Azure Dynamics Corporation
(A Development Stage Enterprise)
Unaudited Interim Consolidated Financial Statements
For the six months ended June 30, 2003

CONTENTS

Azure Dynamics Corporation
(A Development Stage Enterprise)

Consolidated Interim Balance Sheets

As at	June 30 2003 (Unaudited)	December 31 2002 (Audited)	June 30 2002 (Audited)
ASSETS			
Current			
Cash and cash equivalents	**$ 432,974**	$ 1,030,594	$ 1,896,248
Accounts receivable	**61,714**	28,253	68,327
Contributions receivable	**72,680**	264,455	567,626
Prepaid and other expenses	**41,174**	13,320	53,961
	608,542	1,336,622	2,586,162
Employee loans	**257,429**	259,214	259,214
Capital assets	**212,663**	276,036	372,019
Other assets	**101,286**	97,992	97,005
	$ 1,179,920	$ 1,967,864	$ 3,314,400
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities	**$ 372,125**	$ 347,313	$ 442,625
Deferred sponsorship contributions	**527,363**	-	-
Obligations under capital leases	**2,575**	9,796	13,748
	902,063	357,109	456,373
Obligations under capital leases	**-**	-	2,575
	902,063	357,109	458,948
Shareholders' equity			
Share capital	**11,813,905**	11,788,905	11,195,038
Special warrants	**90,000**	90,000	-
Deficit	**(11,626,048)**	(10,268,150)	(8,339,586)
	277,857	1,610,755	2,855,452
	$ 1,179,920	$ 1,967,864	$ 3,314,400

Approved on behalf of the Board:

"D. Campbell Deacon" Director

"J. Brian Aune" Director

Azure Dynamics Corporation
(A Development Stage Enterprise)

Unaudited Consolidated Interim Statements of Operations and Deficit

	For the three months ended June 30		For the six months ended June 30	
	2003	2002***	**2003**	2002***
Revenue				
Other income	**$ 7,674**	$ 16,592	**$ 13,850**	$ 32,985
Expenses				
Research and development, net*	**58,933**	431,850	**340,122**	1,154,786
Selling and marketing	**151,948**	287,898	**293,765**	451,833
General and administrative	**275,868**	495,675	**537,868**	957,328
Rent	**56,843**	130,882	**113,836**	283,990
Amortization	**43,265**	63,176	**86,157**	83,355
	586,857	1,409,481	**1,371,748**	2,931,292
Net loss for the period before other items	**(579,183)**	(1,392,889)	**(1,357,898)**	(2,898,307)
Lease termination	**-**	457,665	**-**	457,665
Net loss for the period	**(579,183)**	(1,850,554)	**(1,357,898)**	(3,355,972)
Deficit, beginning of period	**(11,046,865)**	(6,489,032)	**(10,268,150)**	(4,983,614)
Deficit, end of period	**$ (11,626,048)**	$ (8,339,586)	**$ (11,626,048)**	$(8,339,586)
Earnings per share **	**(0.01)**	(0.04)	**(0.03)**	(0.07)
Weighted average number of shares	**45,031,042**	43,308,430	**45,019,716**	38,843,397

* *See Supplementary Information – page 10.*
** *No fully diluted earnings per share have been disclosed, as these would be anti dilutive.*
*** *Certain comparative figures have been restated to conform with the current period presentation.*

Azure Dynamics Corporation
(A Development Stage Enterprise)

Unaudited Consolidated Interim Statements of Cash Flows

	For the three months ended June 30		For the six months ended June 30	
	2003	2002	**2003**	2002
Cash flows from operating activities				
Operations				
Net loss for the period	**$ (579,183)**	$ (1,850,554)	**$ (1,357,898)**	$ (3,355,972)
Adjustment for:				
Amortization	**43,265**	63,176	**86,157**	83,355
Lease termination	-	457,665	-	457,665
Shares issued in lieu of non-executive directors fees	**6,250**	-	**12,500**	-
Bad debt write-off	-	-	**1,786**	-
Changes in non-cash working capital items	**(373,833**	(361,559)	**(304,865**	(958,078)
	(903,501	(1,691,272)	**(1,562,320**	(3,773,030)
Cash flows from financing activities				
Issuance of common shares (net of costs)	-	134,213	-	5,193,120
Research and development sponsorship funds received	**1,000,000**	-	**1,000,000**	-
Reduction in employee loans	-	7,143	-	14,287
Repayment of obligations under capital lease	**(3,702**	(2,933)	**(7,222**	(5,794)
	996,298	138,423	**992,778**	5,201,613
Cash flows from investing activities				
Acquisition of capital assets	**(3,246**	(68,534)	**(3,246**	(139,013)
Acquisition of intellectual properties	**(7,293**	(3,180)	**(24,832**	(45,747)
	(10,539	(71,714)	**(28,078**	(184,760)
Increase (decrease) in cash and cash equivalents	**82,258**	(1,624,563)	**(597,620)**	1,243,823
Cash and cash equivalents, beginning of period	**350,716**	3,520,811	**1,030,594**	652,425
Cash and cash equivalents, end of period	**$ 432,974**	$ 1,896,248	**$ 432,974**	$ 1,896,248

1. Nature of Operations and Basis of Presentation

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. On December 31, 2002, in order to harmonize its financial reporting requirements with internal operations and its industry sector, the reporting year-end for the consolidated entities was changed to December 31 from 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 for the foreseeable future. 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 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. The unaudited interim consolidated financial statements and notes do not include all disclosures required for annual statements and should be read in conjunction with the audited financial statements for the six months ended December 31, 2002.

2. Significant Accounting Policies

The unaudited interim consolidated financial statements of the Company have been prepared by management in accordance with generally accepted accounting principles in Canada. The accounting policies and methods of application used in preparation of these financial statements are consistent with the December 31, 2002 audited financial statements, unless noted otherwise.

<u>Stock-based compensation</u>
Effective July 1, 2002 the Company adopted the recommendations in the Canadian Institute of Chartered Accountants handbook section 3870 – Stock-Based Compensation and Other Stock-Based Payments. This section requires that direct awards of stock, or plans that create liabilities based on the price of common stock, be measured at fair value at each reporting date, with the change in fair value reported in the statements of income and encourages, but does not require, the use of the fair value method for all other types of stock-based compensation plans.

The Company has a stock option plan (“the plan”) for employees and consultants of the Company which falls within the section 3870 definition of “other types of stock-based compensation plans”. Stock options issued to consultants are accounted for by determining the fair value of the option grant, at the date of the grant, and charging “compensation expense” to the income statement over the vesting period of the option with a corresponding credit to share capital.

As permitted by section 3870, the Company does not record compensation expense for employee share option grants but instead discloses the pro-forma impact of the amount of compensation expense on earnings and earnings per share in the notes to its financial statements. In both cases, the compensation expense amount is determined based on the fair value of the option as estimated using the Black-Scholes option pricing model.

3. 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

Common Shares	Number of Common Shares	Amount
Balance, December 31, 2002	44,981,042	$ 11,788,905
Issued in lieu of non-executive directors fees	50,000	25,000
Balance, March 31, 2003 and June 30, 2003	**45,031,042**	**$ 11,813,905**

(c) Issued and outstanding special warrants

Special Warrants	Number of Special Warrants	Amount
Balance, March 31, 2003 and June 30, 2003	**200,000**	**$ 90,000**

On November 21, 2002, the Company completed a private placement of 200,000 Special Warrants of the Company (the "Special Warrant Financing"), at a price of $0.50 per Special Warrant, for net proceeds of $90,000 after deducting issue costs estimated at $10,000. Under the Special Warrant Financing, each Special Warrant is exercisable into one common share of the Company and one Warrant, each Warrant being exercisable into one common share at $0.55, until November 30, 2003.

Also on November 21, 2002, the Company completed a private placement of 1,300,000 units of the Company (the "Unit Financing"), at a price of $0.50 per unit, for net proceeds of $560,000 after deducting issue costs estimated at $90,000. Under the Unit Financing, each unit was comprised of one common share of the Company and one quarter Warrant, each whole Warrant being exercisable into one common share at $0.55, until November 30, 2003. On closing of the transaction, the Company issued 1,300,000 common shares. No warrants have been exercised and therefore 325,000 warrants remain outstanding pursuant to the Unit Financing.

(d) Stock Options

The Company has a stock option plan (the “Plan”) for which up to 6,754,656 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, subject to applicable stock exchange pricing policies. The options have a maximum term of five years and generally vest over a twelve to twenty-four month period. As at June 30, 2003, the Company had 5,320,000 stock options outstanding under the Plan, of which 4,213,000 were exercisable at a weighted average exercise price of $0.39 per common share. After taking into consideration options already exercised there are an additional 1,434,656 options available for future grant under the Plan. The stock options expire on various dates between April 25, 2006 and February 1, 2008. Stock option transactions for the six months ended June 30, 2003, and the number of stock options outstanding are summarized as follows:

	Number of Optioned Common Shares #	**Weighted Average Exercise Price $**
Balance, December 31, 2002	5,005,000	0.44
Options issued January 1, 2003	410,000	0.50
Options issued February 1, 2003	205,000	0.50
Options expired	(300,000)	(0.60)
Total Options Outstanding, June 30, 2003	5,320,000	0.44

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

As at June 30, 2003 options outstanding and exercisable are as follows:

Expiry date	Number of optioned common shares outstanding	Number of optioned common shares exercisable	Exercise price
	#	#	$
April 25, 2006	2,614,000	2,614,000	0.25
August 20, 2006	282,000	188,000	0.44
November 5, 2006	227,000	151,333	0.45
November 26, 2006	112,000	74,667	0.50
January 22, 2007	50,000	33,333	0.61
February 12, 2007	75,000	50,000	0.61
March 7, 2007	20,000	13,333	0.71
March 11, 2007	1,150,000	766,667	0.73
April 12, 2007	30,000	20,000	0.94
May 1, 2007	145,000	96,667	0.80
January 1, 2008	410,000	136,667	0.50
February 1, 2008	205,000	68,333	0.50
Total Stock Option Plan	5,320,000	4,213,000	

The Company does not record compensation expense when stock options are issued to directors, officers and employees, as disclosed in Note 2. Had compensation expense been determined, based on the fair value of the options at the grant dates, the net loss and loss per share would have been increased to the pro forma amounts indicated below:

	For the three months ended June 30, 2003		For the six months ended June 30, 2003	
	As Reported	Pro forma	As Reported	Pro forma
Net loss for the period	$ (579,183)	$ (593,522)	$ (1,357,898)	$ (1,407,120)
Loss per share	$ (0.01)	$ (0.01)	$ (0.03)	$ (0.03)

The fair value of the share options was estimated using the Black-Scholes option-pricing model with the following assumptions: Dividend yield (Nil), Expected volatility (0.17), risk-free interest rate (5.0%), and a weighted average life of 5 years.

4. Related Party Transactions

a) The Company incurred costs of $7,826 (2002 - $7,593) in respect of administrative services provided by B.C. Research Inc., a principal shareholder, during the six months ended June 30, 2003.

b) The Company incurred costs of $74,842 (2002 - $79,425) in respect of leased premises and equipment provided by B.C. Research Inc. during the six months ended June 30, 2003.

5. Contributions Receivable

During the quarter ended June 30, 2003, the Company reached the first contribution limit of $1 million (out of the $9 million funds available to Azure) specified in its agreement with Technology Partnerships Canada ("TPC") and hence only recorded a receivable of $72,680 in the quarter compared to a receivable of $186,811 if the limit were not in place. In order to access TPC contributions in excess of the $1 million limit, the Company must demonstrate that it has raised sufficient additional equity or other financing arrangements; the Company has commenced discussions with TPC with a view to amending the limit terms of the agreement.

6. Deferred Sponsorship Contributions

During the quarter ended June 30, 2003, the Company entered into a sponsorship arrangement with EnCana Corporation whereby EnCana has contributed $1,000,000 towards the development costs of seven hybrid electric demonstration vehicles that the Company has contracted to build under the terms of a development program with Canada Post Corporation. Under the terms of the Canada Post agreement, Canada Post will contribute $325,000 towards the cost of the five vehicles it will acquire from the program and Azure will retain two vehicles for testing purposes. The Company has recorded $472,637 of the EnCana sponsorship contribution as a reduction of research and development expenses incurred in the quarter with respect to the program. The balance of the EnCana sponsorship contribution received by the Company, $527,363, is deferred on the Company's balance sheet until such time as the related program costs are incurred.

7. Subsequent Events

On August 1, 2003, the Company announced the completion of a $2.21 million secured convertible debenture financing. $1 million of the proceeds from the financing is immediately available to the Company; of the balance of the proceeds, $0.25 million will be held in escrow until the Company obtains reporting issuer status in the jurisdiction of Quebec, and $0.96 million will be subject to escrow release on September 15, 2003, pending the satisfaction of certain conditions including the receipt of a third party consent in respect of the security, oral consent for which has already been received.

The Debentures mature on June 30, 2004 and are secured by all of the property of the Company and 100% of the equity of the Company's operating subsidiary, Azure Dynamics Inc. (the "Sub"). The Debentures do not bear interest. The Company may repay the Debentures at any time, and at such time each Debenture holder may elect to be repaid in cash or shares. If the Debenture holder elects to be repaid in cash, then the Company shall pay a redemption premium, calculated monthly, commencing August 1, 2003, equal to 2% per month of the face value of the Debenture outstanding, payable in shares ("Redemption Premium Shares"). The Redemption Premium Shares shall be issued at an issuance price based on the 5 day weighted average trading price for such month-end. If the Debenture holder elects to be repaid in shares, then such conversion will be at a conversion price equal to $0.30. Under the conversion terms of the Debentures, each Debenture holder may convert the Debenture into shares of the Corporation at any time before March 31, 2004 at a conversion price of $0.30.

Events of default under the Debentures include failure to repay by March 31, 2004 or failure to maintain a positive working capital balance of at least $100,000. An event of default will trigger a right of the Debenture holders to either: (a) convert the Debentures into shares of the Corporation at a conversion price equal to the 5 day weighted average trading price prior to the time of the exercise of such default right; or (b) enforce the security.

7. Subsequent Events – cont'd.

On closing of the financing, Mr. David Deacon resigned from the Board to accommodate representation on the Board of two nominees from the lending group, Mr. Robert Donaldson and Mr. Charlie Howard. Also on closing, Mr. Campbell Deacon, Chairman and Chief Executive Officer, and Mr. David Deacon, President and Chief Operating Officer, agreed to forego approximately 50% of their respective annual base remuneration and will therefore instead be compensated on the basis of a base remuneration of $10,000 per month each and appropriate incentives upon execution of key milestones of the Company's business plan. Mr. Campbell Deacon and Mr. David Deacon also agreed to the amendment of their respective employment contracts such that the Company's obligation to them upon termination of their employment shall be limited to no greater than three months notice or salary in lieu thereof.

Breakdown by major category:

Research and Development Expenses

	Three Months Ended June 30 2003	Three Months Ended June 30 2002	Six Months Ended June 30 2003	Six Months Ended June 30 2002
Salaries & benefits	$ 252,126	$ 386,871	$ 538,261	$ 792,153
Bonus	-	24,862	-	24,862
Recruitment and relocation costs	-	1,350	850	8,460
Consulting fees	29,454	-	75,615	15,465
Legal fees	4,177	-	12,813	-
Research collaboration (TM4)	-	-	-	665,000
Product development costs	307,470	43,386	315,417	57,338
Travel expenses	27,758	49,321	44,943	96,449
Telephone, fax and internet costs	1,233	2,813	2,333	5,412
Miscellaneous costs	12,032	30,843	20,445	57,274
	$ 634,250	$ 539,446	$ 1,010,677	$ 1,722,413
Less: Government assistance programs	(72,680)	(107,596)	(167,918)	(567,627)
Customer Contributions	(30,000)	-	(30,000)	-
Sponsorship Contributions	(472,637)	-	(472,637)	-
	$ 58,933	$ 431,850	$ 340,122	$ 1,154,786

Selling and Marketing Expenses

	Three Months Ended June 30 2003	Three Months Ended June 30 2002	Six Months Ended June 30 2003	Six Months Ended June 30 2002
Salaries & benefits	$ 116,971	$ 88,300	$ 220,898	$ 178,415
Bonus	-	92,523	-	92,523
Consulting fees	-	9,500	500	9,500
Travel expenses	20,428	57,092	50,457	102,413
Telephone, fax and internet costs	4,945	6,635	8,933	11,244
Miscellaneous costs	-	345	-	345
Marketing, advertising and PR	9,604	33,503	12,977	57,393
	$ 151,948	$ 287,898	$ 293,765	$ 451,833

General and Administrative Expenses

	Three Months Ended June 30 2003	Three Months Ended June 30 2002	Six Months Ended June 30 2003	Six Months Ended June 30 2002
Salaries & benefits	$ 152,894	$ 189,292	$ 308,383	$ 382,022
Bonus	-	55,070	-	55,070
Recruitment and relocation costs	-	-	4,000	7,100
Consulting fees	6,677	70,534	13,921	224,604
Office supplies	4,236	5,725	5,600	12,132
Contract services	3,975	4,774	7,826	7,593
Travel expenses	37,314	56,242	60,991	95,266
Directors' fees	6,250	-	12,500	-
Audit and tax services	4,754	28,955	4,754	28,955
Legal fees	21,803	29,408	37,690	78,321
Insurance	5,272	-	17,336	10,623
Regulatory filing and transfer agent fees	11,236	8,440	20,725	8,440
Telephone, fax and internet costs	11,750	21,938	24,645	41,959
Miscellaneous costs	9,707	25,297	19,497	5,243
	$ 275,868	$ 495,675	$ 537,868	$ 957,328

Note: Certain comparative figures have been restated to conform with the current period presentation.