

**NAPIER ENVIRONMENTAL  
TECHNOLOGIES INC.**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2007**

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

	June 30 2007	December 31 2006
<b>ASSETS</b>		
Current		
Cash	\$ 30,965	\$ 19,571
Accounts receivable	706,090	185,374
Inventory (Note 4)	610,472	607,250
Prepaid expenses	26,051	28,409
	<u>1,373,578</u>	<u>840,604</u>
Deferred leasehold inducements (Note 3)	240,349	286,869
Deferred financing costs	399,000	462,000
Property, plant and equipment (Note 5)	279,137	326,596
	<u>\$ 2,292,064</u>	<u>\$ 1,916,069</u>
<b>LIABILITIES</b>		
Current		
Loans payable (Note 6)	\$ 3,500,000	\$ 3,300,000
Accounts payable	1,106,995	401,769
Current portion of long term debt (Note 7)	300,000	300,000
	<u>4,906,995</u>	<u>4,001,769</u>
Long term debt (Note 7)	600,000	900,000
	<u>5,506,995</u>	<u>4,901,769</u>
<b>SHAREHOLDERS' DEFICIENCY</b>		
Capital stock (Note 8)	24,819,578	24,093,809
Contributed surplus (Note 8)	386,628	691,774
Deficit	<u>(28,421,137)</u>	<u>(27,771,283)</u>
	<u>(3,214,931)</u>	<u>(2,985,700)</u>
	<u>\$ 2,292,064</u>	<u>\$ 1,916,069</u>

Continuing Operations (Note 1)

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

	Three month period ended June 30		Six month period ended June 30	
	2007	2006	2007	2006
Sales	\$ 1,183,325	\$ 985,770	\$ 1,660,820	\$ 1,790,410
Cost of sales (Note 4)	839,245	754,456	1,257,929	1,359,537
Gross margin	344,080	231,314	402,891	430,873
	29.1%	23.5%	24.3%	24.1%
Expenses				
General and administrative (Schedule)	255,612	369,120	457,880	714,674
Selling and marketing (Schedule)	172,565	270,646	395,801	442,683
Interest and financing costs (Note 3)	92,966	1,038	191,226	67,140
Research and development	38,561	39,290	75,817	77,010
Amortization of deferred financing costs	31,500	31,500	63,000	63,000
	591,204	711,594	1,183,724	1,364,507
Operating loss	(247,124)	(480,280)	(780,833)	(933,634)
Other items				
Foreign exchange loss	(27,938)	(6,039)	(24,720)	(10,370)
Royalty and other income	155,699	-	155,699	-
Gain on disposal of capital assets	-	-	-	1,347
	127,761	(6,039)	130,979	(9,023)
Net loss for the period	(119,363)	(486,319)	(649,854)	(942,657)
Deficit at beginning of the period	(28,301,774)	(26,328,456)	(27,771,283)	(25,872,118)
Deficit at end of the period	\$ (28,421,137)	\$ (26,814,775)	\$ (28,421,137)	\$ (26,814,775)
Weighted average shares outstanding	129,921,742	47,768,042	116,305,107	47,768,042
Net loss per share, basic and fully-diluted	\$ (0.00)	\$ (0.01)	\$ (0.01)	\$ (0.02)

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

	Three month period ended June 30		Six month period ended June 30	
	2007	2006	2007	2006
<b>Operating activities</b>				
Net loss for the period	\$ (119,363)	\$ (486,319)	\$ (649,854)	\$ (942,657)
Items not involving cash				
Depreciation and amortization	34,501	30,223	47,669	62,411
Amortization of deferred leasehold inducements	23,260	24,701	46,520	50,292
Amortization of deferred financing costs	31,500	31,500	63,000	63,000
Stock based compensation	5,807	3,488	9,854	6,385
	(24,295)	(396,407)	(482,811)	(760,569)
<b>Change in non-cash operating working capital</b>				
Accounts receivable	(365,914)	(101,712)	(520,716)	(259,436)
Inventory	(9,931)	96,955	(3,222)	59,925
Prepaid expenses	6,701	15,990	2,358	22,364
Accounts payable	430,343	96,796	705,226	(170,553)
Deferred revenue	(146,250)	-	-	(33,250)
	(85,051)	108,029	183,646	(380,950)
	(109,346)	(288,378)	(299,165)	(1,141,519)
<b>Financing activities</b>				
Proceeds from loans payable and long term debt	-	300,000	300,000	1,200,000
Repayment of loans payable and long term debt	-	-	(400,000)	-
Proceeds on issuance of share capital	-	-	410,769	-
	-	300,000	310,769	1,200,000
<b>Investing activities</b>				
Purchase of property, plant and equipment	-	(1,766)	(210)	(16,181)
Proceeds on disposal of property, plant and equipment	-	-	-	1,750
	-	(1,766)	(210)	(14,431)
Change in cash during the period	(109,346)	9,856	11,394	44,050
Cash at beginning of the period	140,311	44,607	19,571	10,413
Cash at the end of the period	\$ 30,965	\$ 54,463	\$ 30,965	\$ 54,463
<b>Supplemental information</b>				
Interest paid (Note 3)	\$ 92,966	\$ -	\$ 191,226	\$ 66,116

**NAPIER ENVIRONMENTAL TECHNOLOGIES INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2007**  
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**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**  
**JUNE 30, 2007**  
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**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 in July 2005, it still has operating losses, negative working capital and shareholder's deficiency and its ability to continue as a going concern remains dependant on the continued cooperation 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.

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, 2006, 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 June 30, 2007 are not necessarily indicative of the results for the full year.

**NAPIER ENVIRONMENTAL TECHNOLOGIES INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2007**  
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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 accrued on these loans for the three and six months ended June 30, 2007 was \$92,966 and \$191,226 respectively.

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 and six months ended June 30, 2007, the Company incurred costs of \$45,784 and \$91,486 respectively 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 \$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. As at June 30, 2007 the unamortized portion of these deferred leasehold improvements is \$240,349. This sublease has been extended to January 31, 2010.

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 bonus entitlement. 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.

The Company entered into a Sales Service Agreement on February 1, 2007 with I.C.T.C. Under the terms of this agreement, I.C.T.C. accepted the transfer of certain sales staff and their respective expenses in return for a sliding scale sales fee that will be determined at the end of the year. The company accrued an estimated fee payable for the three and six months ended June 30, 2007 of \$26,789 and \$78,789 respectively, based on the year to date sales. This accrual is included in Sales and Marketing costs.

**4. INVENTORY**

Inventory is comprised of:

	June 30, 2007	December 31, 2006
Raw materials	\$ 472,800	\$ 374,250
Finished goods	137,672	233,000
	<u>\$ 610,472</u>	<u>\$ 607,250</u>

**NAPIER ENVIRONMENTAL TECHNOLOGIES INC.**  
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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.

**5. PROPERTY, PLANT AND EQUIPMENT**

	June 30, 2007		December 31, 2006	
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Machinery and equipment	\$ 1,033,471	\$ 896,786	\$ 136,685	\$ 160,662
Furniture and fixtures	213,837	156,542	57,295	65,500
Leasehold improvements	277,544	192,387	85,157	100,434
	<b>\$ 1,524,852</b>	<b>\$ 1,245,715</b>	<b>\$ 279,137</b>	<b>\$ 326,596</b>

**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 June 30, 2007, 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 June 30, 2007.

**7. LONG TERM DEBT**

Long term debt consists of two term loans, each in the amount of \$450,000 (2006: \$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.

**NAPIER ENVIRONMENTAL TECHNOLOGIES INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2007**  
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**8. CAPITAL STOCK**

a) Authorized

Unlimited common shares

b) Issued

	June 30, 2007		December 31, 2006	
	Number of shares	\$	Number of shares	\$
Beginning of the year	88,844,892	24,093,809	47,768,042	23,368,041
Issued on exercise of warrants	41,076,850	410,769	41,076,850	410,768
Financing costs related to warrants excersised		315,000		315,000
End of the year	129,921,742	24,819,578	88,844,892	24,093,809

During the period ended June 30, 2007 the Company issued 41,076,850 common shares upon conversion of 41,076,850 warrants for proceeds of \$410,769. Financing costs of \$315,000 related to warrants exercised have been reclassified from contributed surplus.

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**  
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**8. CAPITAL STOCK (Continued)**

The following table summarizes the status and changes in stock options outstanding at June 30, 2007:

	June 30, 2007		December 31, 2006	
	Number	Weighted average price	Number	Weighted average price
Outstanding, beginning of period	3,095,000	0.07	3,391,000	\$0.12
Granted	100,000	0.08	300,000	0.09
Cancelled / expired	(25,000)	(0.40)	(596,000)	(0.28)
Outstanding, end of period	<u>3,170,000</u>	<u>0.06</u>	<u>3,095,000</u>	<u>0.07</u>
Exercisable, end of period	<u>1,770,000</u>	<u>\$0.07</u>	<u>1,755,000</u>	<u>\$0.07</u>
Options reserved for issuance, under stock option plan	<u>1,450,000</u>		<u>1,525,000</u>	

The following table summarizes information about stock options outstanding at June 30, 2007:

exercise prices	options	contractual life	exercise price
\$0.04 - \$0.12	2,900,000	3.3 years	\$0.05
\$0.15 - \$0.28	270,000	1.1 years	\$0.25
	<u>3,170,000</u>	<u>3.1 years</u>	<u>\$0.06</u>

During the period, the Company recorded stock based compensation expense, with a corresponding credit to contributed surplus of \$9,854 relating to the stock options that vested during the period.

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

	2007	2006
Dividend yield	0%	0%
Expected volatility	132%	115% -131%
Expected life	5 yrs	5 yrs
Risk free rate of return	4.50%	4.75% -5.13%
Weighted average fair value of options granted	<u>\$0.07</u>	<u>\$0.08</u>

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**8. CAPITAL STOCK (Continued)**

d) Warrants

	<u>June 30, 2007</u>	<u>December 31, 2006</u>
Outstanding, beginning of period	41,076,850	82,153,700
Issued	-	-
Exercised	(41,076,850)	(41,076,850)
Expired	-	-
Outstanding, end of period	<u>-</u>	<u>41,076,850</u>

As a condition of obtaining the loans described in Note 6 and 8, the Company granted the lenders warrants entitling the lenders to purchase, from treasury, up to 30% each of the common shares of the Company, calculated on a fully-diluted basis, upon payment of \$0.01 per share at any time up to August 31, 2010. During the year ended December 31, 2005 the Company recorded \$630,000 of deferred financing charges with a corresponding increase to contributed surplus related to the fair value of these warrant. This deferred financing cost is being amortized over the 60 month life of the warrants.

During the period ended June 30, 2007 the Company recorded \$nil of deferred financing charges.

*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>

**9. 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 June 30		Six Month Period ended June 30	
<b>GENERAL AND ADMINISTRATIVE</b>	2007	2006	2007	2006
		(Note 9)		(Note 9)
Salaries and wages	\$ 94,805	\$ 165,659	\$ 164,941	\$ 329,775
Insurance	32,711	34,131	65,421	70,019
Professional fees	29,091	43,261	48,530	65,749
Office	21,113	32,423	45,740	56,460
Occupancy	18,442	17,765	42,416	40,586
Regulatory, filing and investor relations	22,943	23,923	28,803	37,914
Director fees	12,000	16,584	24,000	33,168
Telecommunications	5,012	5,342	10,666	10,232
Travel	1,083	13,651	2,495	31,698
Consulting	-	-	-	2,138
Amortization	18,412	16,381	24,868	36,935
	\$ 255,612	\$ 369,120	\$ 457,880	\$ 714,674
<b>SELLING AND MARKETING</b>				
	2007	2006	2007	2006
		(Note 9)		(Note 9)
Salaries and wages	\$ 42,331	\$ 102,822	\$ 108,677	\$ 161,700
Consulting	51,048	51,526	105,135	98,812
Commissions	35,692	14,936	100,644	20,963
Marketing	40,891	54,069	66,514	80,034
Travel and entertainment	850	43,904	9,940	75,796
Communications and other	1,753	2,984	4,891	4,739
Bad debt expense (recovery)	-	405	-	639
	\$ 172,565	\$ 270,646	\$ 395,801	\$ 442,683