



CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in Canadian Dollar)

March 31, 2009 and 2008

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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
March 31, 2009 and December 31, 2008

Expressed in Canadian dollars

	March 31 2009 (Unaudited) \$	December 31 2008 \$
ASSETS		
Current assets		
Cash and cash equivalents	1,237,166	2,252,857
Short-term investments	26,176	25,608
Amounts receivable	143,140	284,675
Inventory	1,115,818	1,142,923
Prepaid expenses and deposits	68,960	77,331
	<u>2,591,260</u>	<u>3,783,394</u>
Capitalized development costs (note 7)	79,921	93,241
Property and equipment (note 5)	311,212	308,850
	-	-
Intangible assets (note 6)	<u>3,981,174</u>	<u>4,095,541</u>
	<u>6,963,567</u>	<u>8,281,026</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	400,345	430,172
Current portion of obligations under contracts (note 8)	405,495	268,440
Current portion of capital leases (note 9)	18,210	17,499
Current portion of deferred tenant inducement	10,375	9,707
	<u>834,425</u>	<u>725,818</u>
Obligations under acquisition contract (note 8)	428,343	540,669
Capital leases (note 9)	4,317	9,145
Deferred tenant Inducement	<u>71,948</u>	<u>74,653</u>
	<u>1,339,033</u>	<u>1,350,285</u>
SHAREHOLDERS' EQUITY		
Share capital (note 10(b))	25,218,213	25,218,213
Share purchase warrants (note 10(e))	1,176,580	1,176,580
Contributed surplus (note 10(g))	2,646,441	2,548,113
Deficit	<u>(23,416,700)</u>	<u>(22,012,165)</u>
	<u>5,624,534</u>	<u>6,930,741</u>
	<u>6,963,567</u>	<u>8,281,026</u>
Nature of operations and liquidity risk (note 1)		
Commitments (note 11)		
Subsequent events (note 17)		
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 Three Months ended March 31, 2009 and March 31, 2008

	Three months ended March 31	
	2009	2008
	\$	\$
Revenue	225,556	422,663
Cost of sales	78,910	154,135
	<u>146,646</u>	<u>268,528</u>
Operating Expenses		
Survey and testing costs	-	871
General and administrative expenses	1,243,401	775,043
Stock-based compensation	98,329	240,842
Research and development	22,530	1,032
Amortization	149,639	78,031
	<u>1,513,899</u>	<u>1,095,819</u>
Loss before undernoted	<u>(1,367,253)</u>	<u>(827,291)</u>
Other (income) expense		
Impairment of intangible assets	-	-
Interest expense	20,112	21,132
Interest Income	(3,388)	(56,160)
Foreign exchange loss (gain)	20,558	(46,530)
	<u>37,282</u>	<u>(81,558)</u>
Loss and comprehensive loss for the period	<u>(1,404,535)</u>	<u>(745,733)</u>
Deficit, beginning of period	<u>(22,012,165)</u>	<u>(17,641,281)</u>
Deficit, end of period	<u>(23,416,700)</u>	<u>(18,387,014)</u>
Loss per share		
Basic and dilluted	<u>(0.03)</u>	<u>(0.02)</u>
Weighted average number of common shares outstanding - basic and diluted	<u>41,182,646</u>	<u>37,129,563</u>

Smartcool Systems Inc.

Consolidated Statements of Cash Flows

Three Months ended March 31, 2009 and March 31, 2008

	Three months ended March 31	
	2009	2008
	\$	\$
Cash flows from operating activities		
Loss and comprehensive loss for the period	(1,404,535) \$	(745,733)
Items not affecting cash:		
Amortization of property and equipment	35,735	27,990
Amortization of intangible assets	113,904	50,041
Amortization of Research & development	13,320	-
Stock-based compensation	98,329	240,842
Deferred tenant inducement	(2,037)	(2,037)
Accretion of obligation under acquisition contract	19,036	19,466
Foreign exchange (gain) loss on obligations under acquisition contract	5,587	12,042
Other	-	(9,453)
	(1,120,661)	(406,842)
Changes in non-cash working capital items:		
Amounts receivable	141,536	(256,955)
Inventory	27,105	(11,434)
Prepaid expenses and deposits	8,370	(203,301)
Accounts payable and accrued liabilities	(29,827)	(24,320)
	(973,477)	(902,852)
Cash flows from financing activities		
Shares and warrants issued for cash-net of cash issue costs	-	9,654
Shares issued on exercise of warrants	-	81,525
Repayment of capital lease obligations	(4,117)	(3,512)
	(4,117)	87,667
Cash flows from investing activities		
Sale of short-term investment	-	176,259
Purchase of property & equipment	(38,097)	(29,294)
	(38,097)	146,965
Increase (decrease) in cash and cash equivalents	(1,015,692)	(668,220)
Cash and cash equivalents, beginning of period	2,252,857	6,020,860
Cash and cash equivalents, end of period	1,237,166	5,352,640

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 Alton, 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[™]) and ECO^{3™} to customers in North America and the sale of the ESM[™] and ECO^{3™} to distributors worldwide.

The ESM[™] and ECO^{3™} are manufactured by a third party in Australia and China and are 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[™] and ECO^{3™} use the latest in microprocessor technology and software developments.

During the three months ended March 31, 2009, the company incurred a loss of \$1,404,535 and the company had an accumulated deficit of \$23,416,700 as at March 31, 2009.

Though in prior years the company was able to raise capital to finance its operations, 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.

Due to the current economic crisis, the company might not be able to raise additional capital to expand its operations in the coming year. As a proactive action, the company has done a comprehensive review of its business development programs, operations and cash flow projections and taken certain cost reduction measures 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 to fifteen months.

2 Significant accounting policies

Basis of presentation

The unaudited balance sheets at March 31, 2009 and the unaudited interim statements of operations, comprehensive loss and deficit, and statements of cash flows for the three months ended March 31, 2009 and March 31, 2008, 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, 2008. 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, 2009 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, 2008.

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, 2008.

Changes in accounting policies

Effective January 2009, the company adopted the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3064 “Goodwill and Intangible Assets” which replaces Section 3062 “Goodwill and Other Intangible Assets” and Section 3450 “Research and Development Costs”. This section establishes standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets by profit-oriented enterprises subsequent to their initial measurement. The adoption of this new standard did not have a material impact on the consolidated financial statements of the company.

Effective January 1, 2009, the company adopted the CICA issued EIC-173 “Credit and the Fair Value of Financial Assets and Financial Liabilities”. The EIC provides guidance on how to take into account the credit risk of an entity and counterparty when determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this EIC did not have a material impact on the consolidated financial statements of the company.

Future Accounting Standards

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. The company is currently considering the impact of these standards on its financial statements.

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 impact on the accounting of future business combinations.

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 impact on the accounting of future business combinations.

3 Business acquisition

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

The purchase price was fully paid in May 2008.

4 Inventory

	March 31 2009	December 31 2008
	\$	\$
ESM TM , ESM TM peripherals and ECO ^{3TM}	1,072,818	1,119,053
Other products	33,000	23,870
	<hr/>	<hr/>
	1,115,818	1,142,923
	<hr/>	<hr/>

During the three months ended March 31, 2009, total inventory of \$47,592 (2008 - \$293,782) have been recognized as expenses.

5 Property and equipment

	March 31, 2009		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Computer hardware and software	158,996	69,402	89,594
Testing and demonstration equipment	220,409	109,098	111,311
Office equipment and furniture	52,674	14,095	38,579
Leasehold improvements	116,318	44,590	71,728
	548,397	237,185	311,212
	December 31, 2008		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Computer hardware and software	156,839	57,652	99,187
Testing and demonstration equipment	190,841	89,956	100,885
Office equipment and furniture	46,302	12,160	34,142
Leasehold improvements	116,318	41,682	74,636
	510,300	201,450	308,850

As at March 31, 2009, assets under capital lease with total cost of \$49,543 and accumulated amortization of \$28,900 are included in property and equipment and are classified under computer hardware and software.

Amortization expense for assets under capital lease recorded in the statements of operations, comprehensive loss and deficit for the three months ended March 31, 2009 was \$4,129 (2008 - \$16,515).

6 Intangible assets

	March 31, 2009		
	Cost	Accumulated	Net book
	\$	amortization	value
	\$	\$	\$
ESM™ brand (a)	56,100	-	56,100
ESM™ intellectual property (a)	124,100	34,128	89,972
North American distribution rights	279,853	83,956	195,897
Distribution agreements (a)	1,861,841	412,016	1,449,825
Supplier agreements (a)	113,650	31,254	82,396
United Kingdom distribution rights (b)	2,299,100	192,116	2,106,984
	4,734,644	753,470	3,981,174

	2008		
	Cost	Accumulated	Net book
	\$	amortization	value
	\$	\$	\$
ESM™ brand (a)	56,100	-	56,100
ESM™ intellectual property (a)	124,100	31,025	93,075
North American distribution rights	279,853	76,960	202,893
Distribution agreements (a)	1,861,841	374,916	1,486,925
Supplier agreements (a)	113,650	28,412	85,238
United Kingdom distribution rights (b)	2,299,100	127,790	2,171,310
	4,734,644	639,103	4,095,541

a) ESM™ Intellectual Property and worldwide distribution rights

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

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

b) Distribution Rights from TECC Services

On July 11, 2008, the company acquired the exclusive rights to distribute the ESM™ in the United Kingdom, Spain, Portugal, and the Middle East from T.E.C.C. Services Ltd. ("TECC"). Consideration of £1,035,000GBP (CA\$1,738,750) was payable in cash and £265,000GBP (CA\$532,067) was payable in the form of common shares of the company. Upon closing, payment of £435,000GBP (CA\$873,393) was

made and 743,709 shares were issued. The share price was based on the average closing price of the company's shares on the TSX Exchange for 20 consecutive trading days, with the last of such trading days being the second day preceding the date of closing.

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

7 Capitalized development costs

During the three months ended March 31, 2009 the company incurred \$9,210 (2008 - \$150,473) of research and development costs. These costs were expensed in the period (2008 - \$43,912). During the year 2008, development costs of \$106,561 were capitalized. These deferred costs will be 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 operating expenses for the three months ended March 31, 2009 (2008 - \$13,320)

8 Obligations under acquisition contract

TECC Services

At March 31, 2009, the company owed £600,000GBP related to its acquisition of distribution rights from TECC Services. The amount is non-interest bearing and has been recorded at its present value using a discount rate of 16% as follows:

	\$
Balance - July, 11, 2008	865,358
Accretion	40,853
Foreign exchange	<u>(97,102)</u>
Balance - December 31, 2008	809,109
Accretion	19,036
Foreign exchange	<u>5,693</u>
Balance - March 31, 2009	<u>833,838</u>
Less: Current portion	<u>(405,495)</u>
	<u>428,343</u>

Required repayments are as follows:

	GBP £
January 11, 2009	75,000
July 11, 2009	75,000
January 11, 2010	75,000
July 11, 2010	75,000
January 11, 2011	75,000
July 11, 2011	75,000
January 11, 2012	75,000
July 11, 2012	<u>75,000</u>
	600,000
Less: Current portion	<u>(225,000)</u>
	<u>375,000</u>

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

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

9 Capital leases

In the year 2007, the company entered into two contractual lease agreements to finance the purchases of computer equipment. Both leases expire in June 2010 and have an implied annual interest rate of 16.17%. Interest paid in the three months ended March 31, 2009 related to obligations under capital lease was \$1,041 (2008 - \$5,711).

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

	\$
Capital lease payments	
2009	15,477
2010	<u>9,610</u>
	25,087
Amount representing interest at 16.17%	<u>(2,560)</u>
Balance of the obligations	22,527
Less: Current portion	<u>(18,210)</u>
	<u>4,317</u>

10 Share capital

- a) Authorized: unlimited common shares without par value
 100,000,000 Class A preferred shares
 100,000,000 Class B preferred shares
- b) Issued common shares

	Shares	Amount \$
Balance - December 31, 2006	28,336,321	15,210,145
Private placement (i)	5,000,000	6,176,555
Shares for consulting services (c)	11,197	12,000
Options exercised (d)	793,419	343,439
Share purchase warrants exercised (e)	2,933,750	1,765,068
Share issuance costs	-	(933,996)
	<hr/>	<hr/>
Balance - December 31, 2007	37,074,687	22,573,211
Share purchase warrants exercised (e)	3,329,250	2,088,234
Options exercised (d)	35,000	18,216
TECC acquisition (f)	743,709	530,636
Share issuance cost adjustment	-	7,916
	<hr/>	<hr/>
Balance – March 31, 2009	41,182,646	25,218,213

- i) On August 16, 2007, the company issued 5,000,000 Units at \$1.50 per unit pursuant to a brokered private placement, for gross proceeds of \$7,500,000. Finalized cash share issuance costs were \$596,081. Each Unit consists of one common share and one-half share purchase warrant. Each full share purchase warrant entitles the holder to purchase one common share at a price of \$1.90 until August 16, 2009. These warrants are transferable after December 17, 2007. A total value of \$1,323,445 was allocated to them.
- ii) During the year ended December 31, 2007, the company issued 371,419 warrants as part of the private placement commission to agents. The fair value of these warrants of \$257,028 has been reflected within share issuance costs.
- c) Shares for consulting services

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

d) Stock options

Under the company's stock option plan, the company may grant stock options to employees, directors, officers and consultants. The maximum number of shares to be awarded under the plan is 7,869,827. The stock options have vesting periods of up to 18 months and an exercise period of up to five years.

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

	Number of options	Weighted average exercise price \$
Balance - December 31, 2006 (2,440,669 share options exercisable)	3,904,419	0.37
Granted	2,195,000	1.24
Exercised	(793,419)	0.30
	<hr/>	
Balance - December 31, 2007 (3,647,250 share options exercisable)	5,306,000	0.77
Granted	385,000	0.50
Forfeited	(325,000)	1.21
Expired	(350,000)	1.50
Exercised	(35,000)	0.26
	<hr/>	
Balance – December 31, 2008 (4,396,000 share options exercisable)	4,981,000	0.67
Cancelled	(5,000)	0.30
	<hr/>	
Balance – March 31, 2009 (4,669,750 share options exercisable)	4,976,000	0.36

During the period, no options were granted to employees (2008 - 160,000) and non-employees (2008-225,000). In February 2009, the company reduced the exercise price of 1,895,000 incentive stock options - with exercise prices ranging from \$0.90 per common share to \$1.40 per common share - to an exercise price of \$0.30 per common share. This modified price was not lower than the market price at the time of modification. The re-pricing of the stock options is subject to the approval of disinterested shareholders. The company intended to seek such disinterested shareholders' approval for the amendment to insiders' options at its next annual general meeting currently scheduled to take place during the summer of 2009. There will be no change to the expiry dates of the options.

Stock-based compensation expense related to employees and non-employees for the three months ended March 31, 2009 was \$98,329 (2008 - \$449,639), of which \$22,699 (2008 - \$29,835) related to non-employees.

Options outstanding at March 31, 2009 were as follows:

Exercise price \$	Options outstanding			Options exercisable	
	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number outstanding	Weighted average exercise price \$
0.10 - 0.20	90,000	4.58	0.17	22,500	0.17
0.21 - 0.30	2,991,000	2.45	0.27	2,887,250	0.27
0.33 - 0.48	1,225,000	2.13	0.40	1,200,000	0.40
0.54 - 0.89	520,000	3.32	0.60	410,000	0.62
0.90 - 1.10	50,000	3.10	0.96	50,000	0.96
1.11 - 1.42	100,000	3.50	1.20	100,000	1.20
	4,976,000	2.52	0.36	4,669,750	0.36

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:

	2009	2008
Risk-free interest rate	-	2.26% - 3.74%
Dividend yield	-	0%
Volatility	-	88.47% - 92.03%
Expected life	-	4.5 - 5 years

e) Share purchase warrants

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

	Number outstanding	Amount \$
Balance - December 31, 2006	5,941,331	577,357
Granted	2,871,419	1,581,433
Expired	(5,000)	-
Exercised	(2,933,750)	(343,427)
Warrants issue costs	-	(148,603)
	<hr/>	<hr/>
Balance - December 31, 2007	5,874,000	1,666,760
Expired	(44,750)	(6,789)
Exercised	(3,329,250)	(485,128)
Warrants issue cost adjustment	-	1,737
	<hr/>	<hr/>
Balance – March, 2009	<u>2,500,000</u>	<u>1,176,580</u>

As at March 31, 2009, there were 2,500,000 outstanding warrants. These warrants have an exercise price of \$1.90 and will expire on August 16, 2009. Each warrant entitles the holder to purchase one common share of the company.

f) Shares issued under TECC acquisition agreement

On July 11, 2008, the company acquired distributions rights from TECC Service (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 preceding the date of closing.

g) Contributed surplus

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

	\$
Balance - December 31, 2006	754,510
Stock option expense	1,229,257
Agent stock option expense	219,835
Stock option exercise	<u>(103,751)</u>
Balance - December 31, 2007	2,099,851
Stock option expense	449,639
Stock option exercise	(8,166)
Expiry of warrants	<u>6,789</u>
Balance - December 31, 2008	2,548,113
Stock option expense	<u>98,328</u>
Balance – March 31, 2009	<u>2,646,441</u>

11 Commitments

a) Premise lease

On June 1, 2005, the company entered into an agreement to lease office facilities for 10 years.

In February 2008, the company entered into a new 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:

	\$
2009	57,915
2010	77,220
2011	54,945
2012	51,300
2013 and thereafter	<u>129,375</u>
	<u>370,755</u>

For the three months ended March 31, 2009, the company's rent expense including certain operating expenses and property taxes was \$34,380 (2008 - \$133,836) and its sublease revenue was \$6,135 (2008 - \$23,676).

b) Letter of credit

Upon the signing of the lease contract in June 2005, the company was required to secure its obligations with a letter of credit of \$100,000. The letter of credit is reduced by \$25,000 every year. As at March 31, 2009, the company had open letters of credit of \$25,000 (2008 - \$25,000).

c) 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.

d) 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 three months ended March 31, 2009, the company recorded royalties of US\$400 (2008 - US\$40,000). As at March 31, 2009, royalties of US\$400 were payable to Abbotly USA (2008 - US\$1,344).

12 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, 2009		Year 2008	
	Amount \$	Revenue %	Amount \$	Revenue %
United Kingdom	4,171	2	345,595	29
Australia	34,506	15	203,647	17
Israel	15,773	7	128,583	11
Barbados	8,048	4	127,416	11
Philippines	136,281	60	115,351	10
Other	26,777	12	254,576	22
Total revenue	225,556	100	1,175,168	100

During the three months ended March 31, 2009, revenue from two individual customers exceeded 10% of the company's total revenue. These customers contributed 60% and 13%, respectively.

Property and equipment are located in:

	March 31, 2009 %	December 31, 2008 %
Canada	33	38
USA	43	39
Other	24	23
Total	100	100

13 Related party transactions

Consulting fees of \$63,660 were charged by directors of the company during the period (2008 - \$259,185). Consulting and management fees of \$26,000 were charged by three companies with common directors and officers during the quarter (2008 - \$90,997). The company rents its office in the United Kingdom from a company with a common director. During the three months ended March 31, 2009, rent expense was \$9,843 (2008 - \$21,539). These transactions were recorded at their exchange amounts and have been charged to general and administrative in the statement of operations. At March 31, 2009, £7,877GBP (CDN\$14,196) was owed to these related parties.

The company subleases its Vancouver office and other facilities to a company with a common director. During the three months ended March 31, 2009, sublease income was \$6,135 (2008 - \$23,676). At March 31, 2009, \$8,576 was owed from this related party (2008 - \$2,441).

Total purchases of £2,325GBP were made by a company with a common director during the period (2008 – £108,101GBP) and are recorded as sales in the statement of operations. As at March 31, 2009, £2,231GBP was owed from this related party.

14 Financial instruments

a) Financial Instruments

The company has classified its financial instruments as follows:

	March 31, 2009	December 31, 2008
	\$	\$
Financial assets		
Held-for-trading - measured at fair value		
Cash and cash equivalents	1,237,166	2,252,857
Loans and accounts receivable, recorded at amortized cost		
Amounts receivable	143,140	284,675
Held-to-maturity, recorded at amortized cost		
Short-term investments	26,176	25,608
Financial liabilities - recorded at amortized cost		
Amounts payable and accrued liabilities	400,345	430,172
Acquisition obligations and other	856,364	835,753

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

The following summarizes interest income and expense for the three months ended March 31, 2009:

	March 31, 2009	December 31, 2008
	\$	\$
Interest income from held-for-trading	2,820	111,419
Interest income from held-to-maturity	568	1,458
Interest expense from financial obligations	1,076	5,792
Interest expense from other financial liabilities	19,036	73,115

Fair value

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

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

The carrying value of the long-term portion of obligations under acquisition contract (\$428,343), has been discounted at 16% (see note 8.b) and is considered a close approximation of fair value.

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 amounts 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 amounts receivable is limited due to the company's customer credit evaluation process. The company has \$927,073 invested in bank guaranteed investment certificates, \$336,269 in cash and cash equivalents, and \$125,112 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 2009, equity financing has been considered.

As at March 31, 2009, the company's total account payable, accrued liabilities and current portion of obligation under acquisition contract was \$805,840 with \$535,511 due within 90 days and \$270,330 due within one year. Current portion of capital lease was \$18,210 as at March 31, 2009.

Please see note 1 for further disclosure on liquidity risk.

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 have been mitigated by the use of foreign currency forward contracts.

As at March 31, 2009, the company's monetary assets and liabilities denominated in foreign currencies are as follows:

	US\$	AU\$	GBP
Assets			
Cash and cash equivalents	160,259	27,935	37,123
Accounts receivable	94,200	1,468	3,716
Liabilities			
Accounts payable	96,070	63,215	28,203
TECC acquisition obligation - current portion	-	-	225,000
TECC acquisition obligation - balance	-	-	375,000

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:

	US\$	AU\$	GBP
Gain (loss) on \$0.10 increase in CA\$			
Monetary assets	(25,446)	(2,940)	(4,084)
Monetary liabilities	9,607	6,322	62,820
Net gain (loss)	<u>(15,839)</u>	<u>3,381</u>	<u>58,736</u>

Interest rate risk

The company's exposure to this risk is limited as it has no interest bearing debt.

15 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;
- 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 if that is necessary and appropriate.

The company is not subject to externally imposed capital requirements.

16 Supplementary cash flow information

	Three months ended March	Year 2008
	31, 2009	
	\$	\$
Interest paid in cash	1,076	5,792
Interest income received in cash	1,923	111,205
Non-cash financing and investing activities		
Issuance of warrants for share issue costs	-	-
Issuance of stock options for share issue costs	-	-
Issuance of warrants for intangible assets	-	530,636
Assets purchased under capital lease	-	-
Obligations under TECC intangible asset acquisition	-	865,351

17 Subsequent events

On April 2, 2009, Smartcool International terminated its exclusive distribution agreement for the territory of Mexico with Precision Control Comercial, S.A. de C.V.

On April 16, 2009, Smartcool International appointed Aruba Cooling Pty Ltd., South Africa, to be its authorized, non-exclusive distributor within the territory of South Africa. The distribution agreement has a term of two years and can be renewed for an additional two year period.