

ELECTROVAYA INC.

Unaudited Consolidated Balance Sheets
(Expressed in Thousands of U.S. dollars)

	December 31, 2005	September 30, 2005
Assets		
Current assets		
Cash and cash equivalents	\$ 11,405	\$ 3,333
Short-term investments	-	8,900
Accounts receivable	435	826
Investment tax credits recoverable	-	49
Goods and Services Tax receivable	29	29
Inventories (note 2)	2,060	1,844
Prepaid expenses and other	17	65
	<u>13,946</u>	<u>15,046</u>
Capital assets (see note 1(c))	10,640	10,936
	<u>\$ 24,586</u>	<u>\$ 25,982</u>
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 1,457	\$ 1,604
	<u>1,457</u>	<u>1,604</u>
Shareholders' equity		
Share capital (note 3)	63,745	63,745
Contributed surplus	286	227
Cumulative translation adjustment	7,389	7,504
Deficit	<u>(48,291)</u>	<u>(47,098)</u>
	23,129	24,378
Contingencies (note 1(g))		
	<u>\$ 24,586</u>	<u>\$ 25,982</u>

See accompanying notes to consolidated financial statements.

These unaudited interim consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements for the year ended September 30, 2005.

ELECTROVAYA INC.

Unaudited Consolidated Statements of Operations and Deficit
(Expressed in Thousands of U.S. dollars, except per share amounts)

Three months ended December 31, 2005 and 2004

	2005	2004
Revenue	\$ 588	\$ 1,488
Direct manufacturing costs	627	1,464
	(39)	24
Expenses		
Research and development	488	461
Government assistance (note 1(g))	(219)	(312)
Sales and marketing	174	274
General and administrative	534	657
	977	1,080
Loss before the undernoted	1,016	1,056
Amortization	286	745
Loss from operations	1,302	1,801
Interest income	(76)	(76)
Loss from foreign exchange	(33)	227
	(109)	151
Loss for the quarter	1,193	1,952
Deficit, beginning of year	47,098	40,776
Deficit, end of year	\$ 48,291	\$ 42,728
Basic and diluted loss per common share	\$ 0.02	\$ 0.03

See accompanying notes to consolidated financial statements.

These unaudited interim consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements for the year ended September 30, 2005.

ELECTROVAYA INC.

Unaudited Consolidated Statements of Cash Flows
(Expressed in Thousands of U.S. dollars, except per share amounts)

Three months ended December 31, 2005 and 2004

	2005	2004
Cash provided by (used in)		
Operating activities		
Loss for the year	\$ (1,193)	\$ (1,952)
Amortization which does not involve cash	286	745
Stock compensation expense	59	36
Change in non-cash operating working capital (note 6)	125	211
	(723)	(960)
Investing activities		
Reductions to short-term investments	8,900	10,897
Additions to capital assets	(37)	(46)
	8,863	10,851
Increase in cash and cash equivalents	8,140	9,891
Effect of currency translation adjustments on cash and cash equivalents	(68)	872
Cash and cash equivalents beginning of year	3,333	2,715
Cash and cash equivalents end of year	\$ 11,405	\$ 13,478
Supplemental disclosure of cash flow information		
Interest received	\$ 143	\$ 128

See accompanying notes to consolidated financial statements.

These unaudited interim consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements for the year ended September 30, 2005.

ELECTROVAYA INC.

Unaudited Notes to Consolidated Financial Statements

(Expressed in Thousands of U.S. dollars, except per share amounts and otherwise stated.)

Three months ended December 31, 2005 and 2004

Electrovaya Inc. (the "Company"), incorporated in 1996 under the Business Corporations Act (Ontario), develops, manufactures and markets portable power technology products using its patented lithium ion SuperPolymer® technology.

1. Significant accounting policies

(a) Basis of presentation

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles. These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All inter-company balances and transactions have been eliminated during consolidation.

The company has no operating assets located outside of Canada.

The disclosures contained in these unaudited interim consolidated financial statements do not include all disclosures required under Canadian generally accepted accounting principles (GAAP) for annual financial statements. The unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended September 30, 2005.

The unaudited interim consolidated financial statements are based upon accounting policies consistent with those used and described in the annual consolidated financial statements. The interim financial statements are not considered to be materially affected by seasonal or cyclical factors.

Management believes these unaudited interim consolidated financial statements include all adjustments, including normal recurring adjustments, necessary to present fairly the financial position of the Company as at December 31, 2005 and the results of its operations and its cash flows for the three months ended December 31, 2005. Results for the three months ended December 31, 2005 are not necessarily indicative of the results to be expected for the entire year.

(b) Cash and cash equivalents and short term investments

Cash and cash equivalents include temporary investments in marketable securities which are readily convertible into cash and which have an original term to maturity of 90 days or less. Short term investments consist of temporary investments in marketable securities with longer terms to maturity and are recorded at cost, which is equivalent to their market value.

ELECTROVAYA INC.

Unaudited Notes to Consolidated Financial Statements (continued)
(Expressed in Thousands of U.S. dollars, except per share amounts and otherwise stated.)

Three months ended December 31, 2005 and 2004

1. Significant accounting policies (continued)

(c) Capital assets

Capital assets are recorded at cost less related investment tax credits and accumulated amortization. Amortization is provided on a straight-line basis over the estimated useful lives of the assets at the following annual rates:

Building	4%
Building improvements	7%
Production equipment	17%
Workshop equipment	20%
Patents and technology	20%
Office furniture and equipment	20%
Vehicles	20%

During the fourth quarter of the fiscal year ended September 30, 2005, the Company reviewed the estimated useful life of depreciable assets resulting in a prospective change in amortization for production equipment and building improvements.

This resulted in production equipment and building improvements being amortized on a straight line basis over the next 6 and 15 years respectively.

(d) Impairment of long-lived assets

Capital assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

(e) Research and development costs

Research costs, net of related investment tax credits, are expensed in the period in which they are incurred.

Development costs, net of related investment tax credits, are expensed in the period incurred unless such costs meet the criteria under Canadian generally accepted accounting

ELECTROVAYA INC.

Unaudited Notes to Consolidated Financial Statements (continued)

(Expressed in Thousands of U.S. dollars, except per share amounts and otherwise stated.)

Three months ended December 31, 2005 and 2004

1. Significant accounting policies (continued)

principles for deferral and amortization. To date, the Company has not deferred any development costs.

Certain costs related to the Company's research and development efforts related to fast batteries and electric vehicles are being funded by a repayable grant from Technology Partnerships Canada (see Note 1 (g)).

(f) Inventories

Inventories are comprised of raw materials, work in progress and finished goods. Raw materials and work in progress are recorded at the lower of cost and replacement cost. Finished goods are recorded at the lower of cost and net realizable value.

(g) Government assistance

The Company receives indirect financial assistance from the government by way of the investment tax credit program. This program provides assistance, by way of direct payments and reductions in corporate income taxes, for specially defined qualifying expenditures. Investment tax credits are credited against the related research and development expenses, or capital assets.

The Company has been approved for funding under the Technology Partnerships Canada initiative of Industry Canada. The funding is to support the Company's research and development efforts in fast rate batteries and electric vehicles. The Company will receive contributions of up to 29.7% of the specified costs of the development project, to a maximum amount of \$6,700. Under the terms of the agreement, an amount up to a maximum of \$31,100 is to be repaid by royalties, commencing in 2007 through to 2013, with payment to be deferred or reduced if certain revenue thresholds are not achieved. For the fiscal year ended September 30, 2005, cumulative claims of \$2,524 have been received. Additional claims for \$219 were received by the company during the quarter ended December 31, 2005 (2004-\$312).

(h) Stock based Compensation

In accordance with Handbook section 3870 "Stock-based Compensation and Other Stock-based Payments," the Company applies the fair value method of accounting for employee stock options to all employee stock options granted on or after October 1, 2003. Under the fair value based method, compensation cost is measured at fair value at the date of grant and expensed over the award's vesting period. Stock based compensation expense for the quarter ended December 31, 2005 was \$59 (\$36 – 2004)

ELECTROVAYA INC.

Unaudited Notes to Consolidated Financial Statements (continued)
(Expressed in Thousands of U.S. dollars, except per share amounts and otherwise stated.)

Three months ended December 31, 2005 and 2004

1. Significant accounting policies (continued)

(i) Revenue recognition

Revenue from product sales is recognized upon shipment, since persuasive evidence of an arrangement exists, risks and rewards of ownership have been transferred to customers, selling price is fixed and determinable and collectability is reasonably assured. Estimated returns and allowances and sales rebates are recorded as a reduction of revenue at the time of revenue recognition. In addition, the Company provides for the estimated cost of standard product warranties at the time of revenue recognition. The Company primarily uses a binding purchase order as evidence of its sales arrangements, and with respect to its service arrangements uses contractual agreements. The Company considers delivery to occur upon shipment, provided risks and rewards of ownership, including transfer of title have passed to the customer. At the point of sale, the Company assesses whether collection is reasonably assured. If the Company determines that collection is not reasonably assured, the Company defers recognition of the revenue until collection becomes reasonably assured, which is generally upon receipt of cash. Where an estimate of the potential sales returns cannot be made, the recognition of revenue does not occur until the distributor has sold the product.

Revenue from services provided to third parties under contracts is recognized as services are performed and as each milestone in the contract is achieved and accepted by the customer.

Revenue from custom machine building is recognized based on the percentage of completion method of accounting for contracts. Under such contracts, revenue is recognized based on the ratio of total costs incurred to date to overall estimated costs. Provisions for estimated losses on contracts are recognized when identified.

(j) Warranty costs

Warranty costs are provided for as revenues are earned.

(k) Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the years. Actual results may differ from the estimates. Sales returns are estimated at the time of delivery based on past experience and customer specific factors. Bad debts are determined based on the ageing of accounts receivable where such amounts are not insured and considered uncollectible.

ELECTROVAYA INC.

Unaudited Notes to Consolidated Financial Statements (continued)
(Expressed in Thousands of U.S. dollars, except per share amounts and otherwise stated.)

Three months ended December 31, 2005 and 2004

1. Significant accounting policies (continued)

Warranty accruals are based on the actual warranty experience rate for the past year and sales during the most recent warranty period.

The Company operates in a competitive market subject to fast-paced technological changes. The Company has estimated the provisions for sales returns, warranty costs and obsolete inventory based on historical patterns, communication with its distributors, industry trends and existing competitive pressures. Significant changes in technology or competitors' products could result in a material change in the rate of sales returns.

(l) Income taxes

The Company uses the asset and liability method of accounting for income taxes. Future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carry-forwards. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in the income in the period that includes the date of enactment or substantive enactment. A valuation allowance is recorded against any future income tax asset if it is not more likely than not that the asset will be realized.

(m) Currency translation

Monetary assets and liabilities of the Company which are denominated in foreign currencies are translated into Canadian dollars (which is considered to be the measurement currency) at the exchange rates prevailing at the balance sheet date, and transactions denominated in foreign currencies which are included in operations are translated at the average rates for the period. Non-monetary assets and liabilities are translated at the exchange rate in effect at the transaction date. Exchange gains and losses resulting from the translation of these amounts are reflected in the statement of operations in the period in which they occur.

As the Company's reporting currency is the U.S. dollar, the Company translates assets and liabilities denominated in Canadian dollars into U.S. dollars at the exchange rate prevailing at the balance sheet date, and the results of operations at the average rate for the period. Cumulative net translation adjustments are included as a separate component of shareholders' equity.

ELECTROVAYA INC.

Unaudited Notes to Consolidated Financial Statements (continued)
(Expressed in Thousands of U.S. dollars, except per share amounts and otherwise stated.)

Three months ended December 31, 2005 and 2004

1. Significant accounting policies (continued)

(n) Earnings per share

Basic earnings per share is calculated using the weighted average number of shares outstanding during the year. Diluted earnings per share is computed using the weighted average number of common and potential common shares outstanding during the year, if dilutive.

2. Inventories

	December 31, 2005	September 30, 2005
Raw materials	\$ 857	\$ 816
Work in progress	1,070	896
Finished goods	133	132
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	\$ 2,060	\$ 1,844

3. Share capital

As at December 31, 2005, the Company had 69,575,442 common shares (69,575,442 as at December 31, 2004) outstanding and 3,388,937 options (2,488,934 as at December 31, 2004) to acquire common shares under the Company's employee incentive plan.

4. Financial instruments

(a) Fair values

The reported values of the financial instruments, which consist of cash and cash equivalents, short-term investments, accounts receivable and accounts payable and accrued liabilities, approximate their fair values due to the near-term maturity of those instruments.

(b) Foreign currency risk

The Company is exposed to foreign currency fluctuations to the extent that the Company is holding significant cash and cash equivalent balances denominated in U.S. dollars. The Company does not hedge the risk related to fluctuations of the exchange rate between U.S. and Canadian dollars.

ELECTROVAYA INC.

Unaudited Notes to Consolidated Financial Statements (continued)
(Expressed in Thousands of U.S. dollars, except per share amounts and otherwise stated.)

Three months ended December 31, 2005 and 2004

4. Financial instruments (Continued)

(c) Credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade accounts receivable. The Company performs periodic credit evaluations of the financial condition of its customers and typically does not require collateral from them. Allowances are maintained for potential credit losses consistent with the credit risk of specific customers, historical trends and other information. Credit losses have been within management's range of expectations. The company also insures some of its accounts receivable.

5. Related Party Transactions

- a) The Company in the previous years leased 11,800 square feet at an annual rental amount of \$80 at its Hanna Avenue premises in Toronto, Ontario, from a company owned by its controlling shareholders. On May 1, 2005, the Company vacated the premises and moved into the Company's existing facilities in Mississauga. All the Company's divisions are now located at 2645 Royal Windsor Drive, Mississauga, Ontario.
- b) Electrovaya in the previous years invested \$115 in a private unrelated company. In return for its investment, the Company received 6% of the Class A and 21% of the Class B shares of this private company. Additionally, during the previous years, Electrovaya has provided research and development services totaling \$153 to this private company, and received an additional 30% of the outstanding non-voting, participating Class B shares as consideration for the services rendered. The Class B shares are convertible into Class A voting, participating shares in the event the private company becomes registered on a stock exchange. During the previous years, Electrovaya provided a \$38 loan and space at no additional charge to the company to assist with the operation of a pilot plant, resulting in the potential for Electrovaya to exert significant influence over the activities of the private company. The private company is owned by arm's length private investors and has not yet reached commercial levels of production. The private company is currently seeking additional funding and, in the event these efforts are unsuccessful, may not be a going concern. As a result, the original investment, additional shares and loan were valued at NIL as at December 31, 2005 and December 31, 2004. During the quarter ended December 31, 2005, the Company entered into negotiations to sell its class A and B shares of the private company to a third party.
- c) In August 2005, the Company purchased all of the issued and outstanding shares of 1020204 Ontario Limited from its two principal shareholders, Dr. Sankar Das Gupta, who is a director and officer of the Company and Dr. James Jacobs who is an officer of the Company. Electrovaya Inc. then transferred all of its shares in Electrovaya Corp. to 1020204 Ontario Limited in exchange for shares of 1020204 Ontario Limited. 1020204

ELECTROVAYA INC.

Unaudited Notes to Consolidated Financial Statements (continued)
(Expressed in Thousands of U.S. dollars, except per share amounts and otherwise stated.)

Three months ended December 31, 2005 and 2004

5. Related Party Transactions (continued)

Ontario Limited and Electrovaya Corp. then completed a statutory vertical amalgamation and continued as Electrovaya Corp. (the "amalgamation transaction").

The amalgamation transaction had been accounted for based on CICA Handbook Section 3840, *Related Party Transactions* at the exchange amounts of the assets and liabilities transferred as there has been a substantive change in the ultimate unrelated parties' ownership interests in the subsidiaries. Further the Company had obtained independent evidence on the exchange amounts involved in the amalgamation transaction. An independent committee of the Board was constituted to review the amalgamation transaction.

Upon the amalgamation, the Company received \$509 of cash and assumed a liability of \$77 relating to interest payable on an income taxes liability of 1020204 Ontario Limited. The offset to the \$432 of net assets assumed had been recorded as a credit to income tax recovery in the statement of operations for the fiscal year ended September 30, 2005.

In addition, as at September 30, 2005, Electrovaya Corp carried back income tax losses of \$4,787, eliminating a \$1,148 income tax liability of 1020204 Ontario Ltd. This transaction had no impact on the statement of operations as a full valuation allowance had been recorded against the income tax losses.

- d) During the quarter ended December 31, 2005, the Company paid \$ 39 (2004 - \$34) to a director of a wholly owned subsidiary company for services rendered to the Company in his capacity as an executive officer.

6. Change in non-cash operating working capital

	Quarter ended December 31,	
	2005	2004
Accounts receivable	\$ 391	\$ (460)
Investment tax credits recoverable	49	70
Goods and Services Tax receivable	-	47
Inventories	(216)	487
Prepaid expenses and other	48	(15)
Accounts payable and accrued liabilities	(147)	82
	<hr/>	<hr/>
	\$ 125	\$ 211
