ENERGY POWER SYSTEMS LTD
Form 6-K
December 04, 2002

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13A-16 OR 15D-16
OF THE
SECURITIES EXCHANGE ACT OF 1934

For the month of November, 2002

ENERGY POWER SYSTEMS LIMITED
(FORMERLY: ENGINEERING POWER SYSTEMS LIMITED)

(Address of Principal executive offices)

Suite 301, 2 Adelaide Street West, Toronto, Ontario, M5H 1L6

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover form 20-F or Form 40-F:

Form 20-F X Form 40-F

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2b under the Securities Exchange Act of 1934:

Yes No X

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3- 2(b): 82

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ENERGY POWER SYSTEMS LIMITED
(formerly: Engineering Power Systems Limited)

Date: November 29, 2002 By:____"Sandra J. Hall"____ ______

Sandra J. Hall, President, Secretary & Director

Message to Shareholders:

It has been a challenging year. We live in a time of growing global uncertainty and have seen a significant decline in equity markets. It is in times such as these that good companies take a long hard look at what made them successful and focus themselves accordingly. Energy Power Systems has been doing just that. At Energy Power, we are concentrating on our core competencies; Oil and Gas exploration as well as, Industrial and Offshore contracting.

Energy Power - an Energy Source and Service Company.

Our Industrial & Offshore Division is headquartered in St. John's, Newfoundland and consists of the business of M&M Engineering Limited and M&M Offshore Limited (together "M&M"). Newfoundland and Labrador is the fastest growing province in Canada, the country that leads the G-7 in economic growth. During the past year, our Industrial & Offshore Division played key roles in a number of Atlantic Canada's infrastructure projects. From pipeline installations for the offshore oil facilities at the Newfoundland Transshipment Terminal to the rebuild of major processing units at the 105,000 barrels per day refinery at Come-By-Chance, Newfoundland to fabrication and installation of penstocks for the Granite Canal Hydro Electric Project, M&M's expertise and experience has been counted on. Over the course of 35 years, M&M Engineering has built a world class reputation in industrial contracting.
We believe that there are several exciting opportunities developing in the Atlantic provinces of Canada that will enable our Industrial & Offshore Division to expand its business. These include proposed offshore oil and gas projects for the White Rose Oilfield, the Sable Island Offshore Energy Project, and the Hebron Oilfield, in addition to development of the Voisey's Bay nickel mine. It is also our belief that our Industrial & Offshore Division will be afforded opportunities with respect to the upgrade and maintenance of existing area infrastructure including the Hibernia and Terra Nova oil fields, mechanical fabrication and maintenance of production equipment for refineries, pulp and paper mills (including environmental equipment) and private sector power generation projects (primarily for mining and natural resources).
In the coming years, expenditures for the development of natural resources of Newfoundland and Labrador alone are expected to be in the tens of billions of dollars. With our Industrial & Offshore Division's track record for delivering excellence on large-scale projects, its proven management team, as well as its strategic location and owned facilities we have every reason to be excited about the future.

It has been just over a year since we commenced oil and gas operations as part of an initiative to increase cash flow. We have now acquired oil and gas properties in the proven productive region of the Western Sedimentary Basin in Alberta, Canada, and prospective property in the Central Maritimes Basin of Atlantic Canada. During fiscal 2002, our Oil & Gas Division invested C$2,750,000 in a comprehensive drilling and exploration program. From our participation in eleven wells, two wells are producing oil, one well is producing natural gas and liquids, four wells are shut in pending evaluation, tie in and pipeline facilities, one well is suspended, and the three remaining have been abandoned as uneconomic. We also participated in a 3D seismic exploration program on our Prince Edward Island Property in Atlantic Canada to delineate drilling targets for a proposed winter drilling program.

Our Oil & Gas Division is already adding positive cash flow to Energy Power. With the maturing value of oil and gas commodities, and a growing goal to make North America less reliant on overseas supply, it is management's intention to continue to strategically invest capital resources to expand our portfolio of oil and gas reserves.

In corporate developments, the Company's common shares began trading on the American Stock Exchange ("AMEX") under the symbol "EGY" in May 2002. We are

pleased to provide our shareholders with a listing on a 'national market' and an internationally recognised stock exchange with the prestige of AMEX.

We are dedicated to growing the Company and enhancing shareholder value. On behalf of the management and board of Energy Power Systems Limited, I would like to thank you, our shareholders, for your continued support. We look forward to a rewarding 2003.

On Behalf of the Board of Directors,

Sandra J. Hall
President and Secretary
November 21, 2002

MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND OPERATING RESULTS

The following discussion and analysis of Energy Power Systems Limited ("Energy Power" or the "Company") should be read in conjunction with the Company's Audited Consolidated Financial Statements for the fiscal years ended June 30, 2002, 2001 and 2000 and notes thereto. Unless otherwise indicated, the following discussion is based on Canadian dollars and presented in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). For reference to differences between Canadian and US Generally Accepted Accounting Principles see note 17 of the Audited Consolidated Financial Statements.
Certain statements contained herein constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Reform Act"), which reflect the Company's current expectations regarding the future results of operations, performance and achievements of the Company. The Company has tried, wherever possible, to identify these forward-looking statements by, among other things, using words such as "anticipate," "believe," "estimate," "expect" and similar expressions. These statements reflect the current beliefs of management of the Company, and are based on current available information. Accordingly, these statements are subject to known and unknown risks, uncertainties and other factors which could cause the actual results, performance or achievements of the Company to differ materially from those expressed in, or implied by, these statements. (See the Company's Annual Information Form and Annual Form 20 F for Risk Factors.) The Company is not obligated to update or revise these "forward-looking" statements to reflect new events or circumstances.

OVERVIEW

The Company is a corporation amalgamated under the laws of the Province of Ontario and Provincially registered in the Provinces of Alberta and Newfoundland and is an energy source and service company that operates an Industrial & Offshore Division, and an Oil & Gas Division. The audited consolidated financial results for the fiscal periods ending June 30, 2002, 2001 and 2000 include the accounts of the Company and its wholly owned subsidiary M&M Engineering Limited ("M&M"), a Newfoundland and Labrador company, and M&M's wholly-owned subsidiary M&M Offshore Limited ("MMO"), a Newfoundland and Labrador company (reference to M&M may include MMO). M&M and MMO together operate from their 47,500 square foot fabrication facility and 15 acre property. M&M is an industrial, mechanical contractor. MMO (i) produces steel components for structures and heavy industry; (ii) manufactures pressurized vessels and tanks; and (iii) provides in-plant fabrication, welding and assembly services for the offshore oil sector and heavy

industry.

During fiscal 2001 the Company commenced its oil and gas operations. The activities of the Company's Oil & Gas Division include exploration, development and production of oil and natural gas. The Company's oil and gas properties are located in the Canadian Provinces of Alberta, Ontario and Prince Edward Island. During fiscal 2001 the Company adopted a plan to discontinue the operations of its Power Division. This division has been treated as discontinued operations for accounting purposes (see Note 20). As such the operations of the Company's Power Division have been excluded from the audited consolidated statement of loss and deficit from continuing operations in prior periods. The Company intends to monetize its investment in the Andhra Pradesh Project, India. During fiscal 2000 the Company disposed of its interests in Merlin Engineering A.S. ("Merlin") and divested ASI Holdings, Inc. ("ASIH"). These operations have been treated as discontinued operations for accounting purposes (see Note 20). As such, the operations of Merlin and ASIH have been excluded from the audited consolidated statement of loss and deficit from continuing operations in current and prior periods.

CRITICAL ACCOUNTING POLICIES: The Company's significant accounting policies are described in the notes to the audited consolidated financial statements. It is increasingly important to understand that the application of generally accepted accounting principles involve certain assumptions, judgments and estimates that affect reported amounts of assets, liabilities, revenues and expenses. The application of principles can cause varying results from company to company.

The most significant policies that impact the Company and its subsidiaries relate to revenue recognition policies, oil and gas accounting and reserve estimates, impairment of capital assets, accounting for joint ventures, the future income tax assets and liabilities, contingent liabilities and assets and valuation of the Company's investment in Konaseema EPS Oakwell Power Limited ("KEOPL"). During the 2002 fiscal year the Company adopted the new accounting policies for Goodwill and Other intangibles.

Revenue recognition: Revenue for M&M & MMO is generated principally from contracts or purchase orders awarded through a competitive bidding process. Revenue from construction and fabrication contracts is recognized on the percentage of completion basis, pursuant to which contract revenues are recognized by assessing the value of the work performed in relation to the total estimated cost of the contract based upon the contract value.

Oil and gas revenue is recognized on actual production volumes and delivery of the product to the market, based on the operator's reports.

Oil and gas accounting and reserve estimates: The Company follows the full cost method of accounting for oil and gas operations whereby all costs of exploring for and developing oil and gas reserves are initially capitalized. Such costs include land acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling and overhead charges directly related to acquisition and exploration activities.

Costs capitalized, together with the costs of production equipment, are depleted on the unit-of-production method based on the estimated gross proved reserves. Petroleum products and reserves are converted to equivalent units of oil by converting natural gas at 6,000 cubic feet of gas to 1 barrel of oil. Costs acquiring and evaluating unproved properties are initially excluded from depletion calculations. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion calculations.

Proceeds from a sale of petroleum and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion.

In applying the full cost method, under Canadian GAAP, the Company performs a ceiling test which restricts the capitalized costs less accumulated depletion and amortization from exceeding an amount equal to the estimated undiscounted value of future net revenues from proved oil and gas reserves, as determined by independent engineers, based on sales prices achievable under existing contracts and posted average reference prices in effect at the end of the Company's fiscal year and current costs, and after deducting estimated future general and administrative expenses, production related expenses, financing costs, future site restoration costs and income taxes.

In applying the full cost method under US GAAP, the Company performs a ceiling test based on the same calculations used for Canadian GAAP except the Company is required to discount future net revenue at 10% and there is no deduction from the US GAAP ceiling test for estimated future general and administrative expenses and interest.

Impairment of Capital Assets: The Company has written down $0.3 million of the carrying value of its Port aux Basques property to its estimated net realizable amount of $0.1 million in 2002 ($1.5 million was charged 2001).

Joint Ventures: The Company's Industrial & Offshore Division carries out part of its business in four joint ventures. The Company's audited consolidated financial statements include the Company's proportionate share of these joint ventures assets, liabilities, revenues and expenses.

Future Income Assets and Liabilities: The Company uses the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial statement carrying amounts and their respective income tax bases (temporary differences). Management regularly reviews its tax assets for recoverability and establishes a valuation allowance based on historical taxable income, projected future taxable income and the expected timing of the reversals of existing temporary differences. The Company has $10.2 million of non-capital losses. The Company carries an income tax asset of $0.6 million related to those non-capital losses. Additionally, the Company fully utilized all of its available net operating carry-forwards attributable to continuing operations for financial statement purposes. In 2002 the Company took a valuation allowance charge of $0.5 million which reduced the future tax asset by $0.5 million.

Contingent liabilities and assets: On August 28, 2002 the Company was served a Writ of Summons from Oakwell Engineering Limited ("Oakwell") of Singapore, a former joint venturer in a power project in Andhra Pradesh, India. On November 8, 2002 the Company counter claimed against Oakwell for damages, costs and interest as referred to in Note 21 of the audited consolidated financial statements. No provision has been made in the audited consolidated financial statements for this claim. The Company estimates the range of liability related to pending litigation where the amount and range of loss can be estimated. Where there is a range of loss, the Company records the minimum estimated liability related to those claims. As additional information becomes available, we assess the potential liability related to our pending litigation and revise our estimates accordingly. Revisions of our estimates of the potential liability could materially impact our results of future operations. If the final outcome of such litigation and contingencies differs adversely from that currently expected, it would result in a charge to earnings when determined.

There are deficiencies in the State Government providing lender guarantees for the Karnataka, India power project. The Company is pursuing legal recourses

against the Government of Karnataka and the Karnataka Power Transmission Corporation Limited. At the current time no assessment can be made of the actual recoverable amount. Accordingly no amount has been recorded in these audited consolidated financial statements.

Valuation of the Company's Investment in KEOPL: The Company owns 11,348,200 ordinary equity shares of Rs. 10 each, of KEOPL (the "KEOPL Shares"), a company incorporated in India, which is developing a Power project in Andhra Pradesh, India. Pursuant to the Revised VBC Agreement dated August 10, 2000 between the Company, VBC Group ("VBC"), KEOPL's parent company, and KEOPL, VBC shall purchase the Company's investment in KEOPL for INR 113,482,000 (approximately Cdn. $3,500,000) on or before June 30, 2002 if the Company offers its KEOPL Shares to VBC prior to June 30, 2002.

On May 3, 2002, the Company, pursuant to the Revised VBC Agreement, offered and tendered the KEOPL Shares to VBC for purchase on or before June 30, 2002. On July 1, 2002, VBC raised a dispute regarding the purchase and sale of the KEOPL Shares. The Company is pursuing legal remedies against VBC and Oakwell. The investment in KEOPL is recorded at expected net recoverable amount of $3.5 million. The actual recoverable amount is dependant upon future events and could differ materially from the expected net recoverable amount.

Goodwill: The Company has adopted new accounting policies for Goodwill as required under the recommendations of the new CICA Handbook Section 1581, Business Combinations, and Section 3062, Goodwill and Other Intangibles. The newly adopted accounting policy is also consistent with FASB No. 141, "Business Combinations" (SFAS 141), and No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). As a result of applying the new standards, management has determined that the value of goodwill was impaired, accordingly a transitional impairment loss of $2,056,832 has been charged to opening deficit.

RESULTS OF OPERATIONS

The following discussion of the results of operations of the Company is a comparison of the Company's two fiscal periods ended June 30, 2002 and 2001. Revenue: The Company's consolidated revenues of $22.0 million for the year ending June 30, 2002 increased by 15% from $19.1 million reported during the same period the previous year. Revenue growth was driven by both a 15% increase in revenues to $21.6 million from $18.8 million during 2001 derived from the Company's Industrial & Offshore Division as well as a 33% increase in revenues to $0.4 million from $0.3 million during 2001 from the Company's Oil & Gas Division, which commenced February 1, 2001.

Gross Profit: Consolidated gross profit for the fiscal period ending June 30, 2002 increased 20% to $3.0 million from $2.5 million in 2001. The increase was primarily due to increased gross profits from the Company's Industrial & Offshore Division. This increase in gross profit was primarily driven by increased revenue during the year as the Company's consolidated gross margin as a percent of sales has remained reasonably consistent at 13.5% versus 13.2% for the previous year. During the year gross profits from the Industrial & Offshore Division increased 33% to $3.2 million from $2.4 million during 2001. This increase was due to increased revenues during 2002. Gross margins for the Company's Oil & Gas Division decreased to ($0.2) million from $0.2 million during 2001. This decrease was primarily due to increased depletion of the Company's reserves.

Administrative expenses: Administrative expenses of $4.2 million for the twelve month period ending June 30, 2002 was 62% higher than administrative expenses of $2.6 million the previous year. For the fiscal year 2002 the Company incurred a foreign exchange loss of $0.2 million and in the fiscal year 2001 the Company had a foreign exchange gain of $0.2 million. For the fiscal year 2002

professional fees increased to $0.3 million. In addition during the 2002 fiscal year the Company wrote down its marketable securities by $0.1 million. The Company also had increases in its general and administrative expenditures. Other income: Included in other income is a litigation settlement of $0.7 million related to a claim against a company with respect to an asset purchase agreement. Also included is an overprovision for costs related to the Port aux Basques property settled for $0.2 million less than accrued. The balance of other income relates mainly to credits received for workers compensation adjustments of prior years.

Loss from Continuing Operations before Income Taxes: Losses from Continuing Operations before Income Taxes decreased 77% by $1.7 million to $0.5 million during fiscal 2002 from $2.2 million the previous year. The majority of the decrease in losses was due to a non-cash write down of inactive capital assets of $1.5 million during the previous fiscal period. In the current period the Company wrote down an additional $0.3 million.

Current and Future Income Taxes: During the fiscal period ending June 30, 2002 a net future income tax charge of $0.6 million was incurred compared to a net future income tax credit realization of $1.2 million during fiscal 2001. The tax credit during fiscal 2001 was primarily due to a valuation allowance charge of $1.1 million for expected future income from the Company's oil and gas properties. During fiscal 2002 the effective tax rate for the Company was 39% and fiscal 2001 43%.

Net losses from Continuing Operations: Consolidated loss from continuing operations for the twelve month period ending June 30, 2002 was $1.1 million, 10% more than the $1.0 million loss from continuing operations reported for the previous twelve month period.

Net losses from Continuing Operations Per Share: As a result of the foregoing, net losses from continuing operations per share for the twelve month period ending June 30, 2002 decreased 22% to $0.17 per share from $0.23 per share for fiscal 2001.

Discontinued Operations: Losses incurred from discontinued operations result from the Company's discontinued Power Division in fiscal 2001. During the current year the Company did not incur any losses from discontinued operations. Losses from discontinued operations were $2.7 million for the twelve month period ending June 30, 2001.

Net losses and Net losses per share: As a result of the foregoing, net loss decreased 69% to $1.1 million as compared to a net loss incurred of $3.6 million during the previous fiscal period. Net loss per share decreased 80% to $0.17 per share for the fiscal period ending June 30, 2002 from $0.85 per share for the previous twelve month period.

Goodwill: During the year the Company adopted new accounting policies for Goodwill as required under the recommendations of the new CICA Handbook Section 1581, Business Combinations, and Section 3062, Goodwill and Other Intangibles (see Critical Accounting Policies above). The new accounting policy has not been adapted retroactively. The adjusted net loss and basic loss per share for the comparative fiscal year ending June 30, 2001 if no amortization was recorded in those years is a loss of $3.4 million versus the recorded amount of $3.6 million in 2001 and a net loss per share of $(0.79) versus a loss per share of $(0.85) reported in the financial statements.

The following discussion of the results of operations of the Company is a comparison of the Company's two fiscal periods ended June 30, 2001 and 2000. Revenue: The Company's consolidated revenues of $19.1 million for the year ending June 30, 2001 increased by 1% from $18.9 million reported during the same period the previous year. New sources of revenue from the Company's Oil & Gas

Division, which commenced February 1, 2001, contributed to this revenue growth. Gross Profit: Consolidated gross margins for the fiscal period ending June 30, 2001 decreased 34% to $2.5 million from $3.8 million in 2000. The difference was primarily due to decreased profit margins from the Company's Industrial & Offshore Division. During fiscal 2001 gross profit margins from the Industrial & Offshore Division were 13% compared to 20% the previous year. The difference is attributable to both a high volume low margin contract included in revenues in 2001 and a high volume high margin contract included in revenues in 2000. Consolidated gross profit includes a 43% gross profit margin derived from the Company's Oil & Gas Division.

Administrative expenses: Administrative expenses of $2.6 million for the twelve month period ending June 30, 2001 was substantially lower than administrative expenses of $4.3 million for the previous twelve month period. In 2001 administrative expenses was reduced by previous years overprovision of administrative expenses of approximately $1.0 million.

Loss from Continuing Operations before Income Taxes: Losses from Continuing Operations before Income taxes increased 100% to $2.2 million during fiscal 2001 from $1.1 million the previous year. The majority of the increase was due to a non-cash write down of inactive capital assets of $1.5 million. Before this write down, the losses from continuing operations before income taxes would have been reduced by 35% to $0.7 million. This reduction is due primarily to the corporate restructuring which commenced during fiscal 2000.

Current and Future Income Taxes: Effective July 1, 2000, the Company changed its method of accounting for income taxes from the deferral method to the liability method. The liability method requires that accumulated tax balances be adjusted to reflect changes in the tax rates. This standard was applied retroactively; however, as permitted under the new rules, comparative financial information has not been restated, as the difference was insignificant. During the fiscal period ending June 30, 2001 a net future income tax credit of $1.2 million was realized compared to a net future income tax charge of $0.3 million during fiscal 2000. The tax credit during fiscal 2001 was primarily due to a valuation allowance charge of $1.1 million for expected future income from the Company's oil and gas properties. During fiscal 2001 the effective tax rate for the Company was 43% and fiscal 2000 45%.

Net losses from Continuing Operations: Consolidated loss from continuing operations for the twelve month period ending June 30, 2001 was $1.0 million, 32% less than the loss from continuing operations reported for the previous twelve month period.

Net losses from Continuing Operations Per Share: As a result of the foregoing, net losses from continuing operations per share for the twelve month period ending June 30, 2001 decreased 50% to $0.23 per share from $0.46 per share for fiscal 2000.

Discontinued Operations: Losses incurred from discontinued operations result from the Company's discontinued Power Division and the disposition of ASI Holdings Limited and Merlin Engineering A.S. Losses from discontinued operations increased 108% to $2.7 million for the twelve month period ending June 30, 2001 compared to $1.3 million in the previous fiscal period. The loss was primarily due to the write down of the Karnataka Project and other charges taken against the Company's Independent Power Projects.

Net losses and Net losses per share: As a result of the foregoing, net loss increased 33% to $3.6 million as compared to a net loss incurred of $2.7 million during the previous fiscal period. Net loss per share decreased 1% to $0.85 per share for the fiscal period ending June 30, 2001 from $0.86 per share for the previous twelve month period.

Goodwill: In fiscal 2002 the Company adopted new accounting policies for Goodwill as required under the recommendations of the new CICA Handbook Section 1581, Business Combinations, and Section 3062, Goodwill and Other Intangibles (see Critical Accounting Policies above). The new accounting policy has not been adapted retroactively. The adjusted net loss, basic loss per share from continuing operations and basic loss per share for comparative fiscal years ending June 30, 2001 and 2000 if no amortization was recorded in those years are in a loss of $3.4 million versus the recorded amount of $3.6 million in 2001 and a net loss per share of $(0.79) versus a loss per share of $(0.85) reported in the financial statements.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents at June 30, 2002 were $5.6 million, compared to $1.2 million at the end of the previous year. During the 2002 fiscal year the Company issued common shares for cash of $9.4 million (see note 10 of the audited consolidated financial statements). The primary use of funds was applied to the exploration and development of oil and gas properties. During the year the Company expended $2.8 million on the exploration and development of new oil and gas reserves. In addition the Company repaid $0.4 million of shareholder loans for cash and utilized $0.6 million from its line of credit. Cash of $2.0 million was used to fund the Company's operating activities.

Cash resources at June 30, 2001 were $1.2 million, compared to $1.7 million at the end of the previous year. During fiscal 2001 the Company recovered approximately $3.4 million from its investment in KEOPL (the Andhra Pradesh Project) and issued common and preference shares for a gross proceeds of $1.6 million. The available cash was used to acquire $1.7 million of oil and gas properties and to repay $1.9 million in prior advances from shareholders. The remainder of cash resources of approximately $1.3 million was applied to fund operating activities.

The Company's primary sources of liquidity and capital resources historically have been cash flows from the operations of the Industrial & Offshore Division, issuance of share capital and advances from shareholders. During fiscal 2001 and 2000 the Company recovered part of its investment in KEOPL. During fiscal 2003, it is expected that primary sources of liquidity and capital resources will be derived from the operations of the Industrial & Offshore Division, revenues from the Oil & Gas Division and further recovery of the Company's investment in KEOPL.

The Company's Industrial & Offshore Division maintains their own bank line of credit facility. The Company's M&M and MMO subsidiaries credit facility, through Canadian Imperial Bank of Commerce ("CIBC") was initially entered into December 1994 and was amended on March 9, 2000. The CIBC credit facility currently allows M&M to borrow up to the lesser of (i) $1.75 million, or (ii) 75% of receivables from government or large institutions/corporations and 60% of other receivables to finance working capital requirements on a revolving basis. The CIBC credit facility is payable upon demand. As of June 30, 2002, the principal balance outstanding under the credit facility was $1.5 million, compared to $0.8 million as at June 30, 2001. As security for repayment of the credit facility, M&M granted to CIBC a first priority lien on pledged receivables, inventory and specific equipment; a second priority lien on land, buildings and immovable equipment; and an assignment of insurance. MMO also guarantees the CIBC credit facility. The credit agreement requires M&M to satisfy certain financial tests, limits the amount of indebtedness M&M may incur and restricts the payment of dividends.

M&M is indebted to RoyNat, Inc. ("RoyNat") in the amount of $0.5 million as of June 30, 2002 (compared to $0.6 million in 2001). This indebtedness arose in connection with a mortgage loan, which was renewed August 2000.

The original credit was offered on May 18, 1990 by RoyNat to M&M in connection

with the purchase of its fabrication facility in St. John's, Newfoundland. The mortgage bears interest at RoyNat's cost of funds plus 3.25%, and is payable in monthly principal payments of $7,000, plus interest. As security, M&M granted a first priority lien on land and building, and a secondary lien on all other assets of M&M, subject to a first priority lien in favor of CIBC. M&M Offshore has also guaranteed this mortgage.

OUTLOOK AND PROSPECTIVE CAPITAL REQUIREMENTS: The Industrial & Offshore Division is currently working on a backlog of contracts. Further development of Atlantic Canada's offshore infrastructure could feed further growth for the Industrial & Offshore Division. In addition the Oil & Gas Division is adding positive cash flow to fund corporate operations and future development and growth strategies. At present the Company intends to expand its oil and gas interests.

As part of the Company's oil and gas exploration and development program the Company expects to expend significant capital resources to expand its existing portfolio of proved and probable oil and gas reserves. These expenditures can be funded through existing cash held by the Company. Any excess expenditure may be funded by additional share capital issued by the Company, debt or by other means.

Subsequent to year-end, one of M&M's joint ventures required an increase in its credit facility to the amount of $2,450,000. The facility is repayable on demand on or before December 31, 2002 and bears interest at the bank's prime lending rate plus 2.00% per annum. As security for this facility, M&M was required to confirm that they would not claim repayment of $300,000 owed to them by the joint venture until December 31, 2002. M&M was also required to provide a guarantee of $500,000 until December 31, 2002. Along with the existing postponement of $50,000 and permanent guarantee of $75,000 (see Note 7), M&M's commitment is now at $350,000 postponement and $575,000 guarantee.

With respect to anticipated capital expenditures over the next twelve months, M&M is expected to expend approximately $0.5 million for new and used manufacturing and office-related equipment. Such equipment, which could be utilized to generate additional construction revenues, could be financed through capital leases with equipment manufacturers or credit arrangements with M&M's existing lenders, cash from its parent company or other means.

The Company's future profitability over the longer term will depend upon its ability to successfully implement its business plan. M&M has, in the past, focused on manufacturing and fabricating process piping, production equipment, steel tanks and other metal products requiring specialized welding and fabrication abilities. Management believes that several opportunities are developing in the Atlantic provinces of Canada which will enable M&M to maintain and increase this business. These include proposed offshore oil and gas projects for the White Rose Oilfield, the Sable Island Offshore Energy Project, and the Hebron Oilfield, in addition to development of the Voisey's Bay nickel mine. It is also our belief that M&M will be afforded opportunities with respect to the upgrade and maintenance of existing area infrastructure including the Hibernia and Terra Nova oil fields, mechanical fabrication and maintenance of production equipment for refineries, pulp and paper mills (including environmental equipment) and private sector power generation projects (primarily for mining and natural resources).

RECENTLY ISSUED UNITED STATES ACCOUNTING STANDARDS: In August 2001, the FASB issued SFAS No. 143 "Accounting for Asset Retirement Obligations". SFAS No. 143 requires the fair value of a liability for an asset retirement obligation to be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS No. 143 is effective for the fiscal year ending June 30, 2003. Management believes the adoption of this

statement will have no material impact on the financial statements.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets". SFAS No. 144 requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuous operations or in discontinued operations. Therefore, discontinued operations will no longer be measured at net realizable value or include amounts for operating losses that have not yet occurred. SFAS No. 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001 and, generally, is to be applied prospectively. Currently, the Company is assessing, but has not yet determined how the adoption of SFAS 144 will impact its financial position and results of operation. In April 2002, the FASB issued SFAS No. 145 "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections". SFAS No. 145 rescinds FASB No. 4 "Reporting Gains and Losses from Extinguishment of Debt", and an amendment of that statement, FASB No. 64 "Extinguishments of Debt made to Satisfy Sinking-Fund Requirements". This statement also rescinds FASB No. 44, "Accounting for Intangible Assets of Motor Carriers". This statement amends FASB No. 13, "Accounting for Leases", to eliminate an inconsistency between required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. This statement amends other existing authoritative pronouncements to make various technical

corrections, clarify meanings, or describe their applicability under changed conditions. The provisions for debt extinguishments are applicable for fiscal years beginning after May 15, 2002 and the provisions regarding lease accounting are for transactions occurring after May 15, 2002. Management believes the adoption of this statement will not have a material effect on the financial position and results of operations.

In June 2002, the FASB issued SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities". SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized at the date the liability is incurred and is measured and recorded at fair value. This is effective for exits or disposal activities initiated after December 31, 2002. Management is of the opinion that the adoption of SFAS No. 146 will not impact its financial position and results of operation.

TREND INFORMATION

SEASONALITY: The Company's Industrial & Offshore Division operates in a cyclical and seasonal industry. Fabrication industry activity levels are generally dependent on the level of capital spending in heavy industries such as mining, forestry, oil and gas and petrochemicals. In addition the Company is subject to seasonal levels of activity whereby business activities tends to be lower during the winter months. The level of industry profits, capacity-utilization in the industry and interest rates often affect capital spending in these industries. Success in fabrication will be dependent on the Industrial & Offshore Division's ability to secure and profitably perform fabrication contracts. Fixed price fabrication contracts contain the risk of bid error or significant cost escalation with regard to either labor or material costs, combined with a limited ability to recover such costs from the applicable client.

The Company's Oil & Gas Division is not a seasonal business, but increased consumer demand or changes in supply in certain months of the year can influence the price of produced hydrocarbons, depending on the circumstances. Production from the Company's oil and gas properties is the primary determinant for the volume of sales during the year.

ENERGY POWER SYSTEMS LIMITED

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2002, 2001 AND 2000
(EXPRESSED IN CANADIAN DOLLARS)

ENERGY POWER SYSTEMS LIMITED
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED
JUNE 30, 2002, 2001 AND 2000
(EXPRESSED IN CANADIAN DOLLARS)

CONTENTS

AUDITORS' REPORT 2

COMMENTS BY AUDITOR FOR U.S. READERS ON
CANADA-U.S. REPORTING DIFFERENCE 3

CONSOLIDATED FINANCIAL STATEMENTS
Balance Sheets 4
Statements of Loss and Deficit 5
Statements of Cash Flows 6
Summary of Significant Accounting Policies 7-10
Notes to Consolidated Financial Statements 11-33

AUDITORS' REPORT

TO THE SHAREHOLDERS OF
ENERGY POWER SYSTEMS LIMITED

We have audited the consolidated balance sheets of Energy Power Systems Limited

as at June 30, 2002 and 2001 and the consolidated statements of loss and deficit and consolidated statements of cash flows for the years ended June 30, 2002, 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 audit in accordance with Canadian and U.S. 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 the Company as at June 30, 2002 and 2001 and the results of its operations and its cash flows for the years ended June 30, 2002, 2001 and 2000 in accordance with Canadian generally accepted accounting principles.

(signed) BDO Dunwoody LLP

Chartered Accountants

Toronto, Ontario
August 29, 2002

==

COMMENTS BY AUDITOR FOR U.S. READERS
ON CANADA-U.S. REPORTING DIFFERENCE

In the United States, reporting standards for auditors require the addition of

an explanatory paragraph (following the opinion paragraph) when there is a change in accounting principles that has a material effect on the comparability of the Company's financial statements, such as the change described in Note 5 to the financial statements. Our report to the shareholders dated August 29, 2002 is expressed in accordance with Canadian reporting standards which do not require a reference to such a change in accounting principles in the Auditors' Report when the change is properly accounted for and adequately disclosed in the financial statements.

(signed) BDO Dunwoody LLP

Chartered Accountants

Toronto, Ontario
August 29, 2002

ENERGY POWER SYSTEMS LIMITED
CONSOLIDATED BALANCE SHEETS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30	2002	2001
ASSETS		
CURRENT		
Cash and cash equivalents	$ 5,610,621	$ 1,242,621
Marketable securities (market value $283,800; $255,290 - 2001)	283,800	221,213
Accounts receivable (Note 1)	5,218,201	4,331,086
Inventories and work in progress	2,652,816	1,039,853
Due from co-venturer (Note 6)	159,110	208,652
Prepaid expenses	59,618	67,329
Investment (Note 2)	-	3,500,000
Future income tax asset (Note 11)	61,473	235,000
	14,045,639	10,845,754
INVESTMENT (Note 2)	3,500,000	-
OIL AND GAS PROPERTIES (Note 3)	4,400,078	2,017,493
CAPITAL ASSETS (Note 4)	2,834,859	3,268,096
FUTURE INCOME TAX ASSET (Note 11)	533,527	862,000
GOODWILL (Note 5)	-	2,056,832
	$ 25,314,103	$ 19,050,175
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT		
Bank indebtedness (Note 7)	$ 1,462,766	$ 829,001
Accounts payable and accrued liabilities	4,022,114	4,200,868
Due to shareholders (Note 8)	628,346	1,162,403
Current portion of long term debt (Note 9)	185,925	182,151
Future income tax liability (Note 11)	432,490	266,000
	6,731,641	6,640,423

DUE TO SHAREHOLDERS (Note 8)	-	350,000
LONG-TERM DEBT (Note 9)	501,670	646,311
FUTURE INCOME TAX LIABILITY (Note 11)	22,110	56,000
	7,255,421	7,692,734
SHAREHOLDERS' EQUITY		
Share capital (Note 10)	42,096,732	32,207,289
Deficit	(24,038,050)	(20,849,848)
	18,058,682	11,357,441
	$ 25,314,103	$ 19,050,175

On behalf of the Board:

(signed) Sandra J. Hall

Director

(signed) James C. Cassina

Director

ENERGY POWER SYSTEMS LIMITED
CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT
(EXPRESSED IN CANADIAN DOLLARS)

FOR THE YEARS ENDED JUNE 30	2002	2001	2000
REVENUE	$ 22,010,321	$ 19,083,808	$ 18,924,369
COST OF SALES AND OIL AND GAS OPERATING COSTS (including amortization of capital assets and depletion $574,208; 2001 - $258,629; 2000 - $ 211,703)	19,037,135	16,571,162	15,127,539
GROSS PROFIT	2,973,186	2,512,646	3,796,830
EXPENSES			
Administrative expenses	4,191,316	2,626,513	4,344,657
Amortization of goodwill	-	261,258	261,258
Amortization of capital assets	124,405	157,111	154,416
Interest	78,334	165,965	100,588
Interest on long term debt	57,675	90,523	113,959
	4,451,730	3,301,370	4,974,878

LOSS FROM CONTINUING OPERATIONS BEFORE THE FOLLOWING UNDERNOTED ITEMS	(1,478,544)	(788,724)	(1,178,048)
OTHER INCOME (Note 12)	1,258,677	66,218	72,486
WRITE DOWN OF INACTIVE CAPITAL ASSETS	(316,668)	(1,500,000)	-
NET LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(536,535)	(2,222,506)	(1,105,562)
INCOME TAXES (Note 11)			
Current	(39,765)	-	36,045
Future	634,600	(1,248,100)	330,300
Utilization of loss carryforwards	-	-	(35,000)
	594,835	(1,248,100)	331,345
NET LOSS FROM CONTINUING OPERATIONS	(1,131,370)	(974,406)	(1,436,907)
LOSS FROM DISCONTINUED OPERATIONS (Note 20)	-	(2,660,510)	(1,250,992)
NET LOSS FOR THE YEAR	(1,131,370)	(3,634,916)	(2,687,899)
DEFICIT, beginning of year	(20,849,848)	(17,214,932)	(14,527,033)
TRANSITIONAL IMPAIRMENT LOSS (Note 5)	(2,056,832)	-	-
DEFICIT, beginning of year, as restated	(22,906,680)	(17,214,932)	(14,527,033)
DEFICIT, end of year	$(24,038,050)	$(20,849,848)	$(17,214,932)
NET LOSS FROM CONTINUING OPERATIONS PER SHARE (Note 16)	$ (0.17)	$ (0.23)	$ (0.46)
NET LOSS FOR THE YEAR PER SHARE (Note 16)	$ (0.17)	$ (0.85)	$ (0.86)

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

ENERGY POWER SYSTEMS LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
(EXPRESSED IN CANADIAN DOLLARS)

FOR THE YEARS ENDED JUNE 30	2002	2001	2000
CASH FLOWS PROVIDED BY (USED IN)			
OPERATING ACTIVITIES			
Net loss from continuing operations for the year	$(1,131,370)	$ (974,406)	$(1,436,907)
Adjustments to reconcile net loss to net cash provided by operating activities			

Amortization of goodwill	-	261,258	261,258
Amortization of capital assets and depletion	698,613	415,740	366,119
Income taxes	634,600	(1,248,100)	330,300
Loss on sale of capital assets	(7,895)	7,796	1,825
Gain on sale of marketable securities	(22,311)	-	-
Valuation provision on marketable securities	108,376	-	-
Unrealized foreign exchange loss	-	-	50,000
Write down of inactive capital assets	316,668	1,500,000	-
Professional fees settled by issuance of shares	-	-	225,000
Net change in non-cash working capital balances (Note 13)	(2,617,222)	(1,223,064)	160,235
Cash used by operating activities from continuing operations	(2,020,541)	(1,260,776)	(42,170)
Cash used by discontinued operations	-	(52,278)	(2,487,076)
	(2,020,541)	(1,313,054)	(2,529,246)
INVESTING ACTIVITIES			
Purchase of marketable securities, net	(148,652)	(221,213)	-
Due from co-venturers	49,542	(91,968)	-
Purchase of oil and gas assets	(2,759,206)	(1,727,857)	-
Purchase of capital assets	(163,087)	(213,991)	(181,447)
Proceeds from sale of capital assets	22,900	27,000	55,500
Other assets	-	3,355,025	598,318
Restricted cash	-	-	2,095,984
Investing activities of discontinued operations	-	22,900	4,028,962
	(2,998,503)	1,149,896	6,597,317
FINANCING ACTIVITIES			
Bank indebtedness	633,765	321,779	(135,854)
Long term debt, net	(198,207)	(277,187)	(469,954)
Due to related parties	-	-	490,098
Advances from(repayments to) shareholders	(404,057)	(1,930,057)	282,137
Issuance of common shares	9,355,543	1,350,000	-
Issuance of preference shares	-	250,000	-
Financing activities of discontinued operations	-	(79,803)	(2,700,596)
	9,387,044	(365,268)	(2,534,169)
NET INCREASE (DECREASE) IN CASH DURING THE YEAR	4,368,000	(528,426)	1,533,902
CASH AND CASH EQUIVALENTS, beginning of year	1,242,621	1,771,047	237,145
CASH AND CASH EQUIVALENTS, end of year	$ 5,610,621	$ 1,242,621	$ 1,771,047

SEE SUPPLEMENTARY CASH FLOW INFORMATION (Note 13 (a))

ENERGY POWER SYSTEMS LIMITED
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

NATURE OF BUSINESS
AND PRINCIPLES OF

CONSOLIDATION

Energy Power Systems Limited ("EPS" or the "Company") is a corporation amalgamated under the laws of the Province of Ontario. The Company's business focus is to explore and develop oil and gas reserves. These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries M&M Engineering Limited ("M&M") and its wholly-owned subsidiary M&M Offshore Limited ("MMO") whose business focus is engineering mechanical contracting and steel fabrication in Newfoundland.

Pursuant to Articles of Amendment dated February 2, 2001 the Company changed its name from Engineering Power Systems Limited to Energy Power Systems Limited.

During fiscal 2001 the Company decided to discontinue efforts to act as a developer of independent power projects. The Company is seeking a developer who will purchase its interest in the Karnataka Project. In addition, the Company intends to monetize its investment in the Andhra Pradesh Project. This segment has been treated as discontinued operations for accounting purposes (see Note 20). As such the operations of the Company's Power Division have been excluded from the consolidated statement of loss and deficit from continuing operations in current and prior periods.

During fiscal 2000, EPS disposed of its interests in Merlin Engineering A.S. ("Merlin") and divested ASI Holdings Inc. ("ASIH"). These operations have been treated as discontinued operations for accounting purposes (see Note 20). As such, the operations of Merlin and ASIH have been excluded from the consolidated statement of loss and deficit from continuing operations in current and prior periods.

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada.

OIL AND GAS PROPERTIES

The Company follows the full cost method of accounting for oil and gas operations whereby all costs of exploring for and developing oil and gas reserves are initially capitalized. Such costs include land acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling and overhead charges directly related to acquisition and exploration activities.

Costs capitalized, together with the costs of production equipment, are depleted on the unit-of-production method based on the estimated gross proved reserves. Petroleum products and reserves are converted to equivalent units of natural gas at approximately 6,000 cubic feet to 1 barrel of oil.

==

ENERGY POWER SYSTEMS LIMITED
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

OIL AND GAS PROPERTIES - (CONTINUED)

Costs acquiring and evaluating unproved properties are initially excluded from depletion calculations. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the

property or the amount of the impairment is added to costs subject to depletion calculations.

Proceeds from a sale of petroleum and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion. Alberta Royalty Tax Credits are included in oil and gas sales.

In applying the full cost method, the Company performs a ceiling test which restricts the capitalized costs less accumulated depletion and amortization from exceeding an amount equal to the estimated undiscounted value of future net revenues from proved oil and gas reserves, as determined by independent engineers, based on sales prices achievable under existing contracts and posted average reference prices in effect at the end of the year and current costs, and after deducting estimated future general and administrative expenses, production related expenses, financing costs, future site restoration costs and income taxes.

ROYALTIES

As is normal to the industry, the Company's production is subject to crown, freehold and overriding royalties, and mineral or production taxes. These amounts are reported net of related tax credits and other incentives available.

ENVIRONMENTAL AND SITE RESTORATION COSTS

A provision for environmental and site restoration costs is made when restoration requirements are established and costs can be reasonably estimated. The balance of future salvage value of assets is netted against the future site restoration accrual. The accrual is based on management's best estimate of these future costs on the ratio of actual production to proved producing reserves.

ACCOUNTING ESTIMATES

The preparation of these consolidated 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 and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements of changes in such estimates in future periods could be material.

==

REVENUE RECOGNITION

Industrial and Offshore Division

Revenue from engineering construction and fabrication contracts is recognized on the percentage of completion method. The percentage of completion method recognizes revenue by assessing the value of the work performed in relation to the total estimated cost of the contract based on the contract value. Contract costs include all direct material and labour costs and those indirect costs related to contract performance such as supplies, tools and

repairs. Administrative and general overheads are charged to expense as incurred. Contract losses are provided for in full in the year in which they become apparent.

Oil and Gas Division

Oil and gas revenue is recognized on actual production, and upon delivery of the product to the customer based on the operators' reports.

MARKETABLE SECURITIES

Marketable securities are valued at the lower of cost or market on a portfolio basis.

INVESTMENT

The investment in Konaseema EPS Oakwell Power Limited ("KEOPL") is recorded at expected net recoverable amount. The actual recoverable amount is dependent on future events and could differ materially from the actual amount recovered.

INVENTORIES

Inventories of finished goods are valued at the lower of cost and net realizable value. Raw materials are valued at the lower of cost and replacement cost.

JOINT VENTURES

The Company uses the proportionate consolidation method to account for its non oil and gas joint ventures.

The majority of the Company's petroleum and natural gas exploration activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

CAPITAL ASSETS

Capital assets consist primarily of fabrication buildings, office equipment, and manufacturing equipment. These assets are recorded at cost less accumulated amortization and write down for impairment.

Capital assets are amortized on the declining balance basis over their estimated useful lives at the following rates:

Buildings	3%
Manufacturing equipment	20%
Tools and equipment	20%
Office equipment	20%
Vehicles	30%
Paving	7%
Equipment under capital leases	20%

GOODWILL

Goodwill represents the excess purchase price paid for business combinations over the value assigned to identifiable net assets acquired. Goodwill is tested for impairment at least annually and an impairment loss is recognized when the carrying amount of the goodwill of a reporting unit exceeds the fair value of the goodwill. The fair value of the reporting unit is

obtained using the present value of expected cash flows.

MARKETING AND PROMOTION COST

Marketing and promotion costs for new business opportunities are charged to administrative expenses as incurred.

FOREIGN CURRENCY TRANSLATION

Foreign currency accounts are translated to Canadian dollars as follows:

At the transaction date, each asset, liability, revenue or expense is translated into Canadian dollars by the use of the exchange rate in effect at that date. At the year end date, monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at that date and the resulting foreign exchange gains and losses are included in income in the current period.

INCOME TAXES

The Company accounts for income taxes under the asset and liability method. Under this method, future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial reporting and tax bases of assets and liabilities and available loss carryforwards. A valuation allowance is established to reduce tax assets if it is more likely than not that all or some portions of such tax assets will not be realized.

STOCK BASED COMPENSATION

The Company has established a stock option plan (the "Plan") for directors, officers and key employees. No compensation expense is recognized for these plans when stock or stock options are issued to employees. Any consideration paid by employees on exercise of stock options or purchase of stock is credited to share capital.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash on hand, bank balances and investments in money market instruments with maturities of three months or less.

==

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

----

1. ACCOUNTS RECEIVABLE

Receivables consist of the following:

	2002	2001
Trade	$4,930,847	$4,161,427

Holdbacks	287,354	169,659
	$5,218,201	$4,331,086

2. INVESTMENT

Investment consists of the following:

	2002	2001
Investment in Konaseema EPS Oakwell Power Limited	$3,500,000	$3,500,000
Less: current portion	-	3,500,000
Long term portion	$3,500,000	$ -

The Company owns 11,348,200 ordinary equity shares of Rs. 10 each, of Konaseema EPS Oakwell Power Limited ("KEOPL") (the "KEOPL Shares"), a company incorporated in India, which is developing the Andhra Pradesh Project. Pursuant to the Revised VBC Agreement dated August 10, 2000 between the Company, VBC Group ("VBC"), KEOPL's parent company, and KEOPL, VBC shall purchase the Company's investment in KEOPL for INR 113,482,000 (approximately Cdn. $3,500,000) on or before June 30, 2002 if the Company offers its KEOPL Shares to VBC prior to June 30, 2002.

On May 3, 2002, the Company, pursuant to the Revised VBC Agreement, offered and tendered the KEOPL Shares to VBC for purchase on or before June 30, 2002. On July 1, 2002, VBC raised a dispute regarding the purchase and sale of the KEOPL shares.

The Company is pursuing legal remedies against VBC to effect the purchase and sale of the KEOPL shares to VBC. The Company estimates that the carrying amounts of the investment in KEOPL will be fully recovered. The actual recoverable amount is dependent upon future events and could differ materially from the amount estimated by management.

3. OIL AND GAS PROPERTIES

During the year, the Company commenced an exploration and drilling program resulting in expenditures of $2,759,206. During the previous year the Company

acquired various working interests in producing and non-producing oil and gas properties in Alberta, Ontario and Prince Edward Island. As consideration, the Company paid $1,727,857 cash and issued 90,000 common shares for $335,000. These properties are carried at cost set out below:

Petroleum and natural gas properties and equipment

	COST	ACCUMULATED DEPLETION AND AMORTIZATION	NET BOOK VALUE
June 30, 2002	$4,822,063	$ 421,985	$4,400,078
June 30, 2001	$2,062,857	$ 45,364	$2,017,493

As at June 30, 2002, costs of acquiring unproved properties in the amount of $1,186,516 (2001 - $376,842) were excluded from depletion calculations.

The Company is required to fund its share of costs and expenses. Failure to fund expenditures will in some cases result in a dilution of its interests.

---

4. CAPITAL ASSETS

Capital assets consists of the following:

	2002		2001	
	COST	ACCUMULATED AMORTIZATION	Cost	Accumulated Amortization
Land	$ 342,884	$ -	$ 544,009	$ -
Building	2,139,887	623,270	2,643,700	935,005
Manufacturing equipment	764,482	671,672	755,032	645,057
Tools and equipment	1,164,421	869,526	1,087,315	805,440
Office equipment	311,029	217,999	281,107	200,264
Vehicles	199,805	150,625	204,707	137,452
Paving	37,460	15,999	36,152	14,433
Equipment under capital leases	879,687	455,705	811,907	358,182
	5,839,655	3,004,796	6,363,929	3,095,833
Net book value		$2,834,859		$ 3,268,096

The Company's ownership in the building located in Port aux Basques, Newfoundland, which is an inactive asset with a carrying amount of $100,000

(2001 - $407,705) may be subject to a third party debenture of $500,000 on the leasehold interest that expires on December 22, 2008. The Company's position with respect thereto is that it does not believe the debenture holder's security interest is valid.

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

5. GOODWILL

During the year, the Company adopted the recommendations of the new CICA Handbook Section 1581, Business Combinations, and Section 3062, Goodwill and Other Intangibles. As a result of applying the new standards, management determined that the value of goodwill was impaired and accordingly a transitional impairment loss $2,056,832 has been charged to opening deficit. Goodwill had previously been amortized over 10 years.

Goodwill is recorded net of the transitional impairment loss of $2,056,832 and accumulated amortization prior to adoption of $615,417 (2001 - $615,417).

The adjusted net loss, basic loss per share from continuing operations and basic loss per share for comparative fiscal years ending June 30, 2001 and 2000 if no amortization was recorded in those years are as follows:

		2002	2001	2000
Reported net loss	$	(1,131,370)	$(3,634,916)	$(2,687,899)
Add back: Goodwill amortization		-	261,258	261,258
Adjusted net loss	$	(1,131,370)	$(3,373,658)	$(2,426,641)
Basic loss per share:				
Reported net loss for the year	$	(0.17)	$ (0.85)	$ (0.86)
Goodwill amortization		-	0.06	0.08
Adjusted net loss for the year	$	(0.17)	$ (0.79)	$ (0.78)

6. JOINT VENTURES

The Company's subsidiary, M&M, carries on part of its business in four joint ventures, Newfoundland Service Alliance Inc. ("NSA"), a 20% owned joint venture Magna Services Inc. ("Magna"), a 50% owned joint venture, Liannu, a limited partnership, which the Company owns 49% and acts as the general partner and North Eastern Contractors Limited, a 50% joint venture.

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

6. JOINT VENTURES - (CONTINUED)

During the 2002 fiscal year the Company recorded $1,584,865 (2001 - $1,354,170) of revenue from NSA and eliminated on proportionate consolidation $330,180 (2001 - $225,695). The Company also recorded revenue from Magna of $ Nil (2001 - $166,836) and eliminated $ Nil (2001 - $83,418).

The following is a summary of the combined financial information relating to the Company's proportionate interest in these joint ventures, unadjusted for transactions between the joint venture and the Company:

	PROPORTIONATE SHARE OF JOINT VENTURES' FINANCIAL INFORMATION	
	2002	2001
Balance sheet		
Current assets	$ 1,215,722	$ 562,138
Non current assets	3,636	4,375
Current liabilities	(1,206,601)	(555,763)
Operations		
Revenue	2,932,433	2,860,599
Operating expenses and amortization	2,932,564	2,860,429
Net income	(131)	170
Cash flows		
Operating activities	(117,249)	(179,002)
Investing activities	19,000	75,966
Financing activities	50,000	(51)

7. BANK INDEBTEDNESS

Bank indebtedness of M&M represents a revolving credit facility payable on demand and bears interest at prime plus 2.25% from November 15, 2001 and prime plus 2.0% for previous periods (average 2002 - 6.26%; 2001 - 8.66%).

The bank indebtedness is collateralized by a general assignment of accounts receivable and inventory, a demand debenture providing a second fixed charge over property and immovable equipment, a first fixed charge over certain equipment and a floating charge over all assets.

The credit agreement which M&M has with the bank contains certain restrictive covenants with respect to maintenance of certain financial ratios, declaration and payment of dividends, advancement of funds to and from related parties and acquisition of unfunded capital assets in excess of $400,000 (2001 - $400,000). As at June 30, 2002 M&M was in compliance with these covenants.

During 2002, one of M&M's joint ventures obtained a credit facility in the amount of $150,000, which is repayable on demand and bears interest at the bank's prime lending rate plus 2.00% per annum. As security for this facility, M&M postponed its claim for $50,000 owed to them by the joint venture until repayment of the credit facility to the bank and provided a guarantee of $75,000 (see also Note 18).

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

8. DUE TO SHAREHOLDERS

The amount due to shareholders is comprised of a non-interest bearing promissory note of $313,300 (2001 - $989,172) and a non-interest bearing amount due to a shareholder of $315,046 (2001 - $523,231).

The promissory notes were fully repaid subsequent to June 30, 2002.

9. LONG-TERM DEBT

	2002	2001
Roynat Inc. mortgage maturing in 2008 with interest at Roynat cost of funds plus 3.25% (2002 - 6.26%; 2001 - 9.24%) repayable in monthly principal payments of $7,000, plus interest. The mortgage is collateralized by a first charge on land and building of M&M, and a floating charge on all other assets subject to a prior floating charge in favour of the Canadian Imperial Bank of Commerce (see Note 7)	$ 521,400	$605,400
Capital leases on equipment, with interest at 5.4% to 16.3% (2001 - 7.2% to 16.7%) compounded semi-annually, repayable in blended monthly payments of 10,200 (2001 - $10,000)	166,195	223,062
	687,595	828,462
Less: Current portion	185,925	182,151
	$ 501,670	$646,311

Principal repayments on long-term debt in each of the next five years are estimated as follows:

2003	$185,925
2004	120,808

2005	106,978
2006	88,484
2007 and thereafter	185,400

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

10. SHARE CAPITAL

(a) Authorized

Unlimited Common shares, without par value
Unlimited Class A Preference shares, Series 1
Unlimited Class A Preference shares, Series 2

(b) Issued

	NUMBER OF SHARES	CONSIDERATION
Common shares		
Balance, as at June 30, 2000	12,670,678	$29,322,289
Returned to treasury	(25,000)	-
Issued pursuant to a private placement (i)	8,000,000	800,000
Share consolidation (ii)	(15,482,259)	-
Warrants exercised	1,000,000	520,000
Options exercised (iii)	20,000	30,000
Issued for acquisition of oil and gas property (iv)	90,000	335,000
Balance, as at June 30,2001	6,273,419	31,007,289
Issued pursuant to a private placement (v), net of issue costs of $273,525	1,100,000	6,668,993
Warrants exercised	1,960,000	2,240,000
Options exercised (vi)	277,500	926,550
Settlement of professional fees (vii)	7,726	53,900
Conversion of Preference shares (viii)	960,000	1,200,000
Balance, as at June 30, 2002	10,578,645	$42,096,732
Class A Preference shares, Series 2		
Issued for cash and settlement of debt (viii) during 2001 and balance, as at June 30, 2001	960,000	$ 1,200,000
Conversion to common shares	(960,000)	(1,200,000)

Balance, as at June 30, 2002	-	$ $-
Total issued share capital as at June 30, 2001		$ 32,207,289
Total issued share capital as at June 30, 2002		$ 42,096,732

10. SHARE CAPITAL - (CONTINUED)

(i) On December 28, 2000 the Company issued 8,000,000 pre-consolidated units from treasury to arms length parties. Each unit was ascribed a value of $0.10 and was comprised of one common share, a 1/2 Series A common share purchase warrant and a 1/2 Series B common share purchase warrant. Each whole post consolidated Series A common share purchase warrant and each whole post consolidated Series B common share purchase warrant entitles the holder thereof to purchase one common share at a price of $0.52 per share and $0.80 per share respectively on or before December 28, 2002 and January 16, 2003 respectively.

(ii) On September 12, 2000, at a Special Meeting of Shareholders of the Company, the shareholders approved the consolidation of the Company's issued common shares on the basis that every four (4) pre-consolidation common shares will be converted into one (1) post-consolidation common share. On February 2, 2001 the Company filed Articles of Amendment consolidating the issued common shares on a one for four basis.

(iii) On February 6, 2001 the Company issued 20,000 options to a consultant for professional services. On June 6, 2001 the consultant exercised the 20,000 options for consideration of $30,000.

(iv) On June 30, 2001 the Company issued 90,000 common shares from treasury to an arms length party for consideration of $335,000 for the acquisition of producing and non-producing oil and gas properties.

(v) During the year the Company entered into three private placements with arms length parties as follows:

(a) The Company issued two allotments of 350,000 units at a price of US $4.00 per unit on November 9, 2001 and November 16, 2001 respectively for gross proceeds of US $2.8 million. Each unit was comprised of 350,000 common shares and one-tenth of one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share at a purchase price of US $4.45 per common share exercisable for a period of six months after closing. On May 9, 2002, 35,000 warrants expired under their own terms and on May 16, 2002, 35,000 warrants expired under their own terms.

(b) On March 13, 2002 the Company issued 400,000 units at a price of U.S. $4.00 per unit for gross proceeds of US $1.6 million. Each unit was comprised of one common share and one-tenth of one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share at a purchase price of US $4.45 per common share exercisable for a period of one year after

closing.

(vi) On October 4, 2001 the Company issued 20,000 options to a consultant for professional services. On November 12, 2001 the consultant exercised the 20,000 options for consideration of $85,000. On November 8th, and 12th consultants exercised 4,000 and 20,000 options respectively for total proceeds of $96,000. During the year employees of the Company exercised a total of 233,500 options for total consideration of $745,550.

(vii) On October 19, 2001 the Company issued 7,726 common shares for total consideration of $53,900 to a former professional engaged by the Company for settlement of professional fees.

10. SHARE CAPITAL - (CONTINUED)

(viii) On February 2, 2001 the Company issued 960,000 Class A Preference shares, Series 2 from treasury to arms length parties. Each Series 2 share carries a 5% cumulative preferred annual dividend. Each Series 2 share is convertible during the first 30 months from the date of issuance into one unit of the Company at the rate of $1.25 per unit. Each unit is comprised of one common share and one common share purchase warrant. Each common share purchase warrant is exercisable at $1.50 for one common share for a period of two years after conversion. After 30 months each Series 2 share is convertible into one unit at the weighted average price of the market value of the Company's common shares during the period 10 days prior to conversion (the "Conversion Price"). Each unit is comprised of one common share and one common share purchase warrant exercisable at 10% above the Conversion Price for one common share for a period of two years after conversion. As consideration, $950,000 of promissory notes payable to the shareholders were applied to shareholder loans and $250,000 of cash was received.

During the year holders of 960,000 Series 2 Preference shares in the capital of the Company exercised their conversion rights and acquired 960,000 common shares at $1.25 per share for total consideration of $1,200,000 and 960,000 common share purchase warrants with an exercise price of $1.50 per warrant. The holders subsequently exercised the 960,000 common share purchase warrants at $1.50 each for proceeds to the Company of $1,440,000.

(c) Warrants

The following common share purchase warrants are outstanding as at June 30, 2002:

NUMBER OF WARRANTS	EXPIRY DATE	PRICE
96,000	October 4, 2002	$ 9.60
40,000	March 13, 2003	US $4.45

The continuity of the common share purchase warrants is as follows:

	NUMBER OF WARRANTS
Balance, as at June 30, 2000	4,523,885
Share consolidation (Note 10 (b)(ii))	(3,392,914)
Cancelled	(812,054)
Issued to non-controlling shareholders	2,000,000
Exercised	(1,000,000)
Balance, as at June 30, 2001	1,318,917
Issued to non-controlling shareholders	110,000
Issued upon conversion of Series 2 Preference shares	960,000
Exercised	(1,960,000)
Expired	(292,917)
Balance, as at June 30, 2002	136,000

10. SHARE CAPITAL - (CONTINUED)

(d) Stock Option Plan

The Company has a Stock Option Plan (the "Plan") to provide incentive for the directors, officers, employees, consultants and service providers of the Company and its subsidiaries. The maximum number of shares which may be set aside for issuance under the Plan is 800,000 common shares (2001 - 281,250 common shares). Under the Plan, the Company has granted the following stock options as at June 30, 2002:

HOLDER	NUMBER OF OPTIONS	EXERCISE PRICE	EXPIRY DATE
Directors and employees	274,000	$ 6.30	January 8, 2006
Consultant	21,000	4.00	June 14, 2005

The continuity of stock options is as follows:

	NUMBER OF OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
Balance, June 30, 2000	422,500	$ 4.02
Share consolidation (Note 10 (b)(ii))	(316,875)	16.07
Cancelled	(105,625)	16.07
Issued	275,000	2.73
Exercised	(20,000)	1.50
Balance, June 30, 2001	255,000	2.82
Issued	342,500	6.18
Expired	(25,000)	4.00
Exercised	(277,500)	3.34
Balance, June 30, 2002	295,000	$ 6.14

All options are vested and exercisable.

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

11. INCOME TAXES

Effective July 1, 2000, the Company changed its method of accounting for income taxes from the deferral method to the liability method. The liability method requires that accumulated tax balances be adjusted to reflect changes in the tax rates. This standard was applied retroactively; however, the difference was insignificant.

Significant components of the Company's future tax assets and liabilities are as follows:

	2002	2001
FUTURE INCOME TAX ASSETS:		
Non-capital loss carryforwards	$ 4,016,968	$ 3,698,000
Capital losses	2,340,635	2,465,000
Oil and gas properties	578,230	20,000
	6,935,833	6,183,000
Non-capital losses applied	(773,833)	(21,000)

Valuation allowance	(5,567,000)	(5,065,000)
	$ 595,000	$ 1,097,000
Current portion	$ 61,473	$ 235,000
Long term portion	$ 533,527	$ 862,000
FUTURE INCOME TAX LIABILITIES		
Capital assets	$ (119,375)	$ (56,000)
Work in progress	(985,495)	(196,000)
Holdbacks	(123,563)	(91,000)
	(1,228,433)	(343,000)
Non capital losses applied	773,833	21,000
	$ (454,600)	$ (322,000)
Current portion	$ (432,490)	$ (266,000)
Long term portion	$ (22,110)	$ (56,000)

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

11. INCOME TAXES - (CONTINUED)

The Company's provision for income taxes is comprised as follows:

	2002	2001	2000
Net loss from continuing operations	$(536,535)	$(2,222,506)	$(1,105,562)
Combined federal and provincial income tax rate	39%	43%	45%
Recovery of income tax calculated at statutory rates	$(209,249)	$ (955,678)	$ (497,502)
Increase (decrease) in taxes resulting from:			
Non-deductible expenses	21,263	672,578	461,000
Amortization of goodwill	-	112,000	118,000
Depletion of oil and gas properties	146,883	20,000	-
Other	133,938	-	(352,498)
Benefits of previously unrecorded losses	-	(1,097,000)	-
Losses not recognized for income tax purposes	-	-	602,345
Valuation allowance adjustment	502,000	-	-
Provision for income taxes	$ 594,835	$(1,248,100)	$ 331,345

The Company and its subsidiaries have non-capital losses of approximately $10,200,000 which are available to reduce future taxable income. These non-capital losses expire as follows:

2003	$26,000
2004	887,000
2005	2,900,000
2006	1,938,000
2007	1,427,000
2008	1,580,000
2009	1,442,000

12. OTHER INCOME

Included in other income is a litigation settlement of $650,000 related to a claim against a company with respect to an asset purchase agreement. Also included is an overprovision for costs related to the Port aux Basques property settled for $214,500 less than accrued. The balance of other income relates mainly to credits received for workers compensation adjustments of prior years.

13. CHANGES IN WORKING CAPITAL AND NON-CASH TRANSACTIONS

Non-cash working capital transactions relating to funds from operations are as follows:

	2002	2001	2000
Accounts receivables	$ (887,115)	$ (997,513)	$(580,536)
Inventories and work in progress	(1,612,963)	485,491	(168,205)
Prepaid expenses	7,711	13,758	(6,195)
Accounts payable and accrued liabilities	(124,855)	(724,800)	915,171
	$(2,617,222)	$(1,223,064)	$ 160,235

JUNE 30, 2002, 2001 AND 2000

13. CHANGES IN WORKING CAPITAL AND NON-CASH TRANSACTIONS (CONTINUED)

(a) Supplemental Cash Flow Information

	2002	2001	2000
Cash paid for interest	$136,009	$256,488	$241,247
Cash paid for taxes	-	-	19,501

(b) Non-Cash Transactions

The Company entered into the following non-cash transactions:

	2002	2001	2000
Shares issued pursuant to settlement of professional fees	$53,900	$-	$225,000
Shares issued pursuant to private placement in settlement of promissory notes	-	950,000	768,000
Shares issued pursuant to exercise of warrant in settlement of promissory notes	480,000	-	-
Shares issued to former subsidiary, Merlin	-	-	400,000
Shares issued for acquisition of Oil and Gas Properties	-	335,000	-
Capital assets purchased through capital leases	57,340	95,694	172,755

14. COMMITMENTS

Operating Leases

The Company has entered into agreements to lease vehicles and office equipment for various periods until the year 2007. The minimum rental commitments under operating leases are estimated as follows:

2003	$90,489
2004	55,460
2005	22,000
2006	7,276
2007	3,032
	178,257

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

15. FINANCIAL INSTRUMENTS

The carrying values of the primary financial instruments of the Company, with the exception of long-term debt, approximate fair values due to the short-term maturities and normal trade credit terms of those instruments. Included in cash is $2,613,213 held at one financial institution and $2,693,179 held at a financial intermediary.

The fair value of long-term debt and amounts due to shareholders approximates carrying value in 2002 and 2001 as the terms were renegotiated.

The Company provides services and sells its products to many customers. Four customers represent 53% (2001 - three customers represents 53%) of the trade accounts receivable at year-end. One customer represents 31% (2001 - one customer represents 40%; 2000 - one customer represents 39%) of the revenue for the year. Two suppliers represent 28% (2001 - three suppliers represent 33%) of the trade accounts payable at year-end.

16. PER SHARE INFORMATION

In 2001 the Company adopted the treasury method for computing earnings per share and fully diluted earnings per share. The treasury method has been applied retroactively. Net loss per share has been determined using the weighted average number of common shares outstanding as at June 30, 2002 - 6,638,384 (2001 - 4,256,502; 2000 - 3,135,857).

In each of the fiscal years the exercise of warrants and stock options would be anti-dilutive. The weighted average number of common shares and net loss per share figures for prior year have been retroactively restated for the reverse stock split.

17. RECONCILIATION TO ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES

The Company's accounting policies do not differ materially from accounting principles generally accepted in the United States ("US GAAP") except for the following:

(a) Stock Options

Under US GAAP (FAS 123), stock options granted to consultants are recognized as an expense based on their fair value at the date of grant. Under Canadian GAAP the options are disclosed and no compensation expense is recorded. The calculation for the compensation of $8,621 (2001 - $112,040) is based on the Black-Scholes option pricing model with the assumption that no dividends are to be paid on common shares, a weighted average volatility factor for the Company's share price of 0.31 for 20,000 options issued during fiscal 2002 and a volatility factor for the Company's share price of 0.64 for 70,000 options and 0.43 for 20,000 options issued during fiscal 2001, a weighted average risk free interest rate of 5% over a four year period and a fair value of options of $2.70 (2001 - $3.10 and $1.50 respectively).

==

----

17. RECONCILIATION TO ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES - (CONTINUED)

(a) Stock Options - (Continued)

The Company follows APB 25 for options granted to employees. For employees, compensation expense is recognized under the intrinsic value method. Under this method, compensation cost is the excess, if any, of the quoted market price at grant date over the exercise price. Such expense is reflected over the service period; if for prior services, expensed at date of grant; if for future services, expensed over vesting period. The exercise price of the stock options outstanding to employees is equal or exceeds the market value of the shares at the date granted, therefore, no compensation expense is recognized at grant date for US GAAP purposes.

(b) Interest Free Loans

Under US GAAP, the benefit of interest free loans is reflected as a discount to the debt and a credit to paid in capital. This discount is computed using the current borrowing rate available to the Company and amortized over the life of the debt.

(c) Joint Venture

Under US GAAP, the Company would use the equity method of accounting for joint ventures rather than the proportionate consolidation method of accounting. For further information see Note 6.

(d) Comprehensive Income

Under US GAAP, comprehensive income must be reported which is defined as all changes in equity other than those resulting from investments by owners and distributions to owners.

(e) Marketable Securities

Under accounting principles generally accepted in Canada, gains (losses) in shares of public companies are not recognized until investments are sold unless there is deemed to be an impairment in value which is other than temporary.

Under US GAAP, such investments are recorded at market value and the unrealized gains and losses are recognized as a separate item in the shareholder's equity section of the balance sheet unless impairments are considered other than temporary.

(f) Preference Shares

In 2001 under US GAAP, the Company has recorded a deemed dividend of approximately $420,000 for the beneficial conversion under the terms of the preferred shares.

(g) Oil and Gas Properties

Under US GAAP, the Company is required to discount future net revenues at 10% for purposes of calculating any required ceiling test write-down. Under Canadian GAAP, future net revenues are not discounted, however, they are reduced for estimated future general and administrative expenses and interest. As a result the carrying value of the oil and gas properties under US GAAP would be written down to discounted future net revenues.

==

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

----

17. RECONCILIATION TO ACCOUNTING PRINCIPLES
GENERALLY ACCEPTED IN THE UNITED STATES - (CONTINUED)

(h) Recently Adopted Accounting Standards

In 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 dealing with revenue recognition which is effective in the fourth quarter of the Company's 2000 fiscal year. The adoption of this Staff Accounting Bulletin did not have a material effect on the Company's financial statements.

In March 2000, the Financial Accounting Standards Board Issued FASB Interpretation No. 44, "Accounting for Certain Transactions involving Stock Compensation", an interpretation of APB Opinion No. 25. The Company adopted the interpretation on July 1, 2000. Among other things, the Interpretation requires that stock options that have been modified to reduce the exercise price be accounted for as variable. As of July 1, 2000, under the provisions of Interpretation No. 44, any options that are considered repriced are accounted for as variable options from that date forward. Therefore, the option value will be re-measured on a quarterly basis using the greater of the exercise price or the July 1, 2000 fair market value as the basis for determining increases in the intrinsic value of the options. During 2001, the Company repriced 57,500 options with an intrinsic value of $92,000 which has been included in the compensation expense adjustment. During 2002, these repriced options were exercised and an additional intrinsic value of $102,550 was recorded to the compensation expense adjustment on their respective measurement dates.

In June 2001, the FASB issued FASB Statement No. 141, "Business Combinations" (SFAS 141), and No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). SFAS 141 requires the use of the purchase method of accounting and prohibits the use of the pooling-of-interests method of accounting for business combinations initiated after June 30, 2001. SFAS 141 also requires that the Company recognize acquired intangible assets apart from goodwill if the acquired intangible assets meet certain criteria. SFAS 141 applies to all business

combinations initiated after June 30, 2001 and for purchase business combinations completed on or after July 1, 2001. It also requires, upon adoption of SFAS 142, that the Company reclassifies the carrying amounts of intangible assets and goodwill based on the criteria in SFAS 141. Management believes the adoption of this statement will have no material impact on the financial statements.

SFAS 142 requires, among other things, that companies no longer amortize goodwill, but instead test goodwill impairment at least annually. In addition, SFAS 142 requires that the Company identify reporting units for the purposes of assessing potential future impairments of goodwill, reassess the useful lives of other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life. An intangible asset with an indefinite useful life should be tested for impairment in accordance with the guidance in SFAS 142. SFAS 142 is required to be applied in fiscal years beginning after December 15, 2001 to all goodwill and other intangible assets recognized at that date, regardless of when those assets were initially recognized. SFAS 142 requires that the Company complete a transitional goodwill impairment test six months from the date of adoption. The Company is also required to reassess the useful lives of other intangible assets within the first interim quarter after adoption of SFAS 142. During 2002, the Company early adopted SFAS 142, management has determined that the value of goodwill was impaired, accordingly a transitional impairment loss $2,056,832 has been reported as a cumulative effect of a change in accounting principle. Goodwill had previously been amortized over 10 years. This change in accounting policy has been applied by recording a cumulative adjustment in 2002.

17. RECONCILIATION TO ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES - (CONTINUED)

(h) Recently Adopted United States Accounting Standards (continued)

Goodwill is recorded net of the transitional impairment loss of $2,056,832 and accumulated amortization prior to adoption of $615,417 (2001 - $615,417).

The adjusted net loss from continuing operations per US GAAP, basic and diluted net loss per share from continuing operations and basic and diluted net loss per share for comparative fiscal years ending June 30, 2001 and 2000 if no amortization was recorded in those years are as follows:

	2002	2001	2000
Reported net loss from continuing operations per US GAAP	$ (2,441,721)	$(1,357,753)	$(1,785,582)
Add back: Goodwill amortization	-	261,258	261,258
Adjusted net loss from continuing operations per US GAAP	$ (2,441,721)	$(1,096,495)	$(1,524,324)

Basic and diluted net loss per share from

continuing operations per US GAAP			
Reported net loss from continuing operations per US GAAP	$ (0.37)	$ (0.42)	$ (0.57)
Goodwill amortization	-	0.06	0.08
Adjusted net loss from continuing operations	$ (0.37)	$ (0.36)	$ (0.49)
Basic and diluted net loss per share per US GAAP:			
Reported net loss per US GAAP	$ (0.68)	$ (1.04)	$ (0.97)
Goodwill amortization	-	0.06	0.08
Adjusted net loss for the year per US GAAP	$ (0.68)	$ (0.98)	$ (0.89)

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

17. RECONCILIATION TO ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES - (CONTINUED)

(h) Recently Issued United States Accounting Standards (continued)

In August 2001, the FASB issued SFAS No. 143 "Accounting for Asset Retirement Obligations". SFAS No. 143 requires the fair value of a liability for an asset retirement obligation to be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS No. 143 is effective for the fiscal year ending June 30, 2003. Management believes the adoption of this statement will have no material impact on the financial statements.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets". SFAS No. 144 requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuous operations or in discontinued operations. Therefore, discontinued operations will no longer be measured at net realizable value or include amounts for operating losses that have not yet occurred. SFAS No. 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001 and, generally, is to be applied prospectively. Currently, the Company is assessing, but has not yet determined how the adoption of SFAS 144 will impact its financial position and results of operation.

In April 2002, the FASB issued SFAS No. 145 "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections". SFAS No. 145 rescinds FASB No. 4 "Reporting Gains and Losses from Extinguishment of Debt", and an amendment of that statement, FASB No. 64 "Extinguishments of Debt made to Satisfy Sinking-Fund Requirements". This statement also rescinds FASB No. 44, "Accounting for Intangible Assets of Motor

Carriers". This statement amends FASB No. 13, "Accounting for Leases", to eliminate an inconsistency between required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. This statement amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions for debt extinguishments are applicable for fiscal years beginning after May 15, 2002 and the provisions regarding lease accounting are for transactions occurring after May 15, 2002. Management believes the adoption of this statement will not have a material effect on the financial position and results of operations.

In June 2002, the FASB issued SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities". SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized at the date the liability is incurred and is measured and recorded at fair value. This is effective for exits or disposal activities initiated after December 31, 2002. Management is of the opinion that the adoption of SFAS No. 146 will not impact its financial position and results of operation.

If US GAAP were followed, the effect on the consolidated balance sheet would be as follows:

	2002	2001
Total assets per Canadian GAAP	$25,314,103	$19,050,175
Unrealized gain on marketable securities (e)	-	34,077
Writedown oil and gas properties (g)	(1,044,000)	-
Total assets per US GAAP	$24,270,103	$19,084,252
Total liabilities per Canadian GAAP	$ 7,255,421	$ 7,692,734
Unamortized debt discount (b)	-	(155,180)
Total liabilities per US GAAP	$ 7,255,421	$ 7,537,554
Total shareholders' equity per Canadian GAAP	$18,058,682	$11,357,441
Other paid in capital adjustment per US GAAP		
Compensation expense (a)	413,102	301,931
Debt discount (b)	683,162	683,162
Unrealized gain on marketable securities (e)	-	34,077
Deficit adjustments per US GAAP		
Amortization of debt discount	(683,162)	(527,982)
Compensation expense	(413,102)	(301,931)
Writedown oil and gas properties	(1,044,000)	-
Total shareholders' equity per US GAAP	$17,014,682	$11,546,698

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

17. RECONCILIATION TO ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES - (CONTINUED)

If US GAAP were followed, the effect on the consolidated statements of loss would be as follows:

	2002	2001	2000
Net loss from continuing operations according to Canadian GAAP	$(1,131,370)	$ (974,406)	$(1,436,907)
Compensation expense adjustment (a)	(111,171)	(204,040)	-
Amortization of debt discount (b)	(155,180)	(179,307)	(348,675)
Writedown oil and gas properties (g)	(1,044,000)	-	-
Net loss from continuing operations according to US GAAP	(2,441,721)	(1,357,753)	(1,785,582)
Loss from discontinued operations	-	(2,660,510)	(1,250,992)
Net loss according to US GAAP before cumulative effect of a change in accounting principle	(2,441,721)	(4,018,263)	(3,036,574)
Cumulative effect of a change in accounting principle	(2,056,832)	-	-
Net loss according to US GAAP	(4,498,553)	(4,018,263)	(3,036,574)
Unrealized (loss) gain on marketable securities (e)	(34,077)	34,077	-
Comprehensive net loss according to US GAAP	$(4,498,553)	$(4,018,263)	$(3,036,574)
Net loss according to US GAAP	$(4,498,553)	$(4,018,263)	$(3,036,574)
Deemed dividend on preferred shares (f)	-	(420,000)	-
Net loss available for common shareholders	$(4,498,553)	$(4,438,263)	$(3,036,574)
Basic and diluted net loss per common share from continuing operations according to US GAAP	$ (0.37)	$ (0.42)	$ (0.57)
Loss per common share for the cumulative effect of a change in accounting principle for GAAP	$ (0.31)	$ -	$ -

Basic and diluted net loss per common share according to US GAAP	$ (0.68)	$ (1.04)	$ (0.97)
Shares used in the computation of basic and diluted earnings per share	6,638,384	4,256,502	3,135,857

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

18. SUBSEQUENT EVENT

Subsequent to year-end, one of M&M's joint ventures required an increase in its credit facility to the amount of $2,450,000. The facility is repayable on demand on or before December 31, 2002 and bears interest at the bank's prime lending rate plus 2.00% per annum. As security for this facility, M&M was required to confirm that they would not claim repayment of $300,000 owed to them by the joint venture until December 31, 2002. M&M was also required to provide a guarantee of $500,000 until December 31, 2002. Along with the existing postponement of $50,000 and permanent guarantee of $75,000 (see Note 7), M&M's commitment is now at $350,000 postponement and $575,000 guarantee.

19. SEGMENTED INFORMATION

The Company's operations are separated into two distinct segments; the Industrial & Offshore Division, consisting of the operations of M&M and its wholly-owned subsidiary MMO, and the Oil & Gas Division performing oil and gas exploration and production. M&M and MMO are engineering and construction companies, performing installation, erection, welding, maintenance and ancillary fabrication services.

The following is the Company's segmented information for continuing operations:

For the year ended June 30, 2002

	INDUSTRIAL & OFFSHORE DIVISION	OIL & GAS DIVISION	CORPORATE	2002 TOTAL
Revenue	$21,561,858	$ 448,463	$ -	$22,010,321
Interest expense	131,084	-	4,925	136,009
Amortization	321,991	376,622	-	698,613
Net earnings (loss) from continuing operations	$ 187,642	$ (690,758)	$ (628,254)	$(1,131,370)
Capital assets and Oil and				

Gas Interests	$ 2,834,859	$4,400,078	$ -	$ 7,234,937

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

19. SEGMENTED INFORMATION (CONTINUED)

For the year ended June 30, 2001

	INDUSTRIAL & OFFSHORE DIVISION	OIL & GAS DIVISION	CORPORATE	2001 TOTAL
Revenue	$18,770,318	$ 313,490	$ -	$19,083,808
Interest expense	251,592	-	4,896	256,488
Amortization	631,634	45,364	-	676,998
Net earnings (loss) from continuing operations	$(2,100,005)	$1,239,633	$ (114,034)	$ (974,406)
Capital assets and Oil and Gas Interests	$ 3,268,096	$2,017,493	$ -	$ 5,285,589

For the year ended June 30, 2000

	INDUSTRIAL & OFFSHORE DIVISION	OIL & GAS DIVISION	CORPORATE	2000 TOTAL
Revenue	$18,924,369	$ -	$ -	$18,924,369
Interest expense	214,548	26,700	-	241,248
Amortization	627,377	-	-	627,377
Net earnings (loss) from continuing operations	$ 520,852	$ -	$(1,957,759)	$(1,436,907)

20. DISCONTINUED OPERATIONS

Effective June 30, 2001 the Company adopted a formal plan to dispose of its power segment of business (the "Power Division"). The Company intends to exercise its option under the terms of the Revised VBC Agreement to cause VBC to purchase the Company's equity shares in the KEOPL (see Note 2) and has adopted a formal plan of disposition of its interest in the Karnataka Project.

20. DISCONTINUED OPERATIONS - (CONTINUED)

Effective May 30, 2000, the Company divested its 51% ownership interest in its Norwegian engineering design subsidiary, Merlin, for $10 cash. Effective June 30, 2000 the Company adopted a formal plan of disposition for its barge mounted power plant construction subsidiary ASIH.

The results of each of Power Division, Merlin and ASIH have been accounted for as discontinued operations. Estimated disposal costs have been included in the loss from discontinued operations.

The accounting for these discontinued operations is summarized as follows:

	2002	2001	2000
Revenues			
Merlin	$ -	$ -	$ 5,575,145
ASIH	-	-	-
Power division	-	-	-
	$ -	$ -	$ 5,575,145
Earnings (loss) from operations			
Merlin	$ -	$ -	$ (41,428)
ASIH	-	-	(688,221)
Power division	-	(48,414)	(667,658)
	-	(48,414)	(1,397,307)
Gain (loss) from disposal of operations			
Merlin	-	-	666,610

ASIH	-	-	(520,295)
Power division	-	(2,612,096)	-
	-	(2,612,096)	146,315
Loss from discontinued operations	$ -	$(2,660,510)	$(1,250,992)

The Company's consolidated balance sheets include the following amounts related to the discontinued operations:

	2002	2001
Investment	$3,500,000	$3,500,000
Total net assets	$3,500,000	$3,500,000

ENERGY POWER SYSTEMS LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN CANADIAN DOLLARS)

JUNE 30, 2002, 2001 AND 2000

21. CONTINGENT LIABILITY

Writ of Summons

On August 28, 2002, Oakwell Engineering Limited ("Oakwell"), a company incorporated in the Republic of Singapore, which was the former joint venturer with the Company in the Project referred to in Note 2, pursuant to a Settlement Agreement (the "Agreement") dated December 29, 1998 entered into between Oakwell and the Company, filed a Writ of Summons against the Company. Oakwell's claim against the Company is the sum of US $2,790,000, an amount equivalent to 6.25% of the actual cash available for foreign repatriation from the Project in each of the first five years after the commercial operation date of the Project or in the alternative, damages; interest at 8% per annum and indemnity costs. The Company intends to counter claim against Oakwell for damages, costs and interest. Oakwell has claimed repudiation of the Agreement. Oakwell has renounced further performance of the Agreement which has been accepted by the Company.

Subsequent to the Agreement, a change of circumstances materially affected the Project which may affect the terms of the Agreement. Management will seek all legal remedies to defend against this claim. No provision has been made to these financial statements for the claim.