

CONSOLIDATED FINANCIAL STATEMENTS
AND MANAGEMENT'S DISCUSSION AND ANALYSIS

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

December 31, 2007

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE YEAR ENDED DECEMBER 31, 2007

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, 2007 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, 2007 and December 31, 2006.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

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, 2007 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

The year ended December 31, 2007 was a challenging one for Napier. The focus was the continued rebuilding of relationships with customers with the ultimate goal of increasing sales.

Results of Operations

For the year ended December 31, 2007, we recorded a net loss of \$1,822,051 (\$0.01 per common share) as compared to a net loss of \$1,899,165 (\$0.03 per common share) for the year ended December 31, 2006. While sales were 10.4% lower than the comparative period in 2006, we managed to reduce the overall loss by further controlling costs as well as the development of a stream of royalty income resulting from our licensing arrangement.

We recorded a net loss of \$662,348 during the last three months of 2007 as compared to a loss of \$571,404 during the last three months of 2006. With the fourth quarter being the industry's slowest period of the year, our loss is traditionally larger in this period compared to the first three quarters of the year.

Sales

Sales for the year ended December 31, 2007 totaled \$2,558,686 as compared to \$2,855,074 for the year ended December 31, 2006. The decrease in overall sales of 10.4% resulted from the combination of a number of factors varying from external forces such as foreign exchange, weather and changes in our methods of distribution. In one particular case we shifted the supply of one of our larger customers to a distribution agreement that allows us to take a passive approach by shipping to distribution centers as opposed to shipping to stores directly. It is important to note that despite a decrease in overall sales, we earned royalty revenue during the year which has no related costs associated with it.

We recorded sales of \$177,043 during the last three months of 2007 as compared to \$321,739 for the last three months of 2006. The decrease of \$144,696 is the result of a number of factors noted above, with the biggest impact being our method of distribution to one of largest customers that impacted overall revenues as well as the timing of sales.

Cost of Sales

Cost of sales for the year ended December 31, 2007 was \$2,234,696 (87.34% of sales) compared to \$2,378,773 (83.32% of sales) for the year ended December 31, 2006. The decreased gross margin earned in the year ended December 31, 2007, as compared to the year ended December 31, 2006, is a result of a combination of two key factors. First, the lower volume results in lower gross margins as the absorption of overhead rate of overhead costs changes. Second, our change in distribution method results in lower gross margins on certain products, however the passive approach results in a higher contribution margin from the same sale, despite the lower gross margin.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

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 \$330,211 in the fourth quarter resulting in a gross margin of \$(153,168) as compared to cost of sales and a gross margin of \$417,744 and \$(96,005) respectively, for the three months ended December 31, 2006.

Expenses

General and administrative expenses were \$860,799 for the year ended December 31, 2007 compared to \$1,138,572 for the year ended December 31, 2006, a decrease of \$277,773. This reduction is the result of our commitment to operating the business in the most efficient way possible.

General and administrative expenses for the three months ended December 31, 2007 totaled \$197,317 as compared to \$195,515 for the three months ended December 31, 2006. These costs remained relatively constant in the fourth quarter, year over year.

Selling expenses for the year ended December 31, 2007 were \$740,396 as compared to \$894,674 for the year ended December 31, 2006. The decrease of \$154,278 was the result of our sales service agreement which allowed us to benefit from the resources of I.C.T.C. Holdings Corporation (described under transactions with related parties) by having them represent our products for a result based commission.

Selling expenses for the three months ended December 31, 2007 were \$139,190 as compared to \$223,389 for the three months ended December 31, 2006. The decrease of \$84,199 is the result of the sales service agreement noted above.

Interest and finance costs increased to \$398,946 during the year ended December 31, 2007 as compared to \$66,184 during the year ended December 31, 2006. The increase of \$332,762 is the result of interest being waived by our lenders beginning in April of 2006 through to December 31, 2006. This waiver did not continue in 2007.

Interest and finance costs for the three months ended December 31, 2007 were \$106,213 as compared to \$nil for the three months ended December 31, 2006. As noted above, the change in interest cost is related to the interest being waived by our lenders during the last three quarters of the prior year.

Research and development costs for the year ended December 31, 2007 were consistent at \$150,420 compared to \$151,437 for the year ended December 31, 2006. 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, 2007 were \$37,791 as compared to \$37,274 for the three months ended December 31, 2006.

Foreign exchange loss totaled \$60,199 for the year ended December 31, 2007 as compared to \$6,172 for the year ended December 31, 2006. The Company's foreign exchange loss is primarily due to the fluctuations of the US dollar. In particular, we saw a fairly dramatic shift in the US dollar immediately before the start of the fourth quarter of 2007. The impact of this shift was realized in the fourth quarter.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

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, 2007, 2006 and 2005 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		
	2007	2006	2005
Sales.....	2,558	2,855	4,189
Gross profit.....	324	476	1,213
Loss before other items.....	(1,827)	(1,901)	(1,347)
Royalty and other income.....	65	-	-
Net loss.....	(1,822)	(1,899)	(494)
Loss per share, basic and fully-diluted.....	(0.01)	(0.03)	(0.01)
Total assets.....	1,143	1,916	2,507
Long-term financial liabilities.....	685	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 2007	Sept 30 2007	June 30 2007	March 31 2007	Dec 31 2006	Sept 30 2006	June 30 2006	March 31 2006
Sales	177	721	1,183	477	321	743	986	805
Operating income (loss) before other items	(539)	(507)	(247)	(534)	(583)	(385)	(480)	(453)
Net income (loss)	(663)	(510)	(119)	(530)	(571)	(385)	(486)	(456)
Earnings (loss) per share, Basic	(0.004)	(0.004)	(0.001)	(0.005)	(0.006)	(0.007)	(0.010)	(0.010)
Fully diluted	(0.004)	(0.004)	(0.001)	(0.005)	(0.006)	(0.007)	(0.010)	(0.010)

Liquidity and Capital Resources

At December 31, 2007, our cash on hand was \$4,413 as compared to \$19,571 at December 31, 2006.

At December 31, 2007, we had accounts receivable of \$240,990 as compared to \$185,374 at December 31, 2006. This increase of \$55,616 is due to the inclusion of royalty fees receivable which total USD\$75,000, representing part of the up front technology transfer fees related to our licensing agreement.

Transactions with Related Parties

We have entered into a management services agreement (the "Management Services Agreement"), a sublease (the "Sublease") and a Sales Services Agreement (the "Sales Services Agreement") 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.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

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, 2007, we paid I.C.T.C. a total of \$167,230 (2006: \$187,307) 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.

Pursuant to the Sales Services agreement, effective January 9, 2007 we pay a commission to I.C.T.C. based on successful sales to its retail customers which is managed by the I.C.T.C. Sales and Marketing Staff. Total commissions for the year amounted to \$227,627.

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 \$900,000 is outstanding at December 31, 2006, and revolving loans of which \$3,851,382 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. Total interest charged by these companies in respect of these loans was \$398,946 (2005: \$66,184). Interest on these loans was waived by the lenders for the last three quarters ended December 31, 2006.

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 2,213,000 Common Shares at prices between \$0.04 and \$0.15 per share, expiring between February 9, 2009 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 3 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.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

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, 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, 2007, 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 and remain substantially unchanged. This document is available at www.sedar.com.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

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 as 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 26, 2008