MANAGEMENT'S DISCUSSION AND ANALYSIS

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

This "Management's Discussion and Analysis" has been prepared as of November 07, 2006 and should be read in conjunction with the unaudited consolidated financial statements of the Company for the three months and nine months ended September 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 "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 for commercial and military vehicles. 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, shuttle-bus and military applications. 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 and military vehicle industries to assemble products to its specifications which are then distributed via existing industry channels to the customer.

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. Azure's strategy is to closely align product development and sales efforts with industry partners (Original Equipment Manufacturer's, component suppliers, and customers). The agreement to develop a parallel hybrid powertrain on the Ford chassis platform, announced on October 5, 2006, is significant for the Company in that it provides Azure with an avenue to achieve rapid penetration of the volume market for commercial vehicles in North America. In order to capitalize on this opportunity and to accelerate the penetration of its other product into the markets, Azure's current sales and product development emphasis is focussed as follows:

G1 (series hybrid) production: The G1 product is commercially available in delivery van and shuttle bus form. This product is specifically designed for inner-city use and is highly suitable for urban delivery vans and shuttle busses which both have a demanding drive-cycle. Azure's focus is now on sales growth initiatives and the low-volume infrastructure which is required to support the sales initiatives. Key participants include Workhorse Custom Chassis (part of the International Group) for the chassis platform, Product Concepts Inc. for the hybrid chassis modification, StarTrans (a business division of Supreme Corporation) for the shuttle bus modification and distribution channels, and Purolator Courier Ltd. as the lead customer.

P1 (parallel hybrid) development: The P1 product will have wider application than the G1 series product and is intended to address the broader, higher-volume markets. Azure's product development cycle has progressed through the initial concept development phase and will now be focused on the Ford E-350 and E-450 commercial vehicle chassis. The next phase of development will involve building and testing next-generation prototypes (including customer in-service trials). Pre-production units are anticipated late-2007 with production commencing in 2008. Ford will assist Azure in the P1 powertrain development for Ford's E series commercial chassis and it is intended, subject to formal agreement, to distribute the hybridized chassis through Ford's distribution channels.

P2 (parallel hybrid) development: The first P2 validation prototypes were delivered for in-service testing in October 2006. This program is through the initial concept development phase with promising initial results.

Azure's immediate focus is to formalise industry partner arrangements, which is a pre-requisite to the selection of the product for further development.

Under-The-Hood ("UTH") development: The UTH component product which provides a source for distributed power for both on-board vehicle auxiliary loads and off-vehicle power requirements (depending on application) was developed as a result of Azure's participation in several military programs. Azure has signed a Memorandum of Understanding with Kidron, a division of VT Specialized Vehicles Corporation, for the sale of Azure's UTH systems throughout the North American refrigerated truck body segment and is expected to be in production in 2007.

By focusing on the products and programs mentioned above, it is Management's view that the Company can make significant inroads into its addressable market thereby building a sustainable business. As the effort required to successfully commercialize the products will likely absorb Azure's engineering and operational resources for the foreseeable future, the Company intends to curtail all other activities that are not associated with production programs. Therefore the Company will seek closure on a number of active military and commercial programs where a clear path to future commercial production has not been established.

In the execution of its strategy, the Company is actively seeking one or more strategic industry partners. It is Management's view that gaining access to a relevant industry partner can help accelerate the commercialization of its Technology and also enhance the execution of the commercialization process. A strategic committee of the Board of Directors is tasked with finding suitable strategic partners and with leveraging the strategic value of the Company's asset base. The Company has retained Rothschild to advise and assist in the review of strategic options available. Evaluation of the Company's options is ongoing, and the committee and Rothschild are engaged in discussions with various parties.

Overview of Operations

Activities in the third quarter of 2006 have resulted in a number of strategic developments which have the potential to advance Azure's market penetration and major product development programs. The agreements with Ford and StarTrans align the Company's products with major relevant industry partners in their respective market categories and also provide for access to established distribution networks within those markets.

During the quarter, the first 40 production G1 series hybrid electric powered chassis were completed or are in progress. Thirty of these units are to be fitted with delivery van bodies prior to delivery to the customer in the fourth quarter of 2006. The remaining units are to be converted into shuttle busses mainly for customer deliveries that are now scheduled in early 2007. Production of the shuttle bus bodies will be undertaken by StarTrans, Azure's US shuttle bus partner. The first StarTrans G1 shuttle bus ("CitiBus") was in-progress during the quarter and subsequently completed in October. The bus was unveiled at the North American Buscon trade show in Chicago on October 20, 2006.

As a result of the Company's agreement with Ford, the development of the P1 parallel powertrain will now be focused on the Ford E-350 and Ford E-450 commercial vehicle chassis. All applicable design and testing experience from Azure's existing P1 program will be carried over to the Ford platform. This includes the experience gained from the four P1 prototypes built by Azure over the past year. As a result of technical support to be provided by Ford, the Company expects that the process to integrate the hybrid system with the engine and transmission will be facilitated. The expectation is to have prototype vehicles operational in 2007, pre-production vehicles by the latter part of 2007, and production in 2008.

The P2 parallel powertrain development is currently focused on the two Class 7 delivery trucks to be demonstrated by the Charmer-Sunbelt Group ("Charmer-Sunbelt"). The vehicles were commissioned during the quarter and delivered to the customer in October 2006. Discussions with potential program partners are in-progress with the intent to progress the P2 development into a production program.

Three months and nine months ended September 30, 2006 compared to the three months and nine months ended September 30, 2005 and the year ended December 31, 2005

During the quarter, the Company substantially completed two funded military programs. 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 the third quarter. In addition, an aviation APDS developed for the US Air Force was prepared for a contractual technical sign-off that occurred soon after the quarter ended. Both of these programs will require minimal future support from Azure. Development work on the contract to supply power electronics and drive systems to DRS Sustainment Systems, Inc. ("DRS") for integration into a HMMWV Chemical Biological Protective Shelter ("CBPS-M2") system continued throughout the quarter. All work on this program has now been curtailed while DRS await a decision by the US Military to potentially move the shelter off the HMMWV vehicle platform. Azure has re-deployed the engineering resources from this program to its core production programs, including the commercial UTH system.

During the quarter, the Company also continued to support Smith Electric Vehicles ("Smith") with its program to commission and deliver customer and demonstration vehicles using electric powertrain kits supplied by Azure.

The total number of employees increased from 109 at the end of fiscal 2005 to 114 at September 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)

	Q3, 2006 (Jul – Sep)	Q2, 2006 (Apr – Jun)	Q1, 2006 (Jan – Mar)	Q4, 2005 (Oct – Dec)
Revenue	$ 411	$ 1,205	$ 1,147	$ 965
Gross margin	$ (166)	$ 76	$ 304	$ 56
Expenses, net	$ (8,849)	$ (4,922)	$ (4,870)	$ (6,796)
Net loss for the period	$ (9,015)	$ (4,846)	$ (4,566)	$ (6,740)
Net loss per share	$ (0.06)	$ (0.03)	$ (0.03)	$ (0.04)
Weighted average number of Shares	159,206	158,638	156,631	156,116

	Q3, 2005 (Jul – Sep)	Q2, 2005 (Apr – Jun)	Q1, 2005 (Jan – Mar)	Q4, 2004 (Oct – Dec)
Revenue	$ 1,134	$ 1,525	$ 984	$ -
Gross margin	$ 154	$ 272	$ 291	$ -
Expenses, net	$ (4,788)	$ (5,872)	$ (5,213)	$ (2,729)
Net loss for the period	$ (4,634)	$ (5,600)	$ (4,922)	$ (2,729)
Net loss per share	$ (0.03)	$ (0.04)	$ (0.04)	$ (0.03)
Weighted average number of Shares	146,291	141,203	124,892	94,230

For the quarter ended September 30, 2006, the Company incurred a net loss of $9.0 million ($0.06 per share) compared to a net loss of $4.6 million ($0.03 per share) in the comparable 2005 quarter. The increased net loss in the current quarter is primarily attributable to higher engineering and product development cost, and more specifically relates to the expensing of higher cost, early production vehicles on the G1 product line,

expected to be shipped in the fourth quarter. The expenses related to these vehicles totalled approximately $2.8 million in the current quarter. Consistent with companies in the Development Stage, the costs are expensed to development costs as opposed to cost of goods sold. This increase in product development costs was partially offset by lower operating expenses in selling and marketing and general administrative, which were lower by $0.2 million compared to the comparable 2005 quarter. On a cumulative basis, the Company incurred a net loss of $18.4 million (2005 - $15.2 million). The increased net loss on a cumulative basis is primarily attributable to the higher development costs as stated above. On a cumulative basis, selling, general and administrative expenses were comparable to the prior period.

Revenue: Revenue for the quarter ended September 30, 2006 was $0.4 (2005 – $1.1 million) and $2.8 million year to date (2005 - $3.6 million). The decrease in revenue is attributable to the conclusion of funded engineering contracts which commenced in prior years. Revenue in the quarter was primarily comprised of 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 negative $0.2 million (2005 – $0.2 million) and $0.2 million year to date (2005 - $0.7 million). Gross margin as a percentage of sales was negative 40% (2005 – 14%) for the quarter and 8% (2005 – 20%) year to date. The decrease in gross margin is primarily attributable to product mix and additional costs associated with funded development programs that are winding down in the Boston operation.

Engineering, research, development and related costs, net: Before contributions, the Company expended $7.1 million on engineering, research and development operations in the quarter (2005 – $2.7 million), including $5.6 million in respect of product development costs (2005 - $1.1 million). The expenses were reduced by $0.7 million (2005 – $0.4 million) in respect of government and customer contributions. On a cumulative basis, the Company expended $12.5 million (2005 - $9.8 million) in respect of engineering, research and development operations, including $8.2 million in respect of product development costs (2005 – $4.9 million). Contributions of government and customers was $1.4 million year to date (2005 - $1.5 million). At September 30, 2006, Azure employed 86 research, engineering, operations, supply chain and other technical personnel (2005 - 79). Engineers, technicians 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 $5.6 million for the quarter and $8.2 million year to date (2005 – $1.1 for the quarter and $4.9 million year to date) include the costs of the G1 preproduction development, the cost of early G1 production vehicles as described above, P1 and P2 system development, and costs related to the development and enhancement of system components.

Customer and government contributions were $0.7 million in the third quarter of 2006 (2005 - $0.4 million) and $1.4 million year to date (2005 – $1.5 million). Technology Partnerships Canada ("TPC") contributions of $0.4 million have been recorded in the quarter (2005 - $0.4 million) and $0.9 million have been recorded year to date (2005 – $1.1 million). The Company also recorded customer contributions of $0.3 million in the third quarter of 2006 (2005 -nil) and $0.5 million year to date (2005 - $0.4 million) in respect to product delivered or to be 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 yet recorded any commercial revenues to date from those products, no royalty liability has been incurred.

Selling and marketing: Selling and marketing costs were $0.7 million in the third quarter of 2006 compared to $0.8 million in the comparable 2005 quarter. On a cumulative basis, the Company expended $2.3 million (2005 - $2.3 million). The selling and marketing headcount at September 30, 2006 is eight (2005 – nine).

General and administrative: General and administrative costs were $1.8 million in the quarter compared to $1.9 million in 2005. On a cumulative basis, the Company expended $5.5 million (2005 - $5.5 million). The

headcount at September 30, 2006 is 20 (2005 – 19).

Amortization: Amortization of property, equipment and other assets was $0.2 million in the third quarter of 2006 (year to date $0.6 million) compared to $0.2 million in the third quarter of 2005 (year to date $0.5 million). Property and equipment primarily consists of workshop equipment, tooling, computer hardware and software. The Company purchased assets with a value of $0.1 million in the quarter (2005 - $0.2 million) and $0.7 million year to date (2005 -$0.7 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 $1.2 million year to date (2005 - $1.1 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 loss total $3,000 in the quarter (2005 – gain of $90,000). Year to date, foreign currency loss was $7,000 (2005 – gain of $39,000). 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 September 30, 2006 were $3.8 million compared to $20.7 million at December 31, 2005 and $24.0 million at September 30, 2005. Net cash outflows were approximately $6.9 million in the quarter compared to $11.1 million in the third quarter of 2005. The prior year quarter included proceeds from net equity financings of $14.4. Net cash outflows in respect of operations, working capital financing and capital expenditures were approximately $7.1 million compared to $3.3 million in the third quarter of 2005. On a cumulative basis, net cash outflows were approximately $17.0 million compared to net cash inflows of $10.3 million in the comparable period in 2005. The prior year period included net equity financings of $26.2 million compared to $1.5 million in the current year. Net cash outflows in respect of operations, working capital financing and capital expenditures on a cumulative basis were approximately $18.4 million in the current year compared to $15.9 million in 2005. The increase in cash outflows in 2006 is mainly attributable to the higher operating loss of $3.2 million ($18.4 million year to date 2006 compared to $15.2 million in 2005), partially offset by lower working capital balances. 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 September 30, 2006 were $0.8 million compared to $1.0 million at December 31, 2005 and $2.0 million at September 30, 2005. The higher amount in the previous year quarter compared to the current year quarter primarily relates to a combination of higher revenue levels in the Boston operation in addition to higher levels of customer contributions receivable in the Vancouver operation relating to pre-production vehicles shipped to Purolator.

Contributions receivable: Contributions receivable, representing specific development cost contributions from TPC, were $0.6 million at September 30, 2006 ($0.6 million at December 31, 2005, $1.1 million at September 30, 2005). The balance was higher in September 2005 due to three quarterly claims being outstanding compared to two quarters outstanding at the end of September 2006.

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

Prepaid expenses: Prepaid expenses at September 30, 2006 were $1.0 million compared to $1.0 million at December 31, 2005 and $1.0 million at September 30, 2005.

Property and equipment: Net property and equipment was $5.7 million at September 30, 2006 compared to $5.6 million at December 31, 2005 and $5.6 million at September 30, 2005.

Other assets: Other assets of nil ($61,000 at December 31, 2005 and $62,000 at September 30, 2005), are related to a note receivable. The note was repaid in full during the current quarter.

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 $11.1 million at September 30, 2006 ($12.1 million at December 31, 2005 and $12.5 million at September 30, 2005). The lower amount in 2006 is primarily attributable to the amortization.

Accounts payable and accrued liabilities: Accounts payable and accrued liabilities were $4.2 million at September 30, 2006 compared to $3.4 million at December 31, 2005 and $2.6 million at September 30, 2005. The higher balance at September 2006 compared to the prior year is primarily attributable to payables related to work-in-process related to customer programs and accrued liabilities related to anticipated exit costs associated with switching bus manufacturers.

Customer deposits and deferred revenues: Current and long-term deferred revenue and customer deposits total $1.5 million at September 30, 2006 compared to $2.6 million at December 31, 2005 and $2.5 million at September 30, 2005. The amount 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 $0.9 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 September 30, 2006 was $82.4 million compared to $80.7 million at December 31, 2005 and $80.6 million at September 30, 2005.

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

	November 07, 2006	September 30, 2006	September 30, 2005
Common shares	195,023,454	159,379,983	156,037,448
Stock options issued under the Stock Option Plan, with expiry dates ranging up until July 29, 2013 and average exercise price of $0.93	12,096,068	12,253,068	11,917,738

During the period from September 30, 2006 to November 07, 2006, 157,000 options were exercised into common shares. On November 7, 2006 the Company issued 35,486,471 common shares upon the closing of an equity financing.

Related Party Transactions

During the nine months ended September 30, 2005 the Company paid $251,000 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 nine months ended September 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 September 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 September 30, 2006, the Company has deferred revenue associated with the TTA Agreement in the amount of $1.0 million. During the three months ended September 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 $16,000 ($51,000 year to date). As of September 30, 2006, accounts receivable includes $11,000 due from STK and customer deposits includes $43,000 received from STK.

As of September 30, 2006, the Company's accounts receivables balance includes approximately $17,000 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 September 30, 2006 the Company had $4.5 million (December 31, 2005 - $21.4; September 30, 2005 - $24.7 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 September 30, 2006 approximately $0.7 million (December 2005 - $0.7 million and September 2005 - $0.7 million) of cash was restricted as security in respect of the Boston joint venture property and lease arrangements. Working capital was $3.3 million at September 30, 2006 compared to $18.5 million at December 31, 2005 and $26.5 million at September 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 $1.7 million since December 2005 primarily due to the increases in inventories.

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 September 30, 2006 the Company had claimed approximately $5.8 million in accordance with the terms of the TPC agreement and is therefore eligible for further contributions totalling approximately $3.2 million.

On October 24, 2006 the Company announced the filing of a preliminary short form prospectus in each of the Provinces of Ontario, British Columbia, Alberta and Québec in respect of a marketed offering of common shares. The underwriters for the Offering have also been granted an option to purchase that number of additional common shares as is equal to 10% of the size of the Offering for market stabilization and over-allotment purposes. This option may be exercised in whole or in part until 30 days after the closing of the Offering. The Offering is subject to certain conditions including, but not limited to, the receipt of all necessary approvals, including the approval of the Toronto Stock Exchange and the Alternative Investment Market of the London Stock Exchange

On October 31, 2006 the Company announced the filing of a final short form prospectus in each of the Provinces of Ontario, British Columbia, Alberta and Québec in connection with the previously announced marketed short form prospectus offering of the Company.

On November 7, 2006 the Company announced that it has closed its offering of 31,176,471 common shares of the Company at a price of $0.85 per common share for aggregate gross proceeds of $26,500,000. Clarus Securities Inc. and Paradigm Capital Inc. acted as co-lead underwriters in connection with the offering. The underwriters have also been granted an option to purchase up to an additional 3,117,647 common shares for

market stabilization and over-allotment purposes. This option may be exercised in whole or in part until 30 days after the closing date.

The Company also announced that is has closed its previously announced £1,724,000 (approximately $3,670,000) brokered private placement offering of 4,310,000 common shares in the United Kingdom at a price of £0.40 ($0.85) per common share. Numis Securities Limited acted as Azure's agent in connection with the UK Offering.

The Company intends to use its cash resources and available financing arrangements to fund ongoing product development and commercialization activities in. 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 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 $6.2 million over the next five years, are described in note 7 to the September 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 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 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.