SMARTCOOL™
SYSTEMS INC

CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Expressed in Canadian Dollar)

June 30, 2008 and 2007

Index

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Smartcool Systems Inc.
Consolidated Balance Sheets
June 30, 2008 and December 31, 2007
(Unaudited - Prepared by Management)

	Jun 30 **2008** **$** (Unaudited)	December 31 **2007** **$**
ASSETS		
Current assets		
Cash and cash equivalents	5,736,659	6,020,860
Short-term investments (note 4)	25,000	227,536
Amounts receivable	402,445	197,494
Inventory	657,163	351,267
Prepaid expenses and deposits	207,946	87,546
	7,029,213	6,884,703
Deferred charges -Research & Development (note 7)	83,747	-
Property and equipment (note 5)	339,509	304,220
		-
Intangible assets (note 6)	2,024,305	2,124,386
	9,476,774	9,313,309
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	475,879	333,122
Current portion of obligations under contracts (note 8)	-	138,117
Current portion of capital Leases (note 9)	16,160	14,924
Current portion of deffered tenant inducement	8,371	8,148
	500,410	494,311
Capital leases (note 9)	18,242	26,644
Deferred tenant Inducement	80,063	84,360
	598,715	605,315
SHAREHOLDERS' EQUITY		
Share capital (note 10(b))	24,687,577	22,573,211
Share purchase warrants (note 10(e))	1,183,369	1,666,760
Contributed surplus (note 10(f))	2,434,113	2,099,851
Deficit	(19,427,000)	(17,631,828)
	8,878,059	8,707,994
	9,476,774	9,313,309

Commitments and obligations (note 13)
Subsequent events (note 18)

Approved by the directors	"George Burnes"	"Jeffrey Lowe"
	George Burnes	Jeffrey Lowe

(See accompanying notes to the consolidated financial statements)

Smartcool Systems Inc.

Consolidated Statements of Operations, Comprehensive Loss and Deficit
Six months ended June 30, 2008 and June 30, 2007
(Unaudited - Prepared by Management)

	Three months ended June 30		Six months ended June 30	
	2008	**2007**	**2008**	**2007**
	$	**$**	**$**	**$**
Revenue	120,373	197,808	543,036	209,590
Cost of sales	69,057	65,403	223,191	68,064
Gross profit	51,316	132,405	319,845	141,526
Operating Expenses				
Survey and testing costs	182	4,386	1,053	26,787
Selling, general and administrative expenses	905,642	647,865	1,680,684	1,233,133
Stock-based compensation	101,586	197,022	342,428	416,888
Research and development	21,751	-	22,782	-
Amortization	77,119	67,214	155,151	129,311
	1,106,280	916,487	2,202,098	1,806,119
Loss before undernoted	(1,054,964)	(784,082)	(1,882,253)	(1,664,593)
Other (Income) expense				
Interest expense and accretion	15,115	21,417	36,247	41,162
Interest Income	(24,997)	(4,015)	(81,157)	(17,260)
Foreign exchange gain (loss)	(5,095)	(33,126)	(51,625)	(16,650)
	(14,977)	(15,724)	(96,535)	7,252
Loss and comprehensive loss for the period	(1,039,987)	(768,358)	(1,785,718)	(1,671,845)
Deficit, beginning of period	(18,387,014)	(14,212,034)	(17,641,282)	(13,308,547)
Deficit, end of period	(19,427,000)	(14,980,392)	(19,427,000)	(14,980,392)
Loss per share				
Basic and diluted	(0.03)	(0.02)	(0.05)	(0.06)
Weighted average number of common shares outstanding	38,159,584	31,393,427	37,644,574	30,264,836

Smartcool Systems Inc.

Consolidated Statements of Cash Flows
Six months ended June 30, 2008 and June 30, 2007
(Unaudited - Prepared by Management)

	Three months ended June 30		Six months ended June 30	
	2008	**2007**	**2008**	**2007**
	$	**$**	**$**	**$**
Cash flows from operating activities				
Loss and comprehensive loss for the period	(1,039,987)	(768,358)	(1,785,718)	(1,671,845)
Adjustments for item not involving cash:				
Amortization of property and equipment	27,080	12,105	55,071	18,583
Amortization of intangible assets	50,039	55,109	100,080	110,728
Stock-based compensation	101,586	197,022	342,428	416,888
Deferred tenant inducement	(2,037)	(1,591)	(4,074)	(2,960)
Adjustment of inventory opening balance	-	-	(9,453)	-
Accretion of obligation under acquisition contract	13,557	19,558	33,023	39,285
Foreign exchange (gain) loss on obligations under acquisition contract	1,950	(28,324)	13,992	(10,814)
Consulting fees paid in shares	-	6,000	-	12,000
	(847,812)	(508,479)	(1,254,651)	(1,088,135)
Changes in non-cash working capital items:				
Amounts receivable	52,004	(113,863)	(204,951)	(146,343)
Inventory	(294,461)	(57,893)	(305,896)	(223,856)
Prepaid expenses and deposits	82,901	60,150	(120,400)	57,834
Accounts payable and accrued liabilities	167,076	(86,320)	142,757	13,532
	(840,291)	(706,405)	(1,743,141)	(1,386,968)
Cash flows from financing activities				
Shares issued for cash-net of cash issue costs	-	-	9,654	-
Shares issued on exercise of options	10,050	49,500	10,050	122,568
Shares issued on exercise of warrants	1,521,580	767,510	1,603,105	1,347,900
Repayment of oligations under acquisition contract	(185,133)	-	(185,133)	(371,080)
Repayment of capital lease obligations	(3,654)	-	(7,166)	
	1,342,843	817,010	1,430,510	1,099,388
Cash flows from investing activities				
Sale of short-term investment	26,279	-	202,536	-
Purchase short-term investment	-	(247,900)	-	(258,341)
Purchase of property & equipment	(61,065)	(9,157)	(90,359)	(30,191)
Product developments	(83,747)	-	(83,747)	-
	(118,533)	(257,057)	28,430	(288,532)
Increase (decrease) in cash and cash equivalents	384,019	(146,452)	(284,201)	(576,112)
Cash and cash equivalents, beginning of period	5,352,640	271,159	6,020,860	700,819
Cash and cash equivalents, end of period	5,736,659	124,707	5,736,659	124,707

Supplementary cash flow Information (note 17)

(See accompanying notes to the consolidated financial statements)

1 Nature of operations

Smartcool Systems Inc. (“Smartcool” or the “company”), which was incorporated on August 31, 2000 under the Canada Business Corporations Act as 378211 Canada Inc., changed its name to Citotech Systems Inc. on October 16, 2000, and changed its name again to Smartcool Systems Inc. on July 20, 2004.

In 2004, the company incorporated a wholly owned subsidiary, Smartcool Systems (USA) Inc. (“Smartcool USA”), under the laws of Nevada. Smartcool International Inc. (“Smartcool International”), another wholly owned subsidiary, was incorporated in Barbados in June 2006. In April 2008, the company completed the incorporation of its new subsidiary Smartcool Systems (EMEA) Inc., headquartered in London, England.

Smartcool and its subsidiaries are focused on acquiring, commercializing, and marketing energy saving technologies for commercial and retail businesses. Currently the company has two principal revenue streams: the sale and installation of Energy Savings Modules (ESMs) to customers in North America and the sale of the ESMs to distributors worldwide.

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

The company has not yet realized its revenue expectations and as at June 30, 2008 had an accumulated deficit of $19,427,000. Though in prior years the company was able to raise substantial amounts of capital to finance its operations, its ultimate success and the recoverability of its intangible assets will depend on the company’s ability to successfully execute its business plan which includes the existence of a market for its products and achieving profitable operations in the future, making the payments required as part of its business acquisitions, and the continued support of the company's shareholders and employees.

2 Significant accounting policies

Basis of presentation

The unaudited balance sheets at June 30, 2008 and the unaudited interim statements of operations, comprehensive loss and deficit, and statements of cash flows for the three and six months ended June 30, 2008 and 2007, have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”), on the same basis as the audited financial statements for the year ended December 31, 2007. These interim financial statements include all adjustments, which, in the opinion of management, are necessary for the fair presentation of the results of operations for the interim periods presented. Results for the three and six months ended June 30, 2008 are not necessarily indicative of the results to be expected for the full year. These unaudited interim statements do not include all the disclosures required for annual financial statements, and should be

read in conjunction with the company's annual audited financial statements for the year ended December 31, 2007.
These interim financial statements follow the same accounting policies and methods of their application as the company's annual audited financial statements for the year ended December 31, 2007 with the exception of accounting for inventories.

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 1, 2008 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 11. 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.

3 Business acquisition

On June 30, 2006, the company acquired the business and assets of Abbotly Technologies Pty. Limited (“Abbotly”) for total consideration of AU$2,954,600 (CA$2,423,958). The assets included the brand and worldwide distribution rights of the ESM, supplier agreements and distribution agreements.

On June 30, 2006, $869,300 was settled in cash with the remaining purchase price due in scheduled installments over two years and the last payment due on May 31, 2008. These installments are non-interest bearing. At the acquisition date, the fair value of consideration was determined to be $2,327,250 based on discounting the future payments at a rate of 9.7%. The acquisition has been accounted for using the purchase method, whereby the fair value of consideration was allocated to the estimated fair value of the acquired assets at the effective date of the purchase. The finalized allocation of the purchase price is as follows:

	$
Inventory	48,900
ESM brand	56,100
ESM Intellectual property	124,100
Distribution agreements	1,984,500
Supplier agreements	113,650
	2,327,250
Consideration	
Cash	869,300
Obligations under acquisition contract (note 7)	1,419,950
Transaction costs	38,000
	2,327,250

4 Short-term investments

Short-term investments consist of guaranteed investment certificates that mature by June 30, 2009.

5 Property and equipment

	June 30, 2008		
	Cost $	**Accumulated amortization** $	**Net book value** $
Computer hardware and software	140,551	35,095	105,456
Testing and demonstration equipment	189,067	61,275	127,792
Office equipment and furniture	34,815	9,006	25,809
Leasehold improvements	116,318	35,866	80,452
	480,751	141,242	339,509

	December 31, 2007		
	Cost $	**Accumulated amortization** $	**Net book value** $
Computer hardware and software	131,199	15,252	115,947
Demonstration and display equipment	123,982	34,128	89,854
Office equipment and furniture	19,390	7,240	12,150
Leasehold improvements	116,318	30,049	86,269
	390,889	86,669	304,220

As at June 30, 2008, assets under capital lease with total cost of $49,543 and accumulated amortization of $16,514 are included in property and equipment.
Amortization expense for assets under capital lease recorded in the statement of operations, comprehensive loss and deficit for the three months ended June 30, 2008 was $4,129.

6 Intangible assets

	June 30, 2008		
	Cost	**Accumulated amortization**	**Net book value**
	$	**$**	**$**
ESM brand (b)	56,100	-	56,100
ESM intellectual property (b)	124,100	24,820	99,280
North American distribution rights (a)	279,853	62,968	216,885
Distribution agreements (b)	1,861,841	300,721	1,561,120
Supplier agreements (b)	113,650	22,730	90,920
	2,435,544	411,239	2,024,305

	December 31, 2007		
	Cost	**Accumulated amortization**	**Net book value**
	$	**$**	**$**
ESM brand (b)	56,100	-	56,100
ESM intellectual property (b)	124,100	18,615	105,485
North American distribution rights (a)	279,853	48,975	230,878
Distribution agreements (b)	1,861,841	226,520	1,635,321
Supplier agreements (b)	113,650	17,048	96,602
	2,435,544	311,158	2,124,386

a) North American distribution rights

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

Consideration paid for the acquisition was US$180,000 ($201,953). 500,000 share purchase warrants with an exercise price of $0.27 and a 20% royalty on all products purchased from Abbotly as long as Smartcool Systems USA still holds the distribution rights. The warrants were valued at $77,900 at the transaction date using the Black-Scholes model and the following assumptions:

Expected life	2 years
Volatility	109%
Risk-free interest rate	4.06%
Dividend yield	0%

b) The company acquired $2,278,350 of intangible assets in relation to the acquisition of Abbotly as described in note 3.

c) As one distributor became inactive in 2007, management has performed a review of the carrying value of its distribution agreements. As a result of its assessment, the company recognized an impairment of $116,914 related to distribution agreements.

7 Deferred charges – Product development

The company incurred $106,529 (2007 - $54,853) of research and development costs of which $22,782 (2007 - $54,853) were expensed and $83,747 (2007 - $0) were deferred. No amortization of the deferred cost of $83,747 has been charged to expense as the new product's commercial production has not commenced.

8 Obligations under acquisition contract

As at June 30, 2008, the company has fulfilled its obligation to Abbotly Pty related to its acquisition of Abbotly (note 3). The obligation amount is non-interest bearing and has been recorded at its present value using a discount rate of 9.7% as follows:

	$
Balance - June 26, 2006	1,419,950
Accretion	36,992
Repayments	(440,790)
Foreign exchange	153,938
Balance - December 31, 2006	1,170,090
Accretion	76,929
Repayments	(1,082,840)
Foreign exchange	(26,062)
Balance - December 31, 2007	138,117
Accretion	33,023
Foreign exchange	13,993
Repayment	(185,133)
Balance – June 30, 2008	-

The obligations under the acquisition contract are being accreted to their face value over their term. The accretion charge for the period is recorded within interest expense in the consolidated statement of operations, comprehensive income and deficit.

9 Capital leases

In the year 2007, the company entered into two contractual lease agreements to finance the purchases of computer equipment. Both leases expire in June 2010 and have an implied annual interest rate of 16.17%. Interest paid in the three months and six months ended June 30, 2008 related to obligations under capital lease were $1,505 and $3,152 (2007 - $3,048).

The following is a schedule of future minimum lease payments under these capital leases together with the balance of the obligations.

Capital lease payments

	$
2008	10,318
2009	20,634
2010	9,610
	40,562
Amount representing interest at 16.17%	(6,160)
Balance of the obligations	34,402
Less current portion	(16,160)
	18,242

10 Share capital

a) Authorized: unlimited common shares without par value

100,000,000 Class A preferred shares
100,000,000 Class B preferred shares

b) Issued common shares

	Shares	Amount $
Balance - December 31, 2005	14,196,292	11,491,354
Private placement (i)	3,250,000	504,414
Private placement (ii)	1,000,000	237,023
Private placement (ii)	2,500,000	809,074
Private placement (iv)	1,100,000	440,000
Private placement (v)	1,500,000	1,125,000
Shares for consulting services (c)	30,698	12,000
Options exercised (d)	133,081	48,780
Shares purchase warrants exercised (e)	4,626,250	863,114
Share issuance costs (i) - (vi)	-	(320,614)
Balance - December 31, 2006	28,336,321	15,210,145
Private placement (vii)	5,000,000	6,176,555
Shares for consulting services (c)	11,197	12,000
Options exercised (d)	793,419	343,439
Share purchase warrants exercised (e)	2,933,750	1,765,068
Share issuance costs (vii) - (viii)	-	(933,996)
Balance - December 31, 2007	37,074,687	22,573,211
Share purchase warrants exercised (e)	3,329,250	2,088,234
Options exercised (d)	35,000	18,216
Share issuance cost adjustment	-	7,916
Balance – June 30, 2008	40,438,937	24,687,577

i) On May 31, 2006, the company issued 3,250,000 Units at $0.20 per Unit pursuant to a private placement, for gross proceeds of $650,000. Cash share issuance costs were $29,020. Each Unit consists of one common share and one-half share purchase warrant. Each full share purchase warrant entitles the holder to purchase one common share at a price of $0.40 until May 31, 2008. A total value of $145,586 was allocated to the warrants.

ii) On June 19, 2006, the company issued 1,000,000 Units at $0.30 per Unit pursuant to a private placement, for gross proceeds of $300,000. Cash share issuance costs were $5,000. Each Unit consists of one common share and one-half share purchase warrant. Each full share purchase warrant entitles the holder to purchase one common share at a price of $0.50 until June 19, 2008. A total value of $62,977 was allocated to the warrants.

iii) On June 27 and 28, 2006, the company issued 2,500,000 Units at $0.40 per Unit pursuant to a private placement, for gross proceeds of $1,000,000. Cash share issuance costs were $73,741. Each Unit consists of one common share and one-half share purchase warrant. Each full share purchase warrant entitles the holder to purchase one common share at a price of $0.60 until June 27 and 28, 2008. A total value of $190,926 was allocated to the warrants.

iv) On December 4, 2006, the company issued 1,100,000 common shares at $0.40 per share pursuant to a private placement, for gross proceeds of $440,000. Cash share issuance costs were $2,832.

v) On December 11, 2006, the company issued 1,500,000 common shares at $0.75 per share pursuant to a private placement, for gross proceeds of $1,125,000. Cash share issuance costs were $68,315.

vi) During the year ended December 31, 2006, the company issued 452,581 warrants as part of the private placement commission to agents. The fair value of these warrants of $141,705 has been reflected within share issuance costs.

vii) On August 16, 2007, the company issued 5,000,000 Units at $1.50 per unit pursuant to a brokered private placement, for gross proceeds of $7,500,000. Finalized cash share issuance costs were $596,081. Each Unit consists of one common share and one-half share purchase warrant. Each full share purchase warrant entitles the holder to purchase one common share at a price of $1.90 until August 16, 2009. These warrants are transferable after December 17, 2007. A total value of $1,323,445 was allocated to them.

viii) During the year ended December 31, 2007, the company issued 371,419 warrants as part of the private placement commission to agents. The fair value of these warrants of $257,028 has been reflected within share issuance costs.

c) Shares for consulting services

On July 1, 2006, the company entered into a contract with a consulting firm where it is entitled to receive $2,000 a month of common shares of the company from July 1, 2006 until December 31, 2006. The contract was renewed under the same terms for another six months and expired on June 30, 2007. The issuance of shares for service under this contract was approved by the TSX Venture Exchange.

d) Stock options

Under the company's stock option plan, the company may grant stock options to employees, directors, officers and consultants. The maximum number of shares to be awarded under the plan is 6,298,579. The stock options have vesting periods of up to 18 months and an exercise period of up to five years.

A summary of the company's stock option activity for employees, directors, officers and consultants is as follows:

	Number of options	**Weighted average exercise price $**
Balance - December 31, 2005	2,167,500	0.25
Granted	1,920,000	0.48
Cancelled	(50,000)	0.23
Exercised	(133,081)	0.29
Balance - December 31, 2006	3,904,419	0.37
Granted	2,195,000	1.24
Exercised	(793,419)	0.30
Balance - December 31, 2007	5,306,000	0.77
Granted	25,000	1.28
Cancelled	(325,000)	1.21
Exercised	(35,000)	0.29
Balance – March 31, 2008	4,971,000	0.75

During the second quarter of 2008, the company granted no options to employees . During the first two quarters of 2008, the company granted 25,000 options to an employee (2007 – 2,195,000).

Stock-based compensation expense for the three months and six months ended June 30, 2008 were $101,586 and $342,428 (2007 - $1,229,257).

Options outstanding at June 30, 2008 were as follows:

	Options outstanding			Options exercisable	
Exercise price $	**Number outstanding**	**Weighed average remaining contractual life (years)**	**Weighed average exercise price $**	**Number outstanding**	**Weighed average exercise price $**
0.21 - 0.28	1,101,000	1.86	0.23	1,101,000	0.23
0.33 - 0.48	1,175,000	2.78	0.40	1,175,000	0.40
0.60 - 0.89	300,000	3.36	0.64	300,000	0.64
0.90 - 1.10	585,000	3.46	0.91	563,750	0.91
1.11- 1.42	1,460,000	4.40	1.20	805,000	1.20
1.50	350,000	.13	1.20	350,000	1.50
	4,971,000	2.92	0.75	4,294,750	0.68

The company used the Black-Scholes option pricing model to determine the fair value of the options at the date of grant with the following assumptions:

	Six months ended Jun 30, 2008	**Year ended December 31, 2007**
Risk-free interest rate	3.86%	3.91% - 4.60%
Dividend yield	0%	0%
Volatility	93%	93% - 100%
Expected life	5 years	1 - 5 years

e) Share purchase warrants

A summary of the company's warrant activity is as follows:

	Number outstanding	Amount $
Balance - December 31, 2005	6,240,000	-
Granted	4,327,581	619,094
Exercised	(4,626,250)	(41,737)
Balance - December 31, 2006	5,941,331	577,357
Granted	2,871,419	1,581,433
Expired	(5,000)	
Exercised	(2,933,750)	(343,427)
Warrant issue cost		(148,603)
Balance - December 31, 2007	5,874,000	1,666,760
Expired	(44,750)	
Exercised	(3,329,250)	(485,128)
Warrant issue cost adjustment		1,737
Balance – June 30, 2008	2,500,000	1,183,369

As at June 30, 2008, there were 2,500,000 outstanding warrants. These warrants have an exercise price of $1.90 and will expire on August 16, 2009. Each warrant entitles the holder to purchase one common share of the company.

For the three months and six months ended June 30, 2008, the company assigned a total fair value of $443,736 and $485,128 (2007 - $1,580,474) to warrants exercised during the period and transferred from share purchase warrants to share capital.

f) Contributed surplus

At June 30, 2008, the company's contributed surplus comprised the following:

	$
Balance - December 31, 2005	289,150
Stock option expense	475,224
Stock option exercise	(9,864)
Balance - December 31, 2006	754,510
Stock option expense	1,229,257
Agent stock option expense	219,835
Stock option exercise	(103,751)
Balance - December 31, 2007	2,099,851
Stock option expense	342,428
Stock option exercise	(8,166)
Balance – June 30, 2008	2,434,133

11 Capital management

The company's capital structure includes shareholders' equity, short-term investments, cash and cash equivalents.

The company's objectives when managing capital are:

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

12 Inventories

	June 30, 2008	December 31, 2007
ESM & ESM Peripherals	620,718	351,267
Other products	36,445	-
Total inventory	657,163	351,267

For the three months and six months ended June 30, 2008, total inventories of $33,255 and $149,728 have been recognized as an operating expense during the period.

13 Commitments

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 amounts owed to Abbotly.

14 Segmented information

The company installs, distributes, markets and sells the ESM products and peripherals. The company operates in one segment.

Revenue was derived from customers located in the following geographical regions:

	Three months ended June 30, 2008		**Six months ended June 30, 2008**	
	Amount $	**Revenue %**	**Amount $**	**Revenue %**
Australia	69,913	58	150,272	28
United Kingdom	-	-	130,985	24
Barbados	-	-	93,673	17
USA	-	-	72,264	14
Philippines	22,267	18	65,242	12
Germany	16,505	14	16,505	3
Israel	11,688	10	11,688	2
Israel	-	-	2,407	-
Total revenue	120,373	100	543,036	100

During the three months ended June 30, 2008, revenue from four individual customers exceeded 10% of the company’s total revenue. These customers contributed 58%, 18%, 14% and 10%, respectively. During the six months ended June 30, 2008, revenue from 5 individual customers exceeded 10% of the company’s total revenue. These customers contributed 28%, 24%, 17%, 14% and 12%, respectively.

Property and equipment are located in:

	June 30, 2008	2007
Canada	41%	57%
USA	45%	39%
Other	14%	4%
Total	100%	100%

15 Related party transactions

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.

16 Financial instruments

The company has classified its financial instruments as follows:

a) Cash and cash equivalents: are designated as held for trading and carried at fair value

b) Accounts receivable: are designated as loans and receivables and measured at amortized cost.

c) Short-term investments: are classified as held to maturity and measured at amortized cost.

d) Account payable and accrued liabilities and obligations under acquisition contract are classified as financial liabilities and measured at amortized cost.

There has been no change to the classification of financial assets since January 1, 2007.

Fair value

Fair value estimates of financial instruments are made at a specific point in time, based on relevant information about financial markets and specific financial instruments. As these estimates are subjective in nature, involving uncertainties and matters of significant judgment, they cannot be determined with precision. Changes in assumptions can significantly affect estimated fair value.

The carrying value of cash and cash equivalents, short-term investments, amounts receivable, the current portion of obligations under acquisition contract, and accounts payable and accrued liabilities approximates the fair value because of the short-term nature of these instruments.

Credit risk

The company's cash and cash equivalents, short-term investments and amounts receivable are subject to credit risk. The company limits its exposure to credit loss by placing its cash and cash equivalents and short-term investments with high credit quality financial institutions. Credit risk with respect to amounts receivable is limited due to the company's credit evaluation process.

Foreign exchange risk

Presently, the company is subject to currency risk as most of its international distribution transactions are being carried in foreign currencies. None of this risk has been mitigated through use of foreign currency forward contracts.

17 Supplementary cash flow information

	Three months ended June 30, 2008 $	Six months ended June 30, 2008 $
Interest paid in cash	1,505	3,152
Interest income received in cash	22,486	75,692
Income taxes paid in cash	-	-
Non-cash financing and investing activities		
Issuance of warrants for share issue costs	-	-
Issuance of stock options for share issue costs	-	-
Issuance of warrants for intangible assets	-	-
Purchase of Abbotly for obligations under acquisition contract	-	-
Asset purchased under capital lease	-	-

18 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.