

LUXELL®

DRIVING VISIBLE RESULTS



2007 FISCAL YEAR

**MD&A
&
FINANCIAL
STATEMENTS**

LUXELL TECHNOLOGIES INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

November 30, 2007

INFORMATION CONCERNING LUXELL TECHNOLOGIES INC. FOR THE 4th QUARTER AND YEAR ENDING AUGUST 31, 2007 AND 2006

This Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations should be read in conjunction with the audited consolidated financial statements of Luxell Technologies Inc. (the "Company" or "Luxell") and the accompanying notes for the year ended August 31, 2007 which are presented in accordance with Canadian generally accepted accounting principles. Except as otherwise indicated, all financial information has been reported according to Canadian generally accepted accounting principles (GAAP). All amounts are stated in Canadian dollars unless otherwise stated. All references to a "Fiscal Year" mean the twelve-month period commencing on September 1 and ending on August 31 of the following year. This MD&A has been prepared with all information available up to and including February 26, 2007. Additional information relating to the Company, including the Company's annual information form, is available on SEDAR at www.sedar.com

It is reported that the Company has accumulated a deficit of \$61,384,959 as at August 31, 2007 and for the 12 months ended August 31, 2007, the Company incurred a loss of \$4,294,533 and negative cash flow from operations of \$4,908,688.

Most significantly, on August 28, 2006, Luxell filed a Notice of Intention to make a Proposal (the "Proposal") to its creditors under the Bankruptcy and Insolvency Act (Canada). BDO Dunwoody was appointed as Trustee under the Notice of Intention. On October 18, 2006, the Proposal was approved by the creditors and subsequently by the court. It is noted that the financial statements of the Company have been prepared on the basis that the Company is continuing as a going concern.

Despite several new financial arrangements being entered into, the Company continues to experience a shortage of working capital that will allow it to execute its business plan in full. This results in several additional risks to the Company that are more completely articulated under Operation Risks in the Risk Management section of the MD&A.

This report was prepared as of November 20, 2007, and includes our management's discussion and analysis (MD&A), financial statements and notes for the year and the three-month period ended August 31, 2007. We have written it to help the reader understand our business, performance and financial condition for fiscal 2007.

This report includes the information that management believes is material to investors after considering all circumstances, including potential market sensitivity. We consider something to be material if it results in, or would reasonably be expected to result in, a significant change in

the market price or value of our shares, or if it is quite likely that a reasonable investor would consider the information to be important in making an investment decision.

FORWARD-LOOKING STATEMENTS

This report includes forward-looking statements about our markets, future financial performance, business strategy, plans, goals and objectives. Forward-looking statements normally contain words like believe, expect, anticipate, intend, continue, estimate, may, will, should, plan, forecast, project, target and similar expressions. We have based these statements on estimates and assumptions that we believed were reasonable when the statements were prepared. Our actual results could be substantially different because of the risks and uncertainties associated with our business such as shifts in customer demand, product shipment schedules, competitive products and pricing, technological changes, currency fluctuations, working capital conditions and other variables or because of events that are announced or completed after the date of this report.

The reader will find more information about the risks and uncertainties associated with our business in the business risk and uncertainty section in this MD&A. As we do not update or revise forward-looking information even if new information becomes available unless legislation requires us to do so, the reader should not place undue reliance on forward-looking statements.

OVERVIEW OF THE COMPANY

The Company is engaged in the development design and production of ruggedized flat panel displays (R-FPD) and the employment of advanced flat panel display technologies and solutions for the defence and avionics marketplaces. It is also focused on developing patentable technology and production techniques to advance the design and production of ruggedized displays and components. The Company currently derives all of its revenues from this business.

The Company's research and development capabilities are based on a patented Black Layer™ high-contrast flat panel technology which is designed to be applied to inorganic Thin Film Electro-luminescent ("TFEL") and Organic Light-Emitting Diode ("OLED") display technologies. In addition, the Company also possesses valuable properties capable of being applied to other existing and emerging flat panel display technologies. The Black Layer™ products deliver industry leading display-enhancing and performance enabling features that include higher contrast, better image, lower cost, lower power consumption, longer life, less mass, and a thinner display. The Company continues to manage its IP portfolio while seeking new business opportunities whether through technology partnerships, joint-ventures and or new OLED product development projects.

The Company continues to seek out practical opportunities to realize a Black Layer enhanced OLED product for production and sale. It is this management's view that the business potential of the Company's Black Layer Technology will remain directly linked to the successful adoption of the OLED technology into the mainstream marketplace. This is starting to occur in a variety

of electronics products and is expected to begin to mature in the flat panel display market within the 2009 – 2010 time frame.

A REVIEW OF THE PAST YEAR'S HIGHLIGHTS

In the post-Proposal filing period and as part of its on-going operations, the Company continued to be faced with significant cash requirements to finance production of new orders and a subsequent financing was planned. The Company completed a \$3.75 million non-brokered private placement to retire and refinance existing debt as well as a \$1.2 million private placement for debt and working capital purposes.

In an effort to successfully implement the restructuring and financial recovery plans of the company, the Company hired a restructuring CEO in September 2006 who in turn hired a new CFO in December 2006, a new vice president for design/engineering in January 2007, and a new vice president of business development in January 2007. In June, 2007 the CEO and CFO resigned substantially due to differences in opinion with the Board of Directors and since, following 4 months with Director David Pasioka acting as Interim CEO and conducting a formal CEO recruiting process, the senior vice president of Business Development, Jean Louis Larmor, was named permanent CEO. A suitable CFO continues to be sought and in their place, accounting management services are being provided by a senior accountant of John MacDonald & Associates, a firm owned by a Director, John MacDonald. It should be noted that throughout the period from June 2007 to current, sales have continued to grow as anticipated and new financial arrangements have continued to be executed that have contributed to the positive restructuring of the Company's balance sheet.

Management's financial target for fiscal 2008 is for the Company to achieve positive earnings before interest taxes depreciation and amortization and to achieve positive net earnings the year following. To complete this, the Company has engaged in an aggressive pursuit and growth of the R-FPD business. The Company has also initiated a stringent cash cost control program whereby all expenditures are made only upon approval of the President or his designate and only those expenditures that assist in deriving greater revenues are made. This has assisted in lowering overall expenses relative to revenues.

On the technology side of the business, while the Company substantially reduced its OLED and Black Layer R&D work, it continues to seek out practical opportunities to realize Black Layer enhanced OLED products. It is the market's view that the business potential of the Company's Black Layer technology remains directly linked to the successful commercialization of the OLED technology, which is now expected to begin to mature within the 2009 – 2010 time frame. The Company is currently examining the practicality of specific OLED products with the possibility of inserting the Black Layer technology.

A REVIEW OF THE PAST YEAR'S HIGHLIGHTS

The Company obtained its revenue solely by delivering custom, high-performance display system solutions to customers in the defense and aerospace sectors.

Highlights of the past year include:

- Total revenues for the year reached \$ 3,736,933 as compared to \$3,328,352 reported for the year ended August 31, 2007, a 12.3% increase. The Company's total fiscal 2007 revenues are now derived from product sales and production.
- Expenses for the year actually decreased by \$1,912,020 or just over 15.8% from \$12,103,938 in fiscal 2006 to \$10,191,918 this year. The net loss also decreased by \$4,481,053 or 51.1% from \$8,775,586 in fiscal 2006 to \$4,294,533 this year.
- On November 7, 2006, the Ontario Court of Justice approved a Proposal to creditors for a restructuring of liabilities (originally filed in early September 2006) under the Bankruptcy and Insolvency Act (Canada). Under the Proposal, creditor claims were classified and given different priorities for payment. Ordinary Creditors with proven claims less than or equal to \$1,000 would receive payment in full while ordinary creditors with claims exceeding \$1,000 could elect to accept \$1,000 in full satisfaction of their proven claims or receive a promissory note equal to 50 percent of their proven claim. The promissory notes to be issued would be non-interest bearing and payable in equal monthly payments over a 24-month period, with the first payment being issued on the 1st day of September 2008. The Company has the right to convert the promissory notes into common shares of the Company at a price of \$0.40 per common share. Such conversion is at the discretion of the Company and subject to any required regulatory and shareholder approvals.

The Company presently remains under court protection and expects to complete its obligations during the current year.

- The Company consolidated its Aktelux product and Luxell Research divisions into one brand, being the Luxell Technologies brand. This included flattening its operating structure and moving the business and research activities into product departments under the Luxell brand.
- Immediately following the filing of the Proposal in September 2006, the Company was advised by the Toronto Stock Exchange ("TSX") that its listing was subject to review, which is stayed until such time as the Trustee is discharged by the court. The Company expects that the TSX will then advise the Company of its plan to implement the review process and this can take up to 90 days to be completed.
- Successful completion of a \$3.75 million non-brokered private placement to retire/refinance existing debt and provide additional working capital.
- Due to the delayed filing of the 2007 second quarter financial statements, a management cease trade order was imposed and then lifted as the Company came into full compliance with its filing requirements.

- In September 2006, the Company recruited a new CEO, Alec Couckuyt, and he in turn, built a new senior management team comprised of individuals with significant industry experience in engineering (Richard Pepperall) operations (Anthony Pierro) and business development (Jean-Louis Larmor).
- Richard Pepperall joined Luxell from L3 Canada where he had acquired over 20 years of experience with Flat Panel Display projects and design programs while Jean-Louis Larmor brought more than 2 decades of global experience in flat panel display sales and marketing with companies such as Aerospatiale and Thales.
- In June, 2007 the Company announced the resignations of its CFO and subsequently, its restructuring CEO. The Company also announced that the search for a new CFO was already under way and that it had appointed David Pasieka, a member of its Board of Directors since November 2005, as interim CEO. At the end of September 2007, the appointment of a new CFO was announced but it was shortly determined that there was not an ideal fit, which led to the departure of the CFO. On October 22, 2007, the Company announced it had appointed Jean-Louis Larmor, its former Sr. Vice-President Business Development as the Company's new CEO. This appointment was made after engaging an executive search firm to do an exhaustive scan of flat panel leadership talent in the North American market. The board unanimously endorsed Jean-Louis's appointment as the best candidate to lead the company into its next stage
- As described in more detail under the heading Significant Transaction, on November 30, 2007 the Board of Directors elected to exercise its Option to reacquire its intellectual property that it had sold to the Variable Interest Entities in 2006. While this decision meant foregoing future cash payments to the company, it also allowed the company to raise additional capital for the company at a crucial period and to embark on a plan that will see all of the prior debts of the company being either extinguished or repaid during a reasonable period.
- The Company held its Annual General Meeting ("AGM"), originally scheduled to be held on May 17, 2007, on June 4, 2007. At the meeting, John MacDonald stepped down as Board Chairman and was replaced by Anthony DeCristofaro.
- In July 2007, the Company closed a private placement financing for gross proceeds of \$1,200,000.
- Throughout the third quarter, and as a result of its continued marketing efforts to target systems integrators ("Integrators") who supply Tier One Companies with fully integrated systems, the Company received a significant number of requests for (1) information ("RFI"), (2) proposals ("RFP"), and (3) quotations ("RFQ") from existing customers and also from completely new prospective customers.

These Integrators are increasingly pursuing alternate sources for their flat panel display components due to: (1) increasing product complexity, (2) decreased time-to-market time

frames and (3) long term support requirements. The Company believes it is ideally positioned to play a major role in supporting these Integrators and is committed to building its business model around these three critical success factors. Its participation in various industry exhibitions such as the Canadian Defense and Security Industries Association exposition, the Paris Air Show, National Business Aviation Association show was specifically geared towards the promotion of that positioning strategy.

- The Company is also pursuing strategic relationships in its key North American and European markets. Its goal is to extend the sales and service capabilities as well as to acquire additional product marketing opportunities. Subsequent to the end of the year, the Company announced that it had negotiated agreements with VECTr Systems Inc. for moving map systems and Symbolic Displays Inc., a leading supplier of flight and simulation systems.

FORECAST

In management's view, while the first two quarters were a period of immense challenges, the results of the third quarter continue to support Management's confidence in its business plan and that it will continue to see revenues increase in the fourth quarter and through the balance of calendar 2007. The Company continues to produce against existing contracts and has a high degree of confidence that it will be able to add additional orders from its existing Client base as well as through completely new customers.

The Company fully anticipates the flat panel display products (formerly Aktelux) will drive the Company's growth during fiscal 2008. Elements to its growth plan and expectations are based upon:

- growth in core markets;
 - focusing on North America and Europe;
 - focus on systems integrators and the growing trend in outsourcing of display products;
 - aging technologies (i.e., CRT) and growing demand for insertion of new technologies;
 - increasing sales coverage and product offerings through strategic collaboration and teaming agreements;
 - expanding markets by leveraging expertise in flat panel display technologies and ruggedization of flat panel displays into commercial aerospace, industrial and related niche market segments.
- strengthening relationships with customers;
- maintaining technological leadership in display technologies and ruggedizing know-how;
 - employ Luxell IP to initiate OLED display product development programs with select partner(s);

- focus on product design, quality, value and customer service/support;
- continued focus on cost control and efficiency.

While there have been several interruptions on the way, the Company has nearly completed its development of a new senior management, operations and engineering team. It continues to build its administrative support team in finance and IT to ensure it is able to achieve rigorous control over its business operations data and costs.

SIGNIFICANT TRANSACTION

The following was reported in the 2006 MD&A:

Luxell is the primary beneficiary of two variable interest entities (VIEs) in accordance with the CICA Accounting Guideline (AcG) 15 “Consolidation of Variable Interest Entities” that have been included in these consolidated financial statements.

On November 10, 2005 the Company completed a transaction whereby Luxell’s patented and non-patented intellectual properties and contracts (collectively “Luxell IP”) were transferred to the Lux Operating Limited Partnership (“LUX OLP”) in exchange for promissory notes with a face value of \$26 million and \$3 million in cash. The promissory notes were a direct obligation of the investors in the Lux Investor Limited Partnership (“LUX ILP”), the sole investor in LUX OLP. Many LUX ILP investors were also shareholders of Luxell, and subsequent to the transaction, at the 2005 annual meeting, shareholders approved the appointment of 2 new shareholders to the Board of Directors of the corporation who had participated as investors in the Limited Partnership. Luxell and LUX OLP have a Support Agreement in place whereby Luxell provides the management, production, sales, and administrative support necessary for LUX OLP to continue the business of developing, licensing and manufacturing of flat panel display technology. Luxell is the only service provider for LUX OLP and only provides services to LUX OLP.

Luxell also entered into agreements that grant Luxell the right, but not the obligation, to reacquire the LuxOLP, directly or indirectly, at fair market value up to January 31, 2008; a Call Option Agreement with LUX ILP, and a Right of First Refusal Agreement with LUX OLP. These rights are extended to December 31, 2008 in the event that Luxell is able to obtain \$10,000,000 of third party financing. Luxell has the right to fund the acquisition using common shares and convertible debentures to the extent the fair market value exceeds the \$26 million face value of the notes described above.

The original investment by the partners in LUX ILP consisted of \$6 million in cash, and \$26 million (face value) in notes (“ILP Investor Notes”) repayable in five equal annual installments of \$5.2 million commencing on January 2008. The net cash received of \$5,140,000 was reflected as contributed surplus of the Company as follows:

<i>Cash proceeds of subscription for Lux ILP units</i>	<i>\$6,000,000</i>
<i>Transaction costs on close</i>	<i>(860,000)</i>
<i>Net cash received</i>	<i>\$5,140,000</i>
<i>Issuance of Warrants</i>	<i>(378,493)</i>

*Net Equity Financing allocated to Contributed
Surplus*

\$4,761,507

Under terms of the Support Agreement, LUX OLP is the beneficiary of the revenues from the Luxell OP. LUX OLP is also responsible for certain direct costs and management fees for the provision of services by Luxell under the agreement. In the event of ongoing losses, LUX OLP can reimburse Luxell in the form of Service Notes issued by the limited partnership.

Under AcG 15, investors in LUX OLP and LUX ILP would be the beneficiary of any profits earned from, or appreciation in the value of, the Luxell IP. However, Luxell has directly provided the funding of both the acquisition of the Operating Property (in the form of loans to the LUX ILP investors) and funding of ongoing losses (in the form of Service Notes from LUX OLP).

Under AcG 15, this funding eliminates the partners "equity at risk" and the net impact is that Luxell will be exposed to the ongoing losses from the Luxell OP until such time as it reacquires the property, or the investors repay the notes. As such, Luxell is the primary beneficiary as defined under AcG 15.

As Luxell is the primary beneficiary under AcG 15, the accounts of LUX OLP and LUX ILP (collectively, "the LLPs" or "VIEs") are consolidated in the financial statements of the Company. The consolidated financial statements include the elimination of transactions between the LLPs and Luxell, and recognition of the sale of the Luxell OP in return for LUX ILP Notes has been eliminated until the final consideration for the Luxell OP sale, if any, is determined.

During the second half of fiscal 2007, the Company decided to seek additional capital for the company. Since the Company could not reasonably add new debt to its balance sheet, a strong consideration was given toward bringing capital into the company in the form of common equity. Several Directors of the company held discussions with representatives from a variety of institutions and it soon became abundantly apparent that with a lack of profit history in the Company, the primary asset of the Company was its Intellectual Property.

With Luxell not directly owning its Intellectual Property, it was determined that the Company's ability to raise new capital was severely impaired. In addition, the terms of the agreements with the VIE's, as disclosed above, stipulated that Luxell had a free option to reacquire its Intellectual Property only until January 31, 2008 which could only be extended until December 31, 2008 if Luxell successfully raised \$10 million or more. Since the Company could not be guaranteed to successfully raise \$10 million before January 31, 2008, on 15th May 2007 the Board of Directors voted unanimously to endorse the recommendations of an Independent committee of the board to exercise its Option to reacquire its IP. Subsequent to this decision, the Company successfully raised gross proceeds of \$1.2 million in common equity.

In exercising the Option, the potential of annual installment payments of \$5.2 million was weighed against the certainty of failure without immediate working capital to build and ship increasing orders. The Director's determined that in order to better control the destiny of the Company the decision to exercise the Option was a prudent. Further, the Directors concluded

that the entire transaction, while complex, had been a very fair and successful as Luxell had received benefits from the transaction as follows:

- Cash Payment of \$5.0 million between November-January 2006 at the outset of the transaction
- Monetization of \$33M of tax loss carryforwards due to expire between 2006 and 2010. Upon the exercise of the Option, the Intellectual property will be reacquired as a Capital Asset, eligible for Capital Cost Allowance. This is of benefit to the Company since CCA can be deducted at the discretion of the company without time limit.

RESULTS OF OPERATIONS

Analysis of Revenues and Expenses:

	2007	2006	\$ Change	% Change
Statement of Loss (consolidated)				
REVENUES	\$ 3,736,933	3,328,352	408,581	12.3%
EXPENSES				
Direct labour and materials	2,765,977	3,043,225	(277,248)	-9%
Research and development	2,314,502	4,457,878	(2,143,376)	-48%
General and administrative	3,054,632	2,384,057	670,575	28%
Sales, marketing and royalty	476,850	537,890	(61,040)	-11%
Production support and quality assurance	135,342	381,524	(246,182)	-65%
Loss/(gain) on sale of property and equipment	158,715	426,685	(267,970)	-63%
Foreign exchange (gain) loss	(32,940)	(34,765)	1,825	-5%
Interest expense	1,099,434	95,971	1,003,463	1046%
Amortization of property and equipment	203,898	795,501	(591,603)	-74%
Amortization of licence	15,508	15,972	(464)	-3%
	<u>\$ 10,191,918</u>	<u>12,103,938</u>	<u>(1,912,020)</u>	<u>-16%</u>
NET LOSS BEFORE THE FOLLOWING	\$ (6,454,985)	(8,775,586)	2,320,601	-26%
Gain on Compromise of Debt	2,160,452	-	2,160,452	100%
NET LOSS	<u>(4,294,533)</u>	<u>(8,775,586)</u>	<u>4,481,053</u>	<u>-51%</u>

Revenues

Revenues for the year ended August 31, 2007, increased 12.3% to \$3,736,933 as compared to \$3,328,352 for the year ended August 31, 2006. Of major significance to the Company's longer term outlook in this year was the stabilization and maintenance of the flat panel display sales and production. Specific products were shipped for programs such the Eurofighter, Airbus A400M, BAE Hawk fighter aircraft, the PS Maritime Patrol Aircraft, CH-47 Chinook heavy-lift helicopter and the Westland Lynx battlefield and maritime helicopter. The Company's Black Layer licensing program did not generate revenues in the current fiscal year ended August 31, 2007 but interest in the technology from third parties has increased somewhat.

Expenses

Despite the increase in Revenues, total expenses decreased by 15.8% to \$10,191,918 in fiscal 2007 from \$12,103,938 in fiscal 2006. Direct labour and materials expenditures decreased in fiscal 2007 by 9.1% to \$ 2,765,977 compared to \$3,043,225 in fiscal 2006. Despite additional inventory write down, gross margins improved as reflected in the lower increase in direct expenses versus sales. The company believes it is now well balanced between manpower and operations. Research and development expenditures net of government assistance decreased by 48.1% to \$ 2,314,502 from \$4,457,878 in fiscal 2006 which reflected a concerted effort by management to lower costs in areas of the business that are not providing a direct short term revenue benefit.

General and administrative expenditures increased by 28.1% to \$ 3,054,632 from \$2,384,057 in fiscal 2006. This resulted primarily due to increases in legal and consulting fees associated with financings and personnel changes within the company.

Sales, marketing and royalty expenditures decreased by 11.3% to \$476,850 from \$537,890 in fiscal 2006. This reflected lower overall commissions resulting from higher repeat sales and sales being generated from internal sales personnel with lower reliance on more expensive external agents.

Production support and quality assurance decreased a significant 64.5% in fiscal 2007 to \$ 135,342 from \$381,524 in fiscal 2006, which reflects a concentration of repeat sales across a smaller product line.

The Company recorded a foreign exchange gain of \$32,940 versus a gain of \$34,765 in fiscal 2006. The Company maintains a US accounts payable which result in partial offsetting of exchange impacts against sales into the US. About half of the Company's foreign currency sales are to the US while the other half is predominantly Euro based.

Depreciation and amortization expense in fiscal 2007 was \$ 219,406 compared to \$811,473 last year. This 73.0% decrease is attributable to most assets having become fully depreciated or amortized. It should be noted that the company believes that there is substantial useful life remaining in the capital equipment despite it having become fully amortized and that no significant new capital expenditures are required to maintain the existing level of sales. As sales continue to grow, some capital additions may be required for different types of equipment but no major replacements are currently required.

Interest expense increased by 1045% in fiscal 2007 to \$1,099,434 from \$95,971 in fiscal 2006. Only \$56,250 of the amount of interest cost was paid in cash and the balance was paid through the issuance of common shares. The dramatic increase in total interest expense resulted from the substantial new high cost debt undertaken by the company as part of its restructuring and through working capital financing (primarily factoring of receivables) to assist in funding current operations. The company was successful in raising some new equity in fiscal 2007 to offset some of these debt costs and anticipates further equity funding to replace debts in fiscal 2008 as the financial restructuring is complete.

Loss for the period and loss per share

The net loss for fiscal 2007 was \$ 4,294,533 (\$0.09) compared to a loss of \$8,775,586 (\$0.20 per share) compared to for fiscal 2006. This represents a reduction in losses of 51.1%. The loss before interest, taxes, depreciation and amortization (EBITDA) and gain on compromise of debt for 2007 was \$5,136,145 compared to a loss of \$7,868,142 in 2006. This represents a reduction in losses from operations of 34.7%.

Annual Financial Information on Segmented Basis and Economic Dependence

The Company has two operating segments, "Luxell Research" and "Aktelux" as defined by the chief decision makers of the Company.

- Luxell Research is involved in the research, development, commercialization and licensing of technology, intellectual property rights and know-how for the flat panel display industry.

- Aktelux is involved in the manufacture and distribution of electroluminescent (EL) products, liquid crystal display (LCD) and solutions for the defense and aerospace markets.

The Company has two operating segments, “Luxell Research” and “Aktelux”, as identified by the chief decision makers, which are segregated based on product offerings:

- Luxell Research is involved in the research, development, commercialization and licensing of technology, intellectual property rights and know-how for the flat panel display industry.
- Aktelux is involved in the manufacture and distribution of electroluminescent (EL) products and solutions for the defense and aerospace markets.
- Substantially all of the Company’s assets and employees are located in Canada. In fiscal 2006, export sales accounted for 93% (2006 –77%) of total sales.
- In fiscal 2006, the Company’s contract with three of its customers accounted for 65% (2006 – 63%) of total revenues.

The results of the Lux LLPs are included in the Aktelux operating segment.

Year Ended	31-Aug-07		
	<u>Luxell Research</u>	<u>Aktelux</u>	<u>Total</u>
Revenues	-	3,736,933	3,736,933
Expenses			
Depreciation and amortization of property and equipment	173,641	30,256	203,897
Amortization of licence	15,508	-	15,508
Other expenses		6,712,627	6,712,627
Net interest expense	-	1,099,434	1,099,434
Net Loss	\$ (189,149)	\$ (4,105,384)	\$ (4,294,533)
Total Assets	\$ 28,432	\$ 3,650,149	\$ 3,678,581

Year Ended	31-Aug-06		
	<u>Luxell Research</u>	<u>Aktelux</u>	<u>Total</u>
Revenues	-	3,328,352	3,328,352
Expenses			
Depreciation and amortization of property and equipment	383,139	412,362	795,501
Amortization of licence	15,972	-	15,972
Other expenses	2,566,364	8,630,130	11,196,494
Net interest expense	-	95,971	95,971
Net Loss	\$ (2,965,475)	\$ (5,810,111)	\$ (8,775,586)
Total Assets	\$ 520,677	\$ 4,021,197	\$ 4,541,874

Quarterly Financial Information

Unaudited (\$ thousands)	4th Quarter		3rd Quarter		2nd Quarter		1st Quarter	
	2007	2006	2007	2006	2007	2006	2007	2006
Total revenues	1,315	838	894	703	801	1,493	727	294
Net operating gain (loss) for the period	(1,473)	(3,237)	(1,213)	(1,877)	(1,678)	(1,610)	(2,091)	(2,052)
Operating Gain (Loss) per share \$	(0.03)	(0.07)	(0.03)	(0.04)	(0.04)	(0.04)	(0.04)	(0.05)

Foreign Currency Translation

The Company recognizes “Foreign Currency Translation” gains and losses on monetary items denominated in a foreign currency in income as incurred. The following table reflects the period end foreign exchange rates between the two foreign currencies in which Luxell conducts business. Significant changes in these foreign exchange rates impact the reported amounts of the Company’s revenues and expenses.

Period End Foreign Exchange Rates

Year Ended	August 31, 2007	August 31, 2006	Change
1 US Dollar to 1 Canadian Dollar	1.0564	1.1064	-4.52%

Active currencies:

Fiscal 2007; sales: U.S. dollar & Canadian dollar, expenses: U.S. dollar & Canadian dollar

Fiscal 2006; sales: U.S. dollar & Canadian dollar, expenses: U.S. dollar & Canadian dollar

Recorded foreign exchange gains (losses) for fiscal 2007 was (51,306) loss and fiscal 2006 and a \$ 34,765 gain.

Commitments and Obligations

Royalty commitments:

Under the technology license agreement with the National Research Council of Canada (NRC), the Company is obligated to pay royalties on products and services that incorporate NRC technology, subject to minimum annual obligations. The royalty expense for the fiscal year 2006 amounted to \$75,000 (2005 - \$75,000). The future minimum royalty payments to the NRC are \$75,000 for each of the years ending June 30, 2005 through June 30, 2009.

Operating lease:

The Company signed a two year lease extension in March 2006 for its head office and production facilities that was to expire on August 31, 2008. The minimum obligations under the lease were \$380,386 in both 2007 and 2008.

In September 2006, Luxell disclaimed its lease obligation in accordance with the bankruptcy and Insolvency Act. An agreement was subsequently reached that the landlord would submit a claim of \$599,438 as an ordinary creditor for the remaining lease obligation as part of the Proposal Negotiations are ongoing for a new lease between the Company and the landlord.

Leasehold reconstruction obligation:

Effective September 1, 2004, the Company adopted CICA Handbook Section 3110 Asset

Retirement Obligations”, retroactively with restatement. The effect of the retroactive adoption of this accounting policy was a leasehold reconstruction obligation of \$200,000. The Company has not recognized any accretion expense in the current year for this obligation

Liquidity and Capital Resources

In fiscal 2006 The Company filed a Notice of Intention to make a Proposal to its creditors under the Bankruptcy and Insolvency Act (Canada). On August 31, 2006, the Company obtained Debtor in Possession Financing from investors in the amount of \$1,000,000 of which \$200,000 was outstanding at year-end. Interest on the outstanding principal balance is calculated at a rate of 20% per annum. Interest is paid monthly in arrears and the principal was due on March 31, 2007. Directors MacDonald, Pasioka and Vitali participated in this financing.

In December 2006 the Company obtained Bridge Financing from investors in the amount of \$1,500,000. Interest on the outstanding principal balance is calculated at a rate of 6% per annum. Under the terms of the agreement, in further consideration for the financing, the company will issue common stock to the principals in an amount equal to 10% of the weighted average value of the loan outstanding every 90 days. Interest and principal was due on March 31, 2007. The Company is in negotiations to extend the Bridge Financing amount up to a maximum of \$3,000,000. . Directors MacDonald, Pasioka and Vitali participated in this financing.

In April 2007, the company successfully completed a \$3.75 million non-brokered private placement to retire/refinance existing debt and provide additional working capital. . Directors MacDonald, Pasioka and Vitali participated in this financing.

In July 2007, the Company closed a private placement financing for gross proceeds of \$1,200,000 to provide additional working capital. . Directors MacDonald, Pasioka, Vitali and Carl participated in this financing.

Transactions with related parties

In 2006, the Company entered into a series of financing and business transactions with shareholders or entities that are deemed to be related parties in accordance with Section 3860 of the CICA Handbook. The Company provides services under terms of a Support Agreement to the LUX OLP partnerships. The Chairman of the Board of Luxell also manages the general partner of both LUX OLP and LUX ILP. Compensation of \$60,000 to the general partner was determined on arm’s length terms by the investors in the partnership as discussed in the foregoing “Significant Transaction” section.

Financing arrangements with Oakville Investment Corporation (OIC), which is controlled by Director John MacDonald, are as follows.

1) On September 30, 2005, the Company signed a promissory note for financing in the amount of \$600,000 with OIC. Interest on the outstanding principal balance was calculated at a rate of prime plus 2.5% per annum. Principal and interest payments in respect of the Note were repaid in

full on November 10, 2005.

2) On August 31, 2006, the Company obtained Debtor in Possession Financing (the "Loan") from a group of shareholders and investors, arranged by OIC, in the amount of \$1,000,000 of which \$200,000 was outstanding at year-end. Interest on the outstanding principal balance is calculated at a rate of 20% per annum and is paid monthly in arrears with principal due on December 31, 2006. The Loan is secured by the Company's accounts receivable. Subsequent to year end, the loan was extended until March 31, 2007.

3) In December 2006 Luxell obtained Bridge Financing from a group of shareholders and investors, arranged by OIC, in the amount of \$1,500,000. Interest on the outstanding principal balance is calculated at a rate of 6% per annum. Under the terms of the agreement, in further consideration for the financing, the company will issue common stock to the principals in an amount equal to 10% of the weighted average value of the loan outstanding every 90 days. Interest and principal is due on March 31, 2007. The Company is in negotiations to extend the bridge financing amount up to a maximum of \$3,000,000. The Loan is secured by the Company's accounts receivables.

The company also entered into financing arrangements with shareholders, not involving OIC of Luxell, as follows:

1) On March 18, 2005, the Company signed promissory notes (the "Notes") with shareholders of the Company (the "Lenders") for term financing totaling \$600,000. Interest is charged at a rate of 6% per annum. The Notes were secured by a second charge over all existing and newly acquired undertaking and property of the Company. In fiscal 2006, in return for extending the loan from September 14, 2005 to November 10, 2005, the Lenders received 200,000 common shares of the Company at a fair market value of \$60,000. Principal and interest payments in respect of the

Description of Securities

The Company has authorized an unlimited number of common shares. As at August 31, 2007 there were 59,036,610 common shares issued and outstanding (2006 – 44,713,663).

There are no other classes of shares issued. The increase of common shares resulted from the following:

- On March 7, 2006, the Company issued an aggregate of 200,000 common shares with a value of \$60,000 to the shareholder note holders as a condition of extending the due date of the shareholder notes to November 10, 2005.
- On October 23, 2006, the Company issued an aggregate of 531,280 common shares with a value of \$53,128 to a shareholder note holder in exchange for their note.
- On May 1, 2007, the Company issued an aggregate of 750,000 common shares with a value of \$112,500 in connection with the finder's fee for the \$3,750,000 in series A notes.
- On June 29, 2007, the Company issued an aggregate of 7,070,000 common shares with a value of \$651,072, for cash, net of fees of \$77,328, in connection with a private placement financing.

- On July 18, 2007, the Company issued an aggregate of 2,930,000 common shares with a value of \$421,534, for cash, net of fees of \$50,066, in connection with a private placement financing.
- On August 30, 2007, the Company issued an aggregate of 3,041,667 common shares with a value of \$365,000 in connection with a 10% coupon on the Class A Notes

Risk Management

Operations Risk

While the Company is successfully increasing revenues and reducing costs, the Company remains challenged due to insufficient cash to implement its full business plan. This has created a need to conserve cash wherever possible and has put stress on the supplier relationships and staff of the Company that is not normally associated with a profitable company. These risks include:

- 1) No history of profits – Luxell has not earned profits to date, and there is no assurance that it will earn profits in the future, or that profitability, if achieved, will be sustained. With the emphasis of the company strategy solely focused on building and servicing Flat Panel displays and de-emphasizing its efforts in Black Layer R&D, Management is committed to achieving its profitability goals for 2008. Significant progress towards this objective has been achieved in Q4 2007 and Q1 2008.
- 2) Uncertainty of financing –The Company is currently seeking additional financing to retire \$3.75M of notes due in January 2008 and augment its existing working capital. These notes bear 6% cash coupon and an equity component equivalent to 10% of the face value Management is actively engaged in this fund raising process and is confident that given the level of interest in the Company’s progress and quality of its Business Development activities it will be able to raise the necessary funds to execute its business plans.
- 3) Critical Shortage of Working Capital - while the Company continues to produce flat panel display products to complete existing orders, follow-on orders, new orders and is working to near capacity to respond to new requests for information and proposals, it is accepted that the cash generated from its present and future operations will be not be sufficient to satisfy its liquidity requirements and that it will need to continue to raise capital by selling additional equity, selling some of its assets or by obtaining credit facilities.
- 5) Reliance on Key personnel – The Company is dependent on a number of key personnel to execute its plan. In Q4 2007, the Board revisited the compensation structure of the top 12 managers within the organization. A new bonus structure was implemented and additional (initial) stock options were added to these critical employee compensation plans. Management is confident that these important changes will have the desired impact on ensuring critical personnel remain focused and engaged in the profitable turn-around of Luxell.
- 6) Dependence on supplier of key suppliers – Luxell relies on its suppliers to deliver important components necessary for the construction of its products. Through the BIA process, a number of suppliers were financially affected by the restructuring of company debt. Consequently a number of suppliers are now demanding more

- significant payment terms then before. Management has increased its supplier management program by introducing more frequent discussions and meeting to insure critical congruence. For critical parts, the company is establishing alternative sources of supplier to ensure that there is no disruption in the delivery process.
- 7) Operational support systems - During the second quarter, the Company began an in-depth review of its data management systems and examined steps it could take to streamline its production processes and cost control mechanisms. While the Company subsequently selected an ERP software solution provider to assist it in designing and implementing a data management system for production processes, inventory control and financial processes, the project is incomplete due to personnel changes. Working with internal resources and an external IT resource the company is prioritizing its efforts to address critical and urgent systems support.
 - 8) Market Acceptance of products - The Company's future capital requirements will depend on many factors, including, but not limited to the market acceptance of its products, services, and technology. No assurance can be given that the necessary additional funding will be available or that, if available, it can be obtained on terms favorable to the Company.

The Company's future capital requirements will depend on many factors, including, but not limited to the market acceptance of its products, services, and technology. No assurance can be given that the necessary additional funding will be available or that, if available, it can be obtained on terms favorable to the Company.

Credit Risk

The Company is subject to minimal credit risk on its accounts receivable due to the fact that the Company deals predominately with large defense contractors. Contracts with risky foreign countries are insured through the Export Development Corporation (EDC), and contracts are negotiated with large advances in order to minimize any credit risk.

Currency Risk

The Company is exposed to currency risk as export sales in the current year, primarily in U.S. dollars, account for greater than 78% of total sales. Any decline or strengthening of the Canadian dollar against the U.S. dollar has a significant impact on our business model, as sales are transacted in U.S. dollars and the majority of costs are transacted in Canadian dollars.

Fair Value of Financial Instruments

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, technical development program payable, leasehold reconstruction obligation and due to shareholders approximate fair value. The determination of the fair value of government loans is not practicable as considerable judgment is required to develop estimates of fair value.

Derivative Financial Instruments

The Company does not utilize any derivative financial instruments or hedging instruments.

Stock-Based Compensation

The Company's stock option plan is designed to help the Company attract and retain the best employees, and to better align employee interests with those of our shareholders. On May 17, 1996, the Company adopted a stock option plan (the "1996 Plan") authorizing the granting of options to directors, officers and employees of the Company to purchase common shares. Under the 1996 Plan, including its amendments, options to purchase an aggregate of up to 3,800,000 common shares may be granted. These options will expire if not exercised within a period not exceeding ten years commencing from the date they are granted. As at August 31, 2007 there were options outstanding. During the fiscal year, the Board of Directors approved additional options as described in the companies AIF.

Critical Accounting Estimates

Critical accounting estimates used in the preparation of the Company's financial statements includes estimates used in the calculation of the fair value of stock-based compensation, inventory obsolescence and allowance for doubtful accounts.

The Company uses the Black-Schools option pricing model to determine the fair value of stock options granted during the period. This model requires the Company to make reasonable assumptions in order to derive parameters such as expected volatility of the Company's shares, the expected life of the option and interest rates, all of which are based on historical information.

Future behaviors of these parameters are beyond the Company's control, and thus, may be significantly different from the Company's estimates. Management has reviewed the inventories at year end and has provided for obsolescence and slow moving items. This review involves estimates with regards to general economic conditions, customer demand and market acceptance of our finished goods. The failure to estimate correctly could result in the value of the inventory being either higher or lower than the determined value as of the date of the balance sheet.

In reviewing the allowance for doubtful accounts management bases estimates and assumptions on historical experience and on other factors that we believe to be reasonable under the circumstances, the result of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates.

Disclosure Control Risks

Disclosure control and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management to allow timely decisions to be made regarding disclosure of said matters in the Company's financial reporting products. The Company's Chief Executive Officer and Chief Financial

Officer have concluded, based on their evaluation of the effectiveness of the Company's disclosure controls and procedures as of the date of this Management's Discussion and Analysis, that the disclosure controls and procedures in place provide reasonable assurance that material information is made known to them by others within the Company. Certain weaknesses have been identified and the Company's Chief Executive Officer and Chief Financial Officer do not expect that the disclosure controls and procedures will prevent or detect, on a timely basis, all errors and fraud that may arise. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Management believes that the disclosure controls and procedures that are presently in place are effective.

Internal Control Risks

The Chief Executive Officer and the Chief Financial Officer of the Company are responsible for designing internal controls over financial reporting, or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's consolidated financial statements for external reporting purposes in accordance with Canadian GAAP. The design of the Company's internal control over financial reporting was assessed as of the date of this Management's Discussion and Analysis.

The weaknesses in the Company's internal control over financial reporting, discussed below, result in a more than remote likelihood that a material misstatement may not be prevented or detected on a timely basis. Management and the board of directors, including the audit committee thereof, work to mitigate the risk of any potential material misstatement in the Company's financial reporting however, there can be no assurance that the risk can be reduced to less than a remote likelihood of a potential material misstatement.

1. Segregation of duties

Segregation of duties in the structure of internal control over financial reporting reduces the likelihood of errors and irregularities when one individual does not have responsibility for more than one of the three components of financial reporting -selecting and applying accounting policies, recording transactions and preparing financial statements, including the notes thereto. When the work of one employee is not checked by another and when the responsibility for recording transactions is not separate from the responsibility for preparing the financial statements, including the notes thereto, there is no appropriate segregation of duties. The absence of such segregation of duties over financial reporting limits the ability of the internal control over financial reporting to prevent and detect errors on a timely basis and deter improper activities. Further, such absence of segregation of duties in the structure of internal control over financial reporting could increase the risk of senior management override of the internal control system in place.

In assessing the design of the internal control over financial reporting in place the Company has concluded that certain duties within the finance and administration departments are not properly segregated due to the small number of individuals employed in those areas. In addition, the Company has identified instances where certain employees have the ability to initiate

transactions and accounting entries within certain financial reporting applications that are incompatible with their other roles and responsibilities.

At present, the Chief Executive Officer and the Chief Financial Officer oversee all material transactions and related accounting records. In addition, the audit committee of the board of directors reviews, on a quarterly basis, the consolidated financial statements of the Company and queries management about significant transactions. The result is that the Company is highly reliant on the performance of mitigating procedures during its financial close process and in order to ensure the financial statements present fairly in all material respects. Management will review the current assignment of responsibilities and where possible improve on segregation.

2. Information Technology General Controls

The Company has determined that many of its information systems are subject to general control deficiencies. Although these have not resulted in a misstatement of the consolidated financial statements, when aggregated, these deficiencies represent a material weakness in the Company's control environment because of the pervasiveness and significance of the deficiencies. Specifically these deficiencies are as follows:

- Change management procedures are not well defined and implemented.
- Access controls are not well maintained.
- Business Continuity Plan incomplete and insufficiently documented

The company has recently hired an Information Technology Manager and is currently interviewing software providers to assist in rectifying the situation.

Consolidated Financial Statements of

LUXELL TECHNOLOGIES INC.

August 31, 2007 and 2006

LUXELL TECHNOLOGIES INC.

AUGUST 31, 2007 and 2006

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AUDITORS' REPORT

To: The Shareholders of Luxell Technologies Inc.

We have audited the consolidated balance sheets of Luxell Technologies Inc. as at August 31, 2007 and 2006 and the consolidated statements of operations, deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the corporation as at August 31, 2007 and 2006, and the results of operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Ontario
January 3, 2008



Chartered Accountants
Licensed Public Accountants

LUXELL TECHNOLOGIES INC.**Consolidated Balance Sheets**

August 31, 2007 and 2006

	2007 (Note 1)	2006
ASSETS		
CURRENT		
Cash and cash equivalents	\$ -	\$ 243,992
Accounts receivable (Note 6)	1,651,908	916,838
Inventory (Note 3)	1,440,742	2,228,731
Prepays and other assets	166,548	220,634
	3,259,198	3,610,195
PROPERTY AND EQUIPMENT (Note 4)	390,951	887,739
LICENCE (Note 5)	28,432	43,940
	\$ 3,678,581	\$ 4,541,874
LIABILITIES		
CURRENT		
Bank Indebtedness	\$ 99,106	-
Line of credit (Note 6)	-	\$ 447,540
Accounts payable and accrued liabilities	2,513,166	4,571,582
Class A Notes (Note 17)	3,750,000	-
Due to shareholders (Note 7)	330,161	313,237
Leasehold reconstruction obligation (Note 14(d))	113,088	-
Government loans (Note 8)	-	1,955,960
Deferred revenue	1,252,633	1,240,560
	8,058,154	8,528,879
LONG TERM		
Promissory Notes (Note 16)	1,381,947	-
Leasehold reconstruction obligation (Note 14 (d))	-	200,000
Government loans (Note 8)	957,761	-
	2,339,708	200,000
	\$ 10,397,862	\$ 8,728,879
SHAREHOLDERS' DEFICIENCY		
SHARE CAPITAL (Note 9)	49,083,765	47,480,531
CONTRIBUTED SURPLUS (Note 10)	5,160,026	5,044,397
WARRANTS (Note 9)	421,887	378,493
DEFICIT	(61,384,959)	(57,090,426)
	(6,719,281)	(4,187,005)
	\$ 3,678,581	\$ 4,541,874

APPROVED BY THE BOARD

.....
J.L. Lamour.....
J. MacDonald

The Accompanying Notes are an Integral Part of the Financial Statements.

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LUXELL TECHNOLOGIES INC.**Consolidated Statements of Operations and Deficit**

For the years ended August 31, 2007 and 2006

	2007 (Note 1)		2006	
REVENUES	\$	3,736,933	\$	3,328,352
EXPENSES				
Direct labour and materials		2,765,977		3,043,225
Research and development, net of government assistance (Note 8)		2,314,502		4,457,878
General and administrative		3,054,632		2,384,057
Sales, marketing and royalty		476,850		537,890
Production support and quality assurance		135,342		381,524
Loss on sale of property and equipment		158,715		426,685
Foreign exchange gain		(32,940)		(34,765)
Interest expense		1,099,434		95,971
Amortization of property and equipment		203,898		795,501
Amortization of licence		15,508		15,972
	\$	10,191,918	\$	12,103,938
NET LOSS BEFORE THE UNDERNOTED ITEM	\$	(6,454,985)	\$	(8,775,586)
Gain on Compromise of Debt (Note 16)		2,160,452		-
NET LOSS	\$	(4,294,533)	\$	(8,775,586)
LOSS PER SHARE (Note 9(f))	\$	(0.09)	\$	(0.20)
DEFICIT, BEGINNING OF YEAR		(57,090,426)		(48,314,840)
Net loss for the year		(4,294,533)		(8,775,586)
DEFICIT, END OF YEAR	\$	(61,384,959)	\$	(57,090,426)

LUXELL TECHNOLOGIES INC.
Consolidated Statements of Cash Flows
For the years ended August 31, 2007 and 2006

	2007 (Note 1)	2006
NET (OUTFLOW) INFLOW OF CASH RELATED TO THE FOLLOWING ACTIVITIES		
OPERATING		
Net loss	\$ (4,294,533)	\$ (8,775,586)
Add back non-cash items:		
Stock-based compensation	115,629	59,110
Amortization of property and equipment	203,898	795,501
Amortization of licence	15,508	15,972
Loss on sale of property and equipment	158,715	426,685
Shares issued related to finders fee (Note 9(c))	112,500	-
10% Coupon on the Class A Notes (Note 9(c))	365,000	-
Gain on compromise of debt (Note 16)	(2,160,452)	-
Shares issued as cost of obtaining shareholder loan (Note 9 (c))	-	60,000
	(5,483,735)	(7,418,318)
Changes in non-cash operating assets and liabilities		
Accounts receivable	(735,070)	(100,139)
Inventory	787,989	(996,198)
Prepays and other assets	54,086	(17,669)
Accounts payable and accrued liabilities	655,969	2,173,824
Deferred revenue	12,073	581,630
	(4,708,688)	(5,776,870)
INVESTING		
Additions to property and equipment	(284)	(112,798)
Proceeds from sale of property and equipment	47,097	218,500
	46,813	105,702
FINANCING		
Limited partnership financing (Note 12)	-	5,140,000
Issuance of common shares for cash, net	1,116,000	-
Notes Issued	3,550,000	-
Due to Shareholders	-	(623,052)
Shareholders financing, net	100,317	200,000
Government loans	-	1,375,060
Promissory note	-	(519,644)
Line of credit	(447,540)	197,197
	4,318,777	5,769,561
INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS/BANK INDEBTEDNESS	(343,098)	98,393
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	243,992	145,599
CASH AND CASH EQUIVALENTS/BANK INDEBTEDNESS, END OF YEAR	\$ (99,106)	\$ 243,992
SUPPLEMENTAL CASH FLOW INFORMATION		
INTEREST PAID	\$ 799,117	\$ 122,294

Non-cash Transactions:

The Company has non-Cash transactions for the year as detailed in Note 18.

The Accompanying Notes are an Integral Part of the Financial Statements.

1. DESCRIPTION OF BUSINESS

Basis Of Presentation

Luxell Technologies Inc. ("Luxell" or the "Company"), is engaged in the development, licencing and manufacturing of flat panel display technologies and solutions. These consolidated financial statements of the Company include the accounts of Luxell, its wholly owned subsidiary Aktelux Corporation, and the limited partnerships that are defined as variable interest entities (VIEs) in accordance with the CICA Accounting Guideline 15 ("AcG-15", Consolidations of Variable Interest Entities) as discussed in Note 12.

Continuation Of The Business

These consolidated financial statements have been prepared on a going-concern basis which contemplates that Luxell will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. As described in the following paragraphs there is significant uncertainty concerning Luxell's ability to do so.

On August 28, 2006, Luxell filed a Notice of Intention to Make a Proposal under the Bankruptcy and Insolvency Act (Canada). On October 18, 2006, the creditors voted in favour of an Amended Proposal, which was subsequently approved by the Superior Court of Justice on November 7, 2006. Details of the Proposal are summarized in Note 16.

Luxell has incurred significant operating losses since inception, including a net loss of \$4,294,533 (2006 - \$8,775,586) in the current year. Luxell has a negative working capital balance of \$4,798,956 (2006 - \$4,918,684). The existing cash resources may not be adequate to support current operating levels for the next 12 months.

The validity of the going concern assumption is dependent on achieving profitable levels of operations and/or Luxell's ability to raise additional financing to fund its operations. Luxell has adopted a strategic plan to expand its marketing initiatives and product lines. In addition, management is continuing to identify and secure strategic alliances with key technology developers, suppliers and distributors to enhance its competitive advantage.

If the going concern assumptions were not appropriate for these consolidated financial statements, adjustments would be necessary to the carrying values of assets and liabilities, reported net loss and the balance sheet classifications used.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") on a basis consistent with prior periods, unless otherwise noted. The consolidated financial statements include the accounts of all subsidiaries and variable interest entities for which the Company is determined to be the primary beneficiary. Inter-company balances and transactions have been eliminated.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash and cash equivalents

Cash and cash equivalents include amounts on deposit at the Company's bank and highly liquid investments with an original term to maturity of less than three months.

Inventory

Raw materials are valued at the lower of cost and replacement cost. Work in process and finished goods are valued at the lower of cost and net realizable value. Cost includes materials, labour, overhead, and freight, and is determined on a first in first out basis.

Property and Equipment

Property and equipment are stated at cost. Amortization of property and equipment is provided for using the straight-line method at rates calculated to amortize the cost of the assets over their estimated useful lives:

Computers (hardware and software)	- Straight-line over 3 years
Furniture and fixtures	- Straight-line over 5 years
Production and quality assurance equipment	- Straight-line over 10 years
Research and development equipment	- Straight-line over 10 years
Leasehold improvements	- Straight-line over the term of the lease

Licence

Costs incurred to obtain the licence agreement are capitalized. Amortization is provided on a straight-line basis over the term of the licence.

Development costs

Research costs are charged to operations as incurred. Costs related to developing a technically proven product or process are capitalized to development costs and amortized on a straight-line basis over a period of five years during which commercial sales of the product are expected to continue. The Company reviews the useful life of its development costs and, if required, adjusts amortization periods accordingly.

The ability of the Company to recover development costs is subject to uncertainty and is dependent upon the ability of the Company to successfully produce, market and distribute the related products. Accordingly, the Company has not capitalized the development costs.

Foreign currency

Monetary assets and liabilities denominated in currencies other than Canadian dollars are translated at exchange rates in effect at the balance sheet date. Revenue and expense items are translated at average rates of exchange during the year. Gains and losses on translation are included in net loss for the year.

Use of estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

reported amount of assets and liabilities and disclosure of contingencies at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant management estimates include provision for product warranty costs and provision for inventory obsolescence. Actual results may differ from those estimates.

Revenue recognition

(a) Licencing revenue

Royalty revenue is recognized as it accrues in accordance with the terms of each specific licence agreement and reasonable assurance exists regarding measurement and collectability.

Technology transfer fees are recognized at the inception of a licencing agreement provided that no significant vendor obligations exist and reasonable assurance exists regarding collectability.

(b) Display products revenue

Sales revenue is based on contracts unique to each customer and is recognized upon completion of shipment to the customer, receipt of customer acceptance and assumption for risk of loss, and determination that collection is reasonably assured. Progress billings are presented as deferred revenues on the balance sheet until such time that the criteria for revenue recognition are satisfied.

Income taxes

Income taxes are provided using the asset and liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on temporary differences between the financial reporting and tax basis of assets and liabilities, and measured using the substantively enacted tax rates and laws that are in effect in the years when the temporary differences are expected to be recovered or settled.

Financial instruments

Credit risk - The Company is subject to credit risk on its accounts receivable. At August 31, 2007, 70% (2006 - 72%) of the Company's accounts receivable are from three major customers. Credit risk is minimized by dealing only with large and reputable customers.

Currency risk - The Company is exposed to currency risk as export sales in the current year, primarily in U.S. dollars, account for 90% (2006 - 77%) of total sales. The Company does not actively manage its currency risk.

Fair value of financial instruments - The carrying value of cash and cash equivalents, accounts receivable, line of credit, bank indebtedness, accounts payable and accrued liabilities, Class A Notes, and due to shareholders approximate fair value due to the short-term duration of those instruments. The determination of the fair market value of government loans and leasehold reconstruction obligation is not practicable, as considerable judgment is required to develop estimates of fair value.

Stock-based compensation

The fair market value of stock-based compensation is determined at the date in which the stock options are granted using the Black-Scholes method of valuation. The fair value of stock-based compensation is expensed in the consolidated statement of operations over the stock option vesting period.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Special-purpose entities

As required by Canadian Generally Accepted Accounting Principles [CICA Handbook Section 3051 "Investments" and AcG-15], the Company consolidates variable interest entities when it determines that the risks and rewards of any assets or operations of these entities revert to the company in substantially different proportions from its legal ownership position, or the company can, in substance control activities irrespective of ownership, if any.

Earnings per share

The Company uses Section 3500 ("Earnings per Share") of the CICA Handbook, which directs that the treasury stock method be used to calculate diluted earnings per share.

Diluted earnings per share considers the dilutive impact of the exercise of outstanding stock options, warrants and the conversion of preferred shares, as if events had occurred at the beginning of the period or at a time of issuance, if later. When the effect of computing diluted loss per share is anti-dilutive, this information is not presented.

Asset retirement obligations

The Company has established a fair value for its obligation to restore its operating facility as detailed in its operating lease in accordance with the CICA Handbook Section 3110 "Asset Retirement Obligations". The liability is recognized at its fair value when it is incurred, with a corresponding asset retirement cost added to the related asset, which is amortized to expense on a basis consistent with the amortization policy for the asset. In subsequent periods, the obligation is adjusted for the accretion of discount using the interest method of calculation and any changes in estimates in the amount or timing of the underlying future cash flows. Accretion expense, if applicable, is recognized as an operating expense in the consolidated statement of operations and deficit. Upon settlement of the obligation, the Company will record a gain or loss if actual costs are different than the recorded obligation.

Warrants

The fair market value of warrants is determined at the date in which the warrants are granted using the Black-Scholes method of valuation. The fair value of warrants is applied against the proceeds of the transaction for which the warrants were granted. The proceeds are disclosed net of the warrants granted.

3. INVENTORY

	<u>2007</u>	<u>2006</u>
Raw materials	\$ 1,208,360	\$ 1,620,643
Work in process	127,065	608,088
Finished goods	105,317	-
	<u>\$ 1,440,742</u>	<u>\$ 2,228,731</u>

4. PROPERTY AND EQUIPMENT

	<u>August 31, 2007</u>		<u>Net Carrying Value</u>
	<u>Cost</u>	<u>Accumulated Amortization</u>	
Production and quality assurance equipment	1,117,138	726,290	390,848
Research and development equipment	1,961,654	1,961,654	-
Computers (hardware and software)	779,232	779,232	-
Furniture and fixtures	260,109	260,006	103
Leasehold improvements	1,736,942	1,736,942	-
	<u>\$ 5,855,075</u>	<u>\$ 5,464,124</u>	<u>\$ 390,951</u>

	<u>August 31, 2006</u>		<u>Net Carrying Value</u>
	<u>Cost</u>	<u>Accumulated Amortization</u>	
Production and quality assurance equipment	2,761,583	2,067,510	694,073
Research and development equipment	1,961,654	1,788,013	173,641
Computers (hardware and software)	779,232	761,304	17,928
Furniture and fixtures	260,006	257,909	2,097
Leasehold improvements	1,736,942	1,736,942	-
	<u>\$ 7,499,417</u>	<u>\$ 6,611,678</u>	<u>\$ 887,739</u>

5. LICENCE

	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Carrying Value</u>
August 31, 2007	\$ 210,277	\$ 181,845	\$ 28,432
August 31, 2006	\$ 210,277	\$ 166,337	\$ 43,940

The licence is with the National Research Council of Canada ("NRC") and continues until June 30, 2009. The Company is committed to royalty payments under the terms of the licence agreement (Note 14). The amortization of licence costs for the year is \$15,508 (2006 - \$15,972).

6. LINE OF CREDIT

On December 7, 2004, the Company secured a line of credit in the amount of \$500,000 to finance inventory and accounts receivable bearing interest at a rate of prime plus 2% per annum under the terms of which the Lender provided trade receivable and inventory pre-shipment financing. Under the trade receivable financing the Lender financed up to the lesser of US \$500,000 or 85% of sales to two of the Company's customers (the "Customers"). The line of credit was secured by a first charge and security interest on all existing and newly acquired property (excluding real property) and all assets of the Company.

The Lender was a secured creditor under the Proposal as detailed in Note 16 and did not advance additional funds after August 31, 2006. As at August 31, 2007, the Company owed \$Nil (2006 – \$121,076) related to inventory purchases under the pre-shipment financing arrangement. Included in accounts receivable at August 31, 2007, are assigned trade receivables of \$Nil (2006 – \$326,464). On December 8, 2006 the Lender called the outstanding balance and terminated the line of credit.

7. DUE TO SHAREHOLDERS

On March 18, 2005, the Company signed promissory notes (the "Notes") with three shareholders of the Company (the "Lenders") for term financing totaling \$600,000. Interest is charged at a rate of 6% per annum. The Notes were secured by a second charge over all existing and newly acquired undertaking and property of the Company. In 2006, in return for three separate loan extensions, the Lenders received a total of 200,000 common shares of the Company at a fair market value of \$60,000 as detailed in note 9(c). Principal and interest payments in respect of the Notes were repaid in full on November 10, 2005.

As at August 31, 2006 there were two remaining loans from shareholders that totaled \$113,237. These shareholder loans were non-interest bearing, unsecured and have no specified terms of repayment. On March 7, 2006 the Board approved that shares be exchanged for the loans. One shareholder agreed to accept 531,280 shares in exchange for forgiveness of \$53,128 of these notes and the shares were issued in October 2006 (Note 9(c)). The other shareholder loan has been included in the Proposal discussed in Note 16 and the balance has been reduced to \$29,844 as at August 31, 2007.

On August 31, 2006, the Company obtained Debtor in Possession Financing (the "Loan") from a group of shareholders in the amount of \$1,000,000, of which \$200,000 was outstanding as at August 31, 2006. Interest on the outstanding principal balance was calculated at a rate of 20% per annum and was paid monthly in arrears. The loan was secured by the Company's accounts receivable. On May 1, 2007, the Loan was settled via the issuance of Class A Notes (Note 17).

In December 2006, the Company obtained Bridge Financing from investors in the amount of \$1,750,000. Interest on the outstanding principal balance was calculated at a rate of 6% per annum. Under the terms of the agreement, in further consideration for the financing, the company agreed to pay a "bonus" equal to 10% of the weighted average value of the loan outstanding every 90 days. On May 1, 2007 interest and principal were settled via the issuance of Class A Notes (Note 17), except for a balance of \$300,317 in residual interest that was settled by the issuance of shares subsequent to year-end (Note 21), and included in the Due to Shareholders balance as at August 31, 2007.

8. GOVERNMENT LOANS & ASSISTANCE

In June 2005, the Company entered into an agreement with Technologies Partnerships Canada, an Agency of Industry Canada ("TPC"), to develop flat panel display technologies that will enhance Canadian capability in these technologies pertaining to the Aerospace and Defence sectors. Under the terms of the agreement, the Company was reimbursed for thirty per cent (30%) of costs incurred in the development of flat panel display technologies to a maximum of \$1,950,000. The Company agreed to repay the TPC loan at a rate of 3.5% of Annual Gross Business Revenues ("AGBR") commencing with the AGBR earned in fiscal year 2008 and ending with the AGBR earned in fiscal year 2014.

In accordance with the Proposal to Creditors approved in November 2006 (see Note 16) TPC accepted non-interest bearing notes in the amount of \$957,761 repayable in equal monthly payments over a 24-month period beginning on September 1st, 2008. The amounts due under these promissory notes may be adjusted in the event that notes issued to Class II Ordinary Creditors are converted to common shares as detailed in Note 16.

Prior to the 2007 fiscal year, the Company had entered into an agreement with the Department of National Defence whereby the Company administers a Defence Industry Research (DIR) program that assess the value of New, Emissive Technology Organic Light-Emitting Diode (OLED), for high information content, mission critical aerospace and defence human-machine interface. Under the agreement, the Company receives 51% of the program value in the form of grants. Amounts received are applied to reduce gross research and development expenses as follows:

	<u>2007</u>	<u>2006</u>
Gross research and development	\$ 2,314,502	\$ 4,788,909
Less: Government funding	-	(331,031)
Net research and development	\$ 2,314,502	\$ 4,457,878

9. SHARE CAPITAL

(a) Authorized

An unlimited number of Common Shares without par value and an unlimited number of First Preference shares.

(b) Issued and Outstanding Common Shares

	<u>Number</u>	<u>Amount</u>
August 31, 2007	59,036,610	\$ 49,083,765
August 31, 2006	44,713,663	\$ 47,480,531

9. SHARE CAPITAL (continued)

(c) Share Transactions

The following transactions have occurred during the 2006 and 2007 fiscal years:

Date / Issue	Common Shares Issued	Amount	Description
August 31, 2005	44,513,663	\$ 47,420,531	
March 7, 2006	200,000	60,000	Shareholder loan expense
August 31, 2006	44,713,663	\$ 47,480,531	
October 23, 2006	531,280	53,128	Shareholder loan expense
May 1, 2007	750,000	112,500	Finder's Fee for Class A Notes
June 29, 2007	7,070,000	651,072	Private share offering
July 18, 2007	2,930,000	421,534	Private share offering
August 30, 2007	3,041,667	365,000	10% coupon on Class A Notes
August 31, 2007	59,036,610	\$ 49,083,765	

On March 7, 2006, the Company issued an aggregate of 200,000 common shares with a value of \$60,000 to the shareholder notes holders as a condition of extending the due date of the shareholder notes to November 10, 2005.

On October 23, 2006, the Company issued an aggregate of 531,280 common shares with a value of \$53,128 to a shareholder note holder in exchange for the note (Note 7).

On May 1, 2007, the Company issued an aggregate of 750,000 common shares with a value of \$112,500 in connection with the finder's fee for the \$3,750,000 in series A notes (see Note 17).

On June 29, 2007, the Company issued an aggregate of 7,070,000 common shares with a value of \$651,072, for cash, net of fees of \$77,328, in connection with a private placement financing.

On July 18, 2007, the Company issued an aggregate of 2,930,000 common shares with a value of \$421,534, for cash, net of fees of \$50,066, in connection with a private placement financing.

On August 30, 2007, the Company issued an aggregate of 3,041,667 common shares with a value of \$365,000 in connection with a 10% coupon on the Class A Notes (see Note 17).

(d) Stock-Based Compensation

On May 17, 1996, the Company adopted a stock option plan (the "1996 Plan") authorizing the granting of options to directors, officers and employees of the Company to purchase Common Shares. Under the 1996 Plan, including its amendments, options to purchase an aggregate of up to 3,800,000 common shares may be granted. These options will expire if not exercised within a period not exceeding ten years commencing from the date they are granted.

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9. SHARE CAPITAL (continued)

The fair value of these options has been estimated using the Black Scholes option-pricing model. The pricing model assumes a weighted average risk-free interest rate of between 3.90 and 4.65%, weighted average expected dividend yield of nil, weighted average expected common stock price volatility of between 40.0 and 43.4% and a weighted average expected life of 10 years.

Options Outstanding

A summary of the options outstanding as at August 31, 2007 and 2006 and changes during the years then ended is as follows:

	Years ended August 31			
	2007		2006	
	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
Outstanding, beginning of year	438,250	\$ 1.44	1,295,250	\$ 1.57
Options granted	4,395,000	0.10	-	-
Options exercised	-	-	-	-
Options expired or cancelled	(1,134,500)	0.56	(857,000)	1.63
Outstanding, end of year	3,698,750	0.11	438,250	1.44
Options exercisable, end of year	1,161,550	\$ 0.13	398,050	\$ 1.54

The following table summarizes information on stock options at August 31, 2007:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Options Outstanding	Weighted Average Remaining Life	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
\$ 0.065 to 0.125	2,700,000	111.5 months	\$ 0.08	950,000	\$ 0.07
\$ 0.13 to \$0.25	775,000	120.0 months	\$ 0.14	-	-
\$ 0.25 to \$0.55	223,750	78.3 months	\$ 0.42	211,550	\$ 0.41
	3,698,750	111.3 months	\$ 0.11	1,161,550	\$ 0.13

(e) Warrants

On November 10, 2005, the Company issued 1,772,800 common share warrants to Lux Investor Limited Partnership exercisable into 1,772,800 common shares of the Company at \$0.24 per share with expiry date of November 10, 2010 in connection with the limited partnership transaction detailed in Note 12.

9. SHARE CAPITAL (continued)

The fair value of the warrants has been estimated at \$378,493 using the Black Scholes option-pricing model. The pricing model assumes a weighted average risk-free interest rate of 4%, weighted average expected dividend yield of nil, weighted average expected common stock price volatility of 157.9% and a weighted average expected life of 5 years.

On July 18, 2007 the Company issued 1,000,000 common share warrants to Kingsmill Capital Partners Inc. for exercisable into 1,000,000 common shares of the Company at \$0.13 per share with expiry date of July 18, 2009 in connection with the private placement transaction detailed in Note 9(c).

The fair value of the warrants has been estimated at \$43,394 using the Black Scholes option-pricing model. The pricing model assumes a weighted average risk-free interest rate of 4.65%, weighted average expected dividend yield of nil, weighted average expected common stock price volatility of 75.8% and a weighted average expected life of 2 years.

Warrants Outstanding

A summary of the warrants outstanding as at August 31, 2007 and 2006 and changes during the years then ended is as follows:

	Years ended August 31			
	2007		2006	
	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
Outstanding, beginning of year	1,772,800	\$ 0.24	-	-
Warrants granted	1,000,000	0.13	1,772,800	\$ 0.24
Warrants exercised	-	-	-	-
Warrants expired or cancelled	-	-	-	-
Outstanding, end of year	2,772,800	0.20	1,772,800	0.24
Warrants exercisable, end of year	2,772,800	\$ 0.20	1,772,800	\$ 0.24

(f) Loss Per Share

For the year ended August 31, 2007, the weighted average number of common shares outstanding and used in the loss per share calculation is 46,699,305 (2006 – 44,611,197). The fully-diluted loss per share has not been computed, as the effect would be anti-dilutive.

10. CONTRIBUTED SURPLUS

Balance, September 1, 2005	\$ 223,780
Stock options vested during 2006	59,110
Equity financing during 2006 (Note 12)	<u>4,761,507</u>
Balance, August 31, 2006	5,044,397
Stock options vested during 2007	<u>115,629</u>
Balance, August 31, 2007	<u>\$ 5,160,026</u>

11. TAXATION

As at August 31, 2007, the Company has tax losses available for carry forward of approximately \$9,477,959 (2006 - \$7,214,300) the benefit of which has not been reflected in the Company's financial statements, and which expire as follows:

Year Ending August 31,	
2015	3,696,100
2026	3,518,200
2027	<u>2,263,659</u>
	<u>\$ 9,477,959</u>

As at August 31, 2007, approximately \$9,596,000 (2006 - \$9,596,000) of unclaimed scientific research and experimental development expenditures is available, which can be carried forward indefinitely to apply against future taxable income.

The Company has available for tax purposes unrecognized federal investment tax credits estimated at \$1,876,000 (2006 - \$2,381,000) relating to scientific research and development expenditures, which expire as follows:

Year Ending August 31, 2007	
2008	339,000
2009	349,000
2010	167,000
2011	180,000
2012	296,000
2013	291,000
2014	<u>254,000</u>
	<u>\$ 1,876,000</u>

11. TAXATION (continued)

The Company did not claim federal investment tax credits in 2007. Research and development expenses are stated net of Scientific Research & Experimental Development Investment Tax Credits of nil (2006- nil).

The tax effect of significant temporary differences is as follows:

	<u>August 31,</u> <u>2007</u>	<u>August 31,</u> <u>2006</u>
Tax loss carry forwards	\$ 3,175,137	\$ 2,605,828
Undeducted scientific research and development expenditures	3,214,661	3,466,076
Deferred revenue	419,631	447,888
Property and equipment	1,602,423	1,632,381
Other	274,210	281,375
Future income tax asset before valuation allowance	8,686,062	8,433,548
Less: Valuation allowance	(8,686,062)	(8,433,548)
Future income tax asset	\$ -	\$ -

The Company has recorded a full valuation allowance related to tax loss carry forwards and temporary differences as it believes there is uncertainty in realizing the benefit of the tax loss carry forward and timing differences. Accordingly, the tax benefit of the tax recovery has not been recorded.

The reconciliation of the Company's effective income tax rate is as follows:

	<u>August 31,</u> <u>2007</u>	<u>August 31,</u> <u>2006</u>
Combined Federal and Provincial income tax rates	33.50%	36.12%
Recovery of income taxes at the statutory rates	\$(1,438,669)	\$ (3,169,742)
Effect of:		
Benefit of tax losses not recognized	758,326	1,270,785
Tax on transactions not recognized in the consolidated financial statements (Note 12)	-	234,780
Temporary differences between financial statements and taxable income not recognized	263,138	641,852
Permanent differences between financial statements and taxable income	175,574	147,550
Benefits of tax losses allocated to entities consolidated under AcG 15 (Note 12)	241,631	874,775
Recognition of tax loss carryforwards	-	-
Income tax provision (recovery)	\$ -	\$ -

12. VARIABLE INTEREST ENTITIES

Luxell is the primary beneficiary of two variable interest entities (VIEs), Lux Operating Limited Partnership (“LUX OLP”) and Lux Investor Limited Partnership (“LUX ILP”), the sole investor in LUX OLP. In accordance with the AcG-15 “Consolidation of Variable Interest Entities” these have been included in these consolidated financial statements.

Luxell and LUX OLP have a Support Agreement in place whereby Luxell provides the management, production, sales, and administrative support necessary for LUX OLP to continue the business of developing, licencing and manufacturing of flat panel display technologies. Luxell is the only service provider for LUX OLP and only provides services to LUX OLP.

The original investment by the partners in LUX ILP consisted of \$6 million in cash, and \$26 million (face value) in notes (“ILP Investor Notes”) repayable in five equal annual installments of \$5.2 million commencing in January 2008. In 2006, the net cash received of \$5,140,000 was reflected as contributed surplus of the Company as follows:

Cash proceeds of subscription for Lux ILP units	\$6,000,000
Transaction costs on close	(860,000)
Net cash received	<u>\$5,140,000</u>
Issuance of Warrants (Note 9(e))	(378,493)
Net Equity Financing allocated to Contributed Surplus (Note 10)	<u>\$4,761,507</u>

As Luxell is the primary beneficiary under AcG 15, the accounts of LUX OLP and LUX ILP (collectively, “the LLPs” or “VIEs”) are consolidated in the financial statements of the Company. The consolidated financial statements include the elimination of transactions between the LLPs and Luxell.

13. RELATED PARTY TRANSACTIONS

The Company has entered into a series of financing and business transactions with shareholders or entities that are deemed to be related parties in accordance with Section 3860 of the CICA Handbook. These transactions were either entered in the normal course of business, or in any case, valued at the exchange amount agreed to by the parties.

- a. The Company provides services under terms of a Support Agreement to the LUX OLP partnerships. A Director on the Board of Luxell also manages the general partner of both LUX OLP and LUX ILP (Note 12). Annual compensation of \$60,000 (2006 - \$60,000) to the general partner was determined on arm’s length terms by investors in the partnership.
- b. In 2007, the Company entered into a series of transactions including term loans and debtor in possession financing directly with shareholders, members of the Board of Directors, or entities that they actively manage. The balance outstanding for these loans is \$330,161 (2006 - \$313,237). Terms of the transactions are detailed in Note 7 under Due to Shareholders.
- c. A Director of the Company agreed to accept 531,280 shares in exchange for forgiveness of \$53,128 of notes (Note 7). The shares were issued on October 30, 2006.

13. RELATED PARTY TRANSACTIONS (continued)

- d. In January 2007, the Company hired a business development manager from another province. As part of his remuneration the Company agreed to pay living expenses up until August 2007. The employee's short-term accommodation was being rented from Luxell's CEO at \$2,000 per month until June 30, 2007. Total compensation for the accommodation was \$11,000 (2006 - \$Nil).
- e. During the 2007 fiscal year the Company hired a Company controlled by a Board Member to provide services related to Chief Restructuring Officer work and temporary staffing for the Finance Department. Compensation for the services was \$94,787 (2006 - \$15,881).
- f. During the 2007 fiscal year, the Company hired a Company controlled by a Board Member to provide services related to Interim Chief Executive Officer work. Compensation for the services was \$51,675 (2006 - \$Nil).
- g. During the 2007 fiscal year, the Company hired a Company of which a Director is a Partner to provide services related to the equity raise of \$1,200,000 (Note 9(c)). \$84,000 cash (2006 - \$Nil) and warrants valued at \$43,394 (2006 - \$Nil) were issued as compensation for the services (Note 9(e)).

14. COMMITMENTS AND GUARANTEES

(a) Royalty commitments

Under the technology licence agreement with the National Research Council ("NRC"), the Company is obligated to pay 10% royalties on products and services that incorporate NRC technology, subject to minimum annual obligations.

The royalty expense for the year amounted to \$75,000 (2006 - \$75,000). The future minimum royalty payments to the NRC are \$75,000 for each of the years ending June 30, 2007 through June 30, 2009.

(b) Operating lease

The Company signed a two-year lease extension in March 2006 for its head office and production facilities, which was to expire on August 31, 2008. The minimum obligations under the lease were \$380,386 in both 2007 and 2008.

In September 2006, Luxell disclaimed its lease obligation in accordance with the Bankruptcy and Insolvency Act. An agreement was subsequently reached that the landlord would submit a claim of \$599,438 as an ordinary creditor for the remaining lease obligation as part of the Proposal (See Note 16).

On May 2, 2007, the Company signed a new lease, which will expire on October 31, 2009. The minimum obligations under the lease are \$360,000 in both 2008 and 2009. The new lease includes a mutual 90-day notice option with the landlord as part of the Company's plan to right-size its space requirements following restructuring.

14. COMMITMENTS AND GUARANTEES (continued)

(c) Guarantees

Effective September 1, 2003, the Company adopted CICA Accounting Guideline 14 ("AcG 14"), Disclosure of Guarantees, which requires additional disclosure in the financial statements about a guarantor's obligations under certain guarantees without regard to whether the Company is likely to have to make any payments under these guarantees. AcG-14 defines a guarantee as a contract that contingently requires the guarantor to make payments to a guaranteed party based on: (a) changes in the underlying economic characteristics that is related to an asset, liability or equity security of the guaranteed party; (b) failure of another party to perform under an obligating agreement; or (c) failure of a third party to pay its indebtedness when due.

In the normal course of business, the Company has entered into agreements, such as purchase and sale agreements, confidential agreements, leasing agreements, and financing agreements, which include guarantees in favour of third parties. These guarantees may require the Company to compensate the third parties for losses incurred by the third parties as a result of breaches in representation and regulations or as a result of litigation claims that may be suffered by the third parties as a consequence of the transaction. The maximum amount of the liability cannot be reasonably estimated under these guarantees.

The nature of these guarantees prevents the Company from making a reasonable estimate of the maximum exposure due to the difficulties in assessing the amount of liability that stems from the unpredictability of future events. Historically, the Company has not made any payments under such or similar indemnification agreements and therefore no amount has been accrued in the financial statements with respect to these guarantees.

(d) Leasehold reconstruction obligation

Effective September 1, 2004, the Company adopted the CICA Handbook Section 3110 "Asset Retirement Obligations", retroactively with restatement. The effect of the retroactive adoption of this accounting policy was a leasehold reconstruction obligation of \$200,000. The Company has not recognized any accretion expense in the current year for this obligation.

During 2007, Luxell conducted a comprehensive review of the leasehold reconstruction obligation resulting in a revised obligation of \$113,088. The Company currently operates with a mutual 90-day notice option with its landlord as part of the Company's plan to right-size its space requirements following restructuring. The revised obligation is reflected as a current obligation and is consistent with GAAP as the option may be effected within the year and as a result, is not discounted to the present value.

15. SEGMENTED INFORMATION AND ECONOMIC DEPENDENCE.

The Company has two operating segments, "Luxell Research" and "Aktelux", as identified by the chief decision makers, which are segregated based on product offerings:

- Luxell Research is involved in the research, development, commercialization and licencing of technology, intellectual property rights and know-how for the flat panel display industry.
- Aktelux is involved in the manufacture and distribution of electroluminescent (EL) products and solutions for the defense and aerospace markets.

The results of the Lux LLPs (Note 12) are included in the Aktelux operating segment.

Year Ended	31-Aug-07		
	<u>Luxell Research</u>	<u>Aktelux</u>	<u>Total</u>
Revenues	-	3,736,933	3,736,933
Expenses			
Depreciation and amortization of property and equipment	173,641	30,256	203,897
Amortization of licence	15,508	-	15,508
Other expenses		6,712,627	6,712,627
Net interest expense	-	1,099,434	1,099,434
Net Loss	\$ (189,149)	\$ (4,105,384)	\$ (4,294,533)
Total Assets	\$ 28,432	\$ 3,650,149	\$ 3,678,581

Year Ended	31-Aug-06		
	<u>Luxell Research</u>	<u>Aktelux</u>	<u>Total</u>
Revenues	-	3,328,352	3,328,352
Expenses			
Depreciation and amortization of property and equipment	383,139	412,362	795,501
Amortization of licence	15,972	-	15,972
Other expenses	2,566,364	8,630,130	11,196,494
Net interest expense	-	95,971	95,971
	\$ 2,965,475	\$ 9,138,463	\$ 12,103,938
Net Loss	\$ (2,965,475)	\$ (5,810,111)	\$ (8,775,586)
Total Assets	\$ 520,677	\$ 4,021,197	\$ 4,541,874

16. RESTRUCTURING OF LIABILITIES

On November 7, 2006, the Ontario Court of Justice approved a Proposal to creditors under the Bankruptcy and Insolvency Act (Canada).

Under the Proposal, creditor claims were classified and given different priorities for payment. Claims of Canada Revenue Agency, Preferred Creditors and Secured Creditors were not materially changed and are reflected in the financial statements at their current value and terms.

Ordinary Creditors with proven claims less than or equal to \$1,000 received payment in full. Ordinary Creditors with claims exceeding \$1,000 may have elected to accept \$1,000 in full satisfaction of their proven claims or receive a promissory note equal to 50 percent of their proven claim.

The promissory notes issued in settlement of proven claims are non-interest bearing and payable in equal monthly payments over a 24-month period, with the first payment being issued on the 1st day of September, 2008. The Company has the right to convert the promissory notes into common shares of the Company at a price of \$0.40 per common share. Such conversion is at the discretion of the Company and subject to any required regulatory and shareholder approvals.

Claims of Class II Ordinary Creditors, the group of Creditors not including the Government, totaling \$3,851,519 were identified during the restructuring process. To date, Promissory Notes with a face value of \$1,381,947 have been issued to satisfy approved claims.

The amount of \$61,294 of shareholder loans was satisfied by the issuance of \$29,844 in Promissory Notes as detailed in Note 7. Claims under the Government Loan, the sole Class I Ordinary Creditor, were satisfied by the issuance of \$957,761 in Promissory Notes as detailed in Note 8.

Claims under \$1,000 were paid in full within 90 days of the Court Approval Date.

The write off of amounts owing to ordinary creditors has been reflected as a gain of \$2,160,452, net of restructuring expenses of \$383,262.

Restructuring expenses of \$383,262 reflect fees paid to the trustee and parties assisting in the restructuring, and costs of disclaiming the lease obligation of the Company.

17. CLASS A NOTES

On May 1, 2007, the Company closed a non-brokered private placement (the "Offering") of \$3,750,000 in Class A notes (the "Notes"). The Notes have an initial term of 6 months from the date of issuance which can be extended at the option of Luxell for a further period of 3 months.

The Notes bear an interest rate of 6% per annum which will be paid in cash quarterly in arrears. An additional amount of 10% per quarter will be paid through the issuance of common shares in the capital of the Company based on the 5 day weighted average trading price of the common shares on the TSX for the five trading days immediately preceding the end of each quarter.

A finder's fee of 3% was paid through the issuance of 750,000 shares at a price of \$0.15 per share. The common shares issued in connection with the finder's fee are subject to a 4-month re-sale restriction. The funds received by the Company will be used to first pay existing debt, to refinance currently outstanding debt, with the balance to be applied toward the Company's business development, production operations and general working capital.

17. CLASS A NOTES (continued)

The Notes are secured by a General Security Agreement with the Note-holders, which can immediately become enforceable in the case of a default on the part of the Company. The Collateral involved with the GSA is on all assets of the Company.

18. NON-CASH TRANSACTIONS

- (a) On October 23, 2006, the Company issued an aggregate of 531,280 common shares with a value of \$53,128 to a shareholder note holder in exchange for their note (Note 7).
- (b) On May 1, 2007, the Company issued an aggregate of 750,000 common shares with a value of \$112,500 in connection with the finder's fee for the \$3,750,000 in Series A notes (Note 17).
- (c) On July 18, 2007 the Company issued 1,000,000 common share warrants exercisable into 1,000,000 common shares of the Company at \$0.13 per share with expiry date of July 18, 2009 in connection with the private placement transaction detailed in Note 9(c).
- (d) On August 30, 2007, the Company issued an aggregate of 3,041,667 common shares with a value of \$365,000 in connection with a 10% coupon on the Class A Notes (Note 17).
- (e) In the year ended August 31, 2007, the Company issued \$2,339,708 in Notes Payable to its creditors in relation to the Restructuring of Liabilities as detailed in Note 16.
- (f) On March 7, 2006, the Company issued an aggregate of 200,000 common shares with a value of \$60,000 to the shareholder note holders as a condition of extending the due date of the shareholder notes to November 10, 2005.
- (g) On November 10, 2005, the Company issued 1,772,800 common share warrants to Lux Investor Limited Partnership exercisable into 1,772,800 common shares of the Company at \$0.24 per share with expiry date of November 10, 2010 in connection with the limited partnership transaction detailed in Note 12.

19. CONTINGENCIES

There are pending claims by and against the Company arising from normal business activities. It is the opinion of management that it has good defences against these claims, and the final determination of these claims will not exceed applicable insurance coverage, and accordingly, will not materially affect the financial position or results of operations of the Company. If any losses are assessed, they will be accounted for in the year of determination.

20. ACCOUNTING PRONOUNCEMENTS

(a) International Financial Reporting Standards

Within the next five years, Canadian GAAP for publicly accountable enterprises is expected to be replaced with International Financial Reporting Standards ("IFRSs"). The Corporation will address the impact of the adoption of IFRSs as and when the transition requirements become more clearly defined.

20. ACCOUNTING PRONOUNCEMENTS (continued)

(b) Changes in Accounting Policies, including Initial Adoption

We have reviewed all recently issued, but not yet adopted, accounting standards in order to determine their effects, if any, on our results of operations or financial position. Based on that review, we believe none of these pronouncements will have a significant effect on current or future earnings or operations.

21. SUBSEQUENT EVENTS

Debt Conversion

On October 19, 2007, the company has negotiated an agreement with a group of capital lenders remaining from the past Debtor In Possession financing which was instituted in December 2006 as discussed in Note 7. That group has now agreed to convert the entire balance of the amount owed, being \$300,317, including accrued interest, into shares and forego a cash payment.

Limited Partnership Wind Up

Subsequent to the year-end, the company entered into an agreement with the General Partner of Lux OLP to wind up the partnership as of January 15, 2008 as announced on July 5, 2007 under the terms of the call option agreement. As these financial statements are prepared giving effect to the consolidation of the Limited Partnership, no material change will result. No additional shares will be issued as a result of the windup of the Limited Partnership.