Smartcool Systems Inc. (TSX-V: SSC)

Management Discussion and Analysis

2012 Second Quarter (ending June 30)

www.smartcool.net

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SMARTCOOL™

Management's Discussion and Analysis

The following is management's discussion and analysis ("MD&A") of the operating and financial results of Smartcool Systems Inc. for the three and six months ended June 30, 2012. This information is provided as of August 28, 2012. This MD&A should be read in conjunction with the Company's condensed interim unaudited consolidated financial statements for the three and six months ended June 30, 2012, its audited consolidated financial statements for the years ended December 31, 2011 and 2010 together with accompanying notes. These documents and additional information about Smartcool can be located on the SEDAR website at www.sedar.com or the Company's website at www.smartcool.net .

Table of Contents

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Executive Summary

Major Developments

Sainsbury's Contract Renewed

Smartcool's position as the Primary Contractor for Sainsbury's was renewed for a second full year during the first quarter. Under this contract, Smartcool provides project management services for the implementation of energy efficiency measures on the refrigeration systems of the UK's third largest retailer. This includes the sale of Smartcool's own ECO^3™ and ESM™ as well as third party products. Sainsbury's was the largest account for Smartcool in 2011, representing approximately 75% of Smartcool's direct sales revenue.

Sainsbury's budget year starts April 1, 2012, therefore revenues for work under the contract began being recognized in the second quarter. Under the new contract, stores under Reset 6 are allocated to prime contractors in three disbursements over the year. Smartcool received its first allocation of Reset stores in second quarter and completed its energy saving initiatives. As well Smartcool received purchase orders from other sub-contractors to fit ESM equipment as part of their solution for Sainsbury.

Smartcool has received additional stores during the quarter and is working on completion of these initiatives which will see revenue recognized in third quarter.

Successful Pilot for Eastern European Retailer

During the first quarter, Smartcool successfully concluded a pilot project for the second largest retailer in Poland. The pilot involved the installation and evaluation of Smartcool's ESM™ in two retail outlets. Based on the energy savings achieved by the ESM™ during the evaluation, Smartcool is now working with the Polish retailer to collect equipment data on their wider estate with the view to presenting a financial proposal for larger rollout.

Additional Retailers being added to sales funnel

During the second quarter Smartcool was involved in pilots with two other of the largest retailers in UK. This confirms our strategy of focusing on energy solutions for the refrigeration vertical is showing success.

Ongoing Distributor Development

Smartcool's global distribution network continued to perform well in the second quarter, expanding into new territories in South America and the Middle East. Smartcool has committed resources to a dedicated distributor support structure as well as building a dedicated web site to generate leads from potential distributors. This added support for distributors is producing good results in the Americas, USA, Europe the Middle East and Australia.

Smartcool News

Press releases from the first six months of 2012:

- Smartcool Delivers Data Center Energy Efficiency with ECO3
- Smartcool Comments on Fiscal 2011 and Discusses 2012
- Smartcool Achieves Profitability and Major Growth in the Fourth Quarter of 2011
- Smartcool Announces Private Placement Offering
- Hilton Hotel Malta Improves Energy Efficiency with Smartcool
- Smartcool Comments on Fiscal 2011 and Discusses 2012

Business Overview

Smartcool Systems Inc. is a clean technology company specializing in the development and distribution of energy efficiency solutions for air conditioning, refrigeration and heat pump systems (HVAC).

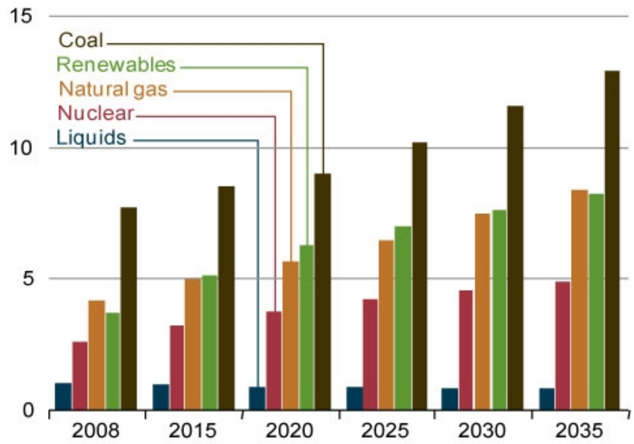
Smartcool was established in 2004, beginning as the North American distributor for the Energy Saving Module (ESM)™, a unique energy efficiency retrofit developed by Abbotly Technologies Pty Ltd of Australia. In 2006, Smartcool purchased the assets of Abbotly, including the intellectual property of the ESM™, and became the sole manufacturer and master distributor. In 2009, Smartcool's research and development cumulated in the delivery of the ECO^3™ to market, a new product specifically designed to bring unprecedented energy efficiency to small scale HVAC systems.

Energy Issues

Smartcool has focused on developing energy efficiency solutions to address the critical energy issues facing the world today and in the future. Electricity is a crucial part of the global economy and our communities. The worldwide demand for electricity has increased by 5.4% since 2010, with the developing countries averaging a 9.5% growth in demand. Coal continues to be the most widely used fuel for electricity generation, followed by natural gas. Electricity generated by these fossil fuels releases vast amounts of greenhouse gases into the atmosphere, contributing to climate change and general air pollution.

An instinctive solution is to switch to renewable energy sources, not only for environmental reasons but also due to issues of energy security. Electricity generation by renewable resources such as hydro, wind, waves and solar is increasing by an average of 3% each year thanks to government incentives. However, as the Energy Information Administration explains, "Although renewable energy sources have positive environmental and energy security attributes, most renewable technologies other than hydroelectricity are not able to compete economically with fossil fuels during the projection period except in a few regions or in niche markets."[1]

EIA World Net Electricity Generation by Fuel 2008-2035
(in trillion kWh)



On average, residential electricity rates around the globe have increased by 150% from 2005 to 2008.[2] Combined with environmental concerns surrounding fossil fuel generated electricity, it is clear that a solution to high energy consumption is urgently needed. Energy efficiency is the only option which is both cost effective and can be implemented rapidly.

[1] Energy Information Administration, *International Energy Outlook 2011*, Published Sept. 19, 2011
http://www.eia.gov/forecasts/ieo/electricity.cfm
[2] Energy Information Administration, *Electricity Prices for Households*, Updated June 10, 2010
http://www.eia.gov/emeu/international/elecprih.html

Smartcool's Energy Efficiency Solutions

Smartcool focuses on reducing the electricity used by refrigeration, air conditioning and heat pumps (HVAC). For target customer industries, such as supermarkets, these systems consume well over 50% of their total energy usage. Even for customers less dependent on HVAC, the systems still account for roughly 20% of their energy bill. The ability to save energy with Smartcool's energy efficiency technology represents a major opportunity to cut operating expenses any customer, typically giving them a return on their investment averaging 18 to 36 months. Electricity generated for buildings produces more greenhouse gases than any other source, so cutting HVAC energy consumption can also have a significant impact on the environment.

The ECO^3™

Smartcool's ECO^3™ and ESM™ are retrofit products, meaning that they are installed by wiring in between the existing thermostat and the compressor in the HVAC system, rather than replacing any expensive equipment. Once installed, the products immediately begin monitoring the cooling cycle of the compressor to identify inefficiencies and opportunities for saving energy. Even the most modern systems have pre-existing inefficiencies that can only be resolved by the intellectual property provided in Smartcool's products. The ECO^3™ and ESM™ dynamically adjust the cooling cycle to save customers energy without any impact to the temperature performance of the HVAC system.

The ESM™

With the ECO^3™ and ESM™, customers see all the benefits of energy efficiency, without any risks. The technology has undergone extensive independent third party testing by highly reputable organizations such as Oak Ridge National Laboratories, the University of Miami for Florida Power & Light, and the Los Angeles Department of Power & Water. These tests have proven unequivocally that the technology provides energy savings with no risks, as do over 30,000 installations worldwide.

For more information on Smartcool's technology, visit www.smartcool.net

The Market Strategy

Smartcool's ECO^{3}™ and ESM™ are cost effective energy efficiency solutions for any air conditioning, refrigeration or heat pump system. The few other energy efficiency products geared towards the HVAC market, do not offer the full package of benefits that the ECO^{3}™ and ESM™ provide. Other products on the market do not provide the same degree of safety, and can cause temperature and humidity performance to be affected. They all lack the wide range of compatibility held by the ECO^{3}™ and ESM™, which can be installed on any HVAC system. Perhaps most significantly, other products cannot easily prove consistent energy savings. Smartcool's energy savings can be instantly verified on the product display screens, letting customers monitor energy savings as they happen. This is a critical feature for utility rebate qualification, which Smartcool has already received from major utilities like Florida Power & Light, Southern California Edison and Con Edison. These factors give Smartcool exclusive access to an immense market.

Direct Sales

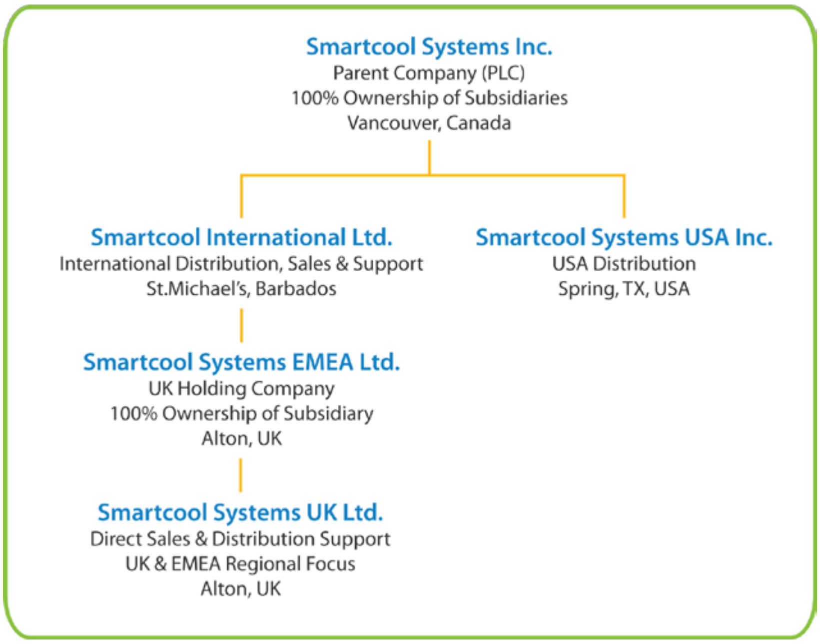
The company distributes its products directly to major clients, providing them with superior project management and service as they roll out Smartcool products to their facilities. For direct sales, Smartcool targets specific industries such as food retailers, telecommunications, commercial real estate and hospitality, where HVAC energy usage tends to represent a very high percentage of a client's operating budget. In Europe, Smartcool has built a strong portfolio of direct sales to Fortune 500 clients such as Sainsbury's and Tesco.

Distribution Sales

Smartcool has developed an intricate network of distributors to target regional markets. Distributors are provided both technical and sales training by Smartcool and receive ongoing support. Distributors have the advantage of detailed regional knowledge, allowing them to build strong client portfolios across the residential sector as well as in industries like food retail, climate controlled storage, hospitality and commercial real estate. Smartcool's distributors have continued to expand their businesses in Australia, India, UAE, Saudi Arabia, Eastern Europe, France, South Africa, and the US (particularly Florida, California and the Mid-West). Distributors have also proven instrumental in launching key accounts for Smartcool, like Telefonica, GE Healthcare, Dell, Saudi Aramco, 7-Eleven, JW Marriott and more.

Corporate Structure

Smartcool has gone through several phases of growth to reach its current structure. Smartcool Systems Inc. is the publicly traded parent company, with four wholly owned subsidiaries: International, USA, EMEA and UK. Smartcool International Ltd. holds the intellectual property and is the master distributor of Smartcool's product line. Smartcool Systems USA Inc. distributes the technology within the United States, using a network of local distributors to deliver the products to market.



Smartcool Systems EMEA was formed in 2008 and is the master distributor for Europe, the Middle East, Africa and the Indian Sub-Continent. In February 2011, Smartcool EMEA acquired all the outstanding shares of Smartcool Systems UK Ltd., a previously independent distributor with extensive technical expertise in Smartcool products.

Smartcool EMEA now conducts business as Smartcool Systems UK Ltd., directly managing a large portfolio of well established customer accounts. This improves gross revenue and profitability for Smartcool. Another significant factor in the acquisition is leveraging the considerable technical abilities of the UK team to assist in continuing the research and development of the Smartcool product line, and providing the best possible service and support to Fortune 500 clients and distribution channels. Smartcool EMEA / UK is headquartered in Alton, UK, providing Smartcool a strong base from which to serve Europe, its fastest growing market.

Financial Overview

After a quarter of slow activities, Smartcool was back on track with substantial growth in revenue and reduction of operating expenses. Revenue for the second quarter increased to $1,066,107 from $276,398 for the second quarter of 2011, an increase of $789,709 or 286%. Operating loss for the quarter was $600,542 compared to $1,164,141 for the second quarter of 2011, a decrease of $563,599 or 48%. Net loss for the quarter was $434,113 ($0.01 per share), compared to $1,253,291 ($0.02 per share) for the second quarter of 2011, a decrease of $819,178 or 65%.

Total assets decreased to $6,469,698 from $7,365,680 at the end of 2011. The Company had $32,736 in cash and cash equivalents as at the end of the quarter, compared to $498,874 at the end of 2011.

Current liabilities at the end of the quarter were $4,244,182 (December 31, 2011 - $3,882,447) which includes acquisition obligations and debentures, current portion of finance leases and tenant inducement totaling $2,843,472. Long-term liabilities were $663,016 (December 31, 2011 - $850,112), consisting of tenant inducement $30,993, finance leases $11,043 and deferred tax liability of $620,980.

	Sep 2011 ($)	Dec 2011 ($)	Mar 2012 ($)	Jun 2012 ($)
Total Revenues	785,689	1,937,749	303,450	1,066,107
Loss	(1,103,805)	(2,282,012)	(1,071,915)	(434,113)
Loss Per Share – basic & diluted	(0.02)	(0.04)	(0.02)	(0.01)
	Sep 2010 ($)	**Dec 2010 ($)**	**Mar 2011 ($)**	**Jun 2011 ($)**
Total Revenues	1,098,949	1337,906	943,958	276,398
Loss	(240,671)*	(381,270)*	(578,824)	(1,253,291)
Loss Per Share – basic & diluted	(0.01)	(0.01)	(0.01)	(0.02)

* IFRS adjusted

Selected Annual Information

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

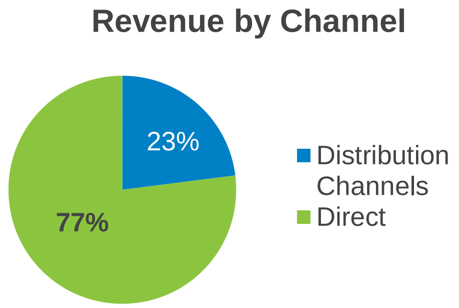
	Dec. 31, 2009 *	Dec. 31, 2010	Dec. 31, 2011
Revenue	$2,402,081	$4,209,645	**$3,943,794**
Selling, General & Administrative	$4,033,161	$3,272,909	**$4,355,436**
Net loss	$(3,390,930)	$(1,619,771)	**$(5,217,928)**
Net loss – Per Share (Basic and Diluted)	$(0.08)	$(0.04)	**$(0.09)**
Total Assets	$5,754,220	$5,343,272	**$7,365,680**
Total Long Term Liabilities	$646,436	$531,167	**$860,932**
Cash Dividends	**$0**	**$0**	**$0**

Note* Under Canadian GAPP

Summary of Operating Results

Revenue

Smartcool sells its products both directly to major customers, and through a network of independent distributors. Distribution sales for the quarter were $248,862 or 23% of total revenue, compared to $248,719 or 90% of total revenue for the second quarter of 2011. Direct sales for the quarter were $817,245 or 77% of total revenue, compared to $27,679 or 10% of total revenue for the second quarter of 2011.



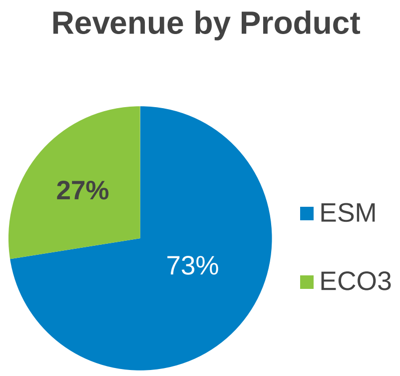
While distribution sales for the quarter remained stable, direct sales have increased significantly thanks to the continued rollout of a major multi-site project in the United Kingdom.

Total revenue for the six months ended June 30, 2012 was $1,369,557 with distribution sales of $510,303 compared to $923,190 for the same period of 2011 and direct sales of $859,254 compared to 297,166 for the same period of 2011. The decrease in distribution sales was a result of inactivity from the South East Asia region. The Company has provided strong technical and marketing support to this distribution channel but these efforts have not been very successful so far.

Revenue from the EMEA (Europe, Middle East, Africa, & India) region was $883,382 for the quarter compared to $80,437 for the second quarter of 2011. Revenue from the Asia-Pacific region was $123,324, as compared to $97,782 in the second quarter of 2011. The Americas region contributed $59,401, compared to $98,179 in the second quarter of 2011.

Revenue from the EMEA (Europe, Middle East, Africa, & India) region was $932,369 for the six months ended June 30, 2012 compared to $419,139 for the first six months of 2011. Revenue from the Asia-Pacific region was $264,835, as compared to $198,803 for the same period of 2011. The Americas region contributed $172,353, compared to $286,357 for the same period 2011. There was no revenue from the South East Asia for the six months ended June 30, 2012 compared to $316,057 for the same period of 2011.

The ESM™ is Smartcool's original product, and due to its complexity is generally reserved for direct sales and only the most experienced and well-resourced distributors. Revenue for the ESM™ in the quarter was $883,810. Smartcool is delivering the ECO^{3}™ to a large market base including the residential sector, through small independent distributors, especially in North America. This strategy will provide stable, recurring long-term revenue for Smartcool, but requires more time to develop. Revenue for the ECO^{3}™ for the quarter was $182,297.



Revenue for the ESM™ in the six months ended June 30, 2012 was $1,076,401. Revenue for the ECO^{3}™ for the six months was $293,156.

Gross profit

Gross profit for the quarter was $536,804 compared to $156,231 for the second quarter of 2011, an increase of $380,573 or 244%. Profit margin for the quarter was 50%, compared to 57% for the same quarter of 2011. As 77% of the quarter's revenue was derived from direct sales, which involved installation services provided by sub-contractors, the quarter's margin was lower than average margin.

Gross profit for the six months ended June 30, 2012 was $734,496 compared to $842,912 for the same period of 2011, a decrease of $108,416 or 13%. Profit margin for the six months was 54%, compared to 69% for the same period of 2011. As 63% of the six months' revenue was derived from direct sales, which involved installation services provided by sub-contractors, the period's margin was lower than average while profit margin for the first six months of 2011was within the expected range.

General and administrative expenses

General and administrative ("G & A") expenses for the quarter were $821,153, a decrease of $196,788, from $1,017,941 for the second quarter of 2011. Salaries for the quarter were $447,226, compared to $549,825 for the same quarter of 2011. Travel expenses for the quarter were $73,974, compared to $109,254 for the same quarter of 2011. Professional fees were $37,644, compared to $65,775 for the same quarter of 2011. These decreases reflected management's effort to streamline less productive activities across the board.

General and administrative ("G & A") expenses for the six months ended June 30, 2012 were $1,661,968, a decrease of $249,224 from $1,911,192 for the same period of 2011. Travel expenses for the quarter were $134,689, compared to $224,212 for the same period of 2011. Professional fees were $47,125, compared to $94,082 for the same period of 2011.

	Three months ended June 30, 2012	**Three months ended June 30, 2011**	**Change**	**%**
Management and consulting fees	$98,022	$93,259	$4,763	5%
Salaries and benefits	447,226	549,825	(102,599)	(19%)
Professional fees	37,644	65,775	(28,131)	(43%)
Investor relations and media	14,959	37,508	(22,549)	(60%)
Travel	73,974	109,254	(35,280)	(32%)
Rent, office and other expenses	149,328	162,320	(12,992)	(8%)
Total selling, general & admin expenses	821,153	1,017,941	(196,788)	(19%)
Stock-based compensation	30,527	106,395	(75,868)	(71%)
Research & Development	9,554	3,428	6,126	179%
Amortization & depreciation	276,112	192,608	83,504	43%
Total operating expenses	**$1,137,346**	**$1,320,372**	**($183,026)**	(14%)

	Six months ended June 30, 2012	Six months ended June 30, 2011	Change	%
Management and consulting fees	$211,803	$200,238	$11,565	6%
Salaries and benefits	911,433	988,738	(77,305)	(8%)
Professional fees	47,125	94,082	(46,957)	(50%)
Investor relations and media	22,482	68,729	(46,247)	(67%)
Travel	134,689	224,212	(89,523)	(40%)
Rent, office and other expenses	334,436	335,193	(757)	-
Total selling, general & admin expenses	1,661,968	1,911,192	(249,224)	(13%)
Stock-based compensation	88,788	164,007	(75,219)	(46%)
Research & Development	9,554	5,360	4,194	78%
Amortization & depreciation	549,111	338,406	210,705	62%
Total operating expenses	**$2,309,421**	**$2,418,965**	**($109,544)**	(5%)

Net loss
Net loss for the quarter was $434,113 compared to $1,253,291 for the second quarter of 2011, a decrease of $819,178 or 65%. Attributable to this significant decrease was increase in revenue, decrease in operating expense and tax recovery from the carry-backward of Smartcool UK's 2011 loss ($248,508).

The loss per share (basic and diluted) for the quarter was $0.01, compared to $0.02 for the first quarter of 2011.

Net loss for the six months ended Jun 30, 2012 was $1,506,026 compared to $1,832,115 for the same period of 2011, a decrease of $326,089 or 18%. Attributable to this decrease was primarily tax recovery from the carry-backward of Smartcool UK's 2011 loss ($248,508) and increase in revenue.

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

Comprehensive loss
Comprehensive loss of $469,399 for the quarter consists of net operating loss $434,113 and foreign currency translation adjustment $35,286. As the functional currencies of Smartcool EMEA, Smartcool UK and Smartcool USA are different from the reporting currency (Canadian dollar), their monetary assets and liabilities as well as non-monetary assets and liabilities in the consolidated financial statements must be translated into the reporting currency based on June 30, 2012 exchange rate under IFRS. This method of foreign currency translation resulted in the above adjustment which is classified as a component of equity. Comprehensive loss for the second quarter of 2011 was $1,264,283.

Comprehensive loss for the six months ended June 30, 2012 was $1,519,332 compared to $1,915,328 for the first six months of 2011.

Amortization and depreciation
Amortization and depreciation expenses for the quarter were $276,112 compared to $192,606 for the second quarter of 2011. Depreciation on property and equipment was $24,196 (June 30, 2011 - $24,121) and amortization of intangible assets was $251,915 (June 30, 2011 - $168,487). Amortization of intangible assets was greater in the quarter due to a revision of these assets' expected life. The revision was a result of December 2011 year-end assessment.

Amortization and depreciation expenses for the six months ended June 30, 2012 were $549,111 compared to $338,406 for the same period of 2011. Depreciation on property and equipment was $45,528 (June 30, 2011 - $41,993) and amortization of intangible assets was $503,583 (June 30, 2011 - $296,413). Amortization of intangible assets was greater in the first six months of 2012 due to a revision of these assets' expected life. The revision was a result of December 2011 year-end assessment.

Stock-based compensation
Stock-based compensation costs for the quarter were $30,527, compared to $106,395 for the second quarter of 2011, a decrease of $75,868. During the quarter, 30,000 options were granted while 1,057,500 stock options were granted in the second quarter of 2011.

Stock-based compensation costs for the six months ended June 30, 2012 were $88,788, compared to $164,007 for the same period of 2011, a decrease of $75,219. During the six months of 2012, 805,000 options with weighted average price of $0.20 were granted while 1,082,500 options with weighted average price of $0.33 were granted in the first six months of 2011.

Capital expenditures
Capital expenditures for the quarter were $33,383 compared to $9,099 for the second quarter of 2011, an increase of $24,284. The increase was primarily due to the upgrade of the Company's ERP (Enterprise Resource Planning) system.

Capital expenditures for the six months were $88,610 compared to $126,108 for the same period of 2011, a decrease of $37,498. Due to the acquisition of Smartcool UK in February 2011 capital expenditures in the previous year were exceptionally high.

Liquidity and Capital Resources
Since incorporation, the Company has financed its operations through the issuance of equity. During the first six months of 2012 the Company issued 2,678,571 common shares for proceeds of $375,000. The proceeds were used for general working capital and purchase of inventory.

As at June 30, 2012, the Company had $32,736 in cash and cash equivalents and bank overdraft of $104,219.

Working capital deficit at the end of the quarter was $2,487,512 compared to $1,663,346 at the end the previous year. Part of the obligations under Smartcool UK acquisition contract, scheduled for payments within a year and classified as current liabilities, can be deferred at the Company's discretion. These installments total $1,198,800 (£750,000).

The Company's net cash flows used in operating activities was $112,308 during the quarter, compared to $681,818 in the first quarter of 2011. The average monthly burn for the quarter was $37,000 compared to $227,000 for the same quarter of 2011. Cash resources consumed in the quarter were primarily for the financing of operating loss.

To ensure that the Company continues to be a going concern with adequate working capital through 2012, steps have been taken to reduce expenses, secure more predictable revenue generation, collect outstanding receivables.

The Company also has received confirmation from holders of major debt obligations that they will not require settlement of outstanding amounts through 2012.

Management is in final steps of approval with its major banking relationship to provide accounts receivable factoring for select accounts. Using this banking facility will improve the timing of cash receipt from customers.

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 of a debenture in the principal amount of $5,000 plus 8,600 warrants, issued at a price of $5,000 per unit. They 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. One whole warrant entitles the holder to purchase one common share at the price of $0.50 per share for a period of three years from the date of issuance. If the Company's share trade at an average price of $0.80 per share for a period of 60 days, the Company, at its election, may force exercise or cancellation of the warrants

The payment of quarterly principal payments owing during the first twelve-month period commencing from the closing date, however, may be delayed and paid on a date that is 13 months from the closing date. As at June 30, 2012, total principal payments of $66,833 have been deferred. The debenture holders have not expressed an intention to demand payment.

During the three months ended June 30, 2012 interest payments totaling $18,300 and principal payments totaling $22,043 (June 30, 2011 - $15,815) were paid. During the six months ended June 30, 2012 interest payments totaling $36,600 and principal payments totaling $107,762 (June 30, 2011 - $115,269) were paid.

As at June 30, 2012, the outstanding principal balance was $329,485 (December 31, 2011 - $437,245) and the carrying amount of these debentures was $397,254 (December 31, 2011 - $497,008).

Outstanding Share Data

The authorized share capital of the Company is an unlimited number of common shares without par value. As at June 30, 2012 the Company had 64,287,297 (December 31, 2011 – 61,608,726) common shares outstanding. The weighted average number of common shares outstanding for the quarter was 64,287,297 compared to 60,545,341 for the second quarter of 2011. The increase in average number of common shares outstanding was a result of the issuance of 800,000 common shares pursuant to December 6, 2011 private placement and 2,678,571 common shares pursuant to February 20, 2012 private placement. As at August 28, 2012, the outstanding shares were 64,287,297 and diluted were 79,053,162.

Warrants and Stock Options

As at June 30, 2012, there were 9,115,865 share purchase warrants and 5,687,500 stock options outstanding which collectively could result in the issuance of 14,803,365 common shares if these warrants and stock options are exercised. The outstanding warrants have weighted average exercise price of $0.43. The outstanding options have a weighted average exercise price of $0.28.

As at August 28, 2012, there are 9,115,865 outstanding warrants and 5,650,000 outstanding options. The outstanding options have weighted average exercise price of $0.28.

Intangible Assets

a. *North American distribution rights*

On March 27, 2006, the Company acquired the exclusive rights to distribute the ESM™ throughout North America from Abbotly Technologies Inc. ("Abbotly USA"). Pursuant to the acquisition, Abbotly USA agreed to assign all of its rights and obligations, and the Company agreed to assume all of Abbotly USA's obligations, under a license agreement between Abbotly USA and Abbotly, and the Company became the master distributor of the ESM™ in North America.

Consideration paid for the acquisition was $201,953 (US$180,000), 500,000 share purchase warrants with an exercise price of $0.27 and a 20% royalty on certain products purchased from Abbotly as long as Smartcool Systems USA still holds the distribution rights.

b. *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 $1,835,701. As at June 30, 2012, cost of distribution agreements consisted of:

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

No impairments were recorded in 2011 and 2010 and the impairment loss recognized in 2008 was not reversed upon transition to IFRS.

c. *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 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 $119,775 (£75,000) at Royal Bank of Canada prime rate plus 4% from January 16, 2009 and additionally on $119,775 (£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. The Company was unable to make scheduled payments under the amended agreement. As at June 30, 2012, the balance of $728,062 (£455,494), including accrued interest of $48,742 (£30,494) 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 2012.

d. *Intangible assets from Smartcool UK*

On February 28, 2011, the Company acquired $4,842,731of 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 months ended June 30, 2012, total amortization of $143,848 (June 30, 2011 - $61,317) was recorded. During the six months ended June 30, 2012, total amortization of $287,570 (June 30, 2011 - $81,903) was recorded.

Impairment

Impairment of Long-Lived Assets

Smartcool amortizes long-lived assets over the estimated useful life of the asset. Evaluation of all long-lived assets occurred periodically for impairment in accordance with IFRS IAS16.

Under IFRS, long-lived assets including property and 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 cash generating units, 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.

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 recoverable amount. 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. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognized in the statement of operations

The Company's definite life intangible assets are ESM™ intellectual property, ESM™ distribution contracts and ESM™ supplier contracts that we acquired from Abbotly USA, Abbotly Technologies Pty, TECC Services and Smartcool UK. 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 2011 cost structures. The undiscounted cash flows supported the recoverability of our definite lived intangible assets.

Impairment of Intangible Assets

On February 28, 2011, the Company acquired $4,842,731of intangible assets in relation to the acquisition of Smartcool UK as described in note 3 of December 31, 2011 consolidated financial statements.

Management has performed a review of the carrying value of these assets. As discrepancies between revenue projections and actual operating results in 2011 resulting in significant uncertainty in future cash generation of these assets, an impairment loss was recorded for the year based on cash flow projections as at December 31, 2011. The value of goodwill was written off and the other assets were reduced 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 year ended December 31, 2011	**$1,854,428**

There were no impairment losses recorded for the three and six months ended June 30, 2012 and 2011.

Transactions with Related Parties

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
Windstone Financial Corp.	Consulting
Key Management	Consulting/General administrative
Richards Buell Sutton LLP	Legal Services
TECC	Rent
Rossair	Installation tools and materials
Magnum Energy Inc.	Rental income

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.

Transactions with related parties	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
	$	$	$	$
Consulting fees	41,840	58,089	70,476	121,183
Legal fees	878	3,726	3,988	17,254
Rent expense	-	-	-	12,777
Lease Income	-	(3,000)	(3,000)	(6,000)

Balances with related parties	June 30, 2012	December 31, 2011
	$	$
Accounts Receivable	1,000	1,000
Trade payables	96,071	42,180

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, short-term investments 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 and other receivables the Company subjects all major customer accounts to its credit evaluation process.

The Company has $1,113,104 (December 31, 2011 - $1,042,580) 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.

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

	Total	**1 year**	**1-2 years**
	$	$	$
Trade payables and accruals	1,296,491	1,242,542	53,949
Bank loan	104,219	104,219	-
Finance leases	45,168	36,367	8,801
Abbotly minimum royalties	80,000	40,000	40,000
Premises leases	217,413	107,469	109,944
Debentures	429,235	429,235	-
Obligations under acquisition	2,401,348	2,401,348	-
Total	**4,573,874**	**4,361,180**	**212,694**

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, British pounds and Euros. 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, 2012, the Company's monetary assets and liabilities denominated in foreign currencies are as follows:

	USD	AUD	GBP	Euro
Assets				
Cash and cash equivalents	21,445	84	-	552
Trade and other receivables	210,127	-	-	61,701
Total	**231,572**	**84**	**-**	**62,253**
Liabilities				
Total payables and accruals	45,713	4,365	31,626	13,818
Finance lease obligations	-	-	-	-
Acquisition obligations, current	-	-	274,605	-
Acquisition obligations, balance	-	-	-	-
Total	**45,713**	**4,365**	**306,231**	**13,818**

The following table demonstrates the effect of exchange rate movement on net income due to gains and losses on the revaluation of monetary assets and liabilities denominated in foreign currencies:

Gain (loss) on $0.10 increase in CAD	**USD**	**AUD**	**GBP**	**Euro**
Monetary Assets	(23,157)	(8)	-	(6,225)
Monetary Liabilities	4,571	437	30,623	1,382
Net gain (loss)	**(18,586)**	**429**	**30,623**	**(4,843)**

Gain (loss) on $0.10 decrease in CAD	**USD**	**AUD**	**GBP**	**Euro**
Monetary Assets	23,157	8	-	6,225
Monetary Liabilities	(4,571)	(437)	(30,623)	(1,382)
Net gain (loss)	**18,586**	**(429)**	**(30,623)**	**4,843**

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, 2012, the total of such payments was $239,760 (£150,000) (December 31, 2011 - $236,985, £150,000).

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 As at June 30, 2012, the total of such payments was $1,598,400 (£1,000,000) (December 31, 2011 - $1,184,925, £750,000).

f. *Sensitivity analysis*

Assuming a 100-basis point increase in RBC prime rate, as at June 30, 2012, the impact on income before income taxes would be a negative adjustment of $18,382 (£11,500).

Critical Accounting Policies & Estimates

Business combinations

The identifiable assets, liabilities and contingent liabilities of a subsidiary, joint venture entity or an associate, which can be measured reliably, are recorded at their provisional fair values at the date of acquisition. Goodwill is the fair value of the consideration transferred (including contingent and previously held non-controlling interests) less the fair value of the Company's share of identifiable net assets on acquisition. Transaction costs incurred in connection with the business combination are expensed. Provisional fair values are finalized within twelve months of the acquisition date.

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 and total comprehensive loss in the period of acquisition.

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 probably collectible, 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.

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.

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. 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 determined using the Black-Scholes option pricing model and the resulting value is charged to share issuance costs.

Intangible assets

Intangible assets are recorded at cost and include the ESM™ brand, ESM™ intellectual property, 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 relationships	5 years

Total amortization for the quarter ended June 30, 2012 of $276,112 is included under net loss for the period on the statement of operations.

Accounting standards issued but not yet effective

Standards issued but not yet effective up to the date of issuance of the Company's condensed consolidated financial statements are listed below.

Financial Instruments: The IASB has issued a new standard, IFRS 9, "Financial Instruments" ("IFRS 9") which will ultimately replace IAS 39, "Financial Instruments: Recognition and Measurement ("IAS 39") . The replacement of IAS 39 is a multi-phase project with the objective of improving and simplifying the reporting of financial instruments and the issuance of IFRS 9 is part of the first phase of this project. This standard becomes effective on January 1, 2013. The Company has not assessed the impact of this new standard.

Consolidated Financial Statements: The IASB has issued a new standard, IFRS 10, which 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" and is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The company is currently evaluating the impact of this standard on its consolidated financial statements.

Fair value measurements: The IASB has issued IFRS 13, which 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 (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except in specified circumstances. IFRS 13 is to be applied for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The company is currently evaluating the impact of this standard on its consolidated financial statements.

The IASB has issued an amendment to IAS 1 "Presentation of financial statements" ("IAS 1 amendment"), which requires the presentation of items of other comprehensive income ("OCI"), classified by nature, to be grouped into items that will not be reclassified subsequently to profit or loss; and items that will be reclassified subsequently to profit or loss when specific conditions are met. The IAS 1 amendment is effective for annual periods beginning on or after July 1, 2012. IAS 1 amendment is not applicable to the Company.

Forward-looking statements

This MD&A contains forward-looking information and 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 place undue reliance on forward-looking information as no assurances can be given to future results, performances, or achievements.

The forward-looking statements included in this MD&A speak only as of the date of this document. The Company does not undertake any obligation to publicly update or revise any of these forward-looking statements to reflect events or circumstances after this date except when required by applicable legislation.

Additional Information

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