

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 three and nine months ended September 30, 2006 and is prepared as of November 2, 2006. The MD&A should be read in conjunction with our unaudited consolidated financial statements and the accompanying notes for the three and nine-month periods ended September 30, 2006. We also encourage you to read the MD&A for the year ended December 31, 2005.

The interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). All amounts in this MD&A are in thousands of 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 condition, results of operations, cash flows 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 the date of this analysis;
- 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, amortization, stock based compensation and restructuring and other costs). 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 and stock-based compensation. We exclude restructuring and other items because they are transitional in nature. We exclude stock-based compensation expense because it largely depends on the accounting methods and assumptions we use, along with non-operating factors, such as the historical 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 (loss) for the past five quarters.

\$000's (Unaudited)	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2006
EBITDA	1,429	1,114	(415)	1,570	2,296
Restructuring and other costs	281	2,010	67	28	181
Stock-based compensation	146	147	144	128	147
Operating income (loss)	1,002	(1,043)	(626)	1,414	1,968
Loss (gain) on sale of property, plant and equipment	2	(21)	3	(4)	(3)
Interest and bank charges	1,149	1,389	825	568	450
Depreciation and amortization	706	599	728	628	676
Non-controlling interest in subsidiary company	11	4	(104)	-	-
Provision for (recovery of) income taxes	(108)	88	(454)	241	303
Income (loss) before discontinued operations	(758)	(3,102)	(1,625)	(19)	542

ABOUT OUR BUSINESS

We are Canada's leading environmental services company specializing in the management of organic based waste streams and contaminated soils with an 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.

Operations

Waste management solutions are provided to clients in Eastern Canada and the Northern United States through our subsidiary GSI Environnement Inc. (GSI). Tank testing and calibration services are provided to clients in Canada through our subsidiary Tanknology Canada Inc. (Tanknology). We report our results of operations by service offerings, of integrated environmental services and tank testing and calibration.

GSI provides integrated environmental services which include:

- Waste Management;
- Environmental contracting; and
- Contaminated soil treatment and recycling.

Tanknology provides tank testing and calibration services, including:

- Storage tank precision leak testing;
- Statistical inventory reconciliation;
- Compliance testing; and
- Calibration.

Integrated Environmental Services

Waste Management

We provide comprehensive waste management adapted to the customer 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; and
- State-of-the-art treatment technologies including dehydration and granulation.

Core to our waste management services are our facilities. We own and operate seven permitted facilities 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, Québec City, St. Fabien, St. Hyacinthe, Lachute and Bury, Québec.

Environmental Contracting

We focus on site reclamation projects in Québec, Ontario and the North-Eastern United States. Our clientele includes municipalities, manufacturing, agri-food, petrochemical and pulp and paper industries. Our site reclamation project management begins with on-site consultations to find the most effective solutions to the issue at hand. Our services include:

- 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;
- Off-site management; sampling, analysis, sizing, conditioning and transportation to treatment, recycling or storage facilities;
- Closing former industrial sites and landfills; and
- Pollution control and prevention.

Our site reclamation experience includes: the reclamation of residential, mining, sand and gravel quarries, 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.

Contaminated soil treatment and recycling

We have been actively treating contaminated soil at our own authorized treatment centres using our proprietary technologies and own and operate four soil treatment facilities. The soil treatment facilities are 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, Sherbrooke, and Ste-Croix de Lotbinière, Québec.

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.

Discontinued Operations

Previously we separated the integrated environmental services into geographical regions of eastern and western Canada; however, in July 2005 we announced our exit from the western Canadian market. Starting in Q4 2005, we sold or closed down a number of businesses that were unprofitable and/or did not fit our strategic direction. Since this time, we have been monetizing receivables to satisfy payables and completing any remaining projects we were unable to sell. The impact of discontinued operations has been reflected in the consolidated financial statements.

RESULTS FROM OPERATIONS

Nine Months

Revenue

Revenue from continuing operations was \$44.8 million for the nine months ended September 30, 2006 compared with revenue of \$38.9 million for the nine months ended September 30, 2005, an increase of 15%. Integrated Environmental Services contributed \$5.3 million to the increase through growth in Waste Management. Waste Management increased primarily as a result of our entering into contracts to treat source separated organic waste (SSO) which are household organics collected at curb side by municipalities. This was offset with a decline in revenues from Environmental Contracting and Soil Recycling. Environmental Contracting revenues declined due to the timing of starting certain projects and the inability to build a strong pipeline of projects resulting from a lack of bonding throughout 2005 and the first quarter of 2006.

Tank testing and calibration increased revenues to \$2.6 million for the nine months ended September 30, 2006 compared with \$2.0 million for the nine months ended September 30, 2005. This increase is primarily attributable to the additional calibration services offered during the second quarter of 2006.

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 nine months ended September 30, 2006 was \$12.2 million compared with \$10.9 million for the nine months ended September 30, 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 nine months ended September 30, 2006 was 27.3% compared with 27.9% for the nine months ended September 30, 2005. The gross margin remained essentially unchanged for the nine months ended September 30, 2005.

EBITDA and Operating Income (Loss)

EBITDA is calculated by deducting indirect expenses from gross operating profit. EBITDA for the nine months ended September 30, 2006 was \$3.5 million compared with \$2.6 million for the nine months ended September 30, 2005.

\$000's (Unaudited)	Nine months ended September 30,	
	2006	2005
Gross operating profit	12,210	10,853
Indirect expenses	8,756	8,207
EBITDA	3,454	2,646
Restructuring and other costs	277	3,293
Stock-based compensation	419	550
Operating income (loss)	2,758	(1,197)

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 nine months ended September 30, 2006 were \$8.8 million compared with \$8.2 million for the nine months ended September 30, 2005.

As a percentage of revenue, indirect expenses for the nine months ended September 30, 2006 was 19.6% compared with 21.1% for the nine months ended September 30, 2005. We expect to see a decline in this percentage as we add more revenue to our indirect cost base. We continue to look at building greater efficiencies within our current operations.

The operating income for the nine months ended September 30, 2006 was \$2.8 million compared with an operating loss of \$1.2 million for the nine months ended September 30, 2005. This improvement to operating income is directly attributable to the significant decrease in restructuring and other items of \$3.0 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 costs of \$3.3 million for continuing operations during the nine months ended September 30, 2005. For the nine months ended September 30, 2006 the restructuring activities, litigation with the former CEO, remaining severance changes, the settlement of trailing lawsuits and legal costs arising from the restructuring activities amounted to \$0.3 million.

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 nine months ended September 30, 2006, the amount of the expense recorded as stock-based compensation for employee stock options in continuing operations was \$0.4 million compared with \$0.5 million for the nine months ended September 30, 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), on March 31, 2006, the Company established a Tandem Option and Share Appreciation Rights (OSAR) plan. Under this plan, the participants have the option to exercise options, 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 exercise price 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 intrinsic value of the options. Under this method the value between the market price of the shares and the face value of the options is expensed over the remaining period of the options vest. As the underlying share price is below the exercise price no expense has been recorded for the three and nine month periods ended September 30, 2006.

Net Loss

Net income or loss is calculated by deducting from the operating income or loss, depreciation, gains and losses on the sale of assets, interest and bank charges, income tax, non-controlling interest in subsidiary company, and discontinued operations.

\$000's (Unaudited)	Nine months ended September 30,	
	2006	2005
Operating income (loss)	2,758	(1,197)
Depreciation and amortization	2,033	2,173
Interest and bank charges	1,841	3,017
Gain on sale of property, plant and equipment	(4)	(309)
Income tax expense (recovery)	91	(170)
Minority interest	(104)	27
Loss before discontinued operations	(1,099)	(5,936)
Income (loss) from discontinued operations	926	(6,650)
Net loss	(173)	(12,586)

Interest expense for the nine months ended September 30, 2006 was \$1.8 million compared with \$3.0 million for the nine months ended September 30, 2005. This decline is due to the refinancing the outstanding debt on March 31, 2006 with a convertible debenture and preferred shares at a cash interest rate of 5%. The benefits of the refinancing were offset by bank charges in the first quarter to monitor, control and extend our debt repayment dates, and prepayment penalties of \$0.1 million for the existing debt.

The average cash cost of debt financing and bank charges was 12% for the nine months ended September 30, 2006, including cash paid or payable for extension agreements. Subsequent to March 31, 2006, the cash interest and bank charges were reduced to 6%. In addition, amortization of financing discount, warrants, deferred financing charges, and prepayment penalties increased the cost of debt financing by an additional \$0.5 million, effectively raising the total cost of interest to 16%. This compares to the average cash cost of debt for the nine months ended September 30, 2005 of 12% and to total cost of 25%.

Depreciation and amortization for the nine months ended September 30, 2006 was \$2.0 million compared with \$2.2 million for the nine months ended September 30, 2005.

Third Quarter

Revenue

Revenue was \$17.8 million for the quarter ended September 30, 2006 compared with revenue of \$13.6 million for the quarter ended September 30, 2005.

The increased revenue results from the additional revenues from the receipt of the City of Toronto's and the Region of York's source separated organics (SSO) contracts and the City of Toronto's biosolid contract, along with the growth in the Waste Management business. In addition, we are providing additional customer services for our Sudbury facility by providing a service inclusive of transportation. In the comparable period of 2005, this service was discontinued due to the additional working capital requirements. Our Environmental Contracting group experienced a decline in revenues due to the inability to quote on projects in 2005 and the first quarter of 2006 partially as a result of a lack of bonding. A bonding facility has now been established, however, there is a delay in quoting on projects and starting work. We anticipate some challenges from this group for the remainder of the year but with improved visibility of upcoming work.

Gross Operating Profit

Gross operating profit for the quarter ended September 30, 2006 was \$5.1 million compared with \$4.2 million for the quarter ended September 30, 2005. The increased gross profit is attributable to additional revenues generated by our waste management group.

Gross margin for the quarter ended September 30, 2006 was 28.8% compared with 30.7% for the quarter ended September 30, 2005. The decrease in gross margin is primarily attributable to lower margin associated with the transportation included pricing for our customers at our Sudbury soil treatment facility.

EBITDA and Operating Income (Loss)

EBITDA for the quarter ended September 30, 2006 was \$2.3 million compared with \$1.4 million for the quarter ended September 30, 2005. The increase in EBITDA for the quarter was a result of the increased revenue and gross margin in the Waste management group including the soil treatment facility.

In prior quarters we made an investment in additional sales resources for our Sudbury and other facility. This increased EBITDA is a result of this additional effort.

\$000's (Unaudited)	Q3 2006	Q3 2005
Gross operating profit	5,138	4,168
Indirect expenses	2,841	2,740
EBITDA	2,297	1,428
Restructuring and other costs	181	281
Stock-based compensation	148	146
Operating income	1,968	1,001

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 costs for the quarter ended September 30, 2006 were \$2.8 million compared with \$2.7 million for the quarter ended September 30, 2005.

As a percentage of revenue, indirect expenses for the year decreased to 15.9% for the quarter ended September 30, 2006 compared with 20.2% for the quarter ended September 30, 2005. Additional business development resources were incurred to improve future revenue streams.

The operating income for the quarter ended September 30, 2006 was \$2.0 million compared with an operating income of \$1.0 million for the quarter ended September 30, 2005. The operating income is attributable to the increased gross operating profit and reduction in the "Restructuring and Other Costs" and office by the additional indirect expenses.

Stock-based compensation for the quarter ended September 30, 2006 was \$147 compared to \$146 for the quarter ended September 30, 2005.

During the quarter, no employee stock options were granted to employees and directors of the Company and 191,431 options were forfeited during the period.

Net Income or Loss

\$000's (Unaudited)	Q3 2006	Q3 2005
Operating income	1,968	1,001
Depreciation and amortization	677	706
Interest and bank charges	449	1,149
Gain (loss) on sale of assets	(3)	2
Income tax expense	303	(108)
Non-controlling interest in subsidiary company	-	11
Income (loss) before discontinued operations	542	(759)
Income (loss) from discontinued operations	308	1,871
Net income	850	1,112

Interest and bank charges for the quarter ended September 30, 2006 was \$0.4 million compared with \$1.1 million for the quarter ended September 30, 2005. The decrease in interest expense is a result of the refinancing as at March 31, 2006.

The average cash interest and bank charges was 6% during the quarter ended September 30, 2006 compared with 11% for the quarter ended September 30, 2005. In addition, amortization of warrants and deferred financing charges increased the cost of debt financing by a total of \$0.2 million, effectively raising the total cost to 11%.

Depreciation for quarter ended September 30, 2006 was \$0.7 million compared with \$0.7 million for the quarter ended September 30, 2005. We expect the depreciation expense will increase as we expand and improve the efficiency of our composting facilities through capital expansion.

Discontinued Operations

During the fourth quarter of 2004, we reviewed the operations of the Company and decided to focus 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 wound down.

At September 30, 2006, all operations with the exception of one trailing project in K-Lor have been fully closed down. In addition we continue to settle 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 income of \$0.9 million for the nine months ended September 30, 2006, compared with a loss of \$6.6 million for the nine months ended September 30, 2005. We anticipate the wind down of the discontinued operations will be finalized by the end of the year, and no additional money will be made available from continuing operations.

RELATED PARTY TRANSACTION

During the nine months ended September 30, 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 was approved by the 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 proceeds of this re-financing were used to 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.

During the nine months ended September 30, 2006, the Company established a \$3.0 million demand loan operating facility at prime plus 25 basis points. This operating facility is collateralized by a first charge over the trade accounts receivable of the Company. Management believes that the Company has sufficient working capital cash along with its operating facility on hand to fund current operations.

CASH FLOW PROVIDED BY / USED IN OPERATING ACTIVITIES

For the nine months ended September 30, 2006, cash used in continuing operations was \$2.3 million compared with cash used in continuing operations of \$4.2 million for the nine months ended September 30, 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. The most significant component is the increase in non-cash working capital with the build up of accounts receivable as a result of second quarter business activity and reduction of outstanding accounts payable.

CASH FLOW PROVIDED BY / USED IN FINANCING ACTIVITIES

For the nine months ended September 30, 2006 cash provided by financing activities of continuing operations was \$4.6 million, compared with cash used in the financing activities of continuing operations of \$3.3 million for the nine months ended September 30, 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 nine months ended September 30, 2006 cash used in investing activities of continuing operations was \$2.6 million compared with cash provided by continuing operations of \$0.02 million for the nine months ended September 30, 2005. During the year we began incurring capital expenditures at certain of our sites in order to better handle source separated organics and other materials and we acquired the remaining 29% of Les Composts du Québec for \$0.2 million cash and approximately \$0.1 million in transaction costs. In addition, \$1.1 million of restricted cash was made available due to the availability of the operating facility.

AVAILABILITY OF FUNDS

As noted under the liquidity and capital resources, the closing of the ONCAP refinancing resulted in the ability of the Company to approach secured lenders to obtain an operating credit facility. A small credit facility was arranged to allow for fluctuations in our cash flow during the year. If the need were to arise, we believe we could increase this operating facility, however, we believe it is sufficient for our current 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, a discontinued operation, 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.

During the year, a former shareholder of GSI Environment Inc. commenced action against the Company, its former President and CEO and the Company's current and former directors. The plaintiff claims \$5.0 million from the Company for alleged breach of contract and misrepresentation; \$5.0 million from the former President and CEO for alleged misrepresentation; and declaratory and compensatory relief for alleged oppressive conduct, together with special damages of \$250 from all defendants. The Company has notified its D&O insurance underwriter and has been advised that this is an insurable claim. The action will not proceed to trial, if at all, for many months and accordingly, at this time, any losses resulting from the claim is undeterminable. As a result no liabilities have been accrued in the financial statements.

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 eight most recently completed quarters.

\$ 000's except per share amounts	Third Quarter		Second Quarter		First Quarter		Fourth Quarter	
	2006	2005	2006	2005	2006	2005	2005	2004
Revenue	17,844	13,576	17,403	17,067	9,512	8,232	13,812	15,310
Income (loss) from continuing operations	542	(759)	(19)	(2,343)	(1,625)	(2,837)	(3,102)	(136)
Net income (loss)	849	1,112	423	(8,794)	(1,446)	(4,904)	(4,738)	(3,854)
Basic earnings (loss) per share								
From continuing operations	0.01	(0.02)	(0.00)	(0.06)	(0.04)	(0.08)	(0.08)	(0.00)
Net income (loss)	0.02	0.03	0.01	(0.23)	(0.04)	(0.13)	(0.13)	(0.11)
Diluted earnings (loss) per share								
From continuing operations	0.01	(0.02)	(0.00)	(0.06)	(0.04)	(0.08)	(0.13)	(0.11)
Net income (loss)	0.01	0.03	0.01	(0.23)	(0.04)	(0.13)	(0.13)	(0.11)

CRITICAL ACCOUNTING ESTIMATES

The preparation of these unaudited interim consolidated financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the reported amounts and disclosures made in the unaudited interim 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 collateralized by all the assets of the Company. Because of the convertible nature of the debentures and preferred shares that are convertible 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 a 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

Under Accounting Guideline 15 (“AcG-15”), “Consolidation of Variable Interest Entities”, companies are required to identify variable interest entities in which they have an interest to determine whether they are the primary beneficiary of such entities and, if so, to consolidate them. A variable interest entity is defined as an entity in which the equity is not sufficient to permit that entity to finance its activities without external support, or the equity investors lack either voting control and the obligation to absorb future losses or the right to receive future returns.

During the quarter, the Company acquired land and buildings adjacent to one of its composting facilities for \$500,000. The land and building was acquired in a company wholly owned by an employee of EMS. Agreements exist between EMS and the employee which provide EMS with the right and ability to control the expected losses or expected residual returns through a contractual interest in the property. Accordingly, EMS has consolidated the company owned by the employee under the accounting requirements of AcG-15. This was acquired for the purposes of additional office space and land for composting support functions such as a weigh scale and maintenance.

NEW ACCOUNTING PRONOUNCEMENTS

In January 2005, the CICA issued generally accepted accounting principles (Section 3855 of the CICA Handbook), providing guidance on the recognition and measurement of financial instruments. The standard applies to all debentures, including those imbedded in contracts. Under this standard, certain financial assets and liabilities would be measured at fair value with gains and losses recognized in the Consolidated Statements of Operations and Deficit or Comprehensive Income. The mandatory effective date is for fiscal years beginning on or after October 1, 2006. The Company will begin application of Section 3855 effective January 1, 2007.

SHARES OUTSTANDING

As at November 2, 2006 there are 38,012,247 common shares outstanding, and 10,296,250 convertible preferred shares. At December 31, 2005 and September 30, 2006, 38,012,247 common shares were outstanding.

As at September 30, 2006 there are 3,276,019 options outstanding with a weighted average exercise price of \$1.07 per share and 8,070,030 share purchase warrants with a weighted average exercise price of \$1.65 per share. In addition, there are 14,500,000 Tandem Option and Share Appreciation rights outstanding with a weighted average exercise price of \$1.18.

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.