

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.

Primary industrial uses for our products are paint stripping, concrete etching, rust or adhesive removal, asbestos removal and containment and lead abatement. The products are applied to a range of surfaces including metal, concrete, and wood. Typical surface preparation applications include aircraft, industrial plants, ships, bridges, storage tanks, oil refineries, railcars, concrete floors, and buildings. In the industry there is limited reliance on a particular market sector due to the diversity of product application, market demand for the products is highly project driven. As well, most applications occur outdoors, so weather plays a major factor. Government spending on projects also has an impact on demand. Napier products have not yet been introduced and adopted for all applications. With steps taken in 2003, aviation is becoming one of our larger sectors.

Consumer uses for the products are similar, with the main difference being a smaller scale of project. Demand on the consumer side has historically been weighted towards wood restoration, wood coatings and some specialty cleaning products. Products for some of the industrial uses, were not available to the consumer due to the complexity and sophistication of tools required for application. In 2003, we developed a new line of products for consumers that overcome these application complexities and consumers now have access to a range of products that was previously only available to industrial users.

Competitive alternatives to our product offerings include products that are not environmentally benign and other surface preparation methods including sand blasting. On the wood coatings side, there are a number of competitive products, yet this is a small portion of our overall business. No one competitor offers the same range of products or has the same level of global product acceptance. Competitors tend to be found on a regional or national level and in some instances are tied to one market sector such as aviation. Our competitive advantage is that our products are environmentally benign, cost effective, safe and easy to use. A number of the products are patented and supported by a competent Research and Development expertise.

Shareholder value for this industry is generated through global distribution and product diversity and acceptance. Our vision is to be the global leader in surface preparation and wood restoration products. Performance will be driven by distribution channels, product profitability and performance, product development, brand awareness, infrastructure and working capital. We continue to optimize our capabilities and resources in each of these areas.

Management's Discussion and Analysis (MD&A) for the year ended 2003 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, 2003 should be read in conjunction with the audited consolidated financial statements of the Company and notes thereto for the periods ending December 31, 2003 and December 31, 2002.

Overview

The year 2003 was one of strategic positioning and transition. A key objective for the year was to increase shareholder value by generating positive cash flow. We did not achieve this, however we did put into place a number of strategic elements necessary for future growth. Changes were

made at a strategic level in distribution channels, market sectors, product lines, marketing, and working capital financing. As each area was addressed both the management structure and team were repositioned to bring the right people in to do the right jobs.

Historically our practise has been to market and distribute our products exclusively through an extensive network of in-house and external sales representatives selling direct to individual paint and hardware companies. To optimize our distribution channel strategy, we broadened this network to partner with manufacturers and distributors of complimentary products with existing extensive distribution networks. This led to changes in our sales force and to new marketing and distribution agreements with national and international paint companies. These companies will market and distribute Napier products and in some instances they will market the products under their own label and brand.

We will continue to use regional representation, to expand our reach into the US mass retail market where products and regions are in most cases specified by the retailer. Extensive education and product training for the new distribution network was complete late in 2003. The full revenue impact of these new contractual relationships will therefore not be felt until 2004.

A careful review of products, margins and market sectors precipitated further changes. Low margin products received less sales emphasis and the company withdrew from some unprofitable business. Pricing was reviewed and adjusted to achieve a level playing field within each distribution channel and region. Napier also broadened its target aviation sector customer base to include commercial aircraft. An agreement was signed with a major international partner to co-brand, market and distribute our products worldwide. With this agreement in place, we are well poised to develop and grow our sales in this sector.

The new marketing and distribution agreements signed will give our technology a much wider acceptance in the market place and therefore improve our sales. However, to improve brand awareness we moved towards consolidating our consumer and industrial products under one Napier brand. In this light, we developed a new "consumer" product line to position Napier as the premiere producer of surface preparation products prior to coating application. The full line of highly effective and environmentally safe products employs the entire spectrum of Napier technology, including SARA, and makes it easy and safe for home use. This focus on re-branding, primarily in the US and international markets under our "RemovAll" brand, is expected to increase shareholder value in 2004 and beyond.

Subsequent to the end of the year, the Company completed a new financing arrangement that will provide required working capital, assuming the sales targets are met.

Results of Operations

The financial results reflect the impact of our strategic positioning and transition. These initiatives generated about \$1.2 million in new sales however this gain was offset by the impact of typical business risks and issues. Overall, sales expectations were not met. From a strategic perspective, a rationalization of the customer base was required, but the resulting sales shortfall was not accounted for in our initial sales planning. To some degree the sales expectation shortfall was also due to weak execution. Risks beyond our control such as weather and economic factors including a weakening in the US dollar also contributed to the reduced sales. Certain large customers reorganized and for a time did not place orders for our products as they focused solely on their own products, while others simply sold less than expected.

During 2003 our working capital met our immediate operating needs but we were unable to create product pull through effective advertising and promotion.

Sales

Sales in 2003 decreased by \$1.1 million or 14% to \$7.0 million in 2003 from \$8.1 million in 2002. New business contracts generated 15% in additional sales, however, this increase was offset by sales reductions as follows:

- \$0.5 million - a strategic change in our customer base to improve future profitability
- \$0.4 million - a major industrial customer underwent an extensive internal reorganization
- \$0.4 million - internal issues at our Australian distributor.
- \$0.4 million - a stronger Canadian dollar and foreign exchange fluctuations
- \$0.4 million - other including lower consumer sales
- \$0.2 million - a one time major aviation contract sale not repeated in 2003

In terms of product mix, sales of consumer products, which were impacted by an unusually wet spring, were down by about 10% in the year and represented a slightly larger portion of overall sales in 2003. Industrial sales were down by about 18%, in large measure a reflection of a weak US economy. Domestic sales although down by about 6% in the year, were a slightly higher percentage of overall sales. International sales were down about 20%, the direct result of poor sales performance in Australia.

Gross Profit

Gross margins reduced to 39% as compared to 41% in the previous year due to product mix as a result of a lower percentage of industrial sales. Consistent with the reduced sales level, gross profit was \$0.6 million or 18% lower than the 2002 level of \$3.3 million.

Selling and Marketing and Research Expenses

Selling and Marketing and Research expenses at \$2.5 million were the same as 2002. Spending exceeded 2002 for strategic initiatives including travel for training and education of our new partners and consulting and severance costs to realign the sales team. Expenses were incurred to re-brand the new "RemovAll" line. This entailed product development and packaging, new professional marketing staff expertise, web design, as well as a communication strategy and materials to facilitate access to retail shelf space. A portion of the increase in cost due to the re-branding was offset by reduced wages due to changes in the sales force and a recovery of over \$123,000 for previously provided bad debts expense.

General and Administration Expenses

Expenses for selling, general and administration for the year 2003 are unchanged from the 2002 level of \$1.6 million. In light of lower sales, tight control over expenditures was maintained and at the end of September, spending levels were approximately 8 % lower than 2002. Expenditures in the fourth quarter exceeded 2002 for consulting fees to secure necessary financing and to deliver more effective investor and shareholder relations, and severance costs to restructure the management team.

Other

Other expenses decreased by \$0.1 million in 2003 due to a larger write down of the investment in Radical Elastomers in 2002.

Net Loss

The Company's net loss for the year, including \$0.2 million non-cash charges, was \$1.8 million as compared to a net loss of \$1.2 million in 2002. The increased loss is primarily attributable to less than expected sales and resulting lower gross profit.

Liquidity and Capital Resources

As of December 31, 2003, the company's working capital was approximately \$0.2 million, including cash and cash equivalents of approximately \$0.1 million and a current ratio of 1.1:1. This ratio reflects a fairly high level of accounts payable and therefore financing through suppliers. During the year, to eliminate the impact of restrictive covenants, the company renegotiated the terms of its bank operating line. This line of credit was converted to a Term Loan which was repaid in full during the second quarter.

In addition a credit facility was made available to provide the company direct advances of funds up to US \$750,000 on export receivables to finance cash requirements and add liquidity in its working capital to meet immediate needs. At year-end, approximately \$0.3 million in receivables had been sold.

In May of 2003, the company issued a Subordinated, Convertible Debenture for proceeds of \$0.5 million. The proceeds of this issue were used to repay the Term Loan and to fund working capital.

Subsequent to the year end, the company completed a financing arrangement with an asset based lender, which provides three financing facilities. The first is a \$2.0 million Factoring Facility which provides for funds on a recourse basis, of a percentage of outstanding trade receivables. The second is a \$1.0 million Operating Loan secured by available inventory based on a fixed percentage of appraised inventory value. Finally there is a small Term Loan of \$48,375 secured by property, plant and equipment. Terms of the financing arrangements include standard financial and reporting covenants including a requirement to satisfy priority payables.

These facilities represent a substantial increase in financial capability in that available credit has increased from \$750,000 US or approximately, \$1.0 million to \$3.1 million dollars. The initial proceeds from this financing were for the most part used to bring our 2003 supplier accounts current. Our challenge in the first part of the year will be to balance meeting supplier obligations as they become due with funding required to grow the business. Assuming our sales targets are met, these facilities will provide the company with the funds it requires for operating working capital. This year, we expect to utilize the full Factoring Facility and about one half of the Operating Loan. The company will continue to assess the need to secure additional financing for growth and to build brand awareness.

Initiatives and Progress

Optimize Distribution Channels and Target Market Sectors

The focus for 2003 was to significantly increase our product presence and availability in North America and worldwide. Significant progress was made in this initiative through the new contracts and the renewed commitment to the aviation sector. We partnered with a major industry player, a leader in the sector, and the largest manufacturer of coatings in the world. They continue to work with us to refine our technology, grow our market and recently extended their agreement to include not only military aircraft but military ground equipment worldwide. Through this partnership, the company has begun and will continue to develop significant relationships with commercial airlines and military in North America, Europe, South America and the Middle and Far East.

After an extensive review of our regional distributors and representatives across North America and Europe we took steps to eliminate under performers and identify more effective representation. To that end we signed agreements with a number of new regional distributors for the Northeast and Southeast United States. Both partnerships brought sales success in 2003 and we expect their sales to continue to grow in 2004. We have good representation in Scandinavia, the United Kingdom and are working on representation in Germany, Italy, Spain and Portugal.

During 2003, in addition to our private label agreements with major paint companies in North America, agreements were obtained to distribute Napier branded products in both their own stores and dealer networks. This encompasses our complete line of paint strippers, surface preparation and wood restoration products. Considerable time, energy and money was and will continue to be spent training and educating their personnel on the use and efficacy of Napier products. In turn, they will use this knowledge and training to merchandise our products throughout their store and dealer network.

Grow Consumer/Retail Sales

To grow consumer sales, we acknowledged the need to increase our presence with mass retailers and to improve overall brand awareness. Accordingly, we became a recognized vendor in a new national mass retailer and we continued to sell to another national mass retailer, a limited range of product which are dropped shipped to individual stores. Our goal in 2004 is to broaden the range of products carried by these mass retailers and to be accepted into central distribution. To do so requires development of an extensive representative network in the US to train local store personnel. In Canada another major mass retailer has taken our products into central distribution replacing the costly drop ship program.

To improve overall brand awareness, we needed to focus on marketing. A new corporate marketing group was formed with existing management and new professional marketing staff. They are responsible for examining and understanding the markets in which we compete and developing products and strategies to meet customer needs. Sales will grow by creating "product pull" through increased brand awareness.

Build the team

As we grow and reorganize, our plans and strategies are increasingly geared to growth in specific markets and targeted customers. This change required not only a change in strategic thinking but also a change in culture including clear objectives and goals coupled with well defined responsibilities and accountabilities. During 2003 we assembled a team that embraced this new culture and is eager to move the Company forward. .

Management Outlook

As we enter 2004 the management team is optimistic and expect sales improvements. Our sales goals are ambitious yet well thought out. Coupled with continued cost management we expect to achieve our objective for the year of being cash flow positive. Accomplishments in 2003 have set the foundation for this improvement. We see these accomplishments impacting 2004 as follows:

- Extensive international distribution - Agreements signed with the three largest international paint and coatings manufacturers has created an awareness and understanding of the efficacy and benefits of our technologies throughout North America and Internationally. Each of them has plans and strategies to grow the relationship and have given us unfettered access to train and educate their personnel. We made significant inroads into commercial aviation and as the aviation paint companies adopt our technology, so do their customers.
- Regional distribution - We continue to attract major US regional distributors such as Lancaster to improve the reach and availability of our products throughout the US.
- Improved merchandising/brand awareness - More and more representatives are interested in carrying and supporting our product line. This enhances demand with independent paint and hardware stores and will eventually help us reach the mass retail market in the US and overseas.

We developed a re-branded "RemovaAll" line making the best of our products and technology available to the consumer market. These products are "EcoLogo" certified. Talent both inside and outside our organization were engaged to launch this product line. To date all customers previewing the product line are impressed with its' look and innovative approach to surface preparation. Our goal is to position the customer as a surface preparation specialist.

In specific markets we are known as an effective and safe means to strip asbestos and lead paint and are receiving enquiries from major US contractors. Our products and technology have been featured on "This Old House" twice in the last 15 months.

Historically we have found it difficult to make meaningful sales forecasts but we are confident in our ability to deliver sales growth in 2004. We expect the Canadian dollar to remain strong. There are signs the US economy is in an extended recovery and we are hopeful this will translate into renewed spending on projects. We achieved price increases this year in selective markets. We have no designs to exit existing business nor are we aware of any planned significant reorganization by key customers. Our experience tells us however, there will be hurdles or obstacles and usual business risks to overcome in 2004. The most important is to ensure that we have sufficient working capital to meet our operating needs. If we achieve our sales targets, our new financing is adequate and we will be cash flow positive. If we don't meet our target, further financing or a review of other strategic alternatives will be required. Sales growth is the key to our success.

We remain committed to increasing both industrial and consumer sales with a broad range of products. Distribution channels are much more extensive on the industrial side and we continue to progress on the consumer side. Historically, Napier's consumer sales growth has been slower as we have been unable to create the "product pull" necessary for rapid growth. In the first quarter of 2004, consumer sales have been softer than previous years due in large measure to an extended "Spring booking program". Performance will be driven by continuing to optimize our capabilities and resources in distribution channels, product profitability, product development, brand awareness and working capital

Governance and Management

On February 1, 2004, Napier appointed Janice Comeau as Chief Financial Officer. Janice's appointment follows Jim Grinnell stepping down as Chief Financial Officer. Brad Aelicks resigned as a director of the company on February 3, 2004.

Financial Management

To the extent that we are able, we have factored a stronger Canadian dollar into pricing for US customers. With our new factoring facility, advances for US and export sales are made in US dollars therefore eliminating the foreign exchange risk for amounts collected.

Bad debt expense incurred in the year was less than 0.1% of sales. With our strategic change in customer base to fewer, larger customers, our credit risk is improved in that we are dealing with higher quality credit risks. We are however subject to a greater exposure from any one particular customer.

The company's adequacy of working capital is directly tied to our sales level. As the year progresses, if sales targets are not achieved, it will be necessary to focus on further cost containment and to obtain additional financing. The Company is currently identifying alternate sources for this financing, should the need arise.

Risk Factors

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. The working capital adequacy is dependent on sales. A significant shortfall in sales is therefore one of the most critical business risks faced by the Company in the current year. Management believes that the strong customer relationships in place form a foundation for sales however, risks inherent to the business as outlined below could result in sales shortfalls. The Company will continue to monitor the sales and working capital level and when appropriate, consider alternative methods of financing including equity. 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.

Other significant risks and uncertainties that face the company are common to other manufacturers operating in an international economy in the industrial and consumer 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 fluctuations, unavailable raw materials, and economic conditions affecting large or potential customers and suppliers, to name a few of the normal but significant factors affecting the Company's day to day business. To minimize some of these risks going forward, we continue to nurture our relationships with key customers and suppliers. Open, honest and straightforward communication has retained their loyalty and continued commitment to Napier.

In 2004 we will face the risks associated with a new product launch. It is difficult to accurately predict the level of sales this line will generate in the year, as we have limited capital to launch the new products and to create the advertising pull required to rapidly gain acceptance.

Our business is seasonal with the first and last quarters delivering a lower level of sales than the second and third. Efforts to offset this seasonality are underway by targeting less seasonal or I business such as the consumer "Removall Line" and sales to the aviation sector. Export sales south of the equator, will allow us to take advantage of peak seasons opposite to those north of the equator. We expect that the results for 2004 will continue to reflect this seasonality yet to a lesser extent.

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 19, 2004