

Financial Statements of



Years ended September 30, 2001 and 2000

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheet of Railpower Technologies Corp. as at September 30, 2001 and 2000 and the 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 financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles. As required by the Company Act (British Columbia), we report that, in our opinion, these principles have been applied on a consistent basis.

KPMG LLP

Chartered Accountants

New Westminster, Canada
November 16, 2001

RAILPOWER TECHNOLOGIES CORP.

Balance Sheets

September 30, 2001 and 2000

	2001	2000
Assets		
Current assets:		
Cash	\$ 121,201	\$ 304,962
Term deposit	400,000	1,000,000
Interest receivable	8,460	20,963
Accounts receivable	75,022	8,617
Prepaid expenses	5,448	-
	<u>610,131</u>	<u>1,334,542</u>
Capital assets (note 4)	42,484	7,088
Patents (note 5)	29,318	9,310
	<u>\$ 681,933</u>	<u>\$ 1,350,940</u>

Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable and accrued liabilities	\$ 130,312	\$ 72,650
Shareholders' equity:		
Share capital (note 6)	1,973,610	1,546,754
Deficit	(1,421,989)	(268,464)
	<u>551,621</u>	<u>1,278,290</u>
	<u>\$ 681,933</u>	<u>\$ 1,350,940</u>

Commitment (note 10)

Subsequent events (note 11)

See accompanying notes to financial statements.

Approved on behalf of the Board:

"Gerard Koldyk" Director

"Frank Donnelly" Director

RAILPOWER TECHNOLOGIES CORP.

Statements of Operations and Deficit

Years ended September 30, 2001 and 2000

	2001	2000
Revenues:		
Interest	\$ 36,107	\$ 30,140
Other	24,013	6,377
	<u>60,120</u>	<u>36,517</u>
Expenses:		
General and administrative (schedule)	316,530	111,960
Research and development (schedule)	897,115	165,042
	<u>1,213,645</u>	<u>277,002</u>
Loss for the year	(1,153,525)	(240,485)
Deficit, beginning of year	(268,464)	(27,979)
Deficit, end of year	<u>\$ (1,421,989)</u>	<u>\$ (268,464)</u>
Net loss per weighted average share (note 3(b)):		
Basic	\$ 0.1480	\$ 0.0381
Weighted average number of common shares outstanding (note 3(b)):		
Basic	<u>7,796,219</u>	<u>6,311,288</u>

See accompanying notes to financial statements.

RAILPOWER TECHNOLOGIES CORP.

Statements of Cash Flows

Years ended September 30, 2001 and 2000

	2001	2000
Cash flows from operating activities:		
Loss for the year	\$ (1,153,525)	\$ (240,485)
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization	20,603	5,037
Accounts receivable	(54,723)	(28,154)
Interest receivable	12,503	-
Prepaid expenses	(4,574)	1,037
Accounts payable and accrued liabilities	39,902	69,241
Net cash used in operating activities	(1,139,814)	(193,324)
Cash flows from investing activities:		
Investment in patents	(22,404)	(9,628)
Purchase of equipment	(53,603)	(7,355)
	(76,007)	(16,983)
Cash flows from financing activities:		
Cash assumed on acquisition of Envirotrain (note 2)	432,060	-
Issuance of common stock for cash, net of share issue costs	-	1,379,830
Shareholder loan	-	(6,179)
Restricted cash	-	46,283
Term deposit	600,000	(1,000,000)
	1,032,060	419,934
Net increase (decrease) in cash	(183,761)	209,627
Cash and cash equivalents, beginning of year	304,962	95,335
Cash and cash equivalents, end of year	\$ 121,201	\$ 304,962
Supplementary information:		
Interest received	\$ 48,610	\$ 9,177
Non-cash transaction:		
Issuance of common shares on acquisition of Envirotrain (note 2)	\$ 426,856	\$ -

See accompanying notes to financial statements.

RAILPOWER TECHNOLOGIES CORP.

Notes to Financial Statements

Years ended September 30, 2001 and 2000

1. The Company:

Railpower Technologies Corp (the "Company") is a public company listed on the Canadian Venture Exchange (CDNX). The Company was formed under the Canada Business Corporations Act on June 30, 2001, as a result of the amalgamation of Railpower Technologies Inc. (Railpower), a private company, and Envirotrain Capital Corp. (Envirotrain), a public company.

Railpower was a developer of new technologies with applications in rail transportation and distributed power systems. The Company will continue to operate in the same line of business and is in the development phase of a prototype hybrid switcher locomotive, the Green Goat.

Envirotrain was a capital pool company.

2. Amalgamation:

The amalgamation completed on June 30, 2001 with the Company acquiring all issued and outstanding shares of Railpower Technologies Inc. (Railpower) and Envirotrain Capital Corp. (Envirotrain) in exchange for shares of the Company on a one-to-one basis. All outstanding options of Railpower and Envirotrain held by directors, officers, employees, and consultants, were exchanged on a one-to-one basis for options to acquire shares of the Company at the same exercise price.

The former shareholders of Railpower held 62.9% of the issued and outstanding shares of the Company after the amalgamation, and accordingly, Railpower was identified as the acquirer. The financial statements of the Company are considered a continuation of the financial statements of Railpower. The purchase method was accounted for as follows:

Net assets acquired, at fair value:	
Cash	\$ 432,060
Accounts receivable	11,682
Prepaid expenses	874
	<hr/>
	444,616
Net liabilities acquired, at fair value:	
Accounts payable	(17,760)
	<hr/>
	\$ 426,856
Consideration rendered:	
Common shares	\$ 426,856

RAILPOWER TECHNOLOGIES CORP.

Notes to Financial Statements

Years ended September 30, 2001 and 2000

3. Significant accounting policies:

(a) Cash and cash equivalents:

Cash and cash equivalents are defined to include highly liquid securities with original maturities of three months or less when purchased.

(b) Net loss per weighted average share:

Net loss per weighted average share is calculated using the weighted average number of shares of common stock outstanding.

(c) Capital assets:

Capital assets are recorded at cost and amortized on a declining-balance basis at 30% per annum.

(d) Patents:

Patents include patent costs and patent maintenance fees. Patents are amortized over the life of the patents which expire in the years 2007, 2008, 2009 and 2010. Patent maintenance fees are amortized over the period of fee coverage being 1 to 4 years.

(e) Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of accounts receivable, useful lives of capital assets and patents, accounts payable and accrued liabilities, at the date of the financial statements. Actual results could differ from those estimates. Adjustments, if any, will be reflected in operations in the period of settlement.

(f) Income taxes:

Income taxes are accounted for under the asset and liability method. 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 and tax credit 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 income in the period that includes the enactment or substantive enactment date.

RAILPOWER TECHNOLOGIES CORP.

Notes to Financial Statements

Years ended September 30, 2001 and 2000

3. Significant accounting policies (continued):

(g) Foreign currency translation:

Transactions of the Company that are denominated in foreign currencies are recorded in Canadian dollars at exchange rates in effect at the related transaction dates. Monetary assets and liabilities denominated in foreign currencies are adjusted to reflect exchange rates at the balance sheet date. Exchange gains and losses arising on the translation of monetary assets and liabilities are included in the determination of income for the year.

(h) Research and development expenditures:

Research costs are expensed in the period in which they are incurred. Development costs are expensed in the period incurred unless such costs meet the criteria for deferral and amortization under Canadian generally accepted accounting principles. The Company did not meet these criteria for deferral of development costs as of the balance sheet date or in prior years.

(i) Stock-based compensation plan:

The Company has one stock-based compensation plan, which is described in note 6(c). No compensation expense is recognized for these plans when stock or stock options are issued to directors and/or employees. Any consideration paid by directors and/or employees on exercise of stock options or purchase of stock is credited to share capital. If stock or stock options are repurchased from directors and/or employees, the excess of the consideration paid over the carrying amount of the stock or the stock option cancelled is charged to retained earnings.

4. Capital assets:

	2001	2000
Capital assets	\$ 64,916	\$ 11,313
Accumulated amortization	22,432	4,225
	\$ 42,484	\$ 7,088

5. Patents:

	2001	2000
Patents	\$ 38,210	\$ 15,807
Accumulated amortization	8,892	6,497
	\$ 29,318	\$ 9,310

RAILPOWER TECHNOLOGIES CORP.

Notes to Financial Statements

Years ended September 30, 2001 and 2000

6. Share capital:

(a) Authorized:

Unlimited number of voting common shares without nominal or par value

Unlimited number of non-voting preferred shares without nominal or par value

(b) Common shares issued:

	2001		2000	
	Shares	Amount	Shares	Amount
Outstanding, beginning of year	6,788,000	\$ 1,546,754	10,576,000	\$ 166,924
Issued for cash	-	-	3,000,000	1,500,000
Share issue costs	-	-	-	(120,170)
Share consolidation 2:1	-	-	(6,788,000)	-
Amalgamation with Envirotrain Capital Corp.	4,000,000	426,856	-	-
Outstanding, end of year	10,788,000	\$1,973,610	6,788,000	\$ 1,546,754

The Company completed a private placement of 3,000,000 shares on April 25, 2000. The gross proceeds received by the Company for the offering were \$1,500,000. After deducting expenses of the offering, including commissions and fees, the net proceeds were \$1,379,830.

On June 13, 2000, the Company consolidated its common shares on a basis of 2:1, thus decreasing the number of outstanding common shares from 13,576,000 to 6,788,000 shares. After the share consolidation, the Company increased its authorized shares from 25,000,000 to 50,000,000 common shares. The amalgamation of June 30, 2001 resulted in Envirotrain's 4,000,000 common shares being exchanged for shares of the Company on a one-to-one basis. The value assigned to the shares of \$426,856 was based on the fair value of Envirotrain's net assets (note 2).

As at September 30, 2001, 5,715,000 common shares were held in escrow in connection with the amalgamation.

(c) Stock options:

As at September 30, 2001, there were 1,360,000 options granted as follows:

- (i) As part of the private placement on April 25, 2000, the Company granted an option to Raymond James Ltd. (the "Agent") to acquire 600,000 shares at \$0.50 per share which expires on December 30, 2002. As at September 30, 2001, the option to acquire 300,000 shares at \$1.00 per share (as a result of 2:1 consolidation) has not been exercised.
- (ii) On January 29, 2001, the Company granted options to its employees to purchase 210,000 common shares at \$1.10 per share. The options vest according to the following schedule; 1/3 on January 29, 2002 and 1/3 on each of January 29, 2003 and January 29, 2004. The options expire on January 29, 2006. As at September 30, 2001, no options are exercisable.

RAILPOWER TECHNOLOGIES CORP.

Notes to Financial Statements

Years ended September 30, 2001 and 2000

6. Share capital (continued):

(c) Stock options (continued):

- (iii) On August 9, 2001, a new Director was appointed to the Company and was given an option to purchase 200,000 common shares at \$1.10 per share exercisable up to August 9, 2006. As at September 30, 2001, this option has not been exercised.
- (iv) As a result of the amalgamation of June 30, 2001, all options of Envirotrain were transferred into the Company on a one-to-one basis. The options transferred in are as follows:
- An option to the Agent to acquire 250,000 shares at \$0.20 per share, exercisable up to May 30, 2002. As at September 30, 2001, this option has not been exercised.
 - Options to the Directors of the Company to purchase 400,000 common shares at \$0.20 per share exercisable up to October 1, 2005. As at September 30, 2001, none of these options have been exercised.

The Company's stock based compensation plan for its directors, officers, consultants and employees allows a number of options equal to 10% of the outstanding common shares to a maximum of 1,500,000.

A summary of the status of the Company's stock-based compensation plan as of September 30, 2001 and 2000, and changes during the years ended on these dates are presented below:

	2001		2000	
	Number of shares	Weighted - average exercise price	Number of shares	Weighted - average exercise price
Outstanding, beginning of year	-	\$ -	-	\$ -
Granted	810,000	0.66	-	-
Outstanding, end of year	810,000	\$ 0.66	-	\$ -
Exercisable, end of year	600,000	\$ 0.50	-	\$ -

RAILPOWER TECHNOLOGIES CORP.

Notes to Financial Statements

Years ended September 30, 2001 and 2000

6. Share capital (continued):

At September 30, 2001, the Company had reserved a total of 810,000 common shares related to the director and employee options:

Exercise prices	Number outstanding, September 30, 2001	Weighted - average remaining contractual life
\$0.20	400,000	4.0 years
\$1.10	410,000	4.6 years
\$0.20 to \$1.10	810,000	4.3 years

7. Related party transactions:

For the year ended September 30, 2001, the Company paid nil (2000 - \$27,000) for consulting fees to an entity controlled by a significant shareholder.

At September 30, 2001, accounts payable and accrued liabilities included \$3,230 (2000 - nil) due to a director and officer of the Company, and \$67 due to an officer of the Company. These amounts were for Company expenses to be reimbursed in the ordinary course of business.

8. Scientific Research and Experimental Development ("SR&ED"):

The Company is heavily involved in research and development and has a claim of approximately \$340,000 in SR&ED tax credits outstanding. The balance has not yet been assessed by Canada Customs and Revenue Agency; therefore, it has not been included in revenue for the year. Consistent with the prior year, due to the uncertainty in the approval of the SR&ED tax credit, it will be recognized as revenue at the time when it is approved.

RAILPOWER TECHNOLOGIES CORP.

Notes to Financial Statements

Years ended September 30, 2001 and 2000

9. Income taxes:

Income tax expense attributable to income from continuing operations was nil for the period ended September 30, 2001 (2000 - nil).

The tax effects of temporary differences that give rise to significant portions of the future tax assets at September 30, 2001 are presented below:

	2001	2000
Future tax assets:		
Net operating loss carryforwards	\$ 216,216	\$ 56,343
Undepreciated capital cost for tax purposes in excess of net book value of depreciable assets	26,960	2,734
Less valuation allowance	(243,176)	(59,077)
Net future tax assets	\$ -	\$ -

The valuation allowance for future tax assets as of September 30, 2001 and 2000 was \$243,176 and \$59,077, respectively. The net change in the total valuation allowance for the periods ended September 30, 2001 and 2000 was an increase of \$184,099 and \$51,975, respectively. 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 the scheduled reversal of future tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. In order to fully realize the future tax asset, the Company will need to generate future taxable income of approximately \$484,571 prior to the expiration of the net operating loss carryforwards starting in 2002. Taxable income for the years ended September 30, 2001 and 2000 was nil, and nil, respectively. Based upon the level of historical taxable income and projections for future taxable income over the periods which the future tax assets are deductible, management has fully provided a valuation allowance for the future tax assets.

RAILPOWER TECHNOLOGIES CORP.

Notes to Financial Statements

Years ended September 30, 2001 and 2000

9. Income taxes (continued):

At September 30, 2001, the Company has net operating loss carryforwards for federal income tax purposes which are available to offset future federal taxable income. These operating losses expire as follows:

2002	\$	500
2003		1,000
2004		1,000
2005		19,491
2006		163,749
2007		227,627
2008		71,204
	\$	484,571

10. Commitment:

The Company has leased its head office for a term of one year expiring January 15, 2002 with monthly rent of \$3,524.

11. Subsequent events:

- (a) The Company raised \$1,000,000 gross proceeds through a private placement which closed on December 19, 2001. The proceeds were raised through the sale of 1,000,000 units at \$1.00 per unit. Each unit comprises one share and one half of one share purchase warrant. Each whole warrant will be exercisable to acquire one additional common share at a price of \$1.10 for a period of 18 months from December 19, 2001. The shares and warrants have a four-month hold period expiring April 20, 2002. As part of the agent's compensation, Raymond James Ltd. received an agent's option to acquire units equal to 15% of the number of units sold in the offering, also with a hold period expiring April 20, 2002.
- (b) On January 8, 2002, Raymond James Ltd. exercised an option to acquire 250,000 common shares at \$0.20 per share.
- (c) The Company raised \$500,000 gross proceeds through a private placement which closed on January 31, 2002. The proceeds were raised through the sale of 500,000 units at \$1.00 per unit. Each unit comprises one share and one half of one share purchase warrant. Each whole warrant will be exercisable to acquire one additional common share at a price of \$1.25 for a period of 18 months from January 31, 2002. The shares and warrants will have a four-month hold period expiring May 31, 2002. As part of the agent's compensation, Raymond James Ltd. has received an agent's option to acquire units equal to 15% of the number of units sold in the offering, also with a hold period expiring May 31, 2002. The board of directors has also approved the grant of 345,000 options to directors and employees at the same \$1.00 price as the offering.

RAILPOWER TECHNOLOGIES CORP.

Schedules of Expenses

Years ended September 30, 2001 and 2000

	2001	2000
General and administrative:		
Amortization	\$ 20,603	\$ 5,037
Consulting	1,033	27,000
Foreign exchange	(1,023)	-
Internet	2,177	1,443
Miscellaneous	5,618	-
Office	19,223	9,348
Professional fees	77,984	17,319
Regulatory	8,883	-
Rent	31,004	3,711
Salaries	118,534	26,329
Travel and promotion	32,494	21,773
	\$ 316,530	\$ 111,960
Research and development:		
Components	\$ 675,964	\$ 122,047
Miscellaneous	11,711	10,140
Rent	3,850	757
Salaries	205,590	32,098
	\$ 897,115	\$ 165,042