SMARTCOOL™

Smartcool Systems Inc. (TSX-V: SSC)
Condensed Consolidated Interim Financial Statements

For the three months ended June 30, 2013 and 2012
Expressed in Canadian Dollars

www.smartcool.net

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NOTICE OF NO AUDITOR 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 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.

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Smartcool Systems Inc.
Condensed consolidated statements of financial position
(Expressed in Canadian dollars, unless otherwise stated)
(unaudited)

	June 30 2013	December 31 2012
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	127,148	247,150
Trade and other receivables (note 3)	278,855	749,136
Inventory (note 4)	334,715	314,484
Prepaid expenses and deposits	85,041	65,244
	825,759	1,376,014
Property and equipment (note 5)	121,338	157,069
Intangible assets (note 6)	3,416,991	3,934,093
Total assets	4,364,088	5,467,176
LIABILITIES		
Current liabilities		
Trade payables and accruals	791,025	940,868
Short-term loan (note 7)	125,833	-
Current portion of obligations under acquistion contracts (note 8)	2,594,141	2,536,357
Current portion of finance leases	4,795	19,409
Current portion of debentures (note 9)	114,717	348,520
Current portion of deferred tenant inducement	16,168	15,052
	3,646,679	3,860,206
Debentures (note 9)	179,437	-
Deferred tenant inducement	14,826	22,911
Deferred tax liability (note 11)	396,651	477,277
Total liabilities	4,237,593	4,360,394
SHAREHOLDERS' EQUITY		
Share capital (note 10(a))	30,070,960	29,835,392
Reserve for equity settled share based transactions (note 10(b)(c))	5,771,299	5,712,544
Foreign currency translation adjustment	(137,086)	(131,138)
Deficit	(35,578,678)	(34,310,016)
	126,495	1,106,782
Total liabilities and shareholders' equity	4,364,088	5,467,176

Approved and authorized for issue by the Board of Directors on August 28, 2013

"George Burnes"	"Jeffrey Lowe"
George Burnes	Jeffrey Lowe

See accompanying notes to the consolidated financial statements

SMARTCOOL™

Smartcool Systems Inc.
Condensed consolidated statements of operations
(Expressed in Canadian dollars, unless otherwise stated)
(unaudited)

	Three months ended June 30		Six months ended June 30	
	2013 $	**2012** $	**2013** $	**2012** $
Revenue	491,253	1,066,107	634,855	1,369,557
Cost of sales	80,992	529,302	126,722	635,061
Gross profit	410,261	536,805	508,133	734,496
Operating Expenses				
General and administrative expenses	552,238	821,153	1,182,342	1,661,968
Stock-based compensation	35,408	30,527	42,575	88,788
Research and development	-	9,554	21,376	9,554
Amortization and depreciation	261,706	276,112	521,161	549,111
	849,352	1,137,346	1,767,454	2,309,421
Operating income (loss)	(439,091)	(600,541)	(1,259,321)	(1,574,925)
Rental income	(29,136)	(28,621)	(57,757)	(28,621)
Finance expense	59,912	76,230	128,428	153,408
Finance income	-	(80)	(1)	(171)
Foreign exchange (gain) loss	(3,086)	(1,967)	11,625	55,843
Loss on sale of property and equipment	(446)	-	(446)	-
	27,245	45,562	81,849	180,459
Income taxes (note 11)	(36,431)	(211,991)	(72,508)	(249,358)
Net loss for the period	**(429,905)**	**(434,113)**	**(1,268,662)**	**(1,506,026)**
Net loss per share				
Basic	(0.01)	(0.01)	(0.02)	(0.02)
Diluted	(0.01)	(0.01)	(0.02)	(0.02)
Weighted average number of common shares outstanding (basic and diluted)	**64,616,967**	**64,287,297**	**64,452,132**	**64,000,666**

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.
Condensed consolidated statements of comprehensive loss

(Expressed in Canadian dollars, unless otherwise stated)
(unaudited)

	Three months ended June 30		Six months ended June 30	
	2013	**2012**	**2013**	**2012**
	$	**$**	**$**	**$**
Net income (loss) for the period	**(429,905)**	**(434,113)**	**(1,268,662)**	**(1,506,026)**
Foreign currency translation adjustment	(47,226)	(35,286)	(5,948)	(13,306)
Total comprehensive income (loss)	**(477,131)**	**(469,399)**	**(1,274,610)**	**(1,049,935)**
Net loss per share				
Basic	**(0.01)**	**(0.01)**	**(0.02)**	**(0.02)**
Diluted	**(0.01)**	**(0.01)**	**(0.02)**	**(0.02)**

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.
Condensed consolidated statement of cash flows

(Expressed in Canadian dollars, unless otherwise specified)
(unaudited)

	Three months ended June 30		Six months ended June 30	
	2013	**2012**	**2013**	**2012**
	$	$	$	$
Cash flows from operating activities				
Loss for the period	(429,905)	(434,113)	(1,268,662)	(1,506,026)
Items not affecting cash:				
Depreciation of property and equipment	16,296	24,196	35,857	45,528
Amortization of intangible assets	245,410	251,915	485,304	503,583
Impairment of intangible assets	-	-	-	-
Stock-based compensation	35,408	30,527	42,575	88,788
Deferred tax liability	(21,932)	37,367	(80,627)	-
Deferred tenant inducement	(3,596)	(3,373)	(6,969)	(6,746)
Foreign exchange (gain) loss	15,749	(26,751)	3,300	3,500
Accrued interest on debentures	(2,754)	2,066	3,350	8,005
Accrued interest of obligation under acquisition contract	43,864	36,507	86,164	62,613
Accretion of obligation under acquisition contract	-	16,881	-	40,242
	(101,460)	(64,778)	(699,707)	(760,513)
Changes in non-cash working capital items:				
Trade and other receivables	(57,065)	(662,843)	470,281	(90,379)
Inventory	(52,305)	89,438	(20,231)	21,100
Prepaid expenses and deposits	97,780	34,179	(19,797)	67,620
Trade payables and accruals	(72,082)	491,696	(149,843)	74,239
Net cash flows (used in) provided by operating activities	(185,132)	(112,308)	(419,297)	(687,933)
Cash flows from investing activities				
Disposal of property and equipment	1,470	-	1,470	-
Purchase of property and equipment	(595)	(33,383)	(2,499)	(88,610)
Business acquisitions, net of cash acquired	-	-	-	-
Net cash (used in) provided by investing activities	875	(33,383)	(1,029)	(88,610)
Cash flows from financing activities				
Shares and warrants issued for cash, net of issue costs	235,568	-	235,568	369,923
Short-term loans	125,833	104,219	125,833	104,219
Debenture issued for cash	-	-	-	-
Decrease in debentures	(41,062)	(22,044)	(41,062)	(107,761)
Decrease in acquisition contract obligation	-	-	-	(39,060)
Increase (decrease) in finance leases	(7,028)	(8,339)	(14,067)	(18,001)
Net cash (used in) provided by financing activities	313,311	73,836	306,272	309,320
Net increase (decrease) in cash and cash equivalents	129,054	(71,855)	(114,054)	(467,223)
Effects of exchange rates changes on cash	(47,226)	611	(5,948)	1,085
Cash and cash equivalents, beginning of period	45,320	103,980	247,150	498,874
Cash and cash equivalents, end of period	127,148	32,736	127,148	32,736

See accompanying notes to the consolidated financial statements

SMARTCOOL™

Smartcool Systems Inc.
Condensed consolidated statement of shareholders' equity
(Expressed in Canadian dollars, unless otherwise stated)

(unaudited)

	Share capital	Reserve for equity settled share based transactions	Foreign currency translation adjustment	Deficit	Total Shareholders' Equity
	$	$	$	$	$
Balance at January 1, 2011	29,465,469	5,589,386	(53,990)	(32,377,744)	2,623,121
Net loss				(1,506,026)	(1,506,026)
Foreign currency translation adjustment			(13,306)		(13,306)
Total comprehensive loss for the period			(13,306)	(1,506,026)	(1,519,332)
Share issued for:					
Private placement	375,000				375,000
Share issue costs	(5,077)				(5,077)
Stock based compensation		88,788			88,788
Balance at June 30, 2012	**29,835,392**	**5,678,174**	**(67,296)**	**(33,883,770)**	**1,562,500**
Net loss				(426,246)	(426,246)
Foreign currency translation adjustment			(63,842)		(63,842)
Total comprehensive loss for the period			(63,842)	(426,246)	(490,088)
Share issued for:					
Private placement					-
Share issue costs					-
Stock based compensation		34,370			34,370
Balance at December 31, 2012	**29,835,392**	**5,712,544**	**(131,138)**	**(34,310,016)**	**1,106,782**
Net loss				(1,268,662)	(1,268,662)
Foreign currency translation adjustment			(5,948)		(5,948)
Total comprehensive loss for the period			(5,948)	(1,268,662)	(1,274,610)
Share issued for:					
Private placement	250,000				250,000
Warrants		16,180			16,180
Share issue costs	(14,432)				(14,432)
Stock based compensation		42,575			42,575
Balance at June 30, 2013	**30,070,960**	**5,771,299**	**(137,086)**	**(35,578,678)**	**126,495**

See accompanying notes to the consolidated financial statements

1. Reporting Entity

Smartcool Systems Inc. (“Smartcool” or the “Company”), is a clean technology corporation focusing on acquiring, commercializing, and marketing energy saving technologies for commercial, industrial and residential customers. Currently the Company has two principal revenue streams: the sale and installation of the ESM™ and ECO3™ to end customers and to distributors worldwide

The ESM™ is manufactured by a third party in Australia and is designed specifically to reduce the electricity consumption and maximum demand of refrigeration and air conditioning compressors by improving their performance and maintaining temperature control. The ESM™ uses microprocessor technology and software algorithms.

Introduced in early 2009, the ECO3™ is manufactured in China and is a simple retrofit product that can be installed on any air conditioning, heat pump or refrigeration unit with one or two compressors, achieving the same energy efficiency gains as the ESM™ for these smaller systems.

The Company’s shares are listed on the TSX Venture Exchange and the head office, principal address, and registered office is located at 1620 – 401 West Georgia Street, Vancouver, BC, V6B 5A1.

2. Significant Accounting Policies

Basis of Presentation and Statement of Compliance

The condensed consolidated interim financial statements of the Company for the three month and six months ended June 30, 2013 comprise the Company and its subsidiaries. These condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards 34, Interim Financial Reporting. They do not include all the necessary annual disclosures as prescribed by International Financial Reporting Standards and should be read in conjunction with the annual audited consolidated financial statements as of December 31, 2012.

The Company’s condensed consolidated interim financial statements have been prepared on the historical cost basis except for certain financial instruments which are measured at fair value, as explained in Note 18 (December 31, 2012 audited financial statements), and are presented in Canadian dollars except where otherwise indicated.

Use of Estimates and Judgments
The preparation of these consolidated financial statements in accordance with IFRS requires the use of certain critical accounting estimates and assumptions. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are outlined below. Actual results may differ from those estimates.

Significant estimates are used for, but not limited to, assessment of impairment of intangible assets and recoverability of long-lived assets, determination of present value of obligations under acquisition contract, determination of fair value of debentures, valuation of stock options and warrants, recoverability of trade and other receivables, inventory valuation, determination of valuation allowance for income tax assets, amortization rates and methods and ability to continue as a going concern.

Judgments made by management in the application of IFRS that have a significant effect on the consolidated financial statements and estimates with a significant risk of material adjustment in the current and following fiscal years are discussed below:

- Useful lives – the useful lives of intangible assets and the related depreciation
- Impairment – the assessment of impairment of intangible assets and goodwill
- Inventory valuation – the provision for obsolescence of inventory and net realizable value
- Receivable valuation – the recoverability of account receivables
- Share-based payments – the inputs used in accounting for share-based payment
- Debentures – discount rate used in fair value calculation of the debenture
- Contingencies – any future contingencies and commitments
- Going concern – the assessment of the Company's ability to continue as a going concern

Basis of Consolidation
The Company consolidates subsidiaries controlled by the Company. Control exists when the Company has the power over the subsidiaries, the rights to variable returns from investment in the subsidiaries and the ability to use power over the subsidiaries to affect the amount of the Company's returns. The financial statements of the subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Smartcool USA, Smartcool International, Smartcool EMEA and Smartcool UK from February 28, 2011, the date of acquisition. All inter-company transactions, balances, revenues and expenses, have been eliminated.

Going Concern
These consolidated financial statements have been prepared assuming the Company will continue as a going concern. The Company is required to assess its ability to continue as a going concern or whether substantial doubt exists as to the Company's ability to continue as a going concern into the foreseeable future.

To ensure that the Company continues to be a going concern with adequate working capital through 2013 steps have been taken to reduce expenses, secure more predictable revenue generation and collect outstanding receivables. Management has arranged with a UK bank to have a short term overdraft protection.

The Company has also received confirmation from the holders of TECC and Smartcool UK purchase obligations that they will not require settlement of outstanding amounts through 2013.

In June 2013, the Company raised additional capital of $250,000 by way of a non-brokered private placement. A second private placement was announced on July 11, 2013 and the company is expecting to raise another $250,000 by early September 2013. The company also obtained a short-term loan of $125,000 from an investor in May 2013. These financing arrangements have helped the Company meet short-term trading obligations.

The Company's ultimate success and the recoverability of its assets will depend on the Company's ability to successfully execute its business plan which includes a growing market for its products, achieving profitable operations, meeting its business acquisition obligations, the continued support of the Company's shareholders and employees, and the continued support from creditors with whom negotiations have been made and waivers obtained.

These material uncertainties may cast significant doubt on the Company's ability to continue as a going concern. These consolidated financial statements do not reflect adjustments to the carrying value of assets and liabilities which may be required should the Company be unable to raise adequate financing or meet current obligations and therefore be unable to continue as a going concern.

Business Combinations and Goodwill

A business combination is defined as an acquisition of assets and liabilities that constitute a business. A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return to the Company and its shareholders in the form of dividends, lower costs, or other economic benefits. A business consists of inputs, including non-current assets, and processes, including operational processes, that when applied to those inputs, have the ability to create outputs that provide a return to the Company and its shareholders. A business also includes those assets and liabilities that do not necessarily have all the inputs and processes required to produce outputs, but can be integrated with the inputs and processes of the Company to create outputs.

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Company, liabilities incurred by the Company to the former owners of the acquiree and the equity interests issued by the Company in exchange for control of the acquiree. Acquisition-related costs are recognized in profit or loss as incurred.

Where the fair value of the identifiable net assets acquired exceeds the cost of the acquisition, the surplus, which represents the discount on the acquisition, is recognized directly in the statement of operations in the period of acquisition. Where the fair value of consideration paid exceeds the fair value of net identifiable tangible and intangible assets, goodwill is recognized.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Company reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period, or additional assets or liabilities are recognized, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognized at that date.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates.

Foreign Currency

The functional currency of Smartcool Systems Inc. and Smartcool International has been determined to be the Canadian dollar. The functional currency of Smartcool USA is the United States dollar. The functional currency of Smartcool EMEA and Smartcool UK is the British pound. The consolidated financial statements have been translated to the Canadian dollar in accordance with IAS 21, “The Effects of Changes in Foreign Exchanges Rates”.

Financial statements of subsidiaries where the functional currency is other than the Canadian dollar are translated to Canadian dollars using the current rate method. Assets and liabilities are translated at the exchange rate at period end and revenues and expenses are translated using the exchange rates at the date of the transactions. All resulting exchange differences are reported as a separate component of shareholders’ equity titled “Foreign Currency Translation Adjustment”.

For foreign subsidiaries where the Canadian dollar is the functional currency, non-monetary assets and liabilities are translated to Canadian dollars using the exchange rate in effect at the original transaction date. Monetary balances are translated at rates of exchange at the period end date. The translation difference resulting from translating the foreign currencies to Canadian dollars is recorded as a component of foreign exchange gain and loss.

Revenue Recognition

Revenue from the sale and installation of the ESM™ and ECO3™ is recognized when the ESM™ & ECO3™ have been installed, significant risks and rewards of ownership of the equipment have been transferred to the customer, the Company does not retain continuing managerial involvement or effective control over the equipment, the sales price can be determined and collection is probable, and the cost of the transaction can be measured reliably.

Revenue from the international distribution of the ESM™ & ECO3™ is recognized when the equipment has been shipped, title has been transferred, the sales price has been determined and the cost of the equipment can be measured reliably. Revenue is also recognized when equipment has been ordered and laid away as instructed by the customer, the sales price has been determined and a significant portion of it has been paid. Provisions are established for estimated warranty costs at the time revenue is recognized. The Company records deferred revenue when cash is received in advance of the above revenue recognition criteria being met.

Warranty

The Company provides for future warranty costs based on management's best estimates of such costs, taking into account past experience and warranty provisions of distribution and sale agreements.

Share-based Payments

The fair value of all stock options granted to employees is determined using the Black-Scholes Option Pricing Model, and the resulting value is charged to operations over the vesting period. Volatility rate is determined based on the trading history of the Company's shares for the relevant period and interest rate is based on Canadian bond rates.

The fair value of options granted to non-employees is determined using fair value of the goods or services received. The resulting value is charged to operations when 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. To estimate the fair value of options granted to non-employees, management considers primarily the fees management would be willing to pay in cash for the service if no options were granted.

A corresponding increase in equity reserve 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 equity reserve. 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. The fair value of warrants issued to agents for their finder's fee is based on the fair value of the services provided and charged to share issuance costs.

Inventory

Inventory is recorded at the lower of cost and net realizable value. Costs of inventories are determined using the weighted average cost method. Cost of inventory includes invoiced cost from the manufacturer and other costs in bring the inventory to their present location and condition and net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

Intangible Assets

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

ESM™ Intellectual property	10 years
North American distribution rights	10 years
United Kingdom distribution rights	9 years
Distribution agreements	5 - 15 years
Supplier agreements	10 years
Customer relationship	5 years

Total amortization of $245,410 (June 30, 2012 - $251,915) for the three months ended June 30, 2013 and $485,304 (June 30, 2012 - $503,583) for the six months ended June 30, 2013 were included under net loss for the period on the statement of operations.

Impairment

a. ***Property, equipment and intangible assets with a finite useful life***

Property, equipment and intangible assets with a finite life are assessed for indications of impairment at the end of each reporting period. If such indications exist, then the recoverable amount of the asset or cash-generating unit ("CGU") is estimated.

An impairment loss is recognized when the carrying amount of the asset or CGU exceeds its recoverable amount. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of cash inflows from other assets or groups of assets. The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and risks specific to the asset or CGU.

Impairment losses are recognized in respects to CGU's are first allocated to reduce the carrying amount of any goodwill allocated to the CGUs, and then to reduce the carrying amount of the other assets in the unit on a pro-rata basis. Impairment losses are recognized in profit and loss for the period it is identified.

b. ***Intangible assets with an indefinite useful life***

Intangible assets with an indefinite life are reviewed and tested 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 recoverable amount. The ESM™ brand is considered to have an indefinite life as the Company has a global market and there is no direct competition for its instinctive green technology.

Reversal of Impairment

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss has been recognized. An impairment loss with respect to goodwill is never reversed.

Share Purchase Warrants

The Company issued common shares and share purchase warrants as a unit as well as units of debenture and share purchase warrants. The unit price is allocated to common shares and warrants based on their relative fair values. The residual method is used to allocate the value of debentures and warrants. The fair value of common shares is the market price on the date of issue and the fair value of warrants is determined using the Black-Scholes Option Pricing Model. Because the Black-Scholes option pricing model requires the input of highly subjective assumptions, including the volatility of share price, changes in subjective input assumptions can materially affect the fair value estimate.

The Company also issued warrants to agents as compensation for services. The fair value of these warrants was determined to be the difference between agent's standard all-cash compensation and compensation with warrants. Warrants were also issued as non-cash consideration for business acquisitions. The fair value of these warrants was determined based on Black Scholes model.

Changes in Accounting Policies

A number of standards and amendments were issued effective for accounting periods beginning on or after January 1, 2013. Many of these updates are not applicable to the Company. As of January 1, 2013, the Company adopted the following IFRS standards and amendments:

- IFRS 10, "Consolidated Financial Statements" ("IFRS 10"), establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 supersedes IAS 27 "Consolidated and Separate Financial Statements" and SIC-12 "Consolidation—Special Purpose Entities". Under IFRS 10, control is based on whether an investor has:
  a) power over the investee
  b) exposure or rights to variable returns from investments with the investee
  c) the ability to use power over the investee to affect the amount of the investor's returns

  The adoption of this standard does not have any impact the Company's consolidated financial statements.

- IFRS 13, "Fair Value Measurement" ("IFRS 13"), defines fair value and sets out in a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. The IFRS 13 applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements. This standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in

an orderly transaction between market participants at the measurement date. It also requires the disclosure of certain information on fair value measurements.
The adoption of this standard does not have any impact the Company's consolidated financial statements.

- Amendments to IAS 1- Presentation of Financial Statements require items of other comprehensive income be grouped based on their potential reclassifiability to profit and loss.
The adoption of this standard does not have any impact on the Company's consolidated financial statements.

3. Trade Receivables

	June 30, 2013	December 31, 2012
[1]Trade receivables, net of allowances for doubtful accounts	$269,115	$742,684
Other receivables	9,740	6,452
	$278,855	**$749,136**

[1] Allowance for doubtful accounts as at June 30, 2013 was $564,120 (December 2012 - $584,656). This allowance consists primarily of receivables from Colt Technology Services ("Colt") of $539,157 (£337,247). The Company has been in negotiations with Colt. This expense has been recorded in General and Administrative Expenses.

4. Inventory

	June 30, 2013	December 31, 2012
ESM™ ECO3™	$269,484	$251,859
Other products	65,231	62,625
	$334,715	**$314,484**

For the three months and six months ended June 30, 2013, total inventories of $80,089 (June 30, 2012 - $88,739) and $122,058 (June 30, 2012 - $152,096), respectively, were recognized as costs of sales.

5. Property and Equipment

The Company leases certain assets under finance lease agreements. As at June 30, 2013, assets under capital lease with total cost of $94,005 (December 31, 2012 - $95,128) and accumulated amortization of $66,186 (December 31, 2012 - $54,352) are included in property and equipment for net book value of $27,819 (December 31, 2012 - $40,876).

Amortization expense for assets under capital lease recorded in the statement of comprehensive loss for the three months ended June 30, 2013 was $4,951 (June 30, 2012 - $6,886) and for the six months ended June 30, 2013 was $12,302 (June 30, 2012 - $13,714).

6. Intangible Assets

Definite Lives

Cost	North American distribution rights (a)	ESM™ intellectual property (b)	Distribution agreements (b)	Supplier agreement (b)	EMEA & UK distribution rights (c)(d)	Customer relationship (d)	Total
Balance at January 1, 2011	**$256,928**	**$124,100**	**$1,861,842**	**$113,651**	**$2,083,315**	**$-**	**$4,439,836**
Acquisition (note 3)	-	-	-	-	2,570,862	1,058,584	3,629,446
Disposal	-	-	(100)	-	-	-	(100)
Effect of change in foreign exchange rates	4,032	-	-	-	2,390	(5,494)	928
Balance at December 31, 2011	**260,960**	**124,100**	**1,861,742**	**113,651**	**4,656,567**	**1,053,090**	**8,070,110**
Effect of change in foreign exchange rates	(3,978)	-	-	-	77,122	25,001	98,145
Balance at December 31, 2012	**$256,982**	**$124,100**	**$1,861,742**	**$113,651**	**$4,733,689**	**$1,078,091**	**$8,168,255**
Effect of change in foreign exchange rates	10,134				(39,857)	(12,729)	(42,452)
Balance at June 30, 2013	**$267,116**	**$124,100**	**$1,861,742**	**$113,651**	**$4,693,832**	**$1,065,362**	**$8,125,803**

SMARTCOOL™

Amortization and impairment losses	North American distribution rights (a)	ESM™ intellectual property (b)	Distribution agreements (b)	Supplier agreements (b)	EMEA & UK distribution rights (c)(d)	Customer relationship (d)	Total
Balance at January 1, 2011	**$122,040**	**$55,845**	**$671,773**	**$51,145**	**$578,684**	**$-**	**$1,479,487**
Amortization	25,758	12,410	148,414	11,365	661,200	176,239	1,035,386
Impairment	-	-	-	-	452,659	188,484	641,143
Effect of change in foreign exchange rate	2,261	-	-	-	4,624	(766)	6,119
Balance at December 31, 2011	**150,059**	**68,255**	**820,187**	**62,510**	**1,697,167**	**363,957**	**3,162,135**
Amortization	25,780	12,410	148,332	11,363	637,182	166,276	1,001,343
Impairment	83,787	-	-	-	-	-	83,787
Effect of change in foreign exchange rate	(2,644)	-	-	-	35,563	10,078	42,997
Balance at December 31, 2012	**$256,982**	**$80,665**	**$968,519**	**$73,873**	**$2,369,912**	**$540,311**	**$4,290,262**
Amortization		6,205	74,197	5,683	316,805	82,414	485,304
Effect of change in foreign exchange rate	10,134				(15,905)	(4,883)	(10,654)
Balance at June 30, 2013	**$267,116**	**$86,870**	**$1,042,716**	**$79,556**	**$2,670,812**	**$617,842**	**$4,764,912**

Carrying amounts	North American distribution rights (a)	ESM™ intellectual property (b	Distribution agreements (b)	Supplier agreement (b)	EMEA & UK distribution rights (c)(d)	Customer relationship (d)	Total
As at January 1, 2011	$134,888	$68,255	$1,190,069	$62,506	$1,504,631	$-	$2,960,349
Balance at December 31, 2011	110,901	55,845	1,041,555	51,141	2,959,400	689,133	4,907,975
Balance at December 31, 2012	$-	$43,435	$893,223	$39,778	$2,363,777	$537,780	$3,877,993
Balance at June 30, 2013	**$-**	**$37,230**	**$819,026**	**$34,095**	**$2,023,020**	**$447,520**	**$3,360,891**

Indefinite Lives

As at June 30, 2013, ESM™ brand (b) had a carrying amount of $56,100 and is not subject to amortization due to having an indefinite useful life. Goodwill arising on the acquisition of Smartcool UK amounted to $1,213,283. The balance of goodwill outstanding at June 30, 2013 was $Nil as an impairment was assessed for the full amount during 2011.

a. *ESM™ Intellectual Property and worldwide distribution rights*

The Company acquired $2,278,350 of intangible assets in relation to the acquisition of Abbotly.

Management has performed a review of the carrying value of its distribution agreements. As a result of its assessment, in 2008, the Company recognized an impairment of $116,914 related to distribution agreements. As a result of this impairment recognition, the total cost of distribution agreements was reduced by $148,799 to $1,835,702. As at March 31, 2013, cost of distribution agreements consisted of:

ESM™ Distribution agreements (b)	$1,835,702
Other distribution rights	$26,040
Total	**$1,861,742**

No impairment was recorded in the three months ended June 30, 2013 and the impairment loss recognized in 2008 was not reversed upon transition to IFRS.

b. *Distribution Rights from TECC Services*

On July 11, 2008, the Company acquired the exclusive rights to distribute the ESM™ in the United Kingdom, Spain, Portugal, and the Middle East from T.E.C.C. Services Ltd. ("TECC"). Consideration of $1,738,750 (£1,035,000) was payable in cash and $532,067 (£265,000) was payable in the form of common shares of the Company. Upon closing, payment of $873,393 (£435,000) was made and 743,709 shares were issued. The share price was based on the average closing price of the Company's shares on the TSX Venture Exchange for 20 consecutive trading days, with the last of such trading days being the second day preceding the date of closing as prescribed by trading regulations.

The remaining balance of $1,204,680 (£600,000) is due in scheduled instalments over four years with the last payment due on July 16, 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 $118,493 (£75,000) at Royal Bank of Canada prime rate plus 4% from January 16, 2009 and additionally on $118,493 (£75,000) 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. During the year ended December 31, 2012, all parties agreed to accrue interest on the remaining outstanding balance of $687,565 (£425,000) at Royal Bank of Canada prime rate plus 4% effective on January 1, 2012. The Company was unable to make scheduled payments under the amended agreement. As at June 30, 2013, the balance of $791,216 (£494,912), including accrued interest of $111,769 (£69,912) remained outstanding. Under the purchase agreement the outstanding balance will become due and payable upon default of payment. However, the Company has received confirmation from the holders of these obligations that they will not require settlement of outstanding amounts through 2013.

c. *Intangible assets from Smartcool UK*

On February 28, 2011, the Company acquired $4,842,731 of intangible assets in relation to the acquisition of Smartcool UK.

These intangible assets include the following definite lived intangible assets: distribution rights of the ESM™ in the United Kingdom, the distribution right related to sales to a major customer and a customer relationship. The remaining balance of the intangible assets acquired related to goodwill which is an indefinite life intangible asset. The expected life of the definite life intangible assets has been determined to be 5 years.

Distribution rights - General	$595,884
Distribution rights - Major customer	1,974,978
Customer relationship	1,058,584
Goodwill	1,213,285
Total	**$4,842,731**

During the three and six months ended June 30, 2013, total amortization of $143,877 (June 30, 2012 - $143,854) and $282,630 (June 30, 2012 - $287,570) were recorded against the asset costs.

In 2011, management performed a review of the carrying value of these assets. As discrepancies between revenue projections and actual operating results in 2011 have resulting in significant uncertainty in future cash generation of these assets, an impairment loss was recorded as at December 31, 2011 based on cash flow projections at this time. The value of goodwill was written off and the other assets were impaired as follows:

	Impairment
Distribution rights - General	$104,919
Distribution rights - Major customer	347,740
Customer relationship	188,484
Goodwill	1,213,285
Total impairment for the year ended December 31, 2011	**$1,854,428**

No impairments were recorded in the three months ended June 30, 2013 and the impairment loss recognized in 2011 was not reversed.

7. Short-term Loan

On May 20, 2013 the Company obtained a short term loan of $125,000 from an investor. The loan had annual interest rate of 6% and matured in three months, on August 20, 2013. The loan’s maturity date has been extended to December 31, 2013 and interest rate reset to 8%.

Interest expense for the three months ended June 30, 2013 was $833. As at June 30, 2013, the outstanding balance was $125,833, including accrued interest.

8. Obligations Under Acquisition Contracts

TECC Services

At June 30, 2013, the Company owed $791,216 ((December 31, 2012 - $776,611) related to its 2008 acquisition of distribution rights from TECC Services.

The obligations under the acquisition contract have been fully accreted to their face value over their term.

Smartcool UK

On February 28, 2011, the Company acquired the business of Smartcool UK for total cash consideration of $4,410,745 (£2,840,438) and some non-cash consideration. Upon closing, $2,922,622 (£1,840,438) was settled in cash with the remaining balance of $1,582,200 (£1,000,000) due in four equal installments over the next 12 months.

Balance – February 28, 2011	**$1,488,049**
Accretion	$87,458
Accrued interest	20,514
Foreign exchange	(2,165)
Balance – December 31, 2011	**1,593,856**
Accretion	6,439
Accrued interest	118,549
Foreign exchange	40,902
Balance – December 31, 2012	**$1,759,746**
Accrued interest	62,808
Foreign exchange	(19,636)
Balance – June 30, 2013	**$1,802,918**
Less: Current portion	**(1,802,918)**
Balance	**$-**

The Company was unable to make the first quarterly payment as scheduled. As at June 30, 2013, principal balance of $1,598,700 (£1,000,000) (December 31, 2012 - $1,617,800, £1,000,000) and accrued interest of $204,218 (£127,740) (December 31, 2012 - $139,063, £85,958) remained outstanding. Principal balance consists of 4 installments of $399,675 (£250,000). Under the purchase agreement the outstanding balance will become due and payable upon default of payment. However, the Company has received confirmation from the holders of these obligations that they will not require settlement of outstanding amounts through 2013.

9. Debentures

In May 2010, the Company completed its offer of 122 units of debenture and share purchase warrants for aggregate proceeds of $610,000. The debenture is not redeemable by the holder.

Each unit comprises a debenture in the principal amount of $5,000 plus 8,600 warrants, issued at a price of $5,000 per unit. The debentures are for a term of three years and entitle the holder to receive interest payment of $150 each quarter per $5,000 of principal amount with an additional interest payment of $150 if the debenture is repaid by December 31, 2011 and two additional interest payments (for a total of $300) if the debenture is repaid after December 31, 2011, but before maturity. The debentures receive 5% of gross cash revenue as principal repayment each quarter. The debentures are secured by a general security agreement over the assets of the Company.

As at December 31, 2012, the outstanding principal balance was $308,473. The Company did not make quarterly principal payments under the terms of the debentures and in January 2013 approached all holders of these units requesting an extension of up to two years. The debenture holders have agreed to extend the debentures effectively March 1, 2013 under these terms:

1. Two additional interest payments ($300 per unit) as specified by the original terms will be added to December 31, 2012 outstanding balance.
2. Interest of 12% on outstanding principal amount will be paid quarterly commencing June 1, 2013.
3. The new principal balance will be repaid in equal quarterly installments in an amount equal to 25% of the principal amount outstanding as at March 1, 2013. These quarterly principal payments will commence on June 1, 2013 with respect to the debentures maturing on March 1, 2014 (46 units) and commence on June 1, 2014 with respect to the debentures maturing on March 1, 2015 (71 units).
4. 3,000 share purchase warrants will be issued to each unit. These warrants have exercise price of $0.15 and expire on March 1, 2015.

The company has received approval from the TSX Venture exchange. The debentures' maturity dates were extended and 351,000 new warrants were issued under the above terms.

Outstanding principal balance, December 31, 2012	$ 308,473
Add: Additional interest payments	$36,600
Outstanding principal balance, March 1, 2013	$ 345,073

The new principal amount has been split between financial liability component and equity component using the residual method. The fair values of debentures and share purchase warrants are as follows:

New principal amount, March 1, 2013	$ 345,073
Liability component, March 1, 2013	$328,893
Equity component	$16,180

The equity component of $16,180 has been credited to equity, Share Purchase Warrants (note 10(c)).

The liability component is measured at amortized cost. Interest expense for four months from March 1 to June 30, 2013 was $16,349, calculated by applying weighted average effective interest rate of 16% to the liability component. Interest payments totaling $10,026 and principal payments totaling $41,062 were paid during the four months from March 1 to June 30, 2013.

As at June 30, 2013, the outstanding principal balance was $304,011 (December 31, 2012 - $308,473) and the carrying amount of these debentures was $294,154 (December 31, 2012 - $348,520).

Maturity date	**March 1, 2014**	**March 1, 2015**	**Total**
Balance at March 1, 2013	82,303	246,590	328,893
Accrued interest	4,149	12,950	17,099
Interest payments	(2,530)	(8,246)	(10,776)
Principal payments	(21,081)	(19,981)	(41,062)
Balance at June 30, 2013	**$62,841**	**$231,313**	**$294,154**
Less: Current portion	(62,841)	(51,876)	(114,717)
	-	179,437	179,437

For the three and six months ended June 30, 2013, total interest expenses were $13,698 (June 30, 2012 - $20,366) and $38,102 (June 30, 2013 - $44,606), respectively.
Interest payments totaling $35,176 (December 31, 2012 - $73,200) and principal payments totaling $41,062 (December 31, 2012 - $128,755) were paid during the six months ended June 30, 2013.

10. Issued Capital and Equity Reserve

Authorized
Unlimited common shares without par value
100,000,000 Class A preferred shares
100,000,000 Class B preferred shares

a) Issued common shares

	Shares	Amount
Balance, January 1, 2011	**46,821,396**	**$26,036,145**
Issued for cash via private placements	14,133,330	3,440,016
Options exercised	654,000	210,298
Share issuance costs	-	(220,990)
Balance, December 31, 2011	**61,608,726**	**29,465,469**
Issued for cash via private placements	2,678,571	375,000
Share issuance costs	**-**	(5,077)
Balance, December 31, 2012	**64,287,297**	**$29,835,392**
Issued for cash via private placements	10,000,000	250,000
Share issuance costs		(14,432)
Balance, June 30, 2013	**74,287,297**	**$30,070,960**

On May 14, 2013, Smartcool Systems announced that it had arranged a non-brokered private placement of up to 10,000,000 common shares at a price of $0.025 per share for aggregate gross proceeds of up to $250,000. The private placement was closed on June 28, 2013. Net proceeds after finder's fee of $240,000 were used to settle trade payables and finance current operations.

b) Stock options

Under the Company's stock option plan, the Company may grant stock options to employees, directors, officers and consultants. The maximum number of shares to be awarded under the plan is 12,161,745.

In October 2010, the stock option plan was amended to extend the option term to a maximum period of ten years. This amendment was approved by shareholders at 2011 annual general meeting and accepted for filing by the TSX Venture Exchange.
In June 2013 the Company reduced the exercise price of 3,525,000 previously granted stock options held by employees, consultants and insiders of the Company (ranging from $0.20 to $0.33 per share) to an exercise price of $0.10 per share.

Of the 3,525,000 options, 605,000 options were granted on December 23, 2009, 550,000 options were granted on January 12, 2010, 870,000 options were granted on December 22, 2010, 345,000 options were granted on April 1, 2011, 30,000 options were granted on June 7, 2011, 50,000 options were granted on July 25, 2011, 300,000 options were granted on October 1, 2011 and 775,000 options were granted on January 26, 2012. All of the options have a five year term. There was no change in the option expiry date.

The re-pricing of the stock options has been approved by the TSX Venture Exchange. The re-pricing of 2,935,000 insider options is subject to disinterested shareholder approval which the Company is seeking at its August 30, 2013 annual general meeting.

As at June 30, 2013, 3,840,000 (December 31, 2012 - 3,900,000) options were outstanding. These options have vesting periods of up to 5 years and weighted average exercise price of $0.14 (December 31, 2012 - $0.28).

During the six months ended June 30, 2013, 30,000 (June 30, 2012 - 805,000) options were granted to an employee with weighted average fair value of $0.05 (June 30, 2012 - $0.20). None of these options had an exercise price lower than the stock price at the date of grant (June 30, 2012 - Nil).

Share-based payments for the three and six months ended June 30, 2013 were $35,408 (June 30, 2012 - $30,527) and $42,575 (June 30, 2013 - $88,788), respectively.

c) Share purchase warrants

Pursuant to the terms of March 1, 2013 debenture extension, the Company issued 351,000 share purchase warrants to debenture holders. Each warrant entitles the holder to purchase one common share at a price of $0.15 until March 1, 2015. The fair value of these warrants has been determined to be $16,180, using residual method.

As at June 30, 2013, there were 1,501,000 (December 31, 2012 - 9,115,865) outstanding warrants with weighted average share price of $0.26 (December 31, 2012 - $0.43).

Share purchase warrants outstanding as at June 30, 2013 were as follows:

	Number of warrants	Weighted average share price
Balance, January 1, 2011	**2,424,200**	**$0.41**
Expired, exercised or cancelled	(1,375,000)	0.35
Issued	8,693,332	0.42
Balance, December 31, 2011	**9,742,532**	**0.42**
Expired, exercised or cancelled	(626,667)	0.30
Balance, December 31, 2012	**9,115,865**	**$0.43**
Granted	351,000	0.15
Expired, exercised or cancelled	(7,965,865)	0.45
Balance, June 30, 2013	**1,501,000**	**$0.26**

Expiry date	Number of shares	Exercise price	Weighted average contractual life (Years)
August 28, 2013	250,000	0.30	0.41
December 6, 2013	400,000	0.30	0.68
February 28, 2014	250,000	0.30	0.91
August 28, 2014	250,000	0.30	1.41
March 1, 2015	351,000	0.15	1.92
Total issued and outstanding, June 30, 2013	**1,501,000**	**$0.26**	**1.09**

11. Income Taxes

The Company’s operations are conducted in a number of countries with complex tax legislation and regulations pertaining to the Company’s activities. Any reassessment of the Company’s tax filings by the tax authorities may result in material adjustments to net income or loss, tax assets and operating loss carry-forwards.

At December 31, 2012, the Company had unused non-capital losses of approximately $18,570,423 available to offset taxable income in future years. In assessing the ability to realize deferred tax assets, management considers whether it is probable that taxable profit will be available against which the deductible temporary difference can be utilized. As management believes there is uncertainty regarding the realization of these deferred tax assets, $5,246,784 has been classified as unrecognized tax assets as at December 31, 2012 (2011 - $5,073,000).

Deferred Tax Liabilities

The Company recorded deferred tax liabilities of $1,078,565 as a result of the acquisition of Smartcool UK assets in February 2011.
During the six months ended June 30, 2013, these liabilities were reduced by $73,485 (2012 - $135,833) upon the recognition of amortization of these assets. The same amount was recorded as deferred income tax recovery in the statement of operations.

As at June 30, 2013, deferred tax liability was $396,651.

Deferred income tax liabilities, February 28, 2011	**$1,078,565**
Amortization of intangible assets	(157,136)
Impairment of intangible assets	(303,698)
Effect of foreign exchange rate	(4,621)
Deferred income tax liabilities, December 31, 2011	**613,110**
Amortization of intangible assets	(147,570)
Effect of foreign exchange rate	11,737
Deferred income tax liabilities, December 31, 2012	**$477,277**
Amortization of intangible assets	(73,485)
Effect of foreign exchange rate	(7,141)
Deferred income tax liabilities, June 30, 2013	**$396,651**

12. Segmented Information

The Company installs, distributes, markets and sells the ECO3™ and ESM™ products and peripherals. Revenue from the ECO3™ for the three months ended June 30, 2013 was $348,704 (June 30, 2012 - $182,297) and revenue for the ESM™ solution was $142,549 (June 31, 2012 - $883,810). Revenue from the ECO3 for the six months ended June 30, 2013 was $407,060 (June 30, 2012 - $293,156) and revenue for the ESM™ solution was $227,795 (June 30, 2012 - $1,076,401).

The Company operates in one segment. Revenue was derived from customers located in the following geographical regions:

	Three months ended June 30, 2013		Three months ended June 30, 2012	
	Amount	%	Amount	%
Europe, Middle East, Africa	$ 114,488	23	$883,382	82
Australia	252,324	52	123,324	12
South East Asia	-	-	-	-
Americas	124,441	25	59,401	6
Total revenue	**$491,253**	**100**	**$1.066,107**	**100**

	Six months ended June 30, 2013		Six months ended June 30, 2012	
	Amount	%	Amount	**%**
Europe, Middle East, Africa	$ 185,325	29	$932,369	68
Australia	252,324	40	264,835	19
South East Asia	-	-	-	-
Americas	197,206	31	172,353	13
Total revenue	**$634,855**	**100**	**$1,369,557**	**100**

13. Related Party Transactions

Trading Transactions

The Company’s related parties consist of companies owned by executive officers and directors and key management as follows:

	Nature of Transaction
384518 BC Ltd.	Consulting services
Windstone Financial Corp.	Consulting services
Richards Buell Sutton LLP	Legal services
Accupro Trademark Services LLP	Legal services
Magnum Energy Inc.	Rental income
T.E.C.C. Services Ltd.	Vehicle lease payments

The Company incurred the following expenses in connection with the companies owned by key management and directors. 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.

	Three months ended June 30		Six months ended June 30	
	2013	2012	2013	2012
Consulting fees	$8,807	$41,840	$29,568	$70,476
Legal fees	2,970	878	3,939	3,988
Rent expense	-	6,364	-	6,364
Rental income	-	-	-	(3,000)
Vehicle lease	8,134	9,315	16,223	19,263
	$19,911	**$58,397**	**$49,730**	**$97,091**

Due to/from Related Parties

Included in trade payables is $148,675 due to related parties as at June 30, 2013 (December 31, 2012 - $206,127). The amounts due to related parties are unsecured, non-interest bearing and have no fixed terms of repayment.

14. Financial Instruments

Financial Instruments

The Company has classified its financial instruments as follows:

	June 30, 2013	December 31, 2012
Financial assets		
Fair value through profit or loss , measured at fair		
Cash and cash equivalents	$127,148	$247,150
Loans and accounts receivable, recorded at amortized		
Trade and other receivables	274,115	747,684
	$401,263	**$994,834**
Other financial liabilities, recorded at amortized		
Trade payables	$615,620	$696,514
Loans payable	125,833	-
Acquisition obligations, finance leases and debentures	2,893,090	2,904,286
	$3,634,543	**$3,600,800**

Interest income from FVTPL and interest expense from short-term loan, acquisition obligations, debentures and other financial liabilities are recognized in finance income and expense.

Financial Risk Management

The Company is exposed to certain financial risks, including credit risk, liquidity risk, and market risk.

a. *Credit 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 and trade and other 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. To mitigate credit risk with respect to trade receivables the Company subjects all major customer accounts to its credit evaluation process.

The Company has $269,115 (December 31, 2012 - $742,684) in trade receivables which are subject to credit risk.

b. *Liquidity risk*

The Company's consolidated financial statements have been prepared on a going concern basis, which assumes the realization of assets and the settlement of liabilities in the normal course of business. 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 current obligations in the next 12 months, measures have been taken to increase cash resources including equity financing through a private placements.

The timing of future payments related to financial liabilities is outlined in the table below:

	Total	**1 year**	**1-2 years**
Trade payables	$615,620	$615,620	$-
Short-term loan	125,833	125,833	
Finance leases	4,795	4,795	-
Abbotly minimum royalties	42,048	42,048	-
Premises leases	223,106	111,553	111,553
Debentures	304,011	123,434	180,577
Obligations under acquisition contracts	2,594,141	2,594,141	-
Total	**$3,909,554**	**$3,617,424**	**$292,130**

c. *Market risk*

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.

d. *Foreign currency risk*

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 has been mitigated through the use of foreign currency forward contracts.

As at June 30, 2013, the Company's monetary assets and liabilities denominated in foreign currencies are as follows:

	USD	AUD	GBP	Euro
Assets				
Cash and cash equivalents	5,633	85	-	56
Trade and other receivables	217,239	-	-	4,754
Total	**222,872**	**85**	**-**	**4,810**
Liabilities				
Trade payables	33,844	7,984	30,876	-
Acquisition obligations, current	-	-	298,257	-
Total	**33,844**	**7,984**	**329,133**	**-**

e. *Interest rate risk*

The Company is exposed to this risk as late payments under TECC acquisition obligations are subject to interest based on Royal Bank of Canada prime rate plus 4%. As at June 30, 2013, the total of such payments was $679,448 (£425,000).

The Company is exposed to this risk as late payments under Smartcool UK acquisition obligations are subject to interest based on Royal Bank of Canada prime rate plus 5%. As at June 30, 2013, the total of such payments was $1,598,700 (£1,000,000).

f. *Sensitivity analysis*

Assuming a 100-basis point increase in RBC prime rate, as at June 30, 2013, the impact on income before income taxes would be a negative adjustment of $22,781 (£14,250).

15. Capital Management

The Company's capital structure includes debentures and shareholders' equity consisting of share capital, reserve for equity settled share based transactions and deficit. As at June 30, 2013, the principal amount of debenture component was $294,154 (December 31, 2012 - $308,490) and shareholders' equity was $126,495 (December 31, 2012 - $1,106,782). The decrease in debentures was attributable to principal payments made during the period. The decrease in shareholders' equity was attributable to net loss, partially offset by capital raised through June 2013 private placement.

The Company's objectives when managing capital are:

- to effectively finance its operations and growth by meeting its operating and capital expenditure budgets;
- to maintain financial flexibility in order to meet financial obligations, including obligations under acquisition contracts;
- to ensure its ability to carry out its strategic plans and take advantage of acquisition opportunities;
- to provide an appropriate investment return to its shareholders and maintain investor, creditor and market confidence.

To ensure that the Company continues to be a going concern with adequate working capital through 2013 steps have been taken to reduce expenses, secure more predictable revenue generation, collect outstanding receivables.

The Company has also received confirmation from the holders of TECC and Smartcool UK purchase obligations that they will not require settlement of outstanding amounts through 2013.

In June 2013, the Company raised additional capital of $250,000 by way of a non-brokered private placement. A second private placement was announced on July 11, 2013 and the company is expecting to raise another $250,000 by early September 2013. The company also obtained a short-term loan of $125,000 from an investor in May 2013.

Management is still working on accounts receivable factoring arrangements. Funds provided from these strategies will smooth out the Company's cash flow.

The Company is not subject to any external capital restrictions.

16. Supplementary cash flow information

	June 30, 2013	June 30, 2012
Interest paid in cash	$38,496	$21,341
Interest income received in cash	$1	$376

17. Subsequent Events

Private Placement

On July 11, 2013, Smartcool announced that it has arranged a non-brokered private placement of up to 5,000,000 common shares at a price of $0.05 per Share for aggregate gross proceeds of up to $250,000.

The Company may, in its sole discretion, pay a finders' fee to agents of the Company consisting of a cash fee in an amount of 5% of the proceeds raised by such finder as part of this private placement.

The proceeds raised will be used for general working capital and purchase of inventory.