MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE THREE AND SIX MONTH PERIOD ENDED JUNE 30, 2006

August 14, 2006 / *The following Discussion and Analysis should be read in conjunction with the unaudited interim consolidated financial statements and related notes for the three and six months ended June 30, 2006, and the audited consolidated financial statements for the year ended December 31, 2005, the accompanying notes, and management's discussion and analysis for the year then ended. The unaudited interim financial statements for the three and six months ended June 30, 2006 and the audited consolidated financial statements for the year ended December 31, 2005 have been prepared in accordance with Canadian generally accepted accounting principles. Additional information about Napier Environmental Technologies Inc. ("**Napier**" or the **"Company"**), including Napier's Annual Information Form, dated March 30, 2006, is available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at www.sedar.com. All dollar amounts, unless otherwise specified, are expressed in Canadian dollars. This MD&A has been prepared by management and reviewed by Napier's Board of Directors.*

Results of Operations

Overview

For the six months ended June 30, 2006 we recorded a net loss of $942,657 ($0.02 per common share) as compared to a net loss of $174,323 ($0.00 per common share) for the same period in 2005. For the three months ended June 30, 2006, we recorded a net loss of $486,319 ($0.01 per common share) as compared to a net loss of $293,157 ($0.01 per common share) for the same period in 2005.

The increased net loss for both the three and six months ended June 30, 2006, as compared to the same periods in 2005 are the result of the need to incur certain costs in order to enhance the business and allow it to grow. It is important to note that during the comparative periods, Napier was not operating as a going concern, but was in fact operating under bankruptcy protection with cash constraints and a minimum level of staffing in order to satisfy the requirements of the trustee and the chief restructuring officer.

As a new management team, we continue to be aware of the fact that the turn around of this business will require patience and persistence on the part of our team and our shareholders.

Sales

Sales for the three months ended June 30, 2006 totaled $985,770 as compared to $1,249,073 for the same period in 2005. Sales for the six months ended June 30, 2006 totaled $1,790,410 as compared to $2,877,231 for the same period in 2005. The decrease in sales of $263,303 and $1,086,821 for the respective three and six month periods ended June 30, 2006 is attributable to the 2006 buying season patterns and certain changes in sales by customer, year over year. Compounding the effects of a slow start, certain of our seasonal retail customers had higher than expected inventory from 2005 available for their first quarter. A final contributing factor in the lower overall sales for the first half of 2006 is the absence of a significant one-time sale that occurred in the first quarter of 2005. We continue to work with our existing and former customers that reduced or eliminated their order quantities through our restructuring process. While these customers do not question the products and their efficacy, they continue to look for signs of sustained financial stability before fully committing to the product line.

Cost of Sales

Cost of sales for the three and six month periods ended June 30, 2006 was $754,456 (76.5% of sales) and $1,359,537 (75.9% of sales). Cost of sales for the comparative three and six month periods in 2005 were a respective $725,044 (58.0% of sales) and $1,617,500 (56.2% of sales). The increase in cost of sales, as a percentage of sales is attributable to reduced production that resulted from restructuring. This decreased level of production absorbed our fixed costs resulting in lower gross margins on sales during that period. We expect this percentage to improve in future years as production increases and continued steps are taken towards reducing the overall level of fixed costs.

Expenses

General and administrative expenses decreased to $369,120 for the three months ended June 30, 2006 as compared to $427,822 for the same period in 2005, a decrease of $58,702. For the six months ended June 30, 2006, general and administrative expenses decreased to $714,674 from $780,213 for the comparative period in 2005, a decrease of $65,539. Although certain expenses such as salaries and wages, office costs and regulatory and filing fees have increased as necessary to allow the business to operate effectively and facilitate growth, these increases were overshadowed by the significant savings in professional and consulting fees as compared with the same periods in 2005. The professional and consulting fees were attributable to the restructuring process that was taking place throughout the comparative periods. General and administrative costs for the three months ended March 31, 2006 and for the six months ended June 30, 2006 also include the costs related to the management services agreement now in place and is further discussed in the related party transactions section of this discussion. This agreement is one of the primary methods of reducing our overall operating costs. We continue to work toward reducing overall expenses.

Selling expenses for the three months and six months ended June 30, 2006 were $270,646 and $442,683 as compared to $177,793 and $334,898 for the same periods in 2005. The increase of $92,853 for the three month period ended June 30, 2006 and $107,785 for the six month period ended June 30, 2006 is a result of the fact that Napier was not operating as a going concern in the comparative periods. The sales force had been reduced to the lowest possible levels and expenditures for marketing, travel and entertainment were eliminated wherever possible. We recognize that certain of these costs are required to enable the business to develop. We expect that the sales and marketing costs will continue to increase as our sales force works toward increasing the distribution channels of our products and seeks new opportunities for the application of our technology.

Interest, finance and bank charges totaled $1,038 and $67,140 for the three and six months ended June 30, 2006 as compared to $134,350 and $186,511 for the comparative periods in 2005. Interest in the comparative periods was paid on factored accounts receivable at rates much higher than the current loan facilities which are outline in more detail in the related party transaction section of this discussion and analysis. Interest paid in the six months ended June 30, 2006 is entirely attributable to the loans advanced to allow us to emerge from creditor protection in the amount of $3,000,000 and the additional loans advanced to finance operations to June 30, 2006 in the amount of $1,500,000. The lenders have waived interest on these loans during the second quarter of 2006, therefore all charges during the three months ended June 30, 2006 relate to bank charges and similar fees.

Research and development costs for the three months ended June 30, 2006 were $39,290 as compared to $78,589 for the same period in 2005 and $77,010 for the six months ended June 30, 2006 as compared to $127,638 for the same period in 2005. While reducing costs where possible, our emphasis on research and development has remained a priority. Research and development costs are important to maintaining product quality and integrity.

Amortization of deferred financing costs for the three and six month periods ended June 30, 2006 were $31,500 and $63,000 respectively. These costs relate to the warrants issued to the lenders as part of the restructuring process and are based on the calculated imputed value of $630,000 amortized over the estimated life of 60 months. There are no similar costs for the comparative periods in 2005 as the warrants had not been issued.

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 Cdn$ except per share data)

	June 30 2006	March 31 2006	Dec 31 2005	Sept 30 2005	June 30 2005	Mar 31 2005	Dec 31 2004	Sept 30 2004
Sales	986	805	415	897	1,249	1,628	814	1,673
Operating income (loss)	(480)	(453)	(453)	(724)	(295)	125	(1,405)	(667)
Net income (loss) for the period	(486)	(456)	(754)	435	(293)	118	(1,217)	(696)
Earnings (loss) per share,								
Basic and fully-diluted	(0.010)	(0.010)	(0.016)	0.009	(0.006)	0.002	(0.026)	(0.015)

Liquidity and Capital Resources

At June 30, 2006, our cash on hand was $54,463 as compared to $10,413 at December 31, 2005. The increase in cash was the result of the advancement of loans.

At June 30, 2006, we had accounts receivable of $567,977 as compared to $308,541 at December 31, 2005. The increase is the result of the cyclical nature of our business, with increasing sales peaking in the summer months and accordingly, the December accounts receivable were lower.

As part of the negotiated restructuring of debt, we have access to an additional $500,000 through a revolving working capital loan, subject to certain conditions and covenants pursuant to the loan agreements. Both the lender and the Company acknowledge that the Company had not met these conditions and covenants both at the time of advancement and at June 30, 2006. Additional funds advanced through this working capital loan will bear interest at prime plus 2%. The revolving loans have a 364-day term and are renewable for successive 364-day extensions at least 90 days prior to the expiry of the applicable term expiry dates and subject to the consent of the lenders.

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. For the three months ended June 30, 2006, we had paid I.C.T.C. a total of $95,692 (2005: nil) 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 and revolving loans up to the aggregate amount of $3,500,000. During the three months ended June 30, 2006, funds in the amount of $300,000, were advanced for use as working capital. Interest on these loans was waived for the three months ended June 30, 2006. Total interest paid to these companies in respect of these loans during the six months ended June 30, 2006 was $65,596 (2005: nil).

Outstanding Share Data

There are currently 47,768,042 common shares (the "**Common Shares**") of Napier issued and outstanding. In addition, there are currently options outstanding to purchase 3,538,000 Common Shares at prices between $0.04 and $0.40 per share, expiring between October 25, 2006 and May 8, 2011, and warrants outstanding to purchase 82,153,700 Common Shares at $0.01 per share at any time up to August 31, 2010.

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 consolidated financial statements for the year ended December 31, 2005, and should be read in conjunction with these 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. The product return provision at the end of the period takes into account new accounting recommendations described in "Accounting Policy Change" below. If the estimate for product returns is understated, this could result in a charge to future earnings should the actual experience for returns be greater than estimated.

Property, Plant and Equipment/Depreciation and Amortization

The estimated useful lives of assets are determined based on historical experience 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

Significant 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, and economic conditions affecting large or 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 are underway by targeting less seasonal businesses. 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 June 30, 2006, the lenders acknowledge that the margin requirements required under these loans were not met.

Our risk factors are discussed in detail in the "Management's Discussion and Analysis" section of our 2005 annual financial statements and in our Annual Information Form dated March 30, 2006 and remain substantially unchanged. Both of these documents are 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 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 30, 2006 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.

“Steve Balmer”

Steve Balmer
President and Chief Operating Officer
August 14, 2006