



FINANCIAL STATEMENTS

(Expressed in Canadian Dollar)

September 30, 2006 (Unaudited – Prepared by Management)

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SmartCool Systems Inc.

CONSOLIDATED BALANCE SHEETS

(Unaudited - Prepared by Management)

	September 30 2006	December 31 2005
ASSETS		
Current assets		
Cash and cash equivalents	\$ 291,170	\$ 348,364
Loan and other receivables	57,154	42,523
Refundable tax credits	8,554	13,534
Inventory	171,065	128,665
Prepaid expenses & deposits	78,128	14,723
Total current assets	606,071	547,809
Long-term investment (Note 3)	2,741,833	26,140
Property plant and equipment		
Demonstration and display equipment (Note 4)	28,249	33,234
Equipment & leaseholds (Note 4)	40,748	44,324
Total assets	\$ 3,416,901	\$ 651,507
LIABILITIES & SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	\$ 139,452	\$ 112,681
Loans payable	-	-
Current portion of obligations under acquisition contract	1,081,080	-
Total current liabilities	1,220,532	112,681
Obligations under acquisition contract (Note 5)	494,802	-
Shareholders' Equity		
Share capital (Note 6)	13,381,343	11,491,354
Obligation to issue shares	25,000	
Contributed surplus	480,622	289,150
Deficit	(12,185,398)	(11,241,679)
Total shareholders' equity	1,701,566	538,825
Total liabilities and shareholders' equity	\$ 3,416,901	\$ 651,507

(See accompanying notes to the consolidated financial statements)

Approved by the directors

"George Burnes"
George Burnes

"Jeffrey Lowe"
Jeffrey Lowe

SmartCool Systems Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS & DEFICIT

(Unaudited - Prepared by Management)

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Revenue	\$ 22,999	\$ -	\$ 179,793	\$ -
Cost of sales, approved projects	38,112	-	148,837	-
Gross profit	(15,113)	-	30,956	-
Survey & testing costs, pending projects	8,419	-	28,224	-
Selling, general & administrative expenses				
Advertising & media	-	-	2,620	-
Amortization	3,914	5,195	11,486	13,145
Commissions	-	-	11,798	-
Equipment lease	3,077	-	9,242	-
Filing and transfer fee	5,388	1,468	19,437	30,191
Financing fee	-	-	-	-
Insurance and licenses	6,098	-	10,894	-
Interest expense	11	6	285	307
Investor relations & news dissemination	5,833	8,200	35,999	15,064
Management and consulting fees	169,786	132,780	414,350	307,650
Office and sundries	13,268	16,064	38,816	26,687
Professional fees	35,645	10,372	111,742	86,730
Project investigation recoveries	-	3,678	(119,136)	(21,465)
Rent	12,723	28,240	38,432	41,614
Salaries & wages	37,544	1,085	57,937	3,390
Stock-based compensation	191,472	-	191,472.0	24,820
Telephone	6,369	4,251	16,223	10,325
Technical consulting	9,705	-	9,705	-
Travel	30,628	30,512	73,285	48,305
	531,285	241,850	934,585	586,762
Interest Income	368	696	2,832	696
Foreign exchange gain (loss)	(2,379)	-	(14,697)	-
Loss for the period	\$ (556,827)	\$ (241,154)	\$ (943,720)	\$ (586,066)
Deficit, beginning of period	(11,628,572)	(10,447,644)	(11,241,679)	(10,102,732)
Deficit, end of period	\$ (12,185,398)	\$ (10,688,798)	\$ (12,185,398)	\$ (10,688,798)
Loss per share - basic and diluted	(0.03)	(0.02)	(0.06)	(0.05)
Weighted average number of common shares outstanding - basic and diluted	21,354,216	13,893,486	17,149,495	11,964,493

SmartCool Systems Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited - Prepared by Management)

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Cash flows used in operating activities				
Loss for the period	\$ (556,827)	\$ (241,154)	\$ (943,720)	\$ (586,066)
Adjustments for item not involving cash:				
- amortization	3,914	5,195	11,486	13,145
- stock-based compensation	191,472	-	191,472	24,820
Changes in non-cash working capital items:				
- Loan & other receivables	(9,690)	-	(14,631)	-
- refundable tax credits	4,544	(16,099)	4,980	(17,327)
- inventory	6,657	-	(42,400)	(113,256)
- prepaid expenses and deposits	(10,857)	(13,122)	(63,404)	(44,237)
- accounts payable and accrued liabilities	2,458	(22,160)	26,771	(40,309)
- loan payable	-	-	-	-
-acquisition contract	- 0.01	-	1,575,882	-
Net cash flows used in operating activities	(368,328)	(287,340)	746,435	(763,230)
Cash flows from financing activities				
Shares issued for cash	11,500	23,750	1,889,989	1,547,449
Shares subscription	-	-	25,000	-
Net cash flows used in financing activities	11,500	23,750	1,914,989	1,547,449
Cash flows used in investing activities				
Acquisition of fixed assets	(1,145)	- 6,224.0	(2,925)	(7,109)
Increase in long term investments	-	(72,500)	(2,715,693)	(145,371)
Net cash flows used in investing activities	(1,145)	(78,724)	(2,718,618)	(152,480)
Increase in cash and cash equivalents	(357,973)	(342,314)	(57,194)	631,739
Cash and cash equivalents, beginning of period	649,143	982,893	348,364	8,840
Cash and cash equivalents, end of period	\$ 291,170	\$ 640,579	\$ 291,170	\$ 640,579
Supplementary cash flow information:				
Interest paid in cash	\$ -	\$ -	\$ -	\$ -
Income taxes paid in cash	\$ -	\$ -	\$ -	\$ -



**Notes to Consolidated Financial Statements
For the three months ended September 30, 2006**

1. Incorporation and Nature of Operations

The company was incorporated on August 31, 2000 under the Canada Business Corporations Act as 378211 Canada Inc. and 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 law of Nevada. Smartcool International Inc. ("Smartcool International"), another wholly-owned subsidiary, was incorporated in Barbados in June 2006. These financial statements have been prepared on a going-concern basis, which assumes that the Company will be able to realize assets and discharge liabilities in the normal course of business. The continued operation of the Company is dependent upon the ability of the Company to obtain financing as the Company has incurred recurring operating losses. Expecting to see revenue increase significantly in the medium term, management's plans in this regard are to raise equity financing in the short term when necessary, to maintain its operations, to complete strategic acquisitions, and to fulfill other contract obligations. These financial statements do not include any adjustments that may result from this uncertainty.

2. Significant Accounting Policies

(a) Principles of consolidation

The consolidated financial statements include the accounts of Smartcool Systems Inc. and its wholly owned subsidiaries, Smartcool USA and Smartcool International. All significant inter-company transactions and balances have been eliminated.

(b) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principle requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the period. Actual results may differ from those estimates.

(c) Cash equivalents

Cash equivalents usually consist of highly liquid investments which are readily convertible into cash with maturities of three months or less when purchased. At September 30, 2006 and December 31, 2005, cash equivalents consist of bank redeemable term investment certificates.

(d) Equipment

Equipment are stated at cost and amortized on a declining balance basis using the following rates:

Computer	30%
Demonstration and display equipment	20%
Engineering equipment	20%
Office equipment	20%
Leaseholds	10 years straight-line

2. Significant Accounting Policies (continued)

(e) Intangible assets

Intangible assets will be amortized over its useful life unless the life is determined to be indefinite. An intangible asset with an indefinite life will not be amortized but will be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired.

An impairment loss is recognized when the carrying value of intangible asset exceeds the estimated undiscounted future cash flow expected to result from the use of the asset and its eventual disposition. The amount of the impairment loss to be recorded is calculated by the excess of the asset's carrying value over its fair value. Fair value is generally determined using a discounted cash flow analysis.

(f) Impairment of long-lived assets

Long-lived assets are reviewed whenever events or changes in circumstances indicate that carrying value of an asset or asset group may not be recoverable. An impairment loss would be recognized when the carrying amount of an asset exceeds the estimated undiscounted future cash flow expected to result from the use of the asset and its eventual disposition. The amount of the impairment loss to be recorded is calculated by the excess of the asset's carrying value over the fair value. Fair value is generally determined using a discounted cash flow analysis.

(g) Loss per share

Basic loss per share is computed using the weighted average number of common shares outstanding during the year. Diluted loss per share amounts are calculated giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares using the treasury stock method. The treasury stock method assumes that proceeds received from the exercise of stock options and warrants are used to repurchase common shares at the prevailing market rate.

(h) Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities measured using substantially effected tax rates and laws that will be in effect when the difference are expected to reverse.

(i) Foreign currency translations

Transactions denominated in foreign currencies are translated into Canadian dollars as follows:

Monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date and revenues and expenses are translated at the monthly average exchange rate. Non-monetary are translated at historical rates. Gains and losses arising from such translation are accounted for as foreign exchanges gains or losses and reflected in earnings.

3. Long Term Investments

a) Abbotly Technologies USA

On January 30th, 2006, the company entered into a Letter of Intent with Abbotly USA to acquire the exclusive rights to distribute the Energy Saving Module (ESM) throughout North America. Pursuant to this LOI, Abbotly USA has agreed to assign all of its rights and obligations, and the Company has agreed to assume all of Abbotly USA's obligations, under a license agreement between Abbotly USA and Abbotly Australia Pty.

3. Long Term Investments (continued)

With the signing of this LOI, Smartcool USA will become the master distributor of the ESM in North America and will be required to meet certain minimum purchase obligations under the license agreement with Abbotly Pty but will no longer be bound by its previous minimum purchase obligations that it had as sub-distributor of Abbotly USA.

The consideration to be paid is US\$30,000 upon the signing of the Letter of Intent, US\$150,000 to be paid May 1, 2006 and 500,000 shares purchase warrants with an exercise price based on the market value at the time of closing, exercisable over a period of 2 years to Abbotly USA. plus a royalty on all products purchased from Abbotly Pty. As at September 30, 2006, payment of CDN\$201,953.49 has been paid to Abbotly Technologies USA. On March 27th, 2006 this transaction closed and Smartcool is now the exclusive distributor of the ESM 4000 for North America.

b) Abbotly Technologies Pty. Ltd.

On February 1, 2005, the Company entered into a memorandum of understanding (MOU) to purchase the assets of Abbotly Technologies Pty. Ltd., an Australian company. Under the terms of the MOU, subject to completion of a satisfactory due diligence review, the company will pay AU\$5.25-million in cash and issue share purchase warrants to purchase up to AU\$1.32-million in shares of the company, at a price to be determined. A non-refundable deposit of AU\$52,500 (CDN\$51,581) was paid by the company on February 9, 2005, to be applied toward the purchase price if the transaction closes.

On July 18, 2005 the Company announced that Abbotly had granted the Company an extension for the negotiation of a formal definitive agreement until December 31, 2005. In consideration for the extension, the Company paid Abbotly another non-refundable deposit of AU\$52,500 (CDN\$48,615). As the transaction did not complete by December 31, total deposit of CDN\$100,196 together with other acquisition costs were written off in 2005.

However, continued discussions and negotiating effort became fruitful in the second quarter of 2006 when the Company and Abbotly entered into a new agreement for the acquisition of the business and assets of Abbotly Pty. The acquisition has been accepted for filing by the TSX Venture Exchange and closed on June 30, 2006. Under the terms of the agreement, the Company purchased the business and assets of Abbotly for the price of AU\$3,000,000. The purchase price will be paid in cash in scheduled payments over two years, with previous deposits of AU\$105,000 being applied towards the last payment. The first payment of AU\$1,000,000 was made upon closing. Total previous deposit of \$AU105,000 and other acquisition costs have therefore been reversed and accounted for as long term investment in the ESM's intellectual property this quarter.

Given the international nature of the acquired business, Smartcool International Inc, another subsidiary of Smartcool, was incorporated in Barbados in June 2006. This wholly owned subsidiary now holds the intellectual property and worldwide distribution rights for the ESM.

4. Property, Plant and Equipment

(a) Demonstration and display equipment

	September 30, 2006		December 31, 2005	
	Cost	Accumulated amortization	Net book value	Net book value
Demonstration and display equipment	\$46,158	\$17,909	\$28,249	\$ 33,234

(b) Equipment & leaseholds

	September 30, 2006			December 31, 2005
	Cost	Accumulated amortization	Net book value	Net book value
Office equipment	\$ 87,116	\$ 60,705	\$ 26,411	\$ 29,136
Computer	6,022	3,693	2,329	1,694
Engineering equipment	4,967	3,021	1,946	2,289
Energy Monitoring equipment	4,936	1,901	3,035	3,571
	\$ 103,041	\$ 69,320	\$ 33,721	\$ 36,690
Leasehold Improvements	\$ 8,107	\$1,081	\$ 7,026	\$7,634

5. Long-term debt

Balance of acquisition price payable, non-interest bearing, specified by purchase agreement with Abbotly Pty:

	AU\$	CDN\$
October 31, 2006	500,000	415,800
March 31, 2007	400,000	332,640
July 31, 2007	400,000	332,640
December 31, 2007	400,000	332,640
May 31, 2008	195,000	162,162
	1,895,000	1,575,882
Less: Current portion	1,300,000	1,081,080
	595,000	494,802

6. 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:

	Shares	Amount
Balance, December 31, 2004	8,612,167	\$9,940,905
Private placement (Note 6(c)(i))	710,000	177,500
Private Placement (Note 6(c)(ii))	4,545,000	1,330,739
Share Purchase Warrants (Note 6(c)(iii))	338,500	42,210
Escrow Shares (Note 6(c)(iv))	(9,375)	-
Balance, December 31, 2005	14,196,292	\$11,491,354
Share Purchase Warrants (Note 6(c)(v))	362,500	36,250
Private Placement (Note 6(c)(vi))	3,250,000	621,532
Private Placement (Note 6(c)(vii))	1,000,000	295,000
Private Placement (Note 6(c)(viii))	2,500,000	925,707
Option exercise (Note (d))	50,000	11,500
Shares for services (Note (f))	17,489	-
Balance, September 30, 2006	21,376,281	\$13,381,343

(c) Shares:

- i. In January 2005, the Company issued 710,000 Units at \$0.25 per Unit pursuant to a private placement, with total proceeds of \$177,500. Each Unit consists of one common share and one-half share purchase warrant. Each warrant entitles the holder to purchase one common share at \$0.35 until January 19, 2007.
- ii. In April 2005, the Company issued 4,545,000 Units at \$0.33 per Unit pursuant to a short form offering, with net proceeds of \$1,330,739, net of share issuance costs. Each Unit consists of one common share and one half non-transferable share purchase warrant. Each full share purchase warrant entitles the holder to purchase one common share at a price of \$0.40 in the first year and \$0.50 in the second year.
- iii. During the last four months of the year 2005, 262,500 share purchase warrants were exercised at \$0.10 per share.

6. Share capital (continued)

- iv. During the third quarter of 2005 9,375 common shares held in escrow were cancelled due to the expiry of the underlying escrow agreement.
- v. During the first six months of 2006 362,500 share purchase warrants were exercised at \$0.10 per share.
- vi. On May 31, 2006, the Company issued 3,250,000 Units at \$0.20 per Unit pursuant to a private placement, with net proceeds of \$628,250, net of share issuance costs. Each Unit consists of one common share and one half non-transferable 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.
- vii. On June 19, 2006, the Company issued 1,000,000 Units at \$0.30 per Unit pursuant to a private placement, with net proceeds of \$295,000, net of share issuance costs. Each Unit consists of one common share and one half non-transferable 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.
- viii. On June 27 & 28, 2006, the Company issued 2,500,000 Units at \$0.40 per Unit pursuant to a private placement, with net proceeds of \$933,800, net of share issuance costs. Each Unit consists of one common share and one half non-transferable 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 & 28, 2008.

In accordance with Financial Instruments – Disclosure and Presentation (CICA HB3860), share purchase warrants attached to private placement units in 2004-2006 were valued using the Residual Approach. Under this approach, proceeds up to the Company's share market value are allocated to the shares and only the excess above the market value is allocated to the attached share purchase warrants. No value has been allocated to these warrants as determined under the Residual Approach.

(d) Stock options

On August 6, 2004, the Company granted 708,000 stock options with an exercise price of \$0.10. The exercise price was lower than the market price at grant date. These options vest from August 6, 2004 to February 6, 2006 and expire on August 6, 2009. On November 15, 2004, these options were re-priced at exercise price of \$0.21 per share, which was lower than the market price at the time of re-pricing.

On November 1, 2004, the Company granted 275,000 stock options with an exercise price of \$0.21 per share. The exercise price was lower than the market price at the grant date. These options vest from November 1, 2004 to May 1, 2006 and expire on November 1, 2009.

On December 22, 2004, the Company granted 50,000 stock options with an exercise price of \$0.33 per share. The exercise price was lower than the market price at the grant date. These options vest from December 22, 2004 to June 22, 2006 and expire on December 22, 2009.

6. Share capital (continued)

On July 13, 2005 the Company granted 50,000 stock options with an exercise price of \$0.21 per share. These options vest from Jul 13, 2005 to January 13, 2007 and expire on July 13, 2010.

On November 4, 2005 the Company granted a total of 430,000 stock options with an exercise price of \$0.27 per share. These options vest from November 4, 2005 to May 4, 2007 and expire on November 4, 2010.

On December 13, 2005, 76,000 options were exercised at the price of \$0.21 per share and 74,000 options with the same exercise price were cancelled.

On December 22, 2005, the Company granted a total of 350,000 stock options with the exercise price of \$0.23 per share. The options vest from December 22, 2005 to Jun 22, 2007 and will expire on December 22, 2010.

On April 10, 2006 the Company granted a total of 235,000 stock options with the exercise price of \$0.22 per share. The options vest from April 10, 2006 to October 10, 2007 and will expire on April 10, 2011.

On June 30, 2006 the Company granted a total of 400,000 stock options with the exercise price of \$0.40 per share. The options vest from June 30, 2006 to December 30, 2007 and will expire on June 30, 2011.

On July 11, 2006 the Company granted 100,000 stock options with the exercise price of \$0.30 per share. The options vest from July 11, 2006 to January 11, 2008 and will expire on July 11, 2011.

On July 27, 2006, 50,000 options were exercised at the price of \$0.23 per share and 50,000 shares with the same exercise price were cancelled.

A summary of the Company's stock options as of September 30, 2006 and December 31, 2005, is presented below:

	September 30, 2006		December 31, 2005	
	Shares	Weighted average exercise price	Shares	Weighted Average Exercise Price
Options outstanding	2,348,000	\$ 0.26	1,713,000	\$ 0.23
Options exercisable	1,444,250	\$ 0.24	869,750	\$ 0.22
			Sep 30 2006	December 31 2005
Weighted average remaining contractual life			3.65 years	4.30 years
Weighted average fair value of options granted			\$0.22	\$ 0.18

6. Share capital (continued)

Stock-based compensation expense of \$85,717 was charged to operations in 2005, understated by \$132,012. The financial statements of 2005 have therefore been restated to account for the additional cost. As a result of this adjustment, deficit and contributed surplus increased by \$132,012.

For the first nine months of this year, stock-based compensation of \$191,472 was charged to operations.

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:

	September 30, 2006
Risk-free interest rate	3.7% - 4.1%
Dividend yield	0%
Volatility	91% - 100%
Approximate expected life	4.25 years

(e) Warrants

Share purchase warrants outstanding as at September 30, 2006:

Number of Shares	Exercise Price	Expiry Date
3,250,000	\$ 0.10	October 26, 2006
355,000	\$ 0.35	January 19, 2007
2,272,500	\$0.50	April 11, 2006
1,625,000	\$0.40	May 31, 2008
500,000	\$0.50	June 19, 2008
904,000	\$0.60	June 27, 2008
577,300	\$0.60	June 28, 2008
9,483,800		

Each warrant entitles the holder to purchase one common share of the Company.

(f) Shares for services

On July 1, 2006 the Company entered into a contract with a consulting firm where it is entitled to receive \$2,000 per month in stock of the Company from July 1, 2006 until Dec 31, 2006. The issuance of shares for service under this contract has been approved by the TSX Venture Exchange.

7. Income Taxes

A reconciliation of the statutory tax rate to the effective tax rate for the Company is as follows:

Statutory income tax rate	(34.12)	(34.12)
Tax loss not benefited	(34.12)	(34.12)
Effective tax rate	-	-

7. Income Taxes (continued)

The Company has non-capital losses of approximately \$2,785,000 for income tax purposes, which may be carried forward to reduce taxable income for future years. The losses will expire commencing 2006 through 2020.

8. Contractual Obligations

a) Premise lease

On June 01, 2005, the company entered into an agreement for lease of premises for 10 years.

The future annual basic payments are:

2006 – 2007	43,200 per annum
2007 – 2009	45,900 per annum
2009 – 2011	48,600 per annum
2011 – 2013	51,300 per annum
2013 – 2015	54,000 per annum

The lease is supported by a letter of credit of \$100,000, reducing to \$25,000 by year 4

b) 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

8. Related Party Transactions

\$147,500 of the management and consulting fees (2005 - \$105,000), were paid or accrued to the directors of the Company from January to September 2006.

9. Financial Instruments

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, refundable tax credits, and accounts payable and accrued liabilities approximate the fair value because of the short-term nature of these instruments.

The Company is not subject to significant credit, interest and current risks arising from these financial instruments.

10. Subsequent Events

Smartcool Systems has arranged for a non-brokered private placement of up to 1.1 million shares at 40 cents per share for gross proceeds of up to \$440,000 to be closed by the end of October. No commissions will be paid on this private placement.

Another non-brokered private placement of up to 1.5 million shares at 75 cents per share for gross proceeds of up to \$1,125,000 has also been arranged. A 6 percent commission will be paid on this private placement to qualifying agents. In addition, the Company will issue agent's warrants representing 10% of the offering.

The proceeds from these private placements will be used for working capital including but not limited to sales and marketing efforts and purchase of inventory of its energy saving module.