

MANAGEMENT'S DISCUSSION AND ANALYSIS

Napier Environmental Technologies Inc. manufactures and distributes highly effective, safe and environmentally advantaged chemicals for stripping paints/coatings, surface preparation as well as a complete line of wood restoration and protection products. Products are cost effective, user friendly and safe to use. As important and especially in today's world Napier products are formulated and designed to be environmentally benign. Napier distributes products both domestically and internationally through an extensive network of distribution channels in the "Industrial" as well as "Consumer" markets. Management expects to increase shareholder value based on initiatives taken in this fiscal year and further improvements anticipated for 2003.

Management's Discussion and Analysis (MD&A) for the year ended 2002 has been prepared to give shareholders and other stakeholders an assessment of what the Company achieved last year as well as an indication of initiatives underway and planned for this year to improve shareholder value. The MD&A for the year ended December 31, 2002 should be read in conjunction with the audited consolidated financial statements of the Company and notes thereto for the periods ending December 31, 2002 and December 31, 2001.

Overview

In 2002, after incurring significant losses in 2001, management's attention in addition to growing sales turned to reducing costs and increasing margins. The Company focused on an overall reduction in both selling costs and administrative overhead and shifted product mix to generate improved margins and increased prices primarily in the retail sector. This renewed emphasis on fundamental business principles served to position the Company for significant growth and profitability in 2003.

Results of Operations

Efforts to tightly control and reduce costs at Napier as well as initiatives to improve selling prices enabled the Company to reduce its operating loss to \$999,000 in 2002 from \$3,433,000 for 2001.

Sales increased from \$7,422,189 in 2001 to \$8,069,430 in 2002, an increase of 8.7%. Gross margins significantly improved to 41% as compared to 28% in the previous year. Cost reduction and price increases also led to an improvement in gross profit of \$1,282,000.

The dramatic improvements in cost structure resulted in a total operating cost decrease of 20% from 2001, a net saving of over \$1,000,000. Selling and marketing costs declined by \$965,000. General and administrative costs declined by a further \$116,000 as compared to 2001. Of note is that these improvements in cost structure were completed without sacrificing the Company's ability to grow sales.

The Company's net loss for the year, including \$430,000 non-cash charges, was \$1,231,000 as compared to a net loss of \$12.9 million in 2001. The 2001 comparative period was negatively impacted by \$9.2 million in goodwill being fully written off during 2001.

Liquidity and Capital Resources

As of December 31, 2002, the Company's working capital was approximately \$1.3 million, including cash and cash equivalents of approximately \$285,000 and a current ratio of 1.9:1. Subsequent to the year-end the Company renegotiated the terms of its operating line with Bank of Nova Scotia and was able to eliminate the restrictive covenants. As a result, the Company balance on the line of credit was converted to a term loan. In addition, to finance cash requirements and add liquidity in its working capital to meet immediate needs, the Company is using credit facilities made available which provide the Company a direct advance of funds on export receivables.

Initiatives and Progress

In 2003 the Company intends to take advantage of an improved cost structure and increase its sales to be cash flow positive. Efforts begun in 2002 to establish new distribution relationships are ongoing and involve major US manufacturers and distributors in the paint and coatings industry. In addition, our marketing and sales organization has been reorganized to more clearly define objectives, responsibilities and accountabilities. To that end we have established marketing and sales divisions with specific responsibilities in the "Industrial" and "Consumer" sectors. In doing so, our plans and strategies are being geared to growth not only in certain markets but also to specific customers, channels of distribution and "brand" development. To support these divisions a new department of "Market Development" has been created with responsibility for product and market development as well as technical training and liaison with Research and Development.

After an intensive review of all products and markets including efficacy, growth potential and profitability conducted early in the first quarter, a renewed emphasis will be directed to our efforts in the aircraft sector as well as asbestos coating removal. The Company is also developing plans to increase our product offering in major "big box" retail outlets throughout North America. These efforts will be developed to support our own brand recognition and, in certain circumstances, under private label programs. Activities to increase penetration of overseas markets are ongoing and as the year progresses we intend to improve distribution channels and in turn grow sales in targeted international markets.

As the year unfolds management is optimistic that we will meet or exceed our goals in spite of a weak US economy, a severe and lasting winter and a war in Iraq. We have good products and a number of market opportunities all of which should lead to enhanced shareholder value.

Governance and Management

Following the resignation of Cliff Davis as Chairman & CEO, the Company appointed Lionel Dodd as Chairman of the Board. Mr. Davis remains a Director of the Company. After an extensive executive search led by PricewaterhouseCoopers LLP, Frank Dixon joined the Company as President and CEO in late November 2002 and was appointed a director of the Company in early December 2002.

Financial Management

As part of the Company's banking arrangements, all foreign accounts receivable were insured effective January 1, 2002. This, coupled with a good collections effort, yielded a recovery of over \$78,000 from previously provided for bad debts. The Company's traditional bank line of credit was converted to a Scotia Open Accounts Receivable Services (SOARS) line of credit in March 2003. The new credit line has an overall higher credit limit with a change from a Canadian dollar line to one designated in US\$. Amounts drawn under the US\$ credit line are offset by specific US\$ billings, eliminating our foreign exchange exposure.

Risk Management

Napier is pleased to report the conclusion to all outstanding legal issues between the Company and certain former employees and Sea to Sky Innovations. The Parties have settled their dispute in a mutually acceptable manner, the terms of which are agreed to be strictly confidential.

Risk Factors

The significant risks and uncertainties that face the Company are common to other manufacturers operating in the international economy in the industrial and retail sectors. The Company must deal with business risks associated with product infringement, technological change, increased market penetration into established supply lines, locating and penetrating new markets, foreign currency transactions, economic conditions affecting large customers and potential customers, to name a few of the normal but significant factors affecting the Company's day to day business. While the Company presently has sufficient immediate working capital, the Company must diligently monitor the make-up of working capital to ensure that cash is available when needed and in light of the changing financial markets there is no assurance that funding by equity subscriptions will be possible at times required or desired by the Company. Management continually addresses the above business risks in a methodical and rational manner.

This MD&A contains forward looking statements that are subject to a number of known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those anticipated in our forward looking statements. Factors that could cause actual results to differ materially include: rapid technological and/or market changes in the industry; the ability to maintain and grow successful third party and customer relationships; to improve current products and develop new products; and to adequately protect the Company's proprietary rights and other factors described in the Company's regulatory filings. Although we believe the expectations reflected in our forward looking statements are reasonable, individual results may vary, and we cannot guarantee future results, levels of activity, performance or achievements.

This MD&A has been prepared by management and reviewed by the Company's Board of Directors.

"Signed"

Frank Dixon
President and Chief Executive Officer

March 29, 2003