

**NAPIER ENVIRONMENTAL
TECHNOLOGIES INC.**

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2006

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

	March 31 2006	December 31 2005
ASSETS		
Current		
Cash	\$ 44,607	\$ 10,413
Accounts receivable	466,265	308,541
Inventory (Note 4)	767,508	730,478
Prepaid expenses	35,630	42,004
	1,314,010	1,091,436
Deferred leasehold inducements	377,854	403,445
Deferred financing costs	556,500	588,000
Property, plant and equipment (Note 5)	404,189	423,712
	\$ 2,652,553	\$ 2,506,593
LIABILITIES		
Current		
Loans payable (Note 6)	\$ 2,700,000	\$ 1,800,000
Accounts payable	434,876	702,225
Current portion of long term debt (Note 8)	300,000	300,000
Deferred revenue (Note 7)	-	33,250
	3,434,876	2,835,475
Long term debt (Note 8)	1,200,000	1,200,000
	4,634,876	4,035,475
SHAREHOLDERS' DEFICIENCY		
Capital stock (Note 9)	23,368,041	23,368,041
Contributed surplus (Note 9)	978,092	975,195
Deficit	(26,328,456)	(25,872,118)
	(1,982,323)	(1,528,882)
	\$ 2,652,553	\$ 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 March 31	
	2006	2005
Sales	\$ 804,640	\$ 1,628,158
Cost of sales (Note 4)	605,081	892,456
Gross profit	199,559	735,702
	24.80%	45.19%
Expenses		
General and administrative (Schedule)	345,554	352,391
Selling and marketing (Schedule)	172,037	157,105
Interest and finance costs	66,102	52,161
Research and development	37,720	49,049
Amortization of deferred financing costs	31,500	-
Operating income (loss)	652,913	610,706
	(453,354)	124,996
Other items		
Foreign exchange loss	(4,331)	(6,162)
Gain on sale of capital asset	1,347	-
	(2,984)	(6,162)
Net income (loss) for the period	(456,338)	118,834
Deficit at beginning of the period	(25,872,118)	(25,378,081)
Deficit at end of the year	\$ (26,328,456)	\$ (25,259,247)
Weighted average shares outstanding:	47,768,042	47,768,042
Loss per share	\$ (0.01)	\$ 0.00

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

	Three month period ended March 31	
	2006	2005
Operating activities		
Net income (loss) for the year	\$ (456,338)	\$ 118,834
Items not involving cash		
Depreciation and amortization	32,188	39,615
Amortization of deferred leasehold inducements	25,591	-
Amortization of deferred financings costs	31,500	-
Stock based compensation	2,897	3,205
	(364,162)	161,654
Change in non-cash operating working capital		
Accounts receivable	(157,724)	(600,215)
Inventory	(37,030)	180,365
Prepaid expenses	6,374	(31,100)
Accounts payable	(267,349)	329,623
Deferred revenue	(33,250)	-
	(488,979)	(121,327)
	(853,141)	40,327
Financing activities		
Proceeds from loans	900,000	-
Repayment of loans	-	(51,059)
	900,000	(51,059)
Investing activities		
Purchase of property, plant and equipment	(14,415)	-
Proceeds on disposal of property, plant and equipment	1,750	-
	(12,665)	-
Change in cash during the period	34,194	(10,732)
Cash at beginning of the period	10,413	73,163
Cash at end of the period	\$ 44,607	\$ 62,431
Supplemental information		
Interest paid	\$ 66,116	\$ 24,931

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 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
MARCH 31, 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 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 controlling 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 used.

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 month period ended March 31, 2006 are not necessarily indicative of the results for the full year.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006
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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. Total interest paid on these loans for the three months ended March 31, 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 their cost, for personnel expenditures incurred on the Company’s behalf. During the three months ended March 31, 2006, the Company incurred costs of \$44,161 related to the management services agreement. These transactions are in the normal course of operations.

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. 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.

4. INVENTORY

Inventory is comprised of:

	March 31, 2006	December 31, 2005
Raw materials	\$ 386,273	\$ 411,682
Finished goods	381,235	318,796
	\$ 767,508	\$ 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 production is lower.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006
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5. PROPERTY, PLANT AND EQUIPMENT

			March 31, 2006	December 31, 2005
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Machinery and equipment	\$ 1,028,487	\$ 824,812	\$ 203,675	\$ 210,691
Furniture and fixtures	213,034	135,871	77,163	82,031
Leasehold improvements	277,544	154,193	123,351	130,990
	\$ 1,519,065	\$ 1,114,876	\$ 404,189	\$ 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%.

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 March 31, 2006, the lenders and the Company acknowledge that the Company did not meet the margin requirements required under these loans. Strict compliance was waived by the lender in connection with the period ended March 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 three months ended March 31, 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 three months ended March 31, 2006.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006
(UNAUDITED – Prepared by Management)

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%. 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

a) Authorized
145,635,962 common shares

b) Issued

	<u>Number of Shares</u>	<u>\$</u>
March 31, 2006 and December 31, 2005	47,768,042	23,368,041

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 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.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006
(UNAUDITED – Prepared by Management)

9. CAPITAL STOCK (Continued)

c) Stock options (Continued)

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

	<u>March 31, 2006</u>		December 31, 2005	
	<u>Number</u>	<u>Weighted average price</u>	<u>Number</u>	<u>Weighted average price</u>
Outstanding, beginning of period	3,391,000	\$0.08	1,788,000	\$0.44
Granted	100,000	0.12	2,900,000	0.04
Cancelled / expired	(50,000)	(0.71)	(1,297,000)	(0.49)
Outstanding, end of period	<u>3,441,000</u>	<u>0.07</u>	<u>3,391,000</u>	<u>(0.08)</u>
Exercisable, end of period	<u>1,741,000</u>	<u>\$0.10</u>	<u>1,791,000</u>	<u>\$0.12</u>
Options reserved for issuance, under stock option plan	<u>1,179,000</u>		<u>1,229,000</u>	

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

<u>Range of exercise prices</u>	<u>Number of options</u>	<u>Weighted average remaining contractual life</u>	<u>Weighted average exercise price</u>
\$0.04 - \$0.12	2,900,000	4.4 years	\$0.04
\$0.15 - \$0.40	541,000	1.6 years	\$0.23
	<u>3,441,000</u>	<u>4.0 years</u>	<u>\$0.07</u>

d) Stock based compensation

During the period, the Company recorded compensation expense, with a corresponding credit to contributed surplus of \$2,897 relating to the stock options that vested during the period. Total fair value of the 100,000 stock options granted during the period was \$9,411.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006
(UNAUDITED – Prepared by Management)

9. CAPITAL STOCK (Continued)

e) Stock based compensation (Continued)

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

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

f) Warrants

	<u>March 31, 2006</u>	<u>December 31, 2005</u>
Outstanding, beginning of period	82,153,700	2,987,120
Issued	-	82,153,700
Expired	-	(2,987,120)
Outstanding, end of period	<u>82,153,700</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.

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

	<u>2005</u>
Dividend yield	0%
Expected volatility	102%
Expected life	5 yrs
Risk free rate of return	<u>3.8%</u>

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006
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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 March 31,	
	2006	2005
Sales by region		
Canadian	\$ 187,642	\$ 292,061
U.S. and International	616,998	1,336,097
	<u>\$ 804,640</u>	<u>\$ 1,628,158</u>
Sales by sector		
Consumer	\$ 641,737	\$ 1,271,913
Industrial	198,903	356,245
	<u>\$ 840,640</u>	<u>\$ 1,628,158</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)

Three month period ended March 31

GENERAL AND ADMINISTRATIVE

	2006	2005
		(Note 11)
Salaries and wages	\$ 163,972	\$ 87,353
Insurance	35,888	55,559
Office	32,855	15,972
Professional fees	20,669	76,870
Amortization	20,554	23,607
Travel	18,047	21,359
Director fees	16,584	-
Regulatory, filing and investor relations	15,815	2,157
Occupancy	14,142	14,242
Telecommunications	4,890	4,213
Consulting	2,138	51,059
	\$ 345,554	\$ 352,391

SELLING AND MARKETING

	2006	2005
		(Note 11)
Salaries and wages	\$ 100,268	\$ 94,103
Travel and entertainment	31,892	22,452
Marketing	26,136	29,859
Commissions	6,027	9,662
Consulting	5,725	7,133
Communications and other	1,755	4,642
Bad debt expense (recovery)	234	(10,746)
	\$ 172,037	\$ 157,105