CONSOLIDATED FINANCIAL STATEMENTS
AND MANAGEMENT'S DISCUSSION AND ANALYSIS

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

December 31, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2006

Napier Environmental Technologies Inc. (the "**Company**" or "**Napier**") is a manufacturer and distributor of highly effective, safe and environmentally friendly chemicals for stripping paints and coatings, surface preparation, as well as a complete line of wood restoration and protective products. These products are cost effective, safe and easy to use, and are formulated and designed to be environmentally benign, which is important given today's environmental awareness. We distribute products both domestically and internationally through a network of distribution channels in the "Industrial" as well as "Consumer" markets.

Primary industrial uses for our products are paint stripping, concrete etching, rust or adhesive removal, asbestos removal and containment, and lead abatement. The products are 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. Napier products have not yet been introduced and adopted for all possible applications.

Consumer uses for the products are a large part of our business. The products and uses are similar to industrial uses with the main difference being a smaller scale project. We have been successful in this market segment through our private label business with some of the world's largest paint and coatings producers who have recognized our unique formulas and have leveraged their respective distribution abilities to position many of our products onto major retailers' shelves. Additionally, Napier has a successful retail network, distributing wood renovation products including; cleaners, surface preparation products and a variety of coatings products. More recently, we have undertaken initiatives to form licensing agreements, which will allow our products to service customers we would otherwise be unable to service because of volume and distribution requirements.

Competitive alternatives to our product offerings include products that are not environmentally benign and other surface preparation methods including sand blasting. In the wood coatings sector of the business, there are a number of competitive products. No one competitor offers the same broad range of products or has the same level of global product acceptance. Competitors tend to be found on a regional or national level and in some instances are tied to one market sector. Our competitive advantage is that our products are environmentally benign, cost effective, safe and easy to use. A number of products are patented and supported by our Research and Development expertise.

Shareholder value for this industry is generated through global distribution, product diversity and acceptance. Our vision is to be the global leader in environmentally friendly "green" surface preparation, wood restoration, lawn and garden and home cleaning products. Our people, distribution channels, product profitability, product development, brand awareness, infrastructure and working capital will drive performance. We continue to optimize our capabilities and resources in each of these areas.

This Management's Discussion and Analysis ("MD&A") for the year ended December 31, 2006 has been prepared to give shareholders and other stakeholders an assessment of what the Company achieved last year as well as an indication of initiatives underway and planned for this year to improve shareholder value. This MD&A should be read in conjunction with the audited consolidated financial statements of the Company and notes thereto for the years ending December 31, 2006 and December 31, 2005.

Disclosure Controls and Internal Controls over Financial Reporting

Pursuant to Multilateral Instrument 52-109 *Certification of Disclosures in Issuers' Annual and Interim Filings*, management has evaluated the effectiveness of the Company's disclosure controls and procedures as at December 31, 2006 and found them to meet required standards. Management has determined that there have been no changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the internal control over financial reporting.

Overview

2006 continued to be a challenge for Napier, working with existing customers to ensure that the relationship with the Company is satisfactory and ensuring that customer service is at an acceptable level. It is our view that customers are beginning to regain the confidence necessary to continue to do business with the Company.

Distribution continues to be very important to our future success. We are relying on the expertise of the management team and their knowledge and experience within the industry, and with our customers, to help us achieve efficiencies, increased sales and ultimately financial strength.

A summary of achievements in this respect so far includes significant cost reductions in terms of overhead costs to the company, negotiation of an interest waiver on existing debt for the last nine months of 2006, negotiating a letter of intent towards a licensing agreement with a major paint company to distribute product through two of the world's largest retailers and a focus of the acquisition of complementary business lines that can help us achieve our overall goal of providing environmentally advantaged products to in the coatings, lawn and garden and the home cleaning product areas.

Results of Operations

For the year ended December 31, 2006, we recorded a net loss of $1,899,165 ($0.03 per common share) as compared to a net loss of $494,037 ($0.01 per common share) for the year ended December 31, 2005. The difference is primarily attributable to the non-recurring gain on settlement of debt. The results of operations highlight the need for a continued focus on penetrating new markets and developing distribution channels that will allow us to increase sales and in turn create shareholder value.

We recorded a net loss of $571,404 during the last three months of 2006 as compared to a loss of $754,355 during the last three months of 2005. With the fourth quarter being the industry's slowest period of the year, our loss is traditionally larger in this period.

Sales

Sales for the year ended December 31, 2006 totaled $2,855,074 as compared to $4,189,417 for the year ended December 31, 2005. The decrease in overall sales continues to be a result of the problems experienced with customers who continue to reflect on the past when the Company was under bankruptcy protection. Our ability to regain our customer's confidence and increase sales to the same customers is dependant on their experience with our company.

We recorded sales of $321,739 during the last three months of 2006 as compared to $415,353 for the last three months of 2005. The main reason for this decrease of $93,614 is the continued impact of the reduced distribution base throughout the year resulting in fewer orders during the last quarter.

Cost of Sales

Cost of sales for the year ended December 31, 2006 was $2,378,773 (83.32% of sales) compared to $2,976,114 (71.04% of sales) for the year ended December 31, 2005. The decreased gross margin earned in the year ended December 31, 2006, as compared to the year ended December 31, 2005, is primarily the result of the lower level of production required to fulfill the sales in the year. The fixed costs included in cost of sales were allocated to a smaller number of units produced resulting in a lower overall gross margin percentage.

The impact of this lower level of production was particularly obvious in the fourth quarter, where the cost of sales, which included an allocation of fixed overhead, exceeded the sales for the same period. We recorded cost of sales totaling $417,744 in the fourth quarter resulting in a gross margin of $(96,005) as compared to cost of sales and a gross margin of $523,755 and $(108,402) respectively, for the three months ended December 31, 2005. To alleviate part of this abnormality, the Company has successfully reduced the fixed overhead costs, which are primarily related to the premises. The Company continues to work towards building relationships with new customers that will allow it to increase sales and in turn production during this historically slow time of year. In the future, we will allocate less overhead to inventory and focus on the direct cost rather than the fluctuating unit of production cost due to our overhead. We believe this will provide the user of the financial statements with more accurate disclosure with respect to the performance of the business.

Expenses

General and administrative expenses were $1,138,572 for the year ended December 31, 2006 compared to $1,400,276 for the year ended December 31, 2005, a decrease of $261,704. We continue to work at operating in the most efficient way possible, and constantly work towards reducing costs. There have been significant savings in general and administrative expenses. In particular, savings have been realized in the areas of salaries and benefits and professional fees as there were significant costs associated with the changes that took place throughout the year ended December 31, 2005 which were not repeated this year.

General and administrative expenses for the three months ended December 31, 2006 totaled $195,515 as compared to $379,755 for the three months ended December 31, 2005. The decrease of $184,240 is primarily due to the current management team's efforts to control expenditures.

Selling expenses for the year ended December 31, 2006 were $894,674 as compared to $613,539 for the year ended December 31, 2005. The increase of $281,135 was the result of our efforts put towards increasing the profile of our products and getting to our customers to discuss our products and the renewed financial strength of the Company

Selling expenses for the three months ended December 31, 2006 were $223,389 as compared to $135,279 for the three months ended December 31, 2005. The increase of $88,110 is the result of increased salaries and commission as well as the respective travel and promotion costs that would have been incurred by a larger sales force.

Interest and finance costs decreased to $66,184 during the year ended December 31, 2006 as compared to $309,368 during the year ended December 31, 2005. The decrease of $243,184 is the result of interest being waived by our lenders beginning in April of 2006 through to the end of the year. There can be no assurance that this waiver will continue.

Interest and finance costs for the three months ended December 31, 2006 were $nil as compared to $30,907 for the three months ended December 31, 2005. As noted, the change in interest cost is related to the interest being waived by our lenders during the last three quarters of the year.

Research and development costs for the year ended December 31, 2006 were $151,437 compared to $195,481 for the year ended December 31, 2005. Our emphasis on research and development has not changed. Research and development expenditures have remained constant, in order to maintain product quality and integrity and ensure that our product development remains current.

Research and development costs for the three months ended December 31, 2006 were $37,274 as compared to $46,684 for the three months ended December 31, 2005.

Foreign exchange loss totaled $6,172 for the year ended December 31, 2006 as compared to $28,429 for the year ended December 31, 2005. The Company's foreign exchange loss is primarily due to the fluctuations of the US dollar.

Selected Financial Information

The following financial information has been prepared in accordance with the Canadian generally accepted accounting principles. It should be read in conjunction with the audited consolidated financial statements of the Company, the notes thereto and the Auditors' Report thereon for the years ended December 31, 2006, 2005 and 2004 respectively.

The following table sets forth selected consolidated financial information for each of the three most recently completed years ended December 31 (audited; in thousands of dollars, except the loss per share figures):

	December 31		
	2006	**2005**	**2004**
Sales…………………………………...................	2,855	4,189	6,675
Gross profit……………………………………............	476	1,213	2,373
Loss before other items……………………………………………….	(1,901)	(1,347)	(2,434)
Net loss……………………………………………..	(1,899)	(494)	(2,297)
Loss per share, basic and fully-diluted……………………….	(0.03)	(0.01)	(0.05)
Total assets…………………………………………	1,916	2,507	1,945
Long-term financial liabilities……………………..	900	1,200	-

Summary of Quarterly Results

The following table sets forth selected consolidated financial information for each of our last eight quarters. The table has been derived from our unaudited interim consolidated financial statements for those periods and is stated in thousands of dollars except for the earnings (loss) per share figures. These results are not necessarily indicative of results for future periods and should not be used or relied upon to predict our future performance.

(in thousands $ except per share data)

	Dec 31 2006	Sept 30 2006	June 30 2006	March 31 2006	Dec 31 2005	Sept 30 2005	June 30 2005	Mar 31 2005
Sales	321	743	986	805	415	897	1,249	1,628
Operating income (loss) before other items	(583)	(385)	(480)	(453)	(743)	(724)	(295)	125
Net income (loss)	(571)	(385)	(486)	(456)	(754)	435	(293)	118
Earnings (loss) per share,								
Basic	(0.006)	(0.007)	(0.010)	(0.010)	(0.016)	0.009	(0.006)	0.002
Fully diluted	(0.006)	(0.007)	(0.010)	(0.010)	(0.016)	0.006	(0.006)	0.002

Liquidity and Capital Resources

At December 31, 2006, our cash on hand was $19,571 as compared to $10,413 at December 31, 2005.

At December 31, 2006, we had accounts receivable of $185,374 as compared to $308,541 at December 31, 2005. This decrease of $123,167 is consistent with the lower volume of sales throughout the fourth quarter of 2006.

Transactions with Related Parties

We have entered into a management services agreement (the "Management Services Agreement") and a sublease (the "Sublease") with I.C.T.C. Holdings Corporation ("I.C.T.C."), a company that is controlled by Anthony Traub, Napier's Chairman, CFO and Secretary, and Steve Balmer, Napier's President and Chief Operating Officer.

Pursuant to the Management Services Agreement, effective September 1, 2005, we reimburse I.C.T.C. for certain costs incurred on Napier's behalf. We pay a variable monthly amount to I.C.T.C. under this agreement based on the actual costs incurred by I.C.T.C. At December 31, 2006, we paid I.C.T.C. a total of $187,307 (2005: $60,516) for services under this agreement.

The Sublease with I.C.T.C. is for half of the premises at 720 Eaton Way, Delta, British Columbia. The Sublease commenced on November 1, 2005 and is based on half of the financial exposure of Napier under its lease commitment.

Anthony Traub controls 6408753 Canada Corporation and Steve Balmer controls 6408788 Canada Corp., the companies that have collectively completed two separate financing transactions consisting of term loans totaling $1,500,000, of which $1,200,000 is outstanding at December 31, 2006, and revolving loans up to the aggregate amount of $3,500,000, of which $3,300,000 is outstanding at December 31, 2006. The initial advances of these financing transactions were made on July 14, 2005 in the aggregate amount of $3,000,000 and were used to pay fees and costs related to the loan transactions and satisfy all amounts owing by Napier to its secured, preferred, unsecured and post filing creditors as of July 14, 2005 as approved by the Supreme Court of British Columbia in Bankruptcy. Since the initial advance, additional funds, in the amount of $1,500,000 (net of repayments), were advanced for use as working capital. Total interest paid to these companies in respect of these loans was $66,184 (2005: $128,921). Interest on these loans was waived by the lenders for the last three quarters ended December 31, 2006.

Subsequent Events

On February 5, 2007 Napier entered into a Letter of Intent with a major paint manufacturer to license the manufacturing and distribution of specific products in return for guaranteed minimum royalty payments of U.S. $500,000 per year for a 12 year term. Napier is in the process of entering into a definitive licensing agreement based on the letter of intent.

On February 15, 2007 Napier entered into a Letter of Intent to acquire two companies for $13.4 million through issuance of approximately 128 million common shares and 1 million common share purchase warrants entitling the holders to acquire common shares at $.10 for a period of five years from completion of the acquisition. The completion of these transactions is subject to certain terms and conditions that have not currently been satisfied.

Outstanding Share Data

There are currently 129,921,742 common shares (the "**Common Shares**") of Napier issued and outstanding. In addition, there are currently options outstanding to purchase 3,070,000 Common Shares at prices between $0.04 and $0.28 per share, expiring between July 28, 2007 and November 15, 2011.

Critical Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires that we 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 to be reasonable under the existing circumstances. New events or additional information may result in the revision of these estimates over time. Significant accounting policies are described in Note 2 of the annual audited financial statements. The following discussion outlines what we believe to be the most critical accounting policies involving the use of significant estimates and assumptions.

Accounts Receivable, Allowance for Doubtful Accounts and Product Returns

The allowance for doubtful accounts is based on historical trends. We regularly review the age of the accounts receivable in detail by customer and follow up on delinquent accounts directly with the customer. Based on discussions with the customer, independent credit reports and past collection history, we 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 Napier to a greater exposure to 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 not be collectable.

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. 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 with comparable assets, technological obsolescence and asset utilization. If our estimates of useful lives of assets are incorrect, we could experience increased or decreased charges to depreciation and amortization in the future.

Income Taxes

We follow 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 basis. 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.

The determination of the income tax assets and liabilities is an inherently complex process requiring the interpretation of continually changing regulations and making certain judgments. While income tax filings are subject to audits and reassessments, we believe the tax assets have been adequately provided. However, changes in the interpretations or judgments may result in increases or decreases to Napier's future income tax asset.

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.

Risk Factors

Risks and uncertainties that face our business are common to other manufacturers operating in an international economy in the industrial and consumer sectors. We 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 as well as increasing costs, and economic conditions affecting existing and potential customers and suppliers, to name a few of the normal but significant factors affecting our day to day operations. To minimize some of these risks going forward, we continue to nurture relationships with key customers and suppliers. Open, honest and straightforward communication has retained their loyalty and continued commitment to Napier. Our business is seasonal with the third and fourth quarters delivering a lower level of sales than the first and second quarters. Efforts to offset this seasonality continue by targeting less seasonal businesses, with a variety of products that Napier have available. On July 14, 2005, subsequent to the end of the second quarter of 2005, we successfully renegotiated Napier's unsecured debt obligations. While the reduction of its unsecured debt obligations and additional financing should assist us in the future, our continued existence is dependent upon Napier's ability to restore and maintain profitable operations and to receive continued support from our lenders. At the time of advancement and at December 31, 2006, the lenders acknowledge that the margin requirements required under these loans were not met.

Our risk factors are discussed in detail in our Annual Information Form dated March 28, 2007 and remain substantially unchanged. This document is available at www.sedar.com.

Cautionary Note Regarding Forward-Looking Statements

This MD&A contains “forward-looking statements” within the meaning of the United States Private Securities Litigation Reform Act of 1995. In certain cases, forward-looking statements can be identified by the use of words such as “plans”, “expects” or “does not expect”, “is expected”, “budget”, “scheduled”, “estimates”, “forecasts”, “intends”, “anticipates” or “does not anticipate”, or “believes”, or variations of such words and phrases or statements that certain actions, events or results “may”, “could”, “would”, “might” or “will be taken”, “occur” or “be achieved”. Forward-looking statements involve known and unknown risks and uncertainties and other factors, which may cause the actual results, performance and achievements expressed or implied by the forward-looking statements. Such factors include, among others, risks related to the going concern status of Napier, historical losses and cash flows, the future need for capital and the uncertainty of additional financing, the possible de-listing from the Toronto Stock Exchange, dilution to shareholders, the volatility of the market price of the common shares, dividend policy, competition, dependence on key personnel, dependence of key customers, weather, seasonality and economic cycles, raw materials, the retail industry, exchange rate fluctuations and conflicts of interest. For further details regarding such risk factors, see the section entitled “Description of the Business – Risk Factors” in our Annual Information Form dated March 28, 2007 and filed with the British Columbia and Ontario securities commissions and the Toronto Stock Exchange, which can be found on SEDAR at www.sedar.com. Although Napier has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be factors that cause actions, events or results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements.

Additional Information

Additional information relating to the Company can be found on SEDAR at www.sedar.com.

This MD&A has been prepared by management and reviewed by the Company’s board of directors.

“Steve Balmer”

Steve Balmer
President and Chief Operating Officer
March 30, 2007

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
CONSOLIDATED BALANCE SHEETS
December 31

		2006		2005
Assets				
Current				
Cash	**$**	**19,571**	$	10,413
Accounts receivable		**185,374**		308,541
Inventory (Note 4)		**607,250**		730,478
Prepaid expenses		**28,409**		42,004
		840,604		1,091,436
Deferred leasehold inducements (Note 3)		**286,869**		403,445
Deferred financing costs (Note 9)		**462,000**		588,000
Property, plant and equipment (Note 5)		**326,596**		423,712
	$	**1,916,069**	$	2,506,593
Liabilities				
Current				
Loans payable (Note 6)	**$**	**3,300,000**	$	1,800,000
Accounts payable		**401,769**		702,225
Current portion of long term debt (Note 8)		**300,000**		300,000
Deferred revenue (Note 7)		**-**		33,250
		4,001,769		2,835,475
Long term debt (Note 8)		**900,000**		1,200,000
		4,901,769		4,035,475
Shareholders' deficiency				
Capital stock (Note 9)		**24,093,809**		23,368,041
Contributed surplus (Note 9)		**691,774**		975,195
Deficit		**(27,771,283)**		(25,872,118)
		(2,985,700)		(1,528,882)
	$	**1,916,069**	$	2,506,593

Continuing Operations (Note 1)
Approved by the Directors:

"David E. Lancaster"
David E. Lancaster

"Stephen C. Balmer"
Stephen C. Balmer

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

Years ended December 31

		2006		2005
Sales	**$**	**2,855,074**	$	4,189,417
Cost of sales		**2,378,773**		2,976,114
Gross profit		**476,301**		1,213,303
		16.68%		28.96%
Expenses				
General and administrative (Schedule)		**1,138,572**		1,400,276
Selling and marketing (Schedule)		**894,674**		613,539
Research and development		**151,437**		195,481
Interest and financing costs		**66,184**		309,368
Amortization of deferred financing costs		**126,000**		42,000
		2,376,867		2,560,664
Loss before other items		**(1,900,566)**		(1,347,361)
Other items				
Foreign exchange loss		**(6,172)**		(28,429)
Gain on disposal of capital assets		**7,573**		-
Gain on settlement of debt, net of restructuring costs (Note 12)		**-**		881,753
		1,401		853,324
Net loss for the year		**(1,899,165)**		(494,037)
Deficit at beginning of the year		**(25,872,118)**		(25,378,081)
Deficit at end of the year	**$**	**(27,771,283)**	$	(25,872,118)
Weighted average shares outstanding		**59,472,131**		47,768,042
Loss per share	**$**	**(0.03)**	$	(0.01)

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31

		2006		2005
Operating activities				
Net loss for the year	$	**(1,899,165)**	$	(494,037)
Items not involving cash				
Depreciation and amortization		**122,702**		146,975
Amortization of deferred leasehold inducements		**116,576**		15,095
Amortization of deferred financing costs		**126,000**		42,000
Deferred revenue		**(33,250)**		-
Gain on settlement of debt (Note 12)		**-**		(1,885,669)
Gain on disposal of capital assets		**(7,573)**		-
Stock based compensation		**31,579**		48,916
		(1,543,131)		(2,126,720)
Change in non-cash operating working capital				
Accounts receivable		**123,167**		54,169
Inventory		**123,228**		213,472
Prepaid expenses		**13,595**		(27,863)
Accounts payable		**(300,456)**		(760,809)
		(40,466)		(521,031)
		(1,583,597)		(2,647,751)
Financing activities				
Proceeds on issuance of share capital		**410,768**		-
Proceeds from loans payable and long term debt		**1,600,000**		3,300,000
Repayment of loans payable and long term debt		**(400,000)**		(225,778)
Repayment of capital lease obligations		**-**		(50,619)
		1,610,768		3,023,603
Investing activities				
Purchase of property, plant and equipment		**(29,884)**		(20,062)
Proceeds on disposal of property, plant and equipment		**11,871**		-
Deferred leasehold inducements		**-**		(418,540)
		(18,013)		(438,602)
Change in cash during the year		**9,158**		(62,750)
Cash at beginning of the year		**10,413**		73,163
Cash at the end of the year	$	**19,571**	$	10,413
Supplemental information				
Interest paid	$	**66,184**	$	231,843

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 include coating removal and wood restoration products.

The 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 does not meet margin requirements required under these loans and has operating losses, negative working capital and shareholders' deficiency. The company's ability to continue as a going concern remains dependant on the continued cooperation and support of its lenders, a return to positive cash flow from operations, and the successful implementation of managements' initiatives for financial stability, sales and marketing, and control of fixed expenditures. Subsequent to year end the Company entered into letters of intent that if successfully implemented will assist the company with improving working capital and cash flow (see Note 15).

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

2. Basis of presentation and significant accounting policies

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 upon consolidation.

The company has concluded that no Variable Interest Entities ("VIEs") exist that are required to be consolidated in these financial statements. VIEs, which include special purpose entities, trusts, partnerships, and other legal structures, as defined in Accounting Guideline 15, "Consolidation of Variable Interest Entities", are entities where equity investors do not have the characteristics of a controlling financial interest or entities that do not have sufficient equity at risk to finance activities without additional subordinated financial support. VIEs are subject to consolidation by the primary beneficiary who will absorb the majority of the entities' expected losses and/or expected residual returns.

Use of Estimates

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. These estimates specifically relate to allowance for doubtful customer accounts, inventory valuation, capital asset amortization policies, accrued liabilities and stock based compensation. Actual results could differ from those estimates.

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.

2. Basis of presentation and significant accounting policies (continued)

Property, plant and equipment

Property, plant and equipment is recorded at cost. Amortization is provided under the straight-line method at annual rates varying from 2 to 10 years.

Impairment of long-lived assets

The Company reviews the carrying amount of long-lived assets for impairment whenever events or changes or circumstances indicate that the carrying amount may not be recoverable or has been impaired. The determination of any impairment would be based on a comparison of estimated future cash anticipated to be generated during the remaining life of the asset to the net carrying value of the asset. If impairment is determined, assets held for use are written down to their fair values.

Asset retirement obligations

Legal obligations related to asset retirement obligations are recognized when a reasonable estimate of fair value can be made. These obligations are recorded at fair value with a corresponding increase in asset value. The liability is accreted over the life of the asset to fair value and the increase in asset value is depreciated over the remaining useful life of the asset. This includes future removal and site restoration costs as required due to environmental law or contracts. Management has determined that the Company has no asset retirement obligations at year end.

Revenue recognition

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

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 bases 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 change occurs including any change in applicable future tax rates.

Deferred financing costs

Costs associated with obtaining financing are deferred and amortized over a period that is equal to the term of the financing.

Deferred leasehold inducements

Leasehold inducements related to the sublease outlined in Note 3 are deferred and amortized to rent expense over 51 months from the commencement date of the sublease. As at December 31, 2006 there are 37 months remaining in the amortization period.

2. Basis of presentation and significant accounting policies (continued)

Stock options

The Company uses 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 the options are granted, using an option-pricing model, and expense it as compensation over the vesting period.

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.

Loss per share

Loss per share is calculated based on the weighted average number of shares outstanding during the period. Potentially dilutive items are described in Note 9. 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.

3. Related party transactions

During the year ended December 31, 2005 the Company obtained financing, described in notes 6 and 8, from 6408753 Canada Corporation and 6408788 Canada Corp., companies controlled by directors and officers of the Company. Total interest paid during the year on these loans was $66,184 (2005: $128,921).

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 by related parties described in the preceding paragraph. Pursuant to the agreement, the Company reimburses I.C.T.C., at their cost, for personnel expenditures incurred on the Company's behalf. During the year the company incurred costs of $187,307 (2005: $60,516) in 2006 related to the management services agreement. These transactions 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, the Company incurred $395,413 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. 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 is due and accordingly there has been no accrual in these financial statements.

4. Inventory

Inventory is comprised of:

		2006		2005
Raw materials	$	**374,250**	$	411,682
Finished goods		**233,000**		318,796
	$	**607,250**	$	730,478

5. Property, plant and equipment

2006

		Cost		Accumulated amortization		Net book value
Machinery and equipment	$	1,035,121	$	874,459	$	160,662
Furniture and fixtures		213,837		148,337		65,500
Leasehold improvements		277,544		177,110		100,434
	$	1,526,502	$	1,199,906	$	326,596

2005

		Cost		Accumulated amortization		Net book value
Machinery and equipment	$	1,019,507	$	808,816	$	210,691
Furniture and fixtures		213,035		131,004		82,031
Leasehold improvements		277,544		146,554		130,990
	$	1,510,086	$	1,086,374	$	423,712

6. Loans payable

Loans payable consist of loan facilities, 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 nine months during the year ended December 31, 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.

At the time of advancement and at December 31, 2006 and 2005, the lenders acknowledged 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 December 31, 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 year ended December 31, 2006, it was determined that the purchaser of this formula will not be marketing and selling the product. The initial royalty payment of $33,250 is not refundable and has been recognized as revenue in the current year.

8. Long term debt

Long term debt consists of term loans, originally in the amount of $750,000, of which $600,000 is outstanding at December 31, 2006, payable to each of 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 nine months ended December 31, 2006. Annual principal repayments of $300,000 in aggregate are required on each of 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

Authorized:

Unlimited common shares

Issued:

	2006		2005	
	Number of shares	**$**	Number of shares	$
Beginning of the year	**47,768,042**	**23,368,041**	47,768,042	23,368,041
Issued on exercise of warrants	**41,076,850**	**410,768**	-	-
Financing costs related to warrants excersised		**315,000**		
End of the year	**88,844,892**	**24,093,809**	47,768,042	23,368,041

During the year ended December 31, 2006 the Company issued 41,076,850 common shares upon conversion of 41,076,850 warrants for proceeds of $410,768. Financing costs of $315,000 related to warrants exercised have been reclassified from contributed surplus.

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 5 years from the date of grant or an alternate period as determined by the Board and within 30 days of termination of employment. Options normally vest over a period of five years.

9. Capital stock (continued)

The following table summarizes the status and changes in stock options outstanding at December 31, 2006 and 2005:

	2006		2005	
	Number	**Weighted average price**	Number	Weighted average price
Outstanding, beginning of year	**3,391,000**	**$0.12**	1,788,000	$0.44
Granted	**300,000**	**0.09**	2,900,000	0.04
Cancelled / expired	**(596,000)**	**(0.28)**	(1,297,000)	(0.49)
Outstanding, end of year	**3,095,000**	**0.07**	3,391,000	0.08
Exercisable, end of year	**1,755,000**	**$0.07**	1,791,000	$0.12
Options reserved for issuance, under stock option plan	**1,525,000**		1,229,000	

The following table summarizes information about stock options outstanding at December 31, 2006:

Range of exercise prices	Number of options	Weighted average remaining contractual life	Weighted average exercise price
$0.04 - $0.12	2,800,000	3.8 years	$0.05
$0.15 - $0.40	295,000	1.5 years	$0.26
	3,095,000	3.6 years	$0.07

9. Capital stock (continued)

Stock-based compensation

During the year the Company recorded compensation expense, with a corresponding credit to contributed surplus of $31,579 (2005 - $48,916) relating to the stock options that vested during the year. Total fair value of the 300,000 (2005 - 2,900,000) stock options granted during the year was $22,365 (2005 - $89,210).

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

	2006	2005
Dividend yield	**0%**	0%
Expected volatility	**115% - 131%**	108% - 111%
Expected life	**5 yrs**	3 - 5 yrs
Risk free rate of return	**4.75% - 5.13%**	4.25%
Weighted average fair value of options granted	**$0.08**	$0.03

Warrants

	2006	2005
Outstanding, beginning of year	**82,153,700**	2,987,120
Issued	**-**	82,153,700
Exercised	**(41,076,850)**	-
Expired	**-**	(2,987,120)
Outstanding, end of year	**41,076,850**	82,153,700

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.

Subsequent to year end the Company issued 41,076,850 common shares upon conversion of 41,076,850 warrants for proceeds of $410,769.

9. Capital stock (continued)

Stock-based compensation (continued)

The Black Scholes option-pricing model assumptions used to compute the fair value of warrants issued during the year ended December 31, 2005 are as follows:

	2005
Dividend yield	**0%**
Expected volatility	**102%**
Expected life	**5 yrs**
Risk free rate of return	**3.8%**

10. Income taxes

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

		2006		2005
Capital assets	**$**	**1,736,000**	$	1,759,000
Investments and other		**(210,000)**		(300,000)
Tax loss carryforwards		**3,960,000**		3,548,000
		5,486,000		5,007,000
Less valuation allowance		**5,486,000**		5,007,000
	$	**-**	$	-

The income tax recovery and change in valuation allowance differs from the amounts computed by applying Canadian statutory rates to net loss for the year before income taxes as follows:

		2006		2005
Income tax recovery at statutory rate of 34.2%	**$**	**(650,000)**	$	(176,000)
Amortization		**125,000**		73,000
Gain on forgiveness of debt		**-**		(672,000)
Other		**46,000**		(90,000)
Valuation allowance		**479,000**		865,000
Income tax recovery	**$**	**-**	$	-

10. Income taxes (continued)

The Company has loss carry-forwards available for income tax purposes as follows:

Expiry date		Amount
December 31, 2007	$	**505,000**
December 31, 2008		**3,000,000**
December 31, 2009		**1,017,000**
December 31, 2010		**1,478,000**
December 31, 2014		**1,752,000**
December 31, 2015		**2,428,000**
December 31, 2026		**1,398,000**
	$	**11,578,000**

The Company has capital loss carry-forwards available for income tax purposes in the amount of $1,194,000 that do not expire.

11. Segmented information

The Company operates in one industry segment, which is the manufacture and distribution of coatings removal products and 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.

		2006		2005
Sales by region				
Canadian	**$**	**1,210,815**	$	1,430,238
U.S. and International		**1,644,259**		2,759,179
	$	**2,855,074**	$	4,189,417
Sales by sector				
Consumer	**$**	**2,183,743**	$	2,579,558
Industrial		**671,331**		1,609,859
	$	**2,855,074**	$	4,189,417

12. Corporate restructuring

A formal proposal was presented and accepted by the unsecured creditors on July 5, 2005, approved by the courts on July 8, 2005 and closed on July 14, 2005 resulting in forgiveness of debt totalling $1,885,669. During the year ended December 31, 2005, the Company incurred certain costs directly related to the restructuring of its unsecured debt obligations. These non-recurring costs consist of legal fees, consulting fees paid to the chief restructuring officer, trustee fees and similar payments totalling $1,003,916, respectively, resulting in a gain on settlement of debt, net of restructuring costs, of $881,753.

13. Commitments

The Company leases its premises under operating leases. The aggregate minimum rental payments remaining under these leases are approximately $199,640 for 2007.

14. Financial instruments

Fair values

The carrying values of cash, accounts receivable, accounts payable and loans approximate their fair value based on their liquidity and short-term nature.

Long-term debt, including the current portion, bears interest at current rates of interest, and as a result, their carrying values approximate their fair market value.

Foreign exchange

The Company undertakes certain transactions in foreign currencies, and as a result is exposed to financial risk resulting from the fluctuations in foreign exchange rates and the degree of volatility of these rates. The Company does not use derivative financial instruments to reduce its exposure to rate changes.

15. Subsequent events

On February 5, 2007 the company entered into a Letter of Intent with a major paint manufacturer to license the manufacturing and distribution of specific products in return for guaranteed minimum royalty payments of U.S. $500,000 per year for a 12 year term. The company is in the process of entering into a definitive licensing agreement based on the Letter of Intent.

On February 15, 2007 the company entered into a Letter of Intent to acquire two companies for $13.4 million through issuance of approximately 128 million common shares and 1 million common share purchase warrants entitling the holders to acquire common shares at $.10 for a period of five years from completion of the acquisition. The completion of these transactions is subject to certain terms and conditions that have not currently been satisfied.

16. Comparative figures

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

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
CONSOLIDATED SCHEDULES
Years ended December 31

		2006		2005
				(Note 16)
General and administrative				
Salaries and wages	**$**	**470,156**	$	492,818
Insurance		**137,360**		130,088
Professional fees		**113,200**		257,085
Office		**103,216**		190,589
Consulting and director fees		**60,648**		77,023
Regulatory, filing and investor relations		**54,008**		56,598
Occupancy		**51,554**		57,648
Travel		**50,507**		31,140
Telecommunications		**25,210**		18,797
Amortization		**72,713**		88,490
	$	**1,138,572**	$	1,400,276

		2006		2005
				(Note 16)
Selling and marketing				
Salaries and wages	**$**	**362,614**	$	355,745
Management services and consulting		**203,825**		52,283
Marketing		**150,741**		102,517
Travel and entertainment		**125,995**		91,365
Commissions		**37,793**		25,391
Communications and other		**13,067**		14,042
Bad debt expense (recovery)		**639**		(27,804)
	$	**894,674**	$	613,539

CORPORATE INFORMATION

Board of Directors

Steve Balmer
Mr. Balmer has been President of Napier Environmental Technologies since July 14, 2005 and COO since September 14, 2005. Mr. Balmer is also President & COO of I.C.T.C. Holdings Corporation, which operates HERO Products, a producer and distributor of equipment for the paint and retail markets of the coatings industry. Mr. Balmer formerly held the position of President and Director of an International company selling equipment and chemicals to the global coatings industry. Prior thereto, Mr. Balmer held the position of Executive Vice President of HERO Industries for 12 years.

Rick Duha*
Mr. Duha was appointed as a director of the Company on August 18, 2005. Mr. Duha is the Managing Director and principal of The Duha Group headquartered in Winnipeg, Canada. Mr. Duha is presently on the board of the Canadian Paint and Coatings Association, and sits on the board of advisors for a major private printing company in Manitoba.

David Lancaster*
Mr. Lancaster was appointed as a director of the Company on July 28, 2005. Mr. Lancaster is a Chartered Accountant and a partner of the accounting firm Lancaster & David, Chartered Accountants. Prior to the formation of Lancaster & David in 1998 he was a partner in the accounting firm Powell Street Lancaster, Chartered Accountants.

Marc Mercier
Mr. Mercier was appointed as a director of the Company on July 14, 2005. Mr. Mercier is a Partner in the Financial Services Group at the law firm of Cassels Brock & Blackwell LLP in Toronto, Ontario and has practiced law with Cassels Brock since June 2003 and prior to that with Fraser Milner Casgrain LLP since May 1991.

Doug Thiemann*
Dr. Thiemann was appointed as a director on September 29, 2005. He is the General Manager of Home Hardware's Paint and Home Products Division. Dr. Thiemann holds a Ph.D. in Organic Chemistry and has over 35 years of experience in the paint and coatings industry.

Anthony Traub
Mr. Traub has been Secretary and a director of the Company since July 14, 2005 and was appointed Chairman and CFO on September 14, 2005. Mr. Traub is the founder, Chairman and Chief Executive Officer of I.C.T.C. Holdings Corporation. Prior thereto, he was a Director and the Founding Partner of a fund manager with $4 billion under management, primarily in the income trust sector, trading on the TSX.

*Denotes audit committee member

Officers

Steve Balmer
President and COO

Anthony Traub
Chairman, Secretary and CFO

Carlos deMelo
Vice President, Customer Service

Thomas Ferrari
Vice President, Sales – Retail

Drew Gagnier
Vice President, Marketing

Brian Morse
Vice President,
Research and Development

Richard Skeats
Vice President, Finance

Michael Sloan
Vice President, Sales – Industrial

Robert Smart
Director, North American Sales

Nicholas Bozikis
Director, Finance

Head Office

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Auditors
Deloitte & Touche LLP
Chartered Accountants

Banker
TD Canada Trust

Legal Counsel
Cassels Brock & Blackwell LLP

Stock Listing
Toronto Stock Exchange
Symbol "NIR"

Annual and Special Meeting
720 Eaton Way
Delta, B.C., Canada
Thursday, May 3, 2007
1:00 p.m. *(Pacific time)*