

AUDITORS' REPORT

To the Shareholders of
Electrovaya Inc.

We have audited the consolidated balance sheets of **Electrovaya Inc.** as at September 30, 2007 and 2006 and the consolidated statements of operations and deficit, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

SGGG LLP

Toronto, Ontario
December 13, 2007

Chartered Accountants
Licensed Public Accountants

ELECTROVAYA INC.

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

	September 30, 2007	September 30, 2006
Assets		
Current assets		
Cash and cash equivalents	\$ 7,247	\$ 4,305
Short-term investments	-	5,845
Accounts receivable	218	434
Related party receivables (note 6 (b))	498	-
Investment tax credits recoverable	390	139
Goods and services tax receivable	20	23
Inventories (note 2(a))	1,448	1,839
Prepaid expenses and other	137	123
	<u>9,958</u>	<u>12,708</u>
Capital assets (note 1(d) and 3)	6,672	6,356
	<u>\$ 16,630</u>	<u>\$ 19,064</u>
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 908	\$ 1,167
Income tax payable (note 6(b))	498	
Related party obligation (note 6 (f))	97	87
	<u>1,503</u>	<u>1,254</u>
Long-term portion of related party obligation (note 6 (f))	260	307
Shareholders' equity		
Share capital (note 4)	63,745	63,745
Contributed surplus	700	495
Accumulated other comprehensive income (notes 1(b) and 13)	10,101	8,301
Deficit	<u>(59,679)</u>	<u>(55,038)</u>
	14,867	17,503
	<u>\$ 16,630</u>	<u>\$ 19,064</u>

See accompanying notes to consolidated financial statements.

ELECTROVAYA INC.

Consolidated Statements of Operations and Deficit
(Expressed in Thousands of U.S. dollars, except per share amounts)
Years ended September 30, 2007 and 2006

	2007	2006
Revenue (note 12)	\$2,344	\$3,358
Direct manufacturing costs (note 2(b))	3,351	3,209
	(1,007)	149
Expenses		
Research and development	2,061	2,690
Government assistance (note 1(g))	(1,174)	(1,655)
Sales and marketing	346	534
Warranty increase/(decrease) (note 1(j))	(229)	41
General and administrative	1,562	2,457
	2,566	4,067
Loss before the undernoted	3,573	3,918
Amortization (see note 1 (d) and 3)	646	979
Capital assets write-down	-	4,020
Loss from operations	4,219	8,917
Interest income	(281)	(366)
(Gain) Loss from foreign exchange	703	281
	422	(85)
Loss for the period before undernoted	4,641	8,832
Gain on sale of investments	-	(892)
Net loss and comprehensive loss for the period (note 1(b))	4,641	7,940
Deficit, beginning of period	55,038	47,098
Deficit, end of period	59,679	55,038
Basic and diluted loss per common share	\$ (0.07)	\$ (0.11)
Weighted average number of shares outstanding, basic and fully diluted	69,575,442	69,575,442

See accompanying notes to consolidated financial statements.

ELECTROVAYA INC.

Consolidated Statements of Cash Flows

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

Years ended September 30, 2007 and 2006

	2007	2006
Cash provided by (used in)		
Operating activities		
Loss for the period	\$ (4,641)	\$ (7,940)
Gain on sale of investments		(892)
Items not involving cash:		
Amortization	646	979
Capital assets write-down	-	4,020
Stock compensation expense (note 1(h))	205	268
Change in related party receivables	(498)	-
Increase/(decrease) in related party obligation	(47)	307
Change in non-cash operating working capital (note 11)	594	(95)
	(3,741)	(3,353)
Investing activities		
Proceeds from short-term investments	5,845	3,055
Additions to capital assets	(276)	(178)
Proceeds on sale of investments	-	892
	5,569	3,769
Increase in cash and cash equivalents	1,828	416
Effect of currency translation adjustments on cash and cash equivalents	1,114	556
Cash and cash equivalents, beginning of year	4,305	3,333
Cash and cash equivalents, end of period	\$ 7,247	\$ 4,305
Supplemental disclosure of cash flow information		
Income taxes paid	\$ 23	\$ 22
Interest received	252	365

See accompanying notes to consolidated financial statements.

ELECTROVAYA INC.

Notes to Consolidated Financial Statements

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

Years ended September 30, 2007 and 2006

Electrovaya Inc. (the Company or "Electrovaya"), incorporated in 1996 under the Business Corporations Act (Ontario), develops, manufactures and markets portable power technology products and services 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.

(b) Changes in Accounting Policy

Effective January 1, 2007, the Company adopted CICA Handbook Section 1530, Comprehensive Income, Section 3855, Financial Instruments – Recognition and Measurement and Section 3861, Financial Instruments – Disclosure and Presentation. The changes are applied prospectively with no restatement in prior quarterly or annual comparatives.

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.

Under Section 3855, financial instruments must be classified into one of these five categories: held-for-trading, held-to-maturity, loans and receivables, available for sale financial assets or other financial liabilities.

Held-for-trading

Financial instruments classified as held-for-trading are carried at fair value at each balance sheet date with the changes in fair value recorded in net earnings (loss) for the period in which these changes arise.

Held-to-maturity investments, loans and receivables and other financial liabilities

Financial instruments classified as loans and receivables, held-to-maturity investments and other financial liabilities are carried at cost using the effective interest method. The interest income or expense is included in net earnings (loss) over the expected life of the instrument.

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

1. Significant accounting policies (continued)

Available for sale

Financial instruments classified as available-for-sale are carried at fair value at each balance sheet date with the changes in fair value recorded in other comprehensive income (loss) in the period in which the change arises.

As a result of the adoption of these new standards, the Company has classified its cash and cash equivalents as held-to-maturity. Accounts receivable are classified as loans and receivables. Accounts payable and accrued liabilities are classified as other financial liabilities, which are measured at amortized cost. The Company had no derivatives or hedge accounting instruments.

The new standards also introduce a new measurement of results called comprehensive income which is composed of the Company's net earnings and other comprehensive income. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners.

(c) 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.

(d) 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%

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

1. Significant accounting policies (continued)

(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 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 repayable grants from Technology Partnerships Canada ("TPC") and Sustainable Development Technology Corp ("SDTC") (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. The Company determines its allowance for inventory obsolescence based upon expected inventory turnover, inventory aging, and current and future expectations with respect to product offerings.

(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 TPC 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 Cdn \$10,000 (\$10,041). 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. These revenue thresholds were not achieved during the fiscal 2007. Cumulative claims of \$3,707 were received by the Company as at September 30, 2006 from the TPC program.

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

1. Significant accounting policies (continued)

During fiscal 2007, the Company received contributions totaling \$727 (2006-\$1,183) from the TPC program.

In July 2005, the Company became eligible for a Cdn \$1,700 grant from SDTC towards a Cdn \$5,100 project related to the development and demonstration of Electrovaya's Lithium Ion SuperPolymer® Battery for application in zero-emission commercial fleet vehicles.

The amount is receivable in scheduled instalments as provided in the contribution agreement between SDTC and the Company and will be received upon the achievement of various project milestones. Under the terms of the agreement SDTC shall pay the lesser of 33% of the eligible project costs or CDN \$ 1,700, the contribution shall not exceed 50% of the eligible project costs and the Company or consortium members, or both, shall provide at least 25% of the project costs in cash, in-kind goods or services or a combination of both. SDTC shall not have any obligation to pay the contribution unless the Company has obtained a commitment and has the financial capacity to finance all the costs related to the entire project.

The project is divided into three milestones, and the first milestone was completed by July 31, 2006. The second milestone was originally budgeted to be completed in the quarter ended June 30, 2007 but the Company has requested SDTC to extend tenure of the project due to certain constraints. The second milestone is likely to be extended up to April 2008. The third milestone is expected to be completed by February 2009 (original completion date of January 2008).

A cash contribution of \$447 was received by the Company during the fiscal 2007 (2006 - \$472) for the achievement of certain milestones. Cumulative claims of \$919 have been received as at September 30, 2007 from SDTC.

(h) Stock based compensation

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 year was \$205 (2006-\$268).

(i) Revenue recognition

Revenue from product sales is recognized upon shipment. 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

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

1. Significant accounting policies (continued)

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. 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.

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

1. Significant accounting policies (continued)

(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) Foreign 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 consolidated 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 other comprehensive income.

(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.

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

1. Significant accounting policies (continued)

(o) Impairment of long-lived assets

The Company reviews capital assets subject to amortization for impairment on an annual basis or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized when the carrying amount of an asset that is held and used exceeds the projected undiscounted future net cash flows expected from its use and disposal, and is measured as the amount by which the carrying amount of the asset exceeds its fair value, which is measured by discounted cash flows when quoted market prices are not available. Management determined that there is no impairment charge for the year ended September 30, 2007.

2. Inventories

(a) Total inventories on hand as at September 30, 2007 and 2006 are as follows:

	September 30,	
	2007	2006
Raw materials	\$ 498	\$ 856
Work in progress	540	844
Finished goods	410	139
	\$ 1,448	\$ 1,839

(b) As per accounting policies (note 1(f)), during the years ended September 30, 2007 and 2006, the following inventory revaluations and obsolescence provisions were included in direct manufacturing costs:

	September 30,	
	2007	2006
Gain on material revaluation	\$ 183	\$ 34
Provision for obsolescence/(reversal)	250	(318)
	\$ 433	\$ (284)

3. Capital assets:

September 30, 2007	Cost	Accumulated amortization	Net book value
Tangible assets			
Land	\$ 3,012	\$ -	\$ 3,012
Building	945	591	354
Building improvements	8,369	5,312	3,057
Production equipment	14,128	14,086	42
Workshop equipment	1,610	1,609	1
Office furniture and equipment	803	777	26
Vehicles	54	54	-
Intangible assets			
Patents and technology	2,406	2,226	180
	\$ 31,327	\$ 24,655	\$ 6,672

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

3. Capital assets (continued)

September 30, 2006	Cost	Accumulated amortization	Net book value
Tangible assets			
Land	\$ 2,690	\$ -	\$ 2,690
Building	844	494	350
Building improvements	7,475	4,346	3,129
Production equipment	12,585	12,504	81
Workshop equipment	1,438	1,437	1
Office furniture and equipment	703	689	14
Vehicles	48	48	-
Intangible assets			
Patents and technology	1,948	1,857	91
	\$ 27,731	\$ 21,375	\$ 6,356

Amortization expense for the year is \$646 (2006 - \$979).

The Company has reported a current-period operating and cash flow loss and has a history of operating and cash flow losses. The recent and historical performance of the Company and its near-term forecast indicated that the carrying amount of the capital assets may not be recoverable.

During the quarter ended March 31, 2006, the Company completed its regular impairment analysis which indicated that the estimated undiscounted future cash flows to be generated by the capital assets were less than their carrying values. The carrying values of the capital assets were therefore reduced to fair market value, resulting in a capital assets write-down of \$4,020. Where possible, management estimated fair market value using third party appraisals.

4. Share capital

(a) Authorized and issued capital stock

Authorized
Unlimited common shares

Issued	Common Shares	
	Number	Amount
Balance, September 30, 2005, 2006 & 2007	69,575,442	\$ 63,745

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

4. Share capital (continued)

(b) Stock options

The Company has reserved up to 5,400,000 common shares for issuance under the stock option plan. Options to purchase common shares of the Company under its stock option plan may be granted by the Board of Directors of the Company to certain full-time and part-time employees, directors and consultants of the Company and its affiliates. Stock options are non-assignable and may be granted for terms of up to 10 years. Stock options vest at various periods from zero to three years. To date, the Company has granted options to purchase 4,760,833 common shares and 3,175,938 remain outstanding (2006 - 3,194,271) at prices ranging from \$ 0.29 to \$8.03 per share. These options have a weighted average remaining life of 5.20 years.

The following table reflects activity under the Plan from September 30, 2005 through September 30, 2007 and the weighted average exercise prices:

	Number	Weighted average exercise prices
Outstanding, September 30, 2005	2,703,937	1.93
Granted	685,000	0.26
Cancelled or expired	(194,666)	0.35
Outstanding, September 30, 2006	3,194,271	1.31
Granted	-	-
Cancelled or expired	(18,333)	0.69
Outstanding, September 30, 2007	3,175,938	1.42

During the year, no options were granted by the Company to purchase common shares.

During the previous year, the Company granted options to purchase common shares to certain employees totaling 685,000 at a price of \$0.26 per share.

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

4. Share capital (continued)

Exercise price	Options outstanding as at September 30, 2007		Options exercisable as at September 30, 2007	
	Number outstanding	Weighted average remaining life (years)	Number exercisable	Weighted average exercise price
\$ 0.62 (Cdn\$0.62)	249,671	4.86	249,671	\$ 0.62
0.68 (Cdn\$0.68)	25,000	5.17	25,000	0.68
0.90 (Cdn\$0.90)	27,666	6.86	27,666	0.90
1.10 (Cdn\$1.10)	408,334	6.64	408,334	1.10
1.68 (Cdn\$1.67)	908,100	1.89	908,100	1.68
3.01 (Cdn\$3.00)	83,000	3.87	83,000	3.01
5.24	96,666	3.09	96,666	5.24
5.33	85,500	2.37	85,500	5.33
8.03 (Cdn\$8.00)	19,000	3.09	19,000	8.03
8.00	60,000	2.95	60,000	8.00
0.56 (Cdn\$0.56)	443,334	7.20	299,999	0.56
0.36 (Cdn\$0.36)	100,000	7.93	100,000	0.36
0.29 (Cdn\$0.29)	669,667	8.23	224,336	0.29
	3,175,938	5.20	2,587,272	1.66

For the options outstanding as at September 30, 2007, the weighted average exercise price is \$1.42 (2006 - \$1.31).

On January 25, 2007, the Company announced a Normal Course Issuer Bid ("Bid") through the Toronto Stock Exchange ("TSX") in effect for a twelve-month period commencing on January 29, 2007. The maximum number of common shares which may be purchased during the Bid is 3,478,772 common shares, being approximately 5% of Electrovaya's issued and outstanding common shares as at January 22, 2007. Common shares purchased by the Company pursuant to this Bid shall be cancelled.

5. Foreign currency and credit risk

(a) 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.

(b) Credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of accounts receivable. The Company performs periodic credit

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

5. Foreign currency and credit risk (continued)

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.

6. Related party transactions

(a) Electrovaya in 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 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 were convertible into Class A voting, participating shares in the event the private company became registered on a stock exchange. During the previous years, Electrovaya provided a \$38 loan and space at no additional charge to the private 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 was owned by arm's length private investors and had not yet reached commercial levels of production. The private company was seeking additional funding and, in the event these efforts were unsuccessful, would have not been a going concern. As a result, the original investment, additional shares and loan were valued at NIL as at September 30, 2005. In April, 2006, the Company sold its class A and B shares of the private company to a third party and recorded a gain of \$892 on the sale.

(b) In August 2005, the Company purchased all of the issued and outstanding shares of 1020204 Ontario Limited ("102") from its two principal shareholders at the time, Dr. Sankar Das Gupta, who is a director and officer of the Company and Dr. James Jacobs who was an officer of the Company. Electrovaya Inc. then transferred all of its shares in Electrovaya Corp. to 102 in exchange for shares of 102. 102 and Electrovaya Corp. then completed a statutory vertical amalgamation and continued as Electrovaya Corp. (the "amalgamation transaction").

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

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

6. Related party transactions (continued)

amalgamation transaction. An independent committee of the Board was constituted to review the amalgamation transaction.

Upon amalgamation, the Company received \$509 of cash and assumed a liability of \$77 relating to interest payable on an income taxes liability of 102. 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 102. This transaction had no impact on the statement of operations as a full valuation allowance had been recorded against the income tax losses.

In August, 2007, 102 received a Notice of Reassessment for a tax liability of approximately \$498 (including accumulated interest) relating to the sale of property by 102 prior to the amalgamation with Electrovaya. A final collection notice was received in December, 2007 and pursuant to discussions between the Company's lawyers, the former shareholders of 102 and the Ministry of Finance, no collection action is expected prior to January 31, 2008 while the Company, the former shareholders of 102 and their lawyers are in discussions with the Ministry of Finance in respect of a possible waiver of this tax liability. Pursuant to the terms of the share purchase agreement, the former shareholders of 102 have indemnified Electrovaya in respect of the full amount including legal and administrative expenses if any resulting tax liability. Therefore, the Company did not accrue the tax liability as an expense.

- (c) During the quarter ended June 30, 2006, 102 was served with a Statement of Claim ("Claim") by the purchaser of the land and building at Hanna Avenue, seeking damages in the amount of \$986. During the quarter ended June 30, 2007 the lawsuit was dropped by the plaintiff and a mutual release was signed, at no cost to Electrovaya.
- (d) During the year ended September 30, 2007, the Company paid \$200 (2006-\$159) to a director of a wholly owned subsidiary company for services rendered to the Company in his capacity as an executive officer. During the year ended September 30, 2007, the Company paid \$ 260 (2006 - 233) to the Chief Executive Officer, who is also a controlling shareholder of the Company.
- (e) During the year ended September 30, 2006, the Company was served with a Statement of Claim for \$1,100 by an executive officer related to an automobile accident involving one of the Company-owned automobiles. The Company is fully insured for the amount of the claim

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

6. Related party transactions (continued)

- (f) Pursuant to a termination of employment agreement between the Company and the co-founder and former Chief Technology Officer of the Company, the Company is obligated to pay 130 biweekly instalments totalling \$448 beginning September 2006. In the event of a change in control, insolvency or wind-up of the Company, all amounts become due and payable immediately. The Company has accounted for the present value of the expected future payments of \$394 as a charge to income during the year ended September 30, 2006.

7. Commitments

- (a) The Company's future minimum lease payments under operating leases for the years ending September 30, are as follows:

2008	6
	\$ 6

- (b) In May, 2006, the Company entered into a fixed price agreement for \$1,000 with the New York State Energy Research and Development Authority ("NYSERDA"). Under the agreement, the Company will expand its operations in New York State to develop lawn and turf off-road equipment and establish sales and service capabilities for its Scribbler Tablet products. To date, the Company has entered into a one year lease for approximately 2,200 square feet of manufacturing and office space and a lease commencing January 1, 2008, for 7,500 square feet of new space at a building to be constructed at the Saratoga Technology + Energy Park ("STEP"). The STEP lease is subject to the landlord obtaining the necessary financing to complete the new building and the availability of space that meets the requirements of the Company.

NYSERDA will pay the Company based on various project milestones achieved. During the quarter ending September 30, 2007, the Company received a milestone payment of \$32,020.

8. Loss per share

The basic and diluted loss per share has been calculated using the weighted average number of common shares outstanding during the periods, which are as follows:

September 30, 2007	69,575,442
September 30, 2006	69,575,442

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

8. Loss per share (continued)

Common share purchase options or other potential dilutive common share issuances were not considered in the calculation of diluted loss per share for each of the periods presented since their effect would be anti-dilutive.

9. Income taxes

The income tax recovery differs from the amount computed by applying the Canadian statutory income tax rate of 36.1% (2006 – 36.1%) to the loss before income taxes as a result of the following:

	Years ended September 30,	
	2007	2006
Loss before income taxes	\$ (4,641)	(7,940)
Expected Recovery of income taxes based on statutory rates	(1,676)	(2,868)
Reduction in income tax recovery resulting from:		
Lower rate on manufacturing profits	80	172
Non-taxable portion of capital gain	107	(161)
Other permanent differences	75	118
Change in valuation allowance	971	1,115
Change in enacted tax rates	425	1,620
Foreign operations taxed at a lower rate	18	4
Income tax recovery	\$ -	\$ -

The income tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities are as follows:

	Years ended September 30,	
	2007	2006
Future tax assets		
Non-capital losses carried forward	\$19,320	\$ 13,098
Capital assets	627	4,607
Unclaimed research and development expenses	3,533	3,107
Other deductible differences	148	314
	23,628	21,126
Less valuation allowance	(23,628)	(21,126)
Net future tax assets	\$ -	\$ -

In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

9. Income taxes (continued)

Management considers projected future taxable income, uncertainties related to the industry in which the Company operates and tax planning strategies in making this assessment. To the extent that management believes that the realization of future income tax assets does not meet the more likely than not realization criterion, a valuation allowance is recorded against the future tax assets.

In addition to the above temporary differences, the Company has unrecorded non-refundable investment tax credits amounting to approximately \$4,539 (2006 – 3,109) which begin to expire in 2008. During the year, the Company recognized \$181 (2006-139) of refundable investment tax credits.

As at September 30, 2007, the expiration dates of the Company's federal non-capital income tax losses carried forward are as follows:

2008	7,368
2009	9,573
2010	6,533
2014	5,152
2015	2,258
2022	978
2023	106
2024	337
2025	39
2026	22,177
2027	3,652
	\$ 58,173

10. Major customers

During 2007, three customers represented 47% (2006 – two customers represented 23%) of total revenue and 52% (2006 - 30%) of accounts receivable.

11. Change in non-cash operating working capital

	Years ended September 30,	
	2007	2006
Accounts receivable	\$ 216	392
Investment tax credits recoverable	(251)	(90)
Goods and services tax receivable	3	6
Inventories	391	5
Prepaid expenses and other	(14)	(58)
Accounts payable and accrued liabilities	(259)	(437)
Related party obligation	10	87
Income tax payable	498	-
	\$ 594	\$ (95)

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

12. Segmented information

The Company has reviewed its operations and determined that it operates in one business segment and has only one reporting unit. The Company develops, manufactures and markets portable power technology products using its patented lithium ion SuperPolymer[®] technology.

Revenues from major business activities were as follows:

	September 30,	
	2007	2006
Services	\$ 691	\$ 891
Consumer electronics	1,491	2,438
Other	162	29
	\$ 2,344	\$ 3,358

Revenues attributed to regions based on location of customer were as follows:

	September 30,	
	2007	2006
Canada	\$ 369	\$ 398
United States & Others	1,975	2,960
	\$ 2,344	\$ 3,358

As at September 30, 2007, all the Company's material assets were located in Canada.

13. Statement of comprehensive income

The following table provides a statement of comprehensive income and "Accumulated other comprehensive income" shown as a separate component of shareholders equity:

For the years ended September 30,	2007	2006
Net loss	\$ (4,641)	\$ (7,940)
Other comprehensive income, net of tax:		
Unrealized foreign currency translation gains and losses	10,101	8,301
Comprehensive income/(loss)	\$ 5,460	\$ (361)

ELECTROVAYA INC.

Notes to Consolidated Financial Statements (continued)

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

Years ended September 30, 2007 and 2006

14. Comparative figures

Certain of the comparative figures have been reclassified to conform with the presentation adopted in the current year.

The financial statements for the year ended September 30, 2006 were audited by another firm of chartered accountants