

**AZURE DYNAMICS CORPORATION**

**ANNUAL REPORT 2002**



**AZURE**

**D Y N A M I C S**

**November, 2002**

It is a pleasure to present the 2002 Annual Report for Azure Dynamics Corporation. Azure remains focused on becoming a world leader in developing hybrid electric systems for light and medium duty commercial vehicles.

The negative investment climate, especially for technology stocks, has presented additional challenges to management as we focus on our strategy of early commercialization. Funding of the magnitude we would like has been difficult to secure, which has resulted in initial commercial production being delayed into 2004. Nevertheless, Azure has made great strides on all fronts.

Our technology has been validated by thorough independent analyses in addition to successful prototype testing with three different end users. We reached a major milestone with the signing of a significant agreement with Purolator, Canada's largest courier company. The Memorandum of Understanding, for up to 3,000 vehicles, reinforces Purolator's leadership role in their industry. We are gratified by the courage and foresight Purolator management has shown in making this commitment which has such positive implications for improving air quality while at the same time reducing operating costs.

More detailed highlights of our progress over the past twelve months follow:

- Funding
  - \$5.2 million of equity raised in January, 2002;
  - Access to \$9 million of funding from Technology Partnerships Canada in April 2002 – approx \$0.27 per \$1.00 of research and development expenditures will be funded by the TPC program up to a total of \$9 million.
  
- Technology development
  - Successful six month prototype program with *Canada Post* resulting in a 58% decrease in fuel consumption and up to 90% reduction in emissions;
  - Successful testing of a prototype electric delivery vehicle for a company in the UK – test results saw a 200% increase in speed and distance and a 100% increase in number of stops and starts the vehicle can make compared to the current fleet vehicle; the improved economics are compelling;
  - Introduction of our second generation prototype to Purolator Courier which entered service October 15, 2002 for the purpose of data collection and performance evaluation;
  - Independent testing of Azure's technology in March/April 2002 confirmed the significant fuel economy and emissions reductions possible in Azure's vehicle category. For example, when measured using the E.P.A. New York City drive cycle, Azure's technology can reduce fuel consumption by 55% in a gasoline delivery van and 47% in a diesel delivery van.
  
- Strategic Alliances
  - Established an alliance with *Hydro-4Xpbec CapiTech Inc.*, a leading investor in technology related to the energy field; Jean-5HQp Marcoux, President and Chief Executive Officer of CapiTech, joined Azure's Board;
  - Established a partnership with *Technologies M-4 Inc.*, a CapiTech subsidiary, for the development of a generator and inverter applicable to series powertrain development; Azure will also use TM4's technology in specified future prototypes;
  - Established a relationship with *London Taxi International* to explore development of both a delivery vehicle and hybrid electric prototype taxi for testing in London;
  - Initiated discussions with two major automotive manufacturers regarding components for Azure's powertrain.

- Commercialization
  - Most significant is the MOU with *Purolator* for delivery of up to 3,000 hybrid electric delivery vans; the largest indication of volume business in the history of our industry;
  - Prototype hybrid electric taxis for London may lead to a major order because of the favorable economics and significant environmental benefits particularly relating to eliminating “smog”.
  
- People
  - Addition of significant experience and talent in the commercialization team – Azure members bring substantial hybrid electric knowledge, experience and expertise from around the world;
  - Addition of full time (October 2001) Chief Financial Officer in Greg Francis – he has made a particularly valuable contribution to the detailed planning that has been required in the development of our financial model and in the negotiations relating to all aspects of the company’s development;
  - Advisory Board established to provide technical and marketing advice and counsel to our employees, management and Board of Directors – the stature and experience of the members is apparent when you review their résumés included in this annual report.

**Summary**

We wish to recognize the exceptional results achieved this year by the Azure team. The contributions of and the accomplishments by our employees and our management in these challenging times bodes well for Azure in its ongoing progress towards commercialization.

Our Board of Directors has been invaluable in the wise advice they have continuously imparted to management as we overcome the technical, commercial and financial challenges facing any relatively new company in today’s world.

It is particularly encouraging to have been able to assemble an Advisory Board of such distinguished and recognized individuals from around the world to aid everyone on the Azure team in making the right decisions at the right time.

In spite of the significant challenges associated with raising funds for commercialization, Azure is building a base to becoming an absolute world leader in its sector.

The compelling environmental and economic benefits of Azure’s technology will ultimately lead the commercial transportation sector we are operating in to make fleet changes and improvements of a substantive nature. We thank you, the shareholders, for your ongoing support of an exciting company that can make a significant contribution to the environment we live in while concurrently producing economic benefits for its customers.

Respectfully submitted on behalf of the Board of Directors,



D. Campbell Deacon  
Chairman and Chief Executive Officer



David E. Deacon  
President and Chief Operating Officer

## **Year Ended June 30, 2002 ("2002") Compared to Year Ended June 30, 2001 ("2001")**

*This "Management's Discussion and Analysis" should be read in conjunction with the Annual Audited Consolidated Financial Statements of the Company for the year ended June 30, 2002 and the Notes thereto.*

### **Business Strategy of the Company**

Azure Dynamics Corporation ("Azure" or the "Company") is an innovative technology company with a vision to become a recognized world leader in hybrid electric systems for commercial vehicles.

The principle business of Azure is the development, and ultimate commercialization of its core technology, Hybrid Electric Vehicle ("HEV") control systems. The Company is a development stage enterprise – it is involved in the development and testing of its technology, with commercialization targeted for the year 2004.

Azure's hybrid electric vehicle control systems were developed as a result of research activities that its principal shareholder, BC Research Inc, began in the mid 1990's. Azure Dynamics Inc. ("ADI") was established by BC Research to commercialize its HEV technology and commenced operations on July 1, 1999. During the fiscal year 2000, ADI established its initial base and operations; during 2001, ADI substantially expanded its employee, asset, and capital resources and secured a public listing for its shares on the TSX Venture Exchange by way of a reverse takeover transaction ("RTO") with Azure Dynamics Corporation ("Azure" formerly Wild Horse Resources Ltd.), an inactive Canadian public company.

Azure's strategy is to develop its HEV adaptive control systems technology into viable products for the light to medium duty commercial vehicle markets, focusing initially on postal, courier, taxi and shuttle-bus applications. Azure has selected these markets as they include some of the least efficient drive cycles; the low-speed, stop-start nature of these applications are well suited to the HEV concept due to the regenerative power captured from braking functions that is then reapplied to recharging the battery and thereby extending operational capacity of the vehicle. Azure continues to align iTSXIf with partners who are recognized suppliers to these markets in order to achieve its goals.

As the Company is engaged in the development of its core technologies it primarily expends monies on research and development activities, and on the management and infrastructure required to develop and commercialize its products. During 2002 Azure focused its technology efforts on the completion of the in-service field trials of its "proof of concept" prototype vehicle and applying the practical experience from those trials to the continued development of the technology and its application in practical customer-specific environments. Technology enhancements have been incorporated into the Company's product specifications, component sourcing operations, and the next generation prototypes currently under construction. Azure anticipates that these efforts will result in the acquisition of further intellectual property, and ultimately customer orders.

Azure has focused its initial sales efforts on the large postal, courier, delivery and taxi fleets within its target markets. To date, the Company has demonstrated prototype vehicles with three customers. On October 28, 2002, the Company announced that it had signed a Memorandum of Understanding with Purolator Courier Ltd., Canada's largest courier company. The Memorandum of Understanding provides for the potential fitting of up to 3,000 Purolator vehicles with Azure's powertrains. Azure also agreed to sell to Purolator, for consideration of \$50,000, an option to acquire up to 2,000,000 common shares of Azure, at a price of \$0.50 per share, expiring on February 28, 2003. Both of the aforementioned terms of the Memorandum of Understanding are subject to certain qualifying conditions.

**Operating Results, Cash Flows and Financial Condition**

**Statement of Operations Discussion**

For the year ended June 30, 2002, the Company incurred a net loss of \$5,756,197 or \$0.18 per share. This compares to a net loss for the year ended June 30, 2001, of \$2,072,074 or \$0.10 per share. Since inception, the Company has incurred a total deficit of \$8,339,586.

The Company's results, presented on a quarterly basis, are as follows:

|                                   | <b>Apr – Jun<br/>2002</b> | <b>Jan – Mar<br/>2002</b> | <b>Oct – Dec<br/>2001</b> | <b>Jul-Sept<br/>2001</b> |
|-----------------------------------|---------------------------|---------------------------|---------------------------|--------------------------|
| Revenue                           | \$ 16,592                 | \$ 16,393                 | \$ 15,193                 | \$ 30,291                |
| Expenses                          | \$ (1,409,481)            | \$ (1,521,811)            | \$ (1,266,675)            | \$ (1,179,034)           |
| Lease termination                 | \$ (457,665)              | \$ -                      | \$ -                      | \$ -                     |
| Net loss for the period           | \$ (1,850,554)            | \$ (1,505,418)            | \$ (1,251,482)            | \$ (1,148,743)           |
| Loss per share                    | \$ (0.04)                 | \$ (0.04)                 | \$ (0.05)                 | \$ (0.05)                |
| Weighted average number of Shares | 43,308,430                | 34,328,753                | 24,659,226                | 24,659,009               |

|                                   | <b>Apr – Jun<br/>2001</b> | <b>Jan – Mar<br/>2001</b> | <b>Oct – Dec<br/>2000</b> | <b>Jul - Sept<br/>2000</b> |
|-----------------------------------|---------------------------|---------------------------|---------------------------|----------------------------|
| Revenue                           | \$ 8,361                  | \$ 26,609                 | \$ 21,667                 | \$ 79,718                  |
| Expenses                          | \$ (946,202)              | \$ (609,711)              | \$ (398,335)              | \$ (216,188)               |
| Net loss for the period           | \$ (938,040)              | \$ (583,931)              | \$ (380,783)              | \$ (169,320)               |
| Loss per share                    | \$ (0.04)                 | \$ (0.03)                 | \$ (0.02)                 | \$ (0.01)                  |
| Weighted average number of Shares | 24,183,883                | 23,079,140                | 20,846,362                | 13,572,300                 |

In 2002, Azure continued to develop its core technology, expanded its development and management team, and made progress in other commercialization activities such as marketing and financing. The increase in the deficit in 2002, compared to 2001, is attributable to the ongoing expansion of the scale of operations. Further, the Company expanded rapidly in the latter stages of 2001 and therefore the results of 2002 include the first full year impact of these changes. Apart from the growth in the size and activity level of the research and development team the Company has also increased its financing, marketing and selling activities. Overhead expenses directly related to headcount are higher than in previous years and in particular travel expenditures are significantly higher mainly as a result of international travel required to support business operations. 2002 is also the Company's first full year of operation as a listed company and hence legal and regulatory compliance costs have been incurred.

**Revenue:** Revenue for fiscal 2002 was \$78,469 compared to \$136,355 in fiscal 2001. Revenue in 2002 represents interest income earned on equity monies placed on short-term investment (2001-\$40,905). The Company had no contract sales revenue (2001 - \$95,450) as it concentrated all of its resources on the development of its core technology.

**Cost of contract sales:** The cost of contract sales in 2001 was \$37,993 or 40% of contract sales revenue.

**Research and development:** The Company expended \$2,975,339 on research and development operations during the year (2001 - \$1,234,025); these costs were reduced by contributions from government assistance programs and investment tax credits of \$579,501 (2001 - \$164,225). The higher level of expenditure on research and development activities in 2002, compared to 2001, is due to new employee hires and infrastructure changes, the incremental impact of 2001 employee hires and infrastructure changes, as well as increased product development costs as the Company continued to advance its programs. During 2002, the focus of the research and development was on the Company's initial prototype and its six-month period of active service delivering mail in a postal fleet. The trials were successfully completed in March 2002; since then the research and development team has applied the practical knowledge gained from the prototype experience, and further research, towards the development of a second generation prototype and other customer-specific activities. Product development expenditures in 2002 include the costs of maintaining the initial prototype and second generation prototype development. Azure also entered into a strategic alliance agreement with Hydro-Québec CapiTech Inc. ("CapiTech") and its wholly-owned subsidiary, Technologies M4 Inc. ("TM4"), and spent \$665,000 on the development of a generator and inverter – components applicable to Azure's hybrid electric series powertrains. CapiTech, a subsidiary of Hydro-Québec, is a corporate venture capital company that invests in companies whose technological products and services are related to the energy field; TM4 is a technology company developing highly-integrated power generation, conversion and control systems for automotive and industrial applications. At June 30, 2002 Azure employed 18 research, engineering and technical employees (2001 – 14).

In 2002, the Company entered into a contribution agreement with Technology Partnerships Canada ("TPC"), a government funded program. Under the terms of this agreement, TPC will provide a proportionate contribution towards eligible research and development expenditures in respect of the Company's series hybrid power train projects – G1 and G2r – up to a maximum contribution of \$9 million. Also, the Company is required to make royalty payments equal to the greater of 0.28% of yearly gross sales or in accordance with a repayment schedule provided that certain minimum sales levels are achieved. TPC contributions receivable for the fiscal year 2002 amounted to \$567,626; as the Company has no commercial revenues in 2002 a royalty liability has not been incurred. Research and development costs were also reduced by an amount of \$11,875 in 2002 (2001 - \$164,225), being costs reimbursed under the terms of a grant from the National Research Council Canada ("NRC"), net of a \$17,924 adjustment to investment tax credits due to the Company.

**Selling and marketing:** Selling and marketing costs total \$756,341 for the year ended June 30, 2002 compared to \$182,185 in 2001. Costs are higher in 2002 as the Company has considerably expanded its sales and marketing efforts since the establishment of this function in January 2001. The Company has been promoting awareness of Azure and its technology amongst its customer base, the investment community, and the general alternative energy industry, including relevant government bodies. The sales and marketing team is small – the headcount at June 30, 2002 was 2 compared to 1 at 2001 – but is strongly supported by the development and corporate teams, and uses external service providers.

**General and administrative:** General and administrative costs total \$1,652,848 for the year ended June 30, 2002, compared to \$726,239 in the prior year. The higher level of costs, 2002 versus 2001, is mainly due to the growth in the executive, finance and administration headcount and related overhead costs, the incremental impact of the employee hires and infrastructure changes made in 2001, and legal and regulatory compliance fees. During 2002 the Company was engaged in intensive financing and strategic partner discussions, necessitating a high level of support from the internal team, Board members and external counsel. Costs, such as consulting, travel and legal, are higher as a result of these activities. The headcount at June 30, 2002, including that of the executive office, was 8 compared to 5 at June 30, 2001. The total headcount of the Company at June 30, 2002 was 28 compared to 20 at the prior year-end.

**Rent:** Rent costs for the year were \$408,913 (2001 - \$108,986). The higher costs for 2002 are attributable to new premises leased in Vancouver (refer to lease termination below), additional space leased at the Company's existing Vancouver site, as well as the first full year of rent for the Company's executive and sales office in Toronto.

**Amortization:** The increase in amortization to \$163,061 in 2002, compared to \$83,226 in 2001, is directly attributable to capital and other asset additions made to support the growth in the scale of the Company's operations over the course of the last two years.

**Lease termination:** Azure entered into an agreement in June 2001 to lease premises in Vancouver with the intention of establishing more effective facilities for its Vancouver operations. The Company has since adopted a plan that requires a smaller investment in its own facilities and more extensive use of the facilities and services provided by established automotive suppliers. Consequently, the leased premises in Vancouver were considered surplus to the Company's requirements and the lease was terminated effective June 30, 2002. The cost to terminate the lease was \$205,000. The Company also wrote off pre-occupation costs of \$247,665 and has provided for estimated legal costs of \$5,000. In conjunction with the lease termination, the landlords of the premises entered into a share subscription agreement for 240,000 shares, at a price of \$0.50 per share, raising gross proceeds of \$120,000.

### **Balance Sheet Discussion**

**Cash and cash equivalents:** Cash and cash equivalents at June 30, 2002 was \$1,896,248 compared to \$2,859,452 at June 30, 2001. Cash inflow of \$5,106,563, mainly from the issuance of common shares, was more than offset by the cash outflow of \$6,069,767 required to support the Company's operations and asset additions.

**Investment tax credits receivable:** Azure has collected all the cash investment tax credits that were due to it under the terms of the Scientific Research and Development ("SRED") government tax program and hence the nil balance at June 30, 2002 versus \$147,341 at June 30, 2001. As Azure is a public company it no longer qualifies for the cash reimbursement of SRED tax credits but instead must set-off credits against income taxes payable. As the Company is in a loss position, and currently has no taxes payable, it has approximately \$1,163,000 of tax credits available for set-off against future tax liabilities. The ability of the Company to utilize these credits is not reasonably assured and therefore no tax asset has been recorded in the consolidated financial statements.

**Accounts receivable:** Accounts receivable mainly represent Goods and Services Taxes and sundry receivables. The balance at June 30, 2002 - \$68,327 is lower than the balance at June 30, 2001 - \$167,393 primarily because the 2001 balance included a backlog of Goods and Services Tax claims that have now been received.

**Contributions receivable:** The \$567,626 receivable at June 30, 2002 represents amounts due to the Company from TPC; the \$75,225 receivable at June 30, 2001 represents amounts due to the Company from NRC – see earlier comments under the heading "Research and development".

**Employee loans:** As June 30, 2002 employee loans amounted to \$259,214 (2001 - \$273,501); the reduction in the amount of loans outstanding is due to employee repayments. The share purchase loans were granted during fiscal 2001 to facilitate the participation by employee's in the public float of the Company – see note 8 to the annual financial statements.

**Capital assets:** After writing off leasehold improvements in respect of the exit of the leased premises in Vancouver, as discussed under the heading "Lease termination" above, net capital assets were \$372,019 at June 30, 2002 compared to \$291,516 at June 30, 2001. Further asset purchases were necessary during 2002 to support the expanded team and research and development activities.

Other assets: The Company continues to seek protection for its intellectual properties wherever available; the net book value of patent and trademark assets is \$73,443 at June 30, 2002 compared to \$11,495 at June 30, 2001. The deferred charge, representing an unsecured employee loan, was amortized by \$13,938 to leave a net book value of \$23,562 at June 30, 2002 (2001 - \$37,500).

Accounts payable and accrued liabilities: Accounts payable and accrued liabilities were \$442,625 at June 30, 2002 compared to \$537,050 at June 30, 2001. Liabilities are lower in June 30, 2002 compared to June 30, 2001 as 2001 included a higher level of trade payables in respect of prototype components.

Share capital and Special warrants: Share capital increased by \$8,698,120 during the year; \$5,000,195 represents the net proceeds from the issuance, and subsequent conversion to common shares, of Special B warrants issued in January 2002, \$66,675 represents the proceeds from the exercise of stock options during 2002, and \$120,000 represents the subscription of common shares in conjunction with the lease termination agreement discussed previously. The balance of \$3,511,250 represents Special A warrant funds that were received and recorded in the financial statements in 2001 (\$3,600,000 less special warrant subscriptions receivable of \$100,000) and which were converted to common shares of the Company in 2002. The net cash impact of this transaction in 2002 is \$11,250 being the receipt of the special warrants subscription receivable of \$100,000 that was outstanding at June 30, 2001 and the payment of issue costs of \$88,750.

### **Liquidity, Capital Resources and Risk Factors**

At June 30, 2002 the Company had \$1,896,248 (2001 - \$2,859,452) in net cash reserves. The Company invests its cash in highly liquid, highly rated financial instruments such as banker's acceptances and term deposits. Working capital was \$2,129,789 at June 30, 2002 compared to \$2,785,361 at June 30, 2001. The primary cause of the reduction in working capital was the use of cash reserves to fund operations.

The Company has no commercial revenue and is therefore dependant on its financing activities to fund its operations. During 2002, Azure improved its financial and investor base through a number of transactions. In January 2002, Azure entered into an investment agreement with Hydro-Québec CapiTech Inc. whereby CapiTech agreed to invest \$2,000,000 in Azure pursuant to a pre-arranged transfer of 3,640,000 common shares to CapiTech over the facilities of the TSX Venture Exchange. Simultaneously, Azure completed a private placement of 10,400,000 Special B warrants so that in total the Company raised gross proceeds of \$5,200,000. Azure also filed a prospectus, dated January 31, 2002, whereby the issued and outstanding 8,000,000 Special A warrants and 10,400,000 Special B warrant were qualified for distribution as common shares of the Company. Finally, Azure entered into a contribution agreement with Technology Partnerships Canada in March 2002, the terms of which allow Azure to claim reimbursement of eligible research and development expenditures incurred in the development of its G1 and G2r series hybrid powertrains, up to a maximum reimbursement of \$9,000,000.

As at June 30, 2002 Azure estimated that its cash reserves were sufficient to fund its operations for a further six months. The Company requires additional financing to continue its operations beyond that point. The raising of finance to fund operations is subject to uncertainty and there is no assurance that such financing will be available on commercially reasonable terms, if at all.

During 2002, Azure expanded its management and technology team by the recruitment of new employees that have added depth and experience to the organization. The Azure team is fortunate to be able to draw on the broad experience base of the Board of Directors and the newly formed Advisory Board which is comprised of a panel of industry related experts. Compensation for full-time employees continues to be weighted towards base salary remuneration and incentive stock options. Post June 30, 2002 certain management executives have entered into employment agreements with the Company that provide for mutually agreeable terms of employment, including confidentiality, non-compete, and termination arrangements.

Azure continues to rent office and test facilities located in the BC Research complex where the majority of its research, development, procurement, and administration activities are performed. As discussed previously, the Company no longer intends to establish a fully-equipped facility in Vancouver. Depending on available financing, Azure intends to locate its operations at a suitable venue where it can minimize its investment in capital intensive plant and equipment and make use of external automotive resources that are already established in the industry sector. Azure believes that this approach will lower overall project risk, due to the lower investment dollars required as well as the inherent industry strength of the selected automotive service providers, with specialized facilities and technical resources at their disposal, which should allow for more rapid execution of Azure's product development programs.

In conclusion, 2002 was an eventful year in the evolution of Azure Dynamics with progress noted on many fronts including product development, selling and marketing, and financing. Whilst management is optimistic regarding further developments, Azure's operations are subject to all of the risks inherent in the establishment of a new business enterprise. In particular Azure will require significant additional funding in the future to develop and market its technology to its full potential<sup>1</sup>.

Note:

<sup>1</sup> See Risk Factors – Prospectus, dated January 31, 2002. This document is available for inspection at [www.sedar.com](http://www.sedar.com).

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**Azure Dynamics Corporation**  
**(A Development Stage Enterprise)**  
**Consolidated Financial Statements**  
**For the years ended June 30, 2002 and 2001**

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## Auditors' Report

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### To the Shareholders of Azure Dynamics Corporation

We have audited the consolidated balance sheets of Azure Dynamics Corporation (a development stage enterprise) as at June 30, 2002 and 2001 and the consolidated statements of operations and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the 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 financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2002 and 2001 and the results of its operations and its cash flows for the years then ended, in accordance with Canadian generally accepted accounting principles.

*BDO Dunwoody LLP*

### Chartered Accountants

Calgary, Alberta  
August 23, 2002 except for note 16 (b) which is dated October 18, 2002

**Azure Dynamics Corporation**  
**(A Development Stage Enterprise)**  
**Consolidated Balance Sheets**


| <b>As at June 30</b>                          | <b>2002</b>         | <b>2001</b>         |
|---|---------------------|---------------------|
| <b>Assets</b>                                 |                     |                     |
| <b>Current</b>                                |                     |                     |
| Cash and cash equivalents (Note 5)            | \$ 1,896,248        | \$ 2,859,452        |
| Investment tax credits receivable             | -                   | 147,341             |
| Accounts receivable                           | 68,327              | 167,393             |
| Contributions receivable (Note 13)            | 567,626             | 75,225              |
| Prepaid expenses                              | 53,961              | 73,000              |
|   | <u>2,586,162</u>    | <u>3,322,411</u>    |
| <b>Employee loans (Note 8(i))</b>             | <b>259,214</b>      | <b>273,501</b>      |
| <b>Related party receivable (Note 8(iii))</b> | <b>-</b>            | <b>14,156</b>       |
| <b>Capital assets (Note 6)</b>                | <b>372,019</b>      | <b>291,516</b>      |
| <b>Other assets (Note 7)</b>                  | <b>97,005</b>       | <b>48,995</b>       |
|   | <u>\$ 3,314,400</u> | <u>\$ 3,950,579</u> |

**Liabilities and Shareholders' Equity**

|  |                     |                     |
|--|---------------------|---------------------|
| <b>Current</b>                                   |                     |                     |
| Accounts payable and accrued liabilities         | \$ 442,625          | \$ 537,050          |
| Obligations under capital leases (Note 9)        | 13,748              | -                   |
|  | <u>456,373</u>      | <u>537,050</u>      |
| <b>Obligations under capital leases (Note 9)</b> | <b>2,575</b>        | <b>-</b>            |
|  | <u>458,948</u>      | <u>537,050</u>      |
| <b>Shareholders' equity</b>                      |                     |                     |
| Share capital (Note 11(b))                       | 11,195,038          | 2,496,918           |
| Special warrants (Note 11(b))                    | -                   | 3,500,000           |
| Deficit  | (8,339,586)         | (2,583,389)         |
|  | <u>2,855,452</u>    | <u>3,413,529</u>    |
|  | <u>\$ 3,314,400</u> | <u>\$ 3,950,579</u> |

Approved on behalf of the Board:

 Director

 Director

The accompanying notes are an integral part of these consolidated financial statements.

**Azure Dynamics Corporation**  
**(A Development Stage Enterprise)**  
**Consolidated Statements of Operations and Deficit**

|   | For the year ended June 30 |                       | Cumulative            |
|---|----------------------------|-----------------------|-----------------------|
|   | 2002                       | 2001                  | Since<br>Inception    |
| <b>Revenue</b>                                    |                            |                       |                       |
| Contract sales                                    | \$ -                       | \$ 95,450             | \$ 258,066            |
| Other   | 78,469                     | 40,905                | 120,336               |
|   | <u>78,469</u>              | <u>136,355</u>        | <u>378,402</u>        |
| <b>Cost of contract sales</b>                     | -                          | 37,993                | 101,073               |
|   | <u>78,469</u>              | <u>98,362</u>         | <u>277,329</u>        |
| <b>Expenses</b>                                   |                            |                       |                       |
| Research and development, net (Note 13)           | 2,395,838                  | 1,069,800             | 3,798,537             |
| Selling and marketing                             | 756,341                    | 182,185               | 938,526               |
| General and administrative                        | 1,652,848                  | 726,239               | 2,560,341             |
| Rent  | 408,913                    | 108,986               | 606,904               |
| Amortization                                      | 163,061                    | 83,226                | 254,942               |
|   | <u>5,377,001</u>           | <u>2,170,436</u>      | <u>8,159,250</u>      |
| <b>Net loss for the period before other items</b> | <b>(5,298,532)</b>         | <b>(2,072,074)</b>    | <b>(7,881,921)</b>    |
| Lease termination (Note 4)                        | 457,665                    | -                     | 457,665               |
| <b>Net loss for the period</b>                    | <b>(5,756,197)</b>         | <b>(2,072,074)</b>    | <b>(8,339,586)</b>    |
| Deficit, beginning of period                      | <u>(2,583,389)</u>         | <u>(511,315)</u>      | <u>-</u>              |
| <b>Deficit, end of period</b>                     | <b>\$ (8,339,586)</b>      | <b>\$ (2,583,389)</b> | <b>\$ (8,339,586)</b> |
| <b>Earnings per share *</b>                       | <b>(0.18)</b>              | <b>(0.10)</b>         |                       |
| <b>Weighted average number of shares</b>          | <b>31,691,179</b>          | <b>20,374,321</b>     |                       |

\* No fully diluted earnings per share have been disclosed, as these would be anti dilutive.

The accompanying notes are an integral part of these consolidated financial statements.

**Azure Dynamics Corporation**  
**(A Development Stage Enterprise)**  
**Consolidated Statements of Cash Flows**

|   | For the year ended June 30 |                     | Cumulative<br>Since<br>Inception |
|---|----------------------------|---------------------|----------------------------------|
|   | 2002                       | 2001                |                                  |
| <b>Cash flows from operating activities</b>             |                            |                     |                                  |
| Operations  |                            |                     |                                  |
| Net loss for the period                                 | \$ (5,756,197)             | \$ (2,072,074)      | \$ (8,339,586)                   |
| Adjustments for:  |                            |                     |                                  |
| Amortization  | 163,061                    | 83,226              | 254,942                          |
| Lease termination (Note 4)                              | 457,665                    | -                   | 457,665                          |
| Common shares issued in exchange<br>for services        | -                          | -                   | 25,000                           |
| Changes in non-cash working capital items<br>(Note 15)  | (467,823)                  | 54,931              | (420,395)                        |
|   | <b>(5,603,294)</b>         | <b>(1,933,917)</b>  | <b>(8,022,374)</b>               |
| <b>Cash flows from financing activities</b>             |                            |                     |                                  |
| Issuance of common shares (net of costs)                | 5,078,120                  | 2,094,693           | 7,824,608                        |
| Issuance of special warrants                            | -                          | 3,500,000           | 3,500,000                        |
| Changes in related party advances                       | 14,156                     | (10,366)            | -                                |
| Repayment of obligations under capital lease            | (10,993)                   | -                   | (10,993)                         |
| Repayment of long term debt                             | -                          | (50,000)            | (50,000)                         |
|   | <b>5,081,283</b>           | <b>5,534,327</b>    | <b>11,263,615</b>                |
| <b>Cash flows from investing activities</b>             |                            |                     |                                  |
| Acquisition of capital assets                           | (392,616)                  | (302,769)           | (760,536)                        |
| Acquisition of subsidiary                               | -                          | (249,610)           | (249,610)                        |
| Acquisition of intellectual properties                  | (62,864)                   | (12,770)            | (75,635)                         |
| Changes in loans to employees                           | 14,287                     | (273,501)           | (259,214)                        |
|   | <b>(441,193)</b>           | <b>(838,650)</b>    | <b>(1,344,995)</b>               |
| <b>Increase (decrease) in cash and cash equivalents</b> | <b>(963,204)</b>           | <b>2,761,760</b>    | <b>1,896,246</b>                 |
| Cash and cash equivalents, beginning of period          | 2,859,452                  | 97,692              | 2                                |
| <b>Cash and cash equivalents, end of period</b>         | <b>\$ 1,896,248</b>        | <b>\$ 2,859,452</b> | <b>\$ 1,896,248</b>              |

The accompanying notes are an integral part of these consolidated financial statements.

**Years ended June 30, 2002 and 2001**

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## **1. Nature of Operations and Basis of Presentation**

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Azure Dynamics Corporation ("the Company") ("ADC") (formerly Wild Horse Resources Ltd.) is incorporated under the laws of Alberta. The Company was party to a reverse takeover transaction ("RTO") between ADC (the deemed acquiree) and Azure Dynamics Inc. ("ADI") (the deemed acquirer), effective April 24, 2001. The corporate structure is currently that ADI is the wholly owned subsidiary of ADC. ADI is incorporated under the laws of Canada. In conjunction with the RTO, management made application to change the reporting year-end for the consolidated entities to June 30.

The Company is a development stage enterprise, involved in developing adaptive hybrid electric vehicle control systems to be used in commercial vehicle applications. The Company has not yet determined the ultimate economic viability of the products under development. The Company is currently in the process of testing its control systems. All costs incurred to date have been recorded as research and development expense. No revenue has been generated from the sale of its products to date.

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis which presumes the realization of assets and discharge of liabilities in the normal course of business. There are several development stages to be completed before the marketability, if any, of the Company's technology can be determined. While the Company has derived limited revenue from the performance of research and development projects for third parties, its ability to continue operations is uncertain and dependent upon the successful completion of technical development and protection of the technology, obtaining additional financing and achieving profitable operations. The outcome of these matters cannot be predicted at this time. These consolidated financial statements do not include any adjustments to the amounts and liabilities that might be necessary should the Company be unable to continue in business.

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## **2. Significant Accounting Policies**

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The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

(a) Consolidation

The consolidated financial statements include the accounts of ADI since July 1, 1999, the date it commenced operations, and the accounts of ADC since the effective RTO date of April 24, 2001.

(b) Revenue recognition

Revenue from contractual projects is recognized on a percentage-of-completion basis based on the ratio of actual costs incurred to the estimated total cost to complete the project. Provision for loss on contracts is recorded in the period in which the loss is determined.

Years ended June 30, 2002 and 2001

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## 2. Significant Accounting Policies – cont'd.

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(c) Research and development costs

Research costs are expensed in the year incurred. Development costs are expensed in the year incurred unless the Company believes a development project meets generally accepted criteria for deferral and amortization. No development costs have been deferred to date.

Reimbursements of eligible costs pursuant to government assistance programs are recorded as a reduction of research and development costs when the related costs have been incurred. Claims not settled by the balance sheet date are recorded as "Contributions receivable" on the consolidated balance sheets. The determination of the amount of the claim, and hence the receivable amount, requires management to make calculations based on its interpretation of eligible expenditures in accordance with the terms of the programs. The reimbursement claims submitted by the Company are subject to review by the relevant government agencies. Although the Company has used its best judgment and understanding of the related program agreements in determining the receivable amount, it is possible that the amounts could increase or decrease by a material amount in the near term dependent on the review and audit by the government agency.

The government assistance programs typically incorporate repayment provisions that are contingent upon future trigger-events. In these cases, a repayment liability is recorded when the event occurs or it is considered more likely than not that the event will occur.

(d) Investment tax credits

The benefits of investment tax credits for scientific research and development expenditures are recognized in the year the qualifying expenditure is made provided there is reasonable assurance of recoverability. The investment tax credit reduces the carrying cost of expenditures for capital assets and research and development expense. The investment tax credit receivable balance is subject to review and audit by the Canada Customs and Revenue Agency. Although the Company has used its best judgment and understanding of the related income tax legislation in determining the amount of this balance, it is possible that the amounts could increase or decrease by a material amount in the near term dependent on the review and audit by the Canada Customs and Revenue Agency.

(e) Capital assets

Capital assets are recorded at cost, less accumulated amortization. Amortization is provided on a straight-line basis over the estimated useful life of the assets.

The following is a summary of estimated useful lives of the assets:

|                      |         |                                |              |
|----------------------|---------|--------------------------------|--------------|
| Laboratory equipment | 5 years | Office furniture and equipment | 5 years      |
| Computer software    | 2 years | Automotive                     | 3 years      |
| Computer hardware    | 3 years | Leasehold improvements         | 1 to 5 years |

(f) Cash and cash equivalents

The Company considers bank balances (including temporary bank overdraft) and all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents.

Years ended June 30, 2002 and 2001

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## 2. Significant Accounting Policies – cont'd.

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(g) Other assets

The costs of acquiring and applying for patents, trademarks and licensed technology are capitalized and amortized on a straight-line basis over their estimated useful lives of 5 years.

The costs of acquiring and applying for patents, trademarks and licensed technology costs do not necessarily reflect present or future values and the ultimate amount recoverable will be dependent upon the successful development and commercialization of products based on these intellectual properties. Management reviews the intellectual properties for impairment whenever events or changes in circumstances indicate that full recoverability is questionable. Management measures any potential impairment by comparing the carrying value to the undiscounted amounts of expected future cash flows. Based on management's review no impairment allowances have been required to June 30, 2002.

(h) Financial instruments

The Company carries a number of financial instruments. Unless otherwise indicated, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

(i) Future income taxes

Income taxes are accounted for using the liability method of tax allocation. Future income taxes are recognized for the future income tax consequences attributable to differences between the carrying values of assets and liabilities and their respective income tax bases. Future income tax assets and liabilities are measured using substantively enacted income tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in rates is included in earnings in the period that includes the enactment date. Future income tax assets are recorded in the consolidated financial statements if realization is considered more likely than not.

(j) Foreign currency translation

The Company follows the temporal method of accounting for the translation of foreign currency amounts into Canadian dollars. Under this method monetary assets and liabilities are translated into Canadian dollars at the exchange rate in effect at the balance sheet date. Revenue and expenses are translated at monthly average exchange rates throughout the year. Foreign exchange gains or losses are reflected in the results of operations.

(k) Stock based compensation

The Company grants stock options to officers, directors, employees and consultants pursuant to a stock option plan described in Note 11(c). No compensation is recognized for this plan when common shares are issued or when stock options are granted. Any consideration received on the exercise of stock options or the purchase of stock is credited to share capital.

(l) Earnings per share

Basic earnings per common share are computed by dividing earnings by the weighted average number of common shares outstanding for the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments, in accordance with new standards approved by the Canadian Institute of Chartered Accountants.

**Years ended June 30, 2002 and 2001**

**3. Business Combinations**

Pursuant to the reverse takeover ("RTO") transaction, effective April 24, 2001, ADC effected a stock consolidation of 1 share for each 10 shares of its issued and outstanding shares resulting in 1,526,269 common shares issued and outstanding to its shareholders, on April 24, 2001. ADC, the legal acquirer, issued 22,944,740 common shares for the acquisition of ADI at a deemed price of \$0.25 per share. The acquisition has been accounted for as a purchase transaction with ADI being the deemed acquirer as the transaction was a reverse takeover.

The carrying values of the assets and liabilities of ADC as at the effective date, April 24, 2001, are as follows:

|   |                     |
|---|---------------------|
| Other current assets  | \$ 3,843            |
| Current liabilities   | <u>(30,116)</u>     |
| Working capital deficiency  | (26,273)            |
| Capital assets  | 1,700               |
| Note payable to ADI   | <u>(250,000)</u>    |
| Net deficiency, attributed to the 1,526,269 common shares issued and outstanding prior to the RTO | <u>\$ (274,573)</u> |

The excess of consideration given over the fair value of the net assets has been reflected as a reduction of share capital, representing the cost to ADI of becoming a public company by effecting a RTO.

**4. Lease Termination**

Effective June 30, 2002, the Company entered into a lease termination agreement whereby it was released from the terms and conditions of a five-year property lease agreement for office and facility premises. The premises were never occupied by the Company, and as a result of the lease termination, pre-occupation costs (leasehold improvements and prepaid expenses) have been written-off in the current year. A summary of the costs expensed and lease termination exit costs are as follows:

|                           |                   |
|---------------------------|-------------------|
| Lease termination payment | \$ 205,000        |
| Pre-occupation costs      | 247,665           |
| Legal costs               | <u>5,000</u>      |
|                           | <u>\$ 457,665</u> |

In conjunction with the lease termination agreement, the landlords of the property agreed to subscribe for 240,000 common shares of the Company, at a price of \$0.50 per share, for gross proceeds of \$120,000. Both transactions were completed on July 16, 2002.

**5. Cash and Cash Equivalents**

|                                  | <b>2002</b>                | <b>2001</b>         |
|----------------------------------|----------------------------|---------------------|
| Cash (bank indebtedness) in bank | <b>\$ (62,465)</b>         | \$ 1,406,633        |
| Short term investments           | <b>1,908,713</b>           | 1,402,819           |
| Restricted investment            | <b>50,000</b>              | 50,000              |
|                                  | <u><b>\$ 1,896,248</b></u> | <u>\$ 2,859,452</u> |

The restricted investment is pledged as security with the bank against any overdrafts in the current account.

Years ended June 30, 2002 and 2001

**6. Capital Assets**

|                                | June 30, 2002     |                             |                        |                   |
|--------------------------------|-------------------|-----------------------------|------------------------|-------------------|
|                                | Cost              | Accumulated<br>Amortization | Write-off<br>of assets | Net book<br>value |
| Laboratory equipment           | \$ 175,634        | \$ 48,984                   | \$ -                   | \$ 126,650        |
| Computer software              | 184,254           | 102,602                     | -                      | 81,652            |
| Computer hardware              | 168,965           | 48,426                      | -                      | 120,539           |
| Office furniture and equipment | 46,949            | 12,331                      | -                      | 34,618            |
| Automotive                     | 13,898            | 5,338                       | -                      | 8,560             |
| Leasehold improvements (i)     | 204,826           | 9,163                       | 195,663                | -                 |
|                                | <b>\$ 794,526</b> | <b>\$ 226,844</b>           | <b>\$ 195,663</b>      | <b>\$ 372,019</b> |

|                                | June 30, 2001     |                             |                        |                   |
|--------------------------------|-------------------|-----------------------------|------------------------|-------------------|
|                                | Cost              | Accumulated<br>amortization | Write-off<br>of assets | Net book<br>value |
| Laboratory equipment           | \$ 148,074        | \$ 24,168                   | \$ -                   | \$ 123,906        |
| Computer software              | 120,637           | 35,658                      | -                      | 84,979            |
| Computer hardware              | 71,422            | 14,656                      | -                      | 56,766            |
| Office furniture and equipment | 24,960            | 7,342                       | -                      | 17,618            |
| Automotive                     | 9,897             | 1,650                       | -                      | 8,247             |
|                                | <b>\$ 374,990</b> | <b>\$ 83,474</b>            | <b>\$ -</b>            | <b>\$ 291,516</b> |

(i) Pursuant to a lease termination agreement, effective June 30, 2002, the Company has written off leasehold improvements, with a net book value of \$195,663 – refer to Note 4.

**7. Other Assets**

|                     | June 30, 2002     |                             |                   |
|---------------------|-------------------|-----------------------------|-------------------|
|                     | Cost              | Accumulated<br>amortization | Net book<br>value |
| Patents             | \$ 66,900         | \$ 5,389                    | \$ 61,511         |
| Licensed technology | 1                 | -                           | 1                 |
| Trademarks          | 13,236            | 1,305                       | 11,931            |
| Deferred charge (i) | 50,000            | 26,438                      | 23,562            |
|                     | <b>\$ 130,137</b> | <b>\$ 33,132</b>            | <b>\$ 97,005</b>  |

|                     | June 30, 2001    |                             |                   |
|---------------------|------------------|-----------------------------|-------------------|
|                     | Cost             | Accumulated<br>amortization | Net book<br>value |
| Patents             | \$ 9,392         | \$ 939                      | \$ 8,453          |
| Licensed technology | 1                | -                           | 1                 |
| Trademarks          | 3,379            | 338                         | 3,041             |
| Deferred charge (i) | 50,000           | 12,500                      | 37,500            |
|                     | <b>\$ 62,772</b> | <b>\$ 13,777</b>            | <b>\$ 48,995</b>  |

(i) A \$50,000 non-interest bearing unsecured employee loan was advanced during the year ended June 30, 2000. The loan is to be forgiven in the amount of \$12,500 for each of the next four years commencing May 19, 2001, provided that the employee remains in the employment of the Company. In the event that the employee leaves the Company's employment for any reason, the remaining balance of the loan which has not been forgiven shall become immediately repayable.

**Years ended June 30, 2002 and 2001**

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## **8. Related Party Transactions**

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In addition to the related party transactions described in other notes to the consolidated financial statements, the Company had the following transactions:

|                           |                   |                   |
|---------------------------|-------------------|-------------------|
| <u>(i) Employee Loans</u> | <u>2002</u>       | <u>2001</u>       |
| Share purchase loans      | <u>\$ 259,214</u> | <u>\$ 273,501</u> |

To facilitate officers and employees participation in the ownership of the Company, a director acquired 700,000 shares of the Company at a cost of \$0.50 per share (\$350,000) from BC Research Inc., a principal shareholder. The shares were converted to 980,000 post-RTO shares with an effective cost of \$0.36 per share, and are subject to escrow restrictions as explained in Note 11(b)(i). Officers of the Company purchased 693,800 of the post-RTO shares.

The officers and employees acquired the shares at the effective cost of \$0.36 and paid by cash (\$76,499) or through share purchase loans funded by the Company (\$273,501). The share purchase loans are repayable on April 24, 2004, can be repaid at any time during the term of the loans, and bear interest that is payable annually at the Canada Customs and Revenue Agency prescribed rate (2002 – 2.0%, 2001 – 6.0%). The outstanding loans are secured by pledges of the applicable shares. Loans totaling \$14,287 (2001 - \$Nil) were repaid during the current year.

- (ii) The Company paid \$14,018 (2001 - \$235,189) in consulting fees to companies controlled by senior officers for managerial services rendered to the Company in their capacity as officers of the Company.
- (iii) At June 30, 2001, the Company had a receivable of \$14,156 from BC Research Inc., a principal shareholder, which represented amounts owing from customers that had been collected by BC Research Inc. The balance outstanding has been received in full. The Company leased premises and equipment from BC Research Inc. and was provided administrative services for which the amounts charged were \$151,256 (2001 - \$108,986) and \$29,608 (2001 - \$25,216) respectively. The Company paid \$10,000 to BC Research Inc. as a fee to gain access to a workshop facility (2001 - \$10,000).
- (iv) On January 29, 2002, the Company completed a placement of 10,400,000 special warrants at price of \$0.50 per special warrant of which 296,443 of these warrants were issued to directors and officers of the Company.

All the related party transactions have been recorded at the agreed upon exchange amount. The exchange amounts agreed upon reflect the carrying values and approximate fair values of the services rendered.

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## **9. Capital Lease Obligations**

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The Company has entered into a capital lease for computer equipment with principal and interest payments of \$1,298 per month. This lease bears interest at 7% per annum and matures August 2003. The lease is secured by a charge on the computer equipment. The carrying value of assets under capital lease is \$27,210.

Years ended June 30, 2002 and 2001

### 9. Capital Lease Obligations – cont'd

Future lease payment obligations of the Company are as follows:

|  | 2002      | 2001 |
|--|-----------|------|
| Year ended June 30:                              |           |      |
| 2003   | \$ 15,578 | \$ - |
| 2004   | 2,596     | -    |
| Total minimum lease payments                     | 18,174    | -    |
| Amount representing interest                     | 1,851     | -    |
| Balance of obligations                           | 16,323    | -    |
| Current portion of capital lease obligations     | 13,748    | -    |
| Non-current portion of capital lease obligations | \$ 2,575  | \$ - |

### 10. Pension Contributions

After an employee has completed one year of service, the Company will contribute up to 5% of the employee's base salary to a self-directed registered retirement plan. The resultant pension contribution expense is recorded in the period that the employee services are rendered. The Company incurred pension contribution expenses of \$23,381 in 2002 (2001 - \$1,983).

### 11. Share Capital, Special Warrants and Stock Options

(a) Authorized

Unlimited common shares without par value

Unlimited preferred shares without par value, non cumulative, redeemable, and non voting

(b) Issued and outstanding common shares

| Class A Common Shares  | Number Pre RTO | Number Post RTO   | Amount               |
|--|----------------|-------------------|----------------------|
| Balance, June 30, 1999   | 2              | 2                 | \$ 2                 |
| Issued to acquire certain intellectual Properties                            | 5,199,998      | 7,279,998         | 1                    |
| Issued for cash pursuant to private placement                                | 1,794,500      | 2,512,300         | 1,795                |
| Issued for cash pursuant to private placement                                | 2,600,000      | 3,640,000         | 650,000              |
| Issued for services  | 100,000        | 140,000           | 25,000               |
| Balance, June 30, 2000   | 9,694,500      | 13,572,300        | \$ 676,798           |
| Issued for cash pursuant to private placement, net of issue costs of \$2,879 | 6,574,600      | 9,204,440         | 2,298,231            |
| Issued for services  | 120,000        | 168,000           | -                    |
| Balance before RTO (i)   | 16,389,100     | 22,944,740        | 2,975,029            |
| RTO transaction  | -              | 1,526,269         | (274,573)            |
| Share issue costs on RTO transaction   | -              | -                 | (248,038)            |
| Issued on exercise of options  | -              | 178,000           | 44,500               |
| Balance, June 30, 2001   | -              | 24,649,009        | \$ 2,496,918         |
| Issued on conversion of Special A Warrants (ii)(iv)                          | -              | 8,000,000         | 3,511,250            |
| Issued on conversion of Special B Warrants (iii)(iv)                         | -              | 10,400,000        | 5,000,195            |
| Issued on exercise of options  | -              | 266,700           | 66,675               |
| Private placement (v)  | -              | 240,000           | 120,000              |
| <b>Balance, June 30, 2002</b>  | <b>-</b>       | <b>43,555,709</b> | <b>\$ 11,195,038</b> |

**Years ended June 30, 2002 and 2001**

**11. Share Capital, Special Warrants and Stock Options – cont'd**

Issued and outstanding special warrants

|   | Number of<br>Special Warrants | Amount       |
|---|-------------------------------|--------------|
| Special warrants issued for cash (ii)                           | 8,000,000                     | \$ 3,600,000 |
| Less special warrants subscription receivable                   | -                             | (100,000)    |
| Balance, June 30, 2001  | 8,000,000                     | 3,500,000    |
| Special A Warrants received (ii)                                | -                             | 100,000      |
| Special A Warrants issue costs (ii)                             | -                             | (88,750)     |
| Special B Warrants issued for cash, net of issuance costs (iii) | 10,400,000                    | 5,000,195    |
| Less Special A and B Warrants converted to shares (iv)          | (18,400,000)                  | (8,511,445)  |
| <b>Balance, June 30, 2002</b>                                   | <b>-</b>                      | <b>\$ -</b>  |

- (i) 14,288,200 common shares were subject to escrow restrictions pursuant to a business combination (Note 3). There are 8,572,920 common shares subject to escrow restrictions as at June 30, 2002 (2001 – 12,859,380). 2,143,230 common shares will be released from escrow restrictions on each subsequent date that is 18, 24, 30, and 36 months from the issue date of April 24, 2001.
- (ii) On June 28, 2001 the Company completed a non-brokered placement of 8,000,000 Special A Warrants at a price of \$0.45 each for net proceeds of \$3,511,250 after deducting issuance costs of \$88,750. Each Special A Warrant entitled the holder to receive, at no additional cost, one common share.
- (iii) On January 29, 2002 the Company completed a non-brokered placement of 10,400,000 Special B Warrants at a price of \$0.50 each for net proceeds of \$5,000,195 after deducting estimated issuance costs of \$199,805. Each Special B Warrant entitled the holder to receive, at no additional cost, one common share.
- (iv) On February 5, 2002 the Company received a receipt for its final prospectus (dated January 31, 2002) from the British Columbia, Alberta, and Ontario Securities Commissions relating to the qualification of 8,000,000 Common Shares issuable upon the exercise of 8,000,000 Special A Warrants and 10,400,000 Common Shares issuable upon the exercise of 10,400,000 Special B Warrants, whereupon the Special A and B Warrants were exercised and converted into common shares.
- (v) Effective June 30, 2002, the Company entered into a private placement subscription agreement for 240,000 common shares of the Company, at a price of \$0.50 per share, for gross proceeds of \$120,000 in conjunction with a lease termination – refer to note 4. The private placement offering was completed on July 16, 2002.
- (c) Stock Options  
 In conjunction with the RTO, the Company received shareholders approval to adopt a Stock Option Plan (the "Plan"), for which up to 3,670,651 common shares can be reserved for issuance to executive officers and directors, employees and consultants. The exercise price of the options is determined by the Board of Directors estimate of the fair value of the common shares at the grant date. The options have a maximum term of five years and generally vest over a period of eighteen to twenty-four months. On December 7, 2001 the Company received shareholders' approval to increase the maximum number of stock options that may be issued under the terms of the stock option plan from 3,670,651 to 6,461,800. At June 30, 2002, 875,500 options are available for future grant under the Plan.

Years ended June 30, 2002 and 2001

**11. Share Capital, Special Warrants, and Stock Options – cont'd**

Stock option transactions for the respective periods and the number of stock options outstanding are summarized as follows:

|   | Number of<br>Optioned<br>Common<br>Shares # | Weighted<br>Average<br>Exercise<br>Price \$ |
|---|---|---|
| Balance, June 30, 2000  | -   | -   |
| Options granted   | 1,825,000                                   | 0.25  |
| Options cancelled   | (225,000)                                   | 0.25  |
| Options cancelled pursuant to RTO transaction                                   | (1,600,000)                                 | 0.25  |
| Options outstanding, April 24, 2001 attributable to pre RTO<br>ADC shareholders | 12,000                                      | 2.50  |
| Options granted April 25, 2001  | 3,316,000                                   | 0.25  |
| Options expired May 13, 2001  | (12,000)                                    | 2.50  |
| Options cancelled May 15, 2001  | (120,000)                                   | 0.25  |
| Balance, June 30, 2001  | 3,196,000                                   | 0.25  |
| Options cancelled on August 13, 2001  | (56,000)                                    | 0.25  |
| Options granted on August 20, 2001  | 427,000                                     | 0.44  |
| Options granted on November 5, 2001   | 247,000                                     | 0.45  |
| Options exercised on November 15, 2001  | (20,000)                                    | 0.25  |
| Options granted on November 26, 2001  | 112,000                                     | 0.50  |
| Options granted on January 17, 2002   | 110,000                                     | 0.50  |
| Options granted on January 22, 2002   | 50,000                                      | 0.61  |
| Options granted on February 12, 2002  | 85,000                                      | 0.61  |
| Options cancelled on February 28, 2002  | (29,500)                                    | 0.25  |
| Options cancelled on March 5, 2002  | (21,000)                                    | 0.25  |
| Options exercised on March 5, 2002  | (88,500)                                    | 0.25  |
| Options granted on March 7, 2002  | 20,000                                      | 0.71  |
| Options exercised on March 12, 2002   | (112,000)                                   | 0.25  |
| Options exercised on March 27, 2002   | (37,000)                                    | 0.25  |
| Options granted on March 11, 2002   | 1,300,000                                   | 0.73  |
| Options granted on April 12, 2002   | 30,000                                      | 0.94  |
| Options granted on May 1, 2002  | 145,000                                     | 0.80  |
| Options cancelled on May 1, 2002  | (20,000)                                    | 0.44  |
| Options exercised on June 10, 2002  | (9,200)                                     | 0.25  |
| Options expired on June 10, 2002  | (9,200)                                     | 0.25  |
| Balance, June 30, 2002  | 5,319,600                                   | 0.43  |
| <b>Broker Financial Advisory Options:</b>                                       |   |   |
| Balance, June 30, 2001 and June 30, 2002  | 72,000                                      | 0.25  |
| <b>Total Options Outstanding, June 30, 2002</b>                                 | <b>5,391,600</b>                            | <b>0.43</b>                                 |

Years ended June 30, 2002 and 2001

**11. Share Capital, Special Warrants, and Stock Options – cont'd**

As at June 30, 2002 stock options and broker stock options outstanding and exercisable are as follows:

| Expiry date                                  | Number of<br>optioned common<br>shares outstanding | Number of<br>optioned common<br>shares exercisable | Exercise price |
|--|--|--|----------------|
| <b>Stock Options</b>                         | #  | #  | \$             |
| September 30, 2002                           | 10,000   | 3,333  | 0.44           |
| December 31, 2002                            | 110,000  | 55,000   | 0.50           |
| April 25, 2006                               | 2,813,600  | 2,105,617  | 0.25           |
| August 20, 2006                              | 397,000  | 132,334  | 0.44           |
| November 5, 2006                             | 247,000  | 82,333   | 0.45           |
| November 26, 2006                            | 112,000  | 37,333   | 0.50           |
| January 22, 2007                             | 50,000   | 16,667   | 0.61           |
| February 12, 2007                            | 85,000   | 28,333   | 0.61           |
| March 7, 2007                                | 20,000   | 6,667  | 0.71           |
| March 11, 2007                               | 1,300,000  | 433,333  | 0.73           |
| April 12, 2007                               | 30,000   | 10,000   | 0.94           |
| May 1, 2007                                  | 145,000  | 48,333   | 0.80           |
| <b>Total Stock Options</b>                   | <b>5,319,600</b>                                   | <b>2,959,283</b>                                   |                |
| <b>Broker Financial Advisory<br/>Options</b> |  |  |                |
| October 25, 2002                             | 72,000   | 72,000   | 0.25           |
| <b>Total Options</b>                         | <b>5,391,600</b>                                   | <b>3,031,283</b>                                   |                |

**12. Income Taxes**

As at June 30, 2002, the Company has unclaimed scientific research and experimental development expenditures of \$2,592,663 that are available to offset future taxable income. These expenditures are available for indefinite carry forward. In addition, the Company also has \$5,737,650 of non-capital tax losses that are available for carry forward to offset future taxable income, and \$1,163,418 of investment tax credits that are available to offset future income taxes payable, that expire as follows:

|      | Non-Capital Losses  | Investment tax credits |
|------|---------------------|------------------------|
| 2003 | \$ 170,763          | \$ -                   |
| 2004 | 292,271             | -                      |
| 2005 | 591,019             | -                      |
| 2006 | 207,151             | -                      |
| 2007 | 1,016,303           | -                      |
| 2008 | 577,205             | 29,508                 |
| 2009 | 2,882,938           | 18,534                 |
| 2010 | -                   | 213,160                |
| 2011 | -                   | 109,180                |
| 2012 | -                   | 793,036                |
|      | <b>\$ 5,737,650</b> | <b>\$ 1,163,418</b>    |

The Company also has net temporary differences, relating primarily to capital assets of \$480,662, which may be used to offset future taxable income.

**Years ended June 30, 2002 and 2001**

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## **12. Income Taxes – cont'd**

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The ability of the Company to utilize the losses and other tax balances carried forward in the future is not reasonably assured and therefore has not been recognized in the financial statements. The effective tax rate for the Corporation is approximately 42%. The difference between the effective rate and the actual rate of nil% is attributable to the fact that no future tax asset has been recorded for available loss carry forwards as their ultimate utilization is uncertain.

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## **13. Projects Under Development**

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The Company is commercializing its technology for hybrid electric vehicle control systems for commercial vehicles, such as postal and courier step-vans. Its activities can be categorized into the following projects:

### **Hybrid Vehicle Energy Management Research Project**

This project addresses the ongoing refinement and development of adaptive energy management systems for hybrid vehicles – the Company's core technology.

The Company incurred \$114,863 in research and development expenses for the year ended June 30, 2002 (year ended June 30, 2001 - \$73,456) related to the Hybrid Vehicle Energy Management Research Project. No costs have been deferred or capitalized and no sales revenue has been earned from this project.

### **Series Hybrid Electric Vehicle Medium-Duty ("G1") Development Project**

The Company's current focus is on development of a series hybrid powertrain package for a commercial vehicle in the weight range 8,500 – 14,000 lbs GVW (gross vehicle weight), and demonstration of the proprietary smart energy management system. The vehicles in this class typically deliver urban mail and packages and are also used in small shuttle bus applications. The Design and Engineering (Initial prototype) phase of this project was completed during the year ended June 30, 2002 and the second phase, Development Testing (Engineering prototype), commenced.

The Company incurred \$2,620,319 in research and development expenses for the year ended June 30, 2002 (year ended June 30, 2001 - \$1,160,568) related to this project. No costs have been deferred or capitalized and no sales revenue has been earned from this project.

### **Series Hybrid Electric Vehicle Light-Duty ("G2r") Development Project**

The Company also intends to apply its technology to the development of a series hybrid powertrain package for a commercial vehicle in the weight range 5,000 – 8,500 lbs GVW. The vehicles in this class typically deliver urban mail, small packages and can also be used in taxi applications. This project is in the first phase, Design and Engineering (Initial prototype).

The Company incurred \$258,081 in research and development expenses for the year ended June 30, 2002 (year ended June 30, 2001 - \$nil) related to this project. No costs have been deferred or capitalized and no sales revenue has been earned from this project.

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**Years ended June 30, 2002 and 2001**

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### **13. Projects Under Development – cont'd**

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#### **Third Party Development Costs**

In January 2002, the Company entered into a strategic alliance agreement with Hydro-Québec CapiTech Inc. ("CapiTech") and its wholly-owned subsidiary Technologies M4 Inc. ("TM4"). In accordance with the terms of the agreement, the Company paid \$665,000 to TM4 for the development of a generator and inverter for the Company's powertrains.

#### **Development Cost Contribution Agreements**

On March 31, 2002 the Company entered into a \$9 million Research and Development agreement with the Government of Canada, through its Technology Partnerships Canada ("TPC") program. The agreement provides for a 26.6% contribution by TPC towards specified expenditures in respect of the research and development of the G1 and G2r series hybrid electric powertrains, up to a maximum reimbursement of \$9 million. The Company has reimbursable costs claims amounting to \$567,626 in the year ended June 30, 2002. This amount has been recorded as a credit to research and development expenses on the income statement, and a corresponding balance sheet receivable asset has been established. Cost reimbursement claims are subject to review by TPC and to disbursement conditions based on financing amounts to be raised by Azure.

During 2001, the Company entered into an agreement with the National Research Council Canada ("NRC") whereby the NRC agreed to contribute up to a maximum of \$214,000 for costs incurred in the direct performance of certain specified activities associated with the development of an adaptive energy management system for hybrid electric delivery vehicles. Cost reimbursement claims are subject to review by the NRC. The Company expended \$29,799 (2001 - \$164,225) in reimbursable costs during the 2002 fiscal year. This amount was recorded as a credit to research and development expenses.

Net contributions from government assistance and investment tax credits were \$579,501 in 2002 (2001 - \$164,225) after allowing for a debit adjustment of \$17,924 in respect of investment tax credits recorded in previous years.

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### **14. Commitments**

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- (a) The Company has committed to future lease payments for its premises and certain equipment requiring minimum payments in future periods as follows:

|      |                   |
|------|-------------------|
| 2003 | \$ 133,000        |
| 2004 | 83,000            |
| 2005 | 10,000            |
|      | <u>\$ 226,000</u> |

Included in the \$226,000 is a \$99,000 commitment to BC Research Inc. for premise and equipment leases.

- (b) Pursuant to contractual agreement with National Research Council 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 \$296,242.

**Years ended June 30, 2002 and 2001**

**14. Commitments – cont'd**

- (c) Pursuant to a contractual agreement with Technology Partnerships Canada, the Company is required to make royalty payments equal to the greater of 0.28% of yearly gross sales or in accordance with a repayment schedule, with repayment amounts ranging from \$0 to \$1,327,507, provided that certain minimum sales levels are achieved. The obligation to make royalty payments commences on July 1, 2003 and continues until the earlier of June 30, 2018 or until a cumulative payment ceiling of \$20,532,400 is reached.

**15. Net Changes in Non-Cash Operating Working Capital**

|  | <b>Year ended June 30</b> |                  | Cumulative<br>Since Inception |
|--|---------------------------|------------------|-------------------------------|
|  | <b>2002</b>               | 2001             |                               |
| Investment tax credits receivable        | \$ 147,341                | \$ (72,341)      | \$ -                          |
| Accounts receivable                      | 99,066                    | (225,267)        | (260,099)                     |
| Contributions receivable                 | (492,401)                 | -                | (492,401)                     |
| Prepaid expenses                         | 19,039                    | (73,000)         | (53,961)                      |
| Accounts payable and accrued liabilities | (240,868)                 | 425,539          | 386,066                       |
|  | <b>\$ (467,823)</b>       | <b>\$ 54,931</b> | <b>\$ (420,395)</b>           |

**16. Subsequent Events**

- (a) Effective July 1, 2002, the Company 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, ranging from one to three 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.
- (b) Effective October 18, 2002, the Company amended the terms of its strategic alliance agreement with CapiTech and TM4 thereby deleting certain terms relating to contingent future commitments and agreed in principle to direct its collaborative agreement with TM4 to include the practical in-service demonstration of the TM4 technology in specified Azure prototype hybrid electric vehicles.
- (c) On August 19, 2002, the Company issued 20,000 consultant stock options exercisable at \$0.45 per share, expiring August 19, 2007.

**Years ended June 30, 2002 and 2001**

**Research and Development Expenses**

Breakdown by major category:

|  | Year ended June 30  |                     | Cumulative<br>Since Inception |
|--|---------------------|---------------------|-------------------------------|
|  | 2002                | 2001                |                               |
| Salaries & benefits  | \$ 1,473,807        | \$ 651,949          | \$ 2,353,958                  |
| Recruitment costs  | 91,636              | 571                 | 91,636                        |
| Product development costs                                    | 502,263             | 524,258             | 1,108,699                     |
| Third party product development costs                        | 665,000             | -                   | 665,000                       |
| Travel expenses  | 143,123             | 28,975              | 180,627                       |
| Miscellaneous costs  | 99,510              | 28,272              | 142,343                       |
|  | <b>\$ 2,975,339</b> | <b>\$ 1,234,025</b> | <b>\$ 4,542,263</b>           |
| Less: Government contributions<br>and Investment tax credits | <b>579,501</b>      | <b>164,225</b>      | <b>743,726</b>                |
|  | <b>\$ 2,395,838</b> | <b>\$ 1,069,800</b> | <b>\$ 3,798,537</b>           |

**Selling and Marketing Expenses**

Breakdown by major category:

|                                     | Year ended June 30 |                   | Cumulative<br>Since Inception |
|-------------------------------------|--------------------|-------------------|-------------------------------|
|                                     | 2002               | 2001              |                               |
| Salaries & benefits                 | \$ 403,535         | \$ 67,400         | \$ 470,935                    |
| Consulting fees                     | 84,494             | 70,800            | 155,294                       |
| Telephone, fax and internet charges | 19,817             | -                 | 19,817                        |
| Travel expenses                     | 168,137            | 39,832            | 207,969                       |
| Miscellaneous costs                 | 345                | -                 | 345                           |
| Marketing/ advertising and PR       | 80,013             | 4,153             | 84,166                        |
|                                     | <b>\$ 756,341</b>  | <b>\$ 182,185</b> | <b>\$ 938,526</b>             |

**General and Administrative Expenses**

Breakdown by major category:

|   | Year ended June 30  |                   | Cumulative<br>Since Inception |
|---|---------------------|-------------------|-------------------------------|
|   | 2002                | 2001              |                               |
| Salaries & benefits                       | \$ 701,641          | \$ 234,273        | \$ 1,003,977                  |
| Consulting fees                           | 319,230             | 136,602           | 498,228                       |
| Office supplies                           | 30,300              | 35,662            | 68,125                        |
| Recruitment costs                         | 55,546              | 31,910            | 87,455                        |
| Contract services                         | 29,608              | 25,216            | 66,824                        |
| Travel expenses                           | 158,553             | 84,144            | 247,309                       |
| Audit and tax services                    | 36,106              | 58,815            | 94,921                        |
| Legal fees                                | 137,792             | 84,573            | 238,750                       |
| Regulatory filing and transfer agent fees | 37,466              | 19,921            | 57,387                        |
| Telephone, fax and internet costs         | 78,298              | 10,587            | 78,298                        |
| Miscellaneous costs                       | 68,308              | 4,536             | 119,067                       |
|   | <b>\$ 1,652,848</b> | <b>\$ 726,239</b> | <b>\$ 2,560,341</b>           |

## Directors

**D. Campbell Deacon, Chairman, Chief Executive Officer and Director**, has been Chairman and Chief Executive Officer of the Company (or predecessors) since October, 2000. From 1994 to 1999 he was the President of UTS Energy Corporation. From 1986 to 1994 he was Chairman and CEO of Deacon Barclays de Zoete Wedd, an international investment banking firm. Mr. Deacon was Vice-Chairman and then Chairman of the Investment Dealers Association of Canada from 1991-1993. Mr. Deacon is currently a director of the following public companies: CPI Plastics Group (CPI: TSX) and UTS Energy Corporation (UTS: TSX).

**David E. Deacon, President, Chief Operating Officer and Director**, has been President and Chief Operating Officer of the Company since January, 2001. Mr. D. Deacon, who won a Canadian racing championship in a Porsche and then drove for the BMW factory team at the 24 hours of Le Mans, became the General Manager of Porsche Canada in 1983. He then started Deacon Day Advertising in 1988 with BMW as his major client. After building the company into a top 30 Canadian agency, he sold it to the Interpublic Group, a NYSE listed company, in 1993. For the next several years, he ran another major Canadian advertising company before starting Investment Profile Inc., a business specializing in building brands. He is familiar with corporate affairs and government relations through long involvement in politics including a term as President of the Ontario Liberal Party.

**J. Brian Aune, Director**, has been Chairman of St. James Financial Corporation since 1989. From 1980 to 1990, Mr. Aune served as Chairman and Chief Executive Officer of Nesbitt, Thomson Inc. and from 1982 to 1983 Mr. Aune served as Chairman of the Investment Dealers Association of Canada. Mr. Aune is currently a director of the following public companies: Teck Cominco Limited (TEK: TSX) and Taiga Forest Products Ltd. (TFP: TSX).

**Nicholas O. Brigstocke, Director**, has been the European Chairman of Moore Clayton & Co. since June, 2001 and is Chairman of its advisory board. Mr. Brigstocke served as Chairman, Equity Capital Markets of Credit Suisse First Boston Ltd. from 1998 until his retirement in May 2001. Prior to joining Credit Suisse First Boston, which occurred when Credit Suisse First Boston purchased the equity and advisory business of Barclays de Zoete Wedd (BZW) at the beginning of 1998, he was Chairman and Managing Director of BZW's UK corporate broking business. Prior to that time, he was head of the Institutional Equity sales team and a member of the Equity Management Committee at BZW. He is a non-executive director of Turbo Genset Inc. (TGN: TSX), Dynamic Digital Depth Ltd., and Bridgewell Ltd.

**Thomas N. Davidson, Sr., Director**, has been Chairman of Quarry Hill Group, a private investment holding partnership, since 1989, and Chairman of NuTech Precision Metals since 1990. During Mr. Davidson's career, he has been a principal owner of several U.S., Canadian, and European enterprises and a director of numerous Canadian and U.S. companies. He is currently a director of Derlan Industries Limited (DRL: TSX), HMI Industries Inc. (HMII: OTC), MDC Corporation Inc. (MDZ.A: TSX) and TLC Laser Eye Centres Inc. (TLC: TSX) (TLCV: NASDAQ). He was International President of the Young Presidents Organization, and Past International President of the World Presidents Organization. Mr. Davidson was recognized as Canadian Entrepreneur of the Year in 1979, and Plastic Industry Man of the Year in 1985.

**Ray A. Geddes, Director**, has been President and Chief Executive Officer of General Energy Technologies Inc. since October, 2000. He has served as Treasurer of the Electric Vehicle Association of the Americas and a Director of the International Institute for Electric Transportation. From 1982 to 1999, he was Chairman and Chief Executive Officer of Unique Mobility Inc. Mr. Geddes holds a Master of Business Administration and a Juris Doctorate from the University of Michigan.

**Directors – cont'd.**

**Jean-5HQp Marcoux, Director**, has been President and Chief Executive Officer of Hydro-Québec CapiTech Inc. and General Manager, Technology Marketing and Affiliates of Hydro-Québec since 1997. Prior to that time, in the private sector, he held positions related to business development with GEC-Alstom and Asea Brown Boveri. At the head of his own company, he acted as an Advisor in the energy sector. From 1969 to 1979, he occupied several positions at Hydro-Québec's Research Institute (IREQ). He has also completed a number of assignments for Hydro-Québec International. He has been actively involved in several organizations as executive, president or member of the board. He holds a Bachelor and a Master of Applied Sciences from the École Polytechnique.

**Dennis A. Sharp, Director**, has been the Chairman and Chief Executive Officer of UTS Energy Corporation (UTS: TSX) since 1998. He is a director of several companies including EnCana Corporation (ECA: TSX), BachTech Enviromet Corporation (YBA: TSX Venture), and Command Drilling Corporation (CDZ: TSX). He has served as Governor of the Canadian Association of Petroleum Producers (CAPP) from March 1994 to July 1997, Vice Chairman of CAPP from 1995 to 1996 and Chairman from 1996 to 1997. He is a geological engineer and he founded CS Resources Ltd. in 1984, which he led until its acquisition in July 1997 by Pan Canadian Petroleum Ltd. In 1993 CS Resources received the Alberta Science and Technology award for outstanding commercial achievement. In 1997 Mr. Sharp was honoured as one of Canada's Master Entrepreneurs.

**Officers**

**Wesley M. Arnold, Vice-President, Vehicle Design**. Mr. Arnold joined Azure on July 30, 2001 from Western Star Trucks where he spent nine years. His most recent role at Western Star was that of Manager of Body Engineering. In this role he managed product development of cab and sleeper structures, interiors and systems (including electrical) on heavy class 8 trucks. Other roles at Western Star included project engineering manager, group leader for cab development, and design leader for the Star Light Sleeper program. Mr. Arnold also invented a unique cab-sleeper mounting system for class 8 trucks. For seven years prior to joining Western Star Mr. Arnold gained experience in lightweight structures and systems in the Canadian Aircraft industry. He was employed in stress, structures and design positions at Bristol Aerospace, Boeing de Havilland, and Northwest Industries division of CAE. Mr. Arnold holds a Bachelor of Science degree in Aerospace Engineering from the University of Michigan as well as degrees from the Southern Alberta Institute of Technology (AET & MET).

**Felicia B. Bortolussi, Corporate Secretary**, has been Corporate Secretary since April, 2002. Ms. Bortolussi is a corporate finance lawyer with the Calgary office of Heenan Blaikie LLP, where she has been practicing since October 2001. Prior to that, Ms. Bortolussi practiced with a corporate finance boutique law firm in Calgary from 1996 to 2001, and with a full service Bay Street law firm from 1993 to 1995. Ms. Bortolussi has advised both emerging and established companies on corporate commercial and securities law matters ranging from public and private equity and debt financings, corporate reorganizations, securities regulatory compliance, shareholder disputes and corporate governance. She is a member of the Canadian Bar Association, the Law Society of Upper Canada and the Law Society of Alberta.

**Gregory P. Francis, Vice-President, Finance and Chief Financial Officer**, has been Vice-President, Finance since February, 2002 and Chief Financial Officer since September, 2001. Mr. Francis has over 20 years of experience in international financial management and business operations. Before joining Azure he held the position Vice-President, Operations West at Kinacor – a division of Wajax Limited, a Canadian company listed on the Toronto Stock Exchange. From 1995 to 1998, he served as Corporate Controller for Wajax Limited. Prior to coming to Canada in 1995, Mr. Francis was European Controller of Pepe Group Plc, an international branded clothing company based in London, England. Mr. Francis is designated as a Chartered Accountant in South Africa and served seven years in public accounting practice with KPMG in Durban, South Africa and London, England. He is a member of Financial Executives International and the South African Society of Chartered Accountants.

**Officers – cont'd.**

**Steven K. Glaser, Vice-President, Corporate Affairs.** Mr. Glaser joined Azure in August, 2001 from Seymour Capital, a company he founded in December of 1997 to provide seed investment capital and business development consultation to start-up businesses. Mr. Glaser also managed a small portfolio of private investment funds, trading in the North American equity and option markets. Prior to Seymour Capital, Mr. Glaser spent eight years with the Royal Bank in various customer service and consulting positions. His last position held was that of Human Resource software consultant. In this role Mr. Glaser gave seminars to Royal Banks corporate clients regarding systems migration. During his tenure with the bank he completed a Bachelor of Administrative Studies degree at York University, graduating in 1996 and a Master of Business Administration degree at Wilfred Laurier University, Waterloo, graduating in 1997.

**Ronald V. Iacobelli, Vice-President, Strategic Development.** Mr. Iacobelli joined Azure on April 12, 2001, from Ballard Power Systems where he developed and led a supplier management program. Prior to that, Mr. Iacobelli spent seven years (1993 to 1999) with Ford Motor Company. At Ford his last position held was that of Supply Chain Manager; he previously held the positions Chassis System Engineer and Electrical Systems Engineer for the Crown Victoria and Grand Marquis car lines. His experience includes exposure to all automotive systems with an emphasis on quality, manufacturing, process development and supplier management. Prior to joining Ford, Mr. Iacobelli was a Thermal Station Engineer with Ontario Hydro. He has a Bachelor of Applied Science degree in Mechanical Engineering from the University of Windsor and holds the P. Eng. designation in Ontario.

**James R. Ireton, Vice-President, Product Development.** Mr. Ireton joined Azure on July 16, 2001 from Ford Motor Company where he led program teams throughout the design and development of powertrain systems for the Explorer and F-Series truck product lines. Mr. Ireton spent eight years (1993 to 2001) at Ford Motor Company as Powertrain Team Leader, Design & Release Engineer, and Engine Calibration Engineer. His experience includes all phases of the Ford product development process from project kick-off through product launch. He has a Bachelor of Science degree in Electrical Engineering from the Colorado School of Mines, a Bachelor of Science degree in Mechanical Engineering from the University of Missouri, and a Master of Science degree in Engineering from Purdue University.

**Advisory Board**

The Advisory Board is chaired by **Dr. Nigel P. Fitzpatrick**, a founder of Azure Dynamics, whose past roles include being a technical director of Alcan International Ltd. where he started Alupower Canada Ltd (now Fuel Cells Technology Inc. – FCT on TSX Venture Exchange) and was also a board member of Alupower-Chloride Ltd., a joint venture between Alcan and the Hawker Battery Group. Dr. Fitzpatrick, who graduated from Imperial College, is a recognized expert consultant in transportation, climate change, battery and fuels.

In addition to Dr. Fitzpatrick the members of the Advisory Board are:

**Professor Colin Besant** is President and Chief Executive Officer of Turbo Genset Inc. Since 1989, he has been Professor of Computer-Aided Manufacture at Imperial College, where he leads a large research section in the field of Advanced Manufacturing Technology supported by such organizations as GEC-Marconi, Rolls-Royce Plc and the United Kingdom Atomic Energy Authority. In the early part of his career he worked on pressurized water reactor design for nuclear submarines for Rolls-Royce and associated companies, following which he joined the UKAEA as a Senior Scientific Officer. He took up his first post at Imperial College in 1963. Professor Besant has been involved in the establishment of a number of high technology companies in the fields of computer-aided design, numerical control and robotics.

**Advisory Board – cont'd.**

**Professor C.C. Chan** is presently the Honda Chair of Engineering and Head of Department of Electrical & Electronic Engineering of the University of Hong Kong, President of the Hong Kong Institution of Engineers, and President of the World Electric Vehicle Association. Professor Chan was awarded an Honorary Doctor of Science degree and a Fellow of The Institute of Electrical and Electronics Engineers (USA) in 1992 for his prominent contribution to modern electric drives and electric vehicles. He is a Fellow of the Royal Academy of Engineering, UK and the First Academician of the Chinese Academy of Engineering in Hong Kong. He is also a Fellow of the Ukraine Academy of Engineering Sciences, the Hong Kong Academy of Engineering Sciences and the Institution of the Electrical Engineers, UK. He has had 11 years industrial experience and 29 years academic experience. He has been serving as Visiting Professor or Honorary Professor of a number of well known universities around the world, including UC Berkeley in 1989, and MIT in 1995. He served as General Chairman and delivered keynote speeches at a number of leading international conferences. He has published over 200 technical papers and served as Guest Editor of IEEE Transactions. He founded the International Research Centre for Electric Vehicles in 1986 and was elected as one of the three wise men in electric vehicle technology in 1990.

**Piotr Drozd**, Azure's founding Vice-President of technology, has many years of involvement in hybrid electric vehicles which led to the identification of the importance of "smart energy management." Mr. Drozd is experienced in heavy-duty equipment, transit bus technology, hybrid propulsion, energy management and vehicle emissions. He was a project engineer at Ortech Corporation (1990 to 1995) involved in contract research and development in the area of computer-aided engineering. Mr. Drozd was involved in the conceptual phase of the hybrid Orion bus development, the first hybrid vehicle commercially sold in North America, and has been the principal researcher for several projects related to the implementation of hybrid buses in Canada. As a senior engineer at BC Research's (BCR) transportation group (1995 to 2000), Mr. Drozd led the technical development of an intelligent energy management system for hybrid vehicles, which resulted in two U.S. patents granted to BCR/Azure in 1999 and 2001. Mr. Drozd obtained his degree at Warsaw Technical University.

**Professor Michel Gou**, Professor at the École Polytechnique in Montreal. Professor Gou is past head of the section of Design of Machines of the mechanical department of engineering. He consults to industry and teaches courses on elements of machines and design. His research and consulting relates especially to subjects concerning the car industry (road safety, brakes and combustion). He has been a member of the Research Center on Transport and has directed, for more than twenty years, the road safety team of the Polytechnic School. Professor Gou was involved in the setting up and training of specialists at the Transport Canada Motor Vehicle Test Center in Blainville, Quebec. His many publications include work on conventional and natural gas engines. His consulting company employs more than nine people and he has directed many studies for industry and government.

**Dr. Michael Heffring**, is a former tenured Associate Professor of Marketing at the University of Calgary teaching marketing strategy courses in the MBA faculty for 10 years, until 1988. Dr. Heffring has also acted as a consultant to numerous companies such as Telus, Petro-Canada, Safeway, and General Motors. In 1980 he started a marketing research company in Calgary which grew to be the largest research company in Alberta. A 50% interest in the company was sold to the Environics Research Group of Toronto, Canada's largest privately held research company. Currently he holds the position of President, Environics West. Dr. Heffring's focus is on integrating customer databases to feed on-line and off-line marketing programs using Customer Relationship Management (CRM) software. He co-founded Ceres Integrated Solutions, in Raleigh, North Carolina. This company specialized in the development of CRM software. Clients included Blockbuster Entertainment, Wal-Mart, JC Penney, Eddie Bauer, Federated Department Stores (Bloomingdales, Bon Marche, etc.), as well as other major US retailers. The company was sold to NCR Corp. in April of 2000. The Ceres CRM software is now the basis for NCR's global CRM solution.

**Advisory Board – cont'd.**

**Michael T. McCabe** was with Ford Motor Company for 30 years in marketing, sales, production programming, and finance in addition to other activities in the automotive industry. He has devoted more than six years specifically to alternative fuel vehicles. In 2001, Mr. McCabe was Marketing Manager for TH!NK Technologies, the organization within Ford Motor Company that is pioneering development of fuel cell and electric vehicles. His chief focus was to ensure that TH!NK Technologies vehicles and advanced powertrains reflected the requirements of customers by linking TH!NK engineers with the "Voice of the Customer", a process for conducting market research to identify customer demands and integrating those demands into future products. Mr. McCabe has experience in both new and established product lines – launching the new Ford Probe in 1989 and implementing marketing plans for the Ford Thunderbird and Mustang brands. Over the past several years, he has developed the marketing strategy for the Ford Ranger EV and the 2004 Ford Escape hybrid electric sport utility vehicle, as well as defined Ford Motor Company's new TH!NK brand.

**Roy W. Poolton** is presently an independent consultant on manufacturing to Inalfa UK, Fiat, the UK Ministry of Defence, the Canadian Department of Defence, Bosch, Penman Specialist Vehicles and Brambles. At the Rover group he held various management positions including Project Trials Manager for the M.O.D., Product Control Manager-Projects, New Products Manager, and Executive Engineer (Group Quality). As Model Manager he participated in the introduction of the Rover 800. This included periods in Japan setting up production at the Honda Sayama plant and agreeing combined quality standards. At Land Rover he was Product Manager. Previously he was with Marshall Specialist Vehicles as General Manager where there were various projects from commercial vehicles to ambulances.

**Edwin O. Riddell** is a Director of Enova Systems. Since 1999, Mr. Riddell has been President of CR Transportation Services, a consultant to the electric vehicle industry. From 1991 to 1999, Mr. Riddell was Product Line Manager of the Transportation Business Unit at the Electric Power Research Institute, and from 1985 until 1990, he served with the Transportation Group, Inc. as Vice President, Engineering, working on electric public transportation systems. From 1979 to 1985, he was Vice President, General Manager and COO of Lift-U, Inc., the leading manufacturer of handicapped wheelchair lifts for the transit industry. Mr. Riddell has also worked with Ford, Chrysler, and General Motors in the area of auto design, and has worked as a member of senior management for a number of public transit vehicle manufacturers. Mr. Riddell served as a member of the American Public Transportation Association's (APTA) Member Board of Governors for over 15 years, and has served on APTA's Board of Directors. Mr. Riddell has also been one of the Managing Partners of the U.S. Advanced Battery Consortium.

## Corporate Information

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Tel: 416-367-0220  
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