

IWG Technologies Inc. (TSX-V: IWG) - EPS in line with expectations

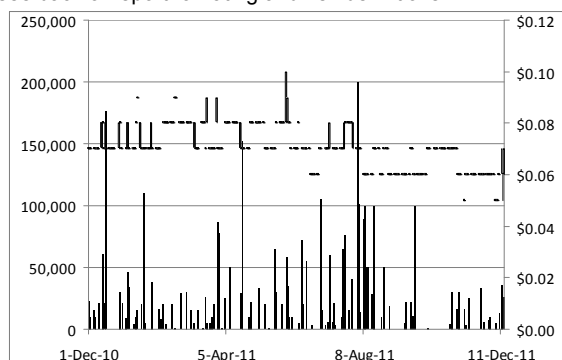
Sector/Industry: Aerospace Products and Services

www.iwgtech.com

Market Data (as of December 22, 2011)

Current Price	C\$0.06
Fair Value	C\$0.30
Rating*	BUY
Risk*	3 (Average)
52 Week Range	C\$0.05 – C\$0.10
Shares O/S	37.62 mm
Market Cap	C\$2.26 mm
P/S (forward)	0.4x
P/E (forward)	6.2x
P/B	0.7x
YoY Return	-14.3%
YoY TSX-V	-33.2%

*see back of report for rating and risk definitions



Highlights

- FY2011 revenues were up 1% YOY from \$4.38 million to \$4.43 million (our forecast was \$4.54 million). EPS was up 107% from \$0.003 to \$0.007. The significant increase in EPS was primarily due to lower operating expenses. FY2011 net income was \$0.27 million - in line with our estimate of \$0.29 million.
- Our net income forecast for FY2012, and FY2013, are \$377,417 (EPS: \$0.099) and \$600,926 (EPS: \$0.0158), slightly higher than our previous forecasts of \$370,218 and \$592,858, respectively.
- On July 8, 2011, the company completed the acquisition of the aviation water heater product line of Keltech, Inc. for US\$0.70 million. IWG's water treatment units and Keltech's water heaters are complimentary products and have similar target markets.
- Keltech was generating about \$0.50 million per year in revenues for this product line.
- Despite the increase in debt (due to the Keltech acquisition), the company continues to maintain a strong balance sheet with good coverage ratios.

Financial Summary (YE Sept 30)

(C\$)	2009	2010	2011	2012E	2013E
Revenue	4,952,911	4,381,894	4,431,148	5,180,824	5,957,948
Gross Margin	63.11%	54.35%	55.54%	55.00%	58.00%
Net Income	312,016	135,423	270,912	361,707	589,441
EPS (basic)	0.01	0.00	0.01	0.01	0.02
Cash	1,362,363	1,122,172	719,937	1,074,829	1,510,968
Assets	3,249,308	3,350,627	3,929,714	4,173,880	4,797,839
Debt to Capital	1.57%	1.05%	9.81%	5.92%	3.19%
ROE	12.09%	4.78%	9.05%	11.02%	15.46%
ROIC	20.87%	8.32%	12.02%	13.59%	21.85%

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.

Acquisition As mentioned in our previous report, IWG completed the acquisition of the aviation water heater product line of Keltech Inc on July 8, 2011, for US\$700,000 cash and non-interest bearing promissory notes. The main advantage for IWG is that both IWG and Keltech's products are complementary and have similar target markets. IWG can now market the water heaters to their customers as well as market their water treatment units to Keltech's customers. Please refer to our previous report for details on Keltech Inc. and the acquisition.

2011 Performance FY2011 revenues of \$4.43 million came in slightly below our estimate of \$4.54 million. On a YOY basis, revenues increased by 1.1% when compared to FY2010 revenues of \$4.38 million. Gross margins improved YOY (from 54.3% to 55.5%) due to higher revenues.

EBITDA, after adjusting for unfavorable foreign exchange losses, was \$449,370. This figure was higher than our estimate of \$391,151. The adjusted EBITDA was up 105% YOY. The significant growth in EBITDA was due to the following:

1. Lower selling expenses (\$384,260 in 2011 vs. \$449,708 in 2010) from a decrease in promotional activities (which is expected to pick up going forward).
2. Lower general & administrative expenses (\$1.19 million in 2011 vs. \$1.26 million in 2010) from decreases in legal, consulting and recruiting expenses.
3. Lower stock-based compensation (\$8,606 in 2011 vs. \$27,364 in 2010).

The decrease in operating expenses resulted in a significant improvement in margins; please refer to the table below.

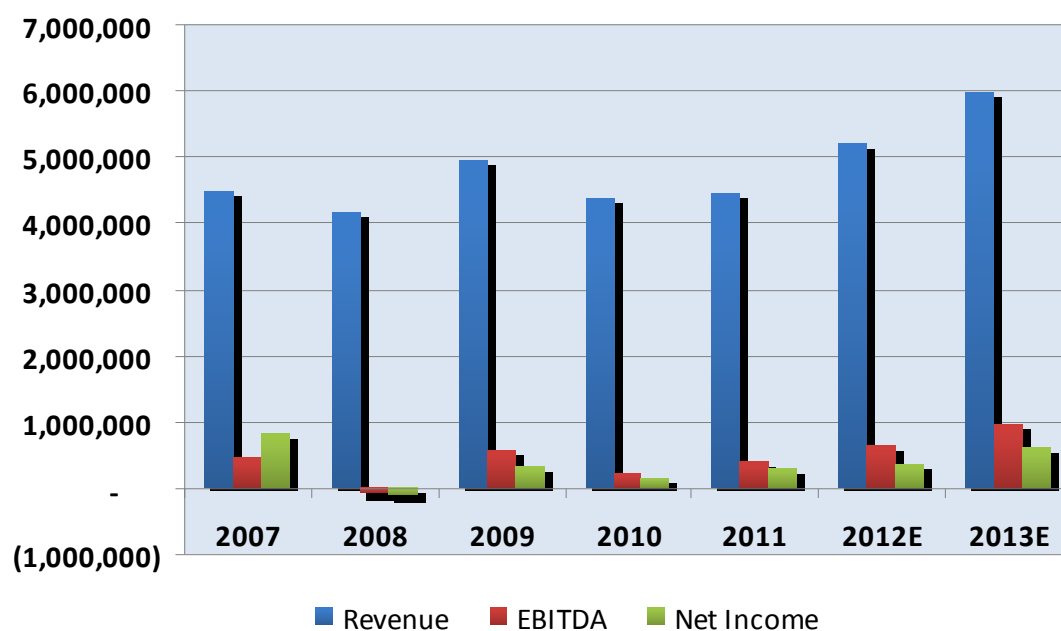
Margins	2010	2011
Gross	54.3%	55.5%
EBITDA	5.0%	8.7%
EBIT	3.7%	7.5%
EBT	3.2%	7.1%
Net Margin	3.1%	6.1%

FY2011 net income (\$270,912, EPS: \$0.0071) was up 100%YOY due to the reasons mentioned above. Our net income forecast was \$288,990, EPS: \$0.0076).

FY2011 net income was negatively affected by one-time restructuring costs (\$95,584) in relation to International WaterGuard Industries Inc becoming a wholly-owned subsidiary of IWG Technologies Inc. (mentioned in our previous reports). **Net income would have been \$366,496 (EPS: \$0.0096) if the restructuring costs were excluded.**

Revenue and EPS Forecasts As Q4 revenues were slightly lower than our estimate, we have slightly adjusted our near-term revenue forecasts. Our revised revenue forecasts are \$5.18 million (previous estimate - \$5.30 million) and \$5.96 million (previous estimate - \$6.09 million) for FY2012, and FY2013, respectively. Our net income forecasts for FY2012, and FY2013, are \$361,707 (EPS: \$0.0096) and \$589,441 (EPS: \$0.0157) - almost in line with our previous forecasts of \$370,218 and \$592,858, respectively.

The company's performance since FY2007 along with our projections are shown below.



Cash Position & Liquidity

At the end of FY2011, IWG had \$719,937 in cash compared to \$1.12 million at the end of FY2010. Although the company generated \$0.26 million from operations in FY2011, cash dropped primarily due to the cash paid out for the acquisition and cash used to repurchase common shares. IWG repurchased 1.61 million of its outstanding shares for a total amount of \$115,346. Also, as shown in the table below, the cash cycle increased slightly from 91 to 97 days due to the acquisition.

Liquidity Analysis	2009	2010	2011	2012E
Working Capital	\$2,266,003	\$2,289,382	\$1,849,764	\$2,209,670
Current Ratio	5.77	6.34	3.91	5.02
Debt / Capital	1.6%	1.05%	9.8%	5.9%
EBIT Interest Coverage Ratio	30.2	8.2	20.4	42.1
Profitability Analysis	2009	2010	2011	2012E
Return on Avg Assets	10.1%	4.1%	7.4%	8.9%
Return on Avg Equity	12.1%	4.8%	9.1%	11.0%
Return on Average Invested Capital	20.9%	8.3%	12.0%	13.6%
Activity Analysis	2009	2010	2011	2012E
Days Inventory Outstanding	107	105	111	98
Days Accounts Receivable	51	65	73	60
Days Accounts Payable	90	78	86	77
Cash Conversion Cycle	68	91	97	82

Debt to capital increased to 9.8% at the end of FY2011 as a result of the non-interest bearing promissory notes used for the acquisition. The notes payable are due as follows: US\$100,000 on July 8, 2012; and US\$75,000 on each of July 8, 2013, 2014 and 2015.

Despite the drop in working capital and current ratio, we believe IWG's cash from operations should be more than sufficient to meet its current liabilities (see table below). Also, note that the company has a \$500,000 undrawn credit facility available.

	2009	2010	2011	2012E	2013E
Cash Flow from Operation	500,668	612	256,004	499,762	549,227
Cash Flow from Financing	(39,691)	(37,559)	(135,872)	(114,870)	(83,087)
Cash Flow from Investing	(38,916)	(203,244)	(522,367)	(30,000)	(30,000)
Net Change in Cash	422,061	(240,191)	(402,235)	354,892	436,140

Stock Options and Warrants

We estimate the company currently has 2.18 million stock options outstanding (weighted average exercise price of \$0.13) and 5 million warrants outstanding exercisable at \$0.17 (expiry date - August 2011). All of them are currently "out of the money".

Valuation and Rating

Our DCF valuation stays at \$0.30 per share. IWG shares continue to trade significantly below industry average valuation multiples. The Aerospace and Defence Industry average Enterprise Value (EV) to revenue, and EV/EBITDA ratios are 0.9x and 7.3x, versus IWG's forward ratios of 0.2x and 1.3x, respectively.

We are maintaining our BUY rating and \$0.30 per share fair value estimate on IWG shares.

Risk

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 have maintained our risk rating at 3 (Average).

Appendix

STATEMENTS OF OPERATIONS
 (in CS)

	2008	2009	2010	2011	2012E	2013E
Sales	4,156,469	4,952,911	4,381,894	4,431,148	5,180,824	5,957,948
COGS	1,922,205	1,827,070	2,000,349	1,970,179	2,331,371	2,621,497
Gross Profit	2,234,264	3,125,841	2,381,545	2,460,969	2,849,453	3,336,451
Expenses						
Selling Expenses	328,773	427,924	449,708	384,260	492,178	506,426
Research&Development	772,194	875,219	421,517	428,035	438,736	476,636
General & Administration	1,186,442	1,230,689	1,264,151	1,190,698	1,244,840	1,338,203
Stock Option Compensation	18,408	35,396	27,364	8,606	51,808	59,579
Foreign exchange loss(gain)				64,726		
EBITDA	(71,553)	556,613	218,805	384,644	621,890	955,606
Amortization	64,758	60,389	56,969	53,676	59,478	52,109
EBIT	(136,311)	496,224	161,836	330,968	562,412	903,498
Interest & Bank Charges	11,733	16,454	19,715	16,207	13,374	8,779
	-	-	-	-	-	-
Earnings from operations, before undernoted	(148,044)	479,770	142,121	314,761	549,039	894,719
Share restructuring costs				(95,584)		
Government Assistance						
Gains on settlement of notes and accounts payable	-	-	-	-	-	-
Gain on sale of commerical division assets	-	-	-	-	-	-
Foreign Exchange		(54,754)	47,202			
Wite-down of assets and costs	-	-	-	-	-	-
Extraordinary						
EBT	(148,044)	425,016	189,323	219,177	549,039	894,719
Taxes/(Income Tax Recovery)	(51,000)	113,000	53,900	(51,735)	187,332	305,278
Net Earnings for the eperiod	(97,044)	312,016	135,423	270,912	361,707	589,441
EPS	(0.00)	0.01	0.003	0.0071	0.0096	0.0157

BALANCE SHEETS						
(in CS)	2008	2009	2010	2011	2012E	2013E
Assets						
Cash	940,302	1,362,363	1,122,172	719,937	1,074,829	1,510,968
Accounts receivable	710,770	672,010	880,150	884,411	831,316	956,013
Inventory	496,335	577,993	569,976	624,115	633,591	712,438
Prepaid Expenses	65,407	42,807	75,696	88,924	51,296	57,679
Future Income Tax		86,000	70,000	168,000	168,000	168,000
Current Assets	2,212,814	2,741,173	2,717,994	2,485,387	2,759,031	3,405,099
LT Receivables				94,000	94,000	94,000
Equipment & Furniture	250,607	229,135	213,363	222,913	193,435	171,326
Deferred Dev Costs and foreign exchange loss			178,170	334,641	334,641	334,641
Future income tax assets	478,000	279,000	241,100	194,835	194,835	194,835
Intangibles				597,938	597,938	597,938
Total Assets	2,941,421	3,249,308	3,350,627	3,929,714	4,173,880	4,797,839
Liabilities & Shareholders' Equity						
Accounts Payables & Accrued Liabilities	449,247	449,413	409,381	520,753	466,274	524,299
Demand / Factoring Loan	-	-	-	-	-	-
Customer Deposits, Bank and Shareholder's loan						
Current portion of capital lease obligations and loan	40,593	25,757	19,231	11,590	8,087	2,878
Current portion of notes payable				103,280	75,000	75,000
Current Liabilities	489,840	475,170	428,612	635,623	549,361	602,177
Convertible Debentures						
Obligations under capital lease and other loan	45,206	18,101	11,566	10,965	2,878	-
Notes and Loans payable				208,504	133,504	58,504
Shareholder's Equity						
Share Capital	8,108,202	8,111,487	8,103,112	2,801,749	2,801,749	2,801,749
Contributed surplus	165,803	200,164	227,528	2,868	54,676	114,256
Deficit	(5,867,630)	(5,555,614)	(5,420,191)	270,005	631,712	1,221,153
Total Liabilities & Shareholders' Equity	2,941,421	3,249,308	3,350,627	3,929,714	4,173,880	4,797,839

STATEMENTS OF CASH FLOWS						
(in CS)	2008	2009	2010	2011	2012E	2013E
Operating Activities						
Net earnings for the period	(97,044)	312,016	135,423	270,912	361,707	589,441
Items not involving cash						
Income tax recovery	(51,000)	113,000	53,900	(51,735)		
Gain on liabilities and sale of commercial division						
Unrealized foreign exchange and other gains	(6,500)	(47,688)	24,024	197,145		
Compensation related to stock option plan	18,408	35,396	27,364	8,606	51,808	59,579
Write-downs						
Interest accrued (on NP, on shareholder loan)						
Amortization and equipment write-down	64,758	60,388	56,969	82,476	59,478	52,109
	(71,378)	473,112	297,680	507,404	472,993	701,129
Changes in non-cash operating working capital						
Accounts receivable	17,008	86,448	(232,164)	(128,424)	53,095	(124,697)
Inventory	145,897	(81,658)	8,017	(54,139)	(9,476)	(78,847)
Prepaid expenses	(27,438)	22,600	(32,889)	(13,228)	37,628	(6,383)
Accounts payable and accrued liabilities	24,175	166	(40,032)	(55,609)	(54,479)	58,025
Customer Deposits	-	-	-	-	-	-
	159,642	27,556	(297,068)	(251,400)	26,769	(151,902)
Cash from from (used in) operations	88,264	500,668	612	256,004	499,762	549,227
Investing activities						
Purchase of furniture and equipment	(47,173)	(38,916)	(25,074)	(29,257)	(30,000)	(30,000)
Product development costs incurred			(178,170)	(185,270)		
Acquisition Costs						
Purchase of Intangible assets				(307,840)		
Proceeds on sale of commercial division						
Deferred Development Costs						
Purchase of equipment and leaseholds	(47,173)	(38,916)	(203,244)	(522,367)	(30,000)	(30,000)
Financing activities						
Proceeds (repayments) of demand loans					(103,280)	(75,000)
Proceeds (repayments) of payables and leases	(33,801)	(41,941)	(29,184)	(20,526)	(11,590)	(8,087)
Convertible debenture issued						
Issue of common share for cash	494,080	2,250		-		-
Purchase of capital stock			(8,375)	(115,346)		
	460,279	(39,691)	(37,559)	(135,872)	(114,870)	(83,087)
Increase (decrease) in cash	501,370	422,061	(240,191)	(402,235)	354,892	436,140
Cash beginning of period	438,932	940,302	1,362,363	1,122,172	719,937	1,074,829
Cash end of period	940,302	1,362,363	1,122,172	719,937	1,074,829	1,510,968

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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