

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management Discussion and Analysis (MD&A) reviews the financial condition and results of operations for Environmental Management Solutions Inc. (EMS) for the first quarter ended March 31, 2006 and 2005. This information is presented as at May 8, 2006. The MD&A should be read in conjunction with our consolidated financial statements and the accompanying notes for the three months ended March 31, 2006. We also encourage you to read the MD&A for the year ended December 31, 2005.

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). All amounts in this MD&A are in Canadian dollars, except as otherwise noted.

Throughout this MD&A, “we”, “us”, “our”, “EMS” and “the Company” refer to Environmental Management Solutions Inc. and its subsidiaries.

You will find more information about EMS, including our Annual Information Form for the year ended December 31, 2005 and recent financial reports filed on SEDAR at www.sedar.com.

FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements about EMS' objectives, strategies, financial conditions, results of operations, cash flow and businesses. These statements are “forward-looking” because they are based on our current expectations, estimates and assumptions about the markets we operate in, the Canadian economic environment, our ability to attract and retain customers, our relationships with our suppliers, availability and costs of fuels and utilities, the results of our ongoing efforts to improve cost effectiveness, changes in regulatory requirements affecting our business, and the availability and terms of financing.

Securities laws encourage companies to disclose forward-looking information so that investors can get a better understanding of the Company's future prospects and make informed investment decisions. A statement we make is forward-looking when it uses what we know and expect today to make a statement about the future. Forward-looking statements may include words such as “anticipate”, “believe”, “could”, “expect”, “goal”, “guidance”, “intend”, “may”, “objective”, “outlook”, “plan”, “seek”, “strive”, “target” and “will”.

It is important to know that:

- Forward-looking statements in this MD&A describe our expectations as at March 31, 2006;
- Our actual results could be materially different from what we expect if known or unknown risks affect our business, or if our estimates or assumptions turn out to be inaccurate. As a result, we cannot guarantee that any forward-looking statement will materialize and, accordingly, you are cautioned not to place undue reliance on these forward-looking statements.
- Forward-looking statements do not take into account the effect of transactions or non-recurring or other special items announced or occurring after the statements are made may have on our business. For example, they do not include the effect of sales of assets, mergers, acquisitions, other business combinations or transactions, asset write-downs or other charges announced or occurring after the forward-looking statements are made.
- We disclaim any intention and assume no obligation to update any of the forward-looking

statements even if new information becomes available, as a result of future events or for any other reason.

Risks that could cause our actual results to differ materially from our current expectations are discussed in this MD&A including, in particular, in the *Risks That Could Affect Our Business* section.

NON-GAAP FINANCIAL MEASURES

EBITDA

Within this MD&A we use the term EBITDA (earnings before interest, taxes, depreciation and amortization). EBITDA does not have any standardized meaning prescribed under GAAP and is therefore unlikely to be comparable to similar measures presented by other companies.

We use EBITDA, among other measures, to assess the operating performance of our ongoing businesses without the effects of restructuring and other items, stock-based compensation, and goodwill and asset impairment charges. We exclude restructuring and other items because they are transitional in nature. We exclude stock-based compensation expense and goodwill and asset impairment charges because they all largely depend on the accounting methods and assumptions we use, along with non-operating factors, such as the historical cost of capital assets and the value of our common shares.

EBITDA allows us to compare our operating performance over time on a consistent basis. We believe that certain investors and analysts use EBITDA to measure a company's ability to service debt and to meet other payment obligations, or as a common valuation measurement in the environmental services industry.

EBITDA should not be confused with cash flow from operating activities. The most comparable GAAP financial measure is operating income, which is discussed in the *Results from Operations* section of the MD&A. The tables below reconcile EBITDA to operating income for the past four quarters.

\$000's	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Q1 2006
EBITDA	(522)	1,739	1,429	1,114	(415)
Restructuring and other items	1,235	1,776	281	2,010	67
Stock based compensation expense	258	146	146	147	145
Operating Income	(2,015)	(183)	1,002	(1,043)	(627)
Gain (loss) on sale of fixed assets	(387)	76	2	(21)	3
Interest and bank charges	894	975	1,149	1,389	825
Depreciation and amortization	703	765	706	599	728
Non-controlling interest in subsidiary	(108)	124	11	4	(104)
Provision for (recovery of) income taxes	(282)	221	(108)	88	(454)
Loss before discontinued operations	(2,834)	(2,344)	(758)	(3,102)	(1,625)

ABOUT OUR BUSINESS

Description

We are Canada's leading environmental services company specializing in the management, treatment, re-use and/or disposal of organic wastes and contaminated soils. We place a very strong emphasis on beneficial re-use for both environmental and financial benefit.

- We are a **knowledge-based** company with expertise in a range of operations, extensive skills and a great number of proprietary processes.
- We are **facilities-based** – using technology, and our proprietary processes to manage, treat, reuse and/or dispose of organic waste streams and contaminated soil.
- Our emphasis is on the **beneficial reuse** of the materials we handle. Beneficial to the environment and beneficial to future generations.

Operations

We report our results of operations by service offerings, being (a) integrated environmental services and (b) tank testing and calibration. Integrated environmental services include; facilities, waste management, site reclamation and remediation, and eco-product sales.

A. Integrated Environmental Services

The core to our integrated environmental services is the facilities. We own and operate eleven permitted facilities of two different types, all licensed by the appropriate provincial ministry of the environment:

- Soil Treatment Facilities (4) - licensed to receive a specific range of contaminated soil and apply a treatment process to reduce contamination, making the soil suitable for an alternative use other than landfilling. The treated soil may be appropriate for re-use or re-vegetation for specific applications. Our facilities are located in Sudbury, Ontario, Lachute, Quebec, Sherbrooke, Quebec and Ste-Croix de Lotbinière, Quebec.
- Composting Centres (7) - licensed to receive an organic waste stream and produce compost through the biological decomposition of the organic waste, which is accelerated through the application of composting technology. Located in St. Henri, L'Ange Gardien, Quebec City, St. Fabien, St. Hyacinthe, Lachute and Bury, Quebec.

Waste Management

We provide comprehensive waste management and environmental services as well as turnkey solutions adapted to the needs and industries of a region. The services we offer in waste management are:

- Transport and recycling services for municipal, industrial, commercial and institutional clients
- Sludge processing and composting of organic wastes
- Beneficial reuse of organic waste for land application, eco-products and site reclamation
- State-of-the-art treatment technologies including dehydration and granulation

Site Reclamation and Remediation

We focus on site reclamation projects in Quebec, Ontario and the North-Eastern United States. We have been actively treating contaminated soil at our own authorized treatment centers using our proprietary technologies.

Our site reclamation project management support for our clientele, which includes municipalities, the manufacturing, agri-food, petrochemical and pulp and paper industries, begins with on-site consultations to find the most effective solutions to the issue at hand. Our services include: 1) on site treatment of soil and ground water: biological and physico-chemical procedures (in-situ or ex-situ), containment and hydraulic barriers, stabilization and chemical washing; 2) off-site management; sampling, analysis, sizing, conditioning and transportation to treatment, recycling or storage facilities; 3) closing former industrial sites and landfills; and 4) pollution control and prevention.

Our site reclamation experience includes: the reclamation of residential, mining, sand and gravel quarries, and sanitary landfill sites, brownfields redevelopment, site assessments and development plans, the management of required authorizations, innovative treatment and remediation of sites using beneficially reused matter such as organic residual waste, revegetation and reforestation, and environmental monitoring.

Eco-Products

Over the years the Company has developed a wide range of eco-products that are by-products of our composting activities. These include over 60 types of horticultural composts and growing mixes that are sent to garden centres, residential, commercial or urban landscaping sites, nurseries, and all sorts of other horticultural professionals, both bagged and in bulk.

Some products are targeted toward the agricultural market: these include amendments and alternative organic fertilizers. The latter have various origins, including pulp and paper mills, mines and municipal treatment plants, etc. The availability of each amendment and fertilizer varies in each region depending on the generators of the residue. The main amendment and alternative organic fertilizer categories are: pulp and paper mill fibres (mixed biosolids and deinking fibres), calcium and magnesium-enriched amendments manufactured from calcium extraction or fibre combustion, organic fertilizer made from municipal biosolids, and compost made from municipal biosolids.

B. Tank Testing and Calibration

We are a national leader in providing technologies for storage tank integrity testing and are dedicated to delivering total loss management solutions. In addition to offering a range of services aimed at identifying and reducing loss of fuel throughout the distribution channel, using an Internet-based communication technology we supply real time verification services to enhance our customers' operations.

Previously we separated the integrated environmental services into geographical regions of eastern and western Canada; however we announced in July 2005 the exit from the western Canadian market. Starting in Q4 2005, we have sold or closed down a number of businesses that were unprofitable and/or did not fit our strategic direction. The impact of discontinued operations has been reflected in the financial statements.

RESULTS FROM OPERATIONS

Revenue

Revenue from continuing operations was \$9.5 million for the three months ended March 31, 2006 compared with revenue of \$8.2 million for the three months ended March 31, 2005, an increase of 16%. Integrated Environmental Services contributed \$1.2 million to the increase with the significant portion coming from Waste Management and the sale of Eco-Products. This was offset with a decline in revenues from Site Reclamation and Remediation. Waste Management increased primarily as a result of our entering into long-term contracts to treat and source separated organic waste (SSO). Eco-Products sales began significantly earlier in 2006 compared with 2005 as a result of a warmer winter. Site Reclamation and Remediation revenues declined due to the timing of the start-up of certain projects.

Gross Operating Profit

Gross operating profit is calculated by deducting from our revenue the direct costs incurred in delivering the revenue. Gross operating profit for the three months ended March 31, 2006 was \$2.4 million compared with \$2.3 million for the three months ended March 31, 2005. The increase in gross operating profit is a result of the increased sales volume.

Gross margin is defined as gross operating profit as a percentage of revenue. Gross margin for the three months ended March 31, 2006 was 26% compared with 27% for the three months ended March 31, 2005. The gross margin in 2006 was less than 2005 as a result of a change in the mix of revenue.

EBITDA and Operating Loss

EBITDA is calculated by deducting indirect expenses from gross operating profit. EBITDA for the three months ended March 31, 2006 was negative \$0.4 million compared with negative \$0.5 million for the three months ended March 31, 2005.

The EBITDA is traditionally negative in the first quarter due to the reduced volumes of waste delivered in the winter months.

\$000's	Q1 2006	Q1 2005
Gross operating profit	2,443	2,253
Indirect expenses	2,858	2,774
EBITDA	(415)	(522)
Restructuring and other items	67	1,235
Stock based compensation expense	144	258
Operating loss	(627)	(2,015)

Indirect expenses include salaries and other costs not directly attributable to the generation of revenue, and include selling and marketing, general and administrative costs, occupancy, legal, accounting, other professional services and bad debt provisions. Indirect expenses for the three months ended March 31, 2006 were \$2.9 million compared with \$2.8 million for the three months ended March 31, 2005.

As a percentage of revenue, indirect expenses for the three months ended March 31, 2006 was 30% compared with 34% for the three months ended March 31, 2005. We expect to see a decline in this

percentage as we add more revenue to our indirect cost base and as revenues increase during the latter three quarters of the year.

Operating loss is calculated by deducting restructuring and other items, and stock-based compensation expense from EBITDA. The operating loss for the three months ended March 31, 2006 was \$0.6 million compared with \$2.0 million for the three months ended March 31, 2005. The decrease in the operating loss was attributable to a significant decrease in restructuring and other items of \$1.2 million, and a decrease in stock based compensation by \$0.1 million.

During the last quarter of 2004, we began to reorganize the management team, close down unprofitable operations, and sell non-core assets. In addition, the former President and CEO, upon his termination, filed a number of suits against the Company and Board of Directors. These costs, along with the associated costs of defending against a dissident shareholder requisition led by the former CEO resulted in a significant restructuring and other items expense of \$1.2 million for continuing operations during Q1 2005. By the first quarter of 2006 the restructuring activities and litigation with the former CEO and the resulting \$67 thousand relate to the settlement of trailing lawsuits arising from the restructuring activities.

During the normal course of operations, stock options are granted to employees and members of the Board of Directors. The value of these options is calculated using the Black Scholes valuation model and expensed over the period in which the options vest. For the three months ended March 31, 2006, the amount of the expense recorded as stock-based compensation for employee stock options in continuing operations was \$0.1 million compared with \$0.3 million for the three months ended March 31, 2005. The decline in the stock based compensation expense is a direct result of the terminations and associated reductions in the number of options outstanding primarily as a result of the above noted restructuring.

In addition to the Employee Stock Option Plan (ESOP), the Company established a Tandem Option and Share Appreciation Rights (OSAR) plan. Under this plan, the participants have the option to exercise options, to the extent that stock options are available, or request the direct value between the exercise price and the market value of the shares at the time of exercise. The OSARs granted vest on a straight-line basis over 5 years, and have a term of 10 years with exercise prices ranging from \$0.635 to \$1.75 per share and a weighted average of \$1.18 per share. Because the participants in the plan have the ability to receive cash, the accounting of the OSAR is based on the market price of the underlying common shares.

Net Loss

Net loss is calculated by deducting from the operating loss, depreciation, gains and losses on the sale of assets, interest and bank charges, income tax, minority interest, and discontinued operations.

\$000's	Q1 2006	Q1 2005
Operating income (loss)	(627)	(2,015)
Depreciation and amortization	728	703
Gain (loss) on sale of assets	3	(387)
Interest and bank charges	825	894
Income taxes	(454)	(282)
Minority interest	(104)	(108)
Loss before discontinued operations	(1,625)	(2,834)
Discontinued operations	179	(2,070)
Net loss	(1,446)	(4,904)

Interest expense for the three months ended March 31, 2006 was \$0.8 million compared with \$0.9 million for the three months ended March 31, 2005. This decline is a result of reducing debt during fiscal 2005 through the scheduled repayment of principal or as a result of the sale of assets, but offset by very large bank charges to monitor, control and extend our debt repayment dates. On March 31, 2006, we closed the re-financing for the Company resulting in the payout of outstanding debt and the replacement by a convertible debt.

The average cash cost of debt financing was 16% for the three months ended March 31, 2006, including cash paid or payable for extension agreements. In addition, amortization of warrants and deferred financing charges, both non-cash items, increased the cost of debt financing by an additional \$0.1 million, effectively raising the total cost of interest to 20%. The average debt outstanding during the three months ended March 31, 2006 was \$15 million compared with \$15 million for the three months ended March 31, 2005.

Depreciation for the three months ended March 31, 2006 was \$0.7 million compared with \$0.7 million for the three months ended March 31, 2005.

Discontinued operations

During the fourth quarter of 2004 we reviewed the operations of the Company and decided to focus the core business on the management, treatment and disposal of organic waste and contaminated soils. In addition we looked at the profitability of operations and the return on average assets. As a result, Greenbank Environmental Inc. (Greenbank), Cannington Excavation (1989) Ltd. (Cannington), Rom-Neg Construction Ltd. (Rom-Neg), K-Lor Contractor Services (K-Lor) and WasteCo Environmental Services Ltd (WasteCo) were either sold or being wound down during 2005.

At March 31, 2006, all operations with the exception of one trailing project in K-Lor have been fully closed down. We are currently in the process of settling where possible outstanding accounts payable as cash comes available from the collection of accounts receivable. The process has necessitated offering discounts to suppliers in order to settle these outstanding balances.

As a result of these settlement activities, discontinued operations recorded a gain of \$0.2 million for the three months ended March 31, 2006, compared with a loss of \$2.1 million for the three months ended March 31, 2005.

RELATED PARTY TRANSACTION

During the three months ended March 31, 2006, there were no transactions with related parties with the exception of paying \$1.7 million in settlement of the multi-party litigation associated with the former President and CEO to ensure support for the re-financing that closed on March 31, 2006 and approved by shareholders on March 22, 2006. This settlement had been accrued as a liability as at December 31, 2005.

LIQUIDITY AND CAPITAL RESOURCES

On March 31, 2006, the Company closed a \$20.0 million re-financing by issuing 20,952.5 units consisting of a \$950 convertible debenture at 5% interest and 500 \$0.10 convertible preferred shares with a cumulative dividend of 5%. The proceed of this re-financing was used to re-pay existing long-term debt,

acquire the minority stake in CDQ, settle outstanding litigation with the former President and CEO, pay legal and other costs associated with closing the deal and capital expenditures. This re-financing allows us to manage the cash operations of the entire group to the best advantage of the entire organization. In addition, with the settlement of the outstanding litigation of the previous CEO we will be able to enter into discussions with senior lenders to establish necessary lines of credit for the efficient management of our working capital requirements. Management believes that the Company has sufficient cash on hand to fund operations for the foreseeable future.

CASH FLOW PROVIDED BY / USED IN OPERATING ACTIVITIES

For the three months ended March 31, 2006, cash used in continuing operations was \$1.3 million compared with cash used in continuing operations of \$3.7 million for the three months ended March 31, 2005. Excluding restructuring and other costs, cash used in operations was \$1.2 million compared with \$2.4 million for 2005. Cash used in operating activities for the year reflect our net loss for the period net of non-cash charges for depreciation, stock-based compensation, and non-controlling interest in subsidiary, plus the change in our working capital.

CASH FLOW PROVIDED BY / USED IN FINANCING ACTIVITIES

For the three months ended March 31, 2006 cash used in financing activities of continuing operations was \$5.1 million, compared with cash provided by the financing activities of continuing operations of \$1.8 million for the three months ended March 31, 2005. The \$20.0 million raised in the re-financing was used to repay the long term debt outstanding.

CASH FLOW PROVIDED BY / USED IN INVESTING ACTIVITIES

For the three months ended March 31, 2006 cash used in investing activities of continuing operations was \$0.6 million compared with cash used in continuing operations of \$0.3 million for the three months ended March 31, 2005. During the quarter we incurred capital expenditures at certain of our sites in order to better handle source separated organics and we acquired the remaining 29% of Les Composts du Quebec for \$0.2 million cash and approximately \$0.1 million in transaction costs.

AVAILABILITY OF FUNDS

As noted under the liquidity and capital resources, the closing of the ONCAP refinancing result in the ability of the Company to approach secure lenders to obtain an operating credit facility. It is our intention to arrange for a line of credit facility to allow the management of our working capital needs.

LITIGATION

EMS, in the normal course of business, is party to a number of claims, which individually and in the aggregate, we believe are immaterial to the financial position or ongoing operations of the business.

WasteCo has been named as a defendant, together with unrelated parties, in a lawsuit commenced by Dura-Lite Heat Transfer Products Ltd. ("Dura-Lite"). The lawsuit relates to a fire and loss that occurred in November 2001. The Statement of Claim seeks damages from all of the defendants in the amount of \$23.8 million. WasteCo has defended against the suit denying any liability to Dura-Lite. We have been

informed that Dura-Lite has already received a significant payment from its insurer in connection with its loss. It is evident from the exchange of documents that has been made that Dura-Lite's damages are far less than the amount claimed. The examinations for discovery are not yet completed and, accordingly, it is too early to make a complete assessment of any liability that may be attributed to WasteCo.

WasteCo's primary insurers have confirmed that a policy of insurance is in place and that it will provide coverage to WasteCo to a maximum amount of \$5 million in the event that it is found liable to Dura-Lite. Dura-Lite is investigating whether any further policy of insurance for excess coverage applies.

We believe the case is without merit and are vigorously defending our position. In addition, under the terms of the arrangement with the other defendants, we are named as an additional insured party under their General Liability Policy. The amount of any potential costs of settlement in excess of the insurance coverage cannot be determined at this time and no amount has been recorded.

As noted previously we entered into a multi-party settlement agreement with the former President and CEO of the Company whereby litigation with the former President and CEO, an associated company, and other related parties was dropped in return for a payment of \$1.7 million.

QUARTERLY RESULTS OF OPERATIONS

The following is a summary of selected consolidated financial information derived from our unaudited interim period consolidated financial statements for each of the six most recently completed quarters.

000's	First Quarter		Fourth Quarter		Third Quarter		Second Quarter	
	2006	2005	2005	2004	2005	2004	2005	2004
Revenue	9,512	8,232	13,812	15,310	13,576	11,482	17,067	16,794
Net Income (loss)	(1,446)	(4,904)	(4,738)	(3,854)	1,112	(16,412)	(8,794)	(1,317)

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the reported amounts and disclosures made in the consolidated financial statements and accompanying notes. We continually evaluate the estimates and assumptions we use. These estimates and assumptions are based on our historical experience, best knowledge of current events, and conditions and activities that EMS may undertake in the future. Actual results could differ from these estimates.

The estimates and assumptions described in this section depend upon subjective or complex judgments about matters that may be uncertain. Changes in these estimates and assumptions could materially affect the consolidated financial statements.

Effective Interest rate

The convertible debentures bears interest at a rate of 5% and are fully secured by all the assets of the Company. Because of the convertible nature of the debentures and preferred shares that is at the option of the holder, there is a debt and equity component to the units. In calculating the separate component the residual method was used whereby the fair value of the debt was calculated using an appropriate discount rate and the residual portion is considered equity. The discount rate used is 9%, being reasonable rate

associated with an 8-year term fully secured senior debt instrument and the business risk of the Company as evidenced by historic operations.

ACCOUNTING STANDARDS IMPLEMENTED IN 2006

None.

NEW ACCOUNTING PRONOUNCEMENTS

None.

SHARES OUTSTANDING

As at March 31, 2006 there are 38,012,247 common shares outstanding.

On March 31, 2006, we issued 10,296,250 convertible preferred shares.

As at March 31, 2006 there are 3,085,196 options outstanding with a weighted average exercise price of \$1.45 per share and 8,070,030 share purchase warrants with a weighted average exercise price of \$1.65 per share.

RISKS THAT COULD AFFECT OUR BUSINESS

As stated above, risks that could cause our actual results to materially differ from our current expectations include, but are not limited to:

- General industry and economic conditions;
- Changes in our relationships with suppliers;
- Pricing pressures and other competitive factors;
- The availability and costs of fuels and utilities;
- The results of our ongoing efforts to improve cost effectiveness;
- Changes in legislative and regulatory requirements affecting our business;
- Costs and risks associated with litigation;
- Potential changes to the mix of businesses we operate;
- Reliance on key personnel; and
- The availability of future financing and the variability of interest rates.

Should one or more of these risks materialize, or should our underlying assumptions prove incorrect, our actual results may materially differ from our current expectations. Therefore, in evaluating forward-looking statements, readers should specifically consider the various factors that could cause our actual results to materially differ from such forward-looking statements.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Corporation's President and Chief Executive Officer and Chief Financial Officer, on a timely basis so that appropriate decisions can be

made regarding public disclosure. As at the end of the period covered by this management's discussion and analysis, management of the Corporation, with the participation of the President and Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the Corporation's disclosure controls and procedures as required by Canadian securities laws. Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer have concluded that, as of the end of the period covered by this management's discussion and analysis, the disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the Corporation's annual filings and interim filings (as such terms are defined under Multilateral Instrument 52-109 – *Certification of Disclosure in Issuers' Annual and Interim Filings*) and other reports filed or submitted under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified by those laws and that material information is accumulated and communicated to management of the Corporation, including the President and Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.