CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Expressed in Canadian Dollar)

September 30, 2008 and 2007

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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
September 30, 2008 and December 31, 2007

(Unaudited - Prepared by Management)

	September 30 **2008** **$** (Unaudited)	December 31 **2007** **$**
ASSETS		
Current assets		
Cash and cash equivalents	3,729,454	6,020,860
Short-term investments (note 4)	25,000	227,536
Amounts receivable	329,456	197,494
Inventory	751,970	351,267
Prepaid expenses and deposits	144,424	87,546
	4,980,304	6,884,702
Research and development (note 7)	105,074	-
Property and equipment (note 5)	335,886	304,220
		-
Intangible assets (note 6)	4,232,337	2,124,386
	9,653,601	9,313,309
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	557,144	333,122
Current portion of obligations under contracts (note 8)	203,302	138,117
Current portion of capital leases (note 9)	16,816	14,924
Current portion of deffered tenant inducement	9,039	8,148
	786,302	494,311
Acquisition contract obligations (note 8)	629,828	
Capital leases (note 9)	13,784	26,644
Deferred tenant Inducement	77,358	84,360
	1,507,272	605,315
SHAREHOLDERS' EQUITY		
Share capital (note 10(b))	25,218,213	22,573,211
Share purchase warrants (note 10(e))	1,183,369	1,666,760
Contributed surplus (note 10(g))	2,509,231	2,099,851
Deficit	(20,764,484)	(17,631,828)
	8,146,329	8,707,994
	9,653,601	9,313,309

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

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

(See accompanying notes to the consolidated financial statements)

Smartcool Systems Inc.

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

	Three months ended September 30		Nine months ended September 30	
	2008	**2007**	**2008**	**2007**
	$	**$**	**$**	**$**
Revenue	204,793	54,107	747,829	263,697
Cost of sales	60,742	26,634	283,933	94,697
Gross profit	144,051	27,473	463,896	169,000
Operating Expenses				
Survey and testing costs	1,724	10,112	2,777	36,898
Selling, general and administrative expenses	1,295,780	656,877	2,976,464	1,890,011
Stock-based compensation	75,118	350,468	417,546	767,356
Research and development	10,418	-	33,200	-
Amortization	123,484	73,436	278,634	202,747
	1,506,523	1,090,892	3,708,621	2,897,013
Loss before undernoted	(1,362,473)	(1,063,419)	(3,244,725)	(2,728,013)
Other (Income) expense				
Interest expense and accretion	22,134	18,390	58,381	59,552
Interest Income	(16,719)	(50,178)	(97,876)	(67,438)
Foreign exchange loss (gain)	(30,403)	34,840	(82,028)	18,190
	(24,988)	3,053	(121,524)	10,305
Loss and comprehensive loss for the period	(1,337,484)	(1,066,472)	(3,123,202)	(2,738,318)
Deficit, beginning of period	(19,427,000)	(14,980,392)	(17,641,282)	(13,308,546)
Deficit, end of period	(20,764,484)	(16,046,864)	(20,764,484)	(16,046,864)
Loss per share				
Basic and diluted	(0.03)	(0.03)	(0.08)	(0.09)
Weighted average number of common shares outstanding	41,109,892	33,973,826	38,808,111	31,524,482

Smartcool Systems Inc.

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

	Three months ended September 30		Nine months ended September 30	
	2008	**2007**	**2008**	**2007**
	$	**$**	**$**	**$**
Cash flows from operating activities				
Loss and comprehensive loss for the period	(1,337,484)	(1,066,472)	(3,123,202)	(2,738,318)
Adjustments for item not involving cash:				
Amortization of property and equipment	32,387	18,251	87,457	36,834
Amortization of intangible assets	91,097	55,185	191,177	165,913
Stock-based compensation	75,118	350,468	417,546	767,356
Deferred tenant inducement	(2,037)	(2,037)	(6,111)	(4,997)
Adjustment of inventory opening balance	-	-	(9,453)	-
Accretion of obligation under acquisition contract	20,778	18,958	53,801	58,243
Foreign exchange (gain) loss on obligations under acquisition contract	(54,434)	(3,835)	(40,442)	(14,649)
Consulting fees paid in shares	-	-	-	12,000
	(1,174,576)	(629,482)	(2,429,226)	(1,717,618)
Changes in non-cash working capital items:				
Amounts receivable	72,989	67,440	(131,962)	(78,904)
Inventory	(94,807)	(28,352)	(400,702)	(252,208)
Prepaid expenses and deposits	63,521	12,784	(56,878)	70,618
Accounts payable and accrued liabilities	81,265	113,214	224,022	126,746
	(1,051,607)	(464,396)	(2,794,747)	(1,851,366)
Cash flows from financing activities				
Shares issued for cash-net of cash issue costs	-	6,894,265	9,654	6,894,265
Shares issued on exercise of options	-	10,500	10,050	133,068
Shares issued on exercise of warrants	-	51,000	1,603,105	1,398,900
Repayment of oligations under acquisition contracts	(901,705)	(368,080)	(1,086,838)	(739,160)
Repayment of capital lease obligations	(3,802)	-	(10,967)	-
	(905,507)	6,587,685	525,004	7,687,073
Cash flows from investing activities				
Sale of short-term investment	-	1,112,195	202,536	853,853
Purchase short-term investment	-	-	-	-
Purchase of property & equipment	(28,764)	(129,027)	(119,123)	(159,217)
Product developments	(21,327)	(54,686)	(105,074)	(54,686)
	(50,091)	928,482	(21,661)	639,951
Increase (decrease) in cash and cash equivalents	(2,007,205)	7,051,771	(2,291,406)	6,475,658
Cash and cash equivalents, beginning of period	5,736,659	124,706	6,020,860	700,819
Cash and cash equivalents, end of period	3,729,454	7,176,477	3,729,454	7,176,477

Supplementary cash flow Information (note 17)

(See accompanying notes to the consolidated financial statements)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Three and Nine Months Ended September 30, 2008 and 2007

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 September 30, 2008 had an accumulated deficit of $20,764,484. 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 September 30, 2008 and the unaudited interim statements of operations, comprehensive loss and deficit, and statements of cash flows for the three and nine months ended September 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 nine months

ended September 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

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.

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 September 30, 2009.

5 Property and equipment

	September 30, 2008		
	Cost $	Accumulated amortization $	Net book value $
Computer hardware and software	146,623	45,918	100,705
Testing and demonstration equipment	200,430	78,379	122,051
Office equipment and furniture	46,144	10,558	35,586
Leasehold improvements	116,318	38,774	77,544
	509,515	173,629	335,886

	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 September 30, 2008, assets under capital lease with total cost of $49,543 and accumulated amortization of $20,643 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 September 30, 2008 was $4,129.

6 Intangible assets

	September 30, 2008		
	Cost $	Accumulated amortization $	Net book value $
ESM™ brand (b)	56,100	-	56,100
ESM™ intellectual property (b)	124,100	27,922	96,178
North American distribution rights (a)	279,853	69,963	209,890
Distribution agreements (b)	1,861,841	337,795	1,524,046
Supplier agreements (b)	113,650	25,571	88,079
United Kingdom distribution rights (c)	2,299,100	41,056	2,258,044
	4,734,644	502,307	4,232,337

	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) ESM™ Intellectual Property and worldwide distribution rights

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

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.

c) Distribution Rights from TECC Services

On July 11, 2008, the company acquired the exclusive rights to distribute the ESM™ in the United Kingdom, Spain, Portugal, and the Middle East from T.E.C.C. Services Ltd. ("TECC"). Consideration of £1,035,000GBP (CA$1,738,750) was payable in cash and £265,000GBP (CA$532,067) was payable in the form of common shares of the company. Upon closing, payment of £435,000GBP (CA$873,393) was made and 743,709 shares were issued. The share price was based on the average closing price of the company's shares on the TSX Exchange for 20 consecutive trading days, with the last of such trading days being the second day preceding the date of closing.

The remaining balance of £600,000GBP is due in scheduled instalments over four years with the last payment due on July 11, 2012. These instalments are non-interest bearing. At the acquisition date, the fair value of consideration was determined to be $2,270,800 based on discounting the future payments at a rate of 16%. Transaction costs of $28,300 were also incurred.

7 Research and development

Over the nine months ended September 30, 2008, the company incurred $138,274 (2007 - $54,853) of research and development costs of which $33,200 (2007 - $54,853) were expensed and $105,074 (2007 - $0) were deferred. No amortization of the deferred cost of $105,074 has been charged to expense as the new product's commercial production was not complete until November 2008.

8 Obligations under acquisition contracts

a) Abbotly

On May 31, 2008, the company 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 – September 30, 2008	-

b) TECC Services

At September 30, 2008, the company owed £600,000GBP related to its acquisition of distribution rights from TECC Services (note 6(c)). The amount is non-interest bearing and has been recorded at its present value using a discount rate of 16% as follows:

	$
Balance – July 11, 2008	865,351
Accretion	20,778
Foreign exchange	(52,999)
Balance - September 30, 2008	833,130
Less: Current portion	(203,302)
	629,828

Required repayments are as follows:

	GBP
January 11, 2009	75,000
July 11, 2009	75,000
January 11, 2010	75,000
July 11, 2010	75,000
January 11, 2011	75,000
July 11, 2011	75,000
January 11, 2012	75,000
July 11, 2012	75,000
	600,000
Less: Current portion	(150,000)
	£450,000

In the event that the company defaults on a payment or disposes of all or substantially all of its assets, all outstanding payments will become due immediately.

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 nine months ended September 30, 2008 related to obligations under capital lease were $1,356 and $4,509 (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	5,159
2009	20,634
2010	9,610
	35,403
Amount representing interest at 16.17%	(4,803)
Balance of the obligations	30,600
Less current portion	(16,816)
	13,784

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
TECC acquisition (f)	743,709	530,636
Share issuance cost adjustment	-	7,916
Balance – September 30, 2008	41,182,646	25,218,213

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 7,869,827. 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	295,000	0.60
Cancelled/Expired	(675,000)	1.36
Exercised	(35,000)	0.29
Balance – September, 2008	4,891,000	0.68

During the third quarter of 2008, the company granted 270,000 options to employees and consultants. During the first three quarters of 2008, the company granted 295,000 options to employee and consultants (2007 – 2,195,000).

Stock-based compensation expense for the three months and nine months ended September 30, 2008 were $75,118 and $417,546 (2007 - $1,229,257).

Options outstanding at September 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	1.61	0.23	1,101,000	0.23
0.33 - 0.48	1,225,000	2.62	0.40	1,187,500	0.40
0.54 - 0.89	520,000	3.82	0.60	355,000	0.63
0.90 - 1.10	585,000	3.21	0.91	563,750	0.91
1.11- 1.42	1,460,000	3.95	1.20	1,041,250	1.20
	4,891,000	2.99	0.68	4,248,500	0.63

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:

	Nine months ended September 30, 2008	Year ended December 31, 2007
Risk-free interest rate	2.97%-3.74%	3.91% - 4.60%
Dividend yield	0%	0%
Volatility	88.47%-92.03%	93% - 100%
Expected life	4.5-5 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 – September 30, 2008	2,500,000	1,183,369

As at September 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 nine months ended September 30, 2008, the company assigned a total fair value of $485,128 (2007 - $1,580,474) to warrants exercised during the period and transferred from share purchase warrants to share capital. No warrants were exercised in the third quarter.

f) Shares issued under TECC acquisition agreement

On July 11, 2008, the company acquired distributions rights from TECC Servicers (see note 6) and retained consulting services of TECC management. Under the purchase and consulting agreements, common shares in the capital of the company with value equal to £265,000GBP were issued to the consultants. The share price was based on the average closing price of the company's shares on the TSX Exchange for 20 consecutive trading days, with the last of such trading day being the second

day of preceding the date of closing. Pursuant to these agreements, 743,049 shares were issued at a price of $0.7135 per share.

g) Contributed surplus

At September 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	417,546
Stock option exercise	(8,166)
Balance – September 30, 2008	2,509,231

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

	September 30, 2008	December 31, 2007
ESM & ESM Peripherals	715,480	351,267
Other products	36,490	-
Total inventory	751,970	351,267

For the three months and nine months ended September 30, 2008, total inventories of $25,569 and $175,296 have been recognized as expenses 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	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).

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 September 30, 2008		Nine months ended September 30, 2008	
	Amount $	Revenue %	Amount $	Revenue %
Australia	19,065	9	169,375	23
United Kingdom	55,366	27	186,351	25
Barbados	29,958	15	123,631	17
USA	25,484	13	98,761	13
Philippines	49,192	24	115,855	16
Israel	9,963	5	21,650	3
Other	15,765	7	32,206	3
Total revenue	204,793	100	747,829	100

During the three months ended September 30, 2008, revenue from four individual customers exceeded 10% of the company's total revenue. These customers contributed 27%, 24%, 15% and 13%, respectively. During the nine months ended September 30, 2008, revenue from 5 individual customers exceeded 10% of the company's total revenue. These customers contributed 25%, 23%, 17%, 16% and 13%, respectively.

Property and equipment are located in:

	September 30, 2008	**December 31,**
Canada	38%	57%
USA	42%	39%
Other	20%	4%
Total	100%	100%

15 Related party transactions

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).

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 September 30, 2008 $	Nine months ended September 30, 2008 $
Interest paid in cash	1,356	4,580
Interest income received in cash	13,799	94,956
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 shares for intangible assets	530,636	530,636
Obligations under TECC intangible asset acquisition	865,351	-
Asset purchased under capital lease	-	-

18 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, Chile, to be its authorized, exclusive distributor within the territory of Barbados. 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 to establish a launch strategy that will outline new distribution channels and expanded market opportunities