
Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008.

This "Management's Discussion and Analysis" has been prepared as of August 13, 2009 and should be read in conjunction with the unaudited consolidated financial statements of Azure Dynamics Corporation ("Azure" or the "Company") for the three months and six months ended June 30, 2009 and the audited consolidated financial statements of the Company for the year ended December 31, 2008.

FORWARD LOOKING STATEMENTS

This MD&A contains forward-looking statements related to Azure's financial and other projections, expected future plans, events, financial and operating results, objectives and performance, as well as underlying assumptions, all of which involve risks and uncertainties. When used in this MD&A, the words "believe", "anticipate", "intend", "estimate", "expect", "project" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain such words. These statements reflect management's current beliefs and are based on information currently available to Azure's management and are subject to certain risks, uncertainties and assumptions. Actual results may differ materially from management expectations as projected in such forward-looking statements for a variety of reasons and no assurances can be given as to actual future results, performance or prospects. Factors that may cause such differences include, but are not limited to, the early stage of development of the Company; a lack of product revenues and a history of losses; the need for additional financing; uncertainty as to commercial viability; uncertainty as to product development and commercialization milestones being met; uncertainty as to the market for the Company's products and unproved acceptance of the Company's technology; competition; uncertainty as to target markets; dependence upon third parties; changes in environmental policies; uncertainty as to patent and proprietary rights; availability of management and key personnel; available regulatory approvals and conflicts of interest by directors and officers of the Company. More detailed information about these and other factors that could affect Azure's operations or financial results are included in Azure's filings with Canadian securities regulatory authorities. Azure does not assume any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. Because of these risks, uncertainties and assumptions, readers should not place undue emphasis on Azure's forward-looking statements.

BUSINESS STRATEGY OF THE COMPANY AND OVERALL PERFORMANCE

The Company has developed proprietary electric and hybrid electric technology principally for the light to heavy duty commercial vehicle category (the "Technology"). Azure has expertise in the areas of vehicle controls software, power electronics, electric machine design, vehicle systems engineering and vehicle integration. The principal business of Azure is the supply of hybrid electric vehicle ("HEV") and electric vehicle ("EV") control and powertrain systems. The Company also has an established portfolio of proprietary component products that compliment its core technical skills and makes use of an extensive industry supplier base to offer complete powertrain solutions to its target market.

Azure has identified three primary target markets, which includes; general delivery, shuttle-bus and electric solutions. Over the past seven years, the Company has primarily been engaged in the development and testing of its Technology. Certain of the Company's products are now generating commercial revenues while other products are still in the development stage. Generally, Azure does not intend to be the ultimate manufacturer of components or assembler of powertrain systems; rather, the Company uses the supply capacity that exists within the commercial vehicle industry to assemble products to its specifications which are then distributed via existing industry channels to the customer.

Azure seeks to closely align its product development and sales efforts with recognised industry partners (Original Equipment Manufacturers, component suppliers, and customers) thereby gaining access to product development support and established distribution networks which can help accelerate the penetration of its

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

electric and hybrid electric products into the commercial vehicle markets. The Company has concluded arrangements with Ford Motor Company ("Ford"), StarTrans (a business division of Supreme Corporation) and Utilimaster Corporation ("Utilimaster"), which have facilitated a concentration of the Company's efforts around its core programs for Azure CitiBus™ (G1 series hybrid) and Balance™ Hybrid Electric (P1 parallel hybrid) to serve two of its primary target markets; general delivery and shuttle buses.

Azure's third area of focus is referred to as Electric Solutions. This includes products such as electric drive systems, components and variants of Low Emission Electric Power (LEEP) such as LEEP Lift and LEEP Freeze. Azure has concluded arrangements with Kidron, a division of VT Specialized Vehicles Corporation, for the branding, marketing and sale of Azure's LEEP Freeze systems throughout the North American refrigerated truck body segment. The Company also signed a Memorandum of Understanding (MOU) for the branding, marketing and sale of Azure's LEEP Lift systems with Altec, a leading manufacturer of aerial boom trucks for the electric utility, telecommunications and contractor markets. Lastly, the Company sells a variety of electric drive systems either direct to companies or through its distributors like Electro Automotive.

15 hybrid electric and 46 electric vehicle systems were shipped during the second quarter. The 15 HEV's were all Balance™ Hybrid Electrics with deliveries to customers including five units to the City of Toronto, three units to the University of Alberta, three units to Collins bus and four individual units to Florida Power and Light, Goshen Bus, Glaval Bus and Con Edison. Furthermore, of the 46 electric vehicle systems shipped in the quarter, 30 Force Drives™ were delivered to various customers, 15 LEEP Freeze systems were shipped to Kidron and one LEEP Lift was shipped to Altec.

During the second quarter the Company continued its efforts to establish its distribution through Ford dealerships. On May 19th the Company announced agreements with 13 additional dealers bringing the total number of dealerships to 27. These agreements allow Ford dealers to serve the growing market demand for Azure's new fuel efficient, low maintenance and environmentally friendly, Balance™ Hybrid Electric (P1 parallel hybrid) Ford E-450 commercial vehicle.

Azure G1 Hybrid and Citibus™ (series hybrid):

The Azure G1 series hybrid delivery vans and Citibus™ product is specifically designed for inner-city use and is highly suitable for urban general delivery vans and shuttle busses which both have demanding start and stop drive-cycles.

Purolator's fleet of 49 series hybrid vehicles have approximately 1.1 million miles as of June 30, 2009. The vehicles are deployed in Montreal, Ottawa, Toronto and Vancouver. The majority of the 19 diesel hybrids have now surpassed 3 years in service and are now outside of their warranty period. The 30 gas series hybrids are either approaching or have surpassed two years in service. Overall the fleet operating uptime remains greater than 98%. In addition to the Purolator fleet, BOEDC has operated their five Citibus™ hybrids for 16 months. Customer mileage on the bus fleet is not being tracked and reported on by Azure.

As of June 30, 2009 the Company had shipped 16 of the 59 Azure CitiBus™ hybrid chassis inventory (series hybrid) to Startrans who completed and delivered buses to various customers bringing the total number of delivered units to 25. The product has completed durability testing at Altoona and is eligible for funding programs administered by the Federal Transit Administration (FTA) in the United States. Azure has signed agreements with various StarTrans bus distributors across North America and therefore has access to a distributor network for the targeted shuttle bus market in the US and Canada.

Most of the development work is complete on product; however, we expect incremental work to continue throughout the final production build of the shuttle buses and engineering changes required based on the early time in service feedback from new shuttle bus customers.

For the quarter and year ended June 30, 2009, the Company incurred \$(0.06) million and \$(0.08) million respectively (2008 – \$0.8 million and \$1.1 million respectively) in gross research and development expenses

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

related to the Azure CitiBus™ (series hybrid) product line. Expenses continue to decrease compared to the prior quarter due to this product line being mostly complete with the exception of ongoing incidental development as mentioned above. During the current quarter, the Company recognized \$Nil (2008 - \$1.9 million) in revenue on the sale of shuttle buses. Year to date, the Company recognized \$Nil (2008 - \$2.1 million) in revenue on the sale of shuttle buses. The Company has a plan to sell the additional buses in inventory and has established a list of potential customers. The Company continues to aggressively pursue these sales opportunities.

Balance™ Hybrid Electric (parallel hybrid):

The agreement to develop a parallel hybrid powertrain on the Ford E-series chassis provides Azure with an avenue to achieve rapid penetration of a higher volume market for commercial vehicles in North America. The Company is launching into production both a stripped hybrid chassis for general delivery vans as well as a cutaway hybrid chassis for use in shuttle buses and other vocational trucks.

During the second quarter the Company completed the first three school bus chassis for Collins bus in support of the agreement which was announced in the 1st quarter.

The Balance™ Hybrid Electric shuttle bus has completed durability testing at Altoona which qualifies Ford E-450 shuttle buses built with Azure's Balance™ Hybrid electric drive train system for Federal Transit Authority (FTA) programs of up to 80% funding when purchased by public transit agencies across the United States. Altoona testing subjects vehicle to a lifetime of usage in just a few months at the Altoona PA accelerated durability test center where harsh road conditions mimic real-world conditions endured by a commercial shuttle bus over a seven year, 200,000 mile cycle.

Also within the quarter the Company received notification from the IRS that the 2009 model Balance Hybrid was certified as a new qualified heavy-duty hybrid motor vehicle which qualifies for a \$3,000 US Federal tax credit to eligible buyers.

With the proven reliability of the Balance™ hybrid fleet and higher quantity of vehicles in service, the Company is no longer tracking specific customer mileage. There are a total of 6 shuttle bus builders on the Balance™ hybrid which accounts for the majority of the North American market in terms of sales.

Within the quarter, the Company continued development and testing of advancements to the current production Balance™ Hybrid system which will reduce the cost and weight versus the current system. The Company was able to demonstrate in test cells and prototype vehicles further advancements to its industry first belt starter generator system on a V8 engine. Also in the quarter the Company began testing of the first level prototype advanced Lithium-Ion battery pack from Johnson Controls Saft (JCS). The production release of the next generation system is scheduled to launch in 2010 along with advanced Lithium battery pack technology.

For the quarter and year ended June 30, 2009, the Company incurred \$0.5 million and \$1.1 million respectively (2008 - \$2.0 million and \$3.5 million respectively) in research and development expenses related to internally funded Balance™ Hybrid Electric projects. The Company anticipates furthers costs for product development will be incurred in future quarters in order to validate this product. No costs have been deferred or capitalized. During the current quarter, the Company recognized approximately \$0.7 million (2008 - \$1.1 million) in revenue on sale of 15 (2007 - 35) Balance™ Hybrid Electric systems. Year to date, the Company recognized \$1.0 million (2008 - \$1.1 million) in revenue on the sale of 21 (2008 - 35) Balance™ Hybrid Electric systems.

Electric Solutions:***Low Emission Electric Power (LEEP):***

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

Electric Drive Solutions consists of Azure's Low Emission Electric Power (LEEP) and electric drive components. The product name LEEP refers to all systems whereby clean electric power is generated via the vehicles' powertrain (and, in some cases, via the grid) to supply a range of auxiliary systems (e.g. pumps, refrigeration, etc.) and export power applications. The Company is currently developing two variants: a refrigeration variant (LEEP Freeze) and a utility and telecommunications truck variant (LEEP Lift).

The Company has a supply agreement with Kidron for the LEEP Freeze refrigeration units that encompass branding, marketing and sale of Azure's LEEP Freeze systems throughout the North American refrigerated truck body market. The LEEP Freeze system developed for Kidron stores cooling potential in the cold plate refrigeration system when the engine is running. When the engine is off, the cold plate is used to maintain refrigeration temperatures in the box. The LEEP Freeze system has the potential to replace the ancillary motors/generators used in the other method of cooling refrigerated trucks, thereby reducing fuel consumption, noise and emissions.

Within the quarter the Company delivered the 15 LEEP freeze systems to Kidron for installation in trucks for a California based customer. Kidron also initiated a field trial of the product with Dreyer's in Florida.

The Company has a working relationship with Altec, a leading manufacturer of aerial boom trucks for the utility, telecommunications and contractor markets. The LEEP Lift system is specifically designed to be installed on these trucks, in which a boom is driven by a hydraulic pump that is normally powered by a transmission power take-off unit. The LEEP Lift system charges onboard high-voltage batteries while the truck is in a normal drive cycle, and when the truck is stationary and the boom is active, the motor/generator drives the hydraulic pump and 12VDC loads using the stored energy to minimize use of the truck's engine during time spent at work sites. The initial unit demonstrated approximately 30% fuel savings versus a conventional truck on a representative test cycle.

Within the quarter the demonstration unit with AT&T in Kansas continued its trial. Also in the second quarter the Company delivered a second prototype vehicle to Altec which is being used for additional customer demonstrations. The Company also delivered the first of six systems ordered by Altec in Q1; the remaining systems will be delivered by the third quarter.

For the quarter and year ended June 30, 2009, the Company incurred \$0.2 million and \$0.3 million respectively (2008 – \$0.2 million and \$0.3 million respectively) in research and development expenses related to internally funded LEEP projects. The Company anticipates further costs for product development will be incurred in 2009, in order to complete this product. No costs have been deferred or capitalized. During the current quarter, the Company recognized approximately \$0.1 million (2008 - \$Nil) in revenue on sale of 16 LEEP systems. Year to date, the Company recognized \$0.2 million (2008 - \$Nil) in revenue on sale of 17 LEEP systems.

Force Drive™ Electric Vehicle Systems and components:

The Company has developed a full range of electric drive components, including AC motors, inverters and converters, controllers and battery chargers. Full powertrain kits or electric drive sub-components can be ordered. The Company sold 30 Force Drive™ electric vehicle systems during the quarter to various customers engaged in the manufacture or conversion of pure electric vehicles.

In the second quarter of 2007, the Company announced it had signed a supply agreement with Electro Autos Eficaces (EAE) of Mexico. The Company has inventory on hand to supply initial delivery requirements for EAE as well as other ForceDrive™ system sales. Deliveries against this order have not yet commenced for reasons outside of the Company's control. As a direct result of the delays and uncertainty currently surrounding whether or not the program will launch, management continues to sell down the inventory against current Force Drive sales where possible.

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

Within the quarter the Company progressed on performance and specification upgrades to its inverter power electronics which will be used in both internal hybrid programs including the Balance™ system as well as external Force Drive sales. Also within the first quarter the Company received a second generation prototype advanced soft-switched inverter which is being developed with support of the Freedom Car program. The inverter will be tested in the coming quarter.

For the quarter and year ended June 30, 2009, the Company incurred \$Nil (2008 – \$8,400 and \$0.1 million respectively) in research and development expenses related to internally funded Electric Drive System projects. The Company does not anticipate additional product development in 2009. The Company is currently in the process of production of electric drive kits for eventual sale to its customers. No costs have been deferred or capitalized. Furthermore, for the quarter and year to date, the Company recognized approximately \$0.3 million and \$0.5 million respectively (2008 – \$0.2 million and \$0.4 million respectively) in revenue on the sale of Force Drive™ electric vehicle systems and components.

The total number of employees decreased from 148 at the end of fiscal 2008 to 112 at June 30, 2009 (2008 – 140). The Company leases facilities in Vancouver (20,000 square feet), Boston (77,000 square feet) and Detroit, MI (36,000 square feet), as well as the service and support center in Mississauga, Canada. The Company considers that its various facilities are suitable to meet the foreseeable requirements for engineering, workshop, test, and administrative accommodations.

Other Operational Developments**Johnson Controls-Saft Agreement**

On January 13, 2009 Azure Dynamics and Johnson Controls-Saft entered into a new supply agreement that will provide some of the world's most advanced lithium-ion (Li-ion) hybrid battery technology to power commercial vehicles in North America. The five-year supply agreement signals progress in the development of a U.S. supply base to help build an infrastructure for development and manufacture of hybrid electric vehicles. Development of the new Lithium pack continued within the quarter and JCS is preparing for preliminary prototype pack builds in the coming quarter.

Restructuring

On January 15, 2009 In light of today's economic challenging marketplace, Azure Dynamics reduced 25% of its current workforce along with expected reductions in all discretionary expense and a focus on actions to offset recent component cost increases. In addition the Company plans to further rationalize its product development efforts to focus on existing products and is actively working with its customers on potential new programs that involve sharing of development costs. Azure is also taking steps to enable the Company to access low cost U.S. and Canadian government loans supporting development of more fuel efficient vehicles. With these initiatives outlined above, the Company continues to review and control all variable costs.

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

OPERATING RESULTS, CASH FLOWS AND FINANCIAL CONDITION

Statement of Operations Discussion:

Selected Quarterly information: (stated in thousands except loss per share amounts):

	Q2, 2009 (Apr - Jun)	Q1, 2009 (Jan - Mar)	Q4, 2008 (Oct - Dec)	Q3, 2008 (Jul - Sep)
Revenue	\$ 1,228	\$ 573	\$ 2,573	\$ 1,325
Gross margin	\$ (1,191)	\$ (539)	\$ (4,079)	\$ (807)
Expenses, net	\$ (5,471)	\$ (6,882)	\$ (10,453)	\$ (7,502)
Net loss for the period	\$ (6,662)	\$ (7,421)	\$ (14,532)	\$ (8,309)
Net loss per share	\$ (0.02)	\$ (0.02)	\$ (0.04)	\$ (0.03)
Weighted average number of shares	379,405	379,376	379,376	316,333
	Q2, 2008 (Apr - Jun)	Q1, 2008 (Jan - Mar)	Q4, 2007 (Oct - Dec)	Q3, 2007 (Jul - Sep)
Revenue	\$ 3,383	\$ 370	\$ 518	\$ 1,534
Gross margin	\$ (182)	\$ (147)	\$ (179)	\$ (197)
Expenses, net	\$ (7,937)	\$ (7,760)	\$ (8,179)	\$ (8,257)
Net loss for the period	\$ (8,119)	\$ (7,907)	\$ (8,359)	\$ (8,454)
Net loss per share	\$ (0.03)	\$ (0.03)	\$ (0.03)	\$ (0.04)
Weighted average number of shares	279,376	279,376	259,101	198,276

For the quarter ended June 30, 2009, the Company incurred a net loss of \$6.7 million (\$0.02 per share) compared to a net loss of \$8.1 million (\$0.03 per share) in the comparable 2008 quarter. The lower loss in the current quarter is partially the result of the Company's restructuring plan as announced in early 2009. During the first quarter of 2009, the Company reduced 25% of the original workforce and reduced all discretionary expense. Negative gross margin during the quarter is primarily the result of production variances, increases in certain component costs, inventory write downs and warranty reserves.

As a result of the early stage in the Company's development, there are currently no specific seasonality patterns for the financial results of the Company over the past eight quarters. Historically, variations in revenues, gross margin, expenses and net loss are driven primarily by the timing of development projects which vary on a project by project basis. Financial results for 2009 reflect early production revenues from the above mentioned programs and it is expected that variations in the future financial results will be driven by expected increase in orders as the Company gains additional customers and completes the product launches of the above mentioned programs.

Revenue: Revenue for the quarter ended June 30, 2009 was \$1.2 million (2008 – \$3.4 million). The lower revenue in the current quarter is attributable to the sale of 15 Balance™ Hybrid Electric (P1 hybrid electric) systems, 16 LEEP systems and 30 Force Drive™ electric vehicle systems recorded in 2009 compared to 14 Azure CitiBus™ (G1 series hybrid) shuttle buses, 35 Balance™ Hybrid Electric systems and 37 Force Drive™ electric vehicle systems recorded in 2008. After considering direct and applicable indirect costs of sales, the gross margin contribution from revenue in the quarter was negative \$1.2 million compared to negative \$0.2 million in the prior year (gross margin as percentage of sales was negative 97% in 2009 versus negative 5% in 2008). The decrease in gross margin contribution in the current quarter is a result of production variances, increases in certain component costs, inventory write downs and warranty reserves. Production variances incurred are typical negative production variances associated with lower volume early stage production.

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

Engineering, research, development and related costs, net: The Company expended \$3.3 million on engineering, research and development operations in the quarter (2008 – \$5.5 million), including \$0.8 million in respect of product development costs (2008 – \$3.1 million). At June 30, 2009, Azure employed 88 research, engineering, operations and technical personnel (2008 – 106). Engineers and technical personnel are either working on revenue contracts and sales orders, on servicing vehicles or products in the field, or on core product development programs. For product development and other unabsorbed overheads the direct costs and related overheads are expensed.

Product development expenses of \$0.8 million (2008 – \$3.1 million) in the quarter included the continuation of Balance™ Hybrid Electric system and LEEP system development, cost related to the development and enhancement of system components and ongoing Azure CitiBus™ series hybrid maintenance.

During the quarter ended June 30, 2009, the Company claimed \$Nil (2008 - \$0.2 million) of reimbursable costs. Reimbursable costs are recorded as a credit to research and development expenses on the income statement; claims not settled by the balance sheet date are recorded as assets (contributions receivable) on the balance sheet. Throughout 2008 and the current year, the Company has held discussions with TPC with respect to extending the length of the program and also to modify the scope of the program to include additional costs related to the development of the P1 parallel hybrid program. Azure's application to request an amendment has been submitted and is currently under review. Management believes that its request will be approved. However, since TPC is under no contractual obligation to grant the requested amendment, the Company has fully reserved for this contribution receivable. As at June 30, 2009 contributions receivable related to TPC of \$1.3 million (2008 - \$1.3 million) has been fully reserved for while the Company continues to obtain finalization of its claims.

The Company is required to make royalty payments to TPC, EnCana Corporation and the Natural Resources Canada (NRCan) based on revenues in respect of specified products. During the current quarter no royalty payments were made. To date, the Company has made payments of \$16,500 each to both EnCana and NRCan. No payments have been made to TPC to date.

Selling and marketing: Selling and marketing costs were \$0.4 million in the quarter compared to \$0.6 million in the comparable quarter in 2008. The decrease is primarily related to a lower level of activities in advertising and product demonstrations. The selling and marketing headcount at June 30, 2009 was six (2008 – seven).

General and administrative: General and administrative costs were \$2.1 million in the quarter compared to \$1.8 million in the comparable quarter in 2008. The increase is primarily related to a general increase in insurance expenses and accounting fees. The headcount at June 30, 2009 was 18 (2008 – 18).

Amortization: Amortization of property, equipment and other assets was \$0.3 million in the quarter compared to \$0.2 million in the prior year. Property and equipment primarily consists of workshop equipment, tooling, computer hardware and software. The Company purchased assets with a value of \$0.1 million in the quarter (2008 - \$0.3 million) which also includes assets under capital lease. Other assets are primarily the cost of patents and trademarks. In addition, the intangible assets acquired as a result of the US acquisition noted above have been amortized by \$0.3 million in the quarter (2008 – \$0.4 million). Amortization of property, equipment and other assets are allocated to the relevant cost categories on the Statement of Operations.

Other expenses: Other expenses totalled \$0.1 million in the quarter (2008 – \$0.1 million). These expenses primarily related to the Company's restructuring plan as announced in early 2009.

Foreign currency gains/losses: Foreign currency gains totalled \$0.3 million in the quarter (2008 – loss of \$0.07 million). These were mainly unrealised gains and losses in respect of foreign currency cash balances which reversed out subsequent to the quarter end.

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

Balance Sheet Discussion:

Cash and cash equivalents: Cash and cash equivalents at June 30, 2009 were \$2.4 million compared to \$13.8 million at December 31, 2008 and \$5.4 million at June 30, 2008. Net cash outflows were approximately \$5.4 million in the quarter compared to net cash outflows of \$8.3 million in the comparable quarter in 2008. The decrease in cash outflows of \$2.9 million in the quarter is primarily a result of the lower net loss (\$1.2 million lower in the current quarter after adjusting for non cash items) and a decrease in non cash working capital of \$1.5 million.

Accounts receivable: Accounts receivable at June 30, 2009 were \$0.7 million compared to \$2.3 million at December 31, 2008 and \$3.2 million at June 30, 2008. The decrease in accounts receivable is mainly due to the receipt of a significant payment from a customer for 10 Azure Citibus™.

Contributions receivable: Contributions receivable were \$Nil at June 30, 2009 (\$Nil at December 31, 2008 and \$1.1 million at June 30, 2008). Throughout 2008 and the current year, the Company has held discussions with TPC with respect to extending the length of the program and also to modify the scope of the program to include additional costs related to the development of the P1 parallel hybrid program. Azure's application to request an amendment has been submitted and is currently under review. Management believes that its request will be approved. However, since TPC is under no contractual obligation grant the requested amendment, and in accordance with generally accepted accounting principles, the Company has fully reserved for this contribution receivable. As at June 30, 2009, contributions receivable related to TPC of \$1.3 million has been fully reserved for as described above.

Inventory: Inventory was \$9.6 million at June 30, 2009 compared to \$8.3 million at December 31, 2008 and \$11.4 million at June 30, 2008. The higher inventory amount at June 30, 2009 compared to the year end is due to the increase in raw material to support future orders and deliveries. The lower balance in the quarter compared to the comparable quarter in the prior year is primarily due to the write downs of inventory to the net realizable value.

Prepaid expenses: Prepaid expenses at June 30, 2009 were \$0.6 million compared to \$0.7 million at December 31, 2008 and \$1.0 million at June 30, 2008.

Property and equipment: Net property and equipment was \$5.7 million at June 30, 2009 compared to \$6.2 million at December 31, 2008 and \$5.9 million at June 30, 2008.

Goodwill and other intangibles: The Company accounted for the acquisition of Azure Dynamics Incorporated (its US subsidiary) using the purchase method, and in accordance with Canadian accounting standards, allocated the purchase price to identifiable assets, including intangibles. The excess of the purchase price consideration over identifiable assets is recorded as goodwill on the balance sheet (\$2.9 million). The Company identified the order book (\$0.9 million) and technology (\$12.5 million) as at-acquisition intangible assets. Intangible assets were \$7.4 million at June 30, 2009 (\$8.0 million at December 31, 2008 and \$8.7 million at June 30, 2008). The lower amount in 2009 is attributable to amortization.

Accounts payable and accrued liabilities: Accounts payable and accrued liabilities were \$6.0 million at June 30, 2009 compared to \$4.8 million at December 31, 2008 and \$4.4 million at June 30, 2008.

Customer deposits and deferred revenues: Current and long-term deferred revenue and customer deposits total \$1.0 million at June 30, 2009 compared to \$1.2 million at December 31, 2008 and \$1.2 million at June 30, 2008). The amount is attributable to the US operation and consists of deferred revenue that is primarily in respect of a payment received from Singapore Technologies Kinetics Ltd. ("STK") for a license agreement for certain technology that expires in 2020. The license agreement fee is being recognised in revenue over the 17-year duration of the agreement.

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

Notes payable: The note payable is attributable to the US subsidiary and is the Company's proportionate share of a mortgage on the Boston property owned by ND Solectria LLC, in which the Company has a 50% interest. The note was refinanced in November 2006, is repayable on November 20, 2011, bears interest at a floating rate of the applicable Treasury rate plus 200 basis points and is secured by the mortgaged premises. As at June 30, 2009, total obligations under the notes payable were \$2.4 million compared to \$2.5 million at December 31, 2008 and \$2.1 million at June 30, 2008.

Share capital: Share capital at June 30, 2009 was \$165.0 million compared to \$165.0 million at December 31, 2008 and \$140.7 million at June 30, 2008. The increase in share capital in the current quarter compared to the prior year quarter is primarily related to the equity financings in August 2008 (increase to share capital of \$24.3 million).

The number of common shares, options and deferred share units ("DSU's") issued and outstanding is presented in the following table:

	August 13, 2009	June 30, 2009	June 30, 2008
Common shares	438,366,707	379,543,178	279,376,177
Deferred Share Units	3,841,825	3,841,825	2,364,235
Stock options issued under the Stock Option Plan, with expiry dates ranging up until March 27, 2016 and average exercise price of \$0.37	26,447,287	26,447,287	17,815,126

During the period from June 30, 2009 to August 13, 2009, the Company issued 58,823,529 common shares upon the completion of an equity offering.

CUSTOMER DEPOSITS AND DEFERRED REVENUE

In November 2003, Solectria entered into a Transfer of Technology and Software Licensing Agreement ("TTA Agreement") with Singapore Technologies Kinetics ("STK"), a former shareholder. Under the terms of the agreement, STK has a non exclusive license to use and manufacture specified technology in specified Asian countries. The Company also provided STK with the training necessary for the transfer of the technology. The license expires in November 2020, and is subject to automatic one-year renewals thereafter. The Company received cash consideration for the license and transfer of technology, and for the training in the aggregate amount of US\$1.0 million. As discussed in note 2(b) of the June 30, 2009 Financial Statements, revenues from the TTA Agreement are being recognized on a straight-line basis over the period of the license agreement. As of June 30, 2009, the Company has deferred revenue associated with the TTA Agreement in the amount of \$0.7 million. During the three months and six months ended June 30, 2009, revenues recognized by the Company from the sale of products to STK and its related companies and from certain other contractual arrangements totalled approximately \$18,000 and \$36,000 respectively (2008 - \$15,000 and \$29,000 respectively).

LIQUIDITY, CAPITAL RESOURCES AND RISK FACTORS

At June 30, 2009 the Company had \$3.8 million (June 30, 2008 – \$6.6 million) in net cash reserves. The Company invests its cash, in accordance with its investments policy, in highly-liquid, highly-rated financial instruments such as bankers acceptances and term deposits. At June 30, 2009 approximately \$1.3 million of cash was restricted (June 30, 2008 – \$1.2 million). The restricted cash is related to a security deposit in respect of the facility in Boston (\$1.0 million), a standby letter of credit associated with a customer contract (\$0.1 million), and a standby letter of credit related to the security deposit for the new facility in Oak Park (\$0.2 million). Working capital was \$6.9 million at June 30, 2009 compared to \$17.5 million at June 30, 2008.

The Company has incurred losses since its inception as it has invested in the development of its Technology. Although the Company is active in a number of revenue-generating programs it also continues to incur product development costs. As a result, the Company has relied on its financing activities to fund its

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

operations. In addition, Azure has in the past, subject to TPC conditions, been eligible to access the grant of up to \$9.0 million available under the terms of the TPC contribution agreement. As at June 30, 2009 the Company had claimed approximately \$7.5 million in accordance with the terms of the TPC agreement. Furthermore, the Company is currently with discussions with TPC to include additional development costs of up to \$1.2 million for cost reimbursement. However, at this time, the outcome of these discussions remains uncertain.

The Company holds substantially all of its cash at a recognized Canadian national financial institution, and as such is exposed to all of the risks associated with that institution. The Company operates in foreign markets and has foreign subsidiaries and is therefore exposed to foreign currency exchange risk. Azure's operations are subject to all of the risks inherent in the establishment of a new business enterprise – please see Risk Factors – Annual Information Form, dated March 31, 2009 (this document and additional information relating to the Company is available for inspection at www.sedar.com). These risks include the practical risks of implementation and execution of its commercialization strategy (for example, the risk that Azure is delayed in the development of customer product requirements specified in development agreements, or is delayed in the process of establishing the infrastructure required to support its commercialization plans). To better manage all risk factors, the Company has a system of reporting and measuring progress towards milestones on a regular basis. The Company has an organization structure commensurate with its growth plans and has implemented an internal control and process system supported by an appropriate ERP system that encompasses all existing engineering/support operations. The Company recently completed its ISO certification at its Canadian location in Vancouver, B.C. The Boston, Massachusetts location already conforms to ISO. Management accepts the responsibility of ensuring that control systems and procedures are established and are effective and monitored and is required to report to the Board and its sub-committees on a regular basis on such matters.

On August 13, 2009, the Company completed a previously announced equity financing for gross proceeds of approximately \$10.0 million. Pursuant to the Offering, the Company issued 58,823,529 common shares at a price of \$0.17 per common share.

CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS
Contractual obligations:

As at June 30, 2009 the Company had the following contractual obligations and operating lease commitments:

(stated in thousands)	Payments due by period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Contractual Obligations					
Operating leases	9,911	729	2,975	2,951	3,256
Purchase obligations	3,436	3,367	69	-	-
Long term debt	2,384	36	2,348	-	-
Capital leases	299	73	194	32	-
Total contractual obligations	16,030	4,205	5,586	2,983	3,256

Off-balance sheet arrangements:

Pursuant to a contractual agreement with Natural Resources Canada, the Company is required to make royalty payments in the event that the Company successfully commercializes its intellectual properties specified in this agreement. The royalty payments, if any, are calculated at a rate of 1% of yearly gross sales earned from its intellectual properties. The obligation to make royalty payments expires at the earlier of January 2011 or when aggregate royalty payments reach \$296,000. To date, the Company has made payments in the amount of approximately \$16,500.

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

Pursuant to a contractual agreement with Technology Partnerships Canada ("TPC"), the Company is required to make royalty payments equal to the greater of 0.28% of yearly gross business revenues or in accordance with a fixed repayment schedule, with repayment amounts ranging from \$0.7 million to \$1.0 million per year starting in 2008 and totalling \$1.3 million, provided that certain minimum sales levels are achieved. The obligation to make royalty payments commences when the minimum sales levels are achieved and continues until the earlier of 2015 or when a cumulative payment ceiling of \$20.5 million is reached. On March 23, 2005, the Company entered into a contract amendment with TPC whereby the royalty payment period was extended to December 31, 2020. The Company has made no royalty payments to date.

Pursuant to a contractual agreement with EnCana Corporation, whereby EnCana sponsored the development of power train product, the Company is required to make royalty payments equal to 1% of gross revenue from sales of the power train product up to a maximum payment of \$1.0 million. To date, the Company has made payments in the amount of approximately \$16,500.

The Company has entered into employment agreements with certain executive directors and officers. In addition to defining the terms of employment, the agreements entitle the executives to termination payments, of up to one year's compensation, and the immediate vesting of all options previously granted, in the event of termination without cause and in some cases in the event of termination due to a change in the control of the Company.

CRITICAL ACCOUNTING ESTIMATES

The consolidated financial statements are prepared in accordance with Canadian GAAP, which require management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. The Company has identified the policies below as critical to the business operations and an understanding of the results of the business operations. The application of these and other accounting policies are described in note 2 to the consolidated financial statements. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurance that actual results will not differ from those estimates.

Revenue Recognition

Certain product lines within Solectria (acquired in January 2005 - see note 3 to the Annual Financial Statements), in addition to the G1 Shuttle Bus and P1 delivery van, are no longer considered development stage. Therefore the Company recognizes revenues on the sales of those products at the point of shipment, provided that the Company has evidence of an arrangement, the fee is fixed and determinable, delivery has occurred, title and risk of loss have passed to the customer, and collection is reasonably assured.

In addition, the Company recognizes revenues on long term engineering contracts using the percentage of completion method. The revenue recognized is determined based on the total contract value and the percentage of the contract estimated completed at the end of the reporting period. Because of inherent uncertainties in estimating the costs to complete contracts in progress, it is possible that the estimates used will change within the near term. Changes in estimated job profitability are accounted for as changes in estimates in the current period. Where applicable, the entire amount of future estimated losses on contracts in progress are recognized when they become known.

Warranty Provision

The Company generally warrants its products against defects and workmanship for a period of one to five years from the date of shipment, subject to certain guidelines and exclusions. A provision has been established for this warranty obligation. In establishing the accrued warranty liability, management has estimated the likelihood that products sold will experience warranty claims and the estimated costs to resolve the claims received, taking into account the nature of the product and the past and projected claims experience with the products. Should these estimates prove to be incorrect, the Company may incur costs different from those provided for in the warranty provisions.

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

Inventory Provision

In establishing the appropriate provision for inventory obsolescence, management estimates the likelihood that inventory carrying values will be affected by changes in market demand for the Company's products and by changes in technology, which could make inventory on hand obsolete. The Company performs regular reviews to assess the impact of changes in technology, sales trends and other changes on the carrying value of inventory. Where it is determined that such changes have occurred and will have a negative impact on the value of inventory on hand, appropriate provisions are made. Unforeseen changes in these factors could result in additional inventory provisions being required.

Intangible Assets and Goodwill

As a result of the Solectria acquisition (see note 3 to the Annual Financial Statements), the Company recorded intangible assets and goodwill on the balance sheet. In accordance with Canadian GAAP, the Company does not amortize goodwill. Intangible assets are amortized over periods ranging from two to ten years. At least annually, management reviews the carrying value of intangible assets and goodwill by segment for potential impairment. If circumstances indicate that impairment in the value of these assets has occurred, the impairment is recorded in the earnings of the current period.

Stock based compensation

The Company grants stock options to officers, directors, employees and consultants pursuant to the Company's stock option plan. The Company accounts for the stock-based compensation using the fair-value method as at the grant date. Under this method, compensation expense related to option grants is recorded in consolidated earnings over the vesting period of the options or, for consultants, as the work is performed. The compensation expense amount is based on the fair value of the option as estimated using the Black-Scholes option pricing model. The assumptions used in calculating the value of the stock options issued include management's best estimate, as of the date of grant, of the expected share price volatility over the term of the stock option and expected option life. As such, the amounts reported as compensation expense are subject to measurement uncertainty as the expense amount may vary significantly based on the assumptions used.

NEW ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENT

Recent accounting pronouncements that have been issued but are not yet effective, and have a potential implication for the Company are as follows:

Goodwill and Intangibles assets

Effective January 1, 2009, the Company adopted Section 3064 "Goodwill and intangible assets", replacing Section 3062, "Goodwill and other intangible assets". The new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The adoption of this standard had no significant impact on the Company's financial statements.

Financial Statement Concepts

Effective January 1, 2009, the Company adopted Section 1000, "Financial Statement Concepts" which has been amended to focus on the capitalization of costs that truly meet the definition of an asset and de-emphasizes the matching principle. The adoption of this standard had no significant impact on the Company's financial statements.

International financial reporting standards (IFRS)

In February 2008, Canada's Accounting Standards Board confirmed that IFRS will replace Canadian GAAP for publicly accountable enterprises for financial periods beginning on and after January 1, 2011. The Company's first mandatory filing under IFRS will be the first quarter of 2011 which will contain IFRS compliant information on a comparative basis. Due to the anticipated changes to IFRS prior to transition, it is currently not possible to fully determine the impact on the Company's consolidated results. The Company is currently in the process of developing the preliminary impact assessment of IFRS.

Three months and six months ended June 30, 2009 compared to the three months and six months ended June 30, 2008 and the year ended December 31, 2008

Business combinations, consolidated financial statements and non-controlling interests

In January 2009, the CICA issued sections 1582, "Business Combinations", 1601, "Consolidated Financial Statements", and 1602 "Non-Controlling Interests" which superseded current sections 1581, "Business Combinations" and 1600 "Consolidated Financial Statements". These sections will be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier adoption is permitted. If an entity applies these sections before January 1, 2011, it is required to disclose that fact and apply each of the new sections concurrently. These new sections were created to converge Canadian GAAP to IFRS.

OTHER MD&A REQUIREMENTS

Management has designed disclosure controls and procedures to provide reasonable assurance that material information relating to the Company, including its consolidated subsidiaries, is made known to the Chief Executive Officer and the Chief Financial Officer by others within those entities, particularly during the period in which the annual filings of the Company are being prepared, in an accurate and timely manner in order for the Company to comply with its continuous disclosure and financial reporting obligations and in order to safeguard assets. Consistent with the concept of reasonable assurance, the Company recognizes that the relative cost of maintaining these controls and procedures should not exceed their expected benefits. As such, the Company's disclosure controls and procedures can only provide reasonable assurance, and not absolute assurance, that the objectives of such controls and procedures are met.

The Corporation's financial reporting procedures and practices have enabled the certification of Azure Dynamics' annual filings in compliance with Multilateral Instrument 52-109 "Certification of Disclosure in Issuers' Annual and Interim Filings". Management has designed such internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements and other annual filings in accordance with Canadian Generally Accepted Accounting Principles, except as noted below.

Given the size of the Company, the evaluation of the design of internal controls over financial reporting for the Company resulted in the identification of the following weaknesses:

Management is aware that due to its relatively small scale of operations there is a lack of segregation of duties due to a limited number of employees dealing with accounting and financial matters. However, management has concluded that considering the employees involved and the control procedures in place, including management and Audit Committee oversight, risks associated with such lack of segregation are not significant enough to justify the expense associated with adding employees to clearly segregate duties.

Management is aware that in-house expertise to deal with complex taxation, accounting and reporting issues may not be sufficient. The Company requires outside assistance and advice on new accounting pronouncements and complex accounting and reporting issues, which is common with companies of a similar size.

There have been no significant changes to the Company's internal control over financial reporting that occurred during the most recent interim period that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ADDITIONAL INFORMATION

Additional information regarding Azure, including its Annual Information Form, can be found on SEDAR at www.sedar.com.