DYNEX POWER INC

REPORT FOR THE QUARTER ENDED JUNE 30th 2006

Our objectives are

To grow and develop as a leading independent manufacturer of high power and high reliability electronic products

Our key values are

Customers

Delivering confidence in our products and services through applying high standards of quality and service whilst maintaining a personal and flexible approach to our customers.

Engineering

Enabling access to the best engineering skills and applying the highest technical standards to our customers' requirements.

Profitability

Sustaining and developing our business through directing efforts into the most profitable sectors of our business.

Integrity

Being honest, straightforward and reliable in dealing with people across all areas of our business.

Table of Contents

This report may contain forward looking statements that involve a number of risks and uncertainties, including statements regarding the outlook for the Corporation's business and results of operations. By nature, these risks and uncertainties could cause actual results to differ materially from those indicated. Such factors include, without limitation, the various factors set forth in the Management Discussion & Analysis of this report as discussed in public disclosure documents filed with the Canadian Regulatory Authorities. Dynex disclaims any intention or obligation to update or revise any forward looking statement whether as a result of new information, future events or otherwise.

Letter to Shareholders

Quarter 2 has remained on plan. Despite the expected decline in revenue, sales this year to date were ahead of last year by 32% in Pounds Sterling (17% when translated in to Canadian dollars) and delivered gross margins of 17% compared to a gross loss of 2% this time last year. Our growth is well ahead of market conditions, typically 10%, and both the revenue growth, and the increased gross profits reflect the outcome of our efforts to improve our manufacturing operations.

… quarter 2 saw a growth in order book

In our previous report we advised that quarter two and the coming third quarter would present a number of challenges, as the phasing of our customers' projects would slow down revenues. Indeed the decline in revenues reported here for the second quarter, compared to the first, is largely attributable to this phasing. However, we are pleased to report that we received contracts for equipment to be used for electric utility interconnections in the Gulf States, and for components for use in the UK Royal Navy type 45 frigates. The total value of these new contracts exceeded $3.5million to be delivered over a period of one year commencing in the fourth quarter, and they secure on-going business for both our Power Assemblies and our Power Modules product groups. As a result, our year-to-date book-to-bill ratio improved to 1.19 and we saw a growth in order book to $13 million, compared to $11 million at this time last year. The other main reason for the revenue slow down was a capacity constraint in one particular process and we have taken steps to increase capacity in this area.

The previously reported interruption to our silicon-on-sapphire (SOS) manufacture due to material and associated process re-qualifications held back revenue in this area which otherwise would have compensated for the slow down in the other businesses. We are pleased to report that the material assessment has been completed successfully and subject to finalising the associated process qualification later this year, we predict further growth in our SOS revenues. However, this growth is running a few months later than planned.

…success in winning R&D funding

One advantage of the Dynex operations facility being located in the UK is that we can benefit from the research and development incentives offered to UK industry by both the European Union (EU) and the UK Department of Trade for Industry (DTI). Last autumn, the DTI announced that it had allocated funds to support innovation in the UK power electronics sector and was accepting proposals for collaborative R&D projects between industries and academia. Since then Dynex has been working with a number of partners, both industrial and academic, to secure a share of this funding. We were advised in June of success in winning R&D funding for all the projects we had submitted. We were further advised that under a different EU funding scheme we would be receiving R&D support for power modules for an aerospace programme. Thus, subject to final negotiations, we anticipate a major boost to R&D investment in all our power business groups giving Dynex a firm foundation for its new product development programmes over the next three years.

Dynex is committed to grow and develop as a leading independent manufacturer of high power and high reliability electronic products. To achieve that goal our R&D and engineering programmes are focused on high power thyristors, ultra-high power IGBT modules, power electronic assemblies and high reliability silicon-on sapphire integrated circuits.

…outlook for the coming two quarters

Looking forward, our outlook for the coming two quarters is for revenues in the third quarter to be similar to the second quarter as shipments under the new Gulf and type 45 contracts will not be effective until the fourth quarter, and qualification of the SOS process is delayed until the fourth quarter. However, revenues in the last quarter are expected to be stronger and will be sustained into next year.

To support the predicted revenues we have continued to increase our levels of employment particularly in the production areas. However, owing to the boost in our R&D funds, and with the further objective of improving our sales coverage, we are also increasing our staffing levels in both sales and R&D. Total numbers employed by Dynex at the start of the year were 192 and at end of June had risen to 207.

Finally, I would like thank you for your support and confidence, and look forward to working with you as together we grow and develop Dynex Power.

Paul Taylor
President and Chief Executive Officer.

Management Discussion & Analysis

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes of the Corporation for the quarter ended June 30th, 2006.

This report may contain certain forward-looking statements that involve a number of risks and uncertainties, including statements regarding the outlook for the Group's business and results of operation. By nature, these risks and uncertainties could cause actual results to differ materially from those indicated. Such factors include, without limitation, the various factors set forth in the Management Discussion & Analysis of this report as discussed in public disclosure documents filed with Canadian regulatory authorities.

Overview

The financial performance in the second quarter of 2006 was in line with the Company's business plan and budget. As forecast, revenue fell back from the level achieved in the first quarter of 2006 and this, together with higher expenses, resulted in a loss of $629,000.

Revenue

Revenue for the second quarter of 2006 was $5.3 million, down by $829,000 or 14% from the first quarter of 2006. As exchange rates between the dollar and sterling have remained stable, this decline reflects the decline seen in sterling in the books of the UK operating company. This decline in revenue compared to the first quarter had been expected. Revenue was down by $306,000 or 5% against the corresponding quarter of last year. However, the strengthening of the dollar over the last twelve months caused this decline. In sterling terms, revenue had risen by 7%.

As previously reported, the second quarter contained no major assembly projects. As a result, revenue in the Assemblies business was down by $439,000 compared to the first quarter. The lack of a major assembly project also held back the revenue reported by the IGBT and Power Units business. A capacity constraint on one process impacted on Bipolar revenue, when the product mix in the quarter placed a heavy demand on that particular process. Steps have been taken to increase capacity in this area. Revenue in the IC business was higher than in the first quarter but could have been higher but for the need to qualify new materials and suppliers in order to safeguard the future potential of this business.

Revenue for the year to date is $1.6 million ahead of last year and is in line with the Company's business plan and budget.

Gross Margin

The gross margin in the second quarter of $803,000 was $312,000 or 28% lower than in the first quarter of 2006, but was $463,000 or 2.4 times the gross margin reported in the corresponding quarter of last year. The fall in gross margin compared to the first quarter reflects the lower revenue reported. Gross margin for the year to date is $2.2 million better than last year and is in line with our budget.

Expenses

Overhead expenses in the second quarter of 2006 of $1.4 million were $290,000 or 26% higher than in the first quarter of 2006, and $397,000 or 38% higher than in the corresponding quarter of last year. Included in overhead expenses in the second quarter was a charge of $132,000 relating to the settlement of legal disputes in France. In addition we have made controlled increases in our sales and marketing and research and development expenditures to support the future growth of the business. For the year to date, overhead expenses are $481,000 or 23% higher than last year. The legal cost and the carefully controlled investment explains this increase.

Interest & Other Income

Interest and other income was $51,000 in the second quarter of 2006, down by $22,000 or 30% compared to the preceding quarter. The figure was $1,000 or 1% higher than that of the corresponding quarter of last year. The main constituent of Other Income continues to be the $39,000 quarterly release of deferred revenue arising from the sale and leaseback of a building in 2003.

Foreign Exchange Loss

There was a foreign exchange loss in the quarter of $52,000, compared to a gain of $20,000 in the first quarter of 2006. A loss of $27,000 had been reported in the corresponding quarter of last year. By their nature, these gains and losses are unpredictable.

Income Taxes

No tax is payable on the profit reported in the quarter or on the profit reported in the corresponding quarter of last year. As a result of brought forward losses, no tax was payable on the profit reported in the first quarter.

Net Profit / Loss

The Company reported a net loss of $629,000 in the quarter compared to the profit reported in the previous quarter $66,000. The loss arises from the fall in revenue for the quarter and had been expected. Net losses of $671,000 had been reported in the corresponding quarter of last year. The net loss for the year to date of $563,000 is in line with our budget and is a reduction of $1.7 million or 75% compared to the year to date loss reported in the first half of 2005.

Segmental Analysis

Revenue for Bipolar Discrete Units in the quarter of $3.2 million was $266,000 or 8% lower than the previous quarter and $190,000 or 6% lower than in the corresponding quarter of last year. This is mainly due to the product mix in the second quarter placing a heavy demand on one particular process. Steps have been taken to increase capacity in this area. Nevertheless the figure for the year to date of $6.8 million is $1.3 million or 24% ahead of the first half of 2005.

Revenue for IGBT and Power Units in the quarter of $759,000 was $226,000 or 23% lower than in the first quarter of 2006. The first quarter sales of IGBT's and Power Units had been the highest for four years and had been expected to fall in the short term. The lack of a major assembly project held back revenue in this business. However, revenue was $117,000 or 18% higher than in the corresponding quarter of last year. For the year to date, sales of $1.7 million are $244,000 or 16% higher than the first half of 2005, indicative of the long term growth expected in this business.

Revenue for Power Electronic Assemblies of $653,000 was $439,000 or 40% lower than in the preceding quarter and $563,000 or 46% lower thanthe corresponding quarter of last year. This drop had been expected and resulted from the lack of a major assembly project during the quarter. For the year to date, the fall in sales is $486,000 or 22%. Nevertheless, with large projects starting late in the third quarter and continuing through the fourth quarter and into 2007, revenue growth for this business is still expected to be reported in 2006.

Revenue from Integrated Circuits for the quarter of $598,000 was $102,000 or 21% higher than in the preceding quarter. Revenue was $330,000 or 1.2 times higher than it had been in the corresponding quarter of last year. Revenue was held back significantly compared to what it could have been if we did not have to qualify new materials and sources of supply. Nevertheless, revenue for the year to date is $562,000 higher, or more than twice what it was, in the first half of 2005. As previously reported, prospects for this business remain good following an announcement to customers that we are able to continue supporting the product.

Seasonality

Management does not regard the business as seasonal. Significant changes in quarterly revenues in bipolar discrete units and IGBT and power units in the past have reflected internal operating conditions. In the case of power electronic assemblies and integrated circuits, small numbers of large contracts drive both these segments. The delivery of a large contract in a particular quarter can cause revenue to fluctuate significantly, giving the appearance of seasonality.

Liquidity & Capital Resources

During the first half of 2006, a private placement of shares raised $550,000 and shares were issued to directors for their services in the second half of 2005. As the value of these two transactions exceeded the loss for the year to date, the deficit on shareholders' funds has fallen slightly.

The total borrowings of the Company have fallen by $1.1 million since the year end with the majority of the reduction taking place in short term debt.

The Company believes that it has access to adequate liquidity to meet its needs for at least the next twelve months.

	2006 Q2	2006 Q1	2005 Q4	2005 Q3	2005 Q2	2005 Q1	2004 Q4	2004 Q3	2005 FY	2004 FY	2003 FY
Revenue	5,253	6,082	7,356	5,681	5,559	4,166	5,543	6,266	22,761	23,886	23,563
Continuing operations:											
Net earnings/(loss)	(629)	66	781	(293)	(671)	(1,606)	(1,442)	(1,438)	(1,788)	(5,380)	(7,477)
Basic EPS	(0.02)	0.00	0.03	(0.01)	(0.02)	(0.06)	(0.05)	(0.06)	(0.07)	(0.23)	(0.38)
Diluted EPS	(0.02)	0.00	0.03	(0.01)	(0.02)	(0.06)	(0.05)	(0.06)	(0.07)	(0.23)	(0.38)
Total operations:											
Net earnings/(loss)	(629)	66	781	(293)	(671)	(1,606)	(1,442)	(1,438)	(1,788)	(5,380)	(2,087)
Basic EPS	(0.02)	0.00	0.03	(0.01)	(0.02)	(0.06)	(0.05)	(0.06)	(0.07)	(0.23)	(0.11)
Diluted EPS	(0.02)	0.00	0.03	(0.01)	(0.02)	(0.06)	(0.05)	(0.06)	(0.07)	(0.23)	(0.11)
Total assets	10,923	11,745	12,798	11,282	11,444	12,482	14,669	14,916	12,798	14,669	14,862
Long term liabilities	3,942	2,445	3,048	3,655	3,884	3,765	271	0	3,048	271	13
Cash Dividends paid	0	0	0	0	0	0	0	0	0	0	0

Selected Financial Information

Selected quarterly financial information (taken from the unaudited quarterly reports) and annual information (taken from the annual reports) are presented below. All amounts are stated in thousands of dollars except for earnings per share figures (EPS) which are stated in dollars per share. The figures for long term liabilities do not include deferred revenues, as these are not a liability of the Corporation and will not give rise to a cash outflow.

Annual revenue has stabilised over the last three years and is forecast to grow in 2006. The fall in the quarterly revenue figures in the fourth quarter of 2004 and the first quarter of 2005 primarily reflected liquidity problems within the Corporation. Since then, revenue has recovered steadily. Revenue in the fourth quarter of 2005 included some very large deliveries of Integrated Circuits and that level of revenue exaggerated the speed of the recovery. The reduction in revenue in the second quarter of 2006 was expected and revenue is expected to recover towards the end of the year.

The reduction in the annual loss from continuing operations is encouraging and clearly shows the impact of long-term cost reduction initiatives. The same trend is evident in the quarterly earnings figures. The net earnings figure in the fourth quarter of 2005 was particularly high due to the large deliveries of Integrated Circuits and that level was uncharacteristic. The return to net losses in the second quarter of 2006 was expected and is a direct result of the lower revenue.

Results from total operations differ from the results from continuing operations in 2003 due to profits earned by the microwave sensors business that was sold in that year and also as a result of the profit on the sale of that business.

Risk Management

The level of worldwide demand for power semiconductors and power semiconductor assemblies is one of the key uncertainties for the Corporation. Demand was at a relatively low level during 2002 and 2003. The incidence of widespread power blackouts, the rising cost of energy and the global plan to reduce carbon emissions have led to widespread discussion of the need for significant investment in power electronic equipment, electrification of transport systems, alternative power generation and high quality power transmission and distribution. Such investment would benefit the Corporation and management has already seen the first stages of recovery in demand from such investment. The failure to carry through this investment would be detrimental to the future of the business.

As disclosed in the Financial Statements, the Corporation has no single customer accounting for over 10% of revenue during the quarter. Our relationship with all our main customers remains good.

Although the Corporation buys some materials in continental Europe, the Far East and North America, the bulk of its costs are incurred in Sterling. However, it sells into world markets with many sales denominated in Euros and US dollars. As a consequence, the Corporation's results are affected by changes in exchange rates between these currencies. Management monitors these exposures but does not believe that it would be beneficial to hedge them. The need to undertake such hedging is reviewed from time to time.

The Corporation's main operating business is in Lincoln, England and the majority of its assets, liabilities, revenues, expenses and cash flows take place and are recorded in Sterling. These values have to be translated to Dollars for inclusion in the consolidated financial statements of the Corporation. Movements in the Dollar-Sterling exchange rate directly affect such values. The Corporation does not hedge such exposures.

Related Party Transactions

The Corporation incurred expenses of $19,928 in the quarter in respect of fees payable to directors. As at June 30th, 2006 a total of $40,000 was payable to Directors in respect of their fees. The Directors' fees are recorded at negotiated amounts and will be paid in shares of the Corporation as per the Directors' Share Plan.

The Corporation has loans from two Directors totalling £1.8 million ($3.7 million) which bear interest at rates between 7% and 10% per annum compounded monthly. The maturity of these debts was renegotiated and extended during the quarter. Repayments now start in April 2007.

Business Development

Revenue in the second quarter of 2006 was in line with expectations. Revenue is expected to remain stable in the third quarter Revenue should increase in the fourth quarter. Management still expects revenue in 2006 to be higher than that reported in 2005, enabling the Corporation to be profitable for the year as a whole.

Subsequent Event

A total of 571,430 common shares was issued at $0.07 per share to the independent directors in August 2006 in payment of their fees for the period January 1st, 2006 to June 30th, 2006.

Breach of Covenant on Short Term Loan

The Corporation is in breach of a covenant on the facility. A replacement facility is being finalised with a new lender that will come into affect as soon as the documentation has been completed.

Bob Lockwood.
Director and Chief Financial Officer

DYNEX POWER INC.
Consolidated Balance Sheet (Unaudited)
Quarter Ended June 30th, 2006

		Jun 30th 2006		Dec 31st 2005
CURRENT ASSETS				
Cash and cash equivalents	$	**309,420**	$	331,897
Accounts receivable		**3,754,498**		5,484,910
Inventories (Note 3)		**5,988,908**		5,951,526
Prepaid expenses and deposits		**413,529**		551,135
		10,466,355		12,319,468
CAPITAL ASSETS (Note 4)		**456,241**		478,938
	$	**10,922,596**	$	12,798,406
CURRENT LIABILITIES				
Accounts payable and accrued liabilities	$	**4,299,433**	$	5,125,882
Short-term loan (Note 5)		**1,513,631**		2,607,515
Current portion of long-term debt (Note 6)		**458,160**		1,396,219
Current portion of deferred revenue (Note 7)		**156,188**		155,515
		6,427,412		9,285,131
LONG-TERM DEBT (Note 6)		**3,942,414**		3,048,252
LONG-TERM DEFERRED REVENUE (Note 7)		**1,679,022**		1,749,547
		12,048,848		14,082,930
CONTINGENCIES (Note 16)		**-**		-
		12,048,848		14,082,930
SHAREHOLDERS' DEFICIENCY				
Share capital (Note 8)		**13,694,330**		12,955,163
Deficit		**(14,388,076)**		(13,824,595)
Cumulative translation adjustment		**(432,506)**		(415,092)
		(1,126,252)		(1,284,524)
	$	**10,922,596**	$	12,798,406

DYNEX POWER INC.
Consolidated Statement of Losses and Deficits (Unaudited)
Quarter Ended June 30th, 2006

	3 months Jun 30th 2006	3 months Jun 30th 2005	YTD Jun 30th 2006	YTD Jun 30th 2005
Revenue	$ 5,252,868	$ 5,558,518	$ 11,335,167	$ 9,724,563
Cost of sales	4,449,732	5,218,483	9,417,274	9,964,273
Gross margin	803,136	340,035	1,917,893	(239,710)
Expenses				
General and administration	743,924	585,657	1,350,082	1,160,967
Sales and marketing	276,568	259,191	479,718	548,445
Research and development	209,036	133,393	359,307	270,019
Interest expense	202,564	56,461	384,956	113,135
	1,432,092	1,034,702	2,574,063	2,092,566
Loss before other income (expenses) and income taxes	(628,956)	(694,677)	(656,170)	(2,332,276)
Other income (expenses)				
Interest and other income	51,154	50,411	124,500	100,174
Foreign exchange loss	(51,645)	(26,685)	(31,811)	(44,644)
	(491)	23,726	92,689	55,530
Income taxes (Note 9)	-	-	-	-
NET LOSS	(629,447)	(670,941)	(563,481)	(2,276,746)
DEFICIT, BEGINNING OF PERIOD	(13,758,629)	(13,642,140)	(13,824,595)	(12,036,335)
DEFICIT, END OF PERIOD	$ (14,388,076)	$ (14,313,081)	$ (14,388,076)	$ (14,313,081)
Loss per share				
Basic	$ (0.02)	$ (0.02)	$ (0.02)	$ (0.08)
Diluted (Note 10)	$ (0.02)	$ (0.02)	$ (0.02)	$ (0.08)
Weighted average number of shares				
Basic	30,107,131	27,070,659	29,454,560	27,012,110
Diluted (Note 10)	30,107,131	27,070,659	29,454,560	27,012,110

DYNEX POWER INC.
Consolidated Statement of Cash Flows (Unaudited)
Quarter Ended June 30th, 2006

	3 months Jun 30th 2006	3 months Jun 30th 2005	YTD Jun 30th 2006	YTD Jun 30th 2005
OPERATING				
Net loss	$ (629,447)	$ (670,941)	$ (563,481)	$ (2,276,746)
Items not affecting cash				
Amortization	56,005	56,811	109,692	116,710
Gain on disposal of capital assets	(39,355)	(44,362)	(78,543)	(89,391)
Shares and options issued for services	117,608	118,956	174,718	123,678
Changes in non-cash operating working capital (Note 12)	(322,783)	(948,096)	1,040,045	496,434
	(817,972)	(1,487,632)	682,431	(1,629,315)
FINANCING				
Shares issued for cash	550,000	-	550,000	-
Increase in loans from a director	-	458,875	-	2,089,088
(Decrease) increase in short-term debt	(416,340)	709,221	(1,110,924)	(406,808)
Decrease in long-term debt	(32,573)	(35,003)	(63,494)	(82,379)
	101,087	1,133,093	(624,418)	1,599,901
INVESTING				
Purchase of capital assets	(51,415)	(58,728)	(84,906)	(60,547)
	(51,415)	(58,728)	(84,906)	(60,547)
NET DECREASE IN CASH	(768,300)	(413,267)	(26,893)	(89,961)
Effect of foreign currency translation on cash flow	4,847	11,393	4,416	13,070
Cash and cash equivalents, beginning of period	1,072,873	575,358	331,897	250,375
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 309,420	$ 173,484	$ 309,420	$ 173,484

Supplementary Information:

Interest paid	$ 152,624	$ 56,461	$ 354,950	$ 113,135
Income taxes paid during period	-	-	-	-

1. DESCRIPTION OF BUSINESS

The Corporation is engaged in the design and manufacture of industrial power equipment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting policies

The consolidated financial statements presented here are prepared using the same accounting policies as were used last year, details of which are set out in the Annual Report for 2005 and are in accordance with Canadian generally accepted accounting principles.

Basis of consolidation

The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries, Dynex Semiconductor Limited and Dynex SARL, in accordance with Canadian generally accepted accounting principles.

Currency of reporting

All figures are in Canadian dollars except as otherwise stated.

Use of accounting estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires the Corporation's management to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period presented. Examples of such estimates include the anticipated useful lives of assets, the provisions required against inventory and accounts receivable, stock based compensation and warranties. Actual results could differ from the estimates made by management.

Cash and cash equivalents

Cash and cash equivalents include investments that have terms of three months or less at the time of acquisition. Cash equivalents consist primarily of term deposits. The carrying amounts of cash and cash equivalents are stated at cost plus accrued interest, which approximates their fair market value.

Inventories

Raw materials and work in progress are valued at the lower of cost and replacement cost, and finished goods at the lower of cost and net realizable value. Raw materials are valued at standard cost that accurately reflects their purchase cost. Work in progress and finished goods are valued at the standard cost of direct material and labour plus allocated overheads. Inventory is provided for if raw materials have not moved in six months and if work in progress or finished goods have not moved in three months unless the Corporation has orders or a realistic expectation of orders for those parts.

Capital assets

Capital assets are recorded at cost. Amortization is calculated using the straight-line method over the anticipated useful lives of the assets as follows:

Equipment	3-8 years

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Deferred revenue

The gain on the sale and leaseback of the land and buildings (note 7) is being amortized over the 15 year minimum term of the resulting lease.

Revenue recognition

The Corporation recognizes revenues from sales to end-customers and to its distributors at the time of shipment provided that all significant contractual obligations, including customer acceptance, have been satisfied and collection is reasonably assured. Any potential for warranty claims is provided for at the time of sale, based on warranty terms and prior claims experience.

Foreign currency translation

The Corporation considers its wholly owned subsidiaries, Dynex Semiconductor Limited and Dynex SARL, to be self-sustaining subsidiaries and the accounts in foreign currency are translated into Canadian dollars using the current rate method of foreign currency translation. Under this method, assets and liabilities are translated at the exchange rate in effect as of the balance sheet date and income and expense items are translated at the average exchange rate for the period. Net unrealized exchange adjustments arising on translation of foreign currency are included in shareholders' deficiency as cumulative translation adjustment.

Research and development costs

Research costs are expensed as incurred. Expenditures for research and development equipment are capitalized. Development costs are expensed as incurred, unless the criteria for deferral under generally accepted accounting principles are met. To date, no such costs have been capitalised.

Income taxes

The Corporation and its subsidiaries account for income taxes using the liability method. Under this method, current income taxes are recognized for estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting basis of assets and liabilities and for the benefits of tax losses available to be carried forward to future years if these are more likely than not to be realized.

Stock-based compensation

The Corporation follows the CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments" which establishes standards for the recognition, measurement and disclosure of stock-based compensation. Any consideration paid by employees on the exercise of stock options is recorded as share capital.

3. INVENTORIES

	Jun 30th 2006	Dec 31st 2005
Raw materials	**$ 1,268,246**	$ 1,242,675
Work in progress	**3,686,678**	3,826,110
Finished goods	**1,033,984**	882,741
	$ 5,988,908	$ 5,951,526

Inventory is stated net of a provision of $5,237,501 (Dec 31st, 2005 - $5,757,672) for obsolescence.

4. CAPITAL ASSETS

	Cost	Accumulated Amortization	Jun 30th 2006 Net Book Value	Dec 31st 2005 Net Book Value
Equipment	**$ 2,084,679**	**$ 1,628,438**	**$ 456,241**	$ 478,938
	$ 2,084,679	**$ 1,628,438**	**$ 456,241**	$ 478,938

5. SHORT-TERM LOAN

The Corporation has a short-term loan of $1,513,631 (Dec 31st, 2005 - $2,607,515) secured by a first charge on all capital assets, inventory, cash and cash equivalents and accounts receivable. The loan is repayable on demand. The Corporation is in breach of a covenant on the facility.

6. LONG-TERM DEBT

		Jun 30th 2006		Dec 31st 2005
Interest free unsecured loan payable in monthly instalments of $10,270 to November 2007.	**$**	**174,593**	$	235,195
Loans from individual shareholders payable in monthly instalments of $25,022 between January 2007 and October 2008, bearing interest at 10% and secured under a general security agreement. A total of $125,000 of these loans is convertible into 357,143 shares at a conversion price of $0.35 per share at any time prior to the repayment date at the option of the lender.		**550,491**		549,620
Loans from two directors payable in monthly instalments of $61,595 between April 2007 and July 2010, bearing interest at 7% and secured under a general security agreement. A total of $1,750,155 of these loans is convertible into approximately 33.2% of the share capital of Dynex Semiconductor Limited at any time prior to the repayment date at the option of the lender.		**2,463,790**		2,453,176
Loan from a director payable in monthly instalments of $30,293 between July 2007 and October 2010 bearing interest at 10% and secured under a general security agreement.		**1,211,700**		1,206,480
		4,400,574		4,444,471
Current portion		**458,160**		1,396,219
	$	**3,942,414**	$	3,048,252

The repayment dates on the loan from shareholders, the loan from a director and the loans from two directors were renegotiated during the quarter. The above repayment dates reflect the new agreements. All other terms and conditions of the loans remain as before.

Principal payments

Principal payments required in each of the next five years are:

Under 1 year	**$**	**458,160**
1-2 years		**1,454,267**
2-3 years		**1,202,736**
3-4 years		**1,102,647**
4-5 years		**182,764**
	$	**4,400,574**

7. DEFERRED REVENUE

On March 25th, 2003 the Corporation's subsidiary entered into a sale and leaseback of its Lincoln, England land and buildings. The gain realized on the sale has been deferred. Amortization of this gain, amounting to $39,355, is included in other income for the quarter ended June 30th, 2006 (Jun 30th, 2005 - $44,362).

8. SHARE CAPITAL

Authorized:
An unlimited number of common shares.
An unlimited number of preferred shares issuable in series.

Issued:
The Corporation's issued and outstanding share capital is as follows:

			Jun 30th 2006		Dec 31st 2005
Common shares	- amount	**$**	**13,694,330**	$	12,955,163
	- number		**32,196,183**		27,058,244

The Corporation has no issued and outstanding preferred shares.

Common share transactions

On May 8th, 2006 the Corporation issued 5,000,000 shares by way of a private placement at $0.11 per share.

On May 8th, 2006 the Corporation issued 137,939 shares to the independent directors for their services in the second half of 2005 under the Independent Directors' Share Plan at a price of $0.30 per share.

Warrant transactions

The Corporation has outstanding warrants to acquire 3,233,334 shares at the option of the holders at $0.60 per share any time before July and August 2006. The Corporation also has outstanding warrants to acquire 357,143 shares at the option of the holders at $0.35 per share any time before October 2007.

8. SHARE CAPITAL (Continued)

Stock option plan

A total of 2,657,316 (Dec 31st, 2005 - 2,657,316) of the common shares of the Corporation outstanding from time to time are reserved for the issuance of stock options pursuant to the Corporation's stock option plan. Generally, options granted under the plan vest evenly over a three-year period commencing one year from the date of grant and expire five years from the date of the grant. Options are not assignable. The movements in stock options are summarized below:

	Number of Options	Weighted Average Exercise Price
Outstanding at December 31st, 2004	1,464,000	$ 1.02
Granted	650,000	0.08
Exercised	-	-
Cancelled	(1,239,000)	1.11
Outstanding at December 31st, 2005	875,000	0.24
Granted	-	-
Exercised	-	-
Cancelled	(75,000)	1.59
Outstanding at June 30th, 2006	**800,000**	**$ 0.11**

The weighted average remaining life of the outstanding options is 3 years and 11 months. At June 30th, 2006 there are 150,000 options exercisable with a weighted average exercise price of $0.23 and a weighted average remaining life of 1 year and 10 months.

At June 30th, 2006 the following stock options are outstanding:

	Grant Date	Expiry Date	Number of Options	Exercise Price
Officers	April 28, 2003	April 27, 2008	150,000	$ 0.23
	Nov 30, 2005	Nov 29, 2010	550,000	0.08
Directors who are not officers	-	-	-	-
All other employees	Nov 30, 2005	Nov 29, 2010	100,000	0.08
Total outstanding			**800,000**	**$ 0.11**

Stock-based compensation

As a result of accounting for stock based compensation related to options granted to employees using the fair-value based method, the Corporation recorded $4,136 of stock based compensation in general & administrative expenses in the quarter ended June 30th, 2006 (Jun 30th, 2005- $1,132). The fair value was determined following the Black-Scholes pricing model using the following assumptions: expected option life of five years; volatility of 58%; and risk free interest rate of 3%.

9. INCOME TAXES

The provision for income taxes reported differs from the amount computed by applying the Canadian statutory rate to earnings before income taxes for the following reasons:

	3 months Jun 30th 2006	3 months Jun 30th 2005	**YTD Jun 30th 2006**	YTD Jun 30th 2005
Loss before income taxes	**$ (629,447)**	$ (670,941)	**$ (563,481)**	$ (2,276,746)
Expected tax (recovery)	**(227,230)**	(242,210)	**(203,417)**	(821,906)
Increase (decrease) resulting From:				
Prior year losses utilized	**-**	-	**-**	-
Unrecorded benefit of tax Loss	**227,230**	242,210	**203,417**	821,906
	$ -	$ -	**$ -**	$ -

The Canadian statutory tax rate of 36.1% (June 30th, 2005 – 36.1%) comprises Federal income tax at approximately 22.1% (Jun 30th, 2005 – 22.1%) and Provincial income tax at approximately 14% (Jun 30th, 2005 – 14%). The United Kingdom statutory rate is 30% (Jun 30th, 2005 – 30%).

As at June 30th, 2006 the Corporation has undeducted research and development expenditures of approximately $43,000 which are available without expiry to reduce future years' Canadian Federal and Provincial taxable income.

As at June 30th, 2006 the Corporation has Canadian capital loss carry forwards of $41,000 without expiry to reduce future years' capital gains.

As at June 30th, 2006 the Corporation also has Canadian tax loss carry forwards available to reduce future years' income for tax purposes. These loss carry forwards expire as follows:

Year of expiry	Provincial	Federal
2006	**$ 520,000**	**$ 520,000**
2007	**424,000**	**424,000**
2008	**421,000**	**421,000**
2010	**688,000**	**688,000**
2014	**109,000**	**109,000**
2015	**679,000**	**679,000**
2016	**202,000**	**202,000**
	$ 3,043,000	**$ 3,043,000**

9. INCOME TAXES (Continued)

As at June 30th, 2006 the Corporation has United Kingdom tax loss carry forwards of £4,210,000 ($8,502,000) available to reduce future years' income for tax purposes. These tax loss carry forwards have no expiry date.

The potential future income tax benefits related to the above items have not been recorded in the financial statements.

10. LOSS PER SHARE

For the quarter ended June 30th, 2006 the number of shares that could potentially dilute basic earnings per share in future but which were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive was 3,740,477 (Jun 30th, 2005 – 4,653,477).

11. COMMITMENTS

Minimum operating lease commitments over the next three years are as follows:

2006	**$**	**262,449**
2007		**484,680**
2008		**484,680**
	$	**1,231,809**

12. CHANGES IN NON-CASH OPERATING WORKING CAPITAL ITEMS

		3 months Jun 30th 2006		3 months Jun 30th 2005		**YTD Jun 30th 2006**		YTD Jun 30th 2005
Accounts receivable	**$**	**186,095**	$	(318,520)	**$**	**1,761,317**	$	1,199,843
Inventories		**(220,905)**		429,016		**(12,611)**		1,166,813
Prepaid expenses and deposits		**54,360**		65,807		**140,322**		117,021
Accounts payable and Accrued liabilities		**(342,333)**		(1,124,399)		**(848,983)**		(1,987,243)
	$	**(322,783)**	$	(948,096)	**$**	**1,040,045**	$	496,434

13. ECONOMIC DEPENDENCE

For the quarter ended June 30th, 2006 the Corporation had no customers accounting for more than 10% of revenue (Jun 30th, 2005 – one customer accounting for approximately 11% of revenue).

14. FINANCIAL INSTRUMENTS

There is financial risk to the Corporation's earnings that arises from fluctuations in foreign exchange rates and the degree of volatility of those rates. The Corporation has not used derivative instruments to hedge its exposure to foreign currency risk. The exposure to foreign currency risk is primarily to fluctuations in the value of the United Kingdom Pound, the Euro and the United States Dollar.

In addition, the Corporation is exposed to credit risk from customers. The Corporation's business is mostly with large corporations, governments and quasi-governmental organisations. The Corporation has credit evaluation, approval and monitoring processes intended to mitigate potential credit risk.

The carrying amounts for cash and cash equivalents, accounts receivable, amounts due from shareholders, accounts payable and short-term loans approximate fair market value because of the short maturity of these instruments.

The fair value of long-term debt is determined by discounting future cash flows using rates that reflect those that the Corporation could currently obtain, on the market, for loans with similar terms, conditions and maturities. The carrying amount of all financial instruments was similar to their fair values.

15. BUSINESS SEGMENT INFORMATION

Business area

The business operates in four distinct product areas – high power bipolar discrete devices, high power IGBT and bipolar modules, power electronic assemblies (the design and assembly of power devices into stacks) and high reliability integrated circuits. The product manufacturing for these areas are supported by common infrastructure at the Corporation's Lincoln, England facility. As at March 31st, 2006 the Corporation does not segregate assets or other balance sheet accounts by product area nor does the Corporation measure operating profits by these areas. The Corporation evaluates performance and allocates resources based on revenue by product area.

Geographic area

The destination of sale (the location of the customer) of revenues and the location of tangible assets determine the geographic areas.

	3 months Jun 30th 2006	3 months Jun 30th 2005	**YTD Jun 30th 2006**	YTD Jun 30th 2005
Revenue:				
Business segment				
Bipolar discrete units	**$ 3,241,868**	$ 3,431,632	**$ 6,750,131**	$ 5,458,839
IGBT and power units	**759,214**	642,425	**1,744,238**	1,500,615
Power electronic assemblies	**653,371**	1,216,019	**1,745,817**	2,231,874
Integrated circuits	**598,415**	268,442	**1,094,981**	533,235
	$ 5,252,868	$ 5,558,518	**$ 11,335,167**	$ 9,724,563
Geographic area				
Europe	**$ 3,347,659**	$ 3,286,531	**$ 7,479,745**	$ 5,735,143
North America	**804,854**	943,796	**1,678,182**	1,997,423
Far East and other	**1,100,355**	1,328,191	**2,177,240**	1,991,997
	$ 5,252,868	$ 5,558,518	**$ 11,335,167**	$ 9,724,563

	Jun 31st 2006	Dec 31st 2005
Capital assets:		
Geographic area		
Europe	**$ 456,241**	$ 478,938
	$ 456,241	$ 478,938

16. CONTINGENCIES

An action against the Corporation was commenced by a former consultant of the Corporation in the Ontario Superior Court of Justice on February 4th, 2002 for payment of $321,000 in respect of claimed outstanding payments. The Corporation has defended this action and believes there is a reasonable prospect of a settlement of this matter that will not have a material adverse effect on the operating results and financial condition of the Corporation. However, the outcome is not determinable at this time.

17. PENSION PLAN

The Corporation incurred expenses of $80,668 (Jun 30th, 2005 - $86,727) with respect to a defined contribution pension plan in place at Dynex Semiconductor Limited. The Corporation instigated a six-month suspension of contributions into this plan, commencing November, 2001. The Corporation's stated intention is to reimburse the contribution shortfall after the six-month period, based on its financial position. At June 30th, 2006 $153,482 (Dec 31st, 2005 - $152,821) is included in accrued liabilities.

18. RELATED PARTY TRANSACTIONS

The Corporation incurred expenses of $19,928 (Jun 30th, 2005 - $25,000) with respect to fees payable to directors. As at June 30th, 2006, $40,000 is payable to directors (Dec 31st, 2005 - $40,833). The directors fees are recorded at the negotiated amounts.

A total of 137,939 common shares was issued at $0.2955 to the independent directors on May 8th, 2006 in payment of their fees for the period July 1st, 2005 to December 31st, 2005.

19. SUBSEQUENT EVENT

A total of 571,430 common shares was issued at $0.07 per share to the independent directors in August 2006 in payment of their services for the period January 1st, 2006 to June 30th, 2006.

Corporate Information

Board of Directors

David F. Banks [1] [2] [3] [4]
Chairman

Paul Taylor [1] [2] [4]
Director, President & CEO

Bob Lockwood [1] [2]
Director, VP Finance & CFO

Debbie Weinstein [1] [3] [4]
Director & Company Secretary

Keith Ralls [1] [3] [4]
Director

Daniel Owen [1] [2] [3] [4]
Director

[1] Member of the Governance Committee
[2] Member of Executive Committee
[3] Member of Audit Committee
[4] Member of Compensation Committee

Senior Officers, VP's & Senior Managers

Paul Taylor
President & CEO

Bob Lockwood
VP Finance & CFO

Bill McGhie
Power Electronic Assemblies Business Manager

Mark Kempton
Bipolar Discretes Business Manager

Stock Exchange Listing

Toronto Ventures Exchange
Symbol: DNX

Auditors

Canada – Deloitte & Touche LLP
UK – Deloitte & Touche LLP

Legal Counsel

LaBarge Weinstein Professional Corporation
Ottawa, Ontario

Transfer Agent

Computershare Trust Company of Canada

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