
DYNEX POWER INC

**REPORT FOR THE QUARTER ENDED
SEPTEMBER 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.

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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

In the report for the quarter ending June 30th 2006 I advised that revenues predicted for the third quarter would be similar to those of the second quarter. However I am pleased to report that, as a result of improved bookings for short lead-time products, there was actually an increase in revenue of 9%. This reflects an underlying business improvement that has seen increased bookings, higher gross margins, and more robustness in our forward order book.

...the highest order book for 4 years.

As reported in recent press releases during the third quarter we have confirmed receipt of major project contracts totalling \$4 million from Areva T&D UK Ltd and Converteam Ltd., two of our long-standing major customers. Alongside these major contracts, there has been a growth in bookings from other customers, giving a year to date book-to-bill ratio at the end of September of 122%, increasing our order book for the current business segments to its highest level for at least four years.

Owing to the robust order book, the growth in bookings, and a high customer interest in Dynex products, we are anticipating sales growth into 2007. For the year to date we are reporting a sales growth in excess of 10% compared to the same period last year, and we expect a similar trend in the coming 12 months.

...reaffirming our strategic direction

With the prospect of growth we have reviewed each of our business segments in order to reaffirm our strategic direction and future goals. As a supplier of power electronic components into the energy management sector, we are well positioned to benefit from the global drive to improve energy efficiency, increase the availability of electric power, convert to renewable power generation, and reduce carbon emissions. To grow and develop as a leading independent manufacturer of high power and high reliability electronic products remains our core ambition.

In the high power bipolar business we have discontinued a number of our less profitable products in order to focus on developing opportunities based on our i^2 thyristor capability and our high power GTO thyristors. As customer interest in the i^2 thyristor grows, we are increasing our production

capacity and material supplies to expand this product line.

The IGBT business is focused onto higher power and higher voltage modules where our special engineering skills provide a technical edge. New products are being developed and certain lower technology and less differentiated products are no longer being promoted.

In the power electronics assembly business we are not only winning business from our major customers, such as Areva and Converteam, but are also developing new business opportunities. Equipment for applications such as industrial electric power conditioning, inverters for motor drives, and high energy pulse power are being designed and supplied to customers, and we are planning to expand our capabilities further.

In our integrated circuit business we are re-establishing our production lines, and re-building our position as a specialist supplier of radiation hard semiconductor components. Based on mature technology, the performance, robustness, and proven reliability of our products are key assets that are in high demand by our customers.

...challenges ahead

Although we predict strong demand for our products in the future there are a number of challenges ahead. In particular energy and material costs will continue to rise for our specialist products, putting pressure on our margins. To avoid passing the full impact of these costs onto our customers, and in many cases the market cannot accept such increases, we need to invest to improve our production efficiencies, implement new designs, and install new manufacturing methods. In preparation for this we have been working on gaining financial support for our product and process development requirements and we have recently announced in the press that we have secured a £530,000 grant from the UK Department of Trade and Industry. We are delighted by this award, such investment will assist Dynex in maintaining competitiveness in the world market through product and process innovations.

I trust you will find the attached report interesting and look forward to your continued support.

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 September 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

Whilst revenue in the third quarter showed some growth over that reported in the second quarter, it fell short of the Company's plan and as a result revenue for the year to date is also below plan. Nevertheless, careful control of all costs and efficiency improvements throughout the year has meant that the loss for the first nine months of this year is lower than plan and some 80% lower than in the corresponding period of last year.

Revenue

Revenue for the third quarter of 2006 was \$5.7 million, up by \$454,000 or 9% from the second quarter of 2006. Higher revenues were recorded in all three high power segments with the strongest growth being in IGBT and power modules. Revenue in Integrated Circuits was stable. Revenue was up marginally by \$26,000 against the corresponding quarter of last year.

Revenue for the year to date is \$1.6 million ahead of last year with strong growth recorded in Bipolar discrete units, IGBT and power modules and Integrated Circuits. The fall of 10% in power electronic sales reflects the timing of major projects last year and this year.

Gross Margin

The gross margin in the third quarter of \$1.0 million

was \$235,000 or 29% higher than in the second quarter of 2006, and was \$153,000 or 17% higher than the gross margin reported in the corresponding quarter of last year. The rise in gross margin compared to the second quarter reflects the higher revenue reported and continued tight control of raw material costs.

Gross margin for the year to date of \$3 million is four and a half times that reported in the first nine months of last year. The improvement reflects the increase in revenue, our continuing efforts to reduce material costs and improvements in manufacturing efficiency.

Expenses

Overhead expenses in the third quarter of 2006 of \$1.2 million were \$198,000 or 14% lower than in the second quarter of 2006, but \$69,000 or 6% higher than in the corresponding quarter of last year. Overhead expenses in the second quarter had included a one-off legal charge. The increase over the third quarter of last year results from some 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 \$550,000 or 17% higher than last year. The legal cost in the second quarter and increased interest expenditure account for the majority of the increase, with the remainder coming from increases to research and development expenditure.

Interest & Other Income

Interest and other income was \$61,000 in the third quarter of 2006, up by \$9,000 or 18% compared to the preceding quarter. The figure was \$16,000 or 37% 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. For the year to date, the figure is \$41,000 or 28% higher than last year. This is mainly as a result of revenue from the disposal of scrap materials in 2006.

Foreign Exchange Loss

There was a foreign exchange gain in the quarter of \$2,000, compared to a loss of \$52,000 in the second quarter of 2006. A loss of \$57,000 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 loss reported in the third quarter, the preceding quarter or the corresponding quarter of last year.

Net Loss

The Company reported a net loss of \$133,000 in the quarter compared to a loss in the previous quarter \$629,000. Whilst a reduction in the loss of nearly 80% represents a significant improvement, the result was disappointing with the increase in revenue insufficient to enable us to return to profitability. The loss arises from the shortfall in revenue against plan for the quarter which had been expected. Net losses of \$292,000 had been reported in the corresponding quarter of last year. The net loss for the year to date of \$696,000 is in line with plan and is a reduction of \$1.9 million or 73% compared to the year to date loss reported in the first nine months of 2005.

Segmental Analysis

Revenue for Bipolar Discrete Units in the quarter of \$3.5 million was \$278,000 or 9% higher than the previous quarter and \$215,000 or 7% higher than in the corresponding quarter of last year. The figure for the year to date of \$10.3 million is \$1.5 million or 17% ahead of the first nine months of 2005, reflecting the strong growth in demand we have seen for these products.

Revenue for IGBT and Power Units in the quarter of \$873,000 was \$114,000 or 15% higher than in the second quarter of 2006. Revenue was \$21,000 or 2% lower than in the corresponding quarter of last year. For the year to date, sales of \$2.6 million are \$223,000 or 9% higher than the first nine months of 2005, again indicative of the strong demand seen for these products recently.

Revenue for Power Electronic Assemblies of \$719,000 was \$66,000 or 9% higher than in the preceding quarter and \$203,000 or 39% higher than the corresponding quarter of last year, again reflecting stronger demand for our products. For the year to date, the fall in sales is \$283,000 or 10%. Nevertheless, with strong orders for the last quarter, revenue growth for this business is expected to be reported for 2006 in total.

Revenue from Integrated Circuits for the quarter of \$594,000 was \$4,000 or less than 1% lower than in the preceding quarter. Revenue was \$372,000 or

38% lower than it had been in the corresponding quarter of last year. This had been expected. 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 \$190,000 or 13% higher than in the first nine months 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. We shall not be able to match the exceptional sales recorded in the fourth quarter of last year as the new production processes are not yet qualified, but growth in sales should be possible in 2007.

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 second quarter 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. Further shares were issued to directors in the third quarter for their services in the first half of 2006. As the value of these three transactions exceeded the loss for the year to date, the deficit on shareholders' funds has fallen slightly since the year end.

The total borrowings of the Company have risen by \$185,000 or 3% since the year-end with the majority of the increase taking place in short term debt.

During the quarter, the Corporation entered into a new short term financing agreement with Landsbanki, replacing the previous financing arrangement. The new relationship should provide better support to our on-going business needs than the previous lender was able to.

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

	2006	2006	2006	2005	2005	2005	2005	2004	2005	2004	2003
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4	FY	FY	FY
Revenue	5,707	5,253	6,082	7,356	5,681	5,559	4,166	5,543	22,761	23,886	23,563
Continuing operations:											
Net earnings/(loss)	(132)	(629)	66	781	(293)	(671)	(1,606)	(1,442)	(1,788)	(5,380)	(7,477)
Basic EPS	(0.00)	(0.02)	0.00	0.03	(0.01)	(0.02)	(0.06)	(0.05)	(0.07)	(0.23)	(0.38)
Diluted EPS	(0.00)	(0.02)	0.00	0.03	(0.01)	(0.02)	(0.06)	(0.05)	(0.07)	(0.23)	(0.38)
Total operations:											
Net earnings/(loss)	(132)	(629)	66	781	(293)	(671)	(1,606)	(1,442)	(1,788)	(5,380)	(2,087)
Basic EPS	(0.00)	(0.02)	0.00	0.03	(0.01)	(0.02)	(0.06)	(0.05)	(0.07)	(0.23)	(0.11)
Diluted EPS	(0.00)	(0.02)	0.00	0.03	(0.01)	(0.02)	(0.06)	(0.05)	(0.07)	(0.23)	(0.11)
Total assets	12,058	10,923	11,745	12,798	11,282	11,444	12,482	14,669	12,798	14,669	14,862
Long term liabilities	3,665	3,942	2,445	3,048	3,655	3,884	3,765	271	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 above. 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 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 the recovery in revenue seen in the third quarter of 2006 is expected to continue.

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. The improvement seen in the third quarter is expected to continue so that the improvement in the annual result seen in the last two years will be continued for this year. 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 strong growth in demand from such investment. The failure to carry through this investment would be detrimental to the future of the business.

Worldwide demand for silicon has risen sharply of late, mainly driven by the demands of the solar power industry. Any shortage in supply of silicon is likely to have a direct impact on costs and the volume of business that the Corporation can carry out.

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 and suppliers 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 issued a total of 571,430 common shares at \$0.07 to the independent directors in August 2006 in payment of their fees for the period January 1st, 2006 to June 30th, 2006.

The Corporation incurred expenses of \$20,000 in the quarter in respect of fees payable to directors. As at September 30th, 2006 a total of \$20,000 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. Repayment of these loans is scheduled to take place between April 2007 and October 2010.

Business Development

It had become apparent in the second quarter that although revenue in the third quarter would show an improvement, it would not reach the level in the plan. Revenue growth is expected in the fourth quarter and although it will not enable us to meet our revenue plan for the year, we expect to be able to report year on year revenue growth of approximately 4% for 2006. Much stronger growth in Sterling revenue of between 10% and 12% is expected to be reported by the UK operating business but a stronger Dollar has reduced the level of growth that will be reported in the Group's accounts.

Despite the shortfall in revenue in the third quarter and consequently in the first three quarters overall, the net loss for the year to date of \$696,000 is lower than in the plan as a result of continued careful control of material prices and overhead costs. However, whilst we expect to reach planned sales in the fourth quarter, we have downgraded our expectation of the fourth quarter net income. Sharp rises in UK energy prices and consequently in other UK input prices are negatively impacting our margins. Management still expects to report a return to profitability in the fourth quarter, but the absolute level of that net profit is unlikely to result in an overall profit for the year.

A small loss for the year will continue the strong and steady recovery in performance seen over the last two years and will provide a platform for a return to annual profitability in 2007.

Subsequent Event

On October 20th, 2006 the Corporation announced that it had been awarded grants totalling £530,000 (\$1.1 million) by the UK Government's Department of Trade and Industry to develop advanced high power semiconductor devices.

Bob Lockwood.
Director and Chief Financial Officer

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

	Sept 30th 2006	Dec 31st 2005
CURRENT ASSETS		
Cash and cash equivalents	\$ 211,296	\$ 331,897
Accounts receivable	4,415,878	5,484,910
Inventories (Note 3)	6,403,667	5,951,526
Prepaid expenses and deposits	602,183	551,135
	11,633,024	12,319,468
CAPITAL ASSETS (Note 4)	424,524	478,938
	\$ 12,057,548	\$ 12,798,406
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 4,156,525	\$ 5,125,882
Short-term loan (Note 5)	2,743,017	2,607,515
Current portion of long-term debt (Note 6)	829,542	1,396,219
Current portion of deferred revenue (Note 7)	161,030	155,515
	7,890,114	9,285,131
LONG-TERM DEBT (Note 6)	3,664,869	3,048,252
LONG-TERM DEFERRED REVENUE (Note 7)	1,690,811	1,749,547
	13,245,794	14,082,930
CONTINGENCIES (Note 16)	-	-
	13,245,794	14,082,930
SHAREHOLDERS' DEFICIENCY		
Share capital (Note 8)	13,811,327	12,955,163
Deficit	(14,520,709)	(13,824,595)
Cumulative translation adjustment	(478,864)	(415,092)
	(1,188,246)	(1,284,524)
	\$ 12,057,548	\$ 12,798,406

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

	3 months	3 months	YTD	YTD
	Sept 30th	Sept 30th	Sept 30th	Sept 30th
	2006	2005	2006	2005
Revenue	\$ 5,706,698	\$ 5,680,842	\$ 17,041,865	\$ 15,405,406
Cost of sales	4,668,074	4,795,212	14,085,348	14,759,485
Gross margin	1,038,624	885,630	2,956,517	645,921
Expenses				
General and administration	604,284	569,183	1,954,366	1,730,151
Sales and marketing	242,822	237,879	722,541	786,324
Research and development	181,839	85,080	541,146	355,099
Interest expense	204,825	272,863	589,780	385,998
	1,233,770	1,165,005	3,807,833	3,257,572
Loss before other income (expenses) and income taxes	(195,146)	(279,375)	(851,316)	(2,611,651)
Other income (expenses)				
Interest and other income	60,551	44,088	185,051	144,262
Foreign exchange gain (loss)	1,962	(57,334)	(29,849)	(101,978)
	62,513	(13,246)	155,202	42,284
Income taxes (Note 9)	-	-	-	-
NET LOSS	(132,633)	(292,621)	(696,114)	(2,569,367)
DEFICIT, BEGINNING OF PERIOD	(14,388,076)	(14,313,081)	(13,824,595)	(12,036,335)
DEFICIT, END OF PERIOD	\$ (14,520,709)	\$ (14,605,702)	\$ (14,520,709)	\$ (14,605,702)
Loss per share				
Basic	\$ (0.00)	\$ (0.01)	\$ (0.02)	\$ (0.09)
Diluted (Note 10)	\$ (0.00)	\$ (0.01)	\$ (0.02)	\$ (0.09)
Weighted average number of shares				
Basic	32,196,183	25,973,642	30,650,637	25,876,616
Diluted (Note 10)	32,196,183	25,973,642	30,650,637	25,876,616

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

	3 months	3 months	YTD	YTD
	Sept 30th	Sept 30th	Sept 30th	Sept 30th
	2006	2005	2006	2005
OPERATING				
Net loss	\$ (132,633)	\$ (292,621)	\$ (696,114)	\$ (2,569,367)
<u>Items not affecting cash</u>				
Amortization	59,930	55,100	169,622	171,810
Gain on disposal of capital assets	(40,032)	(43,550)	(118,575)	(132,941)
Shares and options issued for services	109,569	139,049	284,287	262,727
Changes in non-cash operating working capital (Note 12)	(1,211,482)	(479,163)	(171,438)	17,272
	(1,214,648)	(621,185)	(532,218)	(2,250,499)
FINANCING				
Shares issued for cash	-	-	550,000	-
Increase in loans from a director	-	428,330	-	2,517,423
Increase (decrease) in short-term debt	1,180,308	347,315	69,384	(59,492)
(Decrease) increase in long-term debt	(42,493)	17,789	(105,987)	(64,596)
	1,137,815	793,434	513,397	2,393,335
INVESTING				
Proceeds of disposal of capital assets	-	2,142	-	2,142
Purchase of capital assets	(14,955)	(42,786)	(99,861)	(103,332)
	(14,955)	(40,644)	(99,861)	(101,190)
NET (DECREASE) INCREASE IN CASH	(91,788)	131,605	(118,682)	41,646
Effect of foreign currency translation on cash flow	(6,336)	(1,446)	(1,919)	11,622
Cash and cash equivalents, beginning of period	309,420	173,484	331,897	250,375
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 211,296	\$ 303,643	\$ 211,296	\$ 303,643
Supplementary Information:				
Interest paid	\$ 134,609	\$ 144,291	\$ 489,559	\$ 257,426
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.

DYNEX POWER INC.
Notes to the Consolidated Financial Statements (Unaudited)
Quarter Ended September 30th, 2006

3. INVENTORIES

	Sept 30th 2006	Dec 31st 2005
Raw materials	\$ 1,330,462	\$ 1,242,675
Work in progress	4,109,193	3,826,110
Finished goods	964,012	882,741
	\$ 6,403,667	\$ 5,951,526

Inventory is stated net of a provision of \$5,464,199 (Dec 31st, 2005 - \$5,757,672) for obsolescence.

4. CAPITAL ASSETS

	Sept 30th 2006	Dec 31st 2005
Cost	Accumulated Amortization	Net Book Value
Equipment	\$ 2,160,666	\$ 478,938
	\$ 2,160,666	\$ 478,938

5. SHORT-TERM LOAN

The Corporation has a short-term loan of \$2,743,017 (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.

DYNEX POWER INC.
Notes to the Consolidated Financial Statements (Unaudited)
Quarter Ended September 30th, 2006

6. LONG-TERM DEBT

	Sept 30th 2006	Dec 31st 2005
Interest free unsecured loan payable in monthly instalments of \$10,589 to November 2007.	\$ 148,239	\$ 235,195
Loans from individual shareholders payable in monthly instalments of \$25,307 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.	556,750	549,620
Loans from two directors payable in monthly instalments of \$63,504 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.	2,540,162	2,453,176
Loan from a director payable in monthly instalments of \$31,232 between July 2007 and October 2010 bearing interest at 10% and secured under a general security agreement.	1,249,260	1,206,480
	4,494,411	4,444,471
Current portion	829,542	1,396,219
	\$ 3,664,869	\$ 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 second quarter of 2006. 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	\$ 829,542
1-2 years	1,461,685
2-3 years	1,162,133
3-4 years	1,009,819
4-5 years	31,232
	\$ 4,494,411

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Notes to the Consolidated Financial Statements (Unaudited)
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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 \$40,184, is included in other income for the quarter ended September 30th, 2006 (Sept 30th, 2005 - \$41,409).

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:

			Sept 30th 2006		Dec 31st 2005
Common shares	- amount	\$	13,811,327	\$	12,955,163
	- number		32,767,613		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.

On August 8th, 2006 the Corporation issued 571,430 shares to the independent directors for their services in the first half of 2006 under the Independent Directors' Share Plan at a price of \$0.07 per share

Warrant transactions

During July and August 2006 warrants to acquire 3,233,334 shares at the option of the holders at \$0.60 per share expired unexercised.

The Corporation has outstanding warrants to acquire 357,143 shares at the option of the holders at \$0.35 per share any time before October 2008.

DYNEX POWER INC.
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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 September 30th, 2006	800,000	\$ 0.11

The weighted average remaining life of the outstanding options is 3 years and 8 months. At September 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 7 months.

At September 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 September 30th, 2006 (Sept 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%.

DYNEX POWER INC.
Notes to the Consolidated Financial Statements (Unaudited)
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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 Sept 30th 2006	3 months Sept 30th 2005	YTD Sept 30th 2006	YTD Sept 30th 2005
Loss before income taxes	\$ (132,633)	\$ (292,621)	\$ (696,114)	\$ (2,569,367)
Expected tax (recovery)	(47,881)	(105,636)	(251,297)	(927,541)
Increase (decrease) resulting from:				
Unrecorded benefit of tax loss	47,881	105,636	251,297	927,541
	\$ -	\$ -	\$ -	\$ -

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

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

As at September 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	260,000	260,000
	\$ 3,101,000	\$ 3,101,000

DYNEX POWER INC.
Notes to the Consolidated Financial Statements (Unaudited)
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9. INCOME TAXES (Continued)

As at September 30th, 2006 the Corporation has United Kingdom tax loss carry forwards of approximately £4,160,000 (\$8,662,000) 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 September 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 1,157,143 (Sept 30th, 2005 – 4,649,477).

11. COMMITMENTS

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

2006	\$	131,497
2007		499,704
2008		499,704
		<hr/>
	\$	1,130,905

DYNEX POWER INC.
Notes to the Consolidated Financial Statements (Unaudited)
Quarter Ended September 30th, 2006

12. CHANGES IN NON-CASH OPERATING WORKING CAPITAL ITEMS

	3 months		3 months		YTD		YTD
	Sept 30th		Sept 30th		Sept 30th		Sept 30th
	2006		2005		2006		2005
Accounts receivable	\$ (544,175)	\$	(764,222)	\$	1,217,142	\$	435,621
Inventories	(228,698)		423,665		(241,309)		1,590,478
Prepaid expenses and deposits	(175,521)		(65,923)		(35,199)		51,098
Accounts payable and accrued liabilities	(263,088)		(72,683)		(1,112,072)		(2,059,925)
	\$ (1,211,482)	\$	(479,163)	\$	(171,438)	\$	17,272

13. ECONOMIC DEPENDENCE

For the quarter ended September 30th, 2006 the Corporation had no customers accounting for more than 10% of revenue (Sept 30th, 2005 – one customer accounting for approximately 11% of revenue and two customers each accounting for approximately 10% 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.

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, 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.

DYNEX POWER INC.
Notes to the Consolidated Financial Statements (Unaudited)
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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 September 30th, 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 Sept 30th 2006		3 months Sept 30th 2005		YTD Sept 30th 2006		YTD Sept 30th 2005
Revenue:							
Business segment							
Bipolar discrete units	\$ 3,520,326	\$	3,305,110	\$	10,270,458	\$	8,763,949
IGBT and power units	872,886		893,711		2,617,124		2,394,326
Power electronic assemblies	719,092		515,923		2,464,908		2,747,798
Integrated circuits	594,394		966,098		1,689,375		1,499,333
	\$ 5,706,698	\$	5,680,842	\$	17,041,865	\$	15,405,406
Geographic area							
Europe	\$ 3,535,454	\$	3,436,980	\$	11,015,199	\$	9,172,123
North America	1,097,949		930,242		2,776,131		2,927,666
Far East and other	1,073,295		1,313,620		3,250,535		3,305,617
	\$ 5,706,698	\$	5,680,842	\$	17,041,865	\$	15,405,406

	Sept 30th 2006		Dec 31st 2005
Capital assets:			
Geographic area			
Europe	\$ 424,524	\$	478,938
	\$ 424,524	\$	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 \$87,573 (Sept 30th, 2005 - \$79,456) 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 September 30th, 2006 \$158,240 (Dec 31st, 2005 - \$152,821) is included in accrued liabilities.

18. RELATED PARTY TRANSACTIONS

The Corporation incurred expenses of \$20,000 (Sept 30th, 2005 - \$20,833) with respect to fees payable to directors. As at September 30th, 2006, \$20,000 is payable to directors (Dec 31st, 2005 - \$40,833). The directors fees are recorded at the negotiated amounts.

A total of 571,430 common shares was issued at \$0.07 to the independent directors on August 8th, 2006 in payment of their fees for the period January 1st, 2006 to June 30th, 2006.

The Corporation has loans from two directors totalling \$3,789,422 (December 31st, 2005 - \$3,659,656). Full details of these loans are set out in Note 6.

19. SUBSEQUENT EVENT

On October 20th, 2006 the Corporation announced that it had been awarded grants totalling £530,000 (\$1.1 million) by the UK Government's Department of Trade and Industry to develop advanced high power semiconductor devices.

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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