

**NAPIER ENVIRONMENTAL  
TECHNOLOGIES INC.  
CONSOLIDATED  
FINANCIAL STATEMENTS  
DECEMBER 31, 2000**

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## **AUDITORS' REPORT**

The Shareholders,  
Napier Environmental Technologies Inc.

We have audited the consolidated balance sheets of Napier Environmental Technologies Inc. as at December 31, 2000 and July 31, 2000 and the consolidated statements of operations and deficit and cash flows for the five month period ended December 31, 2000 and the years ended July 31, 2000 and July 31, 1999. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2000 and July 31, 2000 and the results of its operations and its cash flows for the five month period ended December 31, 2000 and the years ended July 31, 2000 and July 31, 1999 in accordance with Canadian generally accepted accounting principles. As required by the Company Act of British Columbia, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Chartered Accountants  
Vancouver, British Columbia

March 7, 2001

# **NAPIER ENVIRONMENTAL TECHNOLOGIES INC.**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2000**

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### **1. BUSINESS OPERATIONS**

The company is incorporated under the Company Act of British Columbia and is primarily involved in the manufacture and distribution of a wide range of products created through environmentally advanced technology. The product lines include coating removal products marketed under patent protection and branded as SARA (selective adhesion release agents) products and a wood restoration and coating line marketed under the retail Biowash brand. In December 2000 the company changed its name from Napier International Technologies Inc. to Napier Environmental Technologies Inc.

### **2. SIGNIFICANT ACCOUNTING POLICIES**

#### **a) Basis of presentation**

These consolidated financial statements include the accounts of the company and its wholly-owned subsidiaries. Intercompany balances and transactions are eliminated on consolidation.

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the revenues and expenses during the reporting period. Actual results could differ from those estimates.

Certain of the comparative figures have been reclassified to conform with the current year's presentation.

#### **b) Cash and cash equivalents**

Cash and cash equivalents are comprised of highly liquid investments having original terms to maturity of 90 days or less when acquired.

#### **c) Inventory**

Raw materials are valued at the lower of cost and replacement cost. Finished goods are valued at the lower of cost and net realizable value.

# NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2000

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### 2. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### d) Investments

The investment, over which the company exercises significant influence, is accounted for using the equity method.

#### e) Capital assets and amortization

Capital assets are recorded at cost. Amortization is provided under the straight-line method at annual rates varying from 2 to 10 years.

#### f) Goodwill

Goodwill arising on the acquisition of Bio-Wash Products (Canada) Inc. is amortized on a straight-line basis over 5 years, commencing December, 1999.

#### g) Income taxes

Effective for the year ended July 31, 2000 the company changed its policy for accounting for income taxes and adopted the liability method whereby future income tax assets and liabilities are recognized for temporary differences between the tax and accounting bases of assets and liabilities as well as for the benefit of tax loss carryforwards that are likely to be realized. Future income tax assets and liabilities are measured using enacted tax rates that are expected to be effective when recovered or settled. The net change in recorded future income tax assets and liabilities is recognized in income in the period in which the change occurs including any change in applicable future tax rates.

#### h) Stock options

The company has an Incentive Stock Option Plan as disclosed in Note 8(c). No compensation expense is recognized when stock options are issued to employees and directors. Any consideration paid by employees and directors on exercise of stock options is credited to capital stock.

# NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2000

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### 2. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### i) Foreign currency translation

The functional currency of the company's operations is the Canadian dollar. Transactions and account balances originally stated in currencies other than the Canadian dollar have been translated into Canadian dollars using the temporal method as follows:

- Revenue and expense items at the rate of exchange in effect on the dates they occur;
- Non-monetary assets and liabilities at historical exchange rates; and
- Monetary assets and liabilities at the exchange rate at the balance sheet dates.

Exchange gains and losses are included in the determination of income in the period in which they occur.

#### j) Loss per share

Loss per share is calculated based on the weighted average number of shares outstanding during the period. Fully diluted loss per share is not presented as the exercise of options and warrants would reduce the loss per share.

#### k) Financial instruments

The carrying value of cash, accounts receivable, and accounts payable reflected in the balance sheet approximate their fair values.

The company is exposed to financial risk resulting from fluctuations in foreign exchange rates and the degree of volatility of these rates. The company does not use derivative financial instruments to reduce its exposure to rate changes.

# NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2000

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### 3. BUSINESS ACQUISITION

On November 30, 1999 the company acquired 100% of the issued and outstanding common shares of Bio-Wash Products (Canada) Inc. for consideration comprised of 10 million common shares, 1 million warrants and cash of \$1 million. The acquisition was accounted for under the purchase method and accordingly the purchase price was allocated to net assets acquired based on their estimated fair market value. The excess purchase price was allocated to goodwill and is being amortized on a straight-line basis over 5 years, commencing December, 1999.

Net assets acquired	
Current assets (including cash of \$29,954)	\$ 665,032
Capital Assets	206,863
Goodwill	11,753,376
Liabilities assumed	(790,434)
	<hr/>
	\$ 11,834,837
	<hr/>
Consideration given	
Common shares	10,782,500
Cash	1,000,000
Acquisition costs, net	52,337
	<hr/>
	\$ 11,834,837
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Cash paid net of cash acquired	\$ 1,022,383
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# NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2000

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### 4. INVENTORY

Inventory is comprised of:

	<b>December 31</b>	July 31
	<b>2000</b>	2000
Raw materials	\$ 444,795	\$ 420,641
Finished goods	<u>1,173,953</u>	<u>860,261</u>
	<b><u>\$ 1,618,748</u></b>	<b><u>\$ 1,280,902</u></b>

### 5. INVESTMENT

The company's investment in the common shares of Consolidated Ecoprogress Technology Inc. ("Ecoprogress") represents a 27 % interest (July 2000 – 26%) and is comprised as follows:

	<b>December 31</b>	July 31
	<b>2000</b>	2000
Balance at beginning of the period	\$ 560,602	\$ 492,273
Investment	174,000	175,000
Equity share of losses	(228,370)	(452,364)
Gain on dilution of equity interest	<u>30,172</u>	<u>345,693</u>
Balance at end of the period	<b><u>\$ 536,404</u></b>	<b><u>\$ 560,602</u></b>

The excess purchase price of the company's investment over the fair value of the underlying net assets has been allocated to product licences owned by Ecoprogress and is amortized on a straight-line basis over the estimated life of the product licenses.

**NAPIER ENVIRONMENTAL TECHNOLOGIES INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2000**

**6. CAPITAL ASSETS**

	<b>December 31</b>		<b>July 31</b>	
	<b>2000</b>		<b>2000</b>	
	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>	<b>Net Book Value</b>
Machinery and equipment	<b>\$ 830,565</b>	<b>\$ 490,182</b>	<b>\$ 340,383</b>	\$330,736
Furniture and fixtures	<b>94,508</b>	<b>44,782</b>	<b>49,726</b>	62,869
Leasehold improvements	<b>55,145</b>	<b>10,856</b>	<b>44,289</b>	49,132
	<b><u>\$ 980,218</u></b>	<b><u>\$ 545,820</u></b>	<b><u>\$ 434,398</u></b>	<b><u>\$ 442,737</u></b>

During the period ended December 31, 2000 the company acquired capital assets at an aggregate cost of \$36,385 (July 31, 2000 \$333,398 comprised of \$206,863 on the business acquisition (Note 3), \$35,302 by means of capital lease, and \$91,233 by means of cash).

**7. LONG TERM DEBT**

	<b>December 31</b>	<b>July 31</b>
	<b>2000</b>	<b>2000</b>
Capital lease obligations repayable in aggregate monthly instalments of \$2,803 including interest averaging 9.6% per annum due from May, 2001 to January, 2005	<b>\$ 90,176</b>	\$ 98,496
Less current portion	<b><u>31,867</u></b>	<u>25,363</u>
	<b><u>\$ 58,309</u></b>	<b><u>\$ 73,133</u></b>

Principal repayments required over the next five years are as follows: 2001 - \$31,867; 2002 - \$27,668; 2003 - \$20,537; 2004 - \$7,105; 2005 - \$2,999.

# NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2000

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### 8. CAPITAL STOCK

- a) Authorized  
146,485,464 common shares

	<b>Number of shares</b>	<b>\$</b>
b) Issued		
Balance, July 31, 1998	26,432,248	\$ 7,337,914
Issued for cash	3,144,084	1,312,392
Conversion of special warrants	392,400	873,000
Reduction of stated capital	-	<u>(6,652,083)</u>
Balance, July 31, 1999	29,968,732	2,871,223
Issued for cash	4,442,752	3,414,573
Issued on business acquisition (Note 3)	<u>10,000,000</u>	<u>10,782,500</u>
Balance, July 31, 2000	44,411,484	17,068,296
Issued for cash	<u>3,686,060</u>	<u>6,210,640</u>
Balance, December 31, 2000	<u>48,097,544</u>	<u>\$ 23,278,936</u>

During the period ended December 31, 2000 the company completed a private placement consisting of 2,719,860 common shares and 2,967,120 warrants for net proceeds of \$5,118,070. Each share purchase warrant entitles the holder to one common share exercisable at \$2.25 for a one year period from date of issue and \$2.40 until date of expiry on September 11, 2002. In addition, the company issued 966,200 common shares on the exercise of 221,200 stock options and 745,000 warrants for net proceeds of \$1,092,570.

During the year ended July 31, 2000 the company completed a private placement consisting of 2,100,000 common shares and 1,150,000 warrants for net proceeds of \$2,241,284. Each share purchase warrant entitles the holder to one common share exercisable at \$1.25 per warrant until November 30, 2000. In addition, the company issued 2,343,752 common shares on the exercise of 407,300 stock options and 1,935,452 warrants for net proceeds of \$1,173,289.

# NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2000

### 8. CAPITAL STOCK (continued)

#### c) Stock options and warrants

	Stock options		Warrants
	Number	Weighted average price	
Outstanding at July 31, 1998	1,480,000	2.07	4,145,000
Granted/issued	1,465,000	1.25	181,818
Conversion of special warrants	-	-	392,400
Exercised	(261,000)	0.29	(2,519,448)
Cancelled/expired	(220,000)	2.44	(82,500)
Outstanding at July 31, 1999	2,464,000	1.74	2,117,270
Granted/issued	1,040,000	1.52	2,150,000
Exercised	(407,300)	0.92	(1,935,452)
Cancelled/expired	(100,000)	1.38	(181,818)
Outstanding at July 31, 2000	2,996,700	1.74	2,150,000
Granted/issued	-	-	2,967,120
Exercised	(221,200)	0.72	(745,000)
Cancelled/expired	(168,000)	2.21	(405,000)
Outstanding at December 31, 2000	2,607,500	1.85	3,967,120

Subsequent to December 31, 2000 the shareholders approved an increase to the number of stock options reserved under the company's Incentive Stock Option Plan and then the Board of Directors granted additional options to purchase 1,446,000 common shares of the company.

Under the Option Plan options are granted upon approval by the Board of Directors and the exercise price of each option is determined by reference to the market price of the company's stock. Options are exercisable within 10 years from the date of grant or a lesser period as determined by the Board and within 30 days of termination of employment. The exercise of certain options is dependent on the achievement of specific performance related criteria by the option holder.

# NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2000

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### 8. CAPITAL STOCK (continued)

#### c) Stock options and warrants (continued)

Stock options outstanding at December 31, 2000 expire on various dates from May 3, 2003 to May 16, 2010. Warrants outstanding at December 31, 2000 are exercisable at \$1.26 until November 26, 2001.

#### d) Escrowed shares

At December 31, 2000, 2,849,502 (July 31, 2000 – 2,849,502; July 31, 1999 – 849,502) common shares are held in escrow. Two million common shares are eligible for release on the earlier of December 31, 2001 or the date the company achieves cumulative gross revenues of \$10 million over a consecutive twelve month period. The release of the remaining 849,502 shares is subject to regulatory approval.

### 9. INCOME TAXES

The approximate tax effect of temporary differences and tax loss carry forwards that give rise to the company's future income tax assets are as follows:

	<b>December 31</b>	July 31
	<b>2000</b>	2000
Capital assets	<b>\$ 1,200,000</b>	\$ 1,140,000
Investments and other	<b>300,000</b>	210,000
Tax loss carryforwards	<b>1,800,000</b>	1,530,000
	<b>3,300,000</b>	2,880,000
Less valuation allowance	<b>3,300,000</b>	2,880,000
	<b>\$ -</b>	\$ -

# NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2000

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### 9. INCOME TAXES (continued)

The approximate tax effects above differs from the amount computed by applying Canadian statutory rates to income (loss) before income taxes as follows:

	<b>December 31</b>	<b>July 31</b>	July 31
	<b>2000</b>	<b>2000</b>	1999
Future income tax assets at combined statutory rate of 45%	<b>\$ (1,490,000)</b>	\$ (1,185,000)	\$ (533,000)
Rate adjustment for manufacturing and processing activities	<b>155,000</b>	95,000	95,000
Amortization of goodwill	<b>440,000</b>	705,000	-
Other	<b>475,000</b>	(15,000)	(30,000)
Change in valuation allowance	<b>\$ (420,000)</b>	\$ (400,000)	\$ (468,000)

The company has loss carryforwards available for tax purposes as follows:

<u>Expiry date</u>	<u>Amount</u>
December 31, 2001	\$ 160,000
December 31, 2002	820,000
December 31, 2003	550,000
December 31, 2004	830,000
December 31, 2005	80,000
December 31, 2006	180,000
December 31, 2007	<u>2,150,000</u>
	<b><u>\$ 4,770,000</u></b>

# **NAPIER ENVIRONMENTAL TECHNOLOGIES INC.**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2000**

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### **10. SEGMENTED INFORMATION**

The company operates predominantly in one industry segment, which is the manufacture and distribution of coatings and coating removal products in Canada and internationally. Within this general industry segment the company operates within both the industrial and retail sectors. All of the company's capital assets are located in Canada.

International sales for the period ended December 31, 2000 totalled \$1,477,000 (July 31, 2000 -\$4,912,000; July 31, 1999 - \$1,350,000).

### **11. COMMITMENTS**

The company leases its premises and certain office equipment under operating leases. The aggregate minimum rental payments under these leases over the next five years are approximately 2001 - \$347,000; 2002 - \$349,000; 2003 - \$352,000; 2004 - 314,000; 2005 - \$340,000 .