



CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Expressed in Canadian Dollar)

June 30, 2007 and 2006

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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
June 30, 2007 and December 31, 2006
(Unaudited - Prepared by Management)

	June 30 2007 (Unaudited)	December 31 2006
ASSETS		
Current assets		
Cash and cash equivalents	\$ 124,706	\$ 700,819
Short-term investments	1,362,195	1,103,853
Amounts receivable	240,069	93,726
Inventory	315,662	91,806
Prepaid expenses and deposits	61,669	119,503
	<u>2,104,301</u>	<u>2,109,707</u>
Property and equipment (note 5)	213,127	154,706
Intangible assets (note 6)	2,350,950	2,462,189
	<u>\$ 4,668,378</u>	<u>\$ 4,726,602</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	\$ 237,036	\$ 223,505
Current portion of obligations under contracts (note 7 & 8)	840,972	1,023,736
	<u>1,078,008</u>	<u>1,247,241</u>
Obligations under acquisition contract (note 7)	-	146,354
Capital leases (note 8 and 10)	32,812	-
Deferred tenant Inducement	96,582	99,542
	<u>1,207,402</u>	<u>1,493,137</u>
SHAREHOLDERS' EQUITY		
Share capital (note 9(b))	16,753,808	15,210,145
Share purchase warrants (note 9(e))	516,162	577,357
Contributed surplus (note 9(f))	1,171,398	754,510
Deficit	(14,980,392)	(13,308,547)
	<u>3,460,976</u>	<u>3,233,465</u>
	<u>\$ 4,668,378</u>	<u>\$ 4,726,602</u>

Nature of operations and going concern (note 1)
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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 & DEFICIT

Three and six months ended June 30, 2007 and June 30, 2006

(Unaudited - Prepared by Management)

	Three months ended June 30		Six months ended June 30	
	2007	2006	2007	2006
Revenue	\$ 197,809	\$ 65,468	\$ 209,590	\$ 156,794
Cost of sales	65,403	68,851	68,063	110,725
Gross profit (loss)	132,406	(3,383)	141,527	46,069
Survey and testing costs	4,386	19,806	26,787	19,806
Selling, general and administrative expenses	647,866	163,871	1,233,134	395,455
Amortization	67,214	5,447	129,311	7,571
Stock-based compensation	197,022	-	416,888	-
	912,102	169,318	1,779,333	403,026
Interest expense and accretion	(21,417)	(274)	(41,162)	(274)
Interest Income	4,015	-	17,260	2,464
Foreign exchange gain (loss)	33,126	(15,614)	16,650	(12,319)
Loss and comprehensive loss for the period	(768,358) \$	(208,395) \$	(1,671,845) \$	(386,893) \$
Deficit, beginning of period	(14,212,034)	(11,288,165)	(13,308,547)	(11,109,667)
Deficit, end of period	\$ (14,980,392)	\$ (11,496,560)	\$ (14,980,392)	\$ (11,496,560)
Loss per share - basic and diluted	(0.02)	(0.01)	(0.06)	(0.03)
Weighted average number of common shares outstanding - basic and diluted	31,393,427	15,810,803	30,264,836	15,012,289

SmartCool Systems Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Three and six months ended June 30, 2007 and June 30, 2006

(Unaudited - Prepared by Management)

	Three months ended June 30		Six months ended June 30	
	2007	2006	2007	2006
Cash flows from operating activities				
Loss and comprehensive loss for the period	\$ (768,359)	\$ (208,395)	\$ (1,671,846)	\$ (386,893)
Adjustments for item not involving cash:				
Amortization	67,214	5,447	129,311	7,571
Foreign exchange gain on obligations under acquisition contract	(28,324)	-	(10,814)	-
Stock-based compensation	197,022	-	416,888	-
Consulting fees paid in shares	6,000	-	12,000	-
Accretion of obligation under acquisition contract	19,558	-	39,285	-
Deferred tenant inducement	(1,591)	-	(2,960)	-
	(508,480)	(202,948)	(1,088,136)	(379,322)
Changes in non-cash working capital items:				
Amounts receivable	(113,863)	53,910	(146,343)	(4,506)
Inventory	(57,893)	(65,557)	(223,856)	(49,057)
Prepaid expenses and deposits	60,150	(49,474)	57,834	(52,547)
Accounts payable and accrued liabilities	(86,320)	(37,685)	13,532	24,313
	(706,406)	(301,754)	(1,386,969)	(461,119)
Cash flows from financing activities				
Shares issued for cash-net of cash issue costs	-	1,869,740	-	1,903,489
Shares issued on exercise of options	49,500	-	122,568	-
Shares issued on exercise of warrants	767,510	-	1,347,900	-
Obligations under acquisition contract	-	1,575,882	(371,080)	1,575,882
	817,010	3,445,622	1,099,388	3,479,371
Cash flows from investing activities				
Purchase of short-term investment	(247,900)	-	(258,341)	-
Purchase of property & equipment	(9,156)	(1,663)	(30,191)	(1,780)
Purchase of Abbotly Australia Pty	-	(2,681,117)	-	(2,715,693)
	(257,057)	(2,682,780)	(288,532)	(2,717,473)
Increase (decrease) in cash and cash equivalents	(146,453)	461,088	(576,113)	300,779
Cash and cash equivalents, beginning of period	271,159	188,055	700,819	348,364
Cash and cash equivalents, end of period	\$ 124,706	\$ 649,143	\$ 124,706	\$ 649,143
Supplementary cash flow information				
Non-cash financing and investing activities				
Issuance of shares for consulting services	\$ 6,000	\$ -	\$ 12,000	\$ -
Issuance of warrants for agent's compensation	\$ 102,060	\$ 42,212	\$ 257,029	\$ 42,212

Smartcool Systems Inc.
Notes to Consolidated Financial Statements
Three and six months ended June 30, 2007
(unaudited)

1 Nature of operations and going concern

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.

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 ESMTM 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 ESMTM uses the latest in microprocessor technology and software developments.

While these financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations, certain conditions cast doubt on the validity of this assumption. The Company has not yet realized its revenue expectations and has relied on financing to fund operations and, as at June 30, 2007, has an accumulated deficit of \$14,980,392. Though the Company has recently been successful in raising capital to finance its operations, the company’s ability to continue as a going concern in the long run is dependant on management'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 the business acquisition, and the continued support of the company's shareholders and employees. These interim financial statements do not include any adjustments that may result from the Company’s inability to continue as a going concern. If the going concern assumption is not appropriate for these interim statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported revenues and expenses and the balance sheet classifications used.

2 Basic of presentation

The unaudited balance sheets at June 30, 2007 and the unaudited interim statements of operations, comprehensive loss and deficit, and statements of cash flows for the three months and six months ended June 30, 2007 and 2006, 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, 2006. 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 and six months ended June 30, 2007 are not necessarily indicative of the results to be expected for

Smartcool Systems Inc.
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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, 2006.

3 Significant accounting policies

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, 2006 with the exception of accounting for financial instruments.

Financial Instruments & Comprehensive Income

The Company adopted Canadian Institute of Chartered Accountants (CICA) Handbook Section 3855, Financial Instruments – Recognition and Measurement; Section 3865, Hedges; Section 1530, Comprehensive Income; Section 3861, Financial Instruments – Disclosure and Presentation; and Section 3251, Equity, effective January 1, 2007 on a prospective basis. Among other things, these sections specify when a financial instrument or non-financial derivative is to be recognized on the balance sheet, require a financial instrument or non-financial derivative to be measured at fair value or using the cost-based measures, and establish how gains and losses are to be recognized and presented, including the introduction of comprehensive income.

The Company has classified its financial instruments as follows:

- a) Cash and cash equivalents: are designated as held of trading and carried on the balance sheet 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 their carrying value approximates fair value, being cost plus accrued interest.
- d) The carrying amount of obligations under acquisition contract approximates fair value.

The Company had no 'other comprehensive income or loss' transactions for the three months and six months ended June 30, 2007 and no opening or closing balances for accumulated other comprehensive income or loss. The adoption of these CICA sections had no effect on the Company's consolidated financial statements.

4 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 ESMTM, supplier agreements and distribution agreements.

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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 March 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 TM brand	53,700
ESM TM Intellectual property	184,000
Distribution agreements	1,898,900
Supplier agreements	141,750
	<u>2,327,250</u>
Consideration	
Cash	869,300
Obligations under acquisition contract (note 9)	1,419,950
Transaction costs	38,000
	<u>2,327,250</u>

5 Property and equipment

	Cost	Accumulated amortization	2007 Net book value
	\$	\$	\$
Computer hardware and software	63,240	6,002	57,238
Demonstration and display equipment	44,774	13,276	31,498
Engineering and energy monitoring equipment	9,903	5,684	4,219
Office equipment	93,389	65,302	28,087
Leasehold improvements	116,318	24,233	92,085
	<u>327,624</u>	<u>114,497</u>	<u>213,127</u>

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	2006		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Computer hardware and software	7,953	4,152	3,801
Demonstration and display equipment	26,916	5,383	21,533
Engineering and energy monitoring equipment	9,903	5,215	4,688
Office equipment	89,197	62,414	26,783
Leasehold improvements	116,318	18,417	97,901
	250,287	95,581	154,706

Some of the Company's computer hardware and software purchases were financed by capital leases. At June 30, 2007, the net book value of these assets was \$46,302.

6 Intangible assets

	2007		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
ESM TM brand	53,700	-	53,700
ESM TM intellectual property	184,000	18,366	165,634
North American distribution rights	279,853	34,982	244,871
Distribution agreements	1,925,040	165,833	1,759,207
Supplier agreements	141,750	14,212	127,538
	2,584,343	233,393	2,350,950

	2006		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
ESM TM brand	53,700	-	53,700
ESM TM intellectual property	184,000	9,183	174,817
North American distribution rights	279,853	20,989	258,864
Distribution agreements	1,925,040	84,876	1,840,164
Supplier agreements	141,750	7,106	134,644
	2,584,343	122,154	2,462,189

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7 Commitments and Obligations

At June 30, 2007, the company owes AU\$995,000 related to its acquisition of Abbotly. The 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	<u>153,938</u>
Balance - December 31, 2006	1,170,090
Accretion	39,285
Repayments	(371,080)
Foreign exchange	<u>(10,814)</u>
Balance – June 30, 2007	827,481
Less: Current portion	<u>(827,481)</u>
	<u>-</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 and deficit.

Required repayments are as follows:

	AU\$
July 31, 2007	400,000
December 31, 2007	400,000
May 31, 2008	<u>195,000</u>
	995,000
Less: Current portion	<u>995,000</u>
	<u>-</u>

In the event the company defaults on a payment, title to the purchased assets and business transfers back to the former owner of Abbotly.

Repayment of AU\$400,000 was made to Abbotly in July 2007 as scheduled.

8 Capital leases

In May 2007, the Company entered into computer hardware and software leases for the same lease term of 36 months. As the present value of total monthly payments exceeds 90% of the fair value of these leased assets and the lease terms are equal to or greater than 75% of their estimated economic lives, both leases have been determined to be capital leases. These leases have effective interest rate of 16.17%.

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Capital lease payments

	\$
2007	9,652
2008	19,284
2009	19,284
2010	9,642
	<u>57,852</u>
Amount representing interest at 16.17%	(9,510)
Balance of the obligation	46,302
Less current portion	<u>(13,490)</u>
	<u>32,812</u>

9 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	3,250,000	504,414
Private placement	1,000,000	237,023
Private placement	2,500,000	809,074
Private placement	1,100,000	440,000
Private placement	1,500,000	1,125,000
Share purchase warrants exercised	4,626,250	863,114
Shares for consulting services	30,698	12,000
Options exercised	133,081	48,780
Share issuance costs	-	(320,614)
Balance - December 31, 2006	28,336,321	15,210,145
Share purchase warrants exercised	2,776,250	1,666,124
Options exercised	371,419	122,568
Share for consulting services	11,197	12,000
Share issuance costs		(257,029)
Balance June 30, 2007	<u>31,495,187</u>	<u>16,753,808</u>

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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 extended to June 30, 2007. During the first six months of 2007, the Company issued 11,197 common shares for service under this contract. The issuance of share for services was approved by the TSX Venture Exchange in 2006.

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 3,561,758. 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
	<hr/>	
Balance - December 31, 2006	3,904,419	0.36
Granted	185,000	1.14
Exercised	(371,419)	0.33
Balance – June 30, 2007	3,718,000	0.40
	<hr/>	
Options exercisable	2,778,000	
Outstanding options weighted average remaining life	3.61 years	
Options exercisable weighted average price	\$0.34	
	<hr/>	

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Exercise price	Number of options
0.21 - 0.23	1,368,000
0.27 - 0.33	580,000
0.40 - 0.48	985,000
0.72 - 0.96	685,000
1.14 - 1.14	100,000
	3,718,000

During the six months ended June 30, 2007, the Company granted 35,000 stock options to a director and an employee (2006 – 1,120,000) and granted 150,000 stock options to two non-employees (2006 – 800,000). As these options were above the maximum of 3,561,758, they were subject to shareholders' approval and regulatory approval. The above grants have been approved by the shareholders at the annual general meeting held on July 27, 2007.

These options had exercise prices that were lower than the stock price at the dates of grant.

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:

	2007	2006
Risk-free interest rate	3.91% - 4.21%	3.85% - 4.28%
Dividend yield	0%	0%
Volatility	98% - 100%	95% - 99%
Expected life	2 - 5 years	2 - 5 years

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e) Share purchase warrants

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

	Number outstanding	Weighted average exercise price \$
Balance - December 31, 2005	6,240,000	0.26
Granted	4,327,581	0.48
Exercised	(4,626,250)	0.18
Balance - December 31, 2006	<u>5,941,331</u>	<u>0.48</u>
Granted	371,419	0.50
Exercised	(2,776,250)	0.49
Expired	(5,000)	0.50
Balance - June 30, 2007 (unaudited)	<u>3,531,500</u>	<u>0.48</u>

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

The Company assigned a total fair value of \$257,029 to share purchase warrants issued during the six months of 2007.

f) Contributed surplus

At June 30, 2007, 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	<u>754,510</u>
Stock option expense	416,888
Balance – June 30, 2007	<u>1,171,398</u>

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10 Commitments

a) Premise lease

On June 1, 2005, the company entered into an agreement to lease office facilities for 10 years. On April 1, 2006, Smartcool USA entered into an agreement to lease office facilities for one year. This lease was renewed in February 2007.

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

	\$
2007	29,120
2008	52,945
2009	47,475
2010	48,600
2011	50,175
2012 and thereafter	<u>180,675</u>
	<u>408,990</u>

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 of June 30, 2007, the company had open letters of credit of \$50,000 (December 31, 2006 - \$75,000).

c) Equipment lease

In July 2005, the company signed a contractual agreement for equipment lease as follows:

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

In March 2007, the company signed a contractual agreement for the lease of computer software and hardware. Under this financing agreement, the company will make 36 monthly payments of \$1,607.

d) Abbotly USA

Under the terms of the North American distribution rights acquisition, the company is required to pay a 20% royalty on all product purchased from Abbotly for North American sales. Once the company purchases all of the remaining ESMTM inventory from Abbotly USA, the company is required to purchase a minimum of \$200,000 of ESMTM inventory from Abbotly per year until July 23, 2008 for purposes of the royalty calculation. During the six month

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ended June 30, 2007, the company did not purchase any product from Abbotly and no royalty has been paid or accrued.

11 Segmented information

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

For the three months and six months ended June 30, 2007, the Company's revenue was derived from customers located in the following geographical regions:

	Three months ended June 30, 2007		Three months ended June 30, 2006	
	Amount \$	Revenue %	Amount \$	Revenue %
United Kingdom	79,278	40	-	-
Mexico	68,882	35	-	-
USA	40,069	20	65,468	100
China	7,989	4	-	-
Australia	1,591	1	-	-
Total revenue	197,809	100	65,468	100

During the three months ended June 30, 2007, revenue from three individual customers exceeded 10% of the Company's total revenue. These customers contributed 40%, 35%, and 19%, respectively. During the same period of the prior year, revenue from one individual customer exceeded 10% of the Company's total revenue. This customer contributed 100%.

	Six months ended June 30, 2007		Six months ended June 30, 2006	
	Amount \$	Revenue %	Amount \$	Revenue %
United Kingdom	91,059	43	-	-
Mexico	68,882	33	-	-
USA	40,069	19	156,794	100
China	7,989	4	-	-
Australia	1,591	1	-	-
Total revenue	209,590	100	156,794	100

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During the six months ended June 30, 2007, revenue from three individual customers exceeded 10% of the Company's total revenue. These customers contributed 43%, 33%, and 18%, respectively. During the same period of the prior year, revenue from three individual customers exceeded 10% of the Company's total revenue. These customers contributed 44%, 43%, and 13%, respectively.

Property and equipment are located in:

	June 30, 2007	Year 2006
Canada	75%	100%
USA	25%	-

12 Related party transactions

Management and consulting fees for the three months and six months ended June 30, 2007 of \$31,000 and \$37,000, respectively, (compared to \$38,000 and \$72,000 for the same periods of 2006), were incurred to directors of the company. These transactions were recorded at their exchange amounts. At June 30, 2007, \$25,000 was owed to these related parties.

The company subleases its office and other facilities to companies owned by certain directors and officers. During the three months and six months ended June 30, 2007, sublease income were \$11,442 and \$22,771, respectively, (compared to \$10,605 and \$21,210 for the same periods of 2006). At June 30, 2007 and 2006, there were no amounts owed from these related parties.

13 Subsequent events

On July 27, 2007, at the annual general meeting, George Burnes, Jeffrey Lowe and Rae Warburton were elected directors of the Company. The shareholders also approved an amendment of the Share Option Plan of Smartcool to increase the number of Common Shares reserved for issuance from 3,561,758 to 6,298,579 Common Shares.

On July 24, 2007, Smartcool announced that the Company had signed a Letter of Intent with Haywood Securities Inc. (the "Agent") with respect to a private placement of up to 5,000,000 units at a price of \$1.50 per unit. Each unit consists of one common share and one-half of a transferable share purchase warrant. Each full share purchase warrant is exercisable at a price of \$1.90 per share for a period of two years. A commission would be paid to the Agent, consisting of cash of 7% and Agent's options entitling the purchase of 7% of the number of Units sold under the Offering for a period of 12 months at \$1.50. This private placement has been accepted for filing by the TSX Venture Exchange and closed on August 16, 2007.

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Proceeds of \$7,500,000 less cash commissions of \$525,000 and legal fees from this private placement will be used towards working capital to allow for increased production and marketing of Smartcool's Energy Savings Module (ESM™).