SMARTCOOL™ SYSTEMS INC

Management's Discussion and Analysis

For the nine months ended September 30, 2008

The following Management's Discussions and Analysis ("MD&A"), dated November 28, 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 nine months ended September 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.

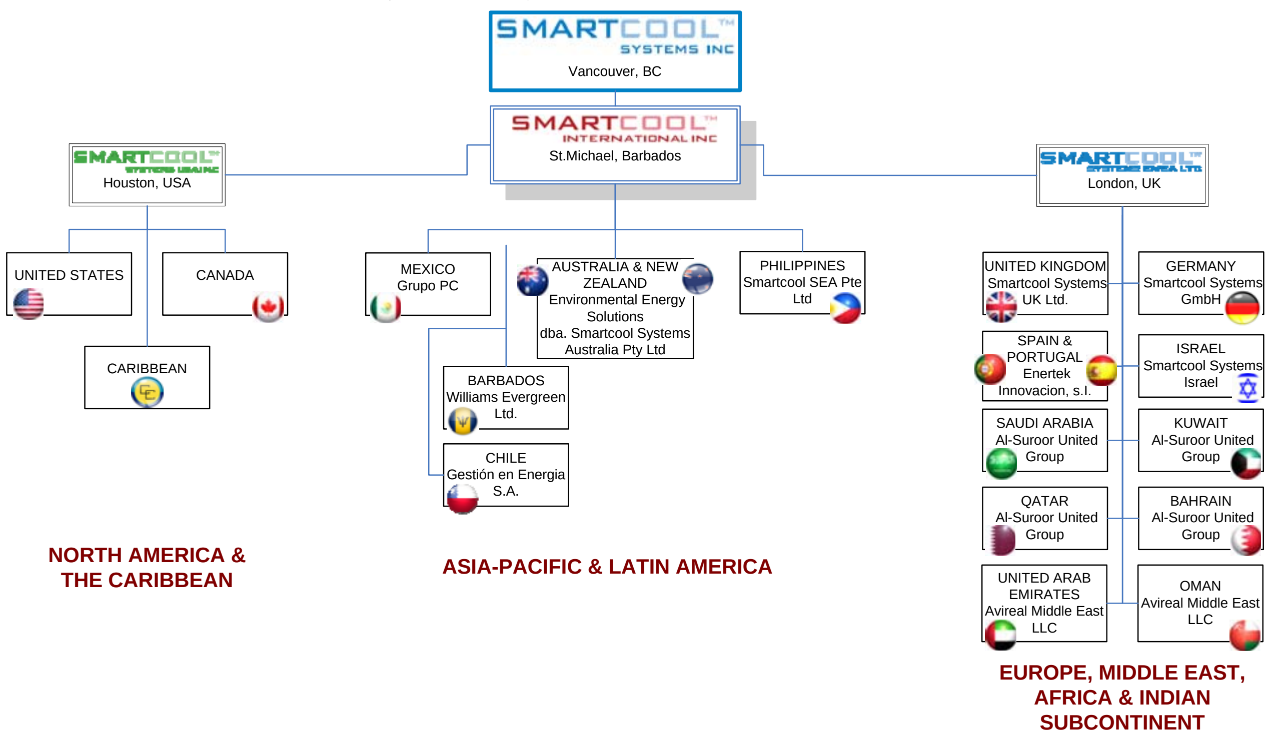
Corporate Structure and Distribution Network

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 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 was payable in the form of cash and common shares in the company. On closing ₤700,000GBP (CDN$1,405,460) 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 sales & 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.

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 September 30, 2008 are as follows:

Revenue was $204,793, increased by $150,686 or 278% from $54,107 for the same period of the prior year with 98% of total revenue 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 when installation is complete.

Net loss was $1,337,484 ($0.03 per share) for the period, increased by $271,012 or 25% from $1,066,472 ($0.03 per share) for the same period of 2007.

As at the end of the period, the Company had $3,729,454 in cash and cash equivalents and short-term investments of $25,000 compared to $7,176,477 in cash and cash equivalents and $250,000 in short-term investments at the end of the third quarter in 2007. Total assets were $9,653,601 as at September 30, 2008 compared to $10,664,998 at September 30, 2007. Due to TECC acquisition, intangible assets have increased significantly from $2,295,330 as at September 30, 2007 to $4,232,337 as at September 30, 2008. This increase was more than offset by the funding of operations with the net result being a reduction in total assets.

Total current liabilities were $786,302 at the end of the third quarter of 2008, including the current portions of capital leases and deferred tenant inducement, compared to $839,115 for the third quarter of 2007. Long-term liabilities were $720,970 consisting of acquisition obligations ($629,528), the balance of capital leases ($13,784) and deferred tenant inducement ($77,358), compared to long-term liabilities of $125,146 for the same period last year. The increase in liabilities was due to obligations under TECC acquisition agreement.

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

Results of Operations

Revenue

Revenue for the third quarter of 2008 was $204,793 compared to $54,107 for the same period of 2007. The increase was primarily attributable to sales to distributors (United Kingdom $55,366, Philippines $49,192, Barbados $29,958, Australia $19,065, Israel $9,963). Satisfactory energy saving results have been achieved for a major multi-location customer and management expects the customer's approval process to complete before the end of the year.

Revenue for the first three quarters of 2008 was $747,829 compared to $263,697 for the same period of 2007. This three-fold growth in revenue was a combined result of the expansion of the company's distribution network and the increasing global demand for green technology products.

Gross profit

Total gross profit for the quarter was $144,051 or 70% of revenue compared to $27,473 or 51% of revenue for the same period of the previous year. The current period's gross margin was well within the expected range while the prior period's margin was affected by the incurrence of installation costs on certain pending projects where revenue was delayed until completion.

Gross profit for the first three quarters of this year was $463,896 or 62% of revenue compared to $169,000 or 64% of revenue of the same period of the prior year. Both margins were within expectations.

Net loss

Net loss for the three months was $1,337,484 compared to $1,066,472 for the same period of the prior year. Though gross profit has remarkably improved, the increase was more than offset by increased operating

costs. For the nine months ended September 30, 2008, total net loss was $3,123,202 compared to $2,738,318 for the same period of 2007.
The loss per share (basic and diluted) for the period was $0.03, no change from that of the third quarter of the previous year. Loss per share (basic and diluted) for the nine months was $0.08, compared to $0.09 for the same period of 2007.
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 $1,295,780 compared to $656,877 for the third quarter of 2007. Due to the growing operations globally, salaries and benefits for the third quarter of 2008 was $580,501 compared to $178,404 for the same quarter of 2007. Consulting fees and travel expenses for the three months increased to $250,945 and $159,071, respectively, from $169,142 and $104,525, respectively, for the same period last year.

Selling, general and administrative expenses for the nine month period were $2,976,464 compared to $1,890,011 for the same period of 2007.

Amortization
Amortization expenses were $123,484 for the quarter compared to $73,436 for the same quarter of the prior year. Amortization on property and equipment was $32,387 (third quarter of 2007 - $18,251) and amortization of intangible assets was $91,097 (third quarter of 2007 - $55,185). Equipment amortization was higher in the period as more testing equipment and computer equipment were purchased this year. Intangible assets amortization increased in 2008 as a result of the acquisition of distribution rights from TECC.

Amortization for the nine month period was $278,634 (equipment amortization $87,457, intangible amortization $191,177) compared to $202,747 for the same period of 2007 (equipment amortization $36,834, intangible amortization $165,913).

Stock-based compensation
Stock-based compensation costs for the three months decreased to $75,118 from $350,468 for the same period in 2007. Stock-based compensation costs for the nine months decreased to $417,546 from $767,356 for the same period in 2007.
The decrease in stock-based compensation costs for both the three months and nine months of this year was a result of two factors: A smaller number of options was granted this year (295,000 options for the nine months ended September 30, 2008 compared to 1,360,000 for the nine months ended September 30, 2007) and fair values of granted options have decreased.

Capital expenditure
Capital expenditures in the third quarter of 2008 were $50,091, compared to $183,713 for the same period of 2007. During the three months, the company purchased a total of $11,364 of testing equipment and $17,400 of office equipment. Research and development costs of $21,327 were also incurred in the period.
Capital expenditures for the nine months were $224,197, compared to $213,903 for the same period in 2007.

Intangible assets
In 2006, Smartcool acquired the intellectual property of the ESM™ and its world wide distribution rights from Abbotly Pty. 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 September 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 2007.

In 2008, Smartcool acquired the ESM™ distribution rights from T.E.C.C. Services Ltd. ("TECC"). The acquisition was closed on July 11, 2008 for total consideration of £1,300,000GBP. Upon closing, cash payment of £435,000GBP (CA$873,393) was made and common shares of the company with value equal to £265,000GBP (CA$532,067) were issued. The remaining balance of £600,000GBP is due in scheduled instalments over four years with the last payment due on July 11, 2012. At September 30, 2008, £600,000GBP (CA$833,130) was due to TECC. The acquired assets included master distribution rights within the territories of the United Kingdom, Spain, Portugal, and the Middle East and several sub-distribution agreements. The business assets also included sales & technical expertise in the form of personnel and documentation.

Summary of Quarterly Results

	Dec 2006 ($)	Mar 2007 ($)	Jun 2007 ($)	Sep 2007 ($)	Dec 2007 ($)	Mar 2008 ($)	Jun 2008 ($)	Sep 2008 ($)
Total Revenues	$145,373	$11,781	$197,809	$54,107	$183,578	$422,663	$120,373	$204,793
Income/(Loss)	(1,123,149)	(903,488)	(768,358)	(1,066,472)	(1,584,963)	(745,733)	(1,039,987)	(1,337,484)
Income/(Loss) Per Share – basic & diluted	(0.11)*	(0.03)	(0.02)	(0.03)	(0.13)*	(0.02)	(0.03)	(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 September 30, 2008	**Three months ending September 30, 2007**	**Nine months ending September 30, 2008**	**Nine months ending September 30, 2007**
Management and consulting fees	250,945	169,142	558,647	495,135
Salaries and benefits	580,501	178,404	1,378,930	476,119
Professional fees	60,473	21,391	124,130	123,751
Investor relations and media	43,719	70,450	140,654	187,616
Travel	159,071	104,525	337,557	254,726
Technical consulting	48,565	28,027	60,767	89,240
Rent, office and other expenses	152,506	84,937	375,779	243,424
Total selling, general & admin expenses	**1,295,780**	**656,877**	**2,976,464**	**1,890,011**
Stock-based compensation	75,118	350,468	417,546	767,356
Survey and testing cost	1,724	10,112	2,777	36,899
Research & Development	10,417	-	33,200	-
Amortization	123,484	73,436	278,634	202,747
Total operating expenses	**1,506,523**	**1,090,892**	**3,708,621**	**2,897,013**

The company's selling, general and administration expenses for the three months and nine months were $1,295,780 and $2,976,464 compared to $656,877 and $1,890,011 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 operations in the United States, United Kingdom & Australia, recruiting experienced technical staff, developing new products designed to provide an economical solution for smaller air conditioning and refrigeration compressors.

As at September 30, 2008, the company had $3,729,454 in cash and cash equivalents and $25,000 in short-term investments. The current portion of acquisition obligations and lease contracts was $220,118.

Working capital at the end of the period was $4,194,003 compared to working capital of $7,152,890 for the same period of 2007.

The current worldwide economic crisis has created certain concerns and management has thoroughly reviewed the company's financing ability and operating budgets for the coming year. 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	22,491
2009	70,609
2010	71,954
2011	54,067
2012	51,300
2013 and thereafter	129,375
	399,796

For the three months and nine months ended September 30, 2008, the company's rent expense including certain operating expenses and property taxes were $32,024 and $87,900 (2007 - $100,008) and its sublease revenue were $5,919 and $17,757 (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 September 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 contractual lease agreements for equipment as follows:

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

These contracts expired in July 2008.

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.

In July 2008, Smartcool USA entered into an office equipment lease agreement. Under this agreement, the company is required to make 24 monthly payments of $369 starting August 2008.

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. For the three months and nine months ended September 30, 2008, the company recorded royalties of US$12,112 and US$ 27,888. Payment of US$40,000 was made in July 2008. As at September 30, 2008, no royalties were payable to Abbotly USA (Year 2007 – US$76,840).

Transactions with Related Parties

Consulting fees of $30,000 and $109,300 were charged by a director of the company during the three months and nine months ended September 30, 2008 (2007 - $62,200). Consulting fees of $6,000 and $18,000 were charged by a company with a common officer during the three months and nine months ended September 30, 2008. These transactions were recorded at their exchange amounts. At September 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 nine months ended September 30, 2008, sublease income was $5,919 and $17,757 (2007 - $35,408). At September 30, 2008, $9,904 was owed from related parties (December 31, 07 - $0).

Outstanding Share Data

The authorized share capital of the company is an unlimited number of common shares without par value. As at September 30, 2008 the company had 41,182,646 common shares outstanding. The following table provided the weighted average number of common shares outstanding for the three months and nine months ended September 30, 2008 and 2007.

	2008	2007
Three month weighted average	41,109,892	33,973,826
Nine month weighted average	38,808,111	31,524,482

The increase in average number of common shares outstanding was a result of the issuance of 743,709 common shares for TECC acquisition, 3,329,250 common shares upon the exercise of warrants and 35,000 common shares upon the exercise of options in the first nine months of 2008.

As at November 27, 2008, the issued and outstanding common shares are 41,182,646. 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 September 30, 2008, there were 2,500,000 share purchase warrants and 4,891,000 stock options outstanding which collectively could result in the issuance of 7,391,000 common shares if these warrants and stock options are exercised. The outstanding options have weighted average exercise price of $0.68. There were 4,248,500 exercisable options on September 30, 2008 with a weighted exercise price of $0.63.

During the three month period ended September 2008, 270,000 options were granted to consultants and employees of the company.
Subsequent to the period end, 65,000 stock options were granted to the company's consultants and employees.
As at November 27, 2008, there are 2,500,000 share purchase warrants and 4,956,000 stock options outstanding which collectively could result in the issuance of 7,456,000 common shares if these warrants and stock options are exercised.

Subsequent Events

On August 25, 2008, Smartcool International appointed Williams Evergreen Ltd., Barbados, to be its authorized, exclusive distributor within the territory of Barbados. The distribution agreement has a term of three years and can be renewed for an additional three year period.

On November 1, 2008, Smartcool International appointed Gestion En Energia S.A., Chile, to be its authorized, exclusive distributor within the territory of Chile. The distribution agreement has a term of five years and can be renewed for an additional five year period.

In November 2008, Smartcool Systems was approved by the B.C. Ministry of Technology, Trade and Economic Development for its Clean Tech Innovation Venture Capital Program, which offers tax credits to investors in clean technology companies operating in B.C. Under this program, an individual investor earns a 30% tax credit that is fully refundable for every dollar of capital invested in eligible companies.

In November 2008, the manufacturing of 5,000 units of the company's new product, ESM ECO^{3TM}, was completed. The ESM ECO^{3TM} utilizes the same technology as the ESM^{TM} but has been designed to provide an economical solution for smaller air conditioning and refrigeration compressors. The company is looking finalizing a launch strategy that will outline new distribution channels and expanded market opportunities.

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 $105,074 of its development costs have met these criteria to date. As the commercial production of the new product was incomplete at the end of the period, no amortization expense has been recorded for the period.

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

In January 2008, the CIBA issued Section 3064 "Goodwill and Intangible Assets" which replaces Section 3062 "Goodwill and Other Intangible Assets" and Section 3450 "Research and Development Costs". This section establishes standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets by profit-oriented enterprises subsequent to their initial measurement.

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™ technology.

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.