

SMARTCOOL™

Management's Discussion and Analysis

For the year ended December 31, 2010

The following Management Discussion and Analysis ("MD&A"), dated April 28th, 2011, provides information that management believes is relevant to an assessment and understanding of the Company's consolidated results of operations and financial condition. This discussion should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2010.

Forward Looking Statements

This MD&A contains forward-looking information, including statements regarding the future results of operations and marketing activities. Forward looking statements generally can be identified by the use of forward looking terminology such as "may", "will", "expect", "intend", "anticipate", "plan", "foresee", "believe" or similar terminology. Although these forward-looking statements are based on what management believes to be current and reasonable assumptions, they involve known and unknown risks, uncertainties and other factors that may cause the actual results and performance to differ materially from those stated, anticipated, or implied in these forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking information as no assurances can be given to future results, performance, or achievements.

Business Overview

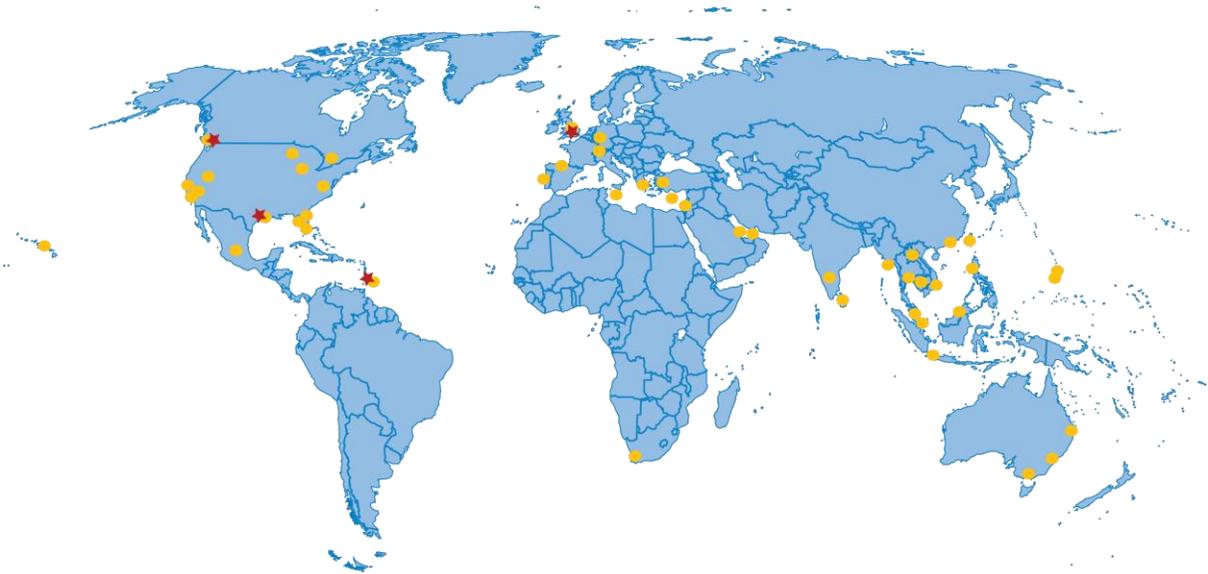
Smartcool Systems Inc. is a cleantech company that specializes in energy and cost reduction technologies for air conditioning and refrigeration systems. Smartcool's first product, the Energy Saving Module™ (ESM™), has met with a great deal of success targeting industrial and commercial businesses around the world. The expansion of the product line with introduction of the new ECO³™ in early 2009 has launched Smartcool into a new era of development and growth.

Smartcool Systems Inc. was established in 2004, and was initially the North American distributor for the ESM™ on behalf of Abbotly Technologies Pty Ltd of Australia. In 2006, Smartcool International Inc., a 100% wholly owned subsidiary of Smartcool Systems Inc., purchased the assets of Abbotly, including intellectual property of the ESM™, and became the sole distributor and manufacturer. With research and development moving to the Vancouver head office, Smartcool Systems was well positioned for further corporate and product development.

Smartcool International Inc. is the master distributor of Smartcool's product line and is located in Barbados. Following the acquisition, Smartcool International developed an international network of distributors using strategically located offices based in Vancouver, Canada, London, England, and Houston, Texas to build support and sales channels. Smartcool Systems USA Inc. is the head distributor for the U.S. and Canada (excluding B.C.) for the Energy savings Module. Smartcool Systems EMEA was formed in 2008 and is the master distributor for Europe, the Middle East, Africa and the Indian Sub-Continent. The Vancouver office supports distributors through the Americas and the Asia-Pacific region. Across the four branches of the Company, Smartcool employs 23 people, including the management team and a full office of 8 people in Vancouver. The following graphic illustrates the current structure of the Smartcool organization including third party distributors:

SMARTCOOL™

International Distribution Network



★ **Smartcool Offices:**
Vancouver, Canada
Houston, USA
Alton, UK
St. Michael's, Barbados

● **Independent Distributors**

www.smartcool.net

Market Opportunity

Achieving greater energy efficiency is a crucial step towards building more sustainable communities. The generation of electricity for use in buildings is the single largest producer of greenhouse gases in the world. There are two ways to reduce the emissions caused by electricity. The first would be to use more renewable energy sources like wind and solar power. The second is to reduce the amount of electricity currently being used around the world. Taking advantage of this 'fifth fuel' is achieving greater momentum every year and provides the most cost effective option for reducing emissions.

According to the International Energy Outlook 2006, world energy consumption is expected to increase by 71% from 2003 to 2030, most rapidly in the industrial sector. In the U.S. alone, space cooling and refrigeration accounts for 15% of total electricity consumption. At a rate of US\$0.07/kWh in the commercial sector, air-conditioning and refrigeration accounts for US\$26 billion in spending annually. Energy consistently ranks as the second or third largest operating expense for businesses with air-conditioning and refrigeration typically representing the largest electrical expense in the market verticals that Smartcool is targeting.

In countries with higher ambient temperatures, the usage in air conditioning will be significantly higher, coming much closer to 30% of total energy consumption. There has been a great deal of development in the lighting field to reduce energy, however, in the area of air conditioning and refrigeration, most of the development has resulted in expensive and complex systems requiring highly skilled installers and programmers. The cost of these systems has prohibited the installation by most small to medium consumers and even larger businesses have been challenged to meet the expense.

With ever increasing energy demands and the rising cost of power, both Government and Industry are searching for ways to simultaneously reduce operating costs and decrease their environmental impact. Governments are implementing rebate programs for companies that institute energy saving measures. Companies are realizing the economic and social benefits of implementing aggressive environmentally conscious programs that reduce their energy costs. The new administration in the U.S has highlighted the energy crisis as a significant challenge they are fully prepared to address. The investment of over US\$150 billion over the next 10 years to address the dependence on foreign oil, address the global climate crisis and create millions of new jobs is a clear indication of that commitment.

Smartcool is helping clients achieve greater energy efficiency, increase profits and promote environmental sustainability through the installation of the Energy Saving Module™ and ECO³™.

Technology Overview

The Energy Saving Module™ and ECO³™ are green technologies that reduce the electricity usage (kWh) and demand (KW) of air conditioning and refrigeration compressors through enhanced system performance. This provides substantial economic and environmental benefits for Smartcool's growing customer base. Smartcool's products are compatible with all types of control systems including the latest building automation systems and computer controlled refrigeration plants. Energy savings achieved by the ESM™ and ECO³™ are quantifiable and the products can qualify for certain government and utility rebates. The technology has been validated by rigorous third party testing, government organizations and private business installations.

The Energy Saving Module™ (ESM™)

The Energy Saving Module™ is designed specifically to reduce the electricity consumption (kWh) and maximum demand (KW/KVA) of refrigeration and air conditioning compressors by improving their performance and maintaining temperature control. The ESM™ is designed to interface with all types and makes of air conditioning and refrigeration controllers from the simple thermostat single condensing systems to the most sophisticated computer based multiple compressor parallel systems.

The ESM™ is not a controller. It is a supplement to the existing system - designed to work with the existing air conditioning and refrigeration equipment along with current control methodology in order to reduce the energy consumption. When a call for cooling comes from the existing controls, the ESM™ takes over to determine when and for how long each compressor or unloader will run. Because the primary control is not replaced, the ESM™ can be put into bypass at any time and the system returns to operating exactly as it was prior to the installation. This is an important distinction for system repairs and/or troubleshooting.

The ESM™ enables the compressor to maximize the rate of heat removal by optimizing the natural physical properties of the compressor operating cycle. This process, known as "Compressor Optimization" can reduce compressor running time by up to 30% with no affect on the temperature conditions.

The ECO³™

In early 2009, Smartcool Systems Inc. through its wholly owned subsidiary Smartcool International Inc. launched its newest product: the ECO³™. This unique retrofit device can be installed on any air conditioning or refrigeration unit with one or two compressors, and will save an average of 12% of the energy used by that system. The most significant feature of the new ECO³™ is its ability to save energy on the cooling and heating cycles of compressor driven heat pumps, significantly increasing the opportunity for energy savings. With its IP64 enclosure rating, and its simple installation process, the ECO³™ can be installed quickly (under 2 hours by an experienced technician) in virtually any location without additional and often costly protection from the elements. Once installed, the large display screen of the ECO³™ allows for easy monitoring of the amount of energy it is saving for the customer.

Third Party Assessment

Smartcool's technology has undergone significant testing, resulting in a great deal of evidence of its energy saving capabilities. In addition to independent third party tests, over 26,000 units of the ESM™ and ECO³™ have been installed worldwide.

The University of Miami, on behalf of Florida Power and Light (FPL), conducted extensive testing of the ESM™ installed over a twelve month period in 2006. The testing showed that the ESM™ reduced kWh usage of the entire air conditioning system by 8.9% – which provides a savings of 13.38% of the kWh usage by the compressors, an annual reduction of 43,660 kWh and a reduction in greenhouse gas emissions of 58,911 lbs. The ESM™ also reduced the peak demand of the system by 10.8%.

Oak Ridge National Laboratory (ORNL), a division of the U.S. Department of Energy, conducted a two phase test of the ESM™ in 2004-2005. The first phase of the test involved the analysis of data collected from an installation on a refrigeration rack in a grocery store. Phase 1 results were sufficiently promising to merit a second phase of testing in a controlled laboratory environment. The second phase evaluated the ability of the ESM™ to reduce the electrical consumption of a four compressor roof top unit in a controlled laboratory environment. Test results showed an 11.87% reduction in kWh usage by the compressors in the system and a 2.2% demand (KW) reduction.

Previously, a test on a refrigeration system was conducted by the Los Angeles Department of Water and Power (LADWP). The ESM™ was installed on two compressors of the refrigeration system of Notrica's Market in Bellflower, California. The average daily kWh usage savings recorded during this test was between 20% and 24%. These reductions were achieved while maintaining the temperature performance of the system.

Applications for Smartcool's Technology

The ESM™ and ECO³™ have a large number of potential applications in a variety of different industries. Between the two products, Smartcool is able to offer a cost-effective energy efficiency solution for virtually any cooling systems, with the exception of blast chillers. In every Smartcool installation, the ESM™ and ECO³™ provide great economic, environmental and energy reducing benefits for the client's facility.

Air Conditioning Units

The ESM™ is compatible with any air conditioning system, while the ECO³™ is compatible with packaged units with one or two stages of control. Air conditioning in facilities such as commercial real estate, supermarkets, hotels, restaurants, schools, hospitals, data centers and telecommunications facilities can all benefit from the energy efficiency products supplied by Smartcool.

Refrigeration Units

The ECO^{3™} is compatible with any single compressor refrigeration system. The ESM™ is compatible with all refrigeration systems, including large multi-compressor racks. Process cooling, cold storage warehouses, hospitals, supermarkets, mini-marts or convenience stores, restaurants and many other businesses can reduce money on their refrigeration bills by installing the ESM™ or ECO^{3™}.

Chillers

Most modern chillers are fitted with Micro-Processor Chiller Management Systems that usually allow a third party interface to modify the chiller capacity control. The Intelligent Interface Module allows the ESM™ to modify chiller capacity control using remote set point control, temperature reset, dual set point control or pulse width modulation.

The ability of the ESM™ to provide savings on a chiller is achieved by the ability of the IIM to interface with the primary controller causing the unit to shed load for a period of time to reduce the amount of energy the system is using. The ESM™ is able to provide this set point shift/load shifting through the full range of ambient conditions and not just at low ambient conditions.

Heat Pumps

Heat pumps are a rapidly growing market in North America, and have been well-established for quite some time in Europe and Australia. With the increasing push towards greater energy efficiency by governments around the world, many new constructions in the residential and commercial sectors are choosing air source or geothermal heat pumps over traditional air conditioning and/or heating systems. It is estimated that 1 in every 3 new homes in the US is built with a heat pump. These systems are gaining traction in many regions of North America thanks to their ability to provide both heating *and* cooling to buildings.

Smartcool's ECO^{3™} is ideally positioned to tackle the heat pump market, due to its unique ability to save energy on the heating and cooling cycles of compressor driven heat pumps. The recent completion of successful testing on ECO^{3™} units installed on heat pumps in Australia and in Canada shows strong results with considerable financial benefit to the customer.

Competitive Advantage

There are no direct competitors at this time with the products offered by Smartcool Systems Inc., and those few products that are geared towards energy efficiency in the air conditioning and refrigeration market do not provide the same package of benefits as does the ESM™ or ECO^{3™}. Most other products aiming to save energy on air conditioning and refrigeration systems do not target the compressors, despite the compressors being responsible for most of the energy consumed by the system. Smartcool's products target the compressors specifically, and are miles ahead of the competition with thanks to a solid technical foundation and certain unique features.

The ECO^{3™} has been developed using the experience gained through distribution of the ESM™, a product that has already met a high level of success with 26,000 units installed around the world. Case studies from ESM™ installations in all of Smartcool's targeted vertical markets show a large, satisfied customer base. As reported previously, Smartcool's ESM™ has also undergone significant independent third party testing, including field and laboratory tests by Oak Ridge National Laboratory (ORNL) on behalf of Wal-Mart, the University of Miami on behalf of Florida Power and Light (FPL) and Los Angeles Department of Water and Power (LADWP). All of the results from these tests have been positive and have verified the effectiveness of the technology. Experience gained from the development and marketing of the ESM™ has allowed the ECO^{3™} to be created and launched into the market with a solid and credible foundation. This gives potential customers additional confidence in the Company and the technology, leading them to choose Smartcool over other alternatives.

Certain features of the ECO³™ also give it an advantage over potential competitors. It is the only product on the market that can save energy on the cooling and heating cycles of compressor driven heat pumps. These types of heat pumps are very common, particularly in areas where cooling may not be necessary year round such as in British Columbia. The ECO³™ has exclusive access to this large market, as it provides the most effective energy efficiency device for customers with these types of units. The IP64 rating and simple installation cut down on additional costs for the customer, as extra protection and long labour hours are not necessary.

Highlights of 2010

Smartcool Year end revenue up 75% over 2009

Smartcool Third Quarter Revenue up 61% over 2009

Smartcool saves Sainsbury Energy in 104 Stores

Smartcool succeeds in Sunshine State with 2,000 Unit Order

Smartcool Six month Results Jump 146% over 2009

Smartcool registers Success with African Banking Giant

Smartcool starts \$1.8 Million Rollout with European Telecom Companies

Smartcool signs Major Distribution Agreement for SE ASIA

Smartcool involved in Multiple Site rollout with Major US Produce Wholesaler

Smartcool installs on 40 sites with Spanish Telecom Provider

Smartcool named part of 2010 TSX Venture 50

Smartcool records success within Australian Banking Industry

A year in review 2010

Smartcool has achieved significant growth in 2010, positioning for positive results in the coming year.

The increasing revenue generation is a result of following our strategic plan that focuses on two important components;

- A) Building a strong, global distribution network that creates sales through third party channel partners but allows Smartcool to engage in direct sales to end user customer due to the technical support available from our network.
- B) Provide a product line that is fully compatible with the maximum number of applications

In 2010 we have added new distribution channels specifically in SE ASIA that now allows our product access to one of the largest markets in the world. Concurrently the shift to the direct management of certain key accounts like Colt Telecom allows Smartcool to earn higher gross income but more importantly higher profitability for those accounts.

Smartcool has repositioned its staffing especially in the EMEA region to build a sales funnel of major accounts that can be secured due to concentration of technical resources supporting multi site rollouts throughout the European market.

To emphasize this shift, Smartcool has acquired its UK Distributor in first quarter of 2011. This strategic acquisition allows Smartcool to strengthen its management group with the addition of one of the principals from the UK distributor who brings over fifteen years of experience supporting the Smartcool technology. As well the addition of strong technical, product management skills from the integration of the technical teams and ownership of the extensive data base will provide support to the distribution network. The expectation is that the sales cycle will be shortened due to the advancement in knowledge transfer.

Managing direct sales secured by the UK team over 2010 will provide further revenue growth in upcoming quarters.

In North America during 2010, we have seen strong sales in ECO product through distribution channels in California, Florida and mid-West. These channels are seeing the improvement in financial circumstances and a renewed interest in Energy Efficiency initiatives as more funding from federal and state government are moving through the system to incent individuals and corporations to install solutions provided by Smartcool. We have been able to leverage success in Europe to secure direct accounts in North America in verticals like telecom and retail.

Another strong year of revenue growth (up 75%) and pursuing profitability, builds a foundation for continued growth both in gross revenue and the expectation of achieving profitability in 2011 for first time. The addition of strong client accounts and personnel from UK acquisition solidifies both goals for the future.

Financial Overview

The financial highlights for the year 2010 are as follows:

Revenue was \$4,209,645, increased by \$1,807,564 or 75%, compared to \$2,402,081 for the previous year. Total assets were \$5,515,157 compared to \$5,754,220 for the year 2009. Net loss for the year was \$1,555,180 (\$0.03 per share), compared to \$3,390,930 (\$0.08 per share) in prior year.

The Company had \$443,972 in cash and cash equivalents at the end of the year, compared to \$147,051 in cash and cash equivalent and short-term investments of \$101,646 at the end of the previous year.

Current liabilities at the end of the year were \$1,428,573 which include the current portions of purchase obligations to TECC Services, debentures and deferred tenant inducement totaling \$770,606. Long-term liabilities were \$531,167, consisting of acquisition obligations \$250,734, debentures \$228,978 and deferred tenant inducement \$51,455.

Selected Annual Information

The following is selected information on Smartcool's financial performance for the past three years:

	December 31, 2008	December 31, 2009	December 31, 2010
Revenue	\$1,175,168	\$2,402,081	\$4,209,645
Selling, General & Administrative	\$4,417,466	\$4,033,161	\$3,272,909
Net loss	\$(4,370,884)	\$(3,390,930)	\$(1,555,180)
Net loss – Per Share (Basic and Diluted)	\$(0.11)	\$(0.08)	\$(0.03)
Total Assets	\$8,281,026	\$5,754,220	\$5,515,157
Total Long Term Liabilities	\$624,467	\$646,436	\$531,167
Cash Dividends	\$0	\$0	\$0

Result of Operations

Revenue

Year 2010 saw the Company's revenue passing 4.2 million dollars as its distribution network continued to expand and many large installations in Europe were successfully completed. Distribution sales made up 62% of total revenue, increasing to \$2,589,310 from \$2,146,772 in the prior year. Direct sales made up 38% of total revenue, increasing to \$1,620,335 from \$255,309 in 2009. ECO^{3™} and IIM, the new products launched in 2009, continued to see high demand (Sales of ECO^{3™} represents 20% of product revenue).

Gross profit

Gross profit for the year was \$2,945,425 compared to \$1,687,648 of the previous year. Profit margin of 70% was consistently maintained for both years.

General and administrative expenses

In addition to the 75% increase in revenue, cost reduction measures continued in the year resulting in general and administrative ("G & A") expenses for the year decreasing to \$3,272,909 from \$4,033,161 of 2009, a 19% decrease. The reduction is attributable to decreases in salaries and wages (\$1,483,967 compared to \$1,799,336 for 2009), consulting fees (\$416,085 compared to \$718,831 for 2009), travel expenses (\$377,670 compared to \$455,723 for 2009) and other cost areas.

Schedule of selling, general and administrative expenses

	Twelve months ended December 31, 2010	Twelve months ended December 31, 2009
Management and consulting fees	416,085	718,831
Salaries and benefits	1,483,967	1,799,336
Professional fees	123,243	156,844
Investor relations and media	128,258	165,550
Travel	377,670	455,723
Technical consulting	157,408	125,799
Rent, office and other expenses	586,278	611,078
Total selling, general & admin expenses	3,272,909	4,033,161
Stock-based compensation	368,960	259,138
Research & Development	51,509	85,052
Amortization	560,102	602,549
Total operating expenses	4,253,480	4,979,900

Net loss

Net loss for the year was \$1,555,180, decreased by \$1,835,750 from \$3,390,930 in the prior year, due to both revenue growth and expense reduction. The loss per share (basic and diluted) for the year was \$0.03, compared to \$0.08 for 2009.

Loss per share is calculated based on the weighted average number of common shares outstanding throughout the year.

Amortization

Amortization expenses were \$560,102 for the year compared to \$602,549 for the prior year. Amortization on property and equipment was \$104,568 (2009 - \$147,090) and amortization of intangible assets was \$455,534 (2009 - \$455,459). Amortization of property and equipment was lower in 2010 as some of the Company's equipment has been fully amortized in the year.

Stock-based compensation

Stock-based compensation costs for the year were \$368,960, compared to \$259,138 for 2009. The increase was due to amortization of options granted in late 2009 as well as new options granted in early 2010.

Capital expenditures

Capital expenditures for the year were \$12,338, compared to \$45,960 for 2009. Energy measuring and monitoring equipment acquired in past years still met the Company's testing and installation needs.

Intangible assets

Smartcool acquired the intellectual property of the ESMTM and its world-wide distribution rights in the year 2006. The acquisition was closed on June 30, 2006 at a price of AU\$2,895,000. The purchase price has been fully paid. The acquired assets included four distribution contracts and several supplier agreements along with the intellectual property of the ESMTM and the ESMTM brand.

Smartcool acquired the exclusive rights to distribute the ESMTM in the United Kingdom, Spain, Portugal, and the Middle East from T.E.C.C. Services Ltd. ("TECC") in July 2008. Consideration of £1,035,000GBP (CA\$1,738,750) was payable in cash and £265,000GBP (CA\$532,067) was payable in the form of common shares of the Company. Upon closing, payment of £435,000GBP (CA\$873,393) was made and 743,709 shares were issued.

The remaining balance of £600,000GBP is due in scheduled instalments over four years with the last payment due on July 11, 2012. These instalments are non-interest bearing. At the acquisition date, the fair value of consideration was determined to be \$2,270,800 based on discounting the future payments at a rate of 16%. Transaction costs of \$28,300 were also incurred.

The purchase agreement was amended on December 21, 2009 where payments were rescheduled with the first payment due on January 16, 2010 and the last one on July 16, 2012. The parties also agreed that interest would accrue on £75,000 GBP at RBC prime rate plus 4% from January 16, 2009 and additionally on £75,000 GBP from July 16, 2009 until these amounts are fully paid. The amendment had no material impact on the company's financial position and no gain or loss was recognized in 2009. As at December 31, 2010, the balance of £464,759 GBP, including accrued interest of £14,759 GBP, remained outstanding.

Impairment of Long-Lived Assets

Smartcool amortizes long-lived assets over the estimated useful life of the asset. Evaluation of all long-lived assets occurs periodically for impairment in accordance with Section 3062 and Section 3063 of the CICA Handbook. These sections require that long-lived assets be evaluated for impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. Events or changes in circumstances include a significant adverse change in business climate that could affect their value. If such an event or change indicates that the carrying value of an asset may not be recoverable, or that our estimated amortization period was not appropriate, we would record an impairment charge against our long lived assets. The amount of impairment would be measured as the difference between the carrying value and the fair value of the impaired asset as calculated using a net realizable value methodology. An impairment charge would be recorded as an operating expense in the period of the impairment and as a reduction in the carrying value of that asset.

At December 31, 2010, to prepare for IFRS transition, we have conducted an impairment test on our definite lived intangibles assets. The intangible assets are ESM™ intellectual property, ESM™ distribution contracts and ESM™ supplier contracts that we acquired from Abbotly USA, Abbotly Technologies Pty and TECC Services. These definite lived intangibles have net book values as at December 31, 2010 of approximately \$80,000, \$3,000,000 and \$62,000, respectively.

As our revenue is primarily derived from the sales of ESM™ products, revenue associated with the above intangible assets is readily identifiable. Revenue from existing distribution channels is projected based on minimum purchase requirements in conjunction with forecasts provided by the distributors themselves. Revenue expected from potential distribution channels is based on business development progress. Cost of goods sold projections are based on our expected margin and operating costs projections based on 2010 cost structures. The undiscounted cash flows supported the recoverability of our definite lived intangible assets.

Due to the above considerations, which are based on our best available information, we have not recorded any impairment on our long-lived assets in fiscal year 2010.

Summary of Quarterly Results

	Mar 2009 (\$)	Jun 2009 (\$)	Sep 2009 (\$)	Dec 2009 (\$)	Mar 2010 (\$)	Jun 2010 (\$)	Sep 2010 (\$)	Dec 2010 (\$)
Total Revenues	225,556	510,844	681,811	983,870	634,927	1,137,863	1,098,949	1,337,906
Loss	(1,404,535)	(929,730)	(471,100)	(585,565)	(668,200)	(249,782)	(259,725)	(377,473)
Loss Per Share – basic & diluted	(0.03)	(0.02)	(0.01)	(0.01)	(0.02)	(0.01)	(0.01)	(0.01)

Revenue for the fourth quarter of 2010 was \$1,337,906, compared to \$983,870 for the same quarter of 2009, an increase of \$354,036 or 36%.

Gross margin for the fourth quarter was \$977,795, compared to \$747,350 for the same quarter of 2009, an increase of \$230,445 or 31%.

General and administration expenses for the fourth quarter were \$1,009,107, increased by \$18,823 or 2% from \$990,284 for the same quarter of 2009.

Net loss for the fourth quarter decreased to \$377,473 from \$585,565 for the same quarter of 2009, a decrease of \$208,092 or 36%. The decrease in net loss was attributable to growth in revenue and reduction of consulting fees.

Liquidity and Capital Resources

Since incorporation, the Company has financed its operations through the issuance of equity. During the year, the Company issued 2,500,000 units (consisting of one common share and one-half warrant) for gross proceeds of \$500,000. The Company also issued 122 units consisting of secured participating debentures and share purchase warrants at a price of \$5,000 per unit, for aggregate proceeds of \$610,000. Each unit consists of a non convertible debenture in the principal amount of \$5,000 and 8,600 warrants.

In February 2011, the Company issued 13,333,330 units (consisting of one common share and one-half warrant) for gross proceeds of \$4,000,000.

Sales of short-term investments in the year also generated \$101,646 in cash. As at December 31, 2010, the Company had \$443,972 in cash and cash equivalents.

Working capital at the end of the year was \$786,785 compared to working capital of \$1,031,507 at the end of 2009.

The Company consumed cash resources of \$384,221 during the year, compared to \$2,439,954 for the previous year. Cash was used mainly to fund the operating loss. The average monthly burn for the year was \$32,000 compared to \$203,000 for the previous year.

Though the Company has been able to raise capital to finance its operations from time to time, its ultimate success and the recoverability of its intangible assets will depend on the Company's ability to successfully execute its business plan which includes the existence of a market for its products, achieving profitable operations, meeting its business acquisition obligations, and the continued support of the Company's shareholders and employees.

During the year ended December 31, 2010, management raised \$500,000 through issuance of equity demonstrating the Company's success with raising financing for future operations. On February 22, 2011, the Company completed a private placement raising gross proceeds of \$4,000,000 from the issuance of 13,333,330 units comprising of one common share and one half of one common share purchase warrant.

Debentures

In May 2010, the Company completed its offer of 122 units of debenture and share purchase warrants for aggregate proceeds of \$610,000.

On February 9, 2010, the Company closed the first tranche of its debenture offering for gross proceeds of \$250,000. On March 19, 2010, the Company closed the second tranche for gross proceeds of \$85,000. On April 29, 2010, the Company closed the third tranche for gross proceeds of \$200,000 and on May 4, 2010, closed the last tranche of its debenture offering for gross proceeds of \$75,000.

The net proceeds received from the issue of debentures have been split between the financial liability component and an equity component, representing the fair value of the share purchase warrants, as follows:

	\$
Net proceeds of issue	552,751
Equity component	8,101
Liability component at date of issue	544,650

The equity component of \$8,101 has been credited to equity, Share Purchase Warrants.

The liability component is measured at amortized cost. The interest expense for the year ended December 31, 2010 was \$115,306, was calculated by applying weighted average effective interest rate of 26% to the liability component. Interest payment total of \$44,688 was paid during the year ended December 31, 2010. As at December 31, 2010, the carrying amount of these debentures was \$615,268.

Commitments

a) Premise lease

In June, 2005, the Company entered into an agreement to lease office facilities for 10 years.

In February 2008, the Company entered into a lease agreement to lease office facilities in Texas for 37 months commencing February 1, 2008 and expiring February 28, 2011, for monthly rent payments of \$1,800 per month, up to February 28, 2009 and monthly payments of \$1,908 thereafter.

The future minimum commitments for the Company's office premises are:

	\$
2011	53,970
2012	51,300
2013	52,875
2014	54,000
2015	22,500
	<u>234,645</u>

For the year ended December 31, 2010, the Company's rent expense including certain operating expenses and property taxes was \$167,273 (2009 - \$174,667) and its sublease revenue was \$16,467 (2009 - \$24,928).

b) Abbotly USA

Under the terms of the North American distribution rights acquisition, the Company is required to pay a 20% royalty on products identified in the Assignment and Assumption agreement dated March 27, 2006 and purchased from Abbotly Pty for North American sales. The initial term of the agreement was to expire on March 3, 2008. Smartcool, under its rights in the Assignment and Assumption agreement, has renewed the licensing agreement for another five year term. The Company has purchased all of the remaining inventory from Abbotly USA as required under this agreement and is now required to purchase a minimum of \$200,000 of products identified in the Assignment and Assumption agreement from Abbotly Pty per year for purposes of the royalty calculation. For the year ended December 31, 2010, the Company recorded royalty expense of US\$40,000. As at December 31, 2010, royalties of US\$12,000 were payable to Abbotly USA (Year 2009 – US\$11,200).

Transactions with Related Parties

During the year ended December 31, 2010, consulting fees of \$120,149 were charged by directors of the Company (2009 - \$254,317). Consulting fees of \$131,500 were charged by two companies with common directors during the above periods (2009 - \$76,000).

The Company rents its office in the United Kingdom from a company with a common director. During the year ended December 31, 2010, rent expense was \$35,418 (2009 –\$39,721). These transactions have been charged to general and administrative in the statement of operations, comprehensive loss and deficit. The Company also utilizes installation services from a company with a common director. During the year ended December 31, 2010, installation and material expenses charged by this related party were \$253,959 (2009 - \$0). These transactions have been charged to cost of sales in the statement of operations, comprehensive loss and deficit. At December 31, 2010, £1,158GBP (CDN\$1,796) was owed to these related parties (December 31,2009 - £8,129GBP(CDN\$13,753)).

The Company subleases its Vancouver office and other facilities to a company with a common director. During the year ended December 31, 2010, sublease income was \$16,467 (2009 - \$24,928). At December 31, 2010, \$1,000 was owed from this related party (December 31, 2009 - \$2,100).

The Company uses the services of a law firm of which a director is a partner. During the year ended December 31, 2010, fees in the amounts of \$36,644 were charged to the Company for legal services provided. As at December 31, 2010, \$55,006 was owed to this related party.

During the year ended December 31, 2010, total sales of \$604,622 were made to company with a common director (2009 – \$226,174). As at December 31, 2010, \$97,051 was owed from this related party (December 31, 2009 \$74,734).

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Outstanding Share Data

The authorized share capital of the Company is an unlimited number of common shares without par value. As at December 31, 2010 the Company had 46,821,396 common shares outstanding. The following table provided the weighted average number of common shares outstanding for the three months and the year ended December 31, 2010.

	2010	2009
Three month weighted average	46,821,396	44,321,396
Annual weighted average	45,787,149	42,807,917

The increase in average number of common shares outstanding was a result of the issuance of 2,500,000 common shares pursuant to June 1, 2010 private placement.

As at April 28, 2010, the outstanding shares are 60,254,726 and diluted are 77,811,258.

Warrants and Stock options

As at December 31, 2010, there were 2,424,200 share purchase warrants and 6,526,500 stock options outstanding which collectively could result in the issuance of 8,950,700 common shares if these warrants and stock options are exercised. The outstanding options have a weighted average exercise price of \$0.31.

As at December 31, 2010 there were 5,085,500 exercisable options with a weighted average exercise price of \$0.33.

During the year, 1,640,000 options were granted to consultants, employees, directors and officers of the Company.

As at April 28, 2011, there were 10,717,532 outstanding warrants and 6,839,000 outstanding options. The outstanding options have a weighted average exercise price of \$0.31.

Financial Instruments and Risk Management

The Company is exposed to certain financial risks, including credit risk, liquidity risk, and market risk. Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations and arises principally from the Company's cash and cash equivalents, short-term investments and amounts receivable. The Company limits its exposure to credit loss by placing its cash and cash equivalents and short-term investments with high credit quality financial institutions.

Liquidity risk results from the Company's inability to meet its financial obligations when they become due. As part of the risk management process, the board approves the Company's annual operating and capital budgets as well as any material transactions outside the ordinary course of business. To ensure that the Company has sufficient liquidity to meet its acquisition obligations and other current obligations in 2010, the Company has raised 4 millions dollars through equity financing.

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the Company's income or valuation of its financial instruments. The Company is exposed to fluctuations in foreign currency as most of its international distribution transactions are settled in U.S. dollars, Australian dollars and British pounds. The Company's net income and cash flow will therefore be affected by fluctuations in foreign exchange rates. None of these risks have been mitigated by the use of foreign currency forward contracts. The Company is exposed to fluctuations in interest rates as late payments under TECC acquisition obligations are subject to interest based on prime rate plus 4%. As at December 31, 2010 the total of such payments was £150,000GBP.

Details of the Company's financial instruments as at December 31, 2010 and risk exposures are disclosed in note 16 to the consolidated financial statements.

Subsequent Events

Business acquisition

In December 2010, the Company entered into a Letter of Intent for the acquisition of Smartcool Systems UK Ltd., a distributor of Smartcool Technologies.

Under the terms of the proposed acquisition, Smartcool Systems EMEA Ltd, a wholly-owned subsidiary of the Company, will acquire all issued and outstanding shares in the capital of Smartcool Systems UK as well as assuming the obligations of all the Company's employment agreements.

Smartcool UK is one of the licensees of Smartcool technologies. Pursuant to a distribution agreement, Smartcool UK owns certain distribution rights to Smartcool products in the United Kingdom and Ireland. As such, this acquisition represents a vertical integration of the Company's current operations.

For consideration, Smartcool agreed to pay to Smartcool UK shareholders:

- an amount of £2,200,000 GBP, of which £1,200,000 GBP is paid on closing and the remainder paid in installments of £250,000 GBP every three months; and
- an amount equal to the net book value of Smartcool UK shares on December 31, 2010, which is approximately £500,000 GBP

The Company will also issue to the shareholders of Smartcool UK a total of 1,000,000 share purchase warrants for a price of \$0.30 per share. 25% of the warrants will be vested at closing, and the remainder will vest in 25% installments every six months. These warrants will expire two years from vesting date.

The acquisition was subject to the Company reaching a definitive legal agreement, raising sufficient capital to fund the acquisition, and obtaining approval from the TSX Venture Exchange. The Company received a conditional approval from the Exchange on February 16, 2011 and the final approval on March 1, 2011.

Private placement

On February 14, 2011, the Company announced that it proposed to offer through a non-brokered private placement up to 10,000,000 units at a price of \$0.30 per unit.

Each unit consists of one common share and one half of one non-transferrable common share purchase warrant. Each whole purchase warrant entitles the holder to acquire one common share at a price of \$0.45 at any time up to 24 months from the closing dates.

On January 17, the Company announced that it now offered up to 13,333,333 units to raise proceeds up to \$4,000,000 instead of \$3,000,000.

On February 22, 2011, this private placement was closed.

Critical Accounting Policies and Estimates

Intangible assets

Intangible assets are recorded at cost and include the ESMTM brand, ESMTM intellectual property, distribution agreements and supplier agreements. The ESMTM brand has been determined to have an indefinite life and is not amortized. The remaining intangible assets are amortized on a straight-line basis over their useful lives as follows:

ESM TM Intellectual property	10 years
North American distribution rights	10 years
European distribution rights	9 years
Distribution agreements	10 - 15 years
Supplier agreements	10 years

Impairment of long-lived assets

Long-lived assets including property and equipment and intangible assets with a finite life are tested for impairment whenever events or changes in circumstances indicate that carrying value of an asset or asset group may not be recoverable. An impairment loss would be recognized when the carrying amount of an asset exceeds the estimated undiscounted future cash flow expected to result from the use of the asset and its eventual disposition. The amount of the impairment loss to be recorded is calculated by the excess of the asset's carrying value over the fair value. Fair value is generally determined using a discounted cash flow analysis.

Intangible assets with an indefinite life are reviewed for impairment annually or more frequently, if events or changes in circumstances indicate that the asset might be impaired. The asset is written down when the carrying amount exceeds its estimated fair value.

Revenue recognition

Revenue from the direct sale and installation of the ESMTM and ECO^{3TM} in North America is recognized when the ESMTM has been installed, title has transferred, collectability is reasonably assured and the fee is fixed and determinable. Revenue from the worldwide distribution of the ESMTM and ECO^{3TM} is recognized when the equipment has been shipped and title has transferred, collectability is reasonably assured and the fee is fixed and determinable. Provisions are established for estimated warranty costs at the time revenue is recognized. The Company records deferred revenue when cash deposits are received in advance of the above revenue recognition criteria being met.

Research and development costs

Research costs are expensed as incurred. Development costs are expensed as incurred unless they meet specific criteria under Canadian GAAP for deferral and amortization, which relate primarily to technical, market and financial feasibility.

Stock-based compensation and other stock-based payments

The fair value of all stock options granted to employees and non-employees is determined using the Black-Scholes option pricing model, and the resulting value is charged to operations over the vesting period. For options granted to non-employees, the fair value is measured when performance is complete, a performance commitment is made or the options are fully vested and non-forfeitable, whichever is earliest, and the expense is recognized over the period in which the goods or services from the non-employees are received. A corresponding increase in contributed surplus is recorded when stock options are expensed. When stock options are exercised, share capital is credited by the sum of the consideration paid and the related portion previously recorded in contributed surplus. At the time of grant, the expense is determined based on estimated forfeiture rate. The expense will be adjusted to recognize the effect of actual forfeitures as they occur.

Internal Controls over Financial Reporting and Disclosure Controls and Procedures

The Chief Executive Officer and Chief Financial Officer make no representation relating to the establishment and maintenance of the Company's disclosure controls and procedures and internal controls over financial reporting.

Future Accounting Standards

International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed that International Financial Reporting Standards ("IFRS") will replace Canadian GAAP for publicly accountable profit-oriented enterprises for interim and annual financial statements effective January 1, 2011.

The Company will therefore be required to report using IFRS commencing with its unaudited interim financial statements for the three months ended March 31, 2011, which must include the interim results for the three months ended March 31, 2010 prepared on the same basis. IFRS uses a conceptual framework similar to Canadian GAAP, but there are some significant differences with regards to recognition, measurement and disclosures. Management has performed an analysis to identify differences between the Company's current accounting policies and IFRS. The impact of IFRS convergence on its financial statements has not been quantified yet as accounting policies are still being finalized.

IFRS 1 - First-time adoption of International Financial Reporting Standards

The basic requirement for IFRS adoption is full retroactive application of all IFRS effective at the reporting date. IFRS 1, however, provides entities that adopt IFRS for the first time with a number of optional exemptions and mandatory exceptions. Management plans to apply the following optional exemptions:

Business combinations – IFRS 1 allows an entity to use IFRS standards for business combinations on a prospective basis rather than restating all business combinations.

Cumulative translation differences – IFRS 1 relieves entities from complying with the requirement of IAS 21 to separately classify the cumulative translation differences as a component of equity. This exemption allows cumulative translation differences to be deemed as zero at the transition date.

Share-based payments – IFRS 1 provides an exemption on IFRS 2 'Share-based payments' to equity instruments that vested before the transition date.

Major accounting policy differences

Set below are the key areas where changes in accounting policies are expected that may impact the Company's consolidated financial statements. The list and comments below should not be regarded as a complete list of changes that will result from transition to IFRS. It is intended to highlight those areas we believe to be most significant; however, analysis of changes is still in process and not all decisions have been made where choices of accounting policies are available. We note that the standard-setting bodies have significant ongoing projects that could affect the ultimate differences between Canadian GAAP and IFRS and their impact on the Company's consolidated financial statements in future years.

Foreign currency translation IAS 21

Under IFRS the financial statements of subsidiaries are translated into consolidated financial statements currency as follows: All assets and liabilities are translated at the closing rate at the balance sheet date. Income statement is translated at exchange rates at the dates of the transactions. All resulting exchange differences are recognized as a separate component of equity.

Presently, the Company follows the temporal method where only monetary assets and liabilities of its integrated foreign operations are translated at balance sheet exchange rate and exchange differences are recognized in the income statement.

To assess the impact of this IFRS standard on the Company's financial statements, we have conducted a review of the functional currency of the Company and each of its subsidiaries. The review indicated our functional currencies remained the same under IFRS. The application of consolidation method prescribed under IFRS, however, resulted in a reduction of the company's assets and shareholders' equity of approximately \$200,000 as at December 31, 2010 and \$160,000 as at January 1, 2010

Intangible assets impairment IAS 36

Canadian GAAP generally uses a two-step approach to impairment testing: (1) comparing asset carrying values with undiscounted future cash flows to determine whether impairment exists; and (2) measuring any impairment by comparing asset carrying values with fair values. Under IAS 36, a one-step approach for both testing for and measuring impairment is used, with asset carrying values being compared directly with (i) the higher of fair value less costs to sell; and (ii) value in use (which uses discounted future cash flows). This may potentially result in more write-downs where carrying values of intangible assets were previously supported under Canadian GAAP on an undiscounted cash flow basis but could not be supported on a discounted cash flow basis. However, the extent of any new write-downs may be partially offset by the requirement under IAS 36 to reverse any previous impairment losses where circumstances have changed such that the impairments have been reduced. Canadian GAAP prohibits reversal of impairment losses.

To assess the impact of this IFRS standard on the Company's financial statements, we have conducted an impairment test on our definite lived intangibles assets as at December 31, 2010. Value in use was determined by discounting future cash flows at 26%, the rate considered appropriate for the Company's size and industry. The discounted cash flows indicated no impairments of our definite lived intangible assets.

Risk Factors

The business of the Company is subject to a number of risks and uncertainties associated with its business for the marketing and distribution of the ESMTM.

Lack of Marketing Network

At the current time the Company has continued to develop new marketing networks throughout the world. A primary objective of the Company's business plan includes the identification and securing new networks however there can be no assurances of the amount of revenue that will be generated from these efforts. To mitigate the risk to a certain extent, the Company when granting exclusive marketing rights for a territory will require a new distributor to agree to purchase a minimum amount of inventory in each year of the agreement to retain exclusivity. This provides the Company with revenue from these territories.

Reliance on Key Personnel

The Company is dependent on certain key members of its management team, and in particular Mr. George Burnes, President, to complete the market development of the ESMTM and ECO^{3TM}. If any of these individuals are unavailable for any reason, the ability of the Company to implement its business plan in the short term would be materially and adversely affected. To mitigate the risk to a certain extent, key personnel in the companies' subsidiaries have been added to complete new marketing initiatives in developing markets.

Concentration on a single product and supplier

Presently, as the Company is placing its sole focus on the distribution of the ESMTM, and ECO^{3TM}, any unfavorable change in the quality of the product or the introduction of similar products by competitors in the market would affect the Company's competitive advantage to a great extent. To mitigate the risk to a certain extent, the Company expanded the application of its technology and made available the ECO3 which allows for sales initiatives in new vertical markets and new distribution channels previously not available.

The Company also relies on Tiller Manufacturing for the manufacturing of its major products, ESMTM and ECO^{3TM}.

Currency risk

Presently the Company's major business dealings are transacted in foreign currencies. Direct sales are in the United States currency as well as the majority of sales to distributors are also in US currency. Any devaluation in these currencies would affect the Company's future revenues. Also, a significant portion of the Company's expenses are in Canadian and Australian currencies. As long as the majority of revenue remains in US currency, appreciation in the value of Canadian and Australia currencies relative to the US dollar would worsen that affect on net operating results. To mitigate this risk to certain extent, recently the Company has had most of its new purchases and sales contracts denominated in US dollars.

Competition Risk

Although the ESM[™] and ECO^{3™} are unique products and the Company is not aware of any direct competitors, there is a possibility that new technologies will be developed that allow direct competition as energy saving activities gain more and more public support. These potential competitors may have greater resources and networking and the Company may not be able to successfully compete with them. This direct competition may adversely affect the Company's operating results and even its ability to sustain the business.

Additional Information

Additional information relating to the Company, including the Company's latest Annual Financial Statements and news releases can be located on the SEDAR website at www.sedar.com or on the Company's website at www.smartcool.net