

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2005**

Napier Environmental Technologies Inc. (the "**Company**" or "**Napier**") is a manufacturer and distributor of highly effective, safe and environmentally friendly chemicals for stripping paints and coatings, surface preparation, as well as a complete line of wood restoration and protective products. These products are cost effective, safe and easy to use, and are formulated and designed to be environmentally benign, which is important given today's environmental awareness. We distribute products both domestically and internationally through a 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. Napier products have not yet been introduced and adopted for all possible applications.

Consumer uses for the products are a large part of our business. The products and uses are similar to industrial uses with the main difference being a smaller scale project. We have been successful in this market segment through our private label business with some of the world's largest paint and coatings producers who have recognized our unique formulas and have leveraged their respective distribution abilities to position many of our products onto major retailers' shelves. Additionally, Napier has a successful retail network, distributing wood renovation products including; cleaners, surface preparation products and a variety of coatings products.

Competitive alternatives to our product offerings include products that are not environmentally benign and other surface preparation methods including sand blasting. In the wood coatings sector of the business, there are a number of competitive products. No one competitor offers the same broad 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. Our competitive advantage is that our products are environmentally benign, cost effective, safe and easy to use. A number of products are patented and supported by our Research and Development expertise.

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

This Management's Discussion and Analysis ("MD&A") for the year ended December 31, 2005 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. This MD&A should be read in conjunction with the audited consolidated financial statements of the Company and notes thereto for the years ending December 31, 2005 and December 31, 2004.

Disclosure Controls

Pursuant to Multilateral Instrument 52-109 *Certification of Disclosures in Issuers' Annual and Interim Filings*, management has evaluated the effectiveness of the Company's disclosure controls and procedures as at December 31, 2005 and found them to meet required standards.

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Overview

2005 has been both a challenging and exciting year for Napier. In the first half of the year there continued to be a great deal of uncertainty with respect to the future direction of the Company, as we worked through our corporate restructuring. In July, we were able to put the resources and team together to allow the Company to move forward and properly market and distribute the products, which are innovative and effective. On July 14, 2005 we commenced putting this new team together and spent the balance of the year assessing the current situation, working with existing customers and suppliers and preparing for the busy period ahead. Now we can focus on the future and consider new opportunities and explore ways to expand the business such as new customers, products, new markets and market segments.

Distribution will be a key to our success going forward. We will rely on the expertise of the new management team and their knowledge and experience within the industry, and with our customers, to help us achieve efficiencies, increased sales and ultimately financial growth.

Results of Operations

For the year ended December 31, 2005, we recorded a net loss of \$494,037 (\$0.01 per common share) as compared to a net loss of \$2,296,525 (\$0.05 per common share) for the year ended December 31, 2004.

The significant change in the results of operations and the posting of a much smaller net loss for the year ended December 31, 2005 as compared to the year ended December 31, 2004, is attributable to both the cost reducing actions undertaken and the gain recognized on the settlement of debt through the acceptance of the proposal to creditors pursuant to the Bankruptcy and Insolvency Act. The amount of this gain for the year ended December 31, 2005 is \$881,753 net of restructuring costs of \$1,003,916. We do not expect similar gains in the future.

We recorded a net loss of \$754,355 during the last three months of 2005 as compared to a loss of \$1,217,622 during the last three months of 2004. There is no comparative figure for this item in 2004. This decrease of \$463,267 is the result of the Company's focus on reducing overall costs and expenditures. This decrease is significant considering the lower level of sales incurred in the fourth quarter of 2005.

Sales

Sales for the year ended December 31, 2005 totaled \$4,189,417 as compared to \$6,674,512 for the year ended December 31, 2004. The decrease in overall sales is attributable to the changes in operations required while Napier sought court acceptance of the proposal to creditors. Under the guidance of an appointed Chief Restructuring Officer and in an attempt to conserve cash, the Company reorganized the sales force, refocused on specific customers in specific regions and did not extend credit terms to customers. These actions were taken to minimize the potential risks to creditors during this period of uncertainty, but in turn had a negative impact on overall sales.

Going forward we are now able to service a wider range of customers and have the working capital required to offer credit terms to our customers.

We recorded sales of \$415,353 during the last three months of 2005 as compared to \$814,049 for the last three months of 2004. The main reason for this decrease of \$398,696 is primarily the result of a reduced distribution base throughout the year resulting in fewer orders during the last quarter.

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Cost of Sales

Cost of sales for the year ended December 31, 2005 was \$2,976,114 (71.04% of sales) compared to \$4,301,023 (64.44% of sales) for the year ended December 31, 2004. The decreased gross margin earned in the year ended December 31, 2005, as compared to the year ended December 31, 2004, is primarily the result of the lower level of production required to fulfill the sales in the year. The fixed costs included in cost of sales were allocated to a smaller number of units produced resulting in a lower overall gross margin percentage.

The impact of this lower level of production was particularly obvious in the fourth quarter, where the cost of sales, which included an allocation of fixed overhead, exceeded the sales for the same period. We recorded cost of sales totaling \$523,755 in the fourth quarter resulting in a negative gross margin of \$108,402 as compared to cost of sales and a gross margin of \$621,781 and \$192,268 respectively, for the three months ended December 31, 2004. To alleviate part of this abnormality, the Company has taken corrective measures to reduce the fixed overhead costs which are primarily related to the premises. The Company is working towards building relationships with new customers that will allow it to increase sales and in turn production during this historically slow time of year.

Expenses

General and administrative expenses were \$1,400,276 for the year ended December 31, 2005 compared to \$1,808,279 for the year ended December 31, 2004, a decrease of \$408,003. We continue to work at operating in the most efficient way possible, however, certain expenses increased as they related to legal, professional fees, and travel costs incurred due to the organizational changes we experienced over the past year. The most significant item that contributed to the decrease in general and administrative expenses was salaries and wages, which decreased from \$803,067 in the year ended December 31, 2004 to \$537,454 in the year ended December 31, 2005. This decrease was a result of the restructuring that was undertaken beginning at the end of 2004.

General and administrative expenses for the three months ended December 31, 2005 totaled \$379,755 as compared to \$725,747 for the three months ended December 31, 2004. The decrease of \$345,992 is primarily due to the current management team's efforts to reduce expenditure and the reduced salary costs that resulted from the corporate restructuring.

Selling expenses for the year ended December 31, 2005 were \$613,539 as compared to \$2,234,557 for the year ended December 31, 2004. The decrease of \$1,621,018 was the result of our corporate restructuring and the reduction of our sales force. These changes also reduced the costs attributed to the number of sales people employed such as travel, promotion and communications costs. Advertising and promotional costs were also reduced, in order to conserve cash during this period. The reduction in sales described above, also reduced the overall commissions paid to the sales force that are included in selling expenses.

Selling expenses for the three months ended December 31, 2005 were \$135,279 as compared to \$354,990 for the three months ended December 31, 2004. The decrease of \$219,711 is the result of reduced salaries and commission as well as the respective travel and promotion costs that would have been incurred by a larger sales force. The salary costs were reduced as an initiative of the corporate restructuring and commission costs are directly related to the reduced sales for the three months ended December 31, 2005.

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Interest and finance costs decreased to \$309,368 during the year ended December 31, 2005 as compared to \$536,815 during the year ended December 31, 2004. Interest and finance costs were exceptionally high during 2004 as the Company factored increasingly larger balances of accounts receivable during that year. During the first two quarters of 2005, the balances of accounts receivable being factored were lower as we did not factor any accounts receivable in the third and fourth quarter resulting in lower interest and finance costs.

Interest and finance costs for the three months ended December 31, 2005 were \$30,907 as compared to \$209,850 for the three months ended December 31, 2004. As noted, the reduced interest and finance costs are the result of the replacement of higher interest loan facilities with restructuring loans discussed in the section entitled "Transactions with Related Parties" in this MD&A.

Research and development costs for the year ended December 31, 2005 were \$195,481 compared to \$227,854 for the year ended December 31, 2004. Our emphasis on research and development has not changed through the process of the proposal to creditors. Research and development expenditures have remained constant, in order to maintain product quality and integrity and ensure that all concepts in our product development remain active.

Research and development costs for the three months ended December 31, 2005 were \$46,684 as compared to \$57,915 for the three months ended December 31, 2004.

Foreign exchange loss totaled \$28,429 for the year ended December 31, 2005 as compared to \$65,917 for the year ended December 31, 2004. The Company's foreign exchange loss is primarily due to the fluctuations of the US dollar.

Selected Financial Information

The following financial information has been prepared in accordance with the Canadian generally accepted accounting principles. It should be read in conjunction with the audited consolidated financial statements of the Company, the notes thereto and the Auditors' Report thereon for the years ended December 31, 2005, 2004 and 2003 respectively.

The following table sets forth selected consolidated financial information for each of the three most recently completed years ended December 31, 2005 (audited; in thousands of dollars, except the loss per share figures):

	December 31		
	2005	2004	2003
Sales.....	4,189	6,675	6,952
Gross profit.....	1,213	2,373	2,735
Operating loss.....	(1,347)	(2,434)	(1,603)
Net loss.....	(494)	(2,297)	(1,800)
Loss per share,			
basic and fully-diluted.....	(0.01)	(0.05)	(0.04)
Total assets.....	2,507	1,945	2,743
Long-term financial liabilities.....	1,200	-	337

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Summary of Quarterly Results

The following table sets forth selected consolidated financial information for each of our last eight quarters. The table has been derived from our unaudited interim consolidated financial statements for those periods and is stated in thousands of dollars except for the earnings (loss) per share figures. These results are not necessarily indicative of results for future periods and should not be used or relied upon to predict our future performance.

(in thousands Cdn\$ except per share data)

	Dec 31 2005	Sept 30 2005	June 30 2005	Mar 31 2005	Dec 31 2004	Sept 30 2004	June 30 2004	Mar 31 2004
Sales	415	897	1,249	1,628	814	1,673	2,586	1,601
Operating income (loss)	(743)	(724)	(5)	125	(1,405)	(667)	(61)	(448)
Net income (loss) for the period	(754)	435	(294)	118	(1,217)	(696)	(143)	(240)
Earnings (loss) per share, Basic and fully-diluted	(0.016)	0.009	(0.006)	0.002	(0.026)	(0.015)	0.003	(0.005)

The foregoing analysis highlights the impact of the restructuring process on sales, specifically during the periods that are traditionally slow, the third and fourth quarter. The resultant operating loss is an improvement relative to sales reflecting the actions taken by management to reduce operating costs. The net income in the current period is the result of the gain on settlement of debt described above.

Liquidity and Capital Resources

At December 31, 2005, our cash on hand was \$10,413 as compared to \$73,163 at December 31, 2004.

At December 31, 2005, we had accounts receivable of \$308,541 as compared to \$362,710 at December 31, 2004. This decrease of \$54,169 is consistent with the lower volume of sales throughout the fourth quarter of 2005.

As part of the negotiated restructuring of debt, we have access to an additional \$1,700,000 through a revolving working capital loan, subject to certain conditions and covenants pursuant to the loan agreements. Additional funds advanced through this working capital loan will bear interest at prime plus 2%. The revolving loans have a 364-day term and are renewable for successive 364-day extensions at least 90 days prior to the expiry of the applicable term expiry dates and subject to the consent of the lenders.

Transactions with Related Parties

We have entered into a management services agreement (the "Management Services Agreement") and a sublease (the "Sublease") with I.C.T.C. Holdings Corporation ("I.C.T.C."), a company that is controlled by Anthony Traub, Napier's Chairman, CFO and Secretary, and Steve Balmer, Napier's President and Chief Operating Officer.

Pursuant to the Management Services Agreement, effective September 1, 2005, we reimburse I.C.T.C. for certain costs incurred on Napier's behalf. We pay a variable monthly amount to I.C.T.C. under this agreement based on the actual costs incurred by I.C.T.C. At December 31, 2005, we had paid I.C.T.C. a total of \$60,516 for services under this agreement.

The Sublease with I.C.T.C. is for half of the premises at 720 Eaton Way, Delta, British Columbia. The Sublease commenced on November 1, 2005 and is based on half of the financial exposure of Napier under its lease commitment.

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Anthony Traub controls 6408753 Canada Corporation and Steve Balmer controls 6408788 Canada Corp., the companies that have collectively completed two separate financing transactions consisting of term loans totaling \$1,500,000 and revolving loans up to the aggregate amount of \$3,500,000. The initial advances of these financing transactions were made on July 14, 2005 in the aggregate amount of \$3,000,000 and were used to pay fees and costs related to the loan transactions and satisfy all amounts owing by Napier to its secured, preferred, unsecured and post filing creditors as of July 14, 2005 as approved by the Supreme Court of British Columbia in Bankruptcy. During the remainder of the year ended December 31, 2005, additional funds, in the amount of \$300,000, were advanced for use as working capital. Total interest paid to these companies in respect of these loans was \$128,921 (2004: nil).

Outstanding Share Data

There are currently 47,768,042 common shares (the “**Common Shares**”) of Napier issued and outstanding. In addition, there are currently options outstanding to purchase 3,391,000 Common Shares at prices between \$0.04 and \$1.10 per share, expiring between February 14, 2006 and August 31, 2010, and warrants outstanding to purchase 82,153,700 Common Shares at \$0.01 per share at any time up to August 31, 2010.

Critical Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires that we make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions are developed based on the best available information and are believed to be reasonable under the existing circumstances. New events or additional information may result in the revision of these estimates over time. Significant accounting policies are described in Note 2 of the annual audited financial statements. The following discussion outlines what we believe to be the most critical accounting policies involving the use of significant estimates and assumptions.

Accounts Receivable, Allowance for Doubtful Accounts and Product Returns

The allowance for doubtful accounts is based on historical trends. We regularly review the age of the accounts receivable in detail by customer and follow up on delinquent accounts directly with the customer. Based on discussions with the customer, independent credit reports and past collection history, we estimate an appropriate allowance for doubtful accounts. A significant portion of sales is to a number of large customers with higher quality credit. This subjects Napier to a greater exposure to any one particular customer. If the estimate of the allowance is understated, this could result in a charge to earnings in the future, should the account ultimately not be collectable.

The provision for product returns is estimated based on historic experience for particular products and customers taking into account, among other things, obsolescence, age and demand. If the estimate for product returns is understated, this could result in a charge to future earnings should the actual experience for returns be greater than estimated.

Property, Plant and Equipment/Depreciation and Amortization

The estimated useful lives of assets are determined based on historical experience with comparable assets, technological obsolescence and asset utilization. If our estimates of useful lives of assets are incorrect, we could experience increased or decreased charges to depreciation and amortization in the future.

Income Taxes

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We follow the liability method of accounting for income taxes whereby future income taxes are recognized based on the differences between the carrying amounts of assets and liabilities reported in the financial statements and their respective tax basis. Future income tax assets are comprised of temporary differences between the carrying amount and the tax basis of assets and liabilities as well as tax losses carried forward. In valuing the future income tax assets, consideration is given to the timing of reversal of the temporary differences, the tax rate enacted for the reversal period and the results of future operations. The value of future tax assets is based on the likelihood of realization of future taxable income against which the tax losses can be applied.

The determination of the income tax assets and liabilities is an inherently complex process requiring the interpretation of continually changing regulations and making certain judgments. While income tax filings are subject to audits and reassessments, we believe the tax assets have been adequately provided. However, changes in the interpretations or judgments may result in increases or decreases to Napier's future income tax asset.

Based on our loss history, we do not have, at this time, reasonable assurance of sufficient taxable income and a valuation allowance has been made equal to the full value of the future income tax assets.

Risk Factors

Risks and uncertainties that face our business are common to other manufacturers operating in an international economy in the industrial and consumer sectors. We 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 as well as increasing costs, and economic conditions affecting existing and potential customers and suppliers, to name a few of the normal but significant factors affecting our day to day operations. To minimize some of these risks going forward, we continue to nurture relationships with key customers and suppliers. Open, honest and straightforward communication has retained their loyalty and continued commitment to Napier. Our business is seasonal with the third and fourth quarters delivering a lower level of sales than the first and second quarters. Efforts to offset this seasonality are underway by targeting less seasonal businesses, with a variety of products that Napier have available. On July 14, 2005, subsequent to the end of the second quarter, we successfully renegotiated Napier's unsecured debt obligations. While the reduction of its unsecured debt obligations and additional financing should assist us in the future, our continued existence is dependent upon Napier's ability to restore and maintain profitable operations and to receive continued support from our lenders. At the time of advancement and at December 31, 2005, the lenders acknowledge that the margin requirements required under these loans were not met.

Our risk factors are discussed in detail in our Annual Information Form dated March 30, 2006 and remain substantially unchanged. This document is available at www.sedar.com.

Cautionary Note Regarding Forward-Looking Statements

This MD&A contains "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995. In certain cases, forward-looking statements can be identified by the use of words such as "plans", "expects" or "does not expect", "is expected", "budget", "scheduled", "estimates", "forecasts", "intends", "anticipates" or "does not anticipate", or "believes", or variations of such words and phrases or statements that certain actions, events or results "may", "could", "would", "might" or "will be taken", "occur" or "be achieved". Forward-looking statements involve known and unknown risks and uncertainties and other factors, which may cause the actual results, performance and achievements expressed or implied by the forward-looking statements. Such factors include, among others, risks related to the going concern status of Napier, historical losses and cash flows, the future need for capital and the

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uncertainty of additional financing, the possible de-listing from the Toronto Stock Exchange, dilution to shareholders, the volatility of the market price of the common shares, dividend policy, competition, dependence on key personnel, dependence of key customers, weather, seasonality and economic cycles, raw materials, the retail industry, exchange rate fluctuations and conflicts of interest. For further details regarding such risk factors, see the section entitled "Description of the Business – Risk Factors" in our Annual Information Form dated March 30, 2006 and filed with the British Columbia and Ontario securities commissions and the Toronto Stock Exchange, which can be found on SEDAR at www.sedar.com. Although Napier has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be factors that cause actions, events or results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements.

Additional Information

Additional information relating to the Company can be found on SEDAR at www.sedar.com.

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

"Steve Balmer"

Steve Balmer
President and Chief Operating Officer
March 30, 2006