to aircraft operators, but also capitalize on the growing global business jet market.

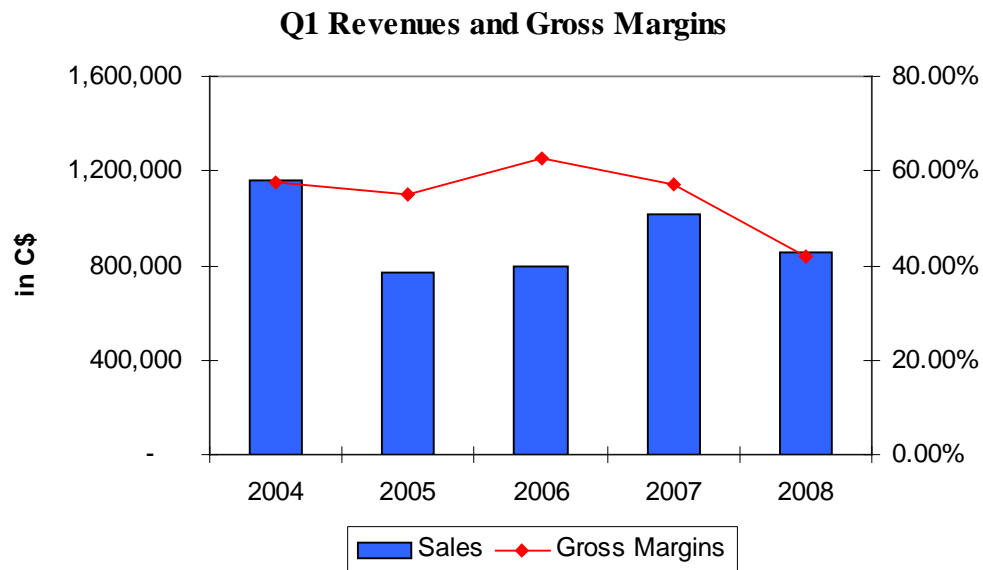
Financial Summary (YE Sept 30)

(C\$)	2004	2005	2006	2007	2008E	2009E
Revenue	3,641,463	3,134,809	3,662,460	4,484,903	4,528,556	6,226,764
Gross Margin	51.31%	53.84%	59.92%	54.91%	50.75%	58.00%
Net Income	(3,961,291)	914,111	404,545	808,147	33,324	653,541
EPS (basic)	(0.21)	0.04	0.01	0.02	0.00	0.02
Cash	64,836	354,804	133,529	438,932	653,749	1,132,186
Assets	1,162,044	1,212,922	1,505,304	2,486,701	2,620,232	3,470,464
Debt to Capital	1025.03%	40.64%	9.21%	3.43%	3.44%	1.79%
ROE	-2286.86%	-247.83%	49.62%	53.24%	1.63%	26.17%
ROIC	-251.05%	257.37%	49.05%	61.22%	2.12%	39.19%

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.

Revenues dropped by 15.7% YOY – No negative change in fundamentals

Revenues in Q1-2008 dropped by 15.7% over the comparable period in the previous year, from \$1.01 million to \$0.85 million. It was the first YOY decline in Q1 revenues since Q1-2005. The chart below shows revenues and gross margins since Q1-2004.



The decline in revenues was disappointing especially because it came at a time when the global business jet market is growing at a strong pace (According to the General Aviation Manufacturers Association, worldwide business-jet deliveries exceeded 1,000 units for the first time in history in 2007). However, management had already warned investors in the previous quarter that they expect revenues to soften in the first half of FY2008, and therefore, the drop in Q1 revenues was no surprise. Revenues dropped in Q1-2008 due to two major reasons:

- **Short-term delays in customer orders:** According to management, one of their major customers (name has not been disclosed) is currently undergoing realignment across their supply chain, which has led to short-term delays in orders for IWG's products. This delay put downward pressure on IWG's revenues in Q1-2008. We met with IWG's management at the Annual General Meeting (AGM) held on March 12, 2008. Our discussions with management indicated that this does not imply that the company will lose any of the orders that they should have received from their customer in Q1. Management expects revenues to pick up in Q3-2008.
- **Unfavorable exchange rates:** Even though the company announced that they were going to selectively increase their U.S. prices by 7%, a strong C\$ with respect to the US\$ continued to have a negative impact on revenues in Q1-2008.

According to IWG, had the C\$/US\$ exchange rate in Q1-2008 remained the same as in Q1-2007, revenues would have been \$0.14 million higher. This implies that total revenues in Q1-2008 would have been \$0.99 million, which represents a YOY drop of only 2.3%. In order to mitigate exchange rate risks, IWG anticipates it will initiate currency hedging in FY2008, and introduce list pricing in C\$ and Euros. Since we expect the C\$/US\$ to

stay above 0.90 for the rest of 2008, we believe that it is very important for IWG to initiate strategies to mitigate exchange rate risks.

Both the above-mentioned factors, we believe, do not really change the fundamentals of the company. However, both factors, we believe, will continue to put downward pressure on the company's revenues in Q2, and to some extent in Q3. As a result, we have lowered our revenue forecasts for FY2008, from \$5.49 million to \$4.53 million. As for FY2009, we have slightly lowered our forecasts from \$6.59 million to \$6.23 million. Since the company's fundamentals remain intact, and since we continue to maintain our positive long-term outlook on the global business jet market, and the commercial airline industry, we have not made any major changes in our revenue forecasts beyond FY2009.

***Announced
new initiatives***

At their AGM, IWG announced that they have started working on developing products for applications beyond water treatment in aircraft. Although management did not disclose too much information, they mentioned that the company is currently working on developing their own electronic control modules that can drive aircraft components like pumps, valves and heaters.

IWG has experience in developing control systems for their water treatment units and systems. IWG's water treatment units have advanced monitoring capabilities, and the company is currently developing design controllers for their water systems. By implementing control modules to drive various aircraft components, IWG can, not only expand its product offerings to aircraft operators, but also capitalize on the growing global business jet market. IWG's management team has extensive experience in the aerospace industry and product engineering, and it is highly encouraging to see that the company has decided to pursue such initiatives that can potentially bring considerable upside potential in the long-term.

Another significant development since our previous report in January 2008 was that IWG, on March 17, 2008, announced they signed a Memorandum of Agreement (MOU) with Gulfstream Aerospace Corporation (NYSE: GD). The MOU constitutes a multi-year contract for IWG's products to be installed on Gulfstream's business jets through 2010. Gulfstream, in addition to Dassault Falcon Jet (Euronext Paris: 012172) and Bombardier Aerospace (TSX: BBD-B), offers IWG's products as standard options on their business jets. In 2007, IWG was awarded a Top Performer award as one of its suppliers of the year by Gulfstream. We believe that such multi-year contracts can significantly lower the company's risks as revenues become more predictable and recurring.

***Lower revenues
impacted
bottom line***

Some of the cost of goods sold (COGS) for the company are fixed costs. Therefore, as revenues dropped in Q1-2008, gross margins also dropped YOY, from 57% to 41.8%. We expect gross margins to stay at the same level in Q2, but expect them to improve as sales improve in the second half of FY2008. We have lowered our gross margins estimate for FY2008 from 58% to 50.7%. However, we have maintained our forecasts for FY2008+ at 58%.

All other margins also dropped YOY as total indirect costs as a percentage of sales increased

YOY from 42.2% to 54.2%. Although total indirect costs increased only from \$0.43 million to \$0.46 million YOY, the drop in revenues led to a significant increase in costs as a percentage of sales. IWG posted EBITDA of (\$0.11 million) in Q1-2008 versus \$0.15 million in Q1-2007.

The table below shows margins since Q1-2004.

Margins	2004-Q1	2005-Q1	2006-Q1	2007-Q1	2008-Q1
Gross	57.67%	55.02%	62.55%	56.99%	41.83%
EBITDA	18.92%	10.32%	12.05%	14.79%	-12.32%
EBIT	10.57%	9.41%	11.82%	13.61%	-14.06%
EBT	7.81%	2.61%	9.09%	13.35%	-14.36%
Net Margin	7.81%	2.61%	9.09%	13.35%	-19.28%

Expenses / Sales	2004-Q1	2005-Q1	2006-Q1	2007-Q1	2008-Q1
Selling Expenses	8.12%	8.56%	12.38%	8.06%	4.97%
R&D	7.61%	10.57%	14.62%	11.11%	18.11%
G & A	23.03%	24.23%	22.56%	22.10%	30.58%
Stock Option Compensation	0.00%	1.36%	0.94%	0.93%	0.50%
Total	38.76%	44.71%	50.50%	42.20%	54.15%

Total indirect costs increased primarily due to an increase in research and development costs (related to the company's new initiatives mentioned earlier), staffing levels, and compensation. We have slightly raised our forecast for total indirect expenses as a percentage of sales in FY2008 from 48.3% to 48.5%.

Posted net loss after 12 consecutive quarters of profits

The company posted a net loss in Q1-2008 after 12 consecutive quarters of net profits. After recording amortization expenses (\$14,815) and interest expenses (\$2,587), IWG posted a net loss before tax of \$0.12 million in Q1-2008. The company recorded \$0.04 million in income tax recovery; therefore, the net loss after tax was reduced to \$0.08 million in Q1-2008, versus a net profit of \$0.14 million in Q1-2007. According to IWG, had the C\$/US\$ in Q1-2008 remained the same as in Q1-2007, earnings would have been approximately \$0.13 million higher, which means the company would have posted a net profit of \$0.05 million.

Our revised EPS forecasts for FY2008, and FY2009, are \$0.03 million (EPS: \$0.00) and \$0.66 million (EPS: \$0.02), respectively, versus our previous estimate of \$0.47 million (EPS: \$0.01) and \$.70 million (EPS: \$0.02).

Cash flows

The company spent a total of \$0.22 million on operating activities (including investment in working capital) in Q1-2008, while it had generated positive cash flows of \$0.22 million in Q1-2007. CAPEX (capital expenditures) in Q1-2008, to purchase equipment, was \$0.05 million, of which \$0.03 million was financed under a capital lease. All operating and investing activities in the quarter were funded by cash on hand at the end of FY2007.

We have maintained our estimate of cash outflows for investing activities in FY2008 at \$0.06 million.

Cash and Liquidity Position

Cash and working capital at the end of Q1-2008 were \$0.19 million and \$1.25 million, respectively, versus \$0.44 million and \$1.39 million at the end of FY2007. Debt to capital increased from 3.4% to 4.6%, as obligations under capital leases increased. IWG's debt to capital continues to be well below the industry average debt to capital of 35.1% (Industry - Aerospace/Defense Products & Services). The table below shows the company's cash and liquidity position.

Liquidity Analysis	2004	2005	2006	2007	Q1-2008
Working Capital	(1,370,085)	576,218	909,496	1,387,326	1,247,590
Current Ratio	0.44	1.96	3.33	4.06	4.29
Debt / Capital	1025.0%	40.6%	9.2%	3.4%	4.6%
Interest Coverage Ratio	0.3	2.1	8.0	44.1	(46.43)

Unless the company decides to make a major investment going forward for pursuing their new initiatives, we do not believe there is any need for the company to pursue any financings in 2008.

Stock Options and Warrants

At the end of Q1-2008, the company had 2.06 million stock options outstanding (0.89 million are currently 'in-the-money' – assuming that none of the outstanding options were exercised since the end of Q1-2008), with exercise prices ranging between \$0.075 and \$0.21, and a weighted average time to maturity of 31.6 months.

Valuation

Our revised Discounted Cash Flow (DCF) valuation dropped from \$0.35 per share to \$0.33 per share as we lowered our short-term revenue and EPS forecasts. A summary of our revised valuation model is shown below.

DCF Valuation Model	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	Terminal
FFO	\$140,932	\$777,550	\$1,171,841	\$1,348,690	\$1,551,748	\$1,731,611	\$1,418,171	\$1,628,229	\$1,869,810
Investment in WC	\$99,991	(\$296,588)	(\$234,601)	(\$211,141)	(\$242,812)	(\$279,234)	(\$321,119)	(\$369,286)	(\$424,679)
CFO	\$240,923	\$480,963	\$937,241	\$1,137,549	\$1,308,936	\$1,452,377	\$1,097,053	\$1,258,943	\$1,445,130
CAPEX	(\$60,000)	(\$60,000)	(\$60,000)	(\$60,000)	(\$60,000)	(\$60,000)	(\$60,000)	(\$60,000)	(\$60,000)
FCF	\$180,923	\$420,963	\$877,241	\$1,077,549	\$1,248,936	\$1,392,377	\$1,037,053	\$1,198,943	\$1,385,130
PV	\$170,956	\$355,154	\$660,805	\$724,726	\$749,996	\$746,548	\$496,459	\$512,464	\$6,578,289
Discount Rate	12%								
Terminal Growth Rate	3%								
Total PV	\$10,995,397								
Cash - Debt	396,247								
Equity Value	\$11,391,644								
Shares O/S (dil)	34,305,194								
Value per share	\$0.33								

As our revised EPS forecast for FY2008 is very low (\$0.001), we do not believe a valuation based on the industry average P/E would reflect the fair value of the company. Our valuation based on the industry average P/S dropped from \$0.18 per share to \$0.16 per share, as we lowered our revenue forecasts for FY2008, and as the industry average P/S dropped from 1.39 to 1.22.

Valuation based on Industry Multiples			
	Industry	IWG	Fair Value
P/E	18.4	113.75	N/A
P/S	1.22	0.83	\$0.16
Average			N/A

Rating

Although our DCF valuation dropped from \$0.35 per share to \$0.33 per share, and our comparables valuation based on the industry average P/S dropped from \$0.18 per share to \$0.16 per share, our outlook on the company and the industry has not changed since our previous report, and therefore we have maintained our BUY rating (Risk 3: Average) and fair value estimate on the company at \$0.35 per share.

Our valuation is solely based on the potential sales of its water treatment units to the business jet market, and does not account for the upside potential associated with sales of water systems and from potential entry into the commercial airline market with their water treatment units. Although we cannot predict as to when the company will be able to break into the commercial airline industry, or sell their next water system, we believe that the probability of occurrence of either of these events has increased since we started covering the company in November 2006. Considering that we continue to maintain a positive long-term outlook on the company, we recommend investors to be patient and wait for the market to realize the fair value of the company.

Risks

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\$, and the company has not yet entered into any foreign exchange contracts to hedge against foreign exchange fluctuations.

Appendix

STATEMENTS OF OPERATIONS
 (in C\$)

	2004	2005	2006	2007	2008E	2009E
Sales	3,641,463	3,134,809	3,662,460	4,484,903	4,528,556	6,226,764
COGS	1,773,115	1,447,104	1,467,763	2,022,031	2,230,494	2,615,241
Gross Profit	1,868,348	1,687,705	2,194,697	2,462,872	2,298,061	3,611,523
Expenses						
Selling Expenses	307,880	300,604	373,683	369,189	270,509	529,275
Research&Development	295,290	362,948	425,338	500,718	713,248	819,463
General & Administration	1,000,565	678,122	864,836	1,069,852	1,166,103	1,478,856
Stock Option Compensation	26,456	18,098	29,745	80,709	45,286	62,268
EBITDA	238,157	327,933	501,095	442,404	102,916	721,661
Amortization	178,833	21,213	39,078	52,414	62,323	61,742
EBIT	59,324	306,720	462,017	389,990	40,594	659,919
Interest & Bank Charges	186,303	143,123	57,472	8,843	7,270	6,378
Earnings from operations, before undernoted	(126,979)	163,597	404,545	381,147	33,324	653,541
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	(3,834,312)	(15,000)	-	-	-	-
EBT	(3,961,291)	914,111	404,545	381,147	33,324	653,541
Taxes/(Income Tax Recovery)	-	-	-	(427,000)	-	-
Net Earnings for the eperiod	(3,961,291)	914,111	404,545	808,147	33,324	653,541
EPS	(0.21)	0.04	0.01	0.02	0.00	0.02

BALANCE SHEETS

(in C\$)	2004	2005	2006	2007	2008E	2009E
Assets						
Cash	64,836	354,804	133,529	438,932	653,749	1,132,186
Accounts receivable	592,467	508,776	755,321	721,278	718,059	987,331
Inventory	423,626	282,922	388,844	642,232	571,713	670,330
Prepaid Expenses	5,529	31,928	21,664	37,969	32,743	38,391
Current Assets	1,086,458	1,178,430	1,299,358	1,840,411	1,976,264	2,828,238
Equipment & Furniture	75,586	34,492	205,946	219,290	216,968	215,226
Deferred Dev Costs and foreign exchange loss						
Future income tax assets				427,000	427,000	427,000
Total Assets	1,162,044	1,212,922	1,505,304	2,486,701	2,620,232	3,470,464
Liabilities & Shareholders' Equity						
Accounts Payables & Accrued Liabilities	1,018,965	226,020	354,383	425,072	446,099	523,048
Demand / Factoring Loan	449,500	367,900	-	-	-	-
Customer Deposits, Bank and Shareholder's loan	256,507					
Current portion of capital lease obligations and loan	4,146	8,292	35,479	28,013	21,826	5,391
Current portion of notes payable	727,425					
Current Liabilities	2,456,543	602,212	389,862	453,085	467,925	528,439
Convertible Debentures						
Obligations under capital lease and other loan	29,021	24,875	70,567	42,685	52,866	47,475
Notes and Loans payable						
Shareholder's Equity						
Share Capital	6,530,913	7,508,539	7,533,289	7,607,553	7,637,453	7,716,753
Contributed surplus	42,956	60,574	90,319	153,964	199,250	261,517
Deficit	(7,897,389)	(6,983,278)	(6,578,733)	(5,770,586)	(5,737,262)	(5,083,721)
Total Liabilities & Shareholders' Equity	1,162,044	1,212,922	1,505,304	2,486,701	2,620,232	3,470,464

STATEMENTS OF CASH FLOWS

(in C\$)	2004	2005	2006	2007	2008E	2009E
Operating Activities						
Net earnings for the period	(3,961,291)	914,111	404,545	808,147	33,324	653,541
Items not involving cash						
Income tax recovery				(427,000)		
Gain on liabilities and sale of commercial division		(765,514)				
Book value of assets sold						
Unrealized foreign exchange and other gains	(42,849)					
Compensation related to stock option plan	26,456	18,098	29,745	80,709	45,286	62,268
Write-downs	3,834,312	15,000				
Interest accrued (on NP, on shareholder loan)	65,053	20,728				
Amortization and equipment write-down	178,833	21,213	39,078	52,414	62,323	61,742
	100,514	223,636	473,368	514,270	140,932	777,550
Changes in non-cash operating working capital						
Accounts receivable	(300,722)	63,691	(246,545)	34,043	3,219	(269,272)
Inventory	207,188	45,482	(105,922)	(253,388)	70,519	(98,617)
Prepaid expenses		(26,399)	10,264	(16,305)	5,226	(5,648)
Accounts payable and accrued liabilities	157,531	(593,126)	128,363	70,689	21,027	76,949
Customer Deposits	(348,257)			-	-	-
	(284,260)	(510,352)	(213,840)	(164,961)	99,991	(296,588)
Cash from from (used in) operations	(183,746)	(286,716)	259,528	349,309	240,923	480,963
Investing activities						
Purchase of furniture and equipment	(1,207)	(15,834)	(107,791)	(65,758)	(60,000)	(60,000)
Proceeds on sale of commercial division		300,000				
Deferred Development Costs	(1,076,642)					
Purchase of equipment and leaseholds	(1,077,849)	284,166	(107,791)	(65,758)	(60,000)	(60,000)
Financing activities						
Proceeds (repayments) of demand loans	548,350	(81,600)	(367,900)	(4,146)		
Proceeds (repayments) of payables and leases	(115,086)	(314,300)	(29,862)	(31,202)	3,994	(21,826)
Convertible debenture issued						
Issue of common share for cash	941,355	688,418	24,750	57,200	29,900	79,300
	1,374,619	292,518	(373,012)	21,852	33,894	57,474
Increase (decrease) in cash	113,024	289,968	(221,275)	305,403	214,817	478,437
Cash beginning of period	(48,188)	64,836	354,804	133,529	438,932	653,749
Cash end of period	64,836	354,804	133,529	438,932	653,749	1,132,186

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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