



**NAPIER ENVIRONMENTAL
TECHNOLOGIES INC.**

**CONSOLIDATED
INTERIM FINANCIAL STATEMENTS**

JUNE 30, 2005

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

**INTERIM CONSOLIDATED BALANCE SHEETS
(UNAUDITED - Prepared by Management)**

	June 30 2005	December 31 2004
ASSETS		
Current		
Cash	\$ 134,693	\$ 73,163
Accounts receivable (Note 3)	967,085	362,710
Inventory (Note 4)	1,150,519	943,950
Prepaid expenses	23,207	14,141
	2,275,504	1,393,964
Capital assets (Note 5)	473,906	550,625
	\$ 2,749,410	\$ 1,944,589
LIABILITIES		
Current		
Accounts payable (Note 10)	\$ 4,370,055	\$ 3,348,703
Deferred revenue (Note 6)	33,250	33,250
Loans payable (Note 7)	177,158	225,778
Current portion of capital lease obligations	50,619	50,619
	4,631,082	3,658,350
SHAREHOLDERS' EQUITY		
Capital stock (Note 8)	23,368,041	23,368,041
Convertible debenture	171,426	165,014
Contributed surplus	131,265	131,265
Deficit	(25,552,404)	(25,378,081)
	(1,881,672)	(1,713,761)
	\$ 2,749,410	\$ 1,944,589

Continuing Operations (Note 1)

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	
	2005	2004	2005	2004
Sales	\$ 1,249,073	\$ 2,585,830	\$ 2,877,231	\$ 4,187,111
Cost of sales	725,044	1,528,360	1,617,500	2,445,662
Gross profit	524,029	1,057,470	1,259,731	1,741,449
	42.0%	40.9%	43.8%	41.6%
Expenses				
Selling and marketing (Schedule)	177,793	654,640	334,898	1,298,663
General and administrative (Schedule)	427,822	401,724	780,213	779,514
Research and product development	78,589	62,128	127,638	115,828
	684,204	1,118,492	1,242,749	2,194,005
Operating income (loss)	(160,175)	(61,022)	16,982	(452,556)
Other items				
Interest and finance expense	(134,350)	(102,193)	(186,511)	(158,634)
Equity loss in investment	-	-	-	(17,655)
Gain on sale of investment	-	-	-	60,000
Gain on disposal of capital assets	-	-	-	159,991
Other income (expense)	1,368	20,442	(4,794)	26,156
	(132,982)	(81,751)	(191,305)	69,858
Net loss for the period	(293,157)	(142,773)	(174,323)	(382,698)
Deficit at beginning of the period	(25,259,247)	(23,321,481)	(25,378,081)	(23,081,554)
Deficit at end of the period	\$ (25,552,404)	\$ (23,464,254)	\$ (25,552,404)	\$ (23,464,252)
Weighted average shares outstanding	47,768,042	47,728,042	47,768,042	47,705,820
Loss per share, basic and fully-diluted	\$ (0.01)	\$ (0.00)	\$ (0.00)	\$ (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	
	2005	2004	2005	2004
Operating activities				
Net loss for the period	\$ (293,157)	\$ (142,773)	\$ (174,323)	\$ (382,698)
Items not involving cash				
Depreciation and amortization	37,104	44,863	76,719	87,259
Accretion of convertible debenture	-	5,468	-	11,038
Stock based compensation	3,207	19,763	6,412	50,788
Equity loss in investment	-	-	-	17,655
Gain on sale of investment	-	-	-	(60,000)
Gain on disposal of capital assets	-	-	-	(159,991)
	(252,846)	(72,679)	(91,192)	(435,949)
Change in non-cash operating working capital				
Accounts receivable	(4,160)	(854,828)	(604,375)	(1,777,970)
Inventory	(386,934)	93,001	(206,569)	(74,934)
Prepaid expenses	22,034	80,776	(9,066)	36,867
Accounts payable	691,729	455,311	1,021,352	564,043
Deferred revenue	-	-	-	33,250
	322,669	(225,740)	201,342	(1,218,744)
	69,823	(298,419)	110,150	(1,654,693)
Financing activities				
Loans payable, net	2,439	321,682	(48,620)	1,490,800
Repayment of capital lease obligations	-	(18,904)	-	(36,938)
	2,439	302,778	(48,620)	1,453,862
Investing activities				
Purchase of capital assets	-	(53,316)	-	(53,316)
Proceeds on disposal of capital assets	-	-	-	161,750
Proceeds on sale of investment	-	-	-	60,000
	-	(53,316)	-	168,434
Change in cash during the period	72,262	(48,957)	61,530	(32,397)
Cash at beginning of the period	62,431	112,777	73,163	96,217
Cash at end of the period	\$ 134,693	\$ 63,820	\$ 134,693	\$ 63,820
Supplemental information				
Interest paid	\$ 56,150	\$ 131,651	\$ 81,081	\$ 157,673

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2005

(UNAUDITED – Prepared by Management)

REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the company have been prepared by and are the responsibility of the company's management.

The company's independent auditor has not performed a review of the comparative figures in these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2005

(UNAUDITED – Prepared by Management)

1. CONTINUING 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 and wood restoration products.

While the consolidated financial statements of the company have been prepared on the basis of accounting principles applicable to a going concern, several adverse conditions and events cast substantial doubt upon the continued validity of this assumption.

On November 3, 2004, as the company was unable to meet its ongoing obligations, it filed a Notice of Intention to File a Proposal subject to the Bankruptcy and Insolvency Act. This afforded the company a period of time, under Court protection, to deal with its unsecured debt obligations.

Subsequent to the end of the second quarter, the company successfully renegotiated its unsecured debt obligations (Note 10). While the reduction of its unsecured debt obligations and additional financing should assist the company in the future, the company's continued existence is dependent upon its ability to restore and maintain profitable operations and to receive continued support from its lenders.

If the going concern assumption were not appropriate for these consolidated financial statements, then adjustments would be necessary to the carrying values of assets and liabilities, the reported net loss and the balance sheet classifications used.

2. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of presentation

These consolidated financial statements include the accounts of the company and its wholly owned subsidiary. Inter-company 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.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2005 (UNAUDITED – Prepared by Management)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

b) 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.

c) Investments

Investments over which the company exercises significant influence are accounted for using the equity method. Other long-term investments are recorded at the lower of cost and estimated net realizable value.

d) 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.

e) Deferred charges

Deferred financing costs are being amortized over the original term of the convertible debenture.

f) Revenue recognition

Revenue is recognized when goods are shipped, significant risks and benefits of ownership are transferred, and collection is reasonably assured.

g) Income taxes

Income taxes are accounted for using the liability method whereby future income tax assets and liabilities are recognized for temporary differences between the tax and accounting basis of assets and liabilities as well as for the benefit of tax losses 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 charge occurs including any change in applicable future tax rates.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2005

(UNAUDITED – Prepared by Management)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

h) Stock options

Effective January 1, 2003 the company adopted, on a prospective basis, the fair value based method of accounting for employee stock based compensation. The fair value based method requires the company to estimate compensation costs on the date options are granted, using an option-pricing model.

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 weighed average number of shares outstanding during the period. Potentially dilutive items are described in Note 8. Fully diluted loss per share is the same as basic loss per share as the exercise of options and warrants would reduce the loss per share.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2005 (UNAUDITED – Prepared by Management)

3. ACCOUNTS RECEIVABLE

In January 2004 the company replaced its revolving arrangement to sell eligible receivables to a major financial institution with a \$2.0 million Factoring Facility which provides for funds on a recourse basis, of 80% of the invoice value in exchange for a minimum fee of 0.9% or, 0.06% per day that the amount is outstanding. This Factoring Facility can be terminated by either party on 30 days notice. This facility contains standard covenant clauses for financial ratios, payment of priority payables, and financial reporting. At June 30, 2005, the company was not in compliance with the covenants of the Factoring Facility as described in Note 7 and was operating same pursuant to a forbearance arrangement.

On April 20, 2005, I.C.T.C. Investments Corporation (“ICTC”) acquired the Factoring Facility from Century Services Inc. (“CSI”). Under the terms of the agreements, this facility was to be repayable on April 29, 2005. On that date, ICTC entered into a forbearance extension agreement with the company to further extend the maturity date to June 28, 2005 in return for a forbearance fee and an adjustment of the interest rate from 2% to 2.5% per month. On June 28, 2005, ICTC agreed to a further forbearance extension to allow the Court to deal with a proposal put before the Court under the Bankruptcy and Insolvency Act (Canada) (the “BIA”) pursuant to a meeting of the unsecured creditors.

At June 30, 2005, the company had factored \$735,000 of accounts receivable under this facility.

On July 14, 2005, this facility, together with the loans payable, was repaid in full.

4. INVENTORY

Inventory is comprised of:

	June 30 2005	December 31 2004
Raw materials	\$ 374,329	\$ 485,687
Finished goods	776,190	458,263
	<u>\$ 1,150,519</u>	<u>\$ 943,950</u>

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2005

(UNAUDITED – Prepared by Management)

5. CAPITAL ASSETS

	June 30 2005		December 31 2004	
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Machinery and equipment	\$ 1,001,179	765,715	235,464	\$284,431
Furniture and fixtures	211,300	119,126	92,174	104,649
Leasehold improvements	277,544	131,276	146,268	161,545
	<u>\$ 1,490,023</u>	<u>\$ 1,016,117</u>	<u>\$ 473,906</u>	<u>\$ 550,625</u>

6. DEFERRED REVENUE

During the year ended December 31, 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.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2005

(UNAUDITED – Prepared by Management)

7. LOANS PAYABLE

	June 30 2005	December 31 2004
Demand operating loan	\$ 145,634	\$ 190,579
Term loan	31,524	35,199
	<u>\$ 177,158</u>	<u>\$ 225,778</u>

On April 20, 2005, ICTC acquired the loans payable from CSI. Under the terms of the loan agreements, these loans were repayable in full on April 29, 2005. On that date, ICTC entered into a forbearance extension agreement with the company to further extend the maturity date of these loans to June 28, 2005 in return for a forbearance fee and an adjustment of the interest rate from 2% to 2.5% per month. On June 28, 2005, ICTC agreed to a further forbearance extension to allow the Court to deal with a proposal put before the Court under the BIA pursuant to a meeting of the unsecured creditors.

At June 30, 2005 the company was in default of certain covenants pursuant to these loans.

On July 14, 2005 these loans, together with the factoring facility, were repaid in full.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(UNAUDITED – Prepared by Management)

8. CAPITAL STOCK

a) Authorized
145,635,962 common shares

b) Issued

	Number of Shares	\$
Balance, December 31, 2004 and June 30, 2005	<u>47,768,042</u>	<u>23,368,041</u>

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.

The following table summarizes the status and changes in stock options outstanding at June 30, 2005 and December 31, 2004.

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(UNAUDITED – Prepared by Management)

8. CAPITAL STOCK (continued)

	June 30, 2005		December 31, 2004	
	Number	Weighted average price	Number	Weighted average price
Outstanding, beginning of period	1,788,000	\$0.44	2,735,000	\$0.49
Granted	-	-	971,000	0.13
Cancelled / expired	(104,000)	0.99	(1,918,000)	0.36
Outstanding, end of period	1,684,000	0.41	1,788,000	0.44
Exercisable, end of period	1,684,000	\$0.41	1,788,000	\$0.44
Options reserved for issuance, under stock option plan	2,671,000		2,567,000	

The following table summarizes information about stock options outstanding at June 30, 2005:

Range of exercise prices	Number of options	Weighted average remaining contractual life	Weighted average exercise price
\$.08 - \$.28	1,307,000	2.4 years	\$0.17
\$.40	90,000	1.3 years	\$0.40
\$1.10	187,000	0.7 years	\$1.10
\$2.18	100,000	4.9 years	\$2.18
	1,684,000	2.3 years	\$0.41

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(UNAUDITED – Prepared by Management)

8. CAPITAL STOCK (continued)

d) Warrants

	June 30, 2005	December 31, 2004
Outstanding, beginning of period	2,987,120	2,937,120
Granted	-	50,000
Expired	(70,000)	-
Outstanding, end of period	<u>2,917,120</u>	<u>2,987,120</u>

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

9. 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.

	Three months ended June 30		Six months ended June 30	
	2005	2004	2005	2004
Sales by region				
Canadian	\$ 625,615	\$ 923,154	\$ 917,676	\$ 1,360,693
U.S. and International	623,458	1,662,676	1,959,555	2,826,418
	<u>\$ 1,249,073</u>	<u>\$ 2,585,830</u>	<u>\$ 2,877,231</u>	<u>\$ 4,187,111</u>
Sales by sector				
Consumer	\$ 833,638	\$ 1,552,010	\$ 2,105,550	\$ 2,362,518
Industrial	415,435	1,033,820	771,681	1,824,593
	<u>\$ 1,249,073</u>	<u>\$ 2,585,830</u>	<u>\$ 2,877,231</u>	<u>\$ 4,187,111</u>

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(UNAUDITED – Prepared by Management)

10. SUBSEQUENT EVENTS

A formal proposal was presented and accepted by the unsecured creditors under the relevant provisions of the BIA on July 5, 2005, approved by the courts on July 8, 2005 and closed on July 14, 2005. Management estimates the unsecured liabilities will be settled at a range of 40% to 50% of face value. The forgiveness of debt is estimated to be \$1.3 million and is subject to the final approval of claims submitted by the unsecured creditors. This forgiveness of debt will result in total liabilities being reduced to approximately \$3.3 million.

The proposal included obtaining additional financing, from companies controlled by individuals who became directors of Napier subsequent to the end of the second quarter and concurrent with the closing of the financing of up to \$5 million. \$3 million of this financing was used on July 14, 2005 to pay all fees and related costs and to satisfy all amounts owed by the company to its secured, preferred, unsecured and post-filing creditors. The balance of the loans will be used as working capital.

The loans have a first and only registered charge on all assets of the company and are a combination of \$1.5 million term loans and \$3.5 million revolving working capital loans, subject to certain conditions and covenants pursuant to the Loan Agreements. The loans bear interest at prime plus 10% until such time as warrants are issued to the lenders at which time the interest rate will change to prime plus 2%. The term loans have a five-year term and are repayable as to interest monthly and as to principal one-fifth on each of the anniversary dates of these loans. The revolving loans have a term of 364 days and are renewable for successive 364 day extensions at least 90 days prior to the expiry of the then applicable term expiry dates and subject to the consent of the lenders. As additional consideration for the granting of these loans, the company has agreed to grant to the lenders warrants entitling the lenders to purchase, from treasury, up to 60% of the shares of the company, calculated on a fully-diluted basis upon payment of \$0.01 per share at any time up to August 31, 2010. Such issuance is subject to approval by the Toronto Stock Exchange, which has been obtained, conditional upon the warrants being issued no later than August 31, 2005.

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	
	2005	2004	2005	2004
Salaries and wages	\$ 111,992	\$ 207,814	\$ 206,095	\$ 458,756
Travel and entertainment	23,529	127,149	45,981	249,562
Advertising and promotional materials	13,105	70,982	42,964	189,141
Commissions	11,085	98,330	20,747	154,116
Retail service fees	17,247	56,772	17,247	64,186
Communications and other	6,208	60,045	13,483	110,645
Consulting	3,146	33,548	7,646	72,257
Bad debt expense (recovery)	(8,519)	-	(19,265)	-
	\$ 177,793	\$ 654,640	\$ 334,898	\$ 1,298,663

GENERAL AND ADMINISTRATIVE EXPENSES

	Three Month Period ended June 30		Six Month Period ended June 30	
	2005	2004	2005	2004
Professional fees	\$ 127,542	\$ 53,567	\$ 204,412	\$ 82,403
Salaries and wages	79,865	162,817	167,218	323,162
Consulting	109,439	32,190	160,498	78,468
Insurance	17,598	54,491	73,157	113,183
Travel and corporate relations	24,792	34,431	46,151	44,612
Office	23,416	20,908	39,388	38,659
Occupancy	13,508	6,583	27,750	17,080
Telecommunications	4,597	6,366	8,810	11,982
Regulatory and filing fees	4,773	671	6,930	13,116
Amortization	22,292	29,699	45,899	56,849
	\$ 427,822	\$ 401,723	\$ 780,213	\$ 779,514