MANAGEMENT'S DISCUSSION AND ANALYSIS

Three months ended March 31, 2007 compared to the three months ended March 31, 2006

This "Management's Discussion and Analysis" has been prepared as of May 8, 2007 and should be read in conjunction with the unaudited consolidated financial statements of Azure Dynamics Corporation ("Azure" or the "Company") for the three months ended March 31, 2007 and the audited consolidated financial statements of the Company for the year ended December 31, 2006.

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 that could affect Azure's operations or financial results are included in Azure's filings with Canadian securities regulatory authorities. Azure does not assume any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. Because of these risks, uncertainties and assumptions, readers should not place undue emphasis on Azure's forward-looking statements.

Business Strategy of the Company and Overall Performance

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

Target markets include urban delivery, postal, courier, taxi and shuttle-bus applications. Over the past five years, the Company has primarily been engaged in the development and testing of its Technology. Certain of the Company's products are now generating commercial revenues while other products are in the development stage. In production, Azure does not intend to be the ultimate manufacturer of components or assembler of powertrain systems. Rather, the Company uses the supply capacity that exists within the commercial vehicle industries to assemble products to its specifications which are then distributed via existing industry channels to the customer.

In the execution of it's strategy, Azure seeks to closely align product development and sales efforts with recognised industry partners (Original Equipment Manufacturer's, component suppliers, and customers). By aligning each of its production or development programs with industry leaders, Azure can gain access to product development support and established distribution networks thereby accelerating the penetration of its hybrid-electric products into the commercial vehicle markets. In 2006, the Company concluded arrangements with Ford Motor Company ("Ford") and StarTrans (a business division of Supreme Corporation) which have facilitated a concentration of the Company's efforts around its core programs for series (G1) and parallel (P1) delivery vans and shuttle buses.

As a result, Management and the Board, after consideration of customer, industry, and market trends and other relevant factors, have implemented organizational and infrastructure changes to take full advantage of the opportunities now available to it in its core programs. On April 17, 2007 Scott T. Harrison was appointed Chief Executive Officer and joined the Azure Board. D. Campbell Deacon, retiring Chief Executive Officer, became Chairman of the Board and Thomas N. Davidson, outgoing Chairman, will retire from the Board at the Annual Meeting of the company in June 2007. The changes were made to ensure that the Company has the appropriate skills to successfully manage the transition from research and development to commercial production. Scott Harrison has extensive production and supply chain experience with both new and established products in the automotive industry.

Further, on May 7, 2007 the Company announced that it will establish a new corporate head office and development center in the heartland of the North American automotive industry. The new location will be selected to ensure the Company can leverage its relationship with Ford and capitalize on the significant opportunities in the mid-sized truck market. The office in Toronto as well as the Kenilworth facility in the UK will be closed. The scope of work with Ford as well as other OEM's makes the establishment of this new facility a compelling action at this stage of the Company's development. In addition these practical moves are expected to provide cost savings in excess of $1.6 million annually. The cost savings are related to both fixed costs for facilities and people as well as in variable costs, such as travel.

During the quarter under review, Management continued to consider strategic proposals from potential industry partners. Although the calibre of the potential partners has been very impressive, it is Managements' assessment (supported by the Board) that the proposals to date do not adequately recognise the value of the Company. This view has been reinforced by recent new customer developments and by the heightened level of interest in the industry in general. The Company will continue to evaluate all alternatives.

G1 (series hybrid) production:

During 2006, 40 production G1 series hybrid electric powered chassis were built. Thirty of these units were fitted with delivery van bodies under the terms of the agreement with Purolator Courier Ltd and the remaining ten hybrid chassis are being used to build shuttle buses.

Purolator has completed the introduction of the 30 new hybrid vans into their fleet operations in the first part of 2007 and their combined fleet of Azure hybrid vehicles now totals 49. The pacing of units into service has been a function of availability of battery packs due to a supplier-related design change which has slowed their production release.

Much of the Company activity in the quarter has been in the development of the final shuttle bus design as well as the build of the initial shuttle buses (nine of which are expected to be used for customer deliveries commencing in Q2, 2007). The Company considers the Shuttle bus application to be ideal for the adoption of its G1 technology as they typically operate in high-usage, high-mileage drive cycles and can be eligible for capital subsidies. During the quarter, all nine of the initial customer units were completed to the cab-chassis stage. These units have been delivered to StarTrans, the manufacturer of the shuttle bus body, for integration of the body to the hybrid cab-chassis. The shuttle bus that will be used to undergo Altoona testing (thereby qualifying for federal capital subsidies in public transit applications) is also being built. The Altoona test is expected to start in May 2007.

Azure has signed agreements with twelve StarTrans bus distributors across North America and therefore has access to a distributor network covering approximately 70% of the targeted shuttle bus market in the US and Canada.

P1 (parallel hybrid) development:

As a result of the Ford agreement, Azure's commercial P1 development program is now focused on the Ford E-350 and E-450 commercial vehicle chassis. During the quarter, the Company advanced through the initial concept phase whereby final production concepts were evaluated in detail to ensure that the most fuel efficient and robust design is utilized. The selected concept is now undergoing detailed design work which will include the building, testing and optimizing of more prototypes. These internal prototypes will lead to the demonstration prototypes which are scheduled for customer in-service trials in the latter half of 2007. Thereafter, a quantity of pre-production units for lead customers is anticipated to be built commencing in early 2008 with full production commencing in mid 2008. It is intended, subject to formal agreement, to distribute the hybridized chassis through Ford's distribution channels.

Other production and product development:

In 2006, Azure entered into a Memorandum of Understanding with Kidron, a division of VT Specialized Vehicles Corporation, for the branding, marketing and sale of Azure's LEEP (Low Emission Electric Power) systems throughout the North American refrigerated truck body segment. The term LEEP refers to all systems whereby clean electric power is generated off the vehicles power train to be used in auxiliary and export power applications. During the current quarter, a refrigerated truck body was provided by Kidron and the Company is currently in the process of designing and building an initial prototype for evaluation purposes. After a short evaluation of the base platform and proposed LEEP system, it is expected that formal contracts will be concluded and the application program will commence. As the development cycle is expected to be relatively short, the LEEP system is anticipated to be in production by the second-half of 2007.

On April 9, 2007 the Company announced it had signed a supply agreement with Electro Autos Eficaces of Mexico ("EAE"). The initial order is for 1,000 drive systems for integration into the Nissan Tsuru platform, which is commonly used in the municipal fleet of Mexico City. The Tsurus are being converted from gasoline powered vehicles to electric vehicles. The Company has commenced the initial vehicle integration and the first converted vehicle was unveiled at the International Electric Vehicle Forum on May 8, 2007 in Mexico City. The balance of the 1,000 vehicles is expected to be converted over the following 18 months. Azure's scope of supply for the 1,000 drive systems includes the motor, controller, gearbox and DC-DC converters. The agreement also includes the potential for Azure to supply a broad range of electric and hybrid electric drive systems and components for various other vehicle applications in Mexico.

The P2 parallel hybrid system, delivered to the Charmer-Sunbelt Group ("Charmer-Sunbelt") in October 2006, continues to be evaluated in-service. Azure will only actively pursue the development of the P2 system when development program partners and engineering resources are available.

The total number of employees increased from 112 at the end of fiscal 2006 to 118 at March 31, 2007. The Company occupies facilities in Vancouver (18,000 square feet) and Boston (77,000 square feet). The Company has also established a service and support center in Mississauga, Canada. The Company considers that its various facilities are suitable to meet the foreseeable requirements for engineering, workshop, test, and administrative accommodations. 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.

Critical Accounting Estimates

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

Revenue Recognition

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

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

Warranty Provision

The Company generally warranties 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 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 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 the 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 intangible assets and goodwill by segment for potential impairment. If circumstances indicate that impairment in the value of these assets has occurred, the impairment is recorded in the earnings of the current period.

Operating Results, Cash Flows and Financial Condition

Statement of Operations Discussion

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

	Q1, 2007 (Jan – Mar)	Q4, 2006 (Oct – Dec)	Q3, 2006 (Jul – Sep)	Q2, 2006 (Apr – Jun)
Revenue	**$ 156**	**$ 3,008**	**$ 411**	**$ 1,205**
Gross margin	**$ 89**	**$ 967**	**$ (166)**	**$ 76**
Expenses, net	**$ (6,596)**	**$ (5,974)**	**$ (8,849)**	**$ (4,922)**
Net loss for the period	**$ (6,507)**	**$ (5,007)**	**$ (9,015)**	**$ (4,846)**
Net loss per share	**$ (0.03)**	**$ (0.03)**	**$ (0.06)**	**$ (0.03)**
Weighted average number of Shares	**198,275**	**166,913**	**159,206**	**158,638**

	Q1, 2006 (Jan – Mar)	Q4, 2005 (Oct – Dec)	Q3, 2005 (Jul – Sep)	Q2, 2005 (Apr – Jun)
Revenue	$ 1,147	$ 965	$ 1,134	$ 1,525
Gross margin	$ 304	$ 56	$ 154	$ 272
Expenses, net	$ (4,870)	$ (6,796)	$ (4,788)	$ (5,872)
Net loss for the period	$ (4,566)	$ (6,740)	$ (4,634)	$ (5,600)
Net loss per share	$ (0.03)	$ (0.04)	$ (0.03)	$ (0.04)
Weighted average number of Shares	156,631	156,116	146,291	141,203

For the quarter ended March 31, 2007, the Company incurred a net loss of $6.5 million ($0.03 per share) compared to a net loss of $4.6 million ($0.03 per share) in the comparable 2006 quarter. The higher loss in the current quarter is primarily attributable to the lower margins associated with lower volume and the higher level of activities in engineering and operations as the Company progresses the P1 Ford development and incurs final engineering and start up costs associated with the ramp up of G1 production.

Revenue: Revenue for the quarter ended March 31, 2007 was $0.2 million (2006 – $1.1 million). The lower revenue is attributable to decreased activities in funded engineering contracts in the Boston operation. The Company substantially completed the funded development programs in 2006 and has now refocused its engineering resources on internal development programs that will be launched into production in 2007 and 2008. Revenue is mainly comprised of sales of components 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 (2006 – $0.3 million). Gross margin as a percentage of sales was 57% (2006 – 27%).

Engineering, research, development and related costs, net: Before contributions, the Company expended $4.2 million on engineering, research and development operations in the quarter (2006 – $2.7 million), including $2.7 million in respect of product development costs (2006 - $1.6 million). The expenses were reduced by $0.3 million (2006 – $0.3 million) in respect of government and customer contributions. At March 31, 2007, Azure employed 90 research, engineering, operations and technical personnel (2006 - 84). Engineers and workshop personnel are either working on revenue contracts and sales orders, on servicing vehicles or products in the field, 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 $2.7 million (2006 – $1.6 million) include the start up costs of the G1 production launch, the P1 system development, and costs related to the development and enhancement of system components.

Customer and government contributions were $0.3 million in the first quarter of 2007 compared to $0.3 in the first quarter of 2006. All of the contributions in the quarter are associated with Technology Partnerships Canada ("TPC") (2006 - $0.25 million). The Company recorded no customer contributions in the first quarter of 2007 (2006 – $49,000).

The Company is required to make royalty payments to TPC, EnCana Corporation 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 first quarter of 2007 compared to $0.7 million in the comparable 2006 quarter. The increase is primarily related to a higher level of activities in advertising, product demonstrations and related travel to grow the order book for launched products and to sign up lead customers for products in development. The selling and marketing headcount at March 31, 2007 was eight (2006 – eight).

General and administrative: General and administrative costs were $2.0 million in the quarter compared to $1.8 million in 2006. The increase is primarily related to a lump sum severance payment related to an employment contract. The headcount at March 31, 2007 was 19 (2006 – 19).

Amortization: Amortization of property, equipment and other assets was $0.2 million in the first quarter of 2007 compared to $0.2 million in the first quarter of 2006. Property and equipment primarily consists of workshop equipment, tooling, computer hardware and software. The Company purchased assets with a value of $0.3 million in the quarter (2006 - $0.2 million). Other assets are primarily the cost of patents and trademarks. In addition, the intangible assets acquired as a result of the US acquisition noted above have been amortized by $0.3 million (2006 - $0.4 million). The decrease in intangible asset amortization in the current quarter is a result of lower revenues associated with backlog at acquisition in the current quarter compared to the prior year. Amortization of property, equipment and other assets are allocated to the relevant cost categories on the Statement of Operations.

Foreign currency losses: Foreign currency losses total $51,000 in the quarter (2006 – loss of $49,000). These were mainly unrealised 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 March 31, 2007 were $20.6 million compared to $27.2 million at December 31, 2006 and $15.8 million at March 31, 2006. Net cash outflows were approximately $6.6 million in the quarter compared to net cash outflows of $4.9 million in the first quarter of 2006. The prior year quarter included net equity financing of $0.6 million compared to $nil in the first quarter of 2007. Net cash outflows in respect of operations, working capital financing and capital expenditures were approximately $6.6 million compared to $5.5 million in the first quarter of 2006. The increase in cash outflows is mainly attributable to the higher operating loss of $1.9 million ($6.5 million compared to $4.6 million in 2006), an increase in capital equipment purchases of $0.1 million, and an increase in restricted cash of $0.2 million (related to a standby letter or credit established for a customer contract), partially offset by working capital requirements that were lower by $1.4 million ($0.3 million in 2007 compared to $1.75 million in the prior year quarter). The non-cash working capital changes are more fully described below.

Accounts receivable: Accounts receivable at March 31, 2007 were $3.6 million compared to $3.4 million at December 31, 2006 and $0.6 million at March 31, 2006. The increase in the current quarter and the year ended December 31, 2006 compared to the prior year quarter primarily relates to the DRS receivable of $3.2 million, which was recorded in December 2006. The payment is expected in the second quarter of 2007.

Contributions receivable: Contributions receivable were $0.6 million at March 31, 2007 ($1.3 million at December 31, 2006, $0.8 million at March 31, 2006). The decrease in the current quarter compared to the year end is primarily related to customer contributions of $0.6 million, which were included in the year end balance, collected during the current quarter.

Inventory and related prepayments: Inventory and related prepayments were $4.6 million at March 31, 2007 compared to $3.8 million at December 31, 2006 and $3.0 million at March 31, 2006. The higher inventory amount at March 31, 2007 compared to the year end and the prior year quarter is attributable to additional work-in-process inventory related to customer orders scheduled to ship in the second quarter of 2007 and additional inventories to support future orders.

Prepaid expenses: Prepaid expenses at March 31, 2007 were $1.0 million compared to $0.8 million at December 31, 2006 and $1.0 million at March 31, 2006.

Property and equipment: Net property and equipment was $5.7 million at March 31, 2007 compared to $5.6 million at December 31, 2006 and $5.6 million at March 31, 2006. Purchases of additional equipment were essentially offset by additional amortization.

Other assets: Other assets were $nil at March 31, 2007 and December 31, 2006 (2006 - $54,000). The balance in the prior year quarter related to a note receivable which was has since been repaid in full.

Goodwill and other intangibles: The Company accounted for the acquisition of Azure Dynamics Incorporated (its US subsidiary) using the purchase method, and in accordance with Canadian accounting standards, allocated the purchase price to identifiable assets, including intangibles. The excess of the purchase price consideration over identifiable assets is recorded as goodwill on the balance sheet ($2.9 million). The Company identified the order book ($0.9 million) and technology ($12.5 million) as at-acquisition intangible assets. Intangible assets were $10.2 million at March 31, 2007 ($10.5 million at December 31, 2006 and $11.8 million at March 31, 2006). The lower amount in 2007 is primarily attributable to the amortization.

Accounts payable and accrued liabilities: Accounts payable and accrued liabilities were $2.7 million at March 31, 2007 compared to $2.8 million at December 31, 2006 and $2.4 million at March 31, 2006. The higher amount in the current quarter and year end compared to the prior year is primarily attributable to increased purchasing levels related to inventory for launched product.

Customer deposits and deferred revenues: Current and long-term deferred revenue and customer deposits total $2.1 million at March 31, 2007 compared to $2.0 million at December 31, 2006 and $2.1 million at March 31, 2006). The amount is attributable to the US operation and is comprised of customer deposits in respect of work-in-progress of $1.3 million, deferred revenue of $1.1 million, and is partially offset by $0.3 million of unbilled revenues. Approximately $0.9 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 deposit balance is primarily related to deposits from initial shuttle bus customers.

Notes payable: The note payable is attributable to the US subsidiary and is the Company's proportionate share of a mortgage on the Boston property owned by ND Solectria LLC, in which the Company has a 50% interest. The note was refinanced in November 2006, is repayable on November 20, 2011, bears interest at a floating rate of the applicable Treasury rate plus 200 basis points and is secured by the mortgaged premises. The lower amount of $2.5 million at March 31, 2007 compared to $2.5 million at December 31, 2006 and $2.6 million at March 31, 2007 is attributable to principle repayments.

Share capital: Share capital at March 31, 2007 was $112.8 million compared to $112.8 million at December 31, 2006 and $81.4 million at March 31, 2006. The increase in share capital compared to the prior year quarter is primarily related to the equity financings in November 2006 (increase to share capital of $30.3 million).

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

	May 8, 2007	March 31, 2007	March 31, 2006
Common shares	198,276,177	198,276,177	157,390,445
Stock options issued under the Stock Option Plan, with expiry dates ranging up until March 21, 2014 and average exercise price of $0.93	15,783,023	15,283,023	14,214,741

During the period from March 31, 2007 to May 8, 2007 500,000 new employee options were granted.

Related Party Transactions

In November 2003, Solectria entered into a Transfer of Technology and Software Licensing Agreement ("TTA Agreement") with Singapore Technologies Kinetics ("STK"). Under the terms of the agreement, STK has a non exclusive license to use and manufacture specified technology in specified Asian countries. The Company also provided STK with the training necessary for the transfer of the technology. The license expires in November 2020, and is subject to automatic one-year renewals thereafter. The Company received cash consideration for the license and transfer of technology, and for the training in the aggregate amount of US$1.0 million (Cdn$1.2 million). As discussed in note 2(b) of the March 31, 2007 Financial Statements, revenues from the TTA Agreement are being recognized on a straight-line basis over the period of the license agreement. As of March 31, 2007, the Company has deferred revenue associated with the TTA Agreement in the amount of $1.0 million. During the three months ended March 31, 2007, 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. As of March 31, 2007, accounts receivable includes $11,000 due from STK and customer deposits includes $43,000 received from STK.

Liquidity, Capital Resources and Risk Factors

At March 31, 2007 the Company had $21.5 million (December 31, 2006 - $27.9, March 31, 2006 - $16.5 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 March 31, 2007 approximately $0.9 million of cash was restricted. The restricted cash is related to a security deposit in respect of the Boston joint venture property and lease arrangements ($0.7 million) and a standby letter of credit associated with a contract in the Boston operation ($0.2 million). Working capital was $26.1 million at March 31, 2007 compared to $32.4 million at December 31, 2006 and $15.3 million at March 31, 2006**.** The decrease in working capital compared to the year end is primarily due to the lower cash balance. The increase in working capital compared to the prior year quarter is primarily due to a combination of higher cash balance (higher by $4.8 million) and higher non-cash working capital levels (higher by $6.1 million). Non-cash working capital balances at March 31, 2007 were comparable to the year end. The increase compared to the prior year quarter of $6.1 million is primarily due to the increases in accounts receivable (higher by $3.0 million) and inventory (higher by $1.5 million) as described above, the decrease in the short term note payable as the note has since been refinanced and classified as long term), partially offset by the decreases in contributions receivable and prepaid expenses and an increase in accounts payable.

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, 2006 the Company raised approximately $31.9 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 March 31, 2007 the Company had claimed approximately $6.2 million in accordance with the terms of the TPC agreement and is therefore eligible for further contributions totalling approximately $2.8 million.

The Company intends to use its cash resources and available financing arrangements from TPC to fund ongoing product development and commercialization activities in 2007. 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.

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 21, 2007 (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 $8.1 million over the next five years, are described in note 7 to the March 31, 2007 financial statements.

Other MD&A Requirements

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

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

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

Additional Information

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