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

ELECTROFUEL INC.

Years ended September 30, 2001 and 2000

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Electrofuel Inc. as at September 30, 2001 and 2000 and the consolidated statements of operations and deficit and cash flows for each of the years ended September 30, 2001 and 2000. 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 the audit to obtain reasonable assurance about 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 Electrofuel Inc. as at September 30, 2001 and 2000 and the results of its operations and its cash flows for each of the years ended September 30, 2001 and 2000 in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Toronto, Canada

November 19, 2001

ELECTROFUEL INC.

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

	September 30, 2001	2000
Assets		
Current assets		
Cash and cash equivalents	$ 2,436	$ 6,337
Short-term investments	28,269	13,000
Accounts receivable	301	185
Investment tax credits recoverable	652	594
Goods and Services Tax receivable	167	255
Inventories (note 2)	1,836	81
Prepaid expenses and other	476	461
	34,137	20,913
Deferred finance charges	–	1,839
Capital assets (note 3)	15,501	8,143
	$ 49,638	$ 30,895
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	$1,110	$ 1,767
Income taxes payable	37	65
	1,147	1,832
Shareholders' equity		
Share capital (note 4)	63,729	35,385
Cumulative translation adjustment	(2,792)	(1,045)
Deficit	(12,446)	(5,277)
	48,491	29,063
Commitments (note 7)		
	$ 49,638	$ 30,895

See accompanying notes to consolidated financial statements.

On behalf of the Board:

"Sankar Das Gupta" Director

"James K. Jacobs" Director

ELECTROFUEL INC.

Consolidated Statements of Operations and Deficit
(Expressed in thousands of U.S. dollars)

	Years ended September 30, 2001	2000
Revenue	$ 1,017	$ 152
Expenses		
Start-up and manufacturing	3,911	–
Research and development	2,054	1,029
Sales and marketing	1,553	829
General and administrative	3,043	1,902
	10,561	3,760
Loss from operations	9,544	3,608
Other income	(57)	(130)
Interest income	(1,869)	(1,128)
Gain from foreign exchange	(486)	(853)
	(2,412)	(2,111)
Loss before income taxes	7,132	1,497
Income tax expense (note 9)	37	21
Loss for the year	7,169	1,518
Deficit, beginning of year	5,277	3,294
Loss on redemption of shares (note 4(c))	–	465
Deficit, end of year	$ 12,446	$ 5,277
Loss per common share (note 8)	$ 0.11	$ 0.03

See accompanying notes to consolidated financial statements.

ELECTROFUEL INC.

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

	Years ended September 30, 2001	2000
Cash provided by (used in)		
Operating activities		
Loss for the year	$ (7,169)	$ (1,518)
Amortization which does not involve cash	1,502	449
Common shares issued for services	–	176
Change in non-cash operating working capital (note 11)	(2,607)	481
	(8,274)	(412)
Financing activities:		
Proceeds from issue of common shares (note 4)	30,006	–
Issue of special warrants (note 4)	–	28,439
Deferred finance charges	–	(1,879)
Exercise of stock options	177	–
Repurchase of stock options	–	(464)
	30,183	26,096
Investing activities		
Additions to short-term investments	(15,269)	(13,000)
Additions to capital assets	(9,193)	(7,876)
	(24,462)	(20,876)
Increase (decrease) in cash and cash equivalents	(2,553)	4,808
Effect of currency translation adjustments on cash and cash equivalents	(1,348)	(849)
Cash and cash equivalents, beginning of year	6,337	2,378
Cash and cash equivalents, end of year	$ 2,436	$ 6,337
Supplemental disclosure of cash flow information:		
Income taxes paid	$ 21	$ –
Interest received	2,070	871

See accompanying notes to consolidated financial statements.

1. Significant accounting policies

(a) Nature of operations

Electrofuel Inc. is an early stage manufacturer and marketer of advanced, high energy, rechargeable batteries based on its patented lithium ion SuperPolymer™ technology. These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries.

During the year the company began commercial production and expects to continue to develop its product lines and explore other potential applications using the developed technology.

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

(b) Cash and cash equivalents

Cash and cash equivalents include temporary investments in marketable securities which are readily convertible into cash and which have a term to maturity of less than 90 days. Temporary investments in marketable securities with longer terms to maturity are recorded as short-term investments and are recorded at cost, which is equivalent to market value.

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	4%
Production equipment	20%
Workshop equipment	20%
Patents and technology	20%
Office furniture and equipment	20%
Dry room	20%
Vehicles	20%
Leasehold improvements	Term of lease

(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.

(e) Startup and manufacturing expenses

In April 2001, the Company commenced production of commercial units at its new manufacturing facility in Mississauga. All of the materials, labour and overhead costs associated with the production of commercial units and the start up of the plant are included in Start-up and manufacturing expenses.

1. Significant accounting policies (continued)

(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 research and development expenses.

(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 on the sale of commercial units produced at the Company's production plant at the time the units are shipped to customers net of a provision for returned units.

(j) Warranty costs

Warranty costs are provided for as revenues are earned.

(k) Deferred finance charges

Direct costs incurred in connection with the issuance of share capital are deferred until such time as the shares are issued.

1. Significant accounting policies (continued)

(l) 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.

(m) 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 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 statement of operations in the period that includes the enactment date.

(n) 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.

(Expressed in Thousands of U.S. dollars)

2. Inventories

Inventories consist of

	September 30, 2001	2000
Raw materials	$ 924	$ 81
Work in progress	767	–
Finished goods	145	–
	$ 1,836	$ 81

3. Capital assets

September 30, 2001	Cost	Accumulated amortization	Net book value
Land	$ 1,899	$ –	$ 1,899
Building	596	45	551
Building improvements	5,096	127	4,969
Production equipment	8,011	1,362	6,649
Workshop equipment	1,013	321	692
Patents and technology	548	190	358
Office furniture and equipment	448	93	355
Vehicles	34	6	28
Leasehold improvements	2	2	–
	$ 17,647	$ 2,146	$ 15,501

September 30, 2000	Cost	Accumulated amortization	Net book value
Land	$ 1,899	$ –	$ 1,899
Building	596	–	596
Building improvements	1,075	–	1,075
Production equipment under construction	2,326	–	2,326
Production equipment	1,425	446	979
Workshop equipment	1,062	124	938
Patents and technology	314	111	203
Office furniture and equipment	150	35	115
Vehicles	12	1	11
Leasehold improvements	3	2	1
	$ 8,862	$ 719	$ 8,143

(Expressed in Thousands of U.S. dollars)

4. Share capital

On August 2, 2000, the Company's shareholders authorized a three-for-one stock split, which became effective on September 18, 2000. All references to common shares, common shares outstanding, stock options and per share amounts in these financial statements have been restated to reflect this three-for-one stock split on a retroactive basis.

(a) Authorized and issued capital stock

	Common Shares		Special Warrants	
Authorized				
Unlimited common shares				
Issued	Number of Shares	Amount	Number of Warrants	Amount
Balance, September 30, 1999	54,394,602	$ 6,770	–	$ –
Issued during 2000				
Private placement (iii)	–	–	1,875,000	28,439
For consulting services	117,429	133	–	–
For directors' compensation	23,256	43	–	–
Balance, September 30, 2000	54,535,287	6,946	1,875,000	28,439
Issued during 2001				
Public offering (i)	6,250,000	28,167	–	–
Conversion of special warrants (iii)	8,589,922	28,439	(1,875,000)	(28,439)
Stock options exercised	163,900	177	–	–
Balance, September 30, 2001	69,539,109	$ 63,729	–	$ –

4. Share capital (continued)

(i) On November 10, 2000, the Company issued 6,250,000 common shares at $5.24 per common share.

(ii) 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 (Cdn $8.00), 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, 2001.

(iii) 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 three common shares of the Company without payment of additional consideration. The special warrants were exchanged to 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 is 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 entitles the holder to receive, without additional payment, one compensation option. Each compensation option entitles the holder to acquire three common shares of the Company for $5.33 per common share until January 10, 2002. The compensation options are subject to a similar adjustment to that described above as a result of the offering price per common share being less than $8.00.

(Expressed in Thousands of U.S. dollars)

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. 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.

Details of stock option transactions are as follows:

	Number of options	Weighted average exercise prices of options
Outstanding, September 30, 1999	1,351,500	$ 1.13
Granted	865,500	4.88
Cancelled	(163,500)	1.28
Outstanding, September 30, 2000	2,053,500	2.70
Granted	359,000	3.23
Exercised	(163,900)	1.13
Cancelled	(636,000)	4.66
Outstanding, September 30, 2001	1,612,600	$ 2.21

(Expressed in Thousands of U.S. dollars)

4. Share capital (continued)

		Options outstanding as at September 30, 2001		Options exercisable as at September 30, 2001	
Exercise price		Number outstanding	Weighted average remaining life (years)	Number exercisable	Weighted average exercise price
$ 1.13	(Cdn. $1.67)	1,078,100	7.90	718,733	$ 1.13
1.95	(Cdn. $3.00)	219,000	9.87	–	–
5.24		140,000	9.10	–	–
5.33		85,500	8.38	28,500	5.33
8.00		90,000	8.96	30,000	8.00
		1,612,600	8.36	777,233	$ 1.55

(c) Loss on redemption of shares

During 2000, the Company paid $465 to an employee upon the surrender and cancellation of 150,000 vested stock options. The cash payment represents the excess of the fair value of the options over the aggregate exercise price and has been charged to retained earnings as a loss on the redemption of shares.

5. Financial instruments

(a) Fair values

The reported values of the financial instruments, which consist primarily 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.

(Expressed in Thousands of U.S. dollars)

6. Related party transactions

The Company leases its Hanna Avenue premises from a company owned by its controlling shareholders for $262 per year. This lease expires on December 31, 2002. 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:

2002	$	196
2003		52
2004		4
	$	252

8. Loss per share

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

September 30, 2001	67,767,257
September 30, 2000	54,515,619

Common share purchase options or other potential dilutive common shares were not considered for each of the periods presented since their effect would be anti-dilutive.

(Expressed in Thousands of U.S. dollars)

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 42.5% (2000 – 44.2%) to the loss before income tax recovery as a result of the following:

	Years ended September 30, 2001	2000
Loss before income taxes	$ (7,169)	$ (1,497)
Computed expected tax recovery	(3,047)	(661)
Reduction in income tax recovery resulting from:		
Lower rate on manufacturing profits	574	93
Permanent differences	2	4
Non-recognition of tax benefit of losses	2,471	564
Large Corporations Tax	37	21
Income tax expense	$ 37	$ 21
Change in valuation allowance	$ 1,352	$ 1,302

(Expressed in Thousands of U.S. dollars)

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, 2001	2000
Future tax assets		
Non-capital tax losses carried forward	$ 2,236	$ 1,902
Share issue costs	422	346
Capital assets	621	–
Unclaimed research and development expenses	834	778
	4,113	3,026
Less valuation allowance	(4,113)	(2,761)
Future tax liability		
Investment tax credits accrued	–	179
Capital assets	–	77
Other	–	9
	–	265
Net future tax assets	$ –	$ –

In addition to the above temporary differences, the Company has unrecorded non-refundable investment tax credits ("ITCs") amounting to approximately $427, which begin to expire in 2007.

As at September 30, 2001, the expiration dates of the Company's tax losses carried forward are as follows:

2004	$ 641
2005	480
2006	719
2007	923
2008	4,692
	$ 7,455

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. Management considers projected future taxable income, uncertainties related to the industry in which the Company operates and tax planning strategies in making this assessment.

(Expressed in Thousands of U.S. dollars)

(c) The Company is entitled to ITCs, which are earned as a percentage of eligible current and capital research and development expenditures incurred in each taxation year. ITCs are typically available to be applied against future income tax liabilities, subject to a 10-year carryforward period. ITCs are accounted for as a reduction of the related expenditure for items of a current nature and a reduction of the related asset cost of items of a long-term nature, provided that the Company has reasonable assurance that the tax credits will be realized.

10. Major customers

During 2001, two customers individually represented 52% and 10% of revenue and comprised 48% and 17% of accounts receivable respectively at year-end. In 2000, one customer represented 59% of revenue and 3 customers comprised 34%, 21% and 11% of accounts receivable as at September 30, 2000.

11. Change in non-cash operating working capital

	Years ended September 30, 2001	2000
Accounts receivable	$ (116)	$ (174)
Investment tax credits recoverable	(58)	(301)
Goods and Services Tax receivable	88	(231)
Inventories	(1,756)	(33)
Prepaid expenses and other	(15)	(434)
Accounts payable and accrued liabilities	(722)	1,588
Income taxes payable	(28)	66
	$ (2,607)	$ 481