# BENNETT ENVIRONMENTAL INC.

## Management's Discussion and Analysis

August 6, 2010

*The following is management's discussion in respect of the results of operations of Bennett Environmental Inc. ("Bennett" or the "Company") for the quarter ended June 30, 2010 and should be read in conjunction with the Company's unaudited interim consolidated comparative financial statements for the quarters ended June 30, 2010 and 2009 and the Company's audited consolidated comparative financial statements and management's discussion and analysis for the years ended December 31, 2009 and 2008. The financial statements of the Company are presented in Canadian dollars and in accordance with generally accepted accounting principles in Canada. The following discussion of the financial condition is dated August 6, 2010. Additional information related to the Company, including its Annual Information Form and Management Information Circular and Proxy form is available on SEDAR at www.sedar.com.*

## OVERVIEW

The Company generates its revenues by treating contaminated soils pursuant to contracts obtained in a competitive bidding process. The Company's customer base is comprised mainly of government agencies, utilities, environmental services companies and industry. The number and size of the contracts obtained each year will vary depending on the funding of the projects and the timing of the processing of contaminated materials from the Company's customer base.

The Company's facilities can only be run efficiently when operating continuously for extended periods. The sporadic level of demand for the Company's services is such that these facilities are rarely operated continuously for extended periods. In order to maximize operating efficiency the Company has adopted a campaign approach which involves periods of shutdown during which inventories are stockpiled followed by periods of operation where the Company processes the accumulated inventories and the entire process is then repeated.

On February 18, 2009 the Company announced that in connection with the Ontario government's announcement of the award of the Pottersburg Creek clean-up that it had in place an agreement to receive the PCB impacted material removed from the storage vaults at that site. The purchase order received in connection with this project was modified several times during 2009 with the most recent version authorizing the Company to receive up to 120,000 tonnes from the site. As at June 30, 2010 the Company had received approximately 111,000 tonnes from the site and had processed approximately 88,000 tonnes of this soil. During the second quarter of 2010, approximately 3,500 tonnes of soil was received from the site. The fact that a portion of the purchase order remains unutilized does not guarantee that additional contaminated soils exist or that such soils will be received by Saint Ambroise.

The Pottersburg Creek clean up and other projects have allowed the Company's Saint Ambroise facility to operate continuously since it was re-opened on April 6, 2009, with the exception of maintenance shutdowns. This long period of uninterrupted production has been primarily responsible for the Company's profitability in 2009 and the first and second quarters of 2010. Based upon standard processing rates the inventory of unprocessed soil at the end of the second quarter of 2010 is expected to be fully processed during the third quarter of this year.

Subsequent to the end of the second quarter of 2010, the Company entered into a contract to remove and treat approximately 10,500 tonnes of PCB contaminated soil located in southern Ontario. It is expected that the soil will be removed from the property in 2010 and processed at the Company's Saint Ambroise facility based on the operating requirements of the facility. The removal and treatment of the soil is subject to the client completing specified financial requirements.

All amounts described as tonnes throughout are metric tonnes ("tonnes").

## STRATEGY

Bennett is continuing to implement its long-term strategy, which is focused on building sustainable growth and shareholder value through the reduction and rationalization of costs and securing orders for soil treatment by building new relationships with key market players and decision makers in treatment projects. The Board and management are seeking opportunities to diversify the Company's business including acquisitions to reduce fluctuations in the Company's financial results.

## COMMON SHARE AND WARRANT ISSUANCE

On May 7, 2010, the Company completed a financing arrangement with a syndicate of underwriters ("Underwriters") whereby the Underwriters agreed to purchase on a bought deal basis, an aggregate of 8,196,722 units ("Units") at a price of $3.05 per Unit. Each Unit consists of one common share of the Company and one-half of one warrant of the Company, with each warrant entitling the holder to purchase one common share of the Company at a price of $3.75 expiring May 7, 2012. The gross proceeds received by the Company from the distribution on May 7, 2010 were $25,000,002. Net proceeds from this financing transaction were $22,835,404.

The Company had agreed to grant the Underwriters an over-allotment option to purchase an additional 15% of the offering, which expired on June 7, 2010. The Underwriters sold 1,229,508 units in connection with the over-allotment which was the maximum amount allowed by the prospectus. The share portion of the over-allotment was satisfied by the Underwriters' purchase of 1,229,508 common shares of the Company in the secondary market. On May 21, 2010 the Company provided the warrant portion of the over-allotment by issuing 614,754 warrants for gross proceeds of $135,246. Net proceeds from this additional financing transaction were $126,455.

The Company granted the Underwriters compensation options to purchase additional Units equal to 6.5% of all Units issued pursuant to the May 7, 2010 closing at a price of $3.05 per Unit. The Underwriters also received compensation options equal to 6.5% of the warrants issued in connection with the over-allotment option. The compensation options issued on May 21, 2010 carry the right to purchase one-half of one warrant at a price of $0.22. All the compensation options expire on May 7, 2012, none have been exercised as at June 30, 2010.

The Company intends to use the net proceeds of the Offering primarily for potential acquisitions and also for working capital and general corporate purposes. The Company is evaluating potential acquisition targets, and seeks to build up and maintain a cash reserve so that it will be available if it finds a suitable acquisition target and decides to proceed with an acquisition. At present there is no proposed acquisition that has progressed to a state that justifies an announcement. Pending deployment for acquisitions, the Company intends to invest most of the proceeds in liquid marketable securities.

While the Company intends to spend the funds available as stated above, there may be circumstances where, for sound business reasons, a reallocation of funds may be deemed prudent or necessary.

More information regarding this distribution can be found in the Short Form Prospectus dated April 29, 2010 which is available on SEDAR at www.sedar.com.

## BUSINESS

*Saint Ambroise Facility:* The Company's soil treatment facility located in Saint Ambroise, Quebec is an ISO 14001(2004)-certified facility. It treats soils contaminated with organics and its Certificate of Authorization was expanded in 2005 to include dioxins and furans. The facility has an annual processing capacity of up to 100,000 metric tonnes depending on the nature of material being processed.

*Belledune Facility:* This facility is located in the Renviro Park near the Village of Belledune, New Brunswick. The Belledune facility is situated on approximately 20 acres of land where it houses a Mark IV Thermal Oxidizer. In April 2006 this facility underwent a compliance test and processed a small amount of soil. Presently due to adverse market conditions, this facility is not operational and is being held for sale. During 2009 the Company sold an option to purchase the Belledune facility and the sale is expected to occur during 2010.

## RESULTS OF OPERATIONS

### OPERATING RESULTS FOR THE THREE MONTHS ENDED JUNE 30, 2010

### Sales

Sales for the second quarter of 2010 were $10.9 million compared to $6.1 million in the same period a year earlier. The increase from the prior year is a result of the facility processing material during the period from various contracts.

## Operating Costs

Operating costs historically consist mainly of transportation costs, fuel, processing supplies, maintenance costs, and labour. Some of these costs fluctuate based on the number of tonnes processed; however, there are some costs which are fixed in nature.

Operating costs for the second quarter of 2010 were $2.5 million compared to $3.5 million in 2009. In the prior period the Company was responsible for the costs of shipping the customer's soil to the Saint Ambroise facility, which was included in the operating costs.

# OTHER INCOME STATEMENT ITEMS

## Administration and Business Development Costs

Administration and business development costs were $1.2 million during the second quarter of 2010 as compared to $1.1 in the same quarter of 2009. The increase is due to higher capital tax and compliance costs. Capital tax rose due to a reassessment of prior periods and a test burn at the Saint Ambroise facility was responsible for the increase in compliance costs.

## Depreciation and amortization

Significant portions of the kiln located at the Saint Ambroise facility have now been fully depreciated for accounting purposes and will not give rise to any further depreciation expenses. This resulted in a reduction of depreciation and amortization expense for the second quarter of 2010 over the same period in 2009 of approximately $0.2 million. While no further depreciation will be taken on these assets in 2010, it should be noted that this may not be the case when the Company converts to International Financial Reporting Standards ("IFRS") in 2011. The Company may elect to revalue certain plant and equipment assets at appraised values on adoption of IFRS. To the extent the appraised values exceed the net book value of those assets, depreciation expenses may increase.

## Interest

During the quarter interest expense was $0.4 million higher than the same period in 2009. This was due to interest charged in connection with a reassessment of capital and income taxes for prior periods.

## Income taxes

For the second quarter of 2010 the Company recorded a current income tax recovery of $0.2 million versus no expense or recovery in the second quarter of 2009. The 2010 recovery is a result of a reassessment of prior years' tax filings.

The Company incurred future income tax expense of $1.5 million in the second quarter of 2010 versus nil in the same period of the prior year. This expense was primarily due to earning taxable income in the quarter which reduced future tax assets recorded in prior periods.

## Net Earnings

The net earnings for the second quarter of 2010 were $5.1 million compared to net earnings of $1.1 million in the same quarter of 2009. The higher net earnings for the second quarter of 2010 compared to the same quarter in the prior year was due to increased volumes of soil processed. The margins were also higher in this quarter due to the type of contaminant contained in the processed soil.

## Contractual Obligations

The Company's contractual obligations consists of its long-term debt obligations relating to payments to the Department of Justice, pension payments to a former CEO of the Company, and operating and lease obligations. The following lists the Company's significant contractual obligations.

| **Millions of Canadian dollars** | **2010** | **2011** | **2012** | **2013** | **2014** | **Thereafter** | **Total** |
|---|---|---|---|---|---|---|---|
| Department of Justice Fine and Restitution | 0.21 | 0.21 | 0.20 | 1.76 | - | - | **2.38** |
| Tenure agreement | 0.04 | 0.08 | 0.08 | 0.08 | 0.08 | 0.48 | **0.84** |
| Operating leases | 0.06 | 0.11 | 0.04 | - | - | - | **0.21** |
| Capital leases | 0.09 | 0.19 | 0.12 | 0.03 | - | - | **0.43** |
| **Total contractual obligations** | **0.40** | **0.59** | **0.44** | **1.87** | **0.08** | **0.48** | **3.86** |

## SUMMARY OF QUARTERLY RESULTS

The following table discloses certain unaudited financial data for the eight most recently completed quarters, expressed in millions of Canadian dollars (except per share data – basic and diluted which is in dollars):

| | 2010 | | 2009 | | | | 2008 | |
|---|---|---|---|---|---|---|---|---|
| | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 |
| Net sales | 10.9 | 11.1 | 10.7 | 10.9 | 6.1 | 0.4 | 6.0 | - |
| Net earnings (loss) | 5.1 | 4.9 | 7.6 | 8.9 | 1.1 | (2.3) | 2.2 | (2.4) |
| Net earnings (loss) per common share | | | | | | | | |
| Basic | 0.15 | 0.17 | 0.28 | 0.33 | 0.04 | (0.09) | 0.08 | (0.09) |
| Diluted | 0.14 | 0.17 | 0.28 | 0.32 | 0.04 | (0.09) | 0.08 | (0.09) |

Variations in revenue over the last eight quarters is primarily due to the volumes of material processed in each quarter. The last four quarters have produced significant variations in net earnings even though the revenue for these periods were roughly equivalent. The difference in net earnings in these four quarters is primarily due to variations in the amounts of future income tax recovered or expensed during each quarter. Earnings per share is lower in the second quarter than in the first quarter of this year. This is due to the increase in the number of shares outstanding resulting from the Company's financing transaction which closed May 7, 2010.

## OPERATING RESULTS FOR THE SIX MONTHS ENDED JUNE 30, 2010

### Sales

Sales for the six months ended June 30, 2010 were $22.1 million compared to $6.5 million in the same period a year earlier. The increase in sales as compared to the prior year was a result of increased production at the company's Saint Ambroise facility which was operational every day during the six months ending June 30, 2010 compared to 89 days during the six months ended June 30, 2009.

### Operating Costs

Operating costs consist mainly of transportation costs, fuel, processing supplies, maintenance costs, and labour. Some of these costs fluctuate based on the number of tonnes processed; however, there are some costs which are fixed in nature.

Operating costs for the six months ended June 30, 2010 were $5.5 million compared to $4.4 million in the same period a year ago. The increase in operating costs compared to the prior period is a result of higher volumes of soil being processed at the Saint Ambroise facility.

## OTHER INCOME STATEMENT ITEMS

### Administration and Business Development Costs

Administration and business development costs were $2.6 million in the six months ended June 30, 2010, compared with $2.4 million in the same period of 2009. The increase is due to higher capital tax, compliance and property taxes. Capital tax rose due to the reassessment of prior periods and a test burn at the Saint Ambroise facility caused the increase in compliance costs. The property taxes were lower in the first half of 2009 because the Company recorded a recovery of municipal taxes in that period.

### Depreciation and amortization

Depreciation and amortization expense for the six months ended June 30, 2010 was $0.5 million compared to $0.9 million for the same period a year ago. This variation is explained in the operating results for the second quarter of 2010 section of this report under the heading "Depreciation and Amortization".

### Interest

During the period interest expense was $0.4 million higher than the same period of the prior year. This was due to interest charged in connection with a reassessment of capital and income taxes of prior years.

### Income taxes

For the first half of 2010 the Company recorded a current income tax recovery of $0.3 million versus an income tax expense of $0.1 million in the same period of the prior year. In both periods, the recovery or expense was a result of a reassessment of prior years' tax filings.

The Company incurred future income tax expense of $3.4 million in the second half of 2010 versus nil in the same period of the prior year. This expense was primarily due to earning taxable income in the period which reduced future tax assets recorded in prior periods.

### Net Earnings

The net earnings for the six months ended June 30, 2010 were $10.0 million compared to a loss of $1.2 million for the same period in the prior year. The increase was the result of increased volumes and higher margin on soil processed during the period.

## LIQUIDITY AND CAPITAL RESOURCES

### LIQUIDITY

At June 30, 2010 the Company had cash and equivalents of $58.9 million and working capital (including cash) of $54.1 million compared to cash and equivalents of $17.6 million and working capital of $19.9 million on December 31, 2009. At June 30, 2010 the Company had $0.01 million in restricted cash compared to $0.9 million at year end 2009. Restricted cash was used to secure corporate credit cards at June 30, 2010. At December 31, 2009 the restricted cash was used to secure corporate credit cards, foreign exchange and butane swap agreements.

### Cash from Operating Activities

For the second quarter of 2010, cash used by operations amounted to approximately $3.2 million as compared to the second quarter of 2009 when cash used by operations was $2.6 million. The use of cash in this period is due to an increase in non-cash working capital in excess of earnings from operations. This increase in non-cash working capital resulted from a reduction in deferred revenue which is recorded when payment is received before soil is processed. During the period the Company processed soil which had been paid for in prior periods thereby drawing down the deferred revenue account. The use of cash in the same period of 2009 was caused by an increase in amounts receivable.

Operations provided cash of $16.7 million and $1.4 million for the first six months of 2010 and 2009, respectively. For the first half of 2010 the cash came primarily from earnings and in the same period of 2009 a reduction in amounts receivable was responsible for the provision of cash.

### Cash from Financing Activities

Cash provided by financing activities was $22.9 million in the second quarter of 2010 versus nil in the same period of the prior year. The majority of the cash received this quarter was due to the offering of shares and warrants which closed during the quarter.

For the first half of this year financing activities provided $23.9 million versus nil in the prior year. As noted above the majority of the cash in 2010 came from the financing deal completed in May 2010. During the first quarter of 2010 options and warrants were exercised which brought in $1.0 million in cash.

### Cash from Investing Activities

Cash of $0.08 million was used in investing activities during the second quarter of 2010 versus cash generated of $0.04 million in the same period of the prior year. The decrease is caused by the purchase of property, plant and equipment. Cash was generated in the prior period by a change in restricted cash.

During the first half of 2010 cash from investing activities amounted to $0.7 million primarily from return of deposits used to secure performance bonds and hedging arrangements compared to a use of $0.02 million in the comparative prior period.

### Capital Expenditures

During the second quarters of 2010 and 2009 the Company purchased equipment for the Saint Ambroise facility of $0.11 million and $0.04 million respectively. Equipment purchases of $0.18 million were made in the first six months of 2010 as compared to $0.07 million in the same period of the prior year.

## FINANCIAL AND OTHER INSTRUMENTS

The Company has on occasion used short-term foreign exchange forward contracts and butane swap contracts to reduce foreign exchange risk and commodity risk, respectively. The Company marks these contracts to market, and records the corresponding gain or loss in income.

At June 30, 2010 and December 31, 2009 the Company had no foreign exchange contracts outstanding.

At June 30, 2010 the Company had no butane swap agreements outstanding. The fair value of the butane swaps outstanding at December 31, 2009 was an unrealized gain of approximately $0.02 million which was recorded as a prepaid on the balance sheet and an operating cost on the statement of operations and comprehensive income.

The unrealized gains and losses described above do not include the impact of currency or commodity price movements on underlying exposures these contracts are intended to protect.

## TRANSACTIONS WITH RELATED PARTIES

During the three months ended June 30, 2010, the Company paid tenure payments of $19,750 (2009 - $232,314), six months ended June 30, 2010 $39,500 (2009 - $232,314) to a former director and officer of the Company.

During the three months ended June 30, 2010, the Company paid consulting fees of nil (2009 - $275,157), six months ended June 30, 2010 nil (2009 - $275,157) and related interest of nil (2009 - $9,297), six months ended June 30, 2010 nil (2009 - $9,297) to a company owned by a former director and officer of the Company pursuant to the termination agreement that was accrued and recorded in expense in 2004.

## CONTINGENCIES

No additional developments have occurred relating to the contingencies as described in note 16 to the 2009 annual audited consolidated financial statements, except as noted below:

During 2009, a former officer and director requested indemnification from the Company for legal costs incurred in connection with the U.S. Department of Justice anti-trust investigation (note 16(c)). The Company has accrued and expensed all invoices received to date in the amount

of $241,188, (approximately $230,000 U.S.). During the first quarter of 2010, this individual brought an Application to the Ontario Superior Court to compel the Company to reimburse him for these invoices and any future costs he may incur in connection with this matter. The Company believes it is not required to indemnify the individual for the expenses and has served a Motion Record seeking to stay the former director's Application pending a resolution of the criminal proceedings against the same individual in the United States. The individual has served a cross-motion seeking interim relief. Both motions are scheduled to be heard on October 26, 2010. Other former officers and directors may also seek indemnification from the Company for legal fees incurred in connection with this investigation.

## CRITICAL ACCOUNTING ESTIMATES

Except as noted below, there are no changes in the Company's critical accounting estimates as described in the Company's annual Management Discussion and Analysis which can be found on SEDAR at www.sedar.com.:

The Company evaluates its future income tax assets to assess whether their realization is more likely than not. If their realization is not considered more likely than not, the Company will provide for a valuation allowance. The ultimate realization of our future tax assets is dependent upon the generation of future taxable income during the periods in which the temporary differences or loss carry-forward amounts can be utilized. The Company considers future taxable income and tax planning strategies in making its assessment. During the first quarter of 2010 the Company reduced the future tax assets carried on its interim consolidated balance sheet based on soil inventories held at the Saint Ambroise facility. The Company bases its estimate of future taxable income on the expected profitability resulting from processing these soil inventories.

## SHARE CAPITAL

The number of common shares outstanding at August 6, 2010 was 37,047,230. In addition, there were 1,716,667 stock options outstanding as at August 6, 2010 exercisable at prices from $0.24 to $1.73 a share. Lastly, the Company had 4,713,115 warrants outstanding at August 6, 2010 with each warrant entitling the holder to purchase one common share at a price of $3.75 expiring May 7, 2012. In connection with the equity offering which closed May 7, 2010, the Company has also issued over-allotment options and compensation options as described in the Common Share and Warrant Issuance section of this report.

## CHANGES IN ACCOUNTING POLICIES

Recently issued pronouncements not yet adopted:

International Financial Reporting Standards

In February 2008, The Canadian Accounting Standards Board confirmed that the use of IFRS will be required in Canada for publicly accountable profit oriented enterprises for fiscal years beginning on or after January 1, 2011. The Company will be required to report using IFRS

beginning January 1, 2011 and included a detailed plan for its transition to IFRS in its Annual MD&A dated March 16, 2010. The Company is progressing in accordance with the milestones set out in the plan as reported below.

During the second quarter of 2010 the Company hired additional staff to assist with the changeover to IFRS. The Company also completed its review of the impact of IFRS on its current business activities and concluded that the new accounting standards will have no significant effect.

Consolidated Financial Statements

In October 2008, the CICA issued Handbook Section 1582, “Business Combinations”, Section 1601, “Consolidated Financial Statements” and Section 1602, “Non-Controlling Interests”.

Section 1582 establishes standards for accounting for business combinations and is equivalent to IFRS 3. The new standards apply to business combinations with an acquisition date on or after January 1, 2011; however, earlier adoption is permitted.

Sections 1601 and 1602, together, replace Section 1600, “Consolidated Financial Statements”. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for non-controlling interest in a subsidiary to a business combination. It is equivalent to the provisions of IFRS standard, IAS 27, Consolidated and Separate Financial Statements. The new standards apply to interim and annual consolidated financial statements with fiscal years beginning on or after January 1, 2011. Early adoption is permitted as of the beginning of a fiscal year. The Company is currently evaluating the impact of adopting this standard on its consolidated financial statements.

## RISK FACTORS

Information on "Risk Factors" can be found in the Company's Annual Information Form dated March 16, 2010 for the fiscal year ended December 31, 2009.

## CONTROLS AND PROCEDURES

### *(a) Management’s Report on Internal Control over Financial Reporting*

Management is responsible for certifying the design of internal control over financial reporting in the Company’s Interim Filings.

Our internal control over financial reporting is intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with applicable GAAP, Internal Control over Financial Reporting should include those policies and procedures that establish the following:

- maintenance of records in reasonable detail, that accurately and fairly reflect the transactions and dispositions of our assets;

- reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with applicable GAAP;
- receipts and expenditures are only being made in accordance with authorizations of management and the Board of Directors; and
- reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management, including the CEO and CFO, carried out an assessment of the design of the Corporation's internal controls over financial reporting and concluded that no disclosable weaknesses existed as at June 30, 2010:

***(b) Internal Control Over Financial Reporting***

There was no change in the Company's internal control over financial reporting that occurred during the period covered by this report that has materially affected or is reasonably likely to materially affect, its internal control over financial reporting.

***(c) Management's Report on Disclosure Controls and Procedures***

Management is responsible for certifying the design of disclosure controls and procedures in the Company's Interim Filings. Management, including the CEO and CFO, carried out an assessment of the design of the Corporation's disclosure controls and procedures and concluded that no disclosable weaknesses existed as at June 30, 2010.

Forward Looking Statements

Certain statements in this management's discussion and analysis may constitute "forward-looking" statements which involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. When used in this management's discussion and analysis such statements are such words as "may", "will", "expect", "believe", "plan", and other similar terminology. These statements reflect management's current expectations regarding future events and operating performance and speak only as of the date of this management's discussion and analysis. These forward-looking statements involve a number of risks and uncertainties. The following are some factors that could cause actual results to differ materially from those expressed in or underlying such forward-looking statements: competition; changes in international, national and local business and economic conditions; legislation and governmental regulation; accounting policies

and practices; and the results of operations and financial condition of the Company. The foregoing list of factors is not exhaustive. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.