MANAGEMENT’S DISCUSSION AND ANALYSIS

Napier’s chemical products are competitively advantaged. The Company is proud to be the manufacturer of products that are effective, safe, environmentally advantaged, worker friendly and have very significant cost advantage, particularly when compared to competitive toxic chemicals and media blast applications. Market acceptance of its products has been demonstrated through established domestic and international distribution channels for both industrial and retail markets. The principle products include paint strippers, coating removers and surface preparation compounds as well as wood restoration products.

The accompanying consolidated financial statements of Napier Environmental Technologies Inc and its subsidiaries (collectively Napier or the Company), and all information in this annual report, are the responsibility of management and have been approved by the Board of Directors. The Management’s Discussion and Analysis (MD&A) has been prepared to give shareholders an assessment of not only what the Company has accomplished in the past fiscal year but also of what management initiatives have been taken to increase shareholder value for the future. All of the MD&A should be read in conjunction with the audited consolidated financial statements of the Company and notes thereto for the fiscal periods ended December 31, 2001, December 31, 2000 and July 31, 2000.

Overview

During fiscal 2001 Napier underwent significant changes in many aspects of its business, including changes in management and governance, enhanced customer relationships, improved methods of doing business and new product line development. The Company is well positioned for fiscal 2002.

A brief look back at some accomplishments …

<u>Governance and management:</u>
After having hired a new CEO in late 2000, fiscal 2001 started off in January with two significant additional changes in senior management. The Company appointed Brad Aelicks as President and hired Mike Sloan as VP Industrial and International Operations. The Board of Directors was then enhanced through the appointment of two new and capable independent directors, Lionel Dodd and Peter Jeffrey. With a majority of independent directors the Board then took steps to better articulate corporate governance and established clear mandates for the committees of the Board. These changes to management and governance provide building blocks for the future.

<u>Financial management:</u>
The Company changed its fiscal year end to December 31 from July 31, effective December 31, 2000 so as to better track the seasonality of its business, align itself with the normal calendar year and to enable shareholders to more easily compare to other companies with December year ends. Napier hired an experienced credit manager in January 2001 and then, in order to move towards more mature corporate arrangements and to average down its weighted average cost of capital, the Company established a traditional bank line of credit with a major Canadian bank. In the last half of the year the Company commenced a program of cost containment so as to reduce excess overheads and enhance profitability for the future. Management has analysed contribution margin by product line to assist in focusing attention on areas of highest potential for 2002.

Manufacturing and distribution operations:
After having carried out the acquisition of the Biowash business in late 1999 the Company merged its physical locations into one facility with greater productive capability in early 2001. Cross training of staff for the different manufacturing processes was carried out by May. With anticipated increased sales and to improve both timeliness and cost effectiveness of delivery, Napier established inventory warehousing arrangements in Rotterdam for Europe, Toronto for eastern Canada and near Atlanta, Georgia to service the eastern and southern United States.

Sales and marketing relationships:
Management has taken a relationship development approach to increasing its sales for the future. The strategy of increasing distribution relationships was taken to increase the leverage and multiplier effect of several different organizations representing the Napier products. Several new distribution agreements have been established during 2001. These are the foundation for the Company's growth.

Product lines:
To assist in marketing the industrial products for distribution, both for larger commercial applications as well as for retail distribution, Napier acquired the already established RemovAll brand for expanded use with its other products. Brand identification to our Napier products going forward will be under two established names – RemovAll and Biowash.

Research and development:
A larger and improved laboratory facility has been built into the new plant in order to advance the development of our technologies. Testing on specific applications requested by our customers and the creation of new products are also pursued in this facility.

Liquidity and Capital Resources

At December 31, 2001 the Company has working capital of $2.2 million, a current ratio of approximately 2.7 times and sufficient cash and access to cash to meet its immediate needs. As demand for the Company's products grows so too will the need for available inventory. The inventory mix of raw materials and finished goods has changed from a year earlier for two reasons; raw materials have increased in order to build finished goods necessary for the 2002 spring selling season and second, prior period finished goods were higher to allow for the down time during the move in premises. For both this anticipated growth and due to the seasonality of the business the Company expects to increase its inventory levels over the first half of 2002.

In past periods the Company has not undertaken any significant borrowing arrangements except for the utilization of capital leases to acquire certain operating equipment. To further enhance the Company's overall financial position and improve the Company's overall weighted average cost of capital, during 2001 the Company entered into additional capital lease arrangements in connection with the acquisition of production equipment. Working capital liquidity has also been improved by the Company's available bank line.

The Company's historical capital needs have been met by equity subscriptions from private placements, exercise of share purchase warrants and exercise of employee stock options, totaling $9.2 million since December 1999. The Company has no near term plans for any significant capital expenditures.

Results of Operations

To properly compare the period to period results of operations requires taking into consideration the significant changes in the Company over the entire period, the combined effect of the change in fiscal year end and the strong seasonality of the business. The loss for the year ended December 31, 2001 of $12.8 million compares to a five month period loss of $3.3 million for December 31, 2000 and a loss of $2.6 million for the year ended July 31, 2000. The current year's loss is very significantly impacted by the non-cash write-off of goodwill of $9.2 million during the Company's third quarter. This charge is more fully discussed in the notes to consolidated financial statements and below.

In November 1999 the Company acquired the Biowash retail business and merged those operations effective December 1, 1999. Accordingly the results for July 31, 2000 include only eight months of combined operations. Another factor is the highly seasonal business. In particular the retail business has a concentration in consumer and contractor home improvement products with a selling season more concentrated in the period during March through September. The industrial division is also seasonal, but less dramatically so. Management expects to see a less significant seasonal influence as a result of its attention to sales and distributor relationships in warmer climates and extra focus on industries that use our products in indoor refurbishment facilities.

The Company has experienced a decline in gross profit, from 44% in July 2000 to 41% in December 2000 to 28% in December 2001. The principle reason for the changes to gross profit relate to sales mix and pricing, largely reflecting the Biowash retail business. The industrial products (coating strippers) command a higher profit margin while the retail products (mainly wood refurbishment) are subject to additional competitive pressures in retailing through big box retailers in North America. The Company is in the process of realigning the operations to create value from the Biowash acquisition. The write-off of goodwill was taken because the benefits originally identified at the time of the acquisition are not expected to be realized with sufficient certainty nor within the time frame originally anticipated. Even though the sales on the associated Biowash product line have been at a similar level to those achieved prior to its acquisition, the growth and contribution to profit has not met expectations.

There are several elements to the action plan. The Company is aiming to shift towards higher sales of its more profitable industrial products and the groundwork has been carried out during 2001 to expect a strong increase by way of industrial distribution. Pricing of certain products sold via retail distributors was a significant contributor to the decline in margin in 2001. Management has addressed this retail pricing problem, has taken the first step to increase prices to provide improvements in margins for 2002. Actions are also in place to introduce selected SARA technology products under the RemovAll brand to retail customers and some Biowash products to industrial customers. These changes, combined with improved and new distributor relationships, should assist significantly in both sales volumes and unit profitability.

The other significant impact to profitability is in the Company's selling/marketing costs and its general and administrative expenses. The selling cost structure that was implemented in fiscal 2000 was excessive for the Company's stage of development at that time. In early fiscal 2001 the problem was recognized and was dealt with over the course of the year. These excess selling overheads were reviewed with the objective of cutting the fixed cost components without losing the benefits of the sales relationships. The Company has invested in the sales side of its business in order to reach the critical sales volume necessary to be successful. This investment has been in senior staff from the coatings industry who are already familiar with the significant benefits of Napier's products. General and administrative costs increased as compared with fiscal 2000 for the same reasons as selling costs did – premature expenses based on planned growth. Since the growth was not realized according to timetable the administrative staff was reduced in mid 2001 to a level commensurate with activity. In addition senior management of the Company demonstrated commitment and leadership by taking large reductions in their personal compensation.

Total selling, marketing, general and administrative costs have decreased from an annualized total for year 2000 of $6.7 million to $5.2 million for 2001. Given that the cost containment program was launched in mid 2001, management expects fiscal 2002 to have further cost reductions in the order of another $1 million.

Looking Forward …

Strong improvement is expected in fiscal 2002 principally because Napier has positioned itself for profitability and significant growth. Specific changes that management expects include (1) improved gross margins due to shift in product mix and due to pricing improvements for retail distribution; (2) substantial increase in sales and marketing through additional distribution arrangements in place for 2002; and (3) reduced operating costs due to a conscious cost containment program. This plan has been carried out specifically to increase shareholder value, using as its foundation basic financial operating fundamentals.

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, market penetration into established supply lines, 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, in light of the always changing financial markets, there is no assurance that funding by equity subscriptions will be possible at times required or if 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, to adequately protect the company's proprietary rights and other factors described in the company's regulatory filings. Although management believes the expectations reflected in our forward looking statements are reasonable, results may vary as there are significant challenges, and management cannot guarantee future results, levels of activity, performance or achievements.

When we look at the market potential for the Napier's products we see growth possibility of multiples of our current sales levels. With this top line prospect together with bottom line focus, shareholder value has significant potential upside as the Company matures in the next few years.

On behalf of the Board of Directors

(signed)

Cliff T. Davis, Chairman and CEO March, 2002