

Three months and six months ended June 30, 2006 compared to the three months and six months ended June 30, 2005 and the year ended December 31, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

Three months and six months ended June 30, 2006 compared to the three months and six months ended June 30, 2005 and the year ended December 31, 2005.

This "Management's Discussion and Analysis" has been prepared as of July 24, 2006 and should be read in conjunction with the unaudited consolidated financial statements of the Company for the three months and six months ended June 30, 2006 and the audited consolidated financial statements of the Company for the year ended December 31, 2005.

Business Strategy of the Company

Azure Dynamics Corporation ("Azure" or the "Company") has developed proprietary hybrid vehicle technology for the light to heavy duty commercial vehicle category. The principal business of Azure is the development and supply of hybrid electric vehicle ("HEV") and electric vehicle ("EV") control and powertrain systems for commercial and military vehicles (collectively the "Technology"). Azure has developed expertise in the areas of vehicle controls software, power electronics, electric machine design, vehicle systems engineering and vehicle integration. The Company also has an established portfolio of proprietary component products that compliment its core technical skills, and make use of an extensive industry supplier base to offer complete powertrain solutions to its target market. To date, the Company has invested in the development and testing of its Technology. Commercial revenues from certain products, no longer in the development stage, commenced in 2005.

The strategy of the Company is to deploy its Technology into viable powertrain products for light to heavy duty commercial and military vehicle markets. Initial commercial markets include urban delivery, postal, courier, taxi and shuttle-bus applications. Azure's products fall within five broad powertrain categories – G1 (series) for vehicles in the medium-duty weight range 7,500 to 16,000 lbs. gross vehicle weight ("GVW"); G2 (series) for the light-duty weight range 5,000 to 7,500 lbs. GVW; P1 (parallel) for the medium-heavy weight category of 10,000 to 19,000 lbs. GVW; P2 (parallel) for the over 19,000 lbs. GVW heavy weight category, and E1 electric covering ranges from 1,000 to 14,000 lbs. In the execution of its strategy, Azure does not intend to be the ultimate manufacturer of components or assembler of powertrain systems. Rather, the Company intends to use the supply capacity that exists within the commercial and military vehicle industries.

A strategic committee of the Board of Directors is tasked with leveraging the strategic value of the Company's asset base. By gaining access to one or more industry partners the Company believes it can accelerate the commercialization of its Technology. In the execution of this strategy, the Company is leveraging its strength in the following four areas.

- Technology - Azure has developed unique electric and hybrid electric Technology and has established know-how in the commercial vehicle industry. Azure's patents have been recognized and cited by leading companies in the automotive and electronics industries.
- Market Differentiation – Azure is operating in a world-wide niche market and has attracted high profile lead customers.
- Independent Source - Azure is one of the few independent electric and hybrid electric research, development and production companies in the world.
- People - Azure has over 80 highly trained engineers and technicians with a depth of experience unavailable in the general marketplace. Azure's core expertise is in power electronics, controls software and vehicle system integration.

The Company has retained Rothschild to advise and assist it in the review of strategic options available to the Company. Evaluation of the Company's options is ongoing, and the committee and Rothschild are engaged in preliminary discussions with various parties.

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Overview of Operations

During the second quarter of 2006, the Company has continued to advance its major product development programs. A major development milestone was achieved with the completion of the Company's first ever commercially produced G1 series hybrid electric powered chassis. The powered chassis was assembled in accordance with Azure's specifications by Product Concepts Inc. ("PCI") of Union City, Indiana. PCI is an automotive service-provider located adjacent to Workhorse Custom Chassis, the supplier of the conventional chassis which is used as the base platform for the G1 series hybrid system. After fitting the hybrid powertrain, the completed chassis is sent to the commercial vehicle body upfitter prior to final inspection and delivery to the customer. The initial volume production from PCI is destined for delivery van and shuttle bus product deliveries commencing in the second half of 2006. The in-service pre-production delivery vehicles continue to accumulate mileage for testing and validation purposes (approximately 150,000 kilometres of in-service driving).

The pre-production G1 shuttle bus ("CitiBus") has been used for demonstration purposes in the second quarter. The production shuttle bus is expected to be completed in the third quarter of 2006 and initial customer deliveries are expected to commence at that time. In addition, the Company has been evaluating opportunities to have the shuttle bus body produced and installed by existing major US shuttle bus manufacturers to gain marketing and cost advantages for U.S. distribution. On July 18, 2006 the Company announced it has signed a Memorandum of Understanding ("MOU") for the production of hybrid shuttle buses with StarTrans, a business division of Supreme Corporation. Under the proposed terms of the MOU, Azure will provide StarTrans with hybrid cab-chassis' on which StarTrans will assemble their shuttle bus body at its manufacturing facilities in Goshen, Indiana. Azure's hybrid cab-chassis is a derivative of Azure's series hybrid chassis integrated with a newly developed cab. When fully assembled, the Azure hybrid electric shuttle bus will be compliant with the United States' Buy-America program and after testing will be eligible for the Federal Transit Administrations funding for bus purchases

During the quarter, the Company received a follow-on order for 20 electric G1 powertrain systems from Smith Electric Vehicles ("Smith"). Smith is using the powertrain kits supplied by Azure to revamp their existing product offering in all-electric delivery vehicles and airport tugs for initial customer orders and demonstration purposes. The Company has a supply agreement (entered into in 2005) for up to 1,000 electric systems with Smith.

The Company has entered into a memorandum of understanding with GKN, a tier 1 supplier to the automotive industry with operations worldwide, to further evaluate the feasibility of the proof-of-concept hybrid Ford Transit Van which was displayed by the parties at the Commercial Vehicle Show in Birmingham, England in April. The intent of the collaboration is to explore the viability of a Through-The-Road hybrid concept – a conventional front wheel drive powertrain layout and an Azure electric drive in the rear. The vehicle can operate using conventional power; electric power; or hybrid power in four-wheel drive mode.

The Company's first P1 parallel hybrid delivery van was publicly unveiled by the United States Postal Service at a press event in May 2006. A further two P1 vehicles are being evaluated internally to optimize fuel efficiency and map out resultant system design modifications. One of the two vehicles is scheduled for customer delivery in the third quarter. The current intended path to production indicates initial vehicles by mid-2007. The P1 parallel for military use, the AM General High Mobility Multipurpose Wheeled Vehicle ("HMMWV") integrated with a third generation Auxiliary Power Distribution System ("APDS"), was delivered in July 2006.

The physical build of the Class 7 delivery trucks for the Charmer-Sunbelt Group ("Charmer-Sunbelt") (P2 parallel development) was completed in the quarter. Commissioning and system optimization is in-progress with vehicle delivery scheduled for the second half of 2006.

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The development phase of the contract to supply power electronics and drive systems to DRS Sustainment Systems, Inc. ("DRS") (formerly DRS Engineered Air Systems Inc.), an operating unit of DRS Technologies, Inc. for integration into a HMMWV Chemical Biological Protective Shelter ("CBPS-M2") system continued. A follow-on order for an additional 43 systems, valued at CDN\$2.8 million was received on June 30, 2006. The total contract is now for the supply of 221 systems which, together with engineering work, is valued in excess of CDN\$19.0 million. Design, development, and testing of the system is ongoing. Delivery of product is expected to be delayed until first half of 2007 due to additional validation and user-testing by the US Military prior to final acceptance of the product.

The total number of employees increased from 109 at the end of fiscal 2005 to 112 at June 30, 2006. The Company occupies facilities in Vancouver (18,000 square feet), Boston (77,000 square feet) and Kenilworth, England (5,000 square feet). The Company considers that its various facilities are suitable to meet the Company's foreseeable requirements for engineering, workshop, test, and administrative accommodations. Additional test and workshop equipment has been acquired to enable the execution of program development and customer deliverables and the Company has implemented an enterprise resource planning ("ERP") system to support all its operations.

Operating Results, Cash Flows and Financial Condition

Statement of Operations Discussion

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

	Q2, 2006 (Apr – Jun)	Q1, 2006 (Jan – Mar)	Q4, 2005 (Oct – Dec)	Q3, 2005 (Jul – Sep)
Revenue	\$ 1,205	\$ 1,147	\$ 965	\$ 1,134
Gross margin	\$ 76	\$ 304	\$ 56	\$ 154
Expenses, net	\$ (4,922)	\$ (4,870)	\$ (6,796)	\$ (4,788)
Net loss for the period	\$ (4,846)	\$ (4,566)	\$ (6,740)	\$ (4,634)
Net loss per share	\$ (0.03)	\$ (0.03)	\$ (0.04)	\$ (0.03)
Weighted average number of Shares	158,638	156,631	156,116	146,291

	Q2, 2005 (Apr – Jun)	Q1, 2005 (Jan – Mar)	Q4, 2004 (Oct – Dec)	Q3, 2004 (Jul – Sep)
Revenue	\$ 1,525	\$ 984	\$ -	\$ -
Gross margin	\$ 272	\$ 291	\$ -	\$ -
Expenses, net	\$ (5,872)	\$ (5,213)	\$ (2,729)	\$ (2,553)
Net loss for the period	\$ (5,600)	\$ (4,922)	\$ (2,729)	\$ (2,553)
Net loss per share	\$ (0.04)	\$ (0.04)	\$ (0.03)	\$ (0.03)
Weighted average number of Shares	141,203	124,892	94,230	87,322

For the quarter ended June 30, 2006, the Company incurred a net loss of \$4.9 million (\$0.03 per share) compared to a net loss of \$5.6 million (\$0.04 per share) in the comparable 2005 quarter. The reduced net loss in the current quarter is primarily attributable to lower operating expenses, particularly engineering and product development costs, when compared to a period of high-activity spending on the G1 program in the second quarter of 2005. As the G1 program transitions from the development phase to pre-production and

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production phases, spending levels have decreased. On a cumulative basis, the Company incurred a net loss of \$9.4 (2005 - \$10.5 million)

Revenue: Revenue for the quarter ended June 30, 2006 was \$1.2 million (2005 – \$1.5 million) and \$2.4 million year to date (2005 - \$2.5 million). The decrease in revenue is attributable to decreased activities in funded engineering contracts in the Boston operation. Revenue is mainly comprised of sales of components, customer engineering contracts, and after-sales service support. After considering direct and applicable indirect costs of sales, the gross margin contribution from revenue in the quarter was \$0.1 million (2005 – \$0.3 million) and \$0.4 million year to date (2005 - \$0.6 million). Gross margin as a percentage of sales was 6% (2005 – 18%) for the quarter and 16% (2005 – 22%) year to date. The decrease in gross margin is primarily attributable to a combination of program mix and additional costs incurred on two development programs in the US operation.

Engineering, research, development and related costs, net: Before contributions, the Company expended \$2.7 million on engineering, research and development operations in the quarter (2005 – \$4.1 million), including \$1.3 million in respect of product development costs (2005 - \$2.4 million). The expenses were reduced by \$0.4 million (2005 – \$0.8 million) in respect of government and customer contributions. On a cumulative basis, the Company expended \$5.4 million (2005 - \$7.2 million), including \$2.6 million in respect of product development costs (2005 – \$3.7 million). Contributions of government and customers was \$0.7 million year to date (2005 - \$1.2 million). At June 30, 2006, Azure employed 84 research, engineering and technical personnel (2005 - 71). Engineers and workshop personnel are either working on revenue contracts and sales orders, or on core product development programs. In the former case, revenues are recognised as product is delivered or in accordance with the percentage of completion methodology in the case of contracts in progress. For product development and other unabsorbed overheads the direct costs and related overheads, net of customer or government contributions, are expensed.

Product development expenses of \$1.3 million for the quarter and \$2.6 million year to date (2005 – \$2.4 for the quarter and \$3.7 million year to date) include the costs of the G1 preproduction development, P1 and P2 system development, and costs related to the development and enhancement of system components.

Customer and government contributions were \$0.4 million in the second quarter of 2006 (2005 - \$0.8 million) and \$0.7 million year to date (2005 – \$1.2 million). Technology Partnerships Canada (“TPC”) contributions of \$0.3 million have been recorded in the quarter (2005 - \$0.4 million) and \$0.6 million have been recorded year to date (2005 – \$0.8 million). The contributions are comparatively lower in 2006 as the Company has incurred a lower amount of expenditures in product development, including those that are covered by government programs than in the prior year. The Company also received customer contributions of \$0.1 million in the second quarter of 2006 (2005 -\$0.4 million) and \$0.1 million year to date (2005 - \$0.4 million) in respect to product delivered.

The Company is required to make royalty payments to TPC, EnCana and the National Research Council based on future revenues in respect of specified products. As the Company has not recorded any commercial revenues to date from those products, no royalty liability has been incurred.

Selling and marketing: Selling and marketing costs were \$0.8 million in the second quarter of 2006 compared to \$0.8 million in the comparable 2005 quarter. On a cumulative basis, the Company expended \$1.5 million (2005 - \$1.4 million). The selling and marketing headcount at June 30, 2006 is eight (2005 – nine).

General and administrative: General and administrative costs were \$1.9 million in the quarter compared to \$2.1 million in 2005. On a cumulative basis, the Company expended \$3.8 million (2005 - \$3.7 million). The headcount at June 30, 2006 is 19 (2005 – 19).

Amortization: Amortization of property, equipment and other assets was \$0.2 million in the second quarter of 2006 (year to date \$0.4 million) compared to \$0.2 million in the second quarter of 2005 (year to date \$0.3

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million). Property and equipment primarily consists of workshop equipment, tooling, computer hardware and software. The Company purchased assets with a value of \$0.4 million in the quarter (2005 - \$0.2 million) and \$0.6 million year to date (2005 -\$0.5 million). In addition, the intangible assets acquired as a result of the Solectria acquisition have been amortized by \$0.4 million in the quarter (2005 - \$0.4 million) and \$0.8 million year to date (2005 - \$0.7 million). Amortization of property, equipment and other assets are allocated to the relevant cost categories on the Statement of Operations.

Foreign currency gains and losses: Foreign currency gain total \$38,000 in the quarter (2005 – gain of \$246,000). Year to date, foreign currency loss was \$11,000 (2005 – gain of \$50,000). These were mainly unrealised gains and losses in respect of foreign currency cash balances which reversed out subsequent to the quarter end.

Balance Sheet Discussion

Cash and cash equivalents: Cash and cash equivalents at June 30, 2006 were \$10.7 million compared to \$20.7 million at December 31, 2005 and \$12.8 million at June 30, 2005. Net cash outflows were approximately \$4.9 million in the quarter compared to \$5.9 million in the second quarter of 2005. The current year quarter included proceeds from the exercise of stock options of \$0.7 million compared to \$39,000 in the second quarter of 2005. Net cash outflows in respect of operations, working capital financing and capital expenditures were approximately \$5.6 million compared to \$5.9 million in the second quarter of 2005. On a cumulative basis, net cash outflows were approximately \$10.0 million compared to \$0.8 million in the comparable period in 2005. The prior year period included net equity financing of \$11.8 million compared to \$1.3 million in the current year. Net cash outflows in respect of operations, working capital financing and capital expenditures on a cumulative basis were approximately \$11.3 million in the current year compared to \$12.5 million in 2005. The decrease in cash outflows in 2006 is mainly attributable to the lower operating loss of \$1.1 million (\$9.4 million year to date 2006 compared to \$10.5 million in 2005) and working capital requirements that were lower by \$0.9 million (\$2.9 million in 2006 compared to \$3.8 million in the prior year), partially offset by higher expenditures for property and equipment of \$0.2 million. Cash inflows in the prior year quarter also included approximately \$0.4 million as a result of the Solectria acquisition.

Accounts receivable: Accounts receivable at June 30, 2006 were \$1.1 million compared to \$1.0 million at December 31, 2005 and \$1.3 million at June 30, 2005. The lower amount in the current quarter compared to the prior year quarter primarily relates to the lower revenue levels.

Contributions receivable: Contributions receivable, representing specific development cost contributions from TPC and contributions from customers, were \$0.6 million at June 30, 2006 (\$0.6 million at December 31, 2005, \$1.8 million at June 30, 2005). The balance was higher in June 2005 due to a backlog of unprocessed claims while the extension of the Company's contract with TPC was awaiting approval (approval was subsequently received on March 23, 2005 although claims were delayed for several months thereafter).

Inventory and related prepayments: Inventory and related prepayments was \$4.3 million at June 30, 2006 compared to \$2.7 million at December 31, 2005 and \$2.7 million at June 30, 2005. The higher inventory amount at June 30, 2006 is primarily attributable to work-in-process related to customer programs scheduled to ship later in 2006 and in early 2007.

Prepaid expenses: Prepaid expenses at June 30, 2006 were \$1.0 million compared to \$1.0 million at December 31, 2005 and \$0.9 million at June 30, 2005. The increase over the prior year is primarily attributable to advance payments relating to the increased number of facilities, insurance, and Company advisors.

Property and equipment: Net property and equipment was \$5.8 million at June 30, 2006 compared to \$5.6 million at December 31, 2005 and \$5.5 million at June 30, 2005.

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Other assets: Other assets of \$44,000 (\$61,000 at December 31, 2005 and \$61,000 at June 30, 2005), are related to a note receivable. Repayment of this note commenced on February 1, 2006 and will conclude on August 1, 2007.

Goodwill and other intangibles: The Company accounted for the acquisition of Azure US using the purchase method, and in accordance with Canadian accounting standards, allocated the purchase price to identifiable assets, including intangibles. The excess of the purchase price consideration over identifiable assets is recorded as goodwill on the balance sheet (\$2.9 million). The Company identified the order book (\$0.9 million) and technology (\$12.5 million) as at-acquisition intangible assets. Intangible assets were \$11.4 million at June 30, 2006 (\$12.1 million at December 31, 2005 and \$12.9 million at June 30, 2005). The lower amount in 2006 is primarily attributable to the amortization.

Accounts payable and accrued liabilities: Accounts payable and accrued liabilities were \$3.0 million at June 30, 2006 compared to \$3.4 million at December 31, 2005 and \$2.6 million at June 30, 2005. The higher balance at June 2006 compared to the prior year is primarily attributable to payables related to work-in-process related to customer programs.

Customer deposits and deferred revenues: Current and long-term deferred revenue and customer deposits total \$1.9 million at June 30, 2006 compared to \$2.6 million at December 31, 2005 and \$1.4 million at June 30, 2005. The amount is attributable to the US operation and is comprised of customer deposits in respect of work-in-progress of \$1.5 million, deferred revenue of \$1.1 million, and is partially offset by \$0.7 million of revenues in excess of billings. Approximately \$1.0 million of the deferred revenue is in respect of a payment received from Singapore Technologies Kinetics Ltd. ("STK") for a license agreement for certain technology that expires in 2020. The license agreement fee is being recognised in revenue over the 17-year duration of the agreement. The amount has decreased compared to December 2005 primarily due to a lower balance in deferred revenues as a result of revenue recognized in the year on programs where advance payments have been received.

Notes payable: The note payable is the Company's proportionate share of a mortgage on the Boston property owned by ND Solectria LLC. The note is repayable on November 20, 2006, bears interest at 6.75 %, and is secured by the mortgaged premises.

Share capital: Share capital at June 30, 2006 was \$82.2 million compared to \$80.7 million at December 31, 2005 and \$66.2 million at June 30, 2005.

The number of common shares, warrants, and options issued and outstanding are presented in the following table:

	June 30, 2006	June 30, 2005
Common shares	159,139,445	141,289,989
Warrants, exercisable until July 27, 2005 at \$1.00	Nil	1,905,625
Obligor Warrants, exercisable from December 16, 2004 until July 27, 2005 at \$1.00	Nil	1,700,000
Stock options issued under the Stock Option Plan, with expiry dates ranging up until May 11, 2017 and average exercise price of \$0.93	12,386,408	11,864,572

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Related Party Transactions

During the six months ended June 30, 2005 the Company paid \$153,000 to a private company controlled by the Chief Executive Officer for remuneration in respect of an employment contract. Payments related to the employment contract were paid directly to the employee during the six months ended June 30, 2006.

In November 2003, Solectria entered into a Transfer of Technology and Software Licensing Agreement ("TTA Agreement") with STK. Under the terms of the agreement, the Company transferred specified technology to STK and granted an exclusive license to use and manufacture the technology. The Company also provided STK with the training necessary for the transfer of the technology. The license expires in November 2020, and is subject to automatic one-year renewals thereafter. The Company received cash consideration for the license and transfer of technology, and for the training in the aggregate amount of US\$1.0 million (Cdn\$1.2 million). As discussed in note 2(b) of the June 30, 2006 Financial Statements, revenues from the TTA Agreement are being recognized on a straight-line basis over the period of the license agreement. As of June 30, 2006, the Company has deferred revenue associated with the TTA Agreement in the amount of \$1.0 million. During the three months ended June 30, 2006, revenues recognized by the Company from the sale of products to STK and its related companies and from certain other contractual arrangements totalled approximately \$17,000 (\$35,000 year to date). As of June 30, 2006, accounts receivable includes \$11,000 due from STK and customer deposits includes \$43,000 received from STK.

As of June 30, 2006, the Company's accounts receivables balance includes approximately \$45,000 from ND Solectria, LLC, the joint venture company related to the Woburn facility, in which the Company retains a 50% interest. This balance relates to a quarterly partnership distribution.

Liquidity, Capital Resources and Risk Factors

At June 30, 2006 the Company had \$11.4 million (December 31, 2005 - \$21.4; June 30, 2005 - \$13.5 million) in net cash reserves. The Company invests its cash, in accordance with its investments policy, in highly-liquid, highly-rated financial instruments such as banker's acceptances and term deposits. At June 30, 2006 approximately \$0.7 million (December 2005 - \$0.7 million and June 2005 - \$0.8 million) of cash was restricted as security in respect of the Boston joint venture property and lease arrangements. Working capital was \$11.5 million at June 30, 2006 compared to \$18.5 million at December 31, 2005 and \$16.3 million at June 30, 2005. The decrease in working capital compared to the prior periods is primarily due to a combination of lower cash balances partially offset by higher non-cash working capital levels. Non-cash working capital has increased by approximately \$3.0 million since December 2005 primarily due to the increases in inventories, and decreases in accounts payable, deposits, and deferred revenues.

The Company has incurred losses since its inception as it has invested in the development of its Technology. Although the Company is active in a number of revenue generating programs it also continues to incur product development costs. As a result, the Company has relied on its financing activities to fund its operations. For the year ended December 31, 2005 the Company raised approximately \$26.3 million in equity financing, net of issue costs. In addition, Azure is eligible, subject to TPC conditions, to access the maximum grant of up to \$9.0 million available under the terms of the TPC contribution agreement. As at June 30, 2006 the Company had claimed approximately \$5.4 million in accordance with the terms of the TPC agreement and is therefore eligible for further contributions totalling approximately \$3.6 million.

The Company intends to use its cash resources and available financing arrangements to fund ongoing product development and commercialization activities in 2006. The Company is generating revenue and expects the volumes to grow as additional products are brought into production. Additional financing may be required in the future, to allow for the uninterrupted development of its various products through the commercialization stage. The raising of financing to fund operations remains subject to uncertainty and there is no assurance that such financing will be available on commercially reasonable terms.

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The Company holds substantially all of its cash at a recognized Canadian national financial institution, and as such is exposed to all of the risks associated with that institution. The Company operates in foreign markets and has foreign subsidiaries and is therefore exposed to foreign currency exchange risk. Azure's operations are subject to all of the risks inherent in the establishment of a new business enterprise – please see Risk Factors – Annual Information Form, dated March 23, 2006 (this document and additional information relating to the Company is available for inspection at www.sedar.com). These risks include the practical risks of implementation and execution of its commercialization strategy (for example, the risk that Azure is delayed in the development of customer product requirements specified in development agreements, or is delayed in the process of establishing the infrastructure required to support its commercialization plans). To better manage all risk factors, the Company has a system of reporting and measuring progress towards milestones on a regular basis. The Company has an organization structure commensurate with its growth plans and is implementing an internal control and process system supported by an appropriate ERP system that will encompass all existing engineering/support operations. Management accepts the responsibility of ensuring that control systems and procedures are established and are effective and monitored and is required to report to the Board and its sub-committees on a regular basis on such matters.

The Company has no long-term contractual purchase obligations. Contractual commitments in respect of leased premises and equipment, totalling \$6.6 million over the next five years, are described in note 7 to the June 30, 2006 financial statements.

Critical Accounting Estimates

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

Revenue Recognition

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

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

Warranty Provision

The Company generally warrants its products against defects and workmanship for a period of one to three years from the date of shipment, subject to certain guidelines and exclusions. A provision has been established for this warranty obligation. In establishing the accrued warranty liability, management has estimated the likelihood that products sold will experience warranty claims and the estimated costs to resolve

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the claims received, taking into account the nature of the product and the past and projected claims experience with the products. Should these estimates prove to be incorrect, the Company may incur costs different from those provided for in the warranty provisions.

Inventory Provision

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

Intangible Assets and Goodwill

As a result of the Solectria acquisition (see note 3 to the Financial Statements), the Company recorded intangible assets and goodwill on our balance sheet. In accordance with Canadian GAAP, the Company does not amortize goodwill. Intangible assets are amortized over periods ranging from 2 to 10 years. At least annually, management reviews the carrying value of our intangible assets and goodwill by segment for potential impairment. If circumstances indicate that impairment in the value of these assets has occurred, the impairment would be recorded in the earnings of the current period.

Forward-Looking Statements

This MD&A contains forward-looking statements related to Azure's financial and other projections, expected future plans, events, financial and operating results, objectives and performance, as well as underlying assumptions, all of which involve risks and uncertainties. When used in this MD&A, the words "believe", "anticipate", "intend", "estimate", "expect", "project" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain such words. These statements reflect management's current belief and are based on information currently available to Azure's management and are subject to certain risks, uncertainties and assumptions. Actual results may differ materially from management expectations as projected in such forward-looking statements for a variety of reasons and no assurances can be given as to actual future results, performance or prospects. Factors that may cause such differences include, but are not limited to, the early stage of development of the Company; a lack of product revenues and a history of losses; the need for additional financing; uncertainty as to commercial viability; uncertainty as to product development and commercialization milestones being met; uncertainty as to the market for the Company's products and unproved acceptance of the Company's technology; competition; uncertainty as to target markets; dependence upon third parties; changes in environmental policies; uncertainty as to patent and proprietary rights; availability of management and key personnel; available regulatory approvals and conflicts of interest by directors and officers of the Company. More detailed information about these and other factors is included in Azure's Annual Information Form dated March 23, 2006, available on SEDAR at www.sedar.com, in the section entitled "Risk Factors" and elsewhere in other disclosure materials filed from time to time by the Company with Canadian securities regulatory authorities. Azure is not obligated to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Because of these risks, uncertainties and assumptions, readers should not place undue emphasis on Azure's forward-looking statements.