Management's Discussion and Analysis

For the three months ended March 31, 2008

The following Management's Discussions and Analysis ("MD&A"), dated March 31, 2008, provides information that management believes is relevant to an assessment and understanding of the company's consolidated results of operations and financial condition. This discussion should be read in conjunction with the company's unaudited consolidated financial statements and accompanying notes for the three months ended March 31, 2008 that are prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). All financial information is stated in Canadian dollars, unless otherwise stated. Additional information regarding Smartcool Systems including our Financial Statements and MD&A for the year ended December 31, 2007 can be found on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

Forward Looking Statements

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

Description of Business

Smartcool Systems Inc. ("Smartcool" or "the company") is a clean technology company headquartered in Vancouver, British Columbia, Canada. Focusing on acquiring, commercializing, and marketing energy and cost reduction technologies for commercial and retail businesses, the company has successfully acquired copyrights and distribution rights of several energy saving products. Presently, the company's core business is the supply and installation of the Energy Saving Module (ESM™). The company's wholly owned subsidiary, Smartcool International Inc., is the owner, developer, and worldwide distributor of the ESM™.

This green technology reduces the electricity consumption (kWh) and maximum demand (KW) of air conditioning and refrigeration compressors through enhanced system performance. The ESM™ enables the compressor to maximize the rate of heat removal by optimizing the natural physical properties of the compressor operation cycle. This process, known as "Compressor Optimization" can reduce compressor runtime by more than 30% and electricity consumption by up to 15%, while maintaining preset temperature levels and without causing over-cycling.

Smartcool directly sells and installs the ESM™ throughout North America through its wholly owned subsidiary Smartcool Systems USA, based in Houston Texas. Smartcool Systems International has developed a network of distributors internationally, focusing efforts in the Middle East, Asia, Australia, Europe, Mexico, Germany, Israel and the Philippines. In the upcoming year initiatives are under way to develop distribution channels in the Far East specifically China and India where installations have already taken place on specific customer sites.

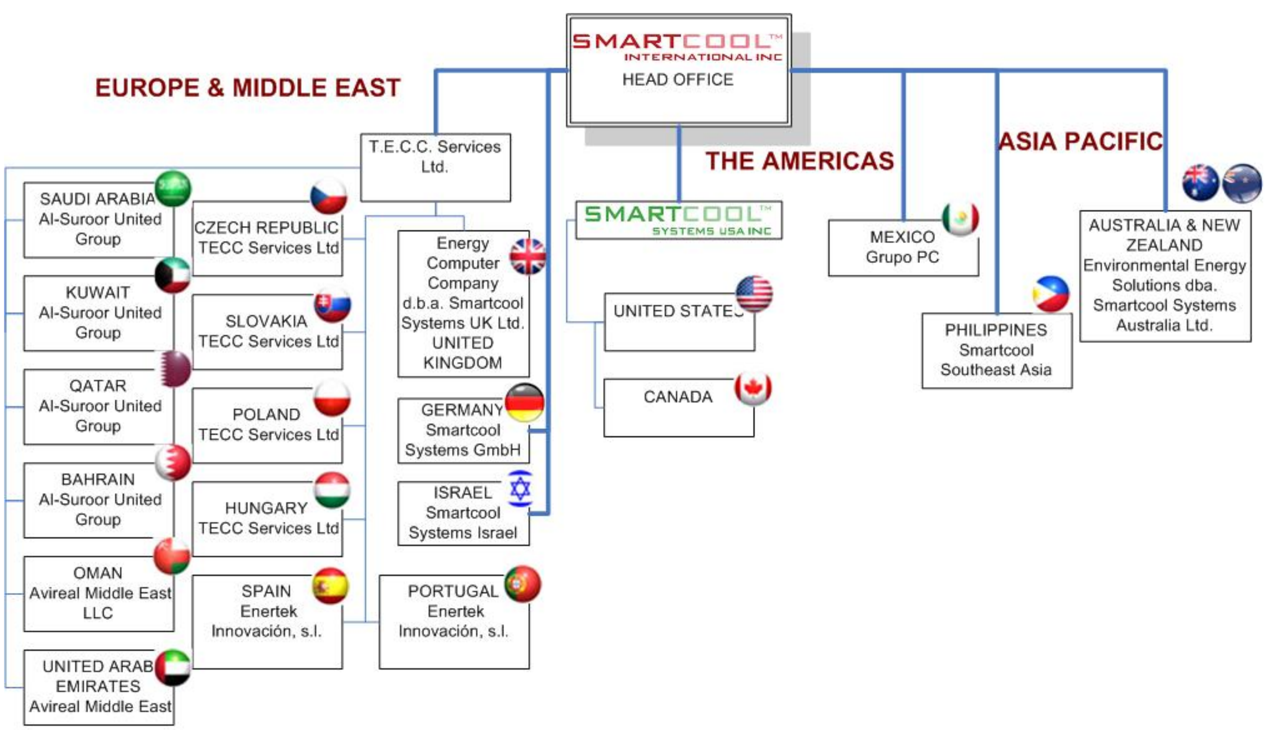
Corporate Structure and Distribution Network

Subsequent to the acquisition of the ESM™ intellectual property and distribution rights in June 2006, management has developed a strategic plan that sets distribution as a major priority. The ESM™ had been marketed in a limited fashion by previous owners with successful installations in strategic vertical markets. Smartcool has expanded this global awareness through its international distribution initiatives.

Smartcool Systems Inc. has two subsidiaries, Smartcool Systems USA Inc. and Smartcool International Inc. Smartcool Systems USA Inc. is a 100% wholly owned subsidiary responsible for the sales and distribution of Smartcool's technology in Canada and the United States utilizing a combination of its own marketing personnel and a direct sales force as well as a network of third party sales channels. The sales strategy is to identify specific customer profiles in a variety of vertical markets where the technology can be applied to save energy. In additional to direct sales the company has approached electric utilities that provide customer incentives and rebate programs to pilot installations that will then be published creating awareness in their own customer base.

The table below illustrates the geographic territories as well as the sales and technical network of independent distributors and sub-distributors that is currently under contract with Smartcool International for distribution of the ESM™ technology. This network is continually being enlarged in an effort to increase distribution and achieve global recognition of Smartcool's technology.

Smartcool International Inc. – Distribution Network



Business History

In August 2003 the Company signed a letter of intent with Abbotly Technologies Inc. ("Abbotly USA") to make Smartcool the exclusive distributor of Abbotly products in Canada and New York State. Abbotly USA was the master distributor of the Energy Saving Module (ESM™) manufactured by Abbotly Technologies Pty Ltd., Australia ("Abbotly"). Abbotly specialized in energy and cost reduction technologies for commercial and retail businesses. The Company signed a definitive agreement granting it exclusive rights to Canada and New York State on October 15, 2003.

On July 22, 2004 the Company amended its Agreement with Abbotly USA to expand its territory to include another 11 U.S. states. Due to the significant size of the Company's territory within the United States, the Company decided to proceed with the assignment of its US territories to a wholly owned US subsidiary. The agreement from Abbotly USA to proceed with such an assignment was received on September 8, 2004.

On October 6, 2004 the Company completed the incorporation of Smartcool Systems (USA) Inc., its wholly owned subsidiary. On January 30th, 2006, the Company entered into a Letter of Intent with Abbotly USA to acquire the exclusive rights to distribute the ESM™ throughout North America. Pursuant to this LOI, Abbotly USA agreed to assign all of its rights and obligations, and the Company agreed to assume all of Abbotly USA's obligations, under an existing license agreement between Abbotly USA and Abbotly Australia Pty.

On March 27, 2006 Smartcool USA became the master distributor of the ESM™ in North America and was required to meet certain minimum purchase obligations under the license agreement with Abbotly Pty but was no longer be bound by its previous minimum purchase obligations that it had as sub-distributor of Abbotly USA. The consideration was paid in the form of cash and a royalty will be paid to Abbotly USA on all products purchased from Abbotly Pty. Smartcool also granted warrants to Abbotly USA.

In June 2006, the company purchased the business and assets of Abbotly Pty, consisting of the intellectual property and distribution rights of the ESM™, for the price of AU$2,895,000. The acquisition was accepted for filing by the TSX Venture Exchange and closed on June 30th, 2006. The purchase price is to be paid in cash in scheduled payments over two years. The first payment of AU$1,000,000 (CND$820,400) was made upon closing. Two other payments totalled AU$500,000 (CDN$440,790) were made in the fourth quarter of 2006. During the year 2007, three payments totalled AU$1,200,000 (CDN$1,082,840) were made as scheduled. The final payment of AU$195,000 is due on May 31, 2008.

Smartcool International Inc, another wholly owned subsidiary, was incorporated in Barbados in June 2006. This wholly owned subsidiary now holds the intellectual property and world wide distribution rights for the ESM™.

About the Energy Saving Module™

The Energy Saving Module System, manufactured in Australia, is designed specifically to reduce the electricity consumption (kWh) and maximum demand (Kw/KVA) of refrigeration and air conditioning compressors by improving their performance and maintaining temperature control. The ESM™ takes advantage of the latest in microprocessor technology and software developments. By monitoring the temperature time rate of change and compressor operating parameters occurring during each cooling cycle, the ESM™, using current and historical data through exclusive algorithms incorporating predicative analyses, determines the optimum operating parameters for the compressor. The ESM™ was first sold commercially in 1986 and to date approximately 26,000 ESM™ units have been installed worldwide. The cost reductions for refrigeration and air conditioning systems average between 15% to 25% using the ESM™.

A unique feature of the product is its ability to interface with, not replace, existing compressor controls. The ESM™'s on and off feature allows it to be switched out of the compressor circuit for easy savings verification, a must for most utility rebate programs. The modules are compatible with all types of control systems including the latest building automation systems and computer controlled refrigeration plants. They are also suitable for virtually all types of refrigeration and air conditioning equipment.

Competition

Control systems which reduce electricity consumption of refrigeration and air conditioning units by improving the efficiency of run cycles of the compressors, represent the primary indirect competition for the ESM™. Control systems are software programs designed to improve the efficiency of compressor run cycles or interaction between compressors. Most modern control systems use Direct Digital Control. Direct Digital Control is commonly referred to as: BMS or Building Management System, DDC or Direct Digital Control. The major function of a control system is to provide the primary control and information system for the air conditioning or refrigeration equipment. The ESM™ complements, but does not replace the primary control system. The major function of the ESM™ is to optimize the performance of the air conditioning system/refrigeration compressors while operating within the control parameters set by the primary control system.

Control systems represent an indirect competition to the ESM™ as the module augments building and refrigeration control systems. Using Building Management Systems (BMS or refrigeration controls) and the ESM™ together will achieve two distinctly different but compatible approaches to savings. The major function of a BMS is to provide the primary control and information system for the air conditioning or refrigeration equipment. The major function of the ESM™ is to reduce the cost of running the air conditioning system/refrigeration compressors while operating within the control parameters set by the primary controller or BMS.

Companies that manufacture and/or distribute controllers that reduce electricity consumption, include: Emerson Electric Co., Hench Controls Corporation, Delta Controls, Logix Controls, Intellidyne, Pace Controls and PowerCold Corporation.

Markets

The company operates in the air conditioning and refrigeration energy savings market. This market includes companies which operate heat, ventilation, and air conditioning and refrigeration equipment.
The Energy Savings Module's market can be segmented into commercial, industrial and retail sectors.

Commercial

This category includes all businesses that require air conditioning. Potential users in this category include electric utilities, telephone companies, office buildings, banks and financial institutions, government buildings, medical centers and hospitals, and ice rinks. Smartcool has expanded its market penetration in the commercial space by introducing a new Intelligent Interface Module (IIM) that allows the ESM™ to more effectively control chillers and centrifugal compressors using slide valve control or temperature reset.

Industrial

This segment includes any industry or manufacturer that has an air conditioned administration building or uses refrigeration or mechanical cooling in the manufacturing process. Such users include food storage and distribution, food processing, plastic injection and molding, computer manufacture, pharmaceuticals, computer rooms, and cold storage facilities.

Retail

The ESM™ can save energy in all types of retail establishments. The greater the air conditioning and refrigeration need of the retailer the greater the value of the product. Any retailer that requires a large air conditioned space and refrigeration area can benefit. Typically, the retail category includes shopping malls, supermarkets, department stores, and movie theatres. Smartcool plans to expand its market penetration in the retail space by using a new product developed in 2007.

Market Opportunity

With ever increasing energy demands and the rising cost of power, both Government and Industry are searching for ways to simultaneously reduce operating costs and decrease their environmental impact. Governments are implementing rebate programs for companies that institute energy saving measures. Companies are realizing the economic and social benefits of implementing aggressive environmentally conscious programs that reduce their energy costs. An example can be taken from a quote by H. Lee Scott, CEO of Wal-Mart, "As one of the largest companies in the world, with an expanding global presence, environmental problems are our problems."

Smartcool has the knowledge and experience to implement an aggressive sales and marketing program to introduce the ESM™ not only to the North American marketplace but the world. Management feels that the company is positioned to take advantage of a sector which is primed for growth as illustrated by a quote from Kleiner Perkins' John Doerr, "Greentech could be the largest economic opportunity of the 21st century."

According to the International Energy Outlook 2006, world energy consumption is expected to increase by 71% from 2003 to 2030, most rapidly in the industrial sector. In the U.S. alone, space cooling and refrigeration accounts for 15% of total electricity consumption. At a rate of US$0.07/kWh in the commercial sector, air-conditioning and refrigeration accounts for US$26 billion in spending annually.

Energy consistently ranks as the second or third largest operating expense for businesses with air-conditioning and refrigeration typically representing the largest electrical expense in the market verticals that Smartcool is targeting.

Marketing

The company has developed various methods of marketing, distributing, and installing the ESM™ around the world through the engagement of a team of commissioned marketing and technical personnel, as well as established companies who will sell directly to customers internationally under distribution agreements. Smartcool International is putting in place three regional hubs located in Europe, Asia Pacific and the Americas that will provide direct sales and technical support to its existing distribution network and will identify and implement new opportunities to expand the distribution network.

The initial sales efforts in North America have focused on large customer accounts that are in specific vertical markets which will provide testimonials that can be the used to expand sales initiatives in the verticals targeted. Other sales strategies have focused on the larger electric utility companies in the US that will indirectly market the technology to their customer base by providing incentives for implementing energy efficient technologies. As a result, the company has test installs under way with a variety of multi-location customers in the United States.

Financial Overview

The financial highlights for the three months ended March 31, 2008 are as follows:

Revenue was $422,663, increased by almost 35 times or $410,882, compared to $11,781 for the same period of the prior year. This substantial increase was a result of growth in both distribution business and direct customer sales.

Net loss was $745,733 ($0.02 per share) for the period, decreased by $157,755 or 17% from $903,488 ($0.03 per share) for the same period of 2007. The decrease in net loss was a result of growth in revenue being greater than increase in operating expenses.

As at the end of the period, the Company had $5,352,640 in cash and cash equivalents and short-term investments of $51,278 compared to $271,159 in cash and cash equivalents and $1,114,295 in short-term investments at the end of the first quarter in 2007. Total assets were $8,891,785 as at March 31, 2008 compared to $4,466,599 at March 31, 2007. The increase in assets was mainly a result of a private placement in 2007.

Total current liabilities were $502,106 at the end of first quarter of 2008, including the current portions of purchase obligation to Abbotly, capital leases and deferred tenant inducement, compared to $990,756 for the first quarter of 2007. Long-term liabilities were $104,850, consisting of the balance of capital leases ($22,527) and deferred tenant inducement ($82,323), compared to long-term liabilities of $267,022 for the same period last year. The decrease in liabilities was due to the fact that payments under acquisition contracts have been made as scheduled.

Selected Annual Information

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

	December 31, 2005	**December 31, 2006**	**December 31, 2007**
Sales	$0	$325,166	$447,275
Selling, General & Administrative	$917,471	$1,276,450	$2,741,892
Net loss	$(1,138,947)	$(2,066,868)	$(4,323,281)
Net loss – Per Share (Basic and Diluted)	$(0.08)	$(0.11)	$(0.13)
Total Assets	$651,507	$4,726,602	$9,313,309
Total Long Term Liabilities	$0	$238,862	$111,004
Cash Dividends	$0	$0	$0

Result of Operations

Revenue

Revenue for the first quarter of 2008 was $422,663 (first quarter of 2007 - $11,781) with $259,398 or 61% relating to distribution sales (first quarter of 2007 - $11,781) and $163,265 or 39% relating to direct customer sales (first quarter of 2007 - $0). This also represents a 130% increase in revenues from the previous quarter (Q4 2007). The increase in distribution sales was attributed to the increased activity of the United Kingdom distributor as well as new distribution relationships in Australia and the Philippines that were established in 2007. The increase in direct customer sales was a result of the completion of several projects that commenced in the previous year and a large order of equipment from a new customer. Though test results on one of the major projects that the company has been working on show very positive energy saving results, the public release of these results was still pending at the end of the first quarter.

Gross profit

Total gross profit for the quarter was $268,528 or 64% of revenue compared to $9,122 or 77% of revenue for the same period of the previous year. Though both margins were within the expected range, revenue for this quarter came from a balanced mix of direct customer and distribution business while the revenue in the first quarter of 2007 was generated from one high margin single equipment type distribution sale.

Net loss

Net loss for the period was $745,733 compared to $903,488 for the same period of the prior year. Though the company incurred more expenses this quarter to support its growing operations in the United States and expansion of the global distribution network, the significant increase in revenue helped offset the increase in costs of doing business.

The loss per share (basic and diluted) for the quarter was $0.02, compared to $0.03 for the first quarter of 2007. Loss per share is calculated based on the weighted average number of common shares outstanding throughout the period. A combination of a reduction in net loss and an increase in the weighted average common shares has resulted in a decrease in the loss per share for the quarter.

Selling, general and administrative expenses

Selling, general and administrative expenses for the period were $775,043 compared to $585,268 for the first quarter of 2007. Mainly contributing to the increase were higher salaries and benefits ($345,233 compared to $151,144 in 2007). In addition to three staff members that were hired when Smartcool USA established an office in Texas last year, a full time project manager was hired this year to co-ordinate installation activities in the United States. Another full time employee was hired by Smartcool to explore opportunities in the Canadian market at the beginning of the period.

Amortization

Amortization expenses were $78,031 for the quarter compared to $62,097 for the same quarter of the prior year. Amortization on property and equipment was $27,990 (first quarter of 2007 - $6,478) and amortization of intangible assets was $50,041 (first quarter of 2007 - $55,619). Intangible assets amortization decreased in 2008 as one distribution contract was written off in December 2007. Property and equipment amortization increased as more testing equipment, office furniture, computer hardware and software have been acquired and put into use in the period.

Stock-based compensation

Stock-based compensation costs for the period increased to $240,842 from 219,866 for the same period in 2007. This increase was primarily a result of stock options granted more recently having higher market prices and greater fair values. $3,007 of the cost was related to technical consulting services and the balance of $237,835 was related to management, general and administrative services.

Capital expenditure
Capital expenditures in the first quarter of 2008 were $29,294, compared to $21,034 for the same period in 2007. During the period, the company purchased a total of $17,879 of testing equipment and $11,415 of office computers and furniture.

Intangible assets
Smartcool acquired the intellectual property of the ESM™ and its world wide distribution rights in the year 2006. The acquisition was closed on June 30, 2006 at a price of AU$2,895,000. Total payments of AU$1,200,000 or CDN$1,082,840 were made in 2007 and AU$1,500,000 or CDN$1,310,090 were made in 2006. At March 31, 2007, AU$195,000 of the purchase price was outstanding.
The acquired assets included four distribution contracts and several supplier agreements along with the intellectual property of the ESM™ and the ESM™ brand. Certain intangible assets were tested for impairment at year end and as one distributor became inactive in 2007, the unamortized fair value of the contract (CDN$116,914) was written off at the end of the year.

Summary of Quarterly Results

	Jun 2006 ($)	Sept 2006 ($)	Dec 2006 ($)	Mar 2007 ($)	Jun 2007 ($)	Sep 2007 ($)	Dec 2007 ($)	Mar 2008 ($)
Total Revenues	$65,468	$22,999	$145,373	$11,781	$197,809	$54,107	$183,578	$422,663
Income/(Loss)	(208,395)	(556,827)	(1,123,149)	(903,488)	(768,358)	(1,066,472)	(1,584,963)	(745,733)
Income/(Loss) Per Share – basic & diluted	(0.01)	(0.04)	(0.11)*	(0.03)	(0.02)	(0.03)	(0.13)*	(0.02)*

*represents the loss per share (basic and diluted) for the fiscal years ended December 2006 and 2007

Though there were notable fluctuations in the quarterly revenue stream, with the establishment of several new distributor relationships in 2007, revenue has remarkably improved this period and appeared to have stabilized.

Schedule of selling, general and administrative expenses

	Three months ending March 31, 2008	**Three months ending March, 2007**	**12 months ending December 31, 2007**
Management and consulting fees	171,533	142,607	599,777
Salaries and benefits	345,233	151,144	738,320
Professional fees	13,908	25,555	198,526
Investor relations and media	49,514	68,166	323,035
Travel	79,785	83,109	384,408
Technical consulting	10,874	34,903	143,806
Rent, office and other expenses	104,196	79,784	354,020
Total selling, general & admin expenses	**775,043**	**585,268**	**2,741,892**
Stock-based compensation	240,842	219,866	1,229,257
Survey and testing cost	871	22,401	108,308
Research & Development	1,032	-	54,853
Amortization	78,031	62,097	302,937
Total operating expenses	**1,095,819**	**889,632**	**4,437,247**

The company's selling, general and administration expenses were $775,043 for the first quarter of 2008 compared to $585,268 for the same period in 2007.

Liquidity and Capital Resources

Since incorporation, the company has financed its operations through the issuance of equity. With capital raised by way of a private placement in August 2007, the company has successfully carried out its growth strategies: acquiring the intellectual property and world wide distribution rights of the ESM™, establishing a permanent presence and full operation in the United States, recruiting experienced technical staff, developing new products to penetrate residential markets.

As at March 31, 2008, the company had $5,352,640 in cash and cash equivalents and $51,278 in short-term investments.

Working capital at the end of the quarter was $6,009,810 compared to working capital of $900,011 for the same period of 2007.

Management believes the current cash resources together with increasing revenue and proceeds from the exercise of warrants is sufficient for the company to support its operations, meet its acquisition obligations, and complete marketing strategies for the next twelve months.

Contractual Obligations

a) Premise lease

On June 1, 2005, the company entered into an agreement to lease office facilities for 10 years. In February 2008, Smartcool USA entered into another agreement to lease office facilities in Texas for 37 months.

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

	$
2008	50,549
2009	70,609
2010	71,954
2011	54,067
2012	51,300
2013 and thereafter	129,375
	428,254

During the year, the company's rent expense including certain operating expenses and property taxes was $38,547 compared to $22,659 for the same period in 2007 and its sublease revenue was $5,919 compared to $11,328 for the same period in 2007.

b) Letter of credit

Upon the signing of the lease contract in June 2005, the company was required to secure its obligations with a letter of credit of $100,000. The letter of credit is reduced by $25,000 every year. As at March 31, 2008, the company had open letters of credit of $50,000 (March 31, 2007 - $75,000).

c) Equipment lease

In July 2005, the company signed a contractual lease agreement for equipment as follows:

- Telecommunication equipment for 40 months at $8,400 per annum
- Office equipment for 36 months at $14,800 per annum

In March 2007, the company signed two contractual agreements for the financing of computer equipment and software. Under these agreements, the company is required to make 36 monthly payments of $1,013 and $706 starting July 2007.

d) Abbotly USA

Under the terms of the North American distribution rights acquisition (note 6(a)), the company is required to pay a 20% royalty on all product purchased from Abbotly for North American sales. Once the company purchases all of the remaining ESM inventory from Abbotly USA, the company is required to purchase a minimum of $200,000 of ESM inventory from Abbotly per year until July 23, 2008 for purposes of the royalty calculation. During the three months ended March 31, 2008, the company accrued royalties of US$10,488 (2007 – US$76,840).

On June 30, 2006, the company acquired the business and assets of Abbotly Technologies Pty. Limited for total consideration of AU$2,954,600 (CA$2,423,958) with payments being scheduled over a two-year period. The amount is non-interest bearing and has been recorded at its present value using a discount rate of 9.7%. As at March 31, 2008, the company owes Abbotly Technologies Pty AU$195,000. This amount is due on May 31, 2008.

Transactions with Related Parties

Consulting fees of $49,300 (first quarter of 2007 - $6,000), were charged by a director of the company during the three months ended March 31, 2008. Consulting fees of $6,000 were charged by a company with a common officer during the period. These transactions were recorded at their exchange amounts. At March 31, 2008 and December 31, 2007, there were no amounts owed to the related parties.

The company subleases its office and other facilities to companies owned by certain directors and officers. During the three months ended March 31, 2008, sublease income was $5,919 compared to $11,328 for the same period in 2007. At March 31, 2008 and December 31, 2007, there were no amounts owed from these related parties.

Outstanding Share Data

The authorized share capital of the company is an unlimited number of common shares without par value. As at March 31, 2008 the company had 37,342,812 common shares outstanding. The following table provided the weighted average number of common shares outstanding for the three months ended March 31, 2008 and 2007.

	2008	2007
Three month weighted average	37,129,563	29,121,137

The increase in average number of common shares outstanding was a result of the issuance of 5,000,000 common shares through a private placement in August 2007, 1,962,394 common shares upon the exercise of warrants, 572,000 common shares upon the exercise of options and 6,632 common shares for consulting services.

As at May 29, 2008, the issued and outstanding common shares are 38,239,512. We also have 100,000,000 Class A preferred shares and 100,000,000 Class B preferred shares, none of which are issued.

Warrants and Stock options

As at March 31, 2008, there were 5,605,875 share purchase warrants and 5,012,250 stock options outstanding which collectively could result in the issuance of 10,793,125 common shares if these warrants and stock options are exercised. The outstanding options have weighted average exercise price of 0.75. There were 3,914,750 exercisable options on March 31, 2008 with a weighted exercise price of $0.66.

During the period, 25,000 stock options were granted to consultants, employees, directors and officers of the company.

Subsequent to the period, 861,700 warrants and 35,000 stock options have been exercised. As at May 29, 2008, there are 4,744,175 share purchase warrants and 4,971,000 stock options outstanding which collectively could result in the issuance of 9,890,175 common shares if these warrants and stock options are exercised.

Subsequent Events

5,000 units of the company's new product, the ESM ECO^{3}™ have been manufactured. The ESM ECO^{3}™ utilizes the same technology as the ESM™. The ESM ECO^{3}™ has been designed to provide an economical solution for smaller air conditioning and refrigeration compressors. Production is expected to be complete in June 2008 and the product will be available for sale to both distributors and direct sale customers.

On April 1, 2008, Smartcool International appointed Smartcool GmbH to be its authorized, exclusive distributor within the territory of Germany. The distribution agreement has a term of three years and can be renewed for an additional three year period.

As part of the company's strategic plan, Smartcool International has contemplated the acquisition of certain exclusive distribution rights within the territory of Europe and the Persian Gulf from its existing distributor, TECC Services Inc. Discussions started in March 2008 but the terms of the acquisition agreement have not been finalized. Once the agreement has been finalized, the company will seek the approval of the TSX Exchange.

Critical Accounting Policies

Intangible assets

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

ESM™ Intellectual property	10 years
North American distribution rights	10 years
Distribution agreements	7-15 years
Supplier agreements	10 years

Impairment of long-lived assets

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

Revenue recognition

Revenue from the sale and installation of the ESM in North America is recognized when the ESM has been installed, title has been transferred, collectability is reasonably assured and the fee is fixed and determinable.

Revenue from the international distribution of the ESM is recognized when the equipment has been shipped, title has transferred, collectability is reasonably assured and the fee is fixed and determinable. Provisions are established for estimated warranty costs at the time revenue is recognized. The company records deferred revenue when cash is received in advance of all of these revenue recognition criteria being met.

Research and development costs

Research costs are expensed as incurred. Development costs are expensed as incurred unless they meet specific criteria under Canadian GAAP for deferral and amortization, which relate primarily to technical, market and financial feasibility. The company has determined that none of its development costs have met these criteria to date.

Stock-based compensation and other stock-based payments

The company applies fair value accounting to the grant of stock options to employees, consultants and others. The value of these options is determined using the Black-Scholes option pricing model, and the resulting value is charged to operations over the vesting period. For options granted to non-employees, the fair value is measured when performance is complete, a performance commitment is made or the options are fully vested and non-forfeitable, whichever is earliest, and the expense is recognized over the period in which the goods or services from the non-employees are received. A corresponding increase in contributed surplus is recorded when stock options are expensed. When stock options are exercised, capital stock is credited by the sum of the consideration paid and the related portion previously recorded in contributed surplus.

Internal Controls over Financial Reporting and Disclosure Controls and Procedures

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

Changes in Accounting Policies

Inventories

Effective January 1, 2008 the company prospectively adopted Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3031. This section prescribes the accounting treatment for inventories and provides guidance on the determination of costs and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

As a result of the adoption of this policy, the company has changed its inventory costing method from specific cost to weighted average cost and adjusted cost of inventory as at January 1, 2008 from $351,267 to $341,814. Retained earnings balance as at January has been adjusted to $17,641,281 from $17,631,828.

Financial Instruments

Effective January 1, 2008 the company adopted CICA Handbook Section 3862, Financial Instruments – Disclosure, and Section 3863, Financial Instruments – Presentation. Section 3862 requires disclosure of the significance financial instruments have on an entity's financial position and performance, the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks. Section 3863, establishes standards for presentation of financial instruments and non-financial derivatives.

The adoption of these standards had no impact on the company's financial statements.

Capital Disclosure

Effective January 1, 2008 the company adopted Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1535, Capital Disclosure. This section establishes standards for disclosing information about the entity's capital and how it is managed to enable users of financial statements to evaluate the entity's objectives, policies and procedures for managing capital.

The new disclosure required by Section 1535 is included in note 10. The adoption of this standard did not have a material impact on the company's financial statements.

Future Accounting Standards

Goodwill and intangibles

Goodwill and intangibles, Section 3062, establishes revised standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets.

The company will adopt this new requirement effective January 1, 2009 and is currently considering the impact this will have on its financial statements.

International Financial Reporting Standards

In January 2006, the Accounting Standards Board adopted a strategic plan for the direction of accounting standards in Canada. Public companies in Canada are required to adopt International Financial Reporting Standards effective January 1, 2011.

Risk Factors

The business of the company is subject to a number of risks and uncertainties associated with its business for the marketing and distribution of the ESM™.

Lack of Marketing Network

At the current time the company has developed a marketing network throughout some of its territories. A primary objective of the company's business plan includes the building up of this network however there can be no assurances that the company can establish such a network in all of its territories and as such revenues from the sale of the ESM™ could be delayed.

Reliance on Key Personnel

The company is dependent on certain key members of its management team, and in particular Mr. George Burnes, President, to complete the market development of the ESM™. If any of these individuals are unavailable for any reason, the ability of the company to implement its business plan in the short term would be materially and adversely affected.

Default in License Agreements

If the company is unable to make the payments to the previous owners under the terms of the sale agreement then the IT and worldwide rights will reverse back to the previous owners.

Concentration on a single product

Presently, as the company is placing its sole focus on the distribution of the ESM™, any unfavorable change in the quality of the product or the introduction of similar products in the market would affect the company's competitive advantage to a great extent.

Currency risk

Presently the company's major business dealings are transacted in foreign currencies. Direct sales are in the United States currency and most of distribution sales are in Australian currency. Any devaluation in these currencies would affect the company's future revenues. Also, a significant portion of the company's expenses are in Canadian and Australian currencies. As long as direct sales in the United States make up the major portion of revenue, appreciation in the value of Canadian and Australia currencies relative to the US dollar would worsen that affect on net operating results.
To mitigate this currency risk, management has considered changing its primarily functional currency into the US currency by negotiation with its trading partners.

Competition Risk

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