



CONSOLIDATED FINANCIAL STATEMENTS

For the three months ended March 31, 2010 and 2009

(expressed in Canadian Dollar)

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
As at March 31, 2010 and December 31, 2009

(expressed in Canadian dollars)

	March 31 2010	December 31 2009
	\$	\$
ASSETS		
Current assets		
Cash and cash equivalents	307,458	147,051
Short-term investments	55,007	101,646
Restricted cash (note 3)	15,783	-
Accounts receivable	545,838	657,841
Inventory	734,948	717,857
Prepaid expenses and deposits	119,008	242,302
	<u>1,778,043</u>	<u>1,866,696</u>
Capitalized development costs (note 7)	26,641	39,961
Property and equipment (note 5)	172,979	207,720
	-	-
Intangible assets (note 6)	<u>3,526,418</u>	<u>3,639,843</u>
	<u>5,504,080</u>	<u>5,754,220</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	643,947	552,034
Current portion of obligations under contracts (note 8)	345,800	263,190
Current portion of capital leases (note 9)	4,317	9,144
Current portion of debentures (note 10)	15,783	-
Current portion of deferred tenant inducement	10,820	10,820
	<u>1,020,667</u>	<u>835,188</u>
Obligations under acquisition contract (note 8)	373,896	582,602
Debentures (note 10)	250,514	
Deferred tenant Inducement	<u>61,129</u>	<u>63,834</u>
	<u>1,706,206</u>	<u>1,481,625</u>
SHAREHOLDERS' EQUITY		
Share capital (note 11(b))	25,639,345	25,639,345
Share purchase warrants (note 11(d))	101,800	52,514
Contributed surplus (note 11(f))	4,128,024	3,983,831
Deficit	<u>(26,071,295)</u>	<u>(25,403,095)</u>
	<u>3,797,874</u>	<u>4,272,595</u>
	<u>5,504,080</u>	<u>5,754,220</u>
Nature of operations and liquidity risk (note 1)		
Commitments (note 12)		
Subsequent events (note 18)		
Approved by the Board of Directors	<u>"George Burnes"</u> George Burnes	<u>"Jeffrey Lowe"</u> Jeffrey Lowe

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.
Consolidated Statements of Operations, Comprehensive Loss and Deficit
For the three months ended March 31, 2010 and 2009

(expressed in Canadian dollars)

	Three months ended March 31	
	2010	2009
	\$	\$
Revenue	634,927	225,556
Cost of sales	295,567	78,910
	<u>339,360</u>	<u>146,646</u>
Operating Expenses		
General and administrative expenses	710,304	1,243,401
Stock-based compensation	144,193	98,329
Research and development	14,363	22,530
Amortization	148,167	149,639
	<u>1,017,027</u>	<u>1,513,899</u>
Loss before undernoted	<u>(677,667)</u>	<u>(1,367,254)</u>
Other (income) expense		
Interest expense	34,670	20,112
Interest Income	(3,633)	(3,389)
Foreign exchange loss (gain)	(40,505)	20,558
	<u>(9,468)</u>	<u>37,282</u>
Loss and comprehensive loss for the period	(668,200)	(1,404,535)
Deficit, beginning of period	(25,403,095)	(22,012,165)
Change in accounting for inventory	-	0
Deficit, end of period	<u>(26,071,295)</u>	<u>(23,416,700)</u>
Loss per share		
Basic and diluted	<u>(0.02)</u>	<u>(0.03)</u>
Weighted average number of common shares outstanding - basic and diluted	<u>44,321,396</u>	<u>41,182,646</u>

Smartcool Systems Inc.
Consolidated Statements of Cash Flows
For the three months ended March 31, 2010 and 2009

(expressed in Canadian dollars)

	Three months ended March 31	
	2010	2009
	\$	\$
Cash flows from operating activities		
Loss and comprehensive loss for the year	(668,200)	(1,404,535)
Items not affecting cash:		
Amortization of property and equipment	34,741	35,735
Amortization of intangible assets	113,425	113,904
Amortization of capitalized development costs	13,320	13,320
Stock-based compensation	144,193	98,329
Deferred tenant inducement	(2,705)	(2,037)
Accrued interest on debentures	10,333	-
Accretion of obligation under acquisition contract	20,986	19,036
Foreign exchange gain on obligations under acquisition contract	(67,700)	5,587
Changes in non-cash working capital items:		
Accounts receivable	112,002	141,536
Inventory	(17,091)	27,105
Prepaid expenses and deposits	123,294	8,370
Accounts payable and accrued liabilities	91,914	(29,827)
	<u>(91,487)</u>	<u>(973,477)</u>
Cash flows from investing activities		
Purchase of short-term investment	-	-
Sale of short-term investment	46,639	-
Purchase of property & equipment	-	(38,097)
Product development	-	-
	<u>46,639</u>	<u>(38,097)</u>
Cash flows from financing activities		
Shares and warrants issued for cash-net of issue costs	-	-
Shares issued on exercise of options	-	-
Shares issued on exercise of warrants	-	-
Debenture issued for cash	305,250	-
Repayment of obligations under acquisition contract	(79,383)	-
Repayment of capital lease obligations	(4,828)	(4,117)
	<u>221,039</u>	<u>(4,117)</u>
Decrease in cash and cash equivalents	176,190	(1,015,691)
Cash and cash equivalents, beginning of year	147,051	2,252,857
Cash and cash equivalents, end of year	<u>323,241</u>	<u>1,237,166</u>
Cash and cash equivalents consist of:		
Deposits with banks	323,241	736,102
Guaranteed investment certificate with annual interest rate of 2.1%	-	501,064
	<u>323,241</u>	<u>1,237,166</u>

Supplementary cash flow information (note 17)

See accompanying notes to the consolidated financial statements

1 Nature of operations and liquidity risk

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) Ltd. ("Smartcool EMEA"), 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 (ESM™ & ECO3™) to end customers and the sale of the ESM™ & ECO3™ 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.

Introduced in early 2009, the ECO3™ is manufactured in China and is a unique retro-fit product to be installed on any air conditioning or refrigeration unit with one or two compressors.

During the three months ended March 31, 2010, the company incurred a loss of \$668,200 (2009 - \$3,390,930) and the company had an accumulated deficit of \$26,071,295 as at March 31, 2010 (2009 - \$25,403,095).

To date the company has been able to raise capital to finance its operations whenever necessary. The company's 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, achieving profitable operations, meeting its business acquisition obligations, and the continued support of the company's shareholders and employees.

The recent global recession had presented a great challenge to Smartcool but with proactive actions the company has effectively managed its resources and was able to renegotiate its acquisition obligations. The company has obtained new financing through a private placement to ensure that it will have sufficient working capital to carry out its core business plan and meet its financial obligations in the next twelve months.

2 Significant accounting policies

Basis of presentation

The interim consolidated financial statements have been prepared by management 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, 2009. 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 months ended March 31, 2010 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, 2009.

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, 2009.

Future Accounting Standards

Business Combinations

In January 2009, the CICA issued Section 1582 "Business Combinations" which establishes principles and requirements of the acquisition method for business combinations and related disclosures. The purchase price is to be based on trading data at the closing date of the acquisition, not the announcement date of the acquisition, and most acquisition costs are to be expensed as incurred. This standard applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011 with earlier application permitted. The company plans to adopt this standard prospectively effective January 1, 2011. The adoption of this standard may have an impact on the accounting of future business combinations.

Consolidated Financial Statements

In January 2009, the CICA issued Section 1601 which establishes standards for the preparation of consolidated financial statements and Section 1602 which provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The company plans to adopt this standard prospectively effective January 1, 2011. The adoption of this standard may have an impact on the accounting of future business combinations.

International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed that International Financial Reporting Standards (“IFRS”) will replace Canadian GAAP for publicly accountable profit-oriented enterprises for interim and annual financial statements effective January 1, 2011.

The company will therefore be required to report using IFRS commencing with its unaudited interim financial statements for the three months ended March 31, 2011, which must include the interim results for the three months ended March 31, 2010 prepared on the same basis. IFRS uses a conceptual framework similar to Canadian GAAP, but there are some significant differences with regards to recognition, measurement and disclosures. Management has performed an analysis to identify differences between the company’s current accounting policies and IFRS. The impact of IFRS convergence on its financial statements has not been quantified yet as accounting policies are still being finalized.

3 Restricted cash

On February 9 and March 19, 2010, the company issued units of participation subordinated secured debentures and warrants through a private placement. Under the terms of the debenture, the holders are entitled to receive quarterly payments towards the principal amount. The total of quarterly payments is equal to 5% of the gross cash revenue received by the company in each quarter. The payment of quarterly principal payments owing during the first twelve-month period commencing from the closing date, however, may be delayed and paid on a date that is 13 months from the closing date. When such payments are delayed, the company is required to deposit into a separate trust account, on a quarterly basis, an amount equal to any first year quarterly principal payment that would otherwise have been payable.

The company has deposited \$15,783, 5% of cash revenue received from February 9 to March 31, 2010, into a trust account in accordance with the debenture terms.

4 Inventories

	2010	2009
ESM™, ECO3™ and Peripherals	716,203	698,814
Other products	18,745	19,043
Total inventory	<u>734,948</u>	<u>717,857</u>

During the first quarter of 2010, total inventories of \$108,418 have been recognized as cost of sales.

Smartcool Systems Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 March 31, 2010 and 2009

5 Property and equipment

	March 31, 2010		
	Cost	Accumulated	Net book
	\$	amortization	value
		\$	\$
Computer hardware and software	158,995	111,695	47,300
Testing and demonstration equipment	220,434	176,642	43,792
Office equipment and furniture	45,710	23,919	21,791
Leasehold improvements	116,318	56,222	60,096
	<u>541,457</u>	<u>368,478</u>	<u>172,979</u>
	December 31, 2009		
	Cost	Accumulated	Net book
	\$	amortization	value
		\$	\$
Computer hardware and software	158,995	100,963	58,032
Testing and demonstration equipment	220,434	157,317	63,117
Office equipment and furniture	45,710	22,143	23,567
Leasehold improvements	116,318	53,314	63,004
	<u>541,457</u>	<u>333,737</u>	<u>207,720</u>

As at March 31, 2010, assets under capital lease with total cost of \$49,543 and accumulated amortization of \$45,415 are included in property and equipment for net book value of \$4,128 (2009 - \$8,257).

Amortization expense for assets under capital lease recorded in the statement of operations, comprehensive loss and deficit for the first quarter of 2010 was \$4,128 (2009 - \$16,515).

Smartcool Systems Inc.
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 March 31, 2010 and 2009

6 Intangible assets

	March 31, 2010		
	Cost	Accumulated	Net book
	\$	amortization	value
	\$	\$	\$
North American distribution rights (a)	279,853	111,941	167,912
ESM™ brand (b)	56,100	-	56,100
ESM™ intellectual property (b)	124,100	46,538	77,562
Distribution agreements (b)	1,861,841	560,414	1,301,427
Supplier agreements (b)	113,650	42,619	71,031
United Kingdom distribution rights (c)	2,299,100	446,714	1,852,386
	<u>4,734,644</u>	<u>1,208,226</u>	<u>3,526,418</u>

	December 31, 2009		
	Cost	Accumulated	Net book
	\$	amortization	value
	\$	\$	\$
North American distribution rights (a)	279,853	104,945	174,908
ESM™ brand (b)	56,100	-	56,100
ESM™ intellectual property (b)	124,100	43,435	80,665
Distribution agreements (b)	1,861,841	523,456	1,338,385
Supplier agreements (b)	113,650	39,777	73,873
United Kingdom distribution rights (c)	2,299,100	383,188	1,915,912
	<u>4,734,644</u>	<u>1,094,801</u>	<u>3,639,843</u>

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 certain 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%

Smartcool Systems Inc.
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March 31, 2010 and 2009

b) ESM™ Intellectual Property and worldwide distribution rights

The company acquired \$2,278,350 of intangible assets in relation to the acquisition of Abbotly.

Management has performed a review of the carrying value of its distribution agreements. As a result of its assessment, in 2008 the company recognized an impairment of \$116,914 related to distribution agreements. No impairment was recorded in 2009.

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.

The purchase agreement was amended on December 21, 2009 where payments were rescheduled with the first payment due on January 16, 2010 and the last one on July 16, 2012. The parties also agreed that interest would accrue on £75,000 GBP at RBC prime rate plus 4% from January 16, 2009 and additionally on £75,000 GBP from July 16, 2009 until paid in full. As at March 31, 2010, the balance of £466,662 GBP, including accrued interest of £8,600 GBP, remained outstanding.

7 Capitalized development costs

During the quarter ended March 31, 2010, the company incurred \$1,043 (2009 - \$31,772) of research and development costs that were fully expensed (2009 - \$31,772). No research and development costs were deferred in the quarter (2009 - \$0). Development costs of \$ 106,561 incurred in 2008 have been capitalized and amortized over a two year period, starting October 1, 2008 when the new products' commercial production was complete and they became available for sale. Amortization of \$13,320 has been charged to expense for the first quarter of 2010.

Smartcool Systems Inc.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 March 31, 2010 and 2009

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 in 2006. The obligation amount was non-interest bearing and had 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	<u>153,938</u>
Balance - December 31, 2006	1,170,090
Accretion	76,929
Repayments	(1,082,840)
Foreign exchange	<u>(26,062)</u>
Balance - December 31, 2007	138,117
Accretion	33,023
Repayment	(185,133)
Foreign exchange	<u>13,993</u>
Balance – December 31, 2008	<u>-</u>

Smartcool Systems Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 March 31, 2010 and 2009

b) TECC Services

At December 31, 2009, the company owed £605,568 GBP related to its acquisition of distribution rights from TECC Services. The obligation amount of £600,000 GBP was originally non-interest bearing and has been recorded at its present value using a discount rate of 16%. The purchase agreement was then amended on December 21, 2009 to accrue interest on 150,000 GBP at RBC prime rate plus 4% and adjust timing and amount of repayments (note 6(c)).

	\$
Balance – July 11, 2008	865,358
Accretion	40,853
Foreign exchange	(97,102)
Balance - December 31, 2008	<u>809,109</u>
Accretion	75,227
Accrued interest	9,420
Foreign exchange	(47,964)
Balance – December 31, 2009	<u>845,792</u>
Payment	(79,383)
Accretion	16,300
Accrued interest	4,687
Foreign exchange	(67,700)
Balance – March 31, 2010	<u>719,696</u>
Less: Current portion	<u>(345,800)</u>
	<u>373,896</u>

Required repayments are as follows:

	GBP
July 16, 2010	103,125
January 16, 2011	112,500
July 16, 2011	112,500
January 16, 2012	112,500
July 11, 2012	112,500
	<u>553,125</u>
Accrued interest on 103,125 GBP	8,600
	<u>561,725</u>
Less: Current portion	<u>(224,225)</u>
	<u>£337,500</u>

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.

Smartcool Systems Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2010 and 2009

9 Capital leases

In 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 first quarter of 2010 related to obligations under capital leases was \$331 (2009 - \$3,135).

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

Capital lease payments	
	\$
2010 Payments	4,453
Amount representing interest at 16.17%	(136)
Balance of the obligations, March 31, 2010	4,317
Less current portion	(4,317)
	<u>-</u>

10 Debentures

On January 13, 2010, Smartcool announced that it intended to offer units consisting of secured participating debentures and share purchase warrants at a price of \$5,000 per unit, for aggregate proceeds of minimum \$250,000 and maximum of \$600,000.

Each unit comprises of a debenture in the principal amount of \$5,000 plus 8,600 warrants, issued at a price of \$5,000 per unit. The debentures are for a term of three years and entitle the holder to receive distribution of \$150 each quarter per \$5,000 of principal amount with an additional distribution of \$150 if the debenture is repaid in months 19 to 24 and two additional distributions (for a total of \$300) if the debenture is repaid in months 15 to 36. The debentures also receive 5% of gross cash revenue to be paid towards the outstanding principal of the debenture each quarter. The debentures are secured by a general security agreement over the assets of the company.

The debentures also entitle the holder to quarterly payments towards principal. The total of principal payments for each quarter is equal to 5% of total cash revenue received by the company in that quarter. The payment of quarterly principal payments owing during the first twelve-month period commencing from the closing date, however, may be delayed and paid on a date that is 13 months from the closing date. When such payments are delayed, the company is required to deposit into a separate trust account, on a quarterly basis, an amount equal to any first year quarterly principal payment that would otherwise have been payable. As at March 31, 2010, \$15,783 has been set aside for future principal payments (see note 4).

Smartcool Systems Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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One whole warrant entitles the holder to purchase one common share at the price of \$0.50 per share for a period of three years from the date of issuance. If the company's share trade at an average price of \$0.80 per share for a period of 60 days, the company, at its election, may force exercise or cancellation of the warrants. If the company repays any portion of the principal amount of the debentures prior to January 1, 2011, the number of common shares purchasable pursuant to the warrants shall be decreased proportionately to the amount of principal so repaid.

Finder's fees equal to 10% of the aggregate proceeds from the offerings of the units were payable to the brokers.

On February 9, 2010, the company closed the first tranche of its debenture offering for gross proceeds of \$250,000. On March 19, 2010, the company closed the second tranche of its debenture offering for gross proceeds of \$85,000.

The net proceeds received from the issue of debentures have been split between the financial liability component and an equity component, representing the fair value of the share purchase warrants, as follows:

	\$
Net proceeds of issue	305,250
Equity component	(49,286)
Liability component at date of issue	255,964

The equity component of \$49,285 has been credited to equity, Share purchase warrants (note 9(d)).

The liability component is measured at amortized cost. The interest expense for the quarter (\$10,333) is calculated by applying weighted average effective interest rate of 35% to the liability component. This high effective interest rate was a result of the allocation of a portion of the net proceeds to equity.

No interest was paid in the quarter. The difference between the carrying amount of the liability component above (\$255,964) and the amount reported on March 31, 2010 balance sheet represents the effective interest accrued for the quarter.

	\$
February 9, 2010 debentures, maturing February 9, 2013	192,191
March 19, 2010 debenture, maturing March 19, 2013	63,773
Accrued interest	10,333
Balance, March 31, 2010	<u>266,297</u>
Less: current portion	<u>(15,783)</u>
	<u>250,514</u>

11 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, 2007	37,074,687	22,573,211
Share purchase warrants exercised (d)	3,329,250	2,088,234
Options exercised (c)	35,000	18,216
TECC acquisition (e)	743,709	530,636
Share issuance costs	-	7,916
Balance – December 31, 2008	41,182,646	25,218,213
Private placement (i)	3,138,750	452,186
Share issuance costs (ii)	-	(31,054)
Balance, March 31, 2010	44,321,396	25,639,345

- i) On June 24, 2009, the company issued 3,138,750 Units at \$0.16 per unit pursuant to a non-brokered private placement, for gross proceeds of \$502,200. Each Unit consists of one common share and one-half warrant. Each full share purchase warrant entitles the holder to purchase one common share at a price of \$0.30 until June 24, 2010. These warrants are not transferable. A total value of \$50,014 was attributed to the warrants. Cash share issuance costs were \$28,554 and noncash share issuance costs were \$5,950. Total issuance cost of \$31,054 was allocated to common shares and \$3,450 to warrants.
- ii) On June 24, 2009, the company issued 163,000 warrants as part of the private placement commission to agents. The fair value of these warrants of \$5,950 has been reflected within share issuance costs.

c) 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 8,864,279. The stock options have vesting periods of up to 18 months and an exercise period of up to five years.

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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 \$
	<u> </u>	<u> </u>
Balance - December 31, 2007	5,306,000	0.77
Granted	385,000	0.50
Cancelled	(318,750)	1.20
Forfeited	(6,250)	1.28
Expired	(350,000)	1.50
Exercised	<u>(35,000)</u>	<u>0.26</u>
Balance - December 31, 2008	4,981,000	0.67
Granted	1,714,000	0.25
Cancelled	(21,250)	0.40
Forfeited	(318,750)	0.66
Expired	<u>(636,000)</u>	<u>0.30</u>
Balance - December 31, 2009	5,719,000	0.33
Granted	<u>650,000</u>	<u>0.31</u>
Balance – March 31, 2010	<u>6,369,000</u>	<u>0.33</u>

During the first quarter of 2010, the company granted 650,000 (2009 –1,080,000) options to officers and employees. None of those options had an exercise price lower than the stock price at the date of grant (2009 –0).

Stock-based compensation expense for the quarter was \$144,193 (2009 - \$259,138), of which \$57,070 related to employees (2009 – \$153,075) and \$87,123 (2009 - \$106,063) related to consultants.

Weighted average fair value of options granted to employees and officers during the quarter was \$0.22 (2009 - \$0.23).

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Options outstanding at March 31, 2010 were as follows:

Exercise price \$	Options outstanding			Options exercisable	
	Number outstanding	Weighed average remaining contractual life (years)	Weighed average exercise price \$	Number outstanding	Weighed average exercise price \$
0.10 - 0.20	789,000	4.40	0.14	272,250	0.15
0.21 - 0.28	515,000	0.85	0.25	515,000	0.25
0.30 - 0.36	3,790,000	3.16	0.31	2,612,500	0.31
0.40 - 0.48	775,000	1.49	0.42	775,000	0.42
0.54 - 0.64	400,000	2.43	0.57	400,000	0.57
0.72 - 0.96	100,000	1.89	0.84	100,000	0.84
	<u>6,369,000</u>	<u>2.86</u>	<u>0.33</u>	<u>4,674,750</u>	<u>0.35</u>

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:

	2010	2009
Risk-free interest rate	2.45%	2.34%-2.76%
Dividend yield	0%	0%
Volatility	98.60%	97.67%-98.73%
Expected life	4.5 years	4.5-5 years

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d) Share purchase warrants

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

	Number outstanding	Amount \$
Balance - December 31, 2007	5,874,000	1,666,760
Expired	(44,750)	(6,789)
Exercised	(3,329,250)	(485,128)
Warrant issue cost adjustment		(1,737)
	<hr/>	<hr/>
Balance - December 31, 2008	2,500,000	1,176,580
Expired	(2,500,000)	(1,176,580)
Issued	1,732,375	52,514
	<hr/>	<hr/>
Balance – December 31, 2009	1,732,375	52,514
Issued	576,200	49,286
	<hr/>	<hr/>
Balance – March 31, 2010	<u>2,308,575</u>	<u>101,800</u>

Share purchase warrants outstanding as at March 31, 2010 were as follows:

Number of shares	Exercise price \$	Expiry date
1,732,375	0.30	Jun 24, 2013
430,000	0.50	February 9, 2013
<u>146,200</u>	0.50	March 19, 2013
<u>2,308,575</u>		

e) Shares issued under TECC acquisition agreement

On July 11, 2008, the company acquired distributions rights from TECC Services (see note 6(b)). As part of the consideration, common shares of the company with value equal to £265,000GBP 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 day being the second day of preceding the date of closing.

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f) Contributed surplus

At December 31, 2009, the company's contributed surplus comprised the following:

	\$
Balance - December 31, 2007	2,099,851
Stock option expense	449,639
Stock option exercised	(8,166)
Expiry of warrants	<u>6,789</u>
Balance – December 31, 2008	2,548,113
Stock option expense	259,138
Expiry of warrants	<u>1,176,580</u>
Balance – December 31, 2009	3,983,831
Stock option expense	<u>144,193</u>
Balance – March 31, 2010	<u><u>4,128,024</u></u>

12 Commitments

a) Premise lease

In June, 2005, the company entered into an agreement to lease office facilities for 10 years.

In February 2008, the company entered into a lease agreement to lease office facilities in Texas for 37 months commencing February 1, 2008 and expiring February 28, 2011, for monthly rent payments of \$1,800 per month, up to February 28, 2009 and monthly payments of \$1,908 thereafter.

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

	\$
2010	53,525
2011	54,051
2012	51,300
2013	52,875
2013 and thereafter	<u>76,500</u>
	<u><u>288,251</u></u>

For the first quarter of 2010, the company's rent expense including certain operating expenses and property taxes was \$42,555 (2009 - \$174,667) and its sublease revenue was \$6,350 (2009 - \$24,928).

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b) Equipment lease

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.

c) Abbotly USA

Under the terms of the North American distribution rights acquisition, 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 Pty 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. The company has purchased all of the remaining inventory from Abbotly USA as required under this agreement and is now required to purchase a minimum of \$200,000 of products identified in the Assignment and Assumption agreement from Abbotly Pty per year for purposes of the royalty calculation. For the first quarter of 2010, the company recorded royalty expense of US\$3,496. As at March 31, 2010, royalties of US\$3,496 were payable to Abbotly USA (Year 2009 – US\$11,200).

13 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 March 31, 2010		Year ended December 31, 2009	
	Amount \$	Revenue %	Amount \$	Revenue %
Europe, Middle East, Africa	479,773	75	952,773	40
Australia	48,002	8	240,970	10
South East Asia	25,350	4	534,982	22
Americas	81,802	13	673,356	28
Total revenue	634,927	100	2,402,081	100

During the first quarter of 2010, revenue from three customers exceeded 10% of the company's total revenue. These customers contributed 28%, 15% and 15% respectively. During the previous year, revenue from one individual customer exceeded 10% of the company's total revenue. This customer contributed 22%.

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Property and equipment are located in:

	<u>2010</u>	<u>2009</u>
Canada	59%	55%
USA	23%	28%
Other	18%	17%
Total	<u>100%</u>	<u>100%</u>

14 Related party transactions

Consulting fees of \$30,733 were charged by directors of the company during the first quarter of 2010 (2009 - \$254,317). Consulting fees of \$32,500 were charged by two companies with common directors during the quarter (2009 - \$76,000). The company rents its office in the United Kingdom from a company with a common director. During the first quarter of 2010, rent expense was \$9,305 (2009 - \$39,721). These transactions have been charged to general and administrative in the statement of operations. The company also utilizes installation services from a company with a common director. During the first quarter of 2010, installation expense was \$143,403 (2009 - \$0). These transactions have been charged to cost of sales in the statement of operations. At March 31, 2010, £102,297GBP (CDN\$158,734) was owed to these related parties. (December 31, 09 - £8,129GBP)

The company subleases its Vancouver office and other facilities to a company with a common director. During the first quarter of 2010, sublease income was \$6,350 (2009 - \$24,928). At March 31, 2010, \$2,117 was owed from this related party (December 31, 09 - \$2,100).

A return of purchase of \$28,215 was made by a company with a common director during the first quarter of 2010, (2009 - Purchase \$226,174). As at March 31, 2010, \$43,338 was owed from this related party (December 31, 2009 \$74,734).

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Management is of the opinion that these transactions were undertaken under the same terms and conditions as transactions with arms-length parties.

15 Financial instruments

a) Financial Instruments

The company has classified its financial instruments as follows:

	2010	2009
	\$	\$
Financial assets:		
Held-for-trading, measured at fair value:		
Cash and cash equivalents	323,241	147,051
Loans and accounts receivable, recorded at amortized cost:		
Accounts receivable	545,838	657,841
Held-to-maturity, recorded at amortized cost:		
Short-term investments	55,007	101,646
Financial liabilities, recorded at amortized cost:		
Accounts payable and accrued liabilities	643,947	552,034
Acquisition obligations, debentures and other liabilities	990,309	854,937

Interest income from held-for-trading and held-to-maturity short-term investments and interest expense from acquisition obligations, debentures and other financial liabilities are recognized in other income (expenses).

The following summarizes interest income and expense for the first quarter of 2010:

	2010	2009
	\$	\$
Interest income from held-for-trading	272	2,542
Interest income from held-to-maturity	3,361	2,270
Interest expense from financial obligations	2,152	5,078
Interest expense from other financial liabilities	32,518	84,649

Fair value

Financial instruments recorded at fair value are measured using a three-level fair value hierarchy:

Level 1: fair value is determined by reference to quoted prices in active markets for identical assets and liabilities.

Level 2: fair value is determined based on inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly.

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Level 3: fair value is determined based on inputs that are unobservable and significant to the overall fair value measurement.

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.

The carrying value of the long term portion of acquisition obligations (\$373,896) and debentures (\$250,514), has been discounted at 16% (see note 7(b)) and 35% (see note 10), respectively, is considered a close approximation of fair value.

The company's financial assets that must be recorded at fair value are presented in the following table:

Fair value measurement at March 31, 2010				
	March 31, 2010 Carrying value	Level 1	Level 2	Level 3
Financial assets	\$	\$	\$	\$
Cash and cash equivalents	323,241	323,241	-	-
Total	323,241	323,241	-	-

Fair value measurement at December 31, 2009				
	December 31, 2009 Carrying value	Level 1	Level 2	Level 3
Financial assets	\$	\$	\$	\$
Cash and cash equivalents	147,051	147,051	-	-
Total	147,051	147,051	-	-

b) Financial risk management

The company is exposed to certain financial risks, including credit risk, liquidity risk, and market risk.

Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations and arises principally from the company's cash and cash equivalents, short-term investments and accounts receivable. 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 accounts receivable is limited due to the company's customer credit evaluation process. The company has \$55,007 invested in bank guaranteed investment certificates and \$545,838 in accounts receivable which are subject to credit risk.

Liquidity risk

The company's consolidated financial statements have been prepared on a going concern basis, which assumes the realization of assets and the settlement of liabilities in the normal course of business. Liquidity risk results from the company's inability to meet its financial obligations when they become due. As part of the risk management process, the board approves the company's annual operating and capital budgets as well as any material transactions outside the ordinary course of business. To ensure that the company has sufficient liquidity to meet its current obligations in the next 12 months, additional financing has been obtained through issuance of debentures this year.

As at March 31, 2010, the company's total account payable and accrued liabilities and current portion of obligation under acquisition contract and debentures was \$1,014,746 with \$632,740 due within 90 days and \$382,006 due within one year. Current portion of capital leases was \$4,317 as at March 31, 2010.

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the company's income or valuation of its financial instruments.

Foreign currency risk

The company is exposed to fluctuations in foreign currency as most of its international distribution transactions are settled in U.S. dollars, Australian dollars and British pounds. The company's net income and cash flow will therefore be affected by fluctuations in foreign exchange rates. None of these risks has been mitigated through the use of foreign currency forward contracts.

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As at March 31, 2010, the company's monetary assets and liabilities denominated in foreign currencies are as follows:

	USD	AUD	GBP
<u>Assets</u>			
Cash and cash equivalents	112,321	1,283	103,461
Accounts receivable	420,464	2,652	56,370
<u>Liabilities</u>			
Accounts Payable	96,221	11,448	177,352
TECC acquisition obligation, current portion			224,225
TECC acquisition obligation, balance			337,500

The following table demonstrates the effect of exchange rate movement on net income due to gains and losses on the revaluation of monetary assets and liabilities denominated in foreign currencies:

	USD	AUD	GBP
Gain (loss) on \$0.10 increase in CAD			
Monetary Assets	(53,278)	(394)	(15,983)
Monetary Liabilities	9,622	1,145	73,908
Net gain (loss)	(43,656)	751	57,925

Interest rate risk

The company is exposed to this risk as late payments under TECC acquisition obligations are subject to interest based on prime rate plus 4%. As at March 31, the total of such payments was £103,125GBP.

16 Capital management

The company's capital structure includes shareholders' equity consisting of issued common shares, warrants, contributed surplus and deficit.

The company's objectives when managing capital are:

- a) to effectively finance its operations and growth by meeting its operating and capital expenditure budgets;
- b) to maintain financial flexibility in order to meet financial obligations, including obligations under acquisition contracts;

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- c) to ensure its ability to carry out its strategic plans and take advantage of acquisition opportunities;
- d) to provide an appropriate investment return to its shareholders.

The company will increase its capital through the issuance of new shares or debentures if that is necessary and appropriate.

The company is not subject to externally imposed capital requirements.

17 Supplementary cash flow information

	2010	2009
	\$	\$
Interest paid in cash	2,152	5,078
Interest income received in cash	5,279	4,838
Income taxes paid in cash	-	-
Non-cash financing and investing activities		
Issuance of warrants for share issue costs		5,950
Issuance of warrants for debenture transaction costs	49,286	-

18 Subsequent events

On April 29, 2010, the company announced the closing of the third tranche of its debenture offering for gross proceeds of \$200,000.

On May 4, 2010, the company announced the closing of the last tranche of its debenture offering for gross proceeds of \$75,000.

On May 21, 2010, the company announced that it has arranged a non-brokered private placement of up to 2 million units at a price of \$0.25 per unit for gross proceeds of up to \$500,000. Each unit consists of one common share and one-half of a common share purchase warrant, each whole warrant entitling the holder to purchase an additional share at a price of \$0.35 share for a period of 12 months from the date of issuance. This proposed private placement was amended on May 26, 2010 to offer up to 2.5 million units at a price of \$0.20. Other terms of the private placement remain the same.

The proceeds from the private placement will be used for general working capital.