SMARTCOOL™
SYSTEMS INC

Management’s Discussion and Analysis

For the six months ended June 30, 2008

The following Management’s Discussions and Analysis (“MD&A”), dated August 27, 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 six months ended June 30, 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 cleantech company headquartered in Vancouver, British Columbia, Canada that specializes in acquiring, commercializing, and marketing energy and cost reduction technologies for the HVACR systems of commercial, industrial and retail businesses. The company’s wholly owned subsidiary, Smartcool International Inc., is the owner, developer, manufacturer and worldwide distributor of the Energy Saving Module (ESM)™ and the ESM ECO³™. These green technology products reduce the electricity consumption (kWh) and maximum demand (KW) of air conditioning and refrigeration compressors through enhanced system performance.

Smartcool Systems Inc. has three wholly owned subsidiaries: Smartcool Systems USA Inc., Smartcool Systems (EMEA) Ltd., and Smartcool International Inc. Smartcool Systems USA Inc. is headquartered in Houston, Texas and is responsible for the sales and distribution of Smartcool’s technology in the United States, Canada and the Caribbean utilizing a direct sales force and various third party sales channels. Smartcool Systems (EMEA) Ltd. is headquartered in London, England and distributes Smartcool’s technology both directly and through a network of third party distributors and sales channels in Europe, the Middle East, the Indian sub-continent and Africa. Smartcool International Inc. has established a sales and technical network of independent distributors that is continually being enhanced, in an effort to increase distribution and achieve global recognition for Smartcool’s technology. There is currently a particular focus on developing distribution channels in the Far East, specifically China and India where installations have already been completed on specific customer sites.

The Energy Saving Module (ESM)™ and ESM ECO³™ enable compressors to maximize the rate of heat removal by optimizing the natural physical properties of the compressor operation cycle. This process is known as "Compressor Optimization" and can reduce compressor runtime by more than 30%, resulting in a significant reduction in electricity consumption and operational costs. This is achieved while maintaining preset temperature levels and without causing over-cycling.

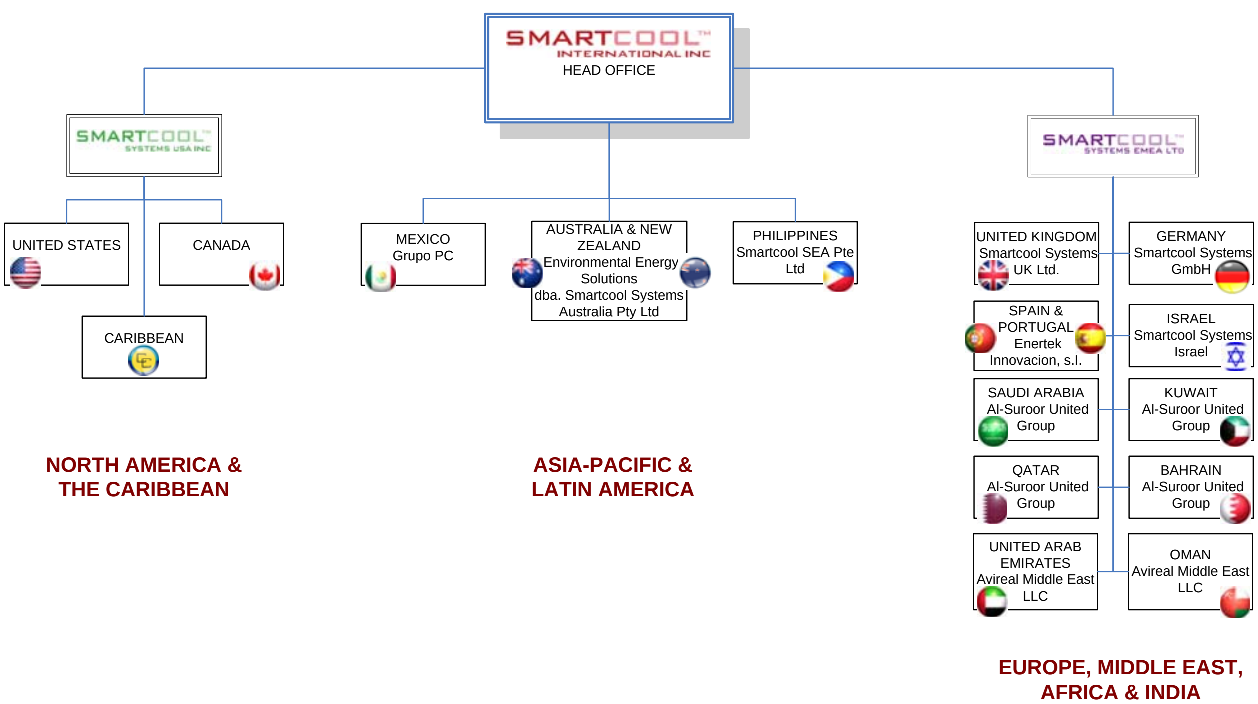
Corporate Structure and Distribution Network

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 three subsidiaries, Smartcool Systems USA Inc., Smartcool International Inc., and Smartcool Systems (EMEA) Ltd. Smartcool Systems USA Inc. is a wholly owned subsidiary responsible for the sales and distribution of Smartcool's technology in United States, Canada and the Caribbean 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. Smartcool Systems (EMEA) Ltd. is headquartered in London, England and distributes Smartcool's technology both directly and through a network of third party distributors and sales channels in Europe, the Middle East, the Indian sub-continent and Africa.

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™.

On April 18th 2008, the company completed the incorporation of its new subsidiary Smartcool Systems (EMEA) Ltd., located in the United Kingdom. On July 11th, 2008, Smartcool Systems (EMEA) Ltd. acquired the distribution rights and related business assets of T.E.C.C. Services Limited of the United Kingdom for the price of £1,300,000 GBP. The consideration will be paid in the form of cash and common shares in the company. On closing £700,000 GBP was paid in combination of cash and shares with the balance paid over four year period. The Distribution rights that were acquired in the transaction covered the United Kingdom, Spain, Portugal, and Middle East. In addition technical expertise both in form of personnel and documentation formed the business assets. This transaction also improves that financial performance of Smartcool as it can down sell direct as well as through third party to sales channels identified in its business strategy for Europe, Middle East, the Indian sub-continent and Africa.

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) 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 secondary controllers that claim to reduce electricity consumption, include: Aircon Energy Saver, AircoSaver, ArcticMaster, Intellidyne, Pace Controls and Optimum Energy.

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 (London, UK) , Asia Pacific (Sydney, AU) and the Americas (Vancouver, BC) 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.

In June of 2008 Smartcool's Energy Saving Module (ESM™) technology successfully completed vigorous testing by the University of Miami's Department of Industrial Engineering on behalf of Florida Power & Light Company ("FPL") under FPL's Conservation R&D Program. The goal of the research was to determine how Smartcool's ESM™ is able to reduce energy consumption overall but more importantly reduce demand during peak hours both in the summer and winter schedule. The ESM technology was installed on the HVAC equipment at a site of a National Drug Chain located in Miami, Florida. The Executive Summary of this report is publicly available and demonstrates impressive kWh savings and peak demand reduction.

Financial Overview

The financial highlights for the three months ended June 30, 2008 are as follows:

Revenue was $120,373, decreased by $77,435 or 39% from $197,808 for the same period of the prior year. All revenue recognized for the period was attributable to distribution sales. Revenue recognition is defined by completion of the Measurement and Verification process in some direct customer sales. There are a number of accounts where deposits have been made and revenue will be recognized in latter quarter.

Net loss was $1,039,987 ($0.03 per share) for the period, increased by $271,629 or 35% from $768,358 ($0.02 per share) for the same period of 2007.

As at the end of the period, the Company had $5,736,659 in cash and cash equivalents and short-term investments of $25,000 compared to $124,706 in cash and cash equivalents and $1,362,195 in short-term investments at the end of the second quarter in 2007. Total assets were $9,476,774 as at June 30, 2008 compared to $4,668,378 at June 30, 2007. The increase in assets was mainly a result of a private placement in August 2007 and the exercise of warrants in the second quarter of 2008.

Total current liabilities were $500,410 at the end of second quarter of 2008, including the current portions of capital leases and deferred tenant inducement, compared to $1,078,008 for the second quarter of 2007. Long-term liabilities were $98,305, consisting of the balance of capital leases ($18,242) and deferred tenant inducement ($80,063), compared to long-term liabilities of $129,394 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 second quarter of 2008 was $120,373 compared to $197,808 for the same period of 2007. The decrease reflected a timing issue in the recognition of revenue from direct sales ($0 compared to $40,068 for second quarter of 2007) and a reduction in distribution sales ($120,373 compared to $157,740 for the second quarter of 2007). Even though satisfactory energy saving results have been achieved for a number of installation tests, they are being reviewed under a rigorous approval process by customers and these potential direct sales can only be recognized once the approval process is complete. Distribution sales did not meet expectations either as the distributors were faced with the same timing issue with their own customers.

Revenue for the first two quarter of 2008 was $543,038 compared to $209,590 for the same period of 2007. This significant increase was attributable to greater revenue for the first quarter of this year.

Gross profit

Total gross profit for the quarter was $51,316 or 43% of revenue compared to $132,405 or 67% of revenue for the same period of the previous year. Though costs of equipment sold for the two periods were compatible and in line with standard margins, royalty expense of $17,996 was recognized this period while no royalties were recognized in the second quarter of 2007. Also, significant installation expenses have been incurred in the second quarter of 2008 on one project as a result of the unusual set-up of the customer's refrigeration systems. These extra costs, though bringing the current period's margin down, might prove beneficial in the future as the customer has other sites that can utilize Smartcool's products.

Gross profit for the first two quarters of this year was $319,845 or 59% of revenue compared to $$141,526 or 68% of revenue of the same period of the prior year. Both margins were within expectations.

Net loss

Net loss for the three months was $1,039,967 compared to $768,358 for the same period of the prior year. As the company continued to grow its operations in the United States and expanded its global distribution network within its operating budgets, the decrease in revenue consequently resulted in a greater net loss.
For the six months ended June 30, 2008, total net loss was $1,785,718 compared to $1,671,845 for the same period of 2007.
The loss per share (basic and diluted) for the three months was $0.03, compared to $0.02 for same period of 2007. Loss per share (basic and diluted) for the six months was $0.05, compared to $0.06 for the same period of the prior year.
Loss per share is calculated based on the weighted average number of common shares outstanding throughout the period.

Selling, general and administrative expenses

Selling, general and administrative expenses for the period were $905,642 compared to $647,865 for the first quarter of 2007. Mainly contributing to the increase were higher salaries and benefits ($453,196 compared to $146,571 in 2007). An experienced technician was hired in the period to assist various installation projects in the US. One project manager and two sales administrators were also hired in the second quarter of this year. Travel expenses were also higher for the period, $98,701 compared to $67,090 for the same quarter of the previous year.

Selling, general and administrative expenses for the six month period were $1,680,684 compared to $1,233,133 for the same period of 2007.

Amortization

Amortization expenses were $77,119 for the quarter compared to $67,214 for the same quarter of the prior year. Amortization on property and equipment was $27,080 (second quarter of 2007 - $12,104) and amortization of intangible assets was $50,039 (second quarter of 2007 - $55,110). Equipment amortization was higher in the period as more testing equipment and computer equipment were purchased this year. Intangible assets amortization decreased in 2008 as one distribution contract was written off in December 2007.

Amortization for the six month period was $155,151 (equipment amortization $55.071, intangible amortization $100,080) compared to $129,311 for the same period of 2007 (equipment amortization $18.583, intangible amortization $110,728).

Stock-based compensation

Stock-based compensation costs for the three months decreased to $101,586 from $197,022 for the same period in 2007. Stock-based compensation costs for the six months decreased to $342,428 from $416,888 for the same period in 2007.

The company only granted 25,000 options in the first quarter of 2008 and cancelled all of them in the second quarter. Stock-based compensation costs for the first three months and six months of 2008 therefore reflected primarily the amortized costs of options granted in previous years.

Capital expenditure

Capital expenditures in the second quarter of 2008 were $61,065, compared to $9,157 for the same period in 2007. During the three months, the company purchased a total of $54,167 of testing equipment to meet the increased testing demand. Office computers and furniture of $6,898 were also purchased.
Capital expenditures for the six months were $90,359, compared to $30,191 for the same period in 2007.

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$195,000 or CDN$185,133 were made in 2008, 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 June 30, 2008 there were no amounts owed to Abbotly.
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

	Sept 2006 ($)	Dec 2006 ($)	Mar 2007 ($)	Jun 2007 ($)	Sep 2007 ($)	Dec 2007 ($)	Mar 2008 ($)	Jun 2008 ($)
Total Revenues	$22,999	$145,373	$11,781	$197,809	$54,107	$183,578	$422,663	$120,373
Income/(Loss)	(556,827)	(1,123,149)	(903,488)	(768,358)	(1,066,472)	(1,584,963)	(745,733)	(1,039,987)
Income/(Loss) Per Share – basic & diluted	(0.04)	(0.11)*	(0.03)	(0.02)	(0.03)	(0.13)*	(0.02)	(0.03)

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

Schedule of selling, general and administrative expenses

	Three months ending June 30, 2008	Three months ending June 30, 2007	Six months ending June 30, 2008	Six months ending June 30, 2007
Management and consulting fees	136,169	183,386	307,702	325,993
Salaries and benefits	453,196	146,571	798,429	297,715
Professional fees	49,750	76,805	63,658	102,360
Investor relations and media	47,425	49,001	96,939	117,166
Travel	98,701	67,091	178,485	150,200
Technical consulting	1,328	26,310	12,202	61,212
Rent, office and other expenses	119,073	98,701	223,269	178,487
Total selling, general & admin expenses	**905,642**	**647,865**	**1,680,684**	**1,233,133**
Stock-based compensation	101,586	197,022	342,428	416,888
Survey and testing cost	183	4,386	1,053	26,787
Research & Development	21,750	-	22,782	-
Amortization	77,119	67,214	155,151	129,311
Total operating expenses	**1,106,280**	**916,487**	**2,202,098**	**1,806,119**

The company's selling, general and administration expenses for the three months and six months were $905,642 and $1,680,681 compared to $647,865 and $1,233,133 for the same periods 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 and proceeds received from the exercise of warrants issued in earlier years, 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 June 30, 2008, the company had $5,736,659 in cash and cash equivalents and $25,000 in short-term investments.

Working capital at the end of the period was $6,528,803 compared to working capital of $1,026,293 for the same period of 2007.

Management believes the current cash resources together with revenue 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	33,966
2009	70,609
2010	71,954
2011	54,067
2012	51,300
2013 and thereafter	129,375
	411,271

For the three months and six months ended June 30, 2008, the company's rent expense including certain operating expenses and property taxes were $29,245 and $55,876 (2007 - $100,008) and its sublease revenue were $5,919 and $11,838 (2007 - $35,408).

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 June 30, 2008, the company had open letters of credit of $25,000 (December 31, 2007 - $50,000).

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) – June 30, 2008 financial statements), the company is required to pay a 20% royalty on products identified in the Assignment and Assumption agreement dated March 27, 2006 and purchased from Abbotly for North American sales. The initial term of the agreement was to expire on March 3, 2008. Smartcool under its rights in the Assignment and Assumption agreement has renewed the licensing agreement for another five year term. Once the company purchases all of the remaining inventory from Abbotly USA, the company is required to purchase a minimum of $200,000 of products identified in the Assignment and Assumption agreement from Abbotly per year for purposes of the royalty calculation. During the three months and six months ended June 30, 2008, the company accrued royalties of US$17,400 and US$27,888 (Year 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 June 30, 2008, the acquisition obligation to Abbotly Technologies Pty has been fulfilled and there were no amount owed to Abbotly.

Transactions with Related Parties

Consulting fees of $30,000 and $91,300 were charged by a director of the company during the three months and six months ended June 30, 2008 (2007 - $62,200). Consulting fees of $6,000 and $12,000 were charged by a company with a common officer during the three months and six months ended June 30, 2008. These transactions were recorded at their exchange amounts. At June 30, 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 and six months ended June 30, 2008, sublease income was $5,919 and $11,838 (2007 - $35,408). At June 30, 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 June 30, 2008 the company had 40,438,937 common shares outstanding. The following table provided the weighted average number of common shares outstanding for the three months and six months ended June 30, 2008 and 2007.

	2008	2007
Three month weighted average	38,159,584	31,393,427
Six month weighted average	37,644,574	30,264,836

The increase in average number of common shares outstanding was a result of the issuance of 3,329,250 common shares upon the exercise of warrants and 35,000 common shares upon the exercise of options in the first six months of 2008.

As at August 26, 2008, the issued and outstanding common shares are 41,647,464. 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 June 30, 2008, there were 2,500,000 share purchase warrants and 4,971,000 stock options outstanding which collectively could result in the issuance of 7,646,000 common shares if these warrants and stock options are exercised. The outstanding options have weighted average exercise price of 0.75. There were 4,294,750 exercisable options on June 30, 2008 with a weighted exercise price of $0.68.

During the three month period, no options were granted to consultants, employees, directors and officers of the company.

Subsequent Events

The manufacturing of 5,000 units of the company's new product, ESM ECO3™, will be completed in the second half of 2008 once final CSA approval is received. The ESM ECO3™ utilizes the same technology as the ESM™ but has been designed to provide an economical solution for smaller air conditioning and refrigeration compressors. The company is looking to establish a launch strategy that will outline new distribution channels and expanded market opportunities.

On April 18th 2008, the company completed the incorporation of its new subsidiary Smartcool Systems (EMEA) Ltd., located in the United Kingdom. On July 11th, 2008, Smartcool Systems (EMEA) Ltd. acquired the distribution rights and related business assets of T.E.C.C. Services Limited of the United Kingdom for the price of ₤1,300,000 GBP. The consideration will be paid in the form of cash and common shares in the company. On closing £700,000 GBP was paid in combination of cash and shares with the balance paid over four year period. The Distribution rights that were acquired in the transaction covered the United Kingdom, Spain, Portugal, and Middle East. In addition technical expertise both in form of personnel and documentation formed the business assets. This transaction also improves the financial performance of Smartcool as it can down sell direct as well as through third party to sales channels identified in its business strategy for Europe, Middle East, the Indian sub-continent and Africa.

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 $83,747 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

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. On February 13, 2008, the Canadian Accounting Standards Board confirmed that International Financial Reporting Standards will replace Canadian GAAP for publicly accountable profit-oriented enterprises for interim and annual financial statements effective January 1, 2011. The company is currently considering the impact of these standards on its financial statements.

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.