

**NAPIER ENVIRONMENTAL
TECHNOLOGIES INC.**

**CONSOLIDATED
INTERIM FINANCIAL STATEMENTS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2004

**SECOND QUARTER 2004
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2004**

Napier Environmental Technologies Inc. manufactures and distributes highly effective, safe and environmentally advantaged chemicals for stripping paints/coatings, surface preparation as well as a complete line of wood restoration and protection products. Products are cost effective, user friendly and safe to use. As important, and especially in today's world Napier products are formulated and designed to be environmentally benign. Napier distributes products both domestically and internationally through an extensive network of distribution channels in the "Industrial" as well as "Consumer" markets.

Primary industrial uses for our products include paint stripping, concrete etching, rust or adhesive removal, as well as asbestos removal and containment and lead abatement. The products can be applied to a range of surfaces including metal, concrete, and wood. Typical surface preparation applications include aircraft, industrial plants, ships, bridges, storage tanks, oil refineries, railcars, concrete floors, and buildings. In the industry there is limited reliance on a particular market sector due to the diversity of product application. Market demand for the products is highly project driven. As well, most applications occur outdoors, so weather plays a major factor. Government spending on projects also has an impact on demand. Napier products have not yet been introduced and adopted for all applications. With steps taken in 2003, aviation will become one of our larger sectors.

Consumer uses for the products are similar, with the main difference being a smaller scale of project for the "do it yourself (DIY)" customer. Demand on the consumer side has historically been weighted towards wood restoration, wood coatings and some specialty cleaning products. Products for some of the industrial uses were not available to the consumer due to the complexity and sophistication of tools required for application. Last year, we developed a new line of products for consumers that overcome these application complexities and consumers now have access to a range of products that was previously only available to industrial users.

Competitive alternatives to our product offerings include products that are not environmentally benign and other surface preparation methods including sand blasting. On the wood coatings side, there are a number of competitive products, yet this is a small portion of our overall business. No one competitor offers the same range of products or has the same level of global product acceptance. This broad range of products gives the company a competitive advantage for mass retailers as they seek to consolidate vendors.

Competitors tend to be found on a regional or national level and in some instances are tied to one market sector such as aviation. Our competitive advantage is that our products are environmentally benign, cost effective, safe and easy to use. A number of the products are patented and supported by a competent Research and Development expertise.

Industrial products are distributed through a network of manufacturers and distributors of complimentary products with existing extensive distribution networks. The network requires extensive education and product training on the use and efficacy of Napier products. In turn, they use this knowledge and training to merchandise our products throughout their store and dealer network. Regional representation is utilized to expand our reach into the US retail market.

Shareholder value for this industry is generated through global distribution and product diversity and acceptance. Our vision is to be the global leader in products designed for surface preparation. In most stores today surface preparation is a confusing product category with a myriad of products, most of which are environmentally hazardous. By positioning ourselves as a surface preparation specialist, we will be a "category leader" just as other larger manufacturers are leaders in primer and paint categories.

Deep distribution channels, product profitability and performance, product development, brand awareness, infrastructure and working capital drive performance. We continue to optimize our capabilities and resources in each of these areas.

Management's Discussion and Analysis (MD&A) for the quarter ended June 30, 2004 has been prepared to give shareholders and other stakeholders an assessment of what the company achieved in the quarter as well as an indication of initiatives underway and planned for this year. The MD&A for the quarter ended June 30, 2004 should be read in conjunction with the interim consolidated financial statements of the company and notes thereto for the periods ending June 30, 2004 and June 30, 2003 and the audited consolidated financial statements and annual MD&A for the fiscal year ended December 31, 2003.

Results of Operations for the Quarter Ended June 30, 2004

Sales

Second quarter sales of \$2.6 million were unchanged from the same quarter last year. Sales for April and May were strong and exceeded last year by 16%. June sales were disappointing and did not meet expectations in all categories. For the quarter, sales from expanded business from two major customers in the US more than doubled for an increase in sales of \$0.5 million over last year. The following offset this success:

- (\$0.1) million – Lower export industrial sales due to timing of projects
- (\$0.2) million – Lower Biowash consumer sales primarily in Canada due to adverse weather and loss of a major wood restoration customer
- (\$0.2) million – Foreign exchange impact of weaker Canadian dollar on US dollar denominated sales

The new and expanded business increased sales to the US by 21%. Domestic and export sales were down by 18% in the quarter due as outlined above. Sales were 60% consumer and 40% industrial which is consistent with last year.

A major North American paint manufacturer, which distributes a number of our products under their own label, are now selling Napier brand products in both their own stores and dealer networks. Sales for this customer doubled in the quarter compared to last year and encompass our complete line of paint strippers, surface preparation and wood restoration products.

Ongoing sales to a major international coatings manufacturer, who was our first customer to private label our products and was engaged in an internal reorganization last year, have returned to normal levels and in fact, increased substantially in the quarter.

Export industrial sales are down due to timing of significant projects in the United Kingdom. These are now underway and export sales should recover in the third quarter.

Biowash consumer sales in Canada, primarily coatings and wood restoration products are down due primarily to the loss of a major customer which purchased a line of wood restoration products to market under their own label. In addition reduced demand for deck products has again resulted from wet weather primarily East of British Columbia. Overall retail sales for home improvement and hardware in Canada were down about 2% in the quarter.

Marketing efforts continued to focus on the new RemovALL product line specifically designed for the DIY market. The line encompasses the very best of our technologies and products including our patented SARA technology, which has historically been available to industrial customers only. Shipments of these products in Canada began in April and sales for the quarter were about \$50,000.

Gross Profit

Gross margins at 41% were 5 percentage points lower than the second quarter of last year. The Canadian dollar is weaker than it was in the second quarter of last year, which reduced margins on US dollar denominated sales or two-thirds of total sales. The net impact is a 2 percentage point reduction in margins year over year. The remaining portion of the margin decrease relates to wood restoration and coatings products pricing below thresholds, which is currently under review. Gross profit of \$1.1 million was \$0.1 million lower than last year.

Selling, Marketing and Research Expenses

Selling, Marketing and Research expenses at \$0.7 million were the same as 2003.

General and Administration Expenses

General and administration expenses at \$0.4 million were the same as 2003.

Other

Interest expense for the second quarter was \$102,193 compared to \$16,004 for the same period of 2003. Interest expense relates to the new financing arrangements.

Net Loss

The company's net loss for the quarter, including non-cash items, was \$142,773 as compared to a net profit of \$10,650 in 2003. The increase in loss is attributable to lower sales margins and higher interest expense.

Results of Operations for the Six Months Ended June 30, 2004

Sales

Sales for the first six months of the year at \$4.2 million were \$0.1 million or 2% ahead of last year. Sales from new business and expanded business from existing customers increased sales by \$1.1 million or 27% over last year. The following mostly offset this success:

- (\$0.4) million – Lower Biowash consumer sales primarily in Canada
- (\$0.1) million – Lower export industrial sales due to timing of projects in the United Kingdom
- (\$0.4) million – Foreign exchange impact of weaker Canadian dollar on foreign sales
- (\$0.1) million – Sales lost due to product line sale in the first quarter

New and expanded business resulted in a 20% increase in US and export sales. Canadian sales were down by 20% for the year to date due primarily to lower consumer Biowash sales, which reduced to 56% of total sales from 58% for the same period last year. Industrial sales increased to 44% from 42% of total sales last year.

In the first six months, the company realized strong growth and a 27% increase for US industrial sales. This trend is expected to continue based on the acceptance and continued expansion of our product line with major customers. Unexpected softness in the business occurred in the consumer Biowash line of products, most notably in Canada. This is attributable partially to weather, however competitive pressures most notably for coatings and wood restoration products played the major role.

Gross Profit

Gross margins for the first six months were 42% or 3 percentage points lower than the same period last year. The majority of the decrease is due to foreign exchange with the remainder relating to lower margins on wood restoration and coatings product lines. Gross profit at \$1.7 million is \$0.1 million less than last year.

Selling, Marketing and Research Expenses

Selling, Marketing and Research expenses at \$1.4 million were the same as 2003.

General and Administration Expenses

General and administration expenses at \$0.8 million were \$0.1 million greater than 2003. Spending exceeded 2003 for consulting fees and expenses related to strategic initiatives and the refinancing.

Other

Interest expense for the second quarter was \$158,634 compared to \$32,117 for the same period of 2003. Interest expense relates to the new financing arrangements.

Net Loss

The company's net loss for year to date, including non-cash items, was \$0.4 million, which is the same as last year. The loss from operations increased by \$0.2 million from 2003 due to lower sales margins. Gains on the sale of an investment and capital assets offset the increased operating loss.

Quarterly Information

Consolidated Quarterly Financial Results (unaudited) (\$ millions unless otherwise indicated)

	2004				2003				2002	
	Q1	Q2	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sales	1.6	2.6	1.5	2.6	1.8	1.1	2.0	3.3	1.9	1.0
Operating income (loss)	(0.4)	(0.1)	(0.3)	0.1	(0.6)	(0.8)	(0.2)	0.2	(0.3)	(0.6)
Net income (loss) for the period	(0.3)	(0.1)	(0.4)	0.0	(0.6)	(0.9)	(0.3)	0.3	(0.4)	(0.8)
Earnings (loss) per share, basic and fully diluted - \$	(0.01)	0.00	(0.01)	0.00	(0.01)	(0.02)	(0.01)	0.01	(0.01)	(0.2)

Critical Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions are developed based on the best available information and are believed by management to be reasonable under the existing circumstances. New events or additional information may result in the revision of these estimates over time. The company's significant accounting policies are described in Note 2 of the interim financial statements. The following discussion outlines what management believes to be the most critical accounting policies involving the use of significant estimates or assumptions.

Accounts Receivable, Allowance for doubtful accounts and product returns.

The allowance for doubtful accounts is estimated based on historical trends. The company regularly reviews the age of accounts receivable in detail by customer and follows up delinquent accounts directly with the customer. Based on discussions with the customer, independent credit rating reports and past collection history, the company will estimate an appropriate allowance for doubtful accounts. A significant portion of sales is to a number of large customers with higher quality credit. This subjects the company to a greater exposure from any one particular customer. If the estimate of the allowance is understated, this could result in a charge to earnings in the future, should the account ultimately be not collectible. Over the past two years, accounts written off as a percent of sales were less than 0.5% in 2003 and 1.8% in 2002. The allowance for doubtful accounts at the end of the quarter is 2.3%

The provision for product returns is estimated based on historic experience for particular products and customers taking into account among other things, obsolescence, age and demand. Over the past two years, product returns have represented about 0.5% of sales. The products return provision at the end of the quarter is 1.0% of sales. This increase in estimate at the end of the quarter takes into account new accounting recommendations described in accounting policy changes below. If the estimate for product returns is understated, this could result in a charge to future earnings should the actual experience for returns be greater than estimated.

Property, Plant and Equipment/Depreciation and Amortization

The estimated useful lives of assets are determined based on historical experience for comparable assets, technological obsolescence and asset utilization. If the company's estimated useful lives of assets were incorrect, the company could experience increased or decreased charges to depreciation and amortization in the future.

Income taxes

The company follows the liability method of accounting for income taxes whereby future income taxes are recognized based on the differences between the carrying amounts of assets and liabilities reported in the financial statements and their respective tax bases. Future income tax assets are comprised of temporary differences between the carrying amount and the tax basis of assets and liabilities as well as tax losses carried forward. In valuing the future income tax assets, consideration is given to the timing of reversal of the temporary differences, the tax rate enacted for the reversal period and the results of future operations. The value of future tax assets is based on the likelihood of realization of future taxable income against which the tax losses can be applied. Based on our loss history we do not have at this time, reasonable assurance of sufficient taxable income and a valuation allowance has been made equal to the full value of the future income tax assets.

The determination of the income tax assets and liabilities is an inherently complex process requiring management to interpret continually changing regulations and to make certain judgements. While income tax filings are subject to audits and reassessments, management believes the tax assets have been adequately provided. However, changes in the interpretations or judgements may result in increase or decrease in the Company's future income tax asset in the future.

Accounting policy change

Revenue Recognition

The company follows the new accounting recommendations for revenue recognition. Under the new guidelines reasonable assurance regarding the measurement of the consideration for the sale of goods must exist. This measurement is to take into account the extent to which goods may be returned or sales may be cancelled. If a contract is cancellable, the sales price can only be determined and therefore revenue can be recognized at the time the cancellation expires. If the sales transaction allows product to be returned then there is not reasonable assurance that the sales consideration is fixed and therefore the revenue should not be recorded. At the time of the sale, management is therefore required to provide an estimate for the value of future returns. The company has recorded an allowance for product returns as outlined above.

Liquidity and Capital Resources

As of June 30, 2004, the company's working capital included cash and cash equivalents of approximately \$0.1 million and a current ratio of just under 1.0:1. This ratio reflects the new financing arrangements completed on January 29, 2004. Proceeds from this financing were used for working capital purposes and primarily to bring major supplier accounts current.

The financing arrangement with an asset based lender provided three financing facilities. There is a \$2.0 million factoring facility, a \$1.0 million operating loan and a \$48,375 term loan. At June 30, 2004 the company had advances outstanding of over \$1.1 million against about \$2.1 million in trade accounts receivable and had drawn down about \$0.3 million of the operating loan based on the inventory levels. At the end of the quarter, the company was in compliance with all of its financial covenants.

Available credit of up to \$3.1 million dollars under the facilities is sales dependent. Based on the company's year to date sales experience, most notably the softness in Biowash sales in Canada, we expect to have access to only about half of this financial capability. The company has a current ratio of just under 1.00 to 1 and lower than expected sales in the first half of the year. For these reasons, it is essential for the company to secure additional financing to fund working capital for ongoing operations prior to the end of the year. Management is pursuing a number of financing alternatives and strategic initiatives in order to obtain the required financial resources.

Initiatives and Progress

Overall, the industrial side of the business is growing, supported by strong fundamentals found in our product acceptance and relationships with major paint manufacturers. Our challenges in the business are primarily in the Biowash consumer wood restoration and coatings product lines. A number of initiatives are underway to overcome these challenges.

Achieve Positive Cash Flow

Management is developing a business model that delivers positive cash flow at the existing level of sales. Profitability for individual products has been evaluated relative to established thresholds. Products that fall below the threshold have been identified and the changes required

to achieve the threshold profit levels have been defined. Products that fall below these thresholds are found primarily in the Biowash consumer line where pricing has been historically low. To achieve acceptable profit levels for these products, a number of aspects are being considered, including accelerated changes in pricing and less expensive distribution channels. It is our expectation that plans will be in place by the end of the year, to ensure that profit thresholds will be achieved for products in 2005.

Optimize Distribution Channels

For the year to date, we have significantly increased our product presence and availability in the US. Distribution channels are deeper due to marketing and distribution agreements signed in the last year with the 3 largest global coatings manufacturers as well as national two-step distributors. We are in the process of building on these agreements by increasing the number and breadth of product offerings for both private label and our own brands. In addition plans are underway with major paint companies to expand our presence in both their own stores and dealers but also with regional DIY stores and national mass retailers. Our strategy is to take advantage of established distribution channels and focus our efforts to train employees in those channels on the efficacy and use of our products.

The partnership agreement signed last year with a major international paint manufacturer to co-brand, market and distribute our products worldwide, in the commercial aviation sector is progressing. The company continues to develop significant relationships, with commercial airlines and military in North America, Europe, South America and the Middle and Far East. Sales orders have been received from Europe, the Middle East as well as the USA. Approval of our products by all major aircraft manufacturers is key to sales growth. To this end, along with our partner, we are improving our technology to work in concert with the latest and most advanced aviation coating systems and composite materials. In this way, our technology remains on the cutting edge to support and meet the needs of our ultimate customer-the plane manufacturer.

In the non-aviation export market competitive influences have created some unfavorable results. We will complete a review of the market and respond to these competitive influences in the last half of the year.

Our overall objective is for our technology to be the "surface preparation solution". By building brand awareness for our products and company at every opportunity, this will be achieved. Our current and future global distribution channels and networks give Napier the opportunity to train and educate knowledgeable and respected people from across the paint and coatings industry in the benefits of our technology and products. They in turn educate contractors, dealers and consumers to adopt new and safer methods of surface preparation. Product acceptance, familiarity and endorsement are growing as more industry insiders and employees of our international distributors are trained and educated. With this rise in familiarity, we are fielding an increasing number of enquiries from other distributors and manufacturers worldwide. As demand for our products increases, we are being accepted into other regional distribution channels, which supply our products to independent dealers, regional home improvement centres and contractors.

Grow Consumer/Retail Sales

To grow consumer sales, we are focused on increasing our product presence with paint stores, independent dealers and regional hardware and home improvement centres across North America. This will be achieved in part by broadening the range of products carried and acceptance into their central distribution.

In April of 2004 we introduced the new "RemovALL" line, which embraces the very best of all our technologies and spans the spectrum of surface preparation products. The product line is "solution based" and has a patented technology platform. It provides consumers with "one stop shopping" for any surface preparation need with products that are not only effective, safe and

simple to use but will not destroy our environment. We intend to use the product "pull" created by this line, to gain increased acceptance into the mass retail market and to encourage vendor consolidation within our product category. Our ultimate objective is to have a RemovALL program in all stores much like paint is merchandized today.

The line has been shown and products demonstrated to all major retail, home improvement and hardware buyers in North America. Without exception, it is well received and Napier is invited to participate in many of the annual fall formal line reviews. In Canada, RONA and Home Hardware immediately ordered certain specific products. Timing of demonstrations with the buyers this year will not result in a large sales impact this year as store programs were underway and shelf space allocated. It is our intent to secure a number of agreements with mass retailers for distribution of the RemovALL line following these reviews. We have also been approached and are considering potential partnership agreements to market and distribute RemovALL.

The independent representative network focused on consumer sales, has grown to 12 and covers most of the US. Independent distributors, who inventory our products in the US, enable these new "reps" to have goods shipped and available to customers, almost immediately.

Rapid growth in consumer sales needs to be driven by creating "product pull" through increased brand awareness and in some instances outright purchase of shelf space. At this time we are considering a number of initiatives to acquire shelf space through merchandizing partnerships.

Our products were featured and discussed twice so far this year on episodes of "This Old House" and "Ask This Old House". Endorsements such as these and credible testimonial evidence on the effectiveness of our products serves to add a new level of credibility with retail buyers. In certain instances we purchased advertising in key publications and as demand for product increases we will increase our commitment to advertising.

Management Outlook

Our outlook for the remainder of the year continues to be optimistic for industrial sales. Our partners and distributors are reordering which is very encouraging and the true indicator of ongoing success and sales growth. Our partnership in the aviation sector is progressing and a number of initiatives are underway to continue the growth in this sector.

Demand for the products on the Biowash consumer side of the business has fallen short of expectations and last year in Canada. Lower demand for these products reflects a highly competitive market along with wet weather. Management is examining various alternatives to maximize the asset value of these products including private labelling, rebranding or partnering with a category leader. Major paint and coatings companies recognize wood restoration product demand is on the rise as consumers and contractors are moving towards wood restoration in the face of increasing lumber prices. This overall increase is occurring in a highly competitive market and will require increased product and brand awareness to augment market share.

Regional and mass retailers continue to examine the new "RemovALL" line with favourable initial responses. The process to secure a distribution agreement with these retailers takes time and it is our expectation that a number of agreements will be in place for 2005.

Our objective for the end of year is to have implemented a plan that will deliver future profitability at existing sales levels. This will entail a number of significant changes in the wood restoration side of our business including pricing, distribution strategies and product offerings. Wood restoration sales softness and low profitability has lead to the need for management to focus on obtaining additional financing to fund ongoing working capital this winter as well as strategic initiatives currently under development. The company is also addressing alternatives to enhance shareholder value.

Governance and Management

On May 6, 2004, Sue Anne Linde was appointed to the Board of Directors. Ms. Linde is currently Director of Marketing and Communications at Simon Fraser University, Vancouver, British Columbia. An experienced marketing communications professional much of her career was spent as a Vice President and Account Manager at Palmer Jarvis DDB, a leading Canadian advertising company.

On July 19, 2004, Mike Muzylowski resigned from the Board. After 14 years as Director and one of Napier's original investors Mr. Muzylowski is stepping down for personal reasons. On behalf of the Company and our Board of Directors I want to take this opportunity to thank Mike for his years of dedicated service and counsel to Napier.

Effective July 19, 2004 Wayne J. Henderson has joined the Napier Board of Directors. Mr. Henderson spent much of his career as an Executive with the Canadian Imperial Bank of Commerce (CIBC) including Managing Director, Investment Banking, CIBC World Markets in Vancouver. An experienced Merchant Banking professional, Mr. Henderson acts as Special Advisor to PricewaterhouseCoopers, LLP and is Chairman of the Board of the Altura Growth Fund (EVCC) Inc.

Risk Factors and Financial Management

The company is pursuing a number of financing alternatives and strategic initiatives. Both the financing and strategic initiatives have risks inherent that may prevent their completion in whole or on a timely basis. Interested parties to these arrangements may not be in a position to prioritise their resources to complete a transaction at the times required by the company. Management is working on a number of alternatives so that the company's timely completion of a financing is not dependent on one source of funding. The Board of Directors is reviewing and evaluating financing options and strategic alternatives.

To the extent that we are able, we have factored a stronger Canadian dollar into pricing for US customers. The company is exposed to foreign exchange risk to the extent we have not been successful in obtaining price increases for US customers. With our new factoring facility, advances for US and export sales are made in US dollars therefore eliminating the foreign exchange risk for amounts collected.

Other significant risks and uncertainties that face the company are common to other manufacturers operating in an international economy in the industrial and consumer sectors. The company must deal with business risks associated with product infringement, technological change, increased market penetration into established supply lines, locating and penetrating new markets, foreign currency fluctuations, unavailable raw materials, and economic conditions affecting large or potential customers and suppliers, to name a few of the normal but significant factors affecting the company's day to day business. To minimize some of these risks going forward, we continue to nurture our relationships with key customers and suppliers. Open, honest and straightforward communication has retained their loyalty and continued commitment to Napier. Management continually addresses the above business risks in a methodical and rational manner.

The RemovALL product launch earlier in the year has encountered the usual risks associated with a new product launch. Limited capital to launch the new products and to create the advertising pull required to rapidly gain acceptance has resulted in limited sales to date and projected for the remainder of year. The line will be reviewed by a number of key mass retailers as part of the fall product line review. It is difficult to predict what impact this will have on sales going into 2005.

Our business is seasonal with the first and last quarters delivering a lower level of sales than the second and third. Results for 2004 will reflect this seasonality. Efforts to offset this seasonality are underway by targeting less seasonal business such as the consumer "RemovALL Line" and sales to the aviation sector. Export sales south of the equator will allow us to take advantage of peak seasons opposite to those north of the equator. .

This MD&A contains forward looking statements that are subject to a number of known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those anticipated in our forward looking statements. Factors that could cause actual results to differ materially include: rapid technological and/or market changes in the industry; the ability to maintain and grow successful third party and customer relationships; to improve current products and develop new products; and to adequately protect the company's proprietary rights and other factors described in the company's regulatory filings. Although we believe the expectations reflected in our forward looking statements are reasonable, individual results may vary, and we cannot guarantee future results, levels of activity, performance or achievements.

This MD&A has been prepared by management and reviewed by the company's Board of Directors.

"Signed"

B. Frank Dixon
President and Chief Executive Officer

July 30, 2004

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2004

(UNAUDITED – Prepared by Management)

1. CONTINUING OPERATIONS

The company is incorporated under the Company Act of British Columbia. It manufactures and distributes highly effective, safe and environmentally advantaged chemicals for stripping paints/coatings, surface preparation as well as a complete line of wood restoration and protection products.

The company has incurred significant losses over the past fiscal periods and has been reliant on sources of cash from other than operations. The ability of the company to continue as a going concern and meet ongoing debt obligations is dependent upon obtaining additional financing to fund ongoing operational working capital later in the year. Management is pursuing a number of financing alternatives and strategic initiatives. Management believes that actions under consideration will mitigate the conditions and events that raise doubts about the validity of the going concern assumption used in preparing these financial statements.

These financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assume that the company will continue to operate in the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. If the going concern assumption was not appropriate, then certain adjustments would be necessary to the carrying values of assets and liabilities, the reported costs and expenses and balance sheet classifications used.

2. BASIS OF PRESENTATION

These interim consolidated financial statements should be read in conjunction with the financial statements for the Company's most recently completed fiscal year ended December 31, 2003. They do not include all disclosures required in annual financial statements but rather are prepared in accordance with recommendations for interim financial statements in conformity with Canadian generally accepted accounting principles. They have been prepared using the same accounting policies and methods as those used in the December 31, 2003 annual accounts. Certain of the comparative figures have been reclassified to conform to the current period's presentation.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.**CONSOLIDATED BALANCE SHEETS
(UNAUDITED - Prepared by Management)**

	June 30	December 31
	2004	2003
Current		
Cash and cash equivalents	\$ 63,820	\$ 96,217
Accounts receivable (Note 3)	2,120,148	342,178
Inventory (Note 4)	1,513,668	1,438,734
Prepaid expenses	120,253	157,120
	3,817,889	2,034,249
Investments (Note 5)	-	17,655
Capital assets (Note 6)	608,370	639,951
Deferred charges (Note 7)	44,396	51,549
	\$ 4,470,655	\$ 2,743,404

LIABILITIES

Current		
Accounts payable	\$ 2,358,544	\$ 1,794,502
Loan Payable (Note 3)	1,123,473	-
Operating loan (Note 8)	320,759	-
Term loan (Note 8)	43,537	-
Deferred revenue (Note 9)	33,250	
Current portion of long term debt	64,262	69,989
	3,943,825	1,864,491
Long term debt (Note 10)	13,768	44,979
Convertible debenture (Note 11)	332,161	337,440
	4,289,754	2,246,910

SHAREHOLDERS' EQUITY

Capital stock (Note 12)	23,368,041	23,343,041
Convertible debenture (Note 11)	165,015	173,700
Contributed surplus (Note 12)	112,097	61,309
Deficit	(23,464,252)	(23,081,556)
	180,901	496,494
	\$ 4,470,655	\$ 2,743,404

Approved by the Directors

signed: B. Frank Dixon

signed: Peter Jeffrey

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

**INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
(UNAUDITED - Prepared by Management)**

	Three month period ended June 30		Six month period ended June 30	
	2004	2003	2004	2003
Sales	\$ 2,585,830	\$ 2,566,779	\$ 4,187,111	\$ 4,093,740
Cost of sales	1,528,360	1,385,872	2,445,662	2,249,711
Gross profit	1,057,470	1,180,907	1,741,449	1,844,029
	40.9%	46.0%	41.6%	45.0%
Expenses				
Selling and marketing (Schedule)	654,640	681,414	1,298,663	1,260,466
General and administrative (Schedule)	401,724	369,074	779,514	711,208
Research and product development	62,128	59,283	115,828	110,780
	1,118,492	1,109,771	2,194,005	2,082,454
Operating loss before the undernoted	(61,022)	71,136	(452,556)	(238,425)
Other items				
Interest expense	(102,193)	(16,004)	(158,634)	(32,117)
Equity loss in investment	-	(27,000)	(17,655)	(54,000)
Gain on sale of investment	-	-	60,000	-
Gain on disposal of capital assets	-	-	159,991	50
Foreign exchange gain (loss), interest and other	20,442	(17,482)	26,156	(43,233)
	(81,751)	(60,486)	69,858	(129,300)
Net loss for the period	(142,773)	10,650	(382,698)	(367,725)
Deficit at beginning of the period	(23,321,481)	(21,659,904)	(23,081,554)	(21,281,529)
Deficit at end of the period	\$ (23,464,254)	\$ (21,649,254)	\$ (23,464,252)	\$ (21,649,254)
Weighted average shares outstanding	47,728,042	47,634,635	47,705,820	47,631,357
Loss per share, basic and fully diluted	\$ 0.00	\$ 0.00	\$ (0.01)	\$ (0.01)

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

**INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED - Prepared by Management)**

	Three month period ended June 30		Six month period ended June 30	
	2004	2003	2004	2003
Operating activities				
Net loss for the period	\$ (142,773)	\$ 10,650	\$ (382,698)	\$ (367,725)
Items not involving cash				
Depreciation and amortization	44,863	42,227	87,259	84,271
Accretion of convertible debenture	5,468	-	11,038	-
Stock based compensation	19,763	-	50,788	-
Equity loss in investment	-	27,000	17,655	54,000
Gain on sale of investment	-	-	(60,000)	-
Gain on disposal of capital assets	-	-	(159,991)	(50)
	<u>(72,679)</u>	<u>79,877</u>	<u>(435,949)</u>	<u>(229,504)</u>
Change in non-cash operating working capital				
Accounts receivable	(854,828)	(493,508)	(1,777,970)	(916,020)
Inventory	93,001	118,366	(74,934)	(191,129)
Prepaid expenses	80,776	38,569	36,867	42,246
Accounts payable	455,311	307,782	564,043	973,174
Deferred Revenue	-	-	33,250	-
	<u>(225,740)</u>	<u>(28,791)</u>	<u>(1,218,744)</u>	<u>(91,729)</u>
	<u>(298,419)</u>	<u>51,086</u>	<u>(1,654,693)</u>	<u>(321,233)</u>
Financing activities				
Bank indebtedness	-	(497,773)	-	(353,000)
Proceeds from loan payable	399,698	-	1,123,473	-
Proceeds on term loan	-	-	48,375	-
Convertible Debenture issued	-	500,000	-	500,000
Proceeds from operating loan, net	(78,016)	-	318,952	-
Repayment of long-term debt	(18,904)	(25,592)	(36,938)	(44,571)
	<u>302,778</u>	<u>(23,365)</u>	<u>1,453,862</u>	<u>102,429</u>
Investing activities				
Purchase of capital assets	(53,316)	(561)	(53,316)	(33,354)
Proceeds on disposal of capital assets	-	-	161,750	50
Proceeds on sale of investment	-	-	60,000	-
	<u>(53,316)</u>	<u>(561)</u>	<u>168,434</u>	<u>(33,304)</u>
Change in cash during the period	(48,957)	27,160	(32,397)	(252,108)
Cash and cash equivalents at beginning of the period	112,777	5,829	96,217	285,097
Cash and cash equivalents at end of the period	\$ 63,820	\$ 32,989	\$ 63,820	\$ 32,989
Supplemental information				
Interest paid	\$ 131,651	\$ 16,004	\$ 157,673	\$ 32,117

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2004

(UNAUDITED – Prepared by Management)

2. BASIS OF PRESENTATION (continued)

The preparation of interim 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.

The company's business has historically been seasonal, with the lowest volumes of business experienced in the first and fourth quarters and the highest volumes in the second and third quarters. There is no reason to expect a change in this pattern during the current year.

3. ACCOUNTS RECEIVABLE

On January 29, 2004 the company entered into a factoring agreement under which 80% of invoices from approved customers will be advanced to the company. Advances will be made up to a maximum of \$2.0 million, on a recourse basis, at a minimum discount rate on the gross invoice of 0.9% or 0.06% per day that the amount is outstanding. Either party can terminate this agreement on 30 days notice. As of June 30, 2004, the company had received advances against about \$1.5 million in invoice value.

This agreement replaced a revolving arrangement to sell eligible receivables with a major financial institution.

4. INVENTORY

Inventory is comprised of:

	June 30 2004	December 31 2003
Raw materials	\$ 644,210	\$ 592,295
Finished goods	869,458	846,439
	<u>\$ 1,513,668</u>	<u>\$ 1,438,734</u>

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2004

(UNAUDITED – Prepared by Management)

5. INVESTMENTS

	June 30 2004	December 31 2003
Investment in Ecoprogress, beginning of the period	\$ 17,655	\$ 111,585
Equity share of losses	(17,655)	(93,930)
Sale of Ecoprogress	-	-
Investment in Ecoprogress, end of the period	\$ -	\$ 17,655

On March 31, 2004, the company sold 100% of its investment in Consolidated Ecoprogress Technology Inc. (“Ecoprogress”) for proceeds of \$60,000.

In 2003 the investment in Radical Elastomers Inc. was written off and in January of 2004, Radical Elastomers Inc, filed for bankruptcy.

6. CAPITAL ASSETS

	June 30 2004		December 31 2003	
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Machinery and equipment	\$ 983,879	\$ 669,613	\$ 314,266	\$317,769
Furniture and fixtures	211,300	94,019	117,281	130,082
Leasehold improvements	277,544	100,721	176,823	192,100
	\$ 1,472,723	\$ 864,353	\$ 608,370	\$ 639,951

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2004

(UNAUDITED – Prepared by Management)

7. DEFERRED CHARGES

The deferred charges represent fees related to the debenture financing. These costs are being amortized over the life of the convertible debenture.

	June 30		December 31	
	2004		2003	
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Deferred Financing charges	\$ 58,000	\$ (13,604)	\$ 44,396	\$51,549

8. OPERATING AND TERM LOANS

	June 30	December 31
	2004	2003
Operating loan	\$ 320,759	\$ -
Term loan	44,746	-
	\$ 365,505	\$ -

The operating loan is authorized up to \$1.0 million, repayable on demand and secured by eligible inventory. Funding is based on 75% of the net orderly liquidation value and interest is payable on a monthly basis at a rate of 2% per month. The company expects to draw down about one third of this facility in 2004.

The term loan of \$43,537 is repayable at \$1,209 per month plus interest at 2% per month and secured by capital assets. The term loan is repayable by January 31, 2005. Principal payments commenced in April 2004.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2004

(UNAUDITED – Prepared by Management)

9. DEFERRED REVENUE

On March 30, 2004, the Company sold a formula for a non-strategic product for proceeds of \$166,250 and a 5% royalty based on sales over the next 5 years. The company received a \$33,250 initial payment on this royalty that will be recognized as revenue when the royalty is earned.

10. LONG TERM DEBT

	<u>June 30</u> <u>2004</u>	<u>December 31</u> <u>2003</u>
Capital lease obligations repayable in aggregate monthly instalments of \$7,123 including interest averaging 11.19% per annum due until January, 2005.	\$ 77,940	\$ 114,968
Less current portion	<u>64,262</u>	<u>69,989</u>
	<u>\$ 13,678</u>	<u>\$ 44,979</u>

Principal repayments required are as follows: 2004 - \$51,956; 2005 - \$44,979.

11. CONVERTIBLE DEBENTURE

On February 11, 2004 the company issued 100,000 common shares and 50,000 warrants on the conversion of \$25,000 of the convertible debenture. On conversion the equity component was reduced by \$8,685 and the liability component was reduced by \$16,315.

During the quarter, the liability component was accreted by \$ 5,467.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2004

(UNAUDITED – Prepared by Management)

12. CAPITAL STOCK

a) Authorized
145,635,962 common shares

b) Issued

	Number of shares	\$
Balance, December 31, 2003	47,668,042	23,343,041
Issued on conversion of debentures	100,000	25,000
Balance, June 30, 2004	47,768,042	23,368,041

During the first quarter, the company issued 100,000 common shares on conversion of \$25,000 of the convertible debentures (Note 11).

c) Stock options

Under the terms of the company's incentive stock option plan, options are granted to employees and directors 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 normally 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. Options generally vest upon grant date, however the Board reserves the right to attach vesting periods to stock options granted.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2004

(UNAUDITED – Prepared by Management)

12. CAPITAL STOCK (continued)

c) Stock options (continued)

	Number	Weighted average price
Outstanding, December 31, 2003	2,735,000	\$0.49
Granted	921,000	0.13
Cancelled/expired	(1,195,000)	0.46
June 30, 2004	<u>2,461,000</u>	<u>0.41</u>
Exercisable, at June 30, 2004	<u>2,086,000</u>	<u>\$0.42</u>
Options reserved for issuance under stock option plan	<u>2,159,000</u>	

The following table summarizes information about stock options outstanding at June 30, 2004:

Range of exercise prices	Number of options	Weighted average remaining contractual life	Weighted average exercise price
Vested			
\$.12 - \$.28	1,615,000	3.5 years	\$0.20
\$.40	95,000	2.6 years	\$0.40
\$.85 - \$1.15	276,000	1.1 years	\$1.00
\$2.18	100,000	5.6 years	\$2.18
	<u>2,086,000</u>	<u>3.2 years</u>	<u>\$0.42</u>
Non-vested			
\$.12 - \$.28	375,000	4.4 years	\$0.13
	<u>2,461,000</u>	<u>3.4 years</u>	<u>\$0.38</u>

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2004

(UNAUDITED – Prepared by Management)

12. CAPITAL STOCK (continued)

d) Stock-based compensation

The company uses the fair value based method of accounting for stock-based compensation. During the first six months, the company issued 921,000 options with a fair value of \$78,164. The company recognizes compensation expense over the vesting period of the options and has recorded \$50,788 in the first 6 months with the balance to be recognized over the average remaining 12 months.

The Black Scholes option-pricing model assumptions used to compute the fair value of options granted in the second quarter are as follows:

Dividend yield	0%
Expected volatility	77%
Expected life	5 yrs
Risk free rate of return	3.5%
Weighted average fair value of options granted	\$ 0.08

Prior to January 1, 2003 the company accounted for employee stock options using the intrinsic value based method and is required to disclose pro forma net loss and loss per share as if the fair value based method had been used. Pro forma compensation expense for 2004 and 2003 relate to 300,000 stock options issued during 2002 that vest over a two-year period and were recorded using the intrinsic value based method.

	Quarter ended	Six months ended
	30-Jun-04	30-Jun-04
Net loss, as reported	\$ (142,773)	\$ (382,698)
Additional compensation expense	(5,775)	(14,437)
Net loss, pro forma	\$ (148,548)	\$ (368,261)
Loss per share, as reported	\$ -	\$ (0.01)
Loss per share, pro forma	\$ -	\$ (0.01)

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2004

(UNAUDITED – Prepared by Management)

12. CAPITAL STOCK (continued)

e) Warrants

During the first quarter, the company issued 50,000 warrants on conversion of \$25,000 of convertible debentures (Note 11).

Outstanding, December 31, 2003	2,937,120
Issued on conversion of debentures	50,000
Outstanding, June 30, 2004	2,987,120

At June 30, 2004, 2,597,120 warrants are exercisable at \$0.41 per share and expire September 11, 2005; 320,000 warrants are exercisable at \$2.40 per share and expire September 11, 2005; and 70,000 warrants are exercisable \$0.50 per share until June 12, 2005.

13. SEGMENTED INFORMATION

The company operates in one industry segment, which is the manufacture and distribution of coatings removal products and wood restoration products in Canada and internationally. Within this general industry segment the company distributes to both retail or consumer and industrial sectors. All of the company's capital assets are located in Canada.

	Quarter ended June 30		Six months ended June 30	
	2004	2003	2004	2003
Sales by region				
Canadian	\$ 923,154	\$ 1,083,419	\$ 1,360,693	\$ 1,715,574
International	1,662,676	1,483,360	2,826,418	2,378,166
Total Sales	\$ 2,585,830	\$ 2,566,779	\$ 4,187,111	\$ 4,093,740
Sales by sector				
Consumer	\$ 1,552,010	\$ 1,544,771	\$ 2,362,518	\$ 2,392,757
Industrial	1,033,820	1,022,008	1,824,593	1,700,983
	\$ 2,585,830	\$ 2,566,779	\$ 4,187,111	\$ 4,093,740

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

**INTERIM CONSOLIDATED SCHEDULES
(UNAUDITED- Prepared by Management)**

SELLING AND MARKETING EXPENSES

	Three Month Period ended June 30		Six Month Period ended June 30	
	2004	2003	2004	2003
Salaries and wages	\$ 207,814	\$ 289,022	\$ 446,790	\$ 551,117
Travel and entertainment	127,149	99,828	249,562	205,434
Promotional materials, advertising and printing	70,982	113,362	189,141	192,383
Commissions	98,330	71,719	154,116	130,874
Communications and other	60,045	23,826	110,645	50,483
Consulting	33,548	26,866	72,257	57,458
Retail service fee	56,772	56,791	64,186	72,717
Stock option Benefit	-	-	11,966	-
	\$ 654,640	\$ 681,414	\$ 1,298,663	\$ 1,260,466

GENERAL AND ADMINISTRATIVE EXPENSES

	Three Month Period ended June 30		Six Month Period ended June 30	
	2004	2003	2004	2003
Salaries and wages	\$ 143,054	\$ 142,210	\$ 289,012	\$ 315,256
Insurance	54,491	55,032	113,183	105,675
Professional fees	53,567	31,790	82,403	50,316
Consulting	32,190	11,613	78,468	13,490
Travel and corporate relations	34,431	28,736	44,612	34,732
Office	20,908	27,930	38,659	49,802
Stock option benefit	19,763	-	34,150	-
Occupancy	6,583	28,278	17,080	59,323
Regulatory and filing fees	671	10,036	13,116	15,506
Telecommunications	6,366	6,871	11,982	13,753
Amortization	29,699	26,578	56,849	53,355
	\$ 401,723	\$ 369,074	\$ 779,514	\$ 711,208