

Consolidated Financial Statements  
(Expressed in thousands of U.S. dollars)

## **ELECTROVAYA INC.**

Years ended September 30, 2003 and 2002



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## **AUDITORS' REPORT TO THE SHAREHOLDERS**

We have audited the consolidated balance sheets of Electrovaya Inc. as at September 30, 2003 and 2002 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 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 Electrovaya Inc. as at September 30, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive, slightly slanted style. Below the signature is a long, horizontal, slightly curved line that extends to the right.

Chartered Accountants

Toronto, Canada

November 14, 2003

# ELECTROVAYA INC.

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

	September 30,	
	2003	2002
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 6,178	\$ 2,529
Short-term investments	11,415	18,089
Accounts receivable	1,047	762
Investment tax credits recoverable	427	378
Goods and Services Tax receivable	55	163
Inventories (note 2)	2,852	3,324
Prepaid expenses and other	138	113
	<u>22,112</u>	<u>25,358</u>
Capital assets (note 3)	12,024	14,539
	<u>\$ 34,136</u>	<u>\$ 39,897</u>

## Liabilities and Shareholders' Equity

Current liabilities		
Accounts payable and accrued liabilities	\$ 1,760	\$ 1,220
Income taxes payable	6	42
	<u>1,766</u>	<u>1,262</u>
Shareholders' equity		
Share capital (note 4)	63,729	63,729
Cumulative translation adjustment	954	(2,657)
Deficit	(32,313)	(22,437)
	<u>32,370</u>	<u>38,635</u>
Commitments (note 7)		
Contingencies (note 1(f))		
	<u>\$ 34,136</u>	<u>\$ 39,897</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:

"Sankar Das Gupta" Director

"George Paterson" Director

# ELECTROVAYA INC.

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

	Years ended September 30,	
	2003	2002
Revenue	\$ 4,323	\$ 2,976
Cost of goods sold	5,331	4,641
Gross margin	(1,008)	(1,665)
Expenses		
Research and development	2,656	1,845
Government assistance Note 1(f)	(1,140)	—
Sales and marketing	2,439	2,221
General and administrative	1,928	2,331
	5,883	6,397
Loss before the undernoted	6,891	8,062
Amortization	2,746	2,495
Loss from operations	9,637	10,557
Interest income	(445)	(597)
Loss(gain) from foreign exchange	652	(11)
	207	(608)
Loss before income taxes	9,844	9,949
Income tax expense (note 9)	32	42
Loss for the year	9,876	9,991
Deficit, beginning of year	22,437	12,446
Deficit, end of year	\$ 32,313	\$ 22,437
Basic and diluted loss per common share (note 8)	\$ 0.14	\$ 0.14

See accompanying notes to consolidated financial statements.

# ELECTROVAYA INC.

Consolidated Statements of Cash Flows  
(Expressed in thousands of U.S. dollars)

	Years ended September 30,	
	2003	2002
Cash provided by (used in)		
Operating activities		
Loss for the year	\$ (9,876)	\$ (9,991)
Amortization which does not involve cash	2,746	2,495
Change in non-cash operating working capital (note 11)	725	(1,620)
	(6,405)	(9,116)
Investing activities		
Reductions to short-term investments	6,674	10,607
Additions to capital assets	(231)	(1,305)
	6,443	9,302
Increase in cash and cash equivalents	38	186
Effect of currency translation adjustments on cash and cash equivalents	3,611	(93)
Cash and cash equivalents beginning of year	2,529	2,436
Cash and cash equivalents end of year	\$ 6,178	\$ 2,529
Supplemental disclosure of cash flow information		
Income taxes paid	\$ 80	\$ 34
Interest received	479	823

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)

Years ended September 30, 2003 and 2002

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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 intercompany balances and transactions have been eliminated in consolidation.

The Company has no distinct operating segments and has no operating assets located outside of Canada.

### (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 are recorded at cost, which is equivalent to their market value.

### (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:

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Building	4%
Building improvements	4%
Production equipment	20%
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)

Years ended September 30, 2003 and 2002

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## 1. Significant accounting policies (continued)

### (d) 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 a repayable grant from Technology Partnerships Canada (see Note 1 (f)).

### (e) 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.

### (f) 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 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 \$31,075 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. The Company's first claim for \$1,140 was received in September, 2003. An additional claim for \$235 was made in August, 2003 and was received in October, 2003.

# ELECTROVAYA INC.

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

Years ended September 30, 2003 and 2002

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## 1. Significant accounting policies (continued)

### (g) Stock-based compensation

The Company issues stock options under the terms of its stock option plan as described in note 4(b). No compensation is recognized when options are issued to employees. Any consideration paid by employees on exercise of stock options is credited to share capital. Effective October 1, 2002, the Company prospectively adopted Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3870, which requires that a fair value based method of accounting be applied to all stock based payments to non-employees and to direct awards of stock to employees.

### (h) Equity instruments issued to non-employees in exchange for services

When equity instruments are issued to non-employees in exchange for services, the equity instruments are recorded at the fair value of the services received, where such value can be reliably measured, or otherwise, at the fair value of the equity instrument issued as consideration.

### (i) Revenue recognition

Revenue is recognized when title to the goods transfers to customers and collection is reasonably assured. Provision is made for potential sales returns at the time of shipment. For services, revenue is recognized as each milestone is achieved and accepted by the customer.

### (j) Warranty costs

Warranty costs are provided for as revenues are earned.

### (k) Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates.



# ELECTROVAYA INC.

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

Years ended September 30, 2003 and 2002

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## 1. Significant accounting policies (continued)

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 carryforwards. 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. 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.

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

Years ended September 30, 2003 and 2002

## 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. The treasury stock method is used to calculate diluted earnings per share. Under the treasury method, it is assumed that the potential proceeds from the exercise of dilutive stock options and warrants would be used to purchase the Company's common shares at the average market price during the period, and the computed incremental number of stock options and warrants are included in the denominator of the diluted earnings per share computation.

## 2. Inventories

	September 30,	
	2003	2002
Raw materials	\$ 1,095	\$ 1,744
Work in progress	1,703	1,524
Finished goods	54	56
	\$ 2,852	\$ 3,324

## 3. Capital assets

September 30, 2003	Cost	amortization	Accumulated value
Land	\$ 1,991	\$ –	\$ 1,991
Building	624	96	528
Building improvements	5,334	716	4,618
Production equipment	9,021	5,138	3,883
Workshop equipment	1,064	765	299
Patents and technology	1,035	570	465
Office furniture and equipment	467	241	226
Vehicles	34	20	14
	\$ 19,570	\$ 7,546	\$ 12,024

# ELECTROVAYA INC.

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

Years ended September 30, 2003 and 2002

## 3. Capital assets (continued)

September 30, 2002	Cost	Accumulated amortization	Net book value
Land	\$ 1,991	\$ –	\$ 1,991
Building	624	68	556
Building improvements	5,331	442	4,889
Production equipment	9,017	3,227	5,790
Workshop equipment	1,062	528	534
Patents and technology	791	340	451
Office furniture and equipment	489	182	307
Vehicles	34	13	21
	\$ 19,339	\$ 4,800	\$ 14,539

## 4. Share capital

### (a) Authorized and issued capital stock

Authorized  
 Unlimited common shares

Warrants Issued	Common Shares		Special	
	Number	Amount	Number	Amount
Balance, September 30, 2000	54,535,287	\$ 6,946	1,875,000	\$ 28,439
Issued during fiscal 2001				
Public offering (i)	6,250,000	28,167	–	–
Conversion of special warrants (ii)	8,589,922	28,439	(1,875,000)	(28,439)
Stock options exercised	163,900	177	–	–
Balance, September 30, 2002 & 2003	69,539,109	\$ 63,729	–	\$ –

- (i) On November 10, 2000, the Company issued 6,250,000 common shares at \$5.24 per common share, resulting in proceeds of \$30,006, net of costs of \$2,744.

# ELECTROVAYA INC.

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

Years ended September 30, 2003 and 2002

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## 4. Share capital (continued)

- (ii) The Company entered into an agency agreement with Yorkton Securities Inc. to offer for sale, on a private placement basis, 1,875,000 special warrants at a price of \$16 per special warrant for net proceeds of \$28,439 after deducting issue costs of \$1,561. This private placement was completed on January 10, 2000. Each special warrant entitled the holder to receive, subject to the adjustment described below, three common shares of the Company without payment of additional consideration. The special warrants were exchanged into common shares at the closing of the public offering of common shares on November 10, 2000.

Each special warrant entitled the holder to acquire, for no additional consideration, such additional number of common shares as was necessary to ensure that the value the special warrant holder received for each special warrant was equal to \$24.00, subject to a maximum adjustment of an additional three common shares for each special warrant held. As a result of the offering price per common share described in note 4(a)(i) being less than \$8.00, each special warrant holder received 1.58 additional common shares for each special warrant held for no additional consideration. The Company filed a prospectus dated November 1, 2000 relating to the qualification for distribution of 8,589,922 common shares of the Company upon the exercise, without payment of additional consideration, of 1,875,000 special warrants.

As additional compensation to the agent, the Company granted 93,750 compensation warrants. Each compensation warrant entitled the holder to receive, without additional payment, one compensation option. Each compensation option entitled the holder to acquire three common shares of the Company for \$5.33 per common share until January 10, 2002. The compensation options were subject to a similar adjustment to that described above as a result of the offering price per common share being less than \$8.00. The 93,750 compensation warrants expired on January 10, 2002 unexercised.

- (iii) On November 9, 2000, the Company issued, for no consideration, a total of 25,000 charitable warrants to three charitable organizations. Each charitable warrant entitles the holder to receive, for cash consideration of \$5.24, one common share. The charitable warrants are fully vested, non-transferable and will expire on November 9, 2010. The warrants remain outstanding at September 30, 2003 and 2002.

# ELECTROVAYA INC.

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

Years ended September 30, 2003 and 2002

## 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. Option 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 2,847,833 common shares and 1,594,933 remain outstanding (2002 - 1,847,599) at prices ranging from \$ 0.46 to \$8.00 per share. These options have a weighted average remaining life of 7.58 years.

The following table reflects activity under the Plan from September 30, 2001 through September 30, 2003 and the weighted average exercise prices:

	Number	Weighted average exercise prices
Outstanding, September 30, 2001	1,504,599	\$ 2.21
Granted	410,333	0.39
Cancelled	(67,333)	1.51
Outstanding, September 30, 2002	1,847,599	\$ 1.80
Granted	25,000	0.50
Cancelled	(277,666)	2.31
Outstanding, September 30, 2003	1,594,933	\$ 1.91

# ELECTROVAYA INC.

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

Years ended September 30, 2003 and 2002

## 4. Share capital (continued)

During the year, the Company granted options to purchase shares of common stock totaling 25,000 at an exchange price of \$0.50 per share to its Directors. The pro forma impact of the stock expense is \$12 with no material impact on loss per share for the period

The compensation costs reflected in these pro forma amounts were calculated using the Black-Scholes option pricing model assuming a risk-free interest rate of approximately 5.2%, a dividend yield of 0%, an expected volatility of 107% and expected lives of stock options of 10 years.

Exercise price	Options outstanding as at September 30, 2003		Options exercisable as at September 30, 2003	
	Number outstanding	Weighted average remaining life (years)	Number exercisable	Weighted average exercise price
\$ 0.46 (Cdn\$0.62)	297,667	8.86	99,226	\$ 0.46
0.50 (Cdn\$0.68)	25,000	9.17	—	0.50
0.62		10,000	8.86	3,333 0.62
1.24 (Cdn\$1.67)	912,100	5.90	912,100	1.24
2.22 (Cdn\$3.00)	85,000	7.87	56,668	2.22
5.24	100,666	7.11	67,110	5.24
5.33	85,500	6.40	85,500	5.33
5.93 (Cdn\$8.00)	19,000	7.09	12,666	5.93
8.00	60,000	6.96	60,000	8.00
	1,594,933	7.58	1,296,603	2.05

During the year, no compensation costs were recorded in the statement of earnings for options granted to employees (2002 - nil)

## 5. 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.

# ELECTROVAYA INC.

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

Years ended September 30, 2003 and 2002

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## 5. Financial instruments (continued)

### (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.

### (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.

## 6. Related party transactions

The Company leases its Hanna Avenue premises in Toronto, Ontario, from a company owned by its controlling shareholders for \$212 per year. In June, 2003, the Machine Building facility was relocated to Hanna Avenue from Concord when 11,800 square feet of additional space was leased for \$ 81 per year. Both leases expire on December 31, 2003. The Company's related party transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

## 7. Commitments

The Company's future minimum lease payments under operating leases, being principally for its premises, for the years ending September 30 are as follows:

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2004	154
2005	19
2006	6
2007	1
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	\$ 180

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# ELECTROVAYA INC.

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

Years ended September 30, 2003 and 2002

## 8. Loss per share

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

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September 30, 2003 and 2002	69,539,109
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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

(a) The provision for income taxes differs from the amount computed by applying the combined federal and provincial income tax rate of 37.1% ( 2002 – 39.1% ) to the loss before income tax recovery as a result of the following:

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	Years ended September 30,	
	2003	2002
Loss before income taxes	\$ (9,844)	\$ (9,949)
Computed expected tax recovery	(3,652)	(3,890)
Reduction in income tax recovery resulting from:		
Lower rate on manufacturing profits	192	597
Permanent differences	191	176
Change in valuation allowance	3,101	2,849
Change in enacted tax rates	139	278
Foreign operations taxed at a lower rate	29	–
Large Corporations Tax	32	32
Income tax expense	\$ 32	\$ 42

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# ELECTROVAYA INC.

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

Years ended September 30, 2003 and 2002

## 9. Income taxes (continued)

- (b) The 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,	
	2003	2002
Future tax assets		
Non-capital tax losses carried forward	\$ 6,744	\$ 4,601
Share issue costs	184	288
Capital assets	1,556	895
Non deductible reserves	102	—
Unclaimed research and development expenses	1,477	1,178
	<u>10,063</u>	<u>6,962</u>
Less valuation allowance	(10,063)	(6,962)
Net future tax assets	<u>\$ —</u>	<u>\$ —</u>

In addition to the above temporary differences, the Company has unrecorded non-refundable investment tax credits ("ITCs") amounting to approximately \$937 which begin to expire in 2004.

As at September 30, 2003, the expiration dates of the Company's tax losses carried forward are as follows:

2004	\$ 727
2005	544
2006	815
2007	980
2008	5,432
2009 and thereafter	15,244
	<u>\$ 23,742</u>

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 not 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)

Years ended September 30, 2003 and 2002

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## 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.

## 10. Major customers

During 2003, three customers represented 58% (2002 - 71% ) of total revenue and 50% (2002 - 66%) of trade accounts receivable.

## 11. Change in non-cash operating working capital

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	Years ended September 30,	
	2003	2002
Accounts receivable	\$ (285)	\$ (461)
Investment tax credits recoverable	(49)	274
Goods and Services Tax receivable	108	4
Inventories	472	(1,488)
Prepaid expenses and other	(25)	(64)
Accounts payable and accrued liabilities	540	110
Income taxes payable	(36)	5
	<hr/>	<hr/>
	\$ 725	\$ (1,620)

## 12. Comparative figures

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