

**NAPIER ENVIRONMENTAL
TECHNOLOGIES INC.**

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006

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

	September 30 2006	December 31 2005
ASSETS		
Current:		
Cash	\$ 86,391	\$ 10,413
Accounts receivable	341,695	308,541
Inventory (Note 4)	709,409	730,478
Prepaid expenses	24,431	42,004
	1,161,926	1,091,436
Deferred leasehold inducements (Note 3)	328,452	403,445
Deferred financing costs (Note 9e)	493,500	588,000
Property, plant and equipment (Note 5)	349,319	423,712
	\$ 2,333,197	\$ 2,506,593
LIABILITIES		
Current:		
Loans payable (Note 6)	\$ 3,100,000	\$ 1,800,000
Accounts payable	469,059	702,225
Current portion of long term debt (Note 8)	300,000	300,000
Deferred revenue (Note 7)	-	33,250
	3,869,059	2,835,475
Long term debt (Note 8)	900,000	1,200,000
	4,769,059	4,035,475
SHAREHOLDERS' DEFICIENCY		
Capital stock (Note 9)	23,778,809	23,368,041
Contributed surplus (Note 9d)	985,205	975,195
Deficit	(27,199,876)	(25,872,118)
	(2,435,862)	(1,528,882)
	\$ 2,333,197	\$ 2,506,593

Continuing Operations (Note 1)

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
(UNAUDITED - Prepared by Management)

	Three month period ended Sept 30		Nine month period ended Sept 30	
	2006	2005	2006	2005
		(Note 11)		(Note 11)
Sales	\$ 742,925	\$ 896,833	\$ 2,533,335	\$ 3,774,064
Cost of sales (Note 4)	602,173	834,859	1,961,029	2,452,359
Gross profit	140,752	61,974	572,306	1,321,705
	18.9%	6.9%	22.6%	35.0%
Expenses				
General and administrative (Schedule)	228,383	529,214	943,057	1,020,521
Selling and marketing (Schedule)	228,603	143,362	671,285	478,260
Research and development	37,153	21,159	114,163	278,461
Interest and financing costs	-	91,950	67,140	148,797
Amortization of deferred financing costs	31,500	-	94,500	-
	525,639	785,685	1,890,145	1,926,039
Operating loss	(384,887)	(723,711)	(1,317,839)	(604,334)
Other items				
Gain on settlement of debt, net of restructuring costs	-	1,170,658	-	881,752
Foreign exchange loss	(214)	(12,306)	(10,584)	(17,100)
Gain on disposal of capital assets	-	-	663	-
	(214)	1,158,352	(9,922)	864,652
Net income (loss) for the period	(385,101)	434,641	(1,327,761)	260,318
Deficit at beginning of the period	(26,814,775)	(25,552,404)	(25,872,115)	(25,378,081)
Deficit at end of the period	\$ (27,199,876)	\$ (25,117,763)	\$ (27,199,876)	\$ (25,117,763)
Weighted average shares outstanding:				
Basic	53,572,380	47,768,042	49,724,082	47,768,042
Fully-diluted	53,572,380	68,904,302	49,724,082	54,280,855
Income (loss) per share				
Basic	\$ (0.01)	\$ 0.01	\$ (0.03)	\$ 0.01
Fully-diluted	\$ (0.01)	\$ 0.01	\$ (0.03)	\$ 0.00

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED - Prepared by Management)

	Three month period ended Sept 30		Nine month period ended Sept 30	
	2006	2005	2006	2005
Operating activities				
Net income (loss) for the period	\$ (385,101)	\$ 434,641	\$ (1,327,761)	\$ 260,318
Items not involving cash				
Depreciation and amortization	30,070	35,373	93,144	112,092
Amortization of deferred leasehold inducements	24,701	-	74,993	-
Amortization of deferred financing costs	31,500	-	94,500	-
Stock based compensation	3,625	31,226	10,010	37,638
	(295,205)	501,240	(1,055,114)	410,048
Change in non-cash operating working capital				
Accounts receivable	226,282	519,104	(33,154)	(85,271)
Inventory	(38,856)	318,890	21,069	112,321
Prepaid expenses	(4,791)	(44,850)	17,573	(53,916)
Accounts payable	(62,613)	(3,920,831)	(233,166)	(2,899,479)
Deferred revenue	-	-	(33,250)	-
	120,022	(3,127,687)	(260,928)	(2,926,345)
	(175,183)	(2,626,447)	(1,316,042)	(2,516,297)
Financing activities				
Repayment of capital lease obligations	-	(50,619)	-	(50,619)
Proceeds on issuance of share capital	410,768	-	410,768	-
Proceeds from loans payable and long term debt	200,000	2,822,842	1,400,000	2,774,222
Repayment of loans payable and long term debt	(400,000)	-	(400,000)	-
	210,768	2,772,223	1,410,768	2,723,603
Investing activities				
Purchase of property, plant and equipment	(3,657)	(1,809)	(20,498)	(1,809)
Proceeds on disposal of property, plant and equipment	-	-	1,750	-
	(3,657)	(1,809)	(18,748)	(1,809)
Change in cash during the period	31,928	143,967	75,978	205,497
Cash at beginning of the period	54,463	134,693	10,413	73,163
Cash at the end of the period	\$ 86,391	\$ 278,660	\$ 86,391	\$ 278,660
Supplemental informat on				
Interest paid	\$ 784	\$ 95,940	\$ 66,900	\$ 177,021

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2006
(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 INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2006
(UNAUDITED – Prepared by Management)

1. CONTINUING OPERATIONS

The Company is governed by the *Business Corporations Act* (British Columbia) and is primarily involved in the manufacture and distribution of a wide range of products created through environmentally advanced technology. These product lines include coating removal and wood restoration products.

The interim consolidated financial statements of the Company have been prepared on the basis of accounting principles applicable to a going concern. While the Company renegotiated its unsecured debt obligations and obtained additional financing during the year ended December 31, 2005, it still has operating losses, negative working capital and shareholder's deficiency and its ability to continue as a going concern remains dependant on the continued cooperation of its lenders. Management has implemented initiatives aimed at financial stability, sales and marketing and the control of fixed costs.

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

2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the footnotes and disclosures required by Canadian generally accepted accounting principles for annual financial statements.

These unaudited interim consolidated financial statements reflect the same significant accounting policies described in the Company's annual consolidated financial statements for the year ended December 31, 2005, and should be read in conjunction with these statements.

It is management's opinion that the unaudited interim consolidated financial statements reflect all adjustments (consisting of normal and recurring accruals) and reclassifications necessary to present fairly the Company's financial position, results of operations and cash flows.

The results of operations for the three and nine month periods ended September 30, 2006 are not necessarily indicative of the results for the full year.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2006
(UNAUDITED – Prepared by Management)

3. RELATED PARTY TRANSACTIONS

During the year ended December 31, 2005 the Company obtained financing, described in notes 6 and 8. from companies controlled by directors and officers of the Company. The lenders waived the interest payable on these loans for the six months ended September 30, 2006. Total interest paid on these loans for the nine months ended September 30, 2006 was \$65,596.

On September 1, 2005, the Company entered into a management services agreement with I.C.T.C. Holdings Corporation (“I.C.T.C.”), a company that is controlled in common with the related parties described in the preceding paragraph. Pursuant to the agreement, the Company reimburses I.C.T.C., at cost, for personnel expenditures incurred on the Company’s behalf. During the three and nine month periods ended September 30, 2006, the Company incurred costs of \$51,650 (2005: \$19,292) and \$95,692 (2005: \$19,292) respectively, related to the management services agreement. These payments and advances are in the normal course of business.

On October 31, 2005 the Company entered into a sublease agreement whereby half of the Company’s premises have been subleased to I.C.T.C until July 30, 2007. As a condition of this agreement, during the year ended December 31, 2005, the Company incurred \$419,913 for leasehold inducements related to I.C.T.C.’s relocation costs and costs associated with the cancellation of I.C.T.C.’s existing lease. The Company amortized \$24,701 and \$74,993 of deferred leasehold inducements during the respective three and nine month periods ended September, 30, 2006. Should the Company and I.C.T.C. decide not to exercise the option to extend the lease to January 31, 2010 the unamortized balance of the leasehold inducements will be repaid by I.C.T.C.

Effective July 1, 2006 the Company’s chairman accepted a revised compensation agreement resulting in nominal annual compensation in return for a bonus based on the net income of the company. This bonus is cumulative and payable at the lesser of 75% of net income or the cumulative entitled bonus. To the extent that the bonus is not paid on an annual basis, an additional 15% will be added to it and compounded annually. No amount related to this bonus has been accrued in these financial statements.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2006
(UNAUDITED – Prepared by Management)

4. INVENTORY

Inventory is comprised of:

	September 30, 2006		December 31, 2005	
Raw materials	\$	375,533	\$	411,682
Finished goods		333,876		318,796
	\$	709,409	\$	730,478

Finished goods inventory contains an allocation of fixed operating costs based on the standard costing method of accounting for inventory and determination of cost of sales. Unallocated fixed operating costs are charged to cost of sales as they occur. As a result, the quarterly gross profit and related gross profit percentage, as it relates to sales, will vary based on the level of production in that quarter. Therefore, due to the cyclical nature of the Company's business, this results in lower gross margins during periods where the Company experiences a decline in production.

5. PROPERTY, PLANT AND EQUIPMENT

			September 30, 2006		December 31, 2005	
	Cost	Accumulated Amortization	Net Book Value	Net Book Value		
Machinery and equipment	\$ 1,037,841	\$ 865,867	\$ 171,974	\$	210,691	
Furniture and fixtures	213,452	144,181	69,271	\$	82,031	
Leasehold improvements	277,544	169,470	108,074	\$	130,990	
	\$ 1,528,837	\$ 1,179,518	\$ 349,319	\$	423,712	

6. LOANS PAYABLE

Loans payable consist of two loan facilities, each to a maximum of \$1,750,000 from each of 6408753 Canada Corporation and 6408788 Canada Corp. (see Note 3) secured as outlined in Note 8. The term of each loan is 364 days and is renewable for successive 364 day terms by giving notice to the lenders and obtaining their consent, at least 90 days prior to the expiry. Interest is payable on the last day of each month at a rate of prime plus 2%. The lenders waived the interest payable on these loans for the six months ended September 30, 2006.

These loans are subject to the following margins: (i) 50% of the aggregate amount of eligible inventory minus the aggregate amount of accounts payable plus (ii) 75% of the aggregate amount of eligible accounts receivable.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2006
(UNAUDITED – Prepared by Management)

6. LOANS PAYABLE (Continued)

At the time of advancement and at September 30, 2006, the lenders and the Company acknowledge that the Company did not meet the margin requirements required under these loans and accordingly, these loans are repayable upon demand. Strict compliance was waived by the lender in connection with the period ended September 30, 2006.

7. 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 five years. The Company received a \$33,250 initial payment on this royalty.

During the nine months ended September 30, 2006, it was determined that the purchaser of this formula will not be selling the product. The initial royalty payment of \$33,250 is not refundable and is therefore included in sales for the nine months ended September 30, 2006.

8. LONG TERM DEBT

Long term debt consists of two term loans, each in the amount of \$750,000 payable to 6408753 Canada Corporation and 6408788 Canada Corp. (see Note 3). The term of each loan is five years and interest is payable monthly at a rate of prime plus 2%. The lenders waived the interest payable on these loans for the six months ended September 30, 2006. Annual principal repayments of \$150,000 to each lender are required on the anniversary dates of the loans until maturity on July 14, 2010. As a condition of these loans, share purchase warrants were issued to the lenders on August 30, 2005 (Note 9). Long term debt and the loans payable (Note 6) are secured by a general security agreement and an assignment of general insurance.

9. CAPITAL STOCK

a) Authorized

Unlimited common shares

b) Issued

	<u>Number of Shares</u>	
Beginning of period	47,768,042	\$ 23,368,041
Issued during the period	41,076,850	\$ 410,768
End of period	<u>88,844,892</u>	<u>\$ 23,778,809</u>

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2006
(UNAUDITED – Prepared by Management)

9. **CAPITAL STOCK (Continued)**

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 recent market price of the Company's stock. Options are normally exercisable within 5 years from the date of grant or an alternate period as determined by the Board or within 30 days of termination of employment. Options normally vest over a period of 5 years.

The following table summarizes the status and changes in stock options outstanding at September 30, 2006:

	<u>September 30, 2006</u>		<u>December 31, 2005</u>	
	Number	Weighted average price	Number	Weighted average price
Outstanding, beginning of period	3,391,000	\$0.08	1,788,000	\$0.44
Granted	200,000	0.11	2,900,000	0.04
Cancelled / expired	(393,000)	(0.33)	(1,297,000)	(0.49)
Outstanding, end of period	<u>3,198,000</u>	<u>\$0.07</u>	<u>3,391,000</u>	<u>\$0.08</u>
Exercisable, end of period	<u>1,958,000</u>	<u>\$0.08</u>	<u>1,791,000</u>	<u>\$0.12</u>
Options reserved for issuance, under stock option plan	<u>1,422,000</u>		<u>1,229,000</u>	

The following table summarizes information about stock options outstanding at September 30, 2006:

Range of exercise prices	Number of options	Weighted average remaining contractual life	Weighted average exercise price
\$0.04 - \$0.12	2,700,000	4.0 years	\$0.05
\$0.15 - \$0.40	498,000	1.1 years	\$0.23
	<u>3,198,000</u>	<u>3.5 years</u>	<u>\$0.07</u>

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2006
(UNAUDITED – Prepared by Management)

9. CAPITAL STOCK (Continued)

d) Stock based compensation

During the three and nine month periods ended September 30, 2006, the Company recorded compensation expense, with a corresponding credit to contributed surplus of \$3,625 and \$10,010 respectively, relating to the stock options that vested during the period. Total fair value of the stock options granted during the nine month period ended September 30, 2006 was \$17,705. There were no stock options granted during the three months ended September 30, 2006.

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

	<u>September 30, 2006</u>	<u>December 31, 2005</u>
Dividend yield	0%	0%
Expected volatility	131 to 115%	108 - 111%
Expected life	5 yrs	3 - 5 yrs
Risk free rate of return	4.75 to 5.13%	4.25%
Weighted average fair value of options granted	\$ 0.07	\$ 0.03

e) Warrants

	<u>September 30, 2006</u>	<u>December 31, 2005</u>
Outstanding, beginning of period	82,153,700	2,987,120
Issued	-	82,153,700
Exercised	(41,076,850)	-
Expired	-	(2,987,120)
Outstanding, end of period	<u>41,076,850</u>	<u>82,153,700</u>

As a condition of obtaining the loans described in Note 6 and 8, the Company granted the lenders warrants entitling the lenders to purchase, from treasury, up to 30% each of the common 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. During the year ended December 31, 2005 the company recorded \$630,000 of deferred financing charges with a corresponding increase to contributed surplus related to the fair value of these warrant. This deferred financing cost is being amortized over the 60 month life of the warrants. During the three months ended September 30, 2006, 41,076,850 of the warrants were exercised.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2006
(UNAUDITED – Prepared by Management)

9. CAPITAL STOCK (Continued)

e) Warrants (Continued)

The Black Scholes option-pricing model assumptions used to compute the fair value of warrants issued are as follows:

	September 30, 2006	December 31, 2005
Dividend yield	-	0%
Expected volatility	-	102%
Expected life	-	5 yrs
Risk free rate of return	-	3.8%

10. 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 September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Sales by region				
Canadian	\$ 349,175	\$ 625,615	\$ 1,079,385	\$ 917,676
U.S. and International	393,750	623,458	1,453,950	1,959,555
	<u>\$ 742,925</u>	<u>\$ 1,249,073</u>	<u>\$ 2,533,335</u>	<u>\$ 2,877,231</u>
Sales by sector				
Consumer	\$ 653,774	\$ 833,638	\$ 1,982,475	\$ 2,105,550
Industrial	89,151	415,435	550,860	771,681
	<u>\$ 742,925</u>	<u>\$ 1,249,073</u>	<u>\$ 2,533,335</u>	<u>\$ 2,877,231</u>

11. COMPARATIVE FIGURES

Certain of the prior period comparative figures have been reclassified to conform to the current period presentation.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
INTERIM CONSOLIDATED SCHEDULES
(UNAUDITED- Prepared by Management)

GENERAL AND ADMINISTRATIVE	Three Month Period ended Sept 30		Nine Month Period ended Sept 30	
	2006	2005 (Note 11)	2006	2005 (Note 11)
Salaries and wages	\$ 72,284	\$ 174,594	\$ 402,059	\$ 341,812
insurance	34,130	23,236	104,149	96,393
Office	27,573	41,551	84,033	80,939
Professional fees	17,768	146,080	83,517	216,661
Occupancy	17,235	14,014	57,821	41,764
Travel	12,379	57,290	44,077	103,441
Regulatory and filing fees	9,984	10,388	47,898	17,318
Director fees	9,983	-	43,151	-
Telecommunications	9,233	5,757	19,465	14,567
Consulting	-	35,004	2,138	40,427
Amortization	17,814	21,300	54,749	67,199
	\$ 228,383	\$ 529,214	\$ 943,057	\$ 1,020,521
SELLING AND MARKETING				
	2006	2005 (Note 11)	2006	2005 (Note 11)
Salaries and wages	\$ 96,793	\$ 69,715	\$ 258,493	\$ 275,810
Management services and consulting	52,297	11,692	151,109	19,338
Marketing	42,446	29,306	122,479	89,517
Travel and entertainment	22,018	25,353	97,814	71,334
Commissions	10,980	1,518	31,943	22,265
Communications and other	4,069	5,778	8,808	19,261
Bad debts (recovery)	-	-	639	(19,265)
	\$ 228,603	\$ 143,362	\$ 671,285	\$ 478,260