

**NAPIER ENVIRONMENTAL
TECHNOLOGIES INC.**

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2009

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2009**

May 25, 2009 / *The following Discussion and Analysis should be read in conjunction with the unaudited interim consolidated financial statements and related notes for the three months ended March 31, 2009, and the audited consolidated financial statements for the year ended December 31, 2008, the accompanying notes, and management's discussion and analysis for the year then ended. The unaudited interim financial statements for the three months ended March 31, 2009 and the audited consolidated financial statements for the year ended December 31, 2008 have been prepared in accordance with Canadian generally accepted accounting principles. Additional information about Napier Environmental Technologies Inc. ("Napier" or the "Company") 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 three months ended March 31, 2009 we recorded a net loss of \$237,129 (\$0.00 per common share) as compared to net loss of \$302,037 (\$0.00 per common share) for the same period in 2008.

The decrease in the loss for the three months ended March 31, 2009 as compared to the same period in 2008 was the result of the repayment of debt resulting in a significant reduction in interest and finance costs. Repayment of debt was achieved pursuant to the sale of intellectual property ("IP") to Freeworld Global (Pty) Ltd. ("Freeworld") more fully described below.

On July 29, 2008 the Company completed the sale of its IP to Freeworld together with an option granting Freeworld the rights to the North American sales, marketing and manufacturing operations of the Company, for aggregate consideration of \$5,150,000. Of these proceeds, \$4,650,000 has been received and the balance of \$500,000 is being held in escrow, to be released \$250,000 in 2009 and \$250,000 in 2010, subject to certain indemnifications made to the purchaser. The Company is not aware of any potential indemnification claims which would reduce the future payments to be received from the escrow account. The balance of the proceeds being held in escrow is recorded on the balance sheet as funds held in trust at March 31, 2009.

On April 1, 2009, Napier has been notified by Freeworld of their intention to exercise their option to acquire the North American operations of Napier. Closing was expected to occur on April 30, 2009. Regulatory approvals have not yet been obtained and accordingly the closing has been delayed. It is still contemplated that coincident with the closing, Napier will enter into an interim Transition Services Agreement ("TSA") to manufacture its current offering of products until Freeworld are in a position to further assess the business. The responsibility for Napier personnel, excluding administrative and finance personnel, premises costs and other operational overhead shall be transferred to Freeworld upon closing. Based upon the latest financial information, Napier will receive proceeds from Freeworld of approximately \$650,000, consisting of \$100,000 for the IP, which has been received, and the balance for production machinery and inventory. In addition to these proceeds, Napier will retain all other net assets and the licensing arrangement for the IP with a major paint manufacturer for the North American market. Upon completion of this transaction and upon the fulfillment of its obligations under the TSA, Napier will no longer own the rights to these products and will accordingly cease manufacturing.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

Sales

Sales for the three months ended March 31, 2009 totaled \$268,760 as compared to \$398,115 for the same period in 2008. The decrease of \$129,355 resulted from the combination of a number of factors varying from external forces such as economy, foreign exchange, weather and changes in our methods of distribution. It is important to note that despite a decrease in overall sales, we earned royalty revenue during the period which has no associated costs.

Cost of Sales

Cost of sales for the three months ended March 31, 2009 was \$299,911 (111.59% of sales) compared to \$356,256 (89.49% of sales) for the same period in 2008. The decrease in cost of sales of 15.8% is due to the corresponding decrease in sales during the period of 32.5%. As expected, the decreased level of production requires a higher absorption of fixed costs resulting in a lower gross margin percentage, as evidenced by the lower percentage of decrease in the cost of sales. This phenomenon is being curtailed due to the management of overall fixed costs.

Expenses

General and administrative expenses increased to \$134,663 for the three months ended March 31, 2009 as compared to \$152,312 for the same period in 2008, a decrease of \$17,649. The decrease in costs is primarily attributable to the bonus accrual related to a compensation agreement with the company's Chairman, which remains unpaid until cash is available to meet this obligation.

Selling and marketing expenses for the three months ended March 31, 2009 were \$65,006 as compared to \$71,162 for the same period in 2008. Selling and marketing expenses decreased when compared to the comparative period primarily as a result of the reduction of expenses within the sales and marketing area relative to the comparative quarter.

Research and development costs for the three months ended March 31, 2009 decreased to \$30,128 as compared to \$46,539 for the same period in 2008. Research and development costs are important to maintaining product quality and integrity.

Interest and finance costs decreased from \$107,942 to \$25,021 for the three months ended March 31, 2009 as compared to the same period in 2008. The decrease of \$82,921 is primarily the result of repayment of \$3,300,000 of loans payable and long term debt during 2008.

Foreign exchange gain for the three months ended March 31, 2009 increased to \$6,339 as compare to \$1,975 for the same period in 2008 is primarily due to the fluctuations of the US dollar.

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)

	March 31	Dec 31	Sept 30	June 30	March 31	Dec 31	Sept 30	June 30
	2009	2008	2008	2008	2008	2007	2007	2007
Sales	269	279	643	746	398	177	721	1,183
Operating income (loss) before other items	(286)	(322)	(1,335)	(486)	(336)	(633)	(475)	(216)
Net income (loss)	(237)	(279)	3891	(348)	(302)	(757)	(478)	(88)
Earnings (loss) per share,								
Basic	(0.002)	(0.002)	0.030	(0.003)	(0.002)	(0.006)	(0.004)	(0.001)
Fully diluted	(0.002)	(0.002)	0.030	(0.003)	(0.002)	(0.006)	(0.004)	(0.001)

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

Liquidity and Capital Resources

At March 31, 2009, our cash on hand was \$155,971 together with Funds held in trust of \$500,000 to be released in 2009 and 2010, as compared to \$196,234 with Funds held in trust of \$500,000 at December 31, 2008.

At March 31, 2009, we had accounts receivable of \$136,764 as compared to \$150,548 at December 31, 2008.

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 March 31, 2009, Napier experienced a recovery through this agreement for services performed for I.C.T.C. totaling \$11,245. For the three months ended March 31, 2008, we recovered a total of \$16,063 for services performed 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. The sublease is in effect until the end of Napier's lease commitment with its landlord, January 31, 2010.

Effective July 1, 2006, the Company's chairman accepted a revised compensation agreement resulting in nominal 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. The Company has been notified by its Chairman that, due to the future prospects of the Company, no further accrual would be necessary beyond February 28, 2009 for the balance of 2009. The Company accrued \$1,042,271 related to this bonus as at March 31, 2009 (March 31, 2008: nil).

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 \$600,000 is outstanding at March 31, 2009, and revolving loans of which \$500,000 is outstanding at March 31, 2009. 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 accrued to these companies in respect of these loans during the three months ended March 31, 2009 was \$25,021 (March 31, 2008: \$107,942).

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 2,000,000 Common Shares at price of \$0.04 per share, expiring between Aug 29, 2010 and May 31, 2012.

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 of those large customers. 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 has 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 March 31, 2009, the lenders acknowledge that the margin requirements required under these loans were not met.

International Financial Reporting Standards ("IFRS")

In February 2008, the Canadian Accounting Standards Board ("AcSB") confirmed January 1, 2011 as the date IFRS will replace current Canadian generally accepted accounting principles ("Canadian GAAP") for publicly accountable enterprises. This will result in the Company reporting under IFRS starting with the interim period ending March 31, 2011, with restatement for comparative purposes of amounts reported under Canadian GAAP.

The conversion to IFRS will likely impact the Company's statement of financial position and results of operations. To transition to IFRS, changes may be required to the Company's information technology and data systems, internal control over financial reporting, disclosure controls and procedures, financial reporting expertise and training requirements, and business activities, such as compensation programs, debt covenants and other contractual arrangements.

The Company will be establishing a project team to manage the conversion process and, complete a high-level impact assessment to identify key areas that will be affected by the conversion. The Company will continuously monitor changes in IFRS leading up to the changeover date, and will update its conversion plan as required.

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 being available, the potential dilution to shareholders, the historical lack of dividend payments, competition, dependence on key personnel, the influence of economic conditions, dependence on key customers and licensees, weather, seasonality, raw materials, the retail industry, foreign exchange rate fluctuations and conflicts of interest. 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
May 25, 2009

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

	March 31 2009	December 31 2008
Assets		
Current		
Cash	\$ 155,971	\$ 196,234
Funds held in trust (Note 4)	250,000	250,000
Accounts receivable	136,764	150,548
Inventory (Note 6)	490,630	417,880
Prepaid expenses	19,364	27,138
	1,052,729	1,041,800
Deferred leasehold inducements (Note 5)	77,532	100,791
Funds held in trust (Note 4)	250,000	250,000
Property and equipment (Notes 7)	113,392	134,908
	\$ 1,493,653	\$ 1,527,499
Liabilities		
Current		
Loans payable (Note 8)	\$ 500,000	\$ 500,000
Accounts payable (Note 5)	1,141,701	1,121,025
Bonus payable (Note 5)	1,042,271	983,938
Deposit (Note 4)	100,000	100,000
Deferred revenue	137,496	8,333
Current portion of long term debt (Note 9)	300,000	300,000
	3,221,468	3,013,296
Deferred revenue	68,057	76,390
Long term debt (Note 9)	300,000	300,000
	3,589,525	3,389,686
Shareholders' deficiency		
Capital stock (Note 10)	24,819,578	24,819,578
Contributed surplus	415,459	412,015
Deficit	(27,330,909)	(27,093,780)
	(2,095,872)	(1,862,187)
	\$ 1,493,653	\$ 1,527,499

Going concern (Note 1)

The accompanying notes are an integral part of these financial statements

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

	Three month period ended March 31	
	2009	2008
Sales	\$ 268,760	\$ 398,115
Cost of sales	299,911	356,256
Gross profit	(31,151)	41,859
	-11.59%	10.51%
Expenses		
General and administrative (Schedule)	134,663	152,312
Selling and marketing (Schedule)	65,006	71,162
Research and development	30,128	46,539
Interest and finance costs	25,021	107,942
	254,818	377,955
Loss before other items	(285,969)	(336,096)
Other items		
Royalty and other income	42,501	32,084
Foreign exchange gain	6,339	1,975
	48,840	34,059
Net loss for the period	(237,129)	(302,037)
Deficit at beginning of the period	(27,093,780)	(30,055,334)
Deficit at end of the period	\$ (27,330,909)	\$ (30,357,371)
Weighted average shares outstanding	129,921,742	129,921,742
Net Loss per share, basic and fully-diluted	\$ (0.00)	\$ (0.00)

The accompanying notes are an integral part of these financial statements

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

	Three month period ended March 31	
	2009	2008
Operating activities		
Net loss for the period	\$ (237,129)	\$ (302,037)
Items not involving cash		
Amortization of property and equipment	21,881	23,825
Amortization of deferred leasehold inducements	23,259	23,259
Stock based compensation	3,443	3,443
	(188,546)	(251,510)
Change in non-cash operating working capital		
Accounts receivable	13,784	(1,170)
Inventory	(72,750)	(180,357)
Prepaid expenses	7,774	23,006
Accounts payable	20,677	19,641
Deposit received	-	250,000
Deferred revenue	120,830	(13,605)
Bonus payable	58,333	-
	148,648	97,515
	(39,898)	(153,995)
Financing activities		
Proceeds from loans payable and long term debt	-	300,000
	-	300,000
Investing activities		
Purchase of property and equipment	(365)	-
	(365)	-
Change in cash during the period	(40,263)	146,005
Cash at beginning of the period	196,234	4,413
Cash at end of the period	\$ 155,971	\$ 150,418

The accompanying notes are an integral part of these financial statements

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

Three month period ended March 31

General and administrative

	2009		2008
Salaries and wages	\$ 79,953	\$	44,563
Occupancy	11,656		10,236
Insurance	8,545		27,751
Professional fees	8,328		19,648
Office	6,504		9,468
Telecommunications	3,108		3,567
Director fees	2,500		11,500
Regulatory, filing and investor relations	580		4,417
Travel	199		7,503
Amortization	13,290		13,659
	\$ 134,663	\$	152,312

Selling and marketing

	2009		2008
Salaries and wages	\$ 37,187	\$	34,223
Consulting	14,095		12,648
Commissions	5,816		6,284
Marketing	3,605		8,228
Travel and entertainment	2,683		8,946
Communications and other	1,620		833
	\$ 65,006	\$	71,162

The accompanying notes are an integral part of these financial statements

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009
(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, 2009
(UNAUDITED – Prepared by Management)

1. CONTINUING OPERATIONS

The Company is governed by the *Business Corporations Act* (British Columbia) and is primarily involved in the manufacturing, distribution and licensing of a wide range of products created through environmentally advanced technology. These 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. The Company continues to incur operating losses, does not meet margin requirements required under its operating loans and long term debt, has negative working capital and a shareholders' deficiency. On April 1, 2009, Napier was notified by Freeworld Global ("Pty") Ltd. ("Freeworld") of their intention to exercise their option to acquire the North American operations of Napier. While closing was intended to occur on April 30, 2009, it has been mutually agreed to defer closing to a future month end prior to December 31, 2009, upon Freeworld providing a minimum of 30 days notice of closing. Napier has entered into an interim Transition Services Agreement ("TSA") to continue manufacturing and selling its current offering of products until Freeworld are in a position to further assess the business. Upon completion of this transaction and upon the fulfillment of its obligations under the TSA, Napier will no longer own the rights to these products and will accordingly cease manufacturing (Note 4). In addition, during the year ended December 31, 2008 the Company was delisted from the Toronto Stock Exchange for failure to meet certain listing requirements. The Company's ability to continue as a going concern remains dependant on the continued cooperation and support of its lenders and to attain positive cash flow from operations.

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, the reported net income and the balance sheet classifications used.

2. CHANGES IN ACCOUNTING POLICIES

2009 and 2008

Effective January 1, 2008, the Company adopted the following recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook:

Capital disclosures

The Company adopted the recommendations of CICA Handbook Section 1535, Capital Disclosures. This Section requires the disclosure of information about an entity's objectives, policies and processes for managing capital and quantitative data about what the entity regards as capital. It also requires disclosure of the nature of externally imposed capital requirements and how those requirements are incorporated into the management of capital, whether the entity has complied with those requirements and when the entity has not complied with those requirements, the consequences of such non-compliance.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009
(UNAUDITED – Prepared by Management)

2. CHANGES IN ACCOUNTING POLICIES (CONTINUED)

Inventories

The Company adopted the recommendations of CICA Handbook Section 3031, Inventories, which provides guidance on the determination of cost of inventories and its subsequent recognition as an expense, and includes additional disclosure requirements. The new Section also requires to account for the reversal of write-downs previously recognized when there is a subsequent increase in the value of inventories. The adoption of this Section had no impact on the interim consolidated financial statements other than the additional disclosures provided in Note 6.

Financial instruments

The Company adopted the recommendations of CICA Handbook Section 3862, Financial Instruments - Disclosures and Section 3863, Financial Instruments - Presentation. Section 3862 requires the disclosure of information about: a) the significance of financial instruments for the entity's financial position and performance and b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. Section 3863 contains standards for presentation of financial instruments and non-financial derivatives.

2007

Effective January 1, 2007, the Company adopted the new recommendations of the CICA Handbook Section 3251, Equity; Section 1530, Comprehensive Income; and Section 3855, Financial Instruments - Recognition and Measurement, and Section 3861, Financial Instruments – Disclosure and Presentation, retroactively, without restatement. These new Handbook Sections, which apply to fiscal years beginning on or after October 1, 2006, provide requirements for the recognition, measurement, presentation and disclosure of financial instruments. The adoption of this standard had no significant impact on net loss and net loss per share for the year ended December 31, 2007.

In accordance with Section 3855, the Company adopted a policy to expense debt financing fees as incurred resulting in an increase to opening deficit as at January 1, 2007 of \$462,000 to eliminate the deferred financing costs that were capitalized and amortized under the Company's previous accounting policy.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009
(UNAUDITED – Prepared by Management)

3. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

These interim consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. Inter-company balances and transactions are eliminated upon consolidation.

Use of estimates

The preparation of interim consolidated 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, property and equipment amortization policies, accrued liabilities and stock based compensation. Actual results could differ from those estimates.

Inventory

Raw materials, work in process and finished goods are valued at the lower of cost and net realizable value. Cost is determined on the first in, first out basis. The cost of work in process and finished goods includes the cost of raw materials and the applicable share of the cost of labour and fixed and variable production overheads. Net realizable value is the estimated selling price less the estimated cost of completion and the estimated costs necessary to make the sale.

Property and equipment

Property and equipment are recorded at cost and the Company provides for amortization computed using the following methods and annual rates:

Machinery and equipment	5 – 10 years straight line
Furniture and fixtures	2 - 5 years straight line
Leasehold improvements	Straight line over lease term

Impairment of long-lived assets

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognized when their carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009
(UNAUDITED – Prepared by Management)

**3. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Revenue recognition

Revenue is recognized when persuasive evidence of an arrangement exists, goods are shipped, price is fixed and determinable, and collection is reasonably assured. Initial non-refundable licensing fees are deferred and recognized over the term of the licensing agreement. Royalty fees are recognized as the licensee sells the licensed product.

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income taxes are recognized based on the expected future tax consequences of differences between the carrying amount of balance sheet items and their corresponding tax basis, using the enacted and substantively enacted income tax rates for the years in which the differences are expected to reverse. Future income tax assets are recognized to the extent it is more likely than not they will be realized.

Deferred leasehold inducements

Leasehold inducements related to the sublease outlined in Note 7 are deferred and amortized to rent expense over 51 months from the commencement date of the sublease. As at March 31, 2009 there are 10 months remaining in the amortization period.

Stock based compensation

The Company uses the fair value method to account for stock based compensation and other stock based payments. This method consists of expensing the fair value of stock based awards over the vesting period of the options granted. Upon exercise of the stock options, consideration received together with amounts previously recognized in contributed surplus is recorded as an increase in share capital.

Foreign currency translation

The functional currency of the Company's operations is the Canadian dollar. Monetary assets and liabilities are translated at the exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at the historical rates. Revenues and expenses are translated at the average rates for the year except for amortization that is translated at historical rates. Translation gains or losses are included in earnings.

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009
(UNAUDITED – Prepared by Management)

**3. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Earnings per share

Earnings per share is calculated based on the weighted average number of shares outstanding during the period. Potentially dilutive items are described in Note 10. Diluted loss per share is the same as basic loss per share as the average market price of the common shares during the period did not exceed the exercise price of the options.

Financial instruments

Fair value

Financial assets and financial liabilities are initially recognized at fair value and their subsequent measurement is dependent on their classification as described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics and the Company's designation of such instruments.

Classification

Asset/liability	Category	Measurement
Cash	Held for trading	Fair value
Funds held in trust	Held-to-maturity	Amortized cost
Accounts receivable	Loans and receivables	Amortized cost
Accounts payable	Other liabilities	Amortized cost
Loans payable	Other liabilities	Amortized cost
Long term debt	Other liabilities	Amortized cost

Recent accounting pronouncements

In February 2008, the CICA issued Section 3064, Goodwill and intangible assets, replacing Section 3062, Goodwill and other intangible assets and Section 3450, Research and development costs. Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company adopted the new standards for its fiscal year beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact that the adoption of this new Section will have on its interim consolidated financial statements.

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**3. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

International Financial Reporting Standards (“IFRS”)

In 2006, the Canadian Accounting Standards Board (“AcSB”) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian Generally Accepted Accounting Principles (“GAAP”) with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that the year 2011 is the changeover date for publicly listed companies to use IFRS, replacing Canadian GAAP. This date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Should Napier regain its position as a publicly listed company, the transition date of January 1, 2011 will require restatement, for comparative purposes, of amounts reported by the Company for the year ended December 31, 2010. The Company is currently evaluating the impact the adoption of IFRS will have on its interim consolidated financial statements.

4. SALE OF INTELLECTUAL PROPERTY

On July 29, 2008 the Company completed the sale of its intellectual property (“IP”) to Freeworld together with an option granting Freeworld the rights to the North American sales, marketing and manufacturing operations of the Company, for aggregate consideration of \$5,150,000. Of these proceeds, \$4,650,000 has been received and the balance of \$500,000 is being held in escrow, to be released \$250,000 in 2009 and \$250,000 in 2010, subject to certain indemnifications made to the purchaser. The Company is not aware of any potential indemnification claims which would reduce the future payments to be received from the escrow account. The balance of the proceeds being held in escrow is recorded on the balance sheet as funds held in trust at March 31, 2009.

On April 1, 2009, Napier has been notified by Freeworld of their intention to exercise their option to acquire the North American operations of Napier. While closing was intended to occur on April 30, 2009, it has been mutually agreed to defer closing to a future month end prior to December 31, 2009, upon Freeworld providing a minimum of 30 days notice of closing. Napier has entered into an interim Transition Services Agreement (“TSA”) to continue manufacturing and selling its current offering of products until Freeworld are in a position to further assess the business. The responsibility for Napier personnel, excluding administrative and finance personnel, premises costs and other operational overhead shall be transferred to Freeworld upon closing. Based upon the latest financial information, Napier will receive proceeds from Freeworld of approximately \$650,000, consisting of \$100,000 for the IP, which has been received, and the balance for production machinery and inventory. In addition to these proceeds, Napier will retain all other net assets and the licensing arrangement for the IP with a major paint manufacturer for the North American market. Upon completion of this transaction and upon the fulfillment of its obligations under the TSA, Napier will no longer own the rights to these products and will accordingly cease manufacturing.

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5. RELATED PARTY TRANSACTIONS

During the year ended December 31, 2005 the Company obtained financing, described in notes 8 and 9, from companies controlled by directors and officers of the Company. Total interest accrued on these loans for the three months ended March 31, 2009 was \$25,021.

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, 2009, the Company earned a recovery of \$11,245 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 31, 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 March 31, 2009 the unamortized portion of these deferred leasehold improvements is \$77,532. 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. The Company was notified by the Company’s chairman that, due to the future prospects of the Company, no further accrual would be necessary beyond February 28, 2009. The company has accrued \$1,042,271 related to this bonus as at March 31, 2009 (December 31, 2008 - \$983,938).

The Company entered into a Sales Service Agreement on January 9, 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 cancelled this agreement effective January 1, 2007. There are fees of \$227,627 accrued and payable to I.C.T.C. relating to services performed under this agreement during the year ended December 31, 2007. During the 2008 fiscal year and three months ended March 31, 2009, the company did not incur any costs related to the sales services agreement.

Included in accounts payable at March 31, 2009 is \$2,019,343 due to related parties (December 31, 2008 - \$1,951,199).

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6. INVENTORY

Inventory is comprised of:

	March 31, 2009	December 31, 2008
Raw materials	\$ 351,492	\$ 285,240
Finished goods	139,138	132,640
	<u>\$ 490,630</u>	<u>\$ 417,880</u>

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.

7. PROPERTY, PLANT AND EQUIPMENT

	March 31, 2009		December 31, 2008	
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Machinery and equipment	\$ 1,034,786	\$ 979,667	\$ 55,119	\$ 64,451
Furniture and fixtures	213,837	183,515	30,322	34,121
Leasehold improvements	277,544	249,593	27,951	36,336
	<u>\$ 1,526,167</u>	<u>\$ 1,412,775</u>	<u>\$ 113,392</u>	<u>\$ 134,908</u>

8. 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 5) 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, 2009, 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, 2009.

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9. LONG TERM DEBT

Long term debt consists of two term loans, each in the amount of \$300,000 payable to 6408753 Canada Corporation and 6408788 Canada Corp. (see Note 5). 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 10). Long term debt and the loans payable (Note 8 and 9) are secured by a general security agreement and an assignment of general insurance.

10. CAPITAL STOCK

a) Authorized

Unlimited common shares

b) Issued

	March 31, 2009		December 31, 2008	
	Number of shares	\$	Number of shares	\$
Beginning of the year	129,921,742	24,819,578	129,921,742	24,819,578
End of the year	129,921,742	24,819,578	129,921,742	24,819,578

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.

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10. CAPITAL STOCK (CONTINUED)

The following table summarizes the status and changes in stock options outstanding at March 31, 2009:

	Number	Weighted average price	Number	Weighted average price
Outstanding, beginning of period	2,013,000	0.04	2,213,000	\$0.05
Cancelled / expired	(13,000)	(0.15)	(200,000)	(0.10)
Outstanding, end of period	2,000,000	0.04	2,013,000	0.04
Exercisable, end of period	1,760,000	\$0.04	1,770,400	\$0.04
Options reserved for issuance, under stock option plan	9,750,000		9,750,000	

The following table summarizes information about stock options outstanding at March 31, 2009:

Range of exercise prices	Number of options	Weighted average remaining contractual life	Weighted average exercise price
\$0.04 - \$0.12	2,000,000	1.6 years	\$0.04
	2,000,000	1.6 years	\$0.04

During the period, the Company recorded stock based compensation expense, with a corresponding credit to contributed surplus of \$3,443 relating to the stock options that vested during the period.

During the year ended December 31, 2007, 100,000 stock options were issued. The fair value of these options was determined to be \$7,010. No stock options were issued during 2008 and three months ended March 31, 2009.

The Black-Scholes option-pricing model assumptions used to compute the fair value of options granted in 2007 are as follows:

Dividend yield	0%
Expected volatility	132%
Expected life	5 yrs
Risk free rate of return	4.0%

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10. CAPITAL STOCK (CONTINUED)

d) Warrants

As a condition of obtaining the loans described in Note 8 and 9, 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. All outstanding warrants were exercised.